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FRBSF Weekly Letter

Trade War Avoided — At What Cost?

"Unless you [Prime Minister Ohira] are prepared to take American citrus and unless you are prepared to take American grain, unless you are prepared to take American goods and services, you have to tell your people they'd better be prepared to sit on the docks of Yokohama in their Toyotas, watching their Sonys, eating their Kobe beef at $18 a pound."— John B. Connally (G.O.P. presidential hopeful).

"[My generation] is indebted to the U.S. If it hadn't been for its generosity, we would not have recovered as we did. But our time is ending. We were almost yes men for the U.S. If the heat was on, we succumbed. That isn't going to hold with the new generation. They demand equality. They demand fairness. They say, 'We've been productive. If the U.S. can't compete, it's their fault.'" — Toshio Shimanouchi, senior *Keidanren* [Japanese Chamber of Commerce] official.

Geneva and Tokyo Agreements
An economist with Japanological interests, this writer has been crying wolf for a decade about the danger of Japanese-American economic warfare. Following the Geneva and Tokyo economic summits this spring and summer, and assuming ratifications of their results, he is pleased to report that conflict has been at least postponed. (Or if it had already begun, an early armistice has been arranged.)

This is good news, but the cloud is not all silver lining. The remaining problem, as I see it, is that the settlements leave the consuming public of each country at the not-so-tender mercies of that country's organized business, organized agriculture, and organized labor.

Eight Bones of Contention
Over the past quarter-century, economic disagreements have developed between the U.S. and Japan under eight main heads, some of which no longer represent live issues.

1. U.S. protectionism. This was the first difficulty to arise. Rather than raising tariffs or imposing import quotas, the U.S. induced the Japanese to impose "voluntary" export quotas on numerous Japanese products, originally cotton textiles, but expanding over the years, chiefly to other textiles and to various forms of steel and steel products. (The Japanese side has later come to use these quotas as vehicles to develop exporters' cartels, giving most of the profits of higher prices to Japanese producers rather than U.S. importers.)

2. Japanese protectionism. This has been primarily non-tariff protection (NTP) in recent years. Among Japan's most irritating forms of NTP have been quotas, elaborate inspection procedures, and "administrative guidance" by Japanese governmental agencies to firms under their supervision to buy Japanese goods.

3. Japanese "dumping." This term is limited traditionally to sale abroad of surplus products at prices below the domestic prices of identical products (plus transportation). In accusing Japanese competitors of dumping in the U.S., American special-interest groups have attempted (without noticeable success) to expand the term to include sales at prices which "disrupt" the American market, interfere with "orderly marketing" of American goods, or are made below "cost" as estimated by the Americans.

4. Japanese "tax breaks" and cheap credits for certain key industries. These industries usually turn out to be export industries or competitors with imports, and the subsidies are sometimes called dumping. And under this same head, we might include Japanese financial arrangements which are "easier" on exporters than on importers.

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5. Japanese capital controls (on purchases of yen by non-Japanese). These controls are directed primarily at foreign direct investment in Japan. They aim at minimizing or postponing foreign firms' expansion of their competitive facilities within the Japanese market, especially in such key lines as computers, unless they embark on joint ventures with Japanese firms.

6. Japanese "cornering." The great Japanese trading companies *(sōgō shōsha),* with great financial resources and superior forecasting abilities, are accused of cornering futures markets for delivery of raw materials where price rises are anticipated, and causing spot shortages in those countries themselves. In the U.S., *shōsha* have been accused, singly and in combination, of buying up supplies of lumber and of soybeans at critical times.

7. American embargoes or boycotts. As inflation-control devices, and also to counteract cornering (#6, above), the U.S. has reduced exports of lumber and halted exports of soybeans to Japan. The "soybean shock" of 1973, although short, was especially resented as "starving Japanese babies to feed American livestock."

8. The yen-dollar rate. Cheap yen make Japanese goods cheap in the U.S. and American goods dear in Japan. "Strong yen" make Japanese goods expensive in the U.S. and American goods cheap in Japan. (The shōsha stand accused of interfering with this easy generalization by increasing their trading margins on American exports rather than lowering yen prices of American goods in Japan, and also cutting their trading margins on Japanese exports rather than raising dollar prices of Japanese goods in the U.S., as the yen rose relative to the dollar.)

Compromises of 1979

The agreements of this year have in general kept existing protectionist restrictions in place, in the name of "orderly marketing." At most, they propose "all deliberate speed" in reducing them. The two governments have, however, agreed to oppose additional restrictions. The scrapping of Japan's "voluntary" export quotas would have helped American consumers, and the influx of American goods and American competitors into the Japanese home market would have helped Japanese consumers. Taken together, such moves would have gone a long way toward countering the OPEC oil price rises for both groups of consumers, and possibly even reduced both American and Japanese inflation rates.

Let us go into slightly more detail on each of our eight sources of conflict and controversy:

1. As for U.S. protectionism, proposals for special levies against Japanese exports have been shelved. Some future easing of American tariffs and quotas may also have been achieved, but the principal gain remains roadblocks against things becoming worse than they are.

2. As for Japanese protectionism, Tokyo has promised to reduce restrictions, but (as always) demanded inordinate amounts of time, primarily to assuage Japanese farmers and retain their allegiance to the ruling (Liberal-Democratic) party. Time is also required to bring the middle-level Japanese bureaucracy around to their seniors' new-found internationalism, or perhaps I should call it new-found adaptation to Japan's positive balances of trade and payments. At the same time, U.S. exports to Japan through May of this year have increased 47 percent over the year-ago figure, to \$6.8 billion — lowering the U.S. bilateral trade deficit to \$3.4 billion, or only about half of last year's amount.

3. On dumping, nothing new. An American "trigger price" system for steel products, in particular, remains in effect, and may be a basis for future extension to other imports. The U.S. continues to consider consolidation of responsibility for enforcing anti-dumping and similar "fair trade" legislation under the Department of Commerce, the most protectionist and least consumer-oriented of the agencies now sharing this responsibility.

4. On Japanese tax and financing policies, no change.

5. On Japanese capital-control practices, direct-investment rules have been liberalized. Still, the terms of joint-venture agreements between Japanese and American companies remain subject to *ex post facto* renegotiations under "administrative guidance" from the Japanese Government.

6. Again, no formal change in the activities of the Japanese shōsha. They may well have promised informally to mend their ways, at least in America.

7. It seems clear that the U.S. will not restrict exports to Japan arbitrarily, so long as the shōsha behave themselves. The Japanese were, however, unable to change U.S. policy on Alaskan oil and natural gas, which (at least until now) may not be exported.

8. Neither the U.S. nor Japan is now using the exchange rate as a weapon of trade war. The exchange rate has been depoliticized, and essentially is determined by private markets. The exchange rate is not used as a protectionist device, except in a modest way when the *shōsha* offset rate changes by shifting trading margins. Today's "proper" rates, incidentally, would have given the Japanese apoplexy ten years ago. At this writing, the dollar is fluctuating in the ¥215-¥220 range; ten years ago it was fixed at a ¥360 rate which had held for 20 years.

Who Won and Who Lost?
Whan a war ends with an armistice, or a crisis ends short of war with an agreement, the question is usually pertinent: who won and who lost?

As between the U.S. and Japan, the "bottom line" seems to be the bilateral trade balances between the two countries, despite all economics-textbook assurances about the unimportance of bilateral balances. In the U.S.-Japanese case, the positive balance has not only swung since 1965 from the U.S. to Japan, but it has become the largest such balance in the entire history of international economic relations. It is already falling; these agreements will lower it further. Insofar as this reduction was sought most deliberately and vociferously in the U.S., the American side may be said to have won. It does not, however, follow that the Japanese side has lost. What doth it profit a nation, after all, to pile up "international reserves" indefinitely for the contemplation of God and the jealousy of its trading partners?

As between producer and consumer interests in each country, however, the case is clear. Producers have retained their past gains and consumers have failed to dislodge them. Protectionist restrictions, even such recent additions as the U.S. trigger-price system, remain in place. Each country is kept safe for its own oligopolies, cartels, labor aristocracies, and farm blocs. Consumers may take what comfort they can in possibly delaying the advance of new agreements at their expense.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 7/25/79	Change from 7/18/79	Change from year ago @ Dollar	Percent
Loans (gross, adjusted) and investments*	129,036	185	+ 16,933	+ 15.10
Loans (gross, adjusted) — total#	106,523	146	+ 15,891	+ 17.53
Commercial and industrial	31,340	67	+ 4,237	+ 15.63
Real estate	38,949	95	+ 8,189	+ 26.62
Loans to individuals	21,821	115	NA	NA
Securities loans	1,707	49	NA	NA
U.S. Treasury securities*	7,506	− 87	− 400	− 5.06
Other securities*	15,007	126	+ 1,442	+ 10.63
Demand deposits — total#	41,830	− 1,624	+ 1,950	+ 4.89
Demand deposits — adjusted	30,750	− 684	+ 1,073	+ 3.62
Savings deposits — total	30,577	− 1	+ 106	+ 0.35
Time deposits — total#	50,743	834	+ 5,650	+ 12.53
Individuals, part. & corp.	42,106	635	+ 6,196	+ 17.25
(Large negotiable CD's)	17,921	771	+ 742	+ 4.32

Weekly Averages of Daily Figures	Week ended 7/25/79	Week ended 7/18/79	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (−)	27	15	− 10
Borrowings	232	84	74
Net free reserves (+)/Net borrowed(−)	− 205	− 69	− 84
Federal Funds — Seven Large Banks			
Net interbank transactions [Purchases (+)/Sales (−)]	+ 1,341	+ 1,634	+ 3
Net, U.S. Securities dealer transactions [Loans (+)/Borrowings (−)]	− 587	− 113	+ 718

* Excludes trading account securities.
# Includes items not shown separately.
@ **Historical data are not strictly comparable due to changes in the reporting panel; however, adjustments have been applied to 1978 data to remove as much as possible the effects of the changes in coverage. In addition, for some items, historical data are not available due to definitional changes.**

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