

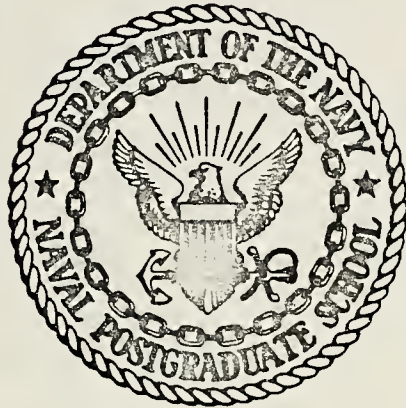
CULTURAL INTERFACE IN FOREIGN PROCUREMENT

Robert Maurice Kreimer

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THESIS

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by

Robert Maurice Kreimer

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It stresses the importance of the role of the U.S. procurement official in creating a good working relationship with the foreign business community to advance U.S. interests in foreign relations.

Cultural Interface in Foreign Procurement

by

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Lieutenant Commander, United States Navy
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Submitted in partial fulfillment of the
requirements for the degree of

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from the
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September 1974

ABSTRACT

This thesis explores the relationship between the traditional cultural heritage and business practices of a foreign country with U.S. military procurement policies and regulations. It centers on U.S. military procurement policy in Japan.

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TABLE OF ABBREVIATIONS

ASBCA	Armed Services Board of Contract Appeals
ASPR	Armed Services Procurement Regulations
CAB	Contract Adjustment Board
CINCPAC	Commander in Chief Pacific
COMNAVFORJ	Commander Naval Forces Japan
GAO	General Accounting Office
IMF	International Monetary Fund
JPCB	Joint Procurement Coordinating Board
MITI	Ministry of International Trade and Industry
NAVSUP	Naval Supply Systems Command
NSD	Naval Supply Depot
OSD	Office of the Secretary of Defense
SOFA	Status of Forces Agreement
SRF	Ship Repair Facility
USFJ	United States Forces Japan

I. INTRODUCTION

This thesis effort is an attempt to establish the relationship between the traditional cultural and business practices of a foreign country with the U.S. military procurement policies and regulations. It is not intended to provide a check list for U.S. contracting officials doing business in a foreign country. Rather it is intended as a warning to these officials that they must have an understanding of the history and cultural heritage of the country in order for their business relationships to be successful. They must have an appreciation of how they are being perceived by the foreign businessman to make sure that they are not inadvertently alienating him.

What the author hopes that the reader will gain from this thesis is an appreciation of the existing problems in this subject area. Too long the image of the "Ugly American" has dominated our foreign dealings. We are considered insensitive to the hopes, desires and aspirations of others, not taking the time or the trouble to learn other languages, traditions, social customs or mores. The U.S. military plays an important role in our relationships with foreign countries. Overseas procurement in support of U.S.

military forces is vital to the economy of many of the countries in which these forces are stationed.

The U.S. contracting official is an important link in this effort for he is one of the few officials that has direct daily face-to-face dealings with the foreign business community. Through his example and by his efforts, the business community receives an image of the United States.

This thesis centers on U.S. military procurement policy in Japan. It presents in an encapsulated form the major cultural traditions and business practices of that country and then takes the reader through a true case — the dollar crisis and subsequent yen revaluation of 1971. The author will attempt to demonstrate that with more indepth knowledge of the country, the problems created during the crisis could have been recognized and thereby minimized earlier, without having any impact on the business relationships between the two countries.

II. STATEMENT OF PROBLEM

The U.S. military is effectively running out of money. Gone are the days when defense budgets sailed through Congress with all flags flying from the yardarm. Today the military budget is faced with Congressional critics intent on cutting as much as possible and shifting the funds to other programs. The economic problems of inflation and staggering cost increases in effective complicated weapons systems have had a direct impact on defense allocations particularly in the research and development area.

This decrease in funds has led the U.S. Defense establishment to cooperate more fully with other friendly nations in the use of foreign technology in weapons system acquisition. For example Army Regulation 70-41, which became effective 1 March 1974, requires that the Army remain "abreast of doctrinal and material research and development in friendly foreign nations." This information will be used in "influencing, planning, and executing Army research and development programs."¹

This policy recognizes that no longer can the U.S. afford to spend millions repeating research and development that has already been accomplished and available to

the U.S. The advantage is not only in dollars saved, but often in the availability of weapons systems years earlier than would otherwise be the case.² The policy contained in the Nixon Doctrine seeks to promote an increase in the share of the burden of defense assumed by our allies and therefore an increased utilization of foreign technology. The Defense Department has many projects under development or in production implementing this policy. To cite a few examples being considered for use by the U.S. Navy include: Harrier Aircraft — United Kingdom; Lynx Helicopter — France; VAK - 191 V/STOL — Germany; WM 22 Fire Control System — Netherlands; Penguin MK1 — Norway; Seasparrow — NATO; 76MM/62 Compact Gun Mount — Italy; Gabriel — Isreal.

The utilization of foreign technology in U.S. weapons systems has been and remains a highly controversial subject. It would involve a quantum jump in the existing foreign purchases under the military procurement regulations above that now done in support of the U.S. forces stationed overseas. Not only would this cause a serious economic problem in the balance of payments program but also a shift in this country's protectionist trade policies.

U.S. military procurement regulations contain policies meant to exclude foreign competition in military purchases.

The Buy American Act passed in 1933 required that mandatory preference be given to domestic goods in government supply and construction contracts. In general the act prohibits federal agencies from purchasing raw materials or manufactured articles from foreign sources for use within the U.S., unless the head of the procuring agency determines that domestic procurement is inconsistent with the public interest, that the domestic cost is unreasonable, that domestic materials or products are not available in sufficient quantities or that they are not of sufficient quality. In 1962 the Department of Defense directed that the services would add on a 50 percent differential to the price of foreign bids or proposals which has all but eliminated foreign competition.³

The problems of buying foreign hardware, real or perceived, which have motivated the Buy American protectionism include: (1) a possibly dangerous reduction of the industrial mobilization base; (2) decrease in "Design American" capability; (3) a balance of payments problem; (4) possible dependence on foreign sources for certain essential components, maintenance, and spare parts; (5) a reduction in potential American employment; (6) Americanization costs which include: metric conversion, language translation, drawing recasting, redesigning and

modifying to meet U.S. quality, reliability and safety standards; (7) strong Congressional and nationalistic pressure to "Buy American."

The international trade policies have started being liberalized over the past few years and this trend appears to be continuing. This means that the U.S. military will be involved more and more in foreign procurements either directly or through licensing agreements between foreign and U.S. industrial firms. There can be no doubt that business in the U.S. is atypical to business as generally conducted in most any other nation in the world. Competition as known in the U.S. has never been accepted elsewhere.⁴ Business interests in the U.S. generally regard government controls as hostile. In contrast, throughout the world, even where governments are not engaged directly in business, they have exercised controls over their respective economies to a far greater extent than that witnessed in the U.S. There can be no doubt that all governments are guided by their own objectives and interests and, therefore, all governments discriminate in their procurement policies and practices in favor of the products of the domestic manufacturer.

In the world of today it is obvious that the lowest bid is not automatically accepted. The following criteria

are applied in particular instances as "the most interesting tender" in Belgium; "the lowest suitable tender if circumstances permit" in Austria; "the most economical bid" in Germany; the "most advantageous to the state when all circumstances are considered" in Sweden; and "the contract will be awarded to that responsible offerer whose offer conforming to the solicitation will be most advantageous to the government, price, and other factors considered" in the United States.⁵ In short, every nation has its machinery for discriminating in favor of products of domestic origin.

An obvious problem in drafting and negotiating foreign contracts is the diversity of language with the difficulty of attaining the desired precision so that no conflict arises in the translated versions of the contract. This diversity of language is compounded by the difference in the understanding of legal principles and differences in well-defined words and phrases of one nation as opposed to another.

The U.S. legal tradition is rooted in the common law system while the majority of nations function under the civil law system which encompasses codified federal legislation as supplemented by various acts of the legislature. Because of this different approach to law there may

result a divergent abstract understanding of legal principles which may go to the essence of the contract being negotiated. For example the concept of contract consideration, i.e., something of value given or done in exchange for something of value given or done by another in order to make a binding contract, is unknown in the civil law system.⁶

In addition to differences in business practices and legal concepts all nations have their own traditional cultural heritage. These traditions must be understood in negotiating with foreign businessmen to achieve any successful relationship.

These are but a few of the specific problems related to foreign procurement. The procurement official must recognize that the human race is divided by barriers of culture. In this contemporary age of interdependence, almost no one is insulated from massive cross-cultural interaction. The principal problem of foreign procurement is to learn how to conduct relations between culturally distinctive groups, and to demolish these barriers through interaction and communication to gain perception and understanding of other viewpoints.

Foreign procurement for weapons systems technology or in support of U.S. forces overseas presents unique

challenges for the U.S. military contracting officer. Not only must he understand the philosophy and policies of his own country but he must be aware of the policies of the other country as well. For how he meets this challenge will determine the success or failure of this new initiative.

III. DESIGN OF THE INVESTIGATION

A. USE OF JAPAN AS THE BASIC MODEL

The Orient has always held a certain fascination to Westerners. Articles, books, movies and other media have always used the term "mysterious" in describing Asia and its peoples. The U.S. has always played a dominant role in the trade and politics of the Orient. In fact the Pacific Ocean has been more an American "lake" policed by the U.S. Navy. This interest has been primarily for the promotion of trade rather than for colonization or imperialism.

The cultures and traditions of Asia are thousands of years old but the growth of Japan into a world economic power has only taken a little over a hundred years. Some authors predict that the 21st Century will be dominated by Japan as its economy equals or surpasses the United States. These predictions have caused great interest in Japan and a quest for the reasons behind this success.

This thesis deals with the cultural interface in foreign procurement and while it is true that any nation could have been chosen as the model for this topic, Japan stands out as the prime candidate. Japan is a homogeneous nation having never really been successfully invaded by

other peoples, therefore, her cultural traditions have not been markedly influenced by others. There is a keen sense of national identity and separateness, in culture, language and race. This is not true of other countries such as Germany, Italy or France.

Also, because of the tremendous interest in Japan, there are numerous excellent reference materials and books on the culture and business practices of Japan. In fact the author found that the abundance of material created a problem in choosing which authors to select and use as a basis for this thesis.

The case introduced later in this thesis was chosen because it emphasizes the problems of cultural interaction and communication between two distinct cultures. It contains specific examples of the cultural traditions described in the literature on Japan. Here one can readily see the clash between differing viewpoints of legal interpretations, business practices and policies, and cultural heritage. Although communication was being carried on there was no common understanding of the interpretations of the dialogue and its effect on alleviating the problems. Each side fell back within its rigid mold of cultural background relying on this to somehow solve the problem. Hopefully the case demonstrates how easily twenty years of mutual

trust and successful business relationships could have been destroyed by failing to understand that all people do not think like we do.

The author also chose this case because of the personal experience of having lived through the dollar crisis of 1971 as the senior Navy procurement representative in Japan. The research material used in this case was provided from the official U.S. Navy files of the Naval Supply Depot, Yokosuka, Japan. The author gratefully acknowledges the assistance of that activity in providing all of the original documents for this thesis effort.

To outline the author's experience in the area of military procurement in Japan, the following list of job titles with dates is included here for authenticity:

1. Assistant to Director, Purchase Department, Naval Supply Depot, Yokosuka, Japan, June 1970 - April 1971; Director, Purchase Department, May 1971 - July 1972.

2. Alternate Navy Member, Japan Procurement Coordinating Board, June 1970 - April 1971; Navy Member, May 1971 - July 1972.

3. Alternate Navy Member, Japan Contract Conciliation Panel, June 1970 - April 1971; Navy Member, May 1971 - July 1972.

IV. CULTURAL INTERFACE

A. BRIEF CULTURAL HISTORY OF JAPAN

The Japanese people, whose history as a nation and whose culture are almost 2,000 years old, have mastered and used the material aspects of European and American modern life more successfully than any other people in Asia. After a long period of isolation from foreign influences, their rulers deliberately entered, only a century ago, into adaptive and imitative competition with the West, which led to great economic power, to conquest by war and finally to crushing defeat. It was only a little more than a quarter of a century ago that Japan lay in ruins, its dreams of an empire in Asia shattered, its economy smashed, its cities in ashes, and its population stunned by the total defeat of World War II.

However, reconstruction was swift and recovery so rapid that by the middle 1950's, Japan was poised for the economic takeoff that transformed it into the world's third most productive economic power, after the United States and the Soviet Union. In fact Japan's long-term growth rate of 10 to 14 percent a year has been so phenomenal that economists predict that the country could come close to rivaling U.S. living standards by the end of this century.¹

Many factors have contributed to this success story. Japan is a remarkably homogeneous nation; its people are well educated and have an almost unlimited capacity for work and self-discipline; its industrialists and financiers combine caution and imagination in a way that stimulates the economy and produces spectacular results; its government is stable; its defense expenditures are minimal, as Japan relies on the umbrella of U.S. military might. As a result of these combinations of favorable circumstances, Japan has plunged into an age of unprecedented prosperity and progress.

At the same time, Japan is a land of delicate beauty and highly stylized cultural forms that lend its landscape and people a charm and serenity that sometimes seems at odds with the country's headlong rush into the world of mass consumer production, traffic jams, pollution and computerized technology.

The turning point in the history of modern Japan begins with the "Meiji Restoration" in 1967. For more than 200 years prior to this, Japan had remained a closed country, ruled by military governors called Shoguns, who had reduced the emperor to a mere figurehead. Under the Tokugawa Shogun Japan was stagnating under a feudal system which divided society into four distinct castes: warriors or samurai, farmers, artisans and tradesmen, in that order. This

system was so powerfully instilled that it exercised control over the very lives of the people to the extent of prescribing exact rules on all activities relating to daily life and behavior.²

The defeat of the Shogun and the restoration of the Meiji Emperor, Mitsuhiro, and his forward looking advisors opened Japan not only to Western ideas and commerce but to all the forces of international politics of the nineteenth century. The young samurai "changed their Japanese dress for top hats and dark suits and sailed off to America and Europe to study Western techniques of government, industry and war."³ By the turn of the century, the process of modernization was far advanced and by 1920 Japan was a world power.

Modernization and industrialization brought far-reaching social changes but without sacrificing Japan's traditional culture. The government sought not only to preserve, but to elaborate and emphasize the values of unquestioning obedience to superiors, absolute loyalty to the emperor and his representatives and self-sacrifice.

Even the first Japanese constitution given by the emperor to the people in 1889 was built on hierarchy. It gave the people a place in the state and established the Diet but the "writers took every possible precaution to

guard against popular interference and the invasion of public opinion."⁴ This was done in a conscience effort to maintain and foster the national well-being. The advantages of observing "proper station" were to be maintained in the modern world.⁵ This sole authority was also used in the field of industrial development. The leaders planned, built and financed with government funds, the industries they decided they needed. A state bureaucracy was then organized to run them. Foreign technicians were imported and Japanese managers were sent abroad to study the industry. Once the industry was thriving the government sold it to a chosen financial oligarchy. These became the controlling combines or zaibatsu, chiefly the Mitsui and Mitsubishi families.⁶ It was felt that industrial development was just too important to be entrusted to the laws of supply and demand or to free enterprise. Japan decided from the beginning that instead of starting industrialization by the production of consumer goods and light industry, she would start with heavy industry. Industries such as arsenals, shipyards, ironworks and railroads had priority and were brought to a high stage of technical efficiency. Light industry and small manufacturing flourished in the country operating with minimum capitalization and maximum utilization of cheap labor. But these small traders had no "proper place" in the government priorities.

In all areas the Japanese order their world with constant reference to hierarchy. In the family and in personal relations, age, generation, sex and class dictate proper behavior. In government, industry, religion and the military, areas are carefully separated into hierarchies where neither the higher or lower may overstep their prerogatives without penalty. This division has never been questioned in Japan because it is felt to be legitimate. Many blame the exportation of this concept on Japan's entry into World War II. For example, the preamble to the Tripartite Treaty with Germany and Italy reads: "the governments of Japan, Germany and Italy consider it as a condition precedent to any lasting peace that all nations of the world be given each its proper station..."⁷ The declaration of war handed to Secretary Hull as Pearl Harbor was being attacked repeated the point: "It is the inimitable policy of the Japanese government to enable each nation to find its proper place in the world. The Japanese government cannot tolerate the perpetuation of the present situation since it runs directly counter to Japan's fundamental policies to enable each nation to enjoy its proper station in the world."⁸

The defeat of Japan in 1945 resulted in its loss of all its overseas holdings and in the occupation of the

home islands by the United States forces representing the Allied powers. Under the Occupation an ambitious program of social, political and economic reform was launched to lay the foundation of a democratic and peaceful order. A new constitution guaranteed civil liberties and established a parliamentary system of government responsive to the electorate. In an important innovation the constitution forever renounced the right of the nation to make war or to use the threat of force in international disputes or to maintain any armed forces. The control of the zaibatsu was taken away from the control of the leading families. Legal measures were taken to remove old social inequalities, grant rights to labor movements and initiate land reform and economic reconstruction. Financed for the most part by American aid the economic miracle since World War II is known to all. The country enjoys material prosperity and experiences the difficulties of trying to live by new standards when old and frequently contradictory ones have not yet disappeared.

What are some of the cultural traits that the Japanese have clung to throughout their history? The most prevailing is hierarchy which has been discussed. Another of the most important is the Japanese capacity for purposive, dedicated and communal action. The remarkable feat of the Japanese in carrying out their modernization plan in the early 20th

century was the first really successful example of industrialization by a non-European country. In part this success and the remarkable recovery following World War II was due to an increasing flexibility and willingness to experiment. One of the outstanding features of the "Japanese mind" throughout history has been its persistent inquisitiveness and flexibility in the face of new and demonstrably superior intellectual systems.⁹ The Japanese have somehow managed to accept quite readily the entire range of thought currents from the West which have resulted in a distinctly Japanese adaptation. The Japanese have always admired good craftsmanship and have been able to master almost any technology available to them.¹⁰ In nearly all activities and issues the Japanese traditionally think of themselves as members of a group and their satisfactions are largely expected to come through group fulfillment of group objectives. In traditional Japanese culture and even today one of the "worst of all sins is to display an egoistic disregard of, disinterest in, or resistance to group mores, attitudes, taboos, totems, traditions or objectives — or often just to display any individualism at all."¹¹

The Japanese are intensely loyal and faithful. The basis for this is bushido or "way of the warrior" which was the code of the samurai.¹² It is similar to vows of

chivalry in the Western world. The foundation for bushido is the laying down of one's life for one's lord or complete loyalty.¹³ Connected with bushido is kokutai translated as "national polity" or "national essence." Kokutai includes the concepts of national structure, particularly the emperor system; national basis, the myth of the divine origin of Japan; and national character, the special moral virtues in individual behavior and social cohesion embodied in bushido. Kokutai was used by the militarists during World War II to rally the people to the cause of Japan and its debt with history.¹⁴ It has been used after the war to rally the people to the task of economic development and reconstruction.

Some other traits of the Japanese character are their feeling of shame, guilt and ridicule. The Japanese are taught to feel shame before society and to fear it. The result is a self-consciousness which borders on an inferiority complex. They avoid shame by preserving "face" and self-respect much as an American would feel from his individual conscience.¹⁵ Guilt is closely related to the sense of social shame and is derived from the system of loyalties which cements the structure of their traditional society. One of the most effective punishments for a Japanese is ridicule. To be ridiculed is to lose one's precious

dignity and self-respect or to "lose face." Behind the seemingly over-politeness of the Japanese is the lurking fear of ridicule and ostracism.¹⁶ It is these traditions that force the Prime Minister to go on television and accept responsibility and guilt for some national disaster or in the past years under bushido for military or government officials to commit harakiri or suicide.

One last important characteristic of the Japanese people is the tremendous interest in foreign opinion about Japan and the Japanese. Any visitor to Japan is asked this question repeatedly during his stay: What do you think about Japan? This also expresses itself in their keen interest in what Americans are buying and taking back from the country. Japanese feel that they as a country and as a people are being judged and that they are "on stage."¹⁷ This characteristic was demonstrated during the Olympics and Osaka Exposition when the government built elaborate facilities to present their nation in a better light to foreigners. The Japanese are highly sensitive about the cultural aspects they export from flower arranging to judo to postage stamps. The Japanese do not care whether or not it is possible for other countries to adopt their institutions and their techniques. Since they consider themselves unique, it would not surprise them if their techniques were so special that they

could not be exported. It is important to them that the unique Japanese be admired and respected and given status in the eyes of the world.¹⁸

B. CAUSES OF POSTWAR BOOM

Much has already been said of the rapid recovery and economic growth of Japan. There are many reasons underlying this growth and any analysis must start with the causes and effects of the actions taken by the Americans during the Occupation that laid the framework for the recovery. The primary objective of the Occupation was to demilitarize Japan and install American style democratic institutions. One of the first acts was the dissolving of the entrenched zaibatsu system and sweeping personnel purge of wartime leaders in the business community. This was closely followed by the passage of the Anti-Monopoly Act to breakup the huge conglomerates as the U.S. tried to dictate and install its own traditional business mechanisms on the Japanese.

The removal of the top family business executives brought about the emergence of a new business leadership in Japan. The change in corporate structure led to a wide diffusion of corporate ownership and resulted in the separation of ownership and management. The real control in the leading industries passed to professional managers who

had come up from the ranks.¹⁹ These were comparatively young men, most of them in their forties who had been serving in the upper-middle level of management in such functions as department heads, plant managers, and division heads. It is estimated that over 3600 key executives in Japan's leading corporations and 56 members of the zaibatsu families were purged causing a crucial leadership gap in the large companies.²⁰ The new leaders rose to the challenges and provided strong and gifted leadership in the postwar era.

This new leadership was able to take advantage of many factors that led to the economic growth. The following list gives causes for this success:²¹

1. An abundant and increasingly well educated work force. Cheap labor was available because of the extremely depressed postwar state of living and the migration from rural to urban areas. This work force was easily adaptable to the industrial process due to its high literacy and excellent lower-level education available during the Meiji period.

2. High labor motivation and employment loyalty. The sense of self-discipline, in part traditional, in part stimulated by the postwar spirit of self-denial, as well as intense motivation and loyalty to employing companies made for high performance and group cohesion.

3. High personal savings. This tradition gave Japanese banks a strong economic position and provided funds for capital investment. The Japanese savings rate is approximately 20 per cent versus 6 to 13 per cent in most other major countries.²²

4. Social stability. The political leadership has remained stable. Also there has been an absence of major or sustained labor strife.

5. Constructive role of government. The government adopted a protective and highly cooperative relationship with the business community. Such key government organs as the Finance Ministry and the Ministry of International Trade and Industry assumed an overall guiding role defining, more through consultation than through centralized direction, basic choices and priorities, and emphasizing long range planning.

6. Corporate cooperation. Though the Japanese cartels were broken up, the tradition of cooperative arrangements was not uprooted. This cooperation permitted an effective division of effort and allocation of resources.

7. Heavy equipment investment. In replacing the bombed out factories the Japanese centered on procuring the newest and most efficient equipment available.

8. Banking structure. Japanese banks played a key role in financing enterprises, in balancing the flow of capital, and in forestalling major business failures.

9. Stiff exchange controls. These provided the Japanese economy with a shield against speculation, protected the yen and the development of promising industries, and avoided the outflow of needed Japanese capital and the internal take-over of Japanese industries by foreign interests.

10. The low value of the yen. The official rate of exchange set at 360 yen to \$1 U.S. provided Japanese exports with a competitive advantage in the world market.

11. Availability of foreign technology. The Japanese were able to exploit the free trade situation to undertake a broad program of importing and adapting to its needs advanced foreign technology, and by buying up patents and licenses from everywhere.²³ Thus they avoided the high cost of indigenous research, development and experimentation.

12. Raw materials. The global postwar development boom opened to the Japanese broad opportunities for access to raw materials.

13. Low defense expenditures. Under the umbrella of U.S. military protection, Japanese industry was able to concentrate its resources in areas offering the greatest competitive payoff. Both the Korean and Vietnam wars

stimulated urgent American purchases in Japan and the rapid development of an industrial sector of tactical and strategic importance to the American war effort.

Certainly the above list is not all inclusive. By Western standards, these business structures and practices in Japan are considered strange and could not be used in most other industrial nations effectively.

C. BUSINESS PRACTICES IN JAPAN

A corporation to a Westerner is an impersonal organization for which he works and from which he receives income. The employer is free to fire the man if he thinks it necessary while the employee is free to find a better job. A Japanese company, in marked contrast, is a family. The man who goes to work for a Japanese company does not "get a job," he "enters the company" and pledges it a lifetime of service.²⁴ The company undertakes to look after the well-being of the employee for the length of his career. Consequently, one of the most agonizing decisions a young college graduate has to make is his choice of a company, as it is in a very real form an act of marriage.²⁵

Once in a company the employee is steered into a planned career development in which he is promoted by seniority up through the middle reaches of the company,

where merit begins to take over. At the very top levels executives sometimes change from one company to another. Usually this is within a group of associated companies or for staffing the top echelons of a new venture.

Despite the security of the lifetime employment system, a Japanese businessman or laborer works hard. He is motivated not by money but mostly by a sense of loyalty and obligation to the company — the same sense of duty he feels to his family and country. Obligations are ingrained in the Japanese ethic, and the employee's performance is more for the good of the company than for himself.

This paternalistic management approach has been criticized by Westerners as inefficient and self-defeating. However, this approach has taken the natural industriousness of the individual Japanese and combined it with the cultural tradition of communal and group participation to set new records of productivity. Any visitor to a Japanese factory at the beginning of the day listening to the employees singing the company song and doing callisthenics together can quickly comprehend the feeling of unity and purposefulness that pervades the plant.

This paternalism has also accounted for the lack of a strong labor movement in Japan as compared to the U.S. and some European countries. Most unions are company unions

which feel little need for a struggle with management, since the goals of both are the same. As the economy has prospered labor has negotiated for higher wages and benefits which are worked out together with management. Strikes of more than a few hours long are rare, and a prolonged labor dispute almost unheard of.²⁶

Another odd practice in the eyes of the Westerner is the process of decision-making in Japan. The Japanese employ a "diffuse, group-centered decision-making apparatus."²⁷ In this process the views of all parties who have an interest in the decision are canvassed, and an attempt is made to accommodate each of these views. Direct confrontations are avoided whenever possible, and many institutional mechanisms, including the use of middlemen, are employed to prevent them. A dissident party may also be placated by granting him a concession on some issue totally unrelated to the decision at hand.²⁸ One of the difficulties that exists is in determining who is the effective decision-maker, since decisions are made by all interested parties, each of whom has veto power. A virtue of the Japanese system is that the effort to keep all parties satisfied practically eliminates the "demoralizing squeaky-wheel phenomenon."²⁹ If some party or group still remains opposed to a given initiative, the result is usually a non-decision, i.e., a decision to stall

and keep the question circulating indefinitely until the matter is either dropped or a change in conditions permits unanimous agreement. A result of this process is a thorough discussion of the issues by all who are affected and an equally thorough educational process. This provides all the alternatives and complete staff work prior to the decision so that once made its implementation is smooth and rapid.

A business practice of particular interest to this thesis is the Japanese view of contracts and contractual disputes. People of different cultures have very different attitudes toward written agreements or contracts. In very few cultures are contracts taken as seriously as in the United States. The Japanese are quite casual about written documents. Kahn, Halloran and George describe this characteristic Japanese attitude as follows:

"Where Americans in cases of dispute tend to say, 'Let us return to the document on which the relationship is based and see what it said,' many Japanese would not think the matter of sufficient importance to be mentioned. For most Japanese the critical issue is the present and past emotional background of a relationship, the personal issues and attributes that led to its creation, and the current power or

bargaining situation. The Japanese would want to know: what was the ambience of the situation in which the document was signed; what events have occurred since the signing and what are the current relationships of the concerned parties? — all things that are usually irrelevant to an American involved in a dispute over a 'contractual issue.'"³⁰

"Japanese businessmen avoid precedent and deprecate legal, contractual obligations because they believe an agreement valid only so long as the conditions under which it was reached continue to hold true. They view contracts with suspicion and draw them up with an eye to flexibility in contrast to the American practice of trying to close every conceivable loophole. Few disputes between Japanese businesses ever go to court because this would be an admission that they have not been able to negotiate a compromise. Courts operate on the same theory and endeavor to mediate a compromise if a dispute comes to them in desperation. Courts are deliberately slow, not only because care is required but because the longer a court holds off, the better the chance the two parties will be forced to compromise."³¹

"A Westerner entering into a contract with a Japanese individual or firm will find that a contract is often considered an agreement to enter into a general course of conduct rather than something fixing the precise terms of performance. As a result there may be basic disagreement over whether or not the agreement has been breached..."³²

Much of the same attitude shown above with regard to business relationships also holds for treaties and other international agreements and understandings. If there is a change in power or other relationships but new emotional relationships have not been built up, then no treaty is likely to have serious moral binding effect on the Japanese.³³

One of the most powerful business practices in Japan is the cooperation between the government and the business sector. Japanese companies compete fiercely for market shares but they do cooperate with each other and with the government in ways that would make U.S. antitrusters bristle. Companies accept "administrative guidance" from the powerful Ministry of International Trade and Industry (MITI) on everything from mergers and the formation of cartels to imports of technology.³⁴ Commercial banks also get guidance in their operations from the Bank of Japan. In return they

borrow heavily from the central bank. Standing behind the Bank of Japan is the Ministry of Finance perhaps the single most influential agency in economic policy making. This ministry appoints and has supervisory authority over the central bank, thus controlling monetary and fiscal policy in the government.³⁵ Another important government bureau is the Economic Planning Agency, whose director is a cabinet member. This agency is responsible for accumulating facts, analyses and projections, and for publishing general economic objectives.³⁶

MITI has long had direct relationships with business. No major decision is taken by an industry without MITI's cognizance.³⁷ Japan's antitrust laws are anemic and non-existent if MITI approves a cartel, a price-fixing arrangement or production quotas. Much of MITI's day-to-day influence is felt through the trade associations to which the companies belong. Major investment and mergers are subject to MITI approval.

This interaction between the government, finance and business sectors of Japan has led to the nickname "Japan, Inc." As implied by the phrase there is the basic assumption that the objectives of government and business are the same: the maintenance of Japan's economic health and the promotion of the nation's interests. "'Japan, Inc.'

is a special kind of corporation: a conglomerate in U.S. terms. A conglomerate can channel cash flows from low-growth to high-growth areas and apply the debt capacity of safe, mature businesses to capitalize rapidly growing but unstable ventures. It can move into a dynamic new industry and bring to it financial power that no existing competitor can match. It can increase capacity quickly. The result is that the conglomerate is in a position to dominate a new industry by setting prices so low that existing competitors cannot finance adequate growth. Its costs are so low, compared with the competition's, that it can sell at the going price and earn large profits. In all these senses 'Japan, Inc.' is indeed a conglomerate, a zaibatsu of zaibatsu. The Bank of Japan is the financial center, and with the bank's help each rapidly growing industry can incur more debt than it could on its own; the borrowing power of the entire portfolio — Japan itself — is available to each industry. Hence the economy as a whole funds new enterprises, holds prices down, competes successfully in the world market and earns large profits."³⁸

D. EFFECTS OF U.S. PROCUREMENT REGULATIONS

1. Armed Services Procurement Regulations

All purchases and contracts made with appropriated funds by the U.S. military services must be made in

accordance with the Armed Services Procurement Regulations (ASPR) under the authority of Chapter 137, Title 10 of the U.S. Code. These regulations provide detailed guidelines for the preparation of the procurement request, solicitation and evaluation of bids and proposals, award of the contract and administration of the performance and acceptance of the goods and services. The agent of the U.S. Government responsible for the proper interpretation and implementation of these regulations is the contracting officer. In many respects the contracting officer is a limited agent.³⁹

His authority to bind the U.S. is restricted to the limitations of his appointment, the directives of his department, the regulations of ASPR, the Federal statutes, interpretative decisions and opinions and the Constitution.

The basic underlying premise of U.S. procurement policy is competition. This powerful force operating in a free enterprise system will effectively provide the required product in a timely manner at the lowest cost to the government, price and other factors considered. Thus, the preferred method of government contracting is formal advertising which requires adequate competition. Recognizing that the basic ingredients for formal advertising may not be present in procurement situations outside the U.S., all foreign contracting (with the exception of some construction) is done by

negotiation. This exception to the rules for formal advertising applies to property and services to be procured and used outside the U.S., its territories, possessions and Puerto Rico. The ASPR states that when these conditions are present "no other negotiating authority shall be used, nor shall formal advertising be used."⁴⁰

The use of negotiation in foreign procurement allows the contracting officer to explain the U.S. procurement regulations, discuss and explain specifications, contract terms, conditions and clauses with the contractor. It also takes a burden off the contracting officer in determining whether true competition is present since he may not be familiar with the foreign country's business practices.

In Japan the contractors for the most part had a good working knowledge of ASPR and the normal standard contract clauses required in the contractual document. New contractors were provided with excerpts from ASPR translated into their language to provide them with the basic U.S. procurement principles. The area of most concern was the accounting practices and disclosure of the company's records to the U.S. audit agencies. To do business with the U.S. military the Japanese contractor

was required to adopt many U.S. accounting standards and the company proposals were subject to audit and review for cost or price analysis before, during and after contract performance.

2. Status of Forces Agreement

The use of Japanese contractors to supply goods and services to the U.S. military stationed in Japan was recognized and specifically agreed upon in the government to government agreements. Under the Status of Forces Agreement (SOFA) it was agreed that "the United States may contract for any supplies or construction work to be furnished or undertaken in Japan for purposes of, or authorized by, this Agreement, without restriction as to choice of supplier or person who does the construction work. Such supplies or construction work may, upon agreement between the appropriate authorities of the two Governments, also be procured through the Government of Japan."⁴¹ It was further agreed that "the United States armed forces will furnish the Japanese authorities with appropriate information as far in advance as practicable on anticipated major changes in their procurement program in Japan."⁴²

Naturally the Japanese government was quite interested in the U.S. contracting as much as possible in Japan. The government agency which coordinated this program was MITI.

MITI provided the contracting officers with lists of sources for various products or services and was able to establish industries that would meet the military's recurring needs.

Although MITI never tried to influence a contract award, copies of all contracts over \$5,000 were provided to this agency monthly so they could see what types of materials were being bought as well as the volume of procurement dollars being spent in Japan. These procedures applied to non-appropriated fund activities such as clubs and exchanges as well.

The largest military contract in Japan was with the Japanese Government to provide Japanese civil service employees to the U.S. This Master Labor Contract set the wage rates, fringe benefits, promotion and classification criteria as well as disciplinary procedures for all the workers on U.S. military installations. This assured that the loyalty and allegiance of the Japanese worker remained with the Japanese government.

3. Competition

As stated earlier the basis of U.S. procurement policy is competition. It does not take a contracting officer in Japan long to perceive that this is not true in Japan. The Japanese, a deliberate people, are reluctant to leave anything to chance, and regulate the economy to bring

all its components into harmony. They intensely dislike competition. The Japanese are personally competitive for power and prestige but fear that if this is not controlled, what they consider excessive competition will cause economic chaos. Japan has limited space for agriculture and industry, limited resources, and limited capital. The margins for error are small, and the Japanese believe that laissez-faire, uncoordinated decision-making, and the play of market forces are luxuries they cannot afford.⁴³

The Japanese realize that U.S. procurement regulations require the appearance of competition and most solicitations for products will receive numerous bidders. However, the low bid will normally be from the contractor who has held the contract since the Occupation. One has the feeling that the pie has already been cut up and the wedges distributed equally to all the interested parties. For example, a review of contracts for fresh produce might reveal that contractor A has been supplying the Naval base at Yokosuka for the last 20 years, while contractor B and C have been supplying the Naval Air Facility, Atsugi and the Naval activities at Yokohama their produce for the same period of time. Both contractor B and C will bid every year on the Yokosuka contract but they are never low nor will they reduce their price during negotiation.

The same will be true for the Atsugi contract. Contractors A and C will bid but contractor B will always come in with the lowest price.

To foster competition the contracting officers have tried various methods. For example, one method used in ship repair is to break the tasks down to small components and then try to get competition among a large firm's subcontractors. The results of this procedure have resulted in the growth and expansion of many of the subcontractors into at least medium-size firms built by American competition. However, when the large firm decides it wants a particular job all the other bidders will drop out immediately.

This non-competitive climate makes the job of the contracting officer much more difficult. The ASPR requires strict rules and procedures for stringent cost or price analysis and indepth audits for non-competitive procurements. It must be stressed however, that Japanese contractors do not take monetary advantage of the lack of competition to make windfall profits or resort to overpricing. In most all cases the low bids are found after close scrutiny to be fair and reasonable.

4. Contractual Disputes

ASPR provides for various routes for adjudication of contractual disputes. Prior to any dispute being taken

directly into the court system, the procurement regulations outline various administrative procedures to settle claims and disputes. These channels basically ensure that the contractor may receive a quick and fair hearing and resolution of the dispute.

There are two basic channels provided the contractor for settlement of litigation. One is through the disputes clause of the contract for matters that relate to problems within the contractual structure itself. The other channel is through the provisions of Public Law 85-804 for matters that relate to problems outside the scope of the contract.

All Department of Defense contracts contain a disputes clause. This clause states that any dispute concerning a question of fact arising out of the contract which cannot be negotiated amicably by the two parties shall be decided by the contracting officer.⁴⁴ The contracting officer makes a final decision in writing and sends it to the contractor. The decision is final and conclusive unless the contractor appeals the decision within 30 days to the Secretary of the appropriate service. Appeals from contracting officer decisions are heard by the Armed Services Board of Contract Appeals (ASBCA) who render decisions which are binding on the contractor and the government unless appealed to the

courts on a question of law. This Board works for the Office of the Secretary of Defense and hears cases from all three military services. Pending the final decision on a dispute the contractor is required to continue performance under the contract in accordance with the contracting officer's final decision.

In Japan the SOFA provided an additional administrative procedure between the contracting officer's decision and the ASBCA. Recognizing that there could be problems and difficulties arising out of differences between Japanese and U.S. economic laws and business practices the SOFA provided for a Contract Conciliation Panel. Specifically the treaty stated "disputes arising out of contracts concerning the procurement of materials, supplies, equipment, services and labor by or for the U.S. armed forces, which are not resolved by the parties to the contract concerned, may be submitted to the Joint Committee for conciliation, provided that the provisions of this paragraph shall not prejudice any right which the parties to the contract may have to file a civil suit."⁴⁵ This Panel composed of the senior U.S. procurement officials in Japan and an equal number of representatives of the Government of Japan could hear contract disputes and try to reach a negotiated settlement between the two parties. It assured the Japanese contractor that he would have

representatives on the Panel that would be able to understand and sympathize with his point of view. The decision of the Panel was not binding and still could be appealed to the ASBCA as the function of the Panel was that of a mediator, and as such, was more to help reach an amicable compromise than hand down a verdict.

The Conciliation Panel was quite active during the Occupation and the Korean War until the contractors began understanding the U.S. procurement rules and regulations. It also took some time for the contractors to develop faith and trust that the ASBCA decisions would be fair and impartial. During the author's tour in Japan, only one case was brought to the Conciliation Panel and this one was settled by outside negotiation before the hearing was concluded.

The other channel for relief outside the contract under Public Law 85-804 is for extraordinary contractual actions necessary to facilitate the National Defense. This Act provides for contractual adjustments such as amendments without consideration, correction of mistakes and the formalization of informal commitments.⁴⁶ To hear cases for relief under this Act a Contract Adjustment Board (CAB) has been established within each military department. Under the Act the CAB's are authorized to provide equitable relief to contractors if and only if they decide that this relief

will facilitate the National Defense. Claims under this procedure are few in number in comparison to the ASBCA because of the extraordinary nature of the statute and the stringent requirements for documentation and evidence.

V. A MODEL - THE DOLLAR CRISIS OF 1971

A. PREPARING FOR THE INEVITABLE

In July 1970 the procurement agencies of the three services were satisfied with the results of negotiations with the Japanese contractors for the FY 1971 annual contracts. For the first time the contractors had raised the question of contingencies for changes in the foreign exchange rate of the Japanese yen. At this time all contracts written by the military services were expressed in U.S. dollars but were paid in yen because of Japan's currency control regulations. Each contract contained a Payments Clause that read: "Payment under this contract shall be made by Yen Check, based upon the official rate of exchange current at the time of payment" (underlining added by author for emphasis). The official rate of exchange had been set at 360 yen to \$1 U.S. This rate had been stable since the postwar administration of General MacArthur. The contractors realized that if a yen revaluation took place they could be subject to monetary losses on each contract, depending upon the adjustment in the new official exchange rate.

During negotiations of the contracts the contractors were advised that contingencies of this type could not be allowed and the Defense Contract Audit Agency and local

Procurement analysts had made every effort to identify and eliminate contingency-based costs whenever they appeared in the proposals. In most cases the contractors had been willing to remove them based on assurances provided by U.S. contracting officials that this matter was under study and that policy direction from higher levels was being sought on this problem.

At this time Japan was experiencing a phenomenal economic growth rate. During the period 1966 through 1970 this rate averaged 12.96 per cent.¹ The Japanese trade surpluses were mounting as exports increased. The Japanese balance of payments surplus had risen from \$60 million in 1966 to \$1900 million in 1970.² At the same time the Government of Japan was discouraging talk of a currency revaluation which would take away the competitive advantage it enjoyed in the world marketplace. In 1969 Japan was first in the world in the production and manufacturing of shipbuilding, radio sets, cameras, transistorized televisions, commercial motor vehicles and motorcycles and was second to the U.S. in the production of television sets, computers, cotton yarn, aluminum, copper, crude steel, caustic soda, plastic resin and second to the U.S.S.R. in the production of cement.³ During this time the value of the U.S. dollar as the recognized unit of world exchange was becoming unstable in the international money market and there was talk of currency exchange rate realignments.

It is interesting to note here that although Japan was the third largest economic power in the world, the U.S. military was not writing contracts in yen but rather in dollars. At the same time the U.S. was writing contracts in local currencies in Hong Kong, Singapore, South Korea and South Vietnam. To the Japanese who feel that they must take their proper place in the world hierarchy, this would appear to have been a cultural "slap in the face." The U.S. justification for this oversight was the convenience of having the contracts expressed in U.S. dollars for the U.S. customers, comptrollers and contracting officers.

The U.S. Navy had experienced problems with the exchange rate from only one group of contractors. These were the aircraft repair, overhaul and rework group consisting of Kawasaki Heavy Industries, Mitsubishi Heavy Industries, Shin Meiwa Industry Company and Japan Aircraft Manufacturing Company, all members or affiliates of the zaibatsu conglomerates with close ties to MITI. This group had submitted proposals containing identical requests that stated:

"Though our quotation is based on the dollar amount, the official rate of exchange shall remain the same as the current rate as of June 1970 during the whole period of the FY71 contract." During negotiations this issue was side-stepped, but based on the importance of these contractors

to the Vietnam war effort, the warning lights were flashing that this matter should be resolved before the next negotiations and the contract payment policy reviewed and changed if possible. Not only did these four contractors represent over \$14 million per year in contracts or about half the Navy procurement business in Japan, but the fact that companies with close ties with MITI were asking for a change was an early indication that the Government of Japan was considering a possible yen revaluation.

At this early stage it should be noted that these firms at the top of the hierarchy would have been the first ones privy to any major economic policy shifts being considered by the Government of Japan. These firms represented those chosen few who would have to be protected from serious economic losses.

Three months later on 29 September 1970 the U.S. Navy received a petition from sixteen of the largest Navy contractors requesting a revision to the existing contract payment clause.⁴ The group again was headed by the four aircraft companies but this time also included two other members of the zaibatsu in the shipbuilding industry; Sumitomo Shipbuilding and Machinery Company and Sasebo Heavy Industries Company. This petition was presented to the Commanding Officer and the contracting officer of the Naval

Supply Depot (NSD), Yokosuka, Japan. The petition expressed concern over the pressure from other countries for Japan to revalue the yen upwards causing the contractors to suffer losses under the U.S. dollar denominated contracts and requested that the payments clause be changed to read that payment be based on the official rate of exchange current at the effective date of the contract award (underlining added by author for emphasis) rather than at the time of payment. This petition was followed the next day by another petition on the same subject from eleven industrial gas contractors doing business with the Navy.⁵ This group advised that the present contract expired on 31 December 1970 and gave the first threat of non-performance of the contract if the rate of exchange was changed. Specifically it stated that: "We are afraid it may be disturbe (sic) perfect contract performance." This petition further provided two other solutions to the payments clause problem; (1) write the contracts in yen thereby negating the need for the payments clause or (2) amend or terminate the contract if and when the yen was revalued. This threat should have been viewed with respect to the Japanese attitude toward contractual agreements. The intent is clear that they were saying that if the yen is revalued the conditions and intent of the parties at the time of signing the contract would be drastically changed and therefore they had the right to terminate the contractual relationship.

In accordance with U.S. Forces Japan (USFJ) Policy Letter 11-14 of 29 April 1968 these petitions were accepted by NSD and forwarded through official channels to USFJ to the Government of Japan and no other action was taken by military procurement or comptroller personnel. In retrospect these petitions were the first subtle evidence being provided at an early date to alert procurement officials to review current policy and consider remedial action.

The question must be raised at this time; was any planning or consideration being given to this problem? To answer the question, one must briefly look at the U.S. procurement regulations and authorities in Japan. Contrary to popular belief the ASPR contains no guidance on the method of payment of foreign procurements. ASPR regulates domestic contracts almost entirely. The power to regulate payment procedures is delegated to a Joint Procurement Coordinating Board (JPCB) in each foreign country. This authority is provided by the Office of the Secretary of Defense through the applicable unified command of the country involved. The Japan JPCB was chaired by USFJ and included representatives from each of the services; normally the senior procurement officer from each service. The Navy member was the Director of Contracts, NSD Yokosuka, representing the Commander, Naval Forces Japan (COMNAVFORJ).

The question of yen revaluation had been of interest to the JPCB since May 1970 when a petition was presented by a group of contractors to the U.S. Army Japan, Director of Procurement, requesting a change in the contract payment clause.⁶ During this time the first official warnings were sent to the three services' higher headquarters citing a possible yen revaluation and requesting guidance.⁷ The payments clause in use at this time had been approved by the JPCB in January 1969 at the request of the U.S. Army.

In the fall of 1970 the Navy made a motion in the JPCB that the clause be changed to have the yen rate pegged at 360 yen to \$1 U.S. in the clause. This motion was discussed at several meetings and after consultation with the U.S. Embassy the motion was tabled. On 12 November 1970 a new policy guidance memo was issued by USFJ which stated that the clause would remain unchanged but gave contracting officers authorization to write a contract in yen if "it was in the best interest of the U.S."⁸ It was unofficially understood however, that prior approval of the JPCB would be sought before the contract was signed.

During the early part of 1971 the yen problem cooled off. The contractors continued to request a change in the payments clause, but willingly signed contracts containing it. At the negotiation table the Japanese contractor would

propose a yen contract but the U.S. would say that our policy was to only issue dollar contracts and that if the yen was revalued then the contractor "would be taken care of." The U.S. official was intent on the contractor signing his name so that a binding contract was executed. The Japanese businessman perceived the U.S. as understanding his problem and viewpoint that he was only agreeing to the contract based on no yen revaluation and that if this changed then the contract would be void.

In March 1971, the yen problem started appearing as front page news in the local press. On 6 March 1971, Prime Minister Sato stated: "I am not thinking of revaluing the yen or redenomination of the yen."⁹ He also noted that Japan's gold and foreign currency reserves had reached \$4.4 billion in January. On 26 March 1971 Mr. Sasaki, Governor of the Bank of Japan, made the same statement and noted that Japan's foreign reserves would reach \$5.3 billion by the end of March.¹⁰ The U.S. news media made the first widely publicized statement on 29 March 1971 when Newsweek stated: "The Japanese Government has repeatedly denied that it is considering revaluation of the yen. But the country's major trading companies, who quote their prices for imports of iron ore, coking coal and other raw materials in foreign currencies, are not convinced. So wary are the trading

companies, in fact, that they have decided to ask Japan's steelmakers and their other major industrial customers to insure them against loss if and when the value of the yen is increased."

On 3 April 1971 the Mainichi Daily News carried an editorial stating that the yen revaluation issue has recently "assumed an inkling of reality."¹¹ A few days later the same paper stated that the U.S. was not exerting pressure on Japan to revalue the yen.¹² On 9 April 1971 the Government of Japan's position appeared to be cracking. The Bank of Japan advised that it was considering lowering the official discount rate by .25 per cent to slow the rise of foreign reserves and it also revealed that the shipbuilding industry had written 77 percent of its commercial contracts in Japanese yen instead of the usual U.S. dollars.¹³ Again it should be emphasized that it was the major industrial firms with close governmental ties that were already hedging against a currency revaluation.

The JPCB held an emergency meeting in early April 1971 when it was learned that NSD Subic Bay Philippines had written a contract in Japan with Japan Aircraft Company changing the payments clause by pegging the rate at 360 yen to \$1 U.S. This contract had been signed without the approval or knowledge of the JPCB or the Navy member. Within a few days

Japanese contractors were calling on procurement officials all over Japan demanding the same treatment in their contracts. In retrospect this action by NSD Subic Bay, heavily condemned at the time, was a blessing in disguise because it forced the issue and was the vehicle used to implement changes to the payment policies. It also forced higher authority to realize for the first time that revaluation of the yen was bigger than just a procurement problem. It would affect Japanese civil service employees working for the U.S., clubs and exchanges, budget and accounting, inventory control, and the U.S. military personnel living on the Japanese economy.

The JPCB requested that each service develop a position on the subject and report back to USFJ in early May. At the same time coordination with the U.S. Embassy would be made by the JPCB. The Navy representative briefed COMNAVFORJ on the problem and advised that NSD was calling a conference of all interested commands and activities on 13 April 1971 to brief them on the potential impact on their mission. The briefing was well attended and for the first time the seriousness and full impact of a yen revaluation was discussed in detail. One example of the action taken based on the briefing was the transferring of the non-appropriated fund clubs and messes retirement reserves from dollar accounts to yen accounts in the Chase Manhattan Bank in

Tokyo.¹⁴ The resulting Navy position that emerged was that action must be taken to change the payment clause to fairly compensate the contractors for the fair value of the goods and services procured, and that the change should be made before the annual contracts were due for signing on 1 July 1971. The Navy proposed that the payments clause be changed to read that payment would be made at the official rate of exchange at the time of contract award rather than at time of contract payment.

The Navy wanted the clause changed while it could still be done voluntarily without the appearance of the U.S. being backed into a position of either changing the clause "or else." This recognized in advance that once the exchange rate changed the inflexibility of U.S. contract law would take over and demand consideration for any changes in the existing contracts. It would also avert any appearance of the Japanese contractors being put in the position of losing face over the issue.

At the May meeting of the JPCB, the Navy and Air Force positions were basically the same; the payments clause should be changed to protect the Japanese contractors, and keep up the relationship of mutual trust that the contracting officer enjoyed with their contractors. The Army position was to defer action on the problem for the present

and take action when and if revaluation came. The Army position can be better understood if one considers that at this time the reversion of Okinawa was being planned. The Army was the principal procurement authority on the island at that time. Since Okinawa was under U.S. administration the currency used throughout the country was the U.S. dollar so that contracts were written in dollars and paid in dollars.¹⁵ Okinawa was due to revert to Japan on 15 May 1972 and the Army, backed by officials at the U.S. Embassy, felt that any yen revaluation would be postponed by the Government of Japan until after that date. If this was not done, thousands of Okinawans would lose money on their dollar checking and savings accounts held by the banks. Officials of the Bank of Japan were quoted in the press as saying that the reversion of Okinawa could be one possible factor to be considered in Japan's decision whether or not to revalue the yen upward.¹⁶

The issue was further clouded by the debate raging in the news media. Foreign sources were being quoted as saying that a revaluation of the yen was necessary and was only a matter of picking the right time for the change. This pressure for a revaluation mounted as the monetary crisis in Europe forced the revaluation and floating of the German mark and Dutch guilder while the U.S. dollar

declined to historic lows on the exchange markets in relation to other currencies. The U.S. was seen as putting pressure on Japan to revalue the yen as Japan's reserves leaped to \$6.3 billion in May 1971. U.S. State Department sources denied these charges stating: "We have made no official, or unofficial, formal or informal proposal" that Japan revalue its yen.¹⁷ Treasury Secretary John Connally was quoted as saying that the yen was "somewhat undervalued" but that this was "very different" from urging the Japanese to increase the parity of their currency.¹⁸ On a trip to Tokyo former Secretary of Agriculture Orville Freeman stated: "Revaluation of the yen will be helpful to the world monetary system" and "In my personal opinion yen revaluation is necessary."¹⁹ He denied however, that he would recommend a yen revaluation to Prime Minister Sato. Business Week magazine said that Japanese businessmen expect a nine per cent upward revaluation of the yen probably in October, despite Japanese Government insistence it will not revalue.²⁰

During this period government and business leaders of Japan were stating flatly that the monetary crisis could be solved without a revaluation of the yen. Finance Minister Fukuda stated that raising the par value of the Japanese currency would "have some obvious demerits amounting to a

loss of national interest.²¹ Prime Minister Sato stated that the yen parity would be maintained.²² The powerful Keidanren²³ strongly opposed any change in the value of the yen — "feeling that if it is carried out now when the economy is in a slump, it might touch off a panic at home."²⁴ The Keidanren recommended that the government take "drastic measures to curb the sharp and steady rise in the nation's foreign exchange reserves."²⁵ The Japan Shipbuilding Industry Association came out strongly against revaluation²⁶ as did Mr. Sato the Director General of the Economic Planning Agency.²⁷ Probably the strongest statement was attributed to Finance Minister Fukuda that "There will never be an upward revaluation of the yen so long as I am in the Government."²⁸

Based on Navy and Air Force insistence that these two services would take unilateral action to change the payments clause in the upcoming FY72 annual contracts, the Army agreed to the new change and the JPCB unanimously recommended to USFJ that the contracts be written in terms of yen starting 1 July 1971. USFJ concurred and issued a classified message to all procurement activities advising of the new policy but requiring that no contracts be changed until that date and that contracts already under negotiation in U.S. dollars be continued. After 1 July

1971 these contracts could be amended to yen contracts only for some form of consideration from the contractor. The effect of this policy was to double the number of dollar contracts that were to later cause so much trouble. Since a major portion of the annual contracts are negotiated at the beginning of the fiscal year, the immediate change to full yen terms on these contracts would have minimized the entire impact of the later revaluation. The classification of the policy change until 1 July was not popular with the Navy or the Air Force, but had been accepted by them as the only way to get Army concurrence to the policy change. Since most of the contracts required extensive negotiation during June and only dollar terms could be discussed, the new contracts effective on 1 July were locked into the old dollar policy for another year. These contracts were expressed in dollars and contained the old payments clause.

COMNAVFORJ through NSD Yokosuka implemented the policy to all Navy procurement activities. The small purchase area was relatively simple to change since most procurements were done under Blanket Purchase Agreements which could be modified unilaterally by the U.S. Major contracts had to be modified by receiving consideration. This was difficult in that the contractors had been honest about taking out revaluation contingencies from their proposals so that to have the contract written in yen terms, many lowered unit

prices, thereby cutting into profit margins. Since the estimate of the proposed revaluation was forecast to be around 10 per cent, NSD was successful in negotiating a 6 per cent reduction in price on a few of the contracts for a change to yen terms, thereby sharing on a 60/40 basis the proposed loss to the contractor. The contractors appeared willing at this time to at least discuss the principle of consideration since the basic situation had still not changed. Although it was offered to all of the contractors as a hedge against a future currency fluctuation, few took advantage of it since most still believed in the U.S. assurances that they would never suffer substantial losses.

During August 1971 rumors were rife that revaluation was imminent. Two events were responsible for this; (1) on 15 August President Nixon removed the gold backing from the U.S. dollar and (2) Japan's foreign reserves had risen to \$12 billion, a quadrupling since the first of the year. The Chase Manhattan Bank on the Yokosuka Naval Base started limiting to \$50 the amount of currency that could be exchanged into yen per person per day. On the weekend of 21 August 1971 the rumors were so strong that people were exchanging dollars off the base at a devalued rate and several contractors called the NSD contracting officer offering to reduce prices by 10 per cent for a conversion of their contract to yen terms.

Late in the evening of Friday, 28 August 1971, the new Japanese Finance Minister, Mr. Mikio Mizuta, made the announcement the world had long expected. The Japanese yen was allowed to float and find its own exchange level against the U.S. dollar. For U.S. procurement officials in Japan the crisis had become real.

B. THE CURRENCY FLOAT

On Saturday morning, 29 August 1971, a conference was held at USFJ headquarters to draft a message to the Office of the Secretary of Defense (OSD) for guidance on the various issues created by the yen float. It was also necessary to adopt a formal U.S. military position for the Joint Committee²⁹ which would be meeting with representatives of the Government of Japan the next day. Representatives were present from all three service Unified Commands as well as Commanding Officers of all major military activities in Japan. The members of JPCB attended to answer questions on the impact of the yen float on existing dollar contracts.

The chairman opened the discussion with a summary of the Government of Japan's position that would be presented the next day. The Japanese representative had already expressed his sorrow that Japan would not abide by the Treaty agreements. The rate of exchange had been established at 360 yen to one dollar during negotiation in 1952 between

the two governments prior to the execution of the Administrative Agreement under Article III of the Security Treaty. Specifically Article XXV paragraph 2b of this agreement stated: "It is agreed that Japan will: (b) Make available without cost to the United States, until the effective date of any new arrangement reached as a result of periodic re-examination, an amount of Japanese currency equivalent to \$155 million per annum for the purpose of procurement by the United States of transportation and other requisite services and supplies in Japan. The rate of exchange at which yen payments will be credited shall be the official par value, or that rate considered most favorable by the United States which on the day of payment is available to any party, authorized by the Japanese Government or used in any transaction with any party by the Japanese Government or its agencies or by Japanese banks authorized to deal in foreign exchange, and which, if both countries have agreed par values with the International Monetary Fund, is not prohibited by the Articles of Agreement of the Fund." Article XIX of the SOFA stated; "Payment in Japan by the United States armed forces and... shall be effected in accordance with the Japanese Foreign Exchange Control Law and regulations. In these transactions the basic rate of exchange shall be used." USFJ Policy Letter 170-2 of 25 April 1969 implemented these

treaties and stated in paragraph 26 entitled; Restrictions on Exchange, that: "Official exchange of U.S. dollars to Japanese yen for U.S. authorized personnel will not be made for fractions of a dollar. Exchange will be made at the official U.S. Forces rate of exchange only. (Currently ¥360 = \$1.00)."

The Government of Japan was going to request that the Agreements be put aside and that the Bank of Japan would no longer provide yen at the official rate of exchange to U.S. Disbursing Officers and U.S. Military Banking Facilities but would furnish yen at the "majority rate" or the rate at which the largest volume of dollars was transacted the preceding day. A discussion ensued as to whether the official rate of exchange was still 360 yen to \$1 or was the official rate the floating rate? A recommendation was made that the U.S. insist that for official transactions such as government contracts and salaries for Japanese civil service employees the Government of Japan provide Disbursing Officers with 360 rate yen and floating rate yen for all other transactions. This recommendation was dropped after a long debate. The final consensus was to accept the floating rate as a temporary measure until higher guidance could be received.

A message was drafted to OSD explaining the problem and outlining the impact of the floating rate particularly on the U.S. military families living on the Japanese economy paying rent, utilities and food costs in yen. It asked OSD and the State Department whether to accept the Government of Japan's position and accept the floating yen rate in view of the government to government agreements. The message also asked OSD for a ruling on the rate to be paid Japanese contractors whose contracts called for payment in yen at the official rate of exchange.

It was agreed that until OSD provided an answer to these questions, all yen exchange would be halted on all U.S. military installations and that no contractor's invoices would be paid by any Disbursing Officer or Fiscal Officer. Military personnel who needed yen would have to utilize commercial banking facilities in the city or town near the base.

On Sunday the Joint Committee met with the representatives of the Government of Japan and approved the temporary measures for yen/dollar conversion at the majority rate.³⁰ The Government of Japan also furnished copies of its official message to the International Monetary Fund stating that: "while the present parity of yen remains unchanged and the Japanese authorities continue to intervene

on the market, dealings in foreign exchange will, with effect August 28, 1971, not necessarily be confined within the margins around par hitherto observed."³¹

On 30 August 1971 OSD provided guidance, agreeing to the majority rate for all yen transactions and stating that contracts written in dollars and payable in yen at the official rate of exchange should be paid at the floating rate current on the day of payment. Thus procurement officials had their marching orders and could now provide the contractors with definitive answers on the outstanding contracts:

C. ACTIONS TO PREVENT CATASTROPHE

One of the basic tenants of U.S. Government procurement is that the Government is willing to pay a fair price for quality products delivered within a specified delivery period. The fair price includes providing the contractor with a reasonable profit return on the cost risk he assumed in undertaking the contract terms and conditions. Procurement courses and training schools emphasize that the Government will not tolerate a contracting officer knowingly placing a contractor in a position of losing money on a contract. Yet by the actions of the sovereign governments of Japan and the United States in the turbulent monetary crisis of 1971 the Japanese contractor appeared to be about

to suffer substantial losses on his contracts with no clear-cut remedy in sight. Clearly the conditions present when the contract was signed had been significantly altered. In the eyes of the Japanese these contractual agreements were no longer valid or binding. One can sympathize with the contractor who is locked into providing the U.S. military with goods and services at a set dollar price that has just been devalued by 15 percent while at the same time paying the same amount of yen for materials and labor. What are the options of the contractor? From the U.S. point of view he could: (1) continue honoring the contract, hoping to make up losses on the new annual contract by raising prices; (2) walk away from the contract and just quit delivery until the U.S. reformed the contract; (3) cut the quality of the product thereby limiting losses; or (4) seek relief from either the Japanese Government through some form of subsidy program or the U.S. through the administrative disputes clauses within the contract.

The problem facing the U.S. procurement officials in Japan during the first week in September 1971 was to forecast which options the contractors would choose. During prior debates at the JPCB the remark was made many times; "Don't worry about the contractors; when the German mark was revalued no contractor there lost money." This

optimistic assurance had been passed on unofficially to the Japanese contractors in good faith, leading to the conclusion, perhaps naive, that the U.S. would take care of them. Now the realization was becoming clear to the U.S. procurement officials that maybe this wasn't going to happen. These assurances, in which the contractors had put so much trust and faith, might come home to haunt the contracting officers. If higher authority dictated that the procurement regulations were to be followed to the letter, then there was no possibility for compromise to avoid a direct confrontation. What if the contractors stopped delivery? What were the legal remedies in this situation that could be exercised? The U.S. Government couldn't go to, say, a Federal District Court and get an injunction to force the contractor to perform. Not even the contracting legal advisors could advise if the Japanese court system would take jurisdiction over the matter.

The first step taken by the Navy was to analyze the outstanding dollar contracts affected by the revaluation. NSD Yokosuka had 43 dollar contracts outstanding for a variety of goods and services. The only other major Naval activities holding dollar contracts were the Public Works Center Yokosuka, mostly in the construction area, and NSD Subic holding the vital aircraft repair and overhaul contracts.

A briefing was given to COMNAVFORJ to outline the critical contracts in terms of sustaining the U.S. military mission in Japan. It was felt that the aircraft companies would continue to perform but were the most likely to submit claims under the disputes clause. On most of the other contracts the goods could be brought in from the U.S. if necessary and the services could be provided by an augmentation of forces and skills to carry them out. Of most concern were the long list of pilot and tug contracts caught in the revaluation. If these contractors refused to honor the contracts, most of the major ports in Japan would be closed to Military Sealift Command ships, commercial tankers, and in some cases the warships. Without logistical support by sea, especially fuel, the military bases in Japan would be hardpressed to keep operating for very long. At the end of the meeting, the first priority was to ensure that these pilots stayed on the job. The next priority was to gain time, for with every month that passed another group of dollar contracts expired and new yen contracts were negotiated to replace them. No thought was given to the fact that the loyalty and trust of the contractors might ensure continued performance. Certainly the U.S. wanted to salvage what it could from the long-standing good business relationships but no U.S. company under the same conditions would continue to perform so why

would a Japanese company? The situation had now become like a war game with the contractors playing the role of the adversary and a strategy had to be developed to checkmate any of his moves.

Let us look first at the pilot and harbor services contracts for it takes some understanding of the background to understand the problems of arriving at a satisfactory solution. Each port in Japan has a Pilots Association that is licensed by the Japanese Government. The rates and fees for all services are set each year for each port by the Japanese Diet.³² These rates are published by each port and are expressed naturally in yen. Each year when the sole source U.S. contract solicitation was sent out, the applicable Pilot Association would submit the published rates as set forth by Japanese law. The contract negotiator would take these yen rates, divide them by 360 and place the rates in the contract at the dollar figure. These contracts contained option clauses that continued the contract from year to year without re-negotiation of the terms except for the legal rates. Of course as long as the yen rate remained unchanged there were no problems; in fact, these were looked on as the easiest contracts to complete each year. With the change in the yen rate the lawyers raised the hypothetical question that if the U.S. paid less than the rate set by

legislation, was the U.S. breaking Japanese law and conversely, if the pilots accepted less than the yen rate were they breaking Japanese law?

Contracting officers had been advised that they could reform dollar contracts if they received consideration, but in this case any consideration would place the rate under the published price. A message was drafted by NSD Yokosuka to the Naval Supply Systems Command (NAVSUP) asking for one time authority to reform this one contract type without consideration to bring the rates in line with the published figures. NAVSUP replied that this request could not be granted since reformation authority for contracts was vested only in the Secretary of the Navy under extraordinary relief provisions of Public Law 85-804. NAVSUP suggested that some form of consideration be negotiated so that the contracts could be legally changed to yen terms. This policy decision followed another of the basic tenets of U.S. procurement regulations; that no U.S. contracting officer may give up any of the U.S. Government rights under a contract without receiving something of equal value in return.

On the remaining contracts the Navy issued a letter to all its contractors stating that the matter was being studied and that at the present time the only way a dollar contract could be changed to yen terms was for the contractor

to give up some form of consideration. It further praised the contractors for their loyalty to the U.S. Navy over the many years and held out the hope that some claims remedy would be agreed upon that could provide some form of relief to the contractors. In the interim it pleaded with them to continue to perform under the terms and conditions of the written contract. This letter appealed to the Japanese cultural heritage more than was realized at the time. It appealed to the sense of loyalty and dismissed the doctrine of consideration as not applying fairly in this case and held out the hope of some remedy that would completely reform the contract without the contractor giving up anything.

A hasty meeting of the JPCB was called to set some formal policy for the three services to follow so that there would only be one face to the Japanese contractors. Each service presented a report on the outstanding balance of dollar contracts. In the aggregate there were 1300 of them with an estimated unexpended balance of \$41,630,000. Using an arbitrary 10 per cent revaluation figure, the potential loss to the contractors would be \$4,163,000. It was felt by the members that this figure was insignificant compared to the loss of goodwill of the Japanese contractors and quite small in comparison to the annual Defense Department expenditures in Japan of approximately half a billion dollars.³³

It became quickly evident that the members of the JPCB were personally sympathetic to the plight of the contractors. Whether or not this was based on a sense of equity or the specter of non-performance will probably never be known. It was felt that legally under the terms of the contracts that had been signed, there was no way to provide relief to the contractors and that they would lose any cases taken through the disputes clause to the ASBCA. This followed the traditional U.S. doctrine of relying solely on the written word of the contract and not on the intentions of the parties at the time of the agreement. There was a grey issue to many since the payments clause of the contract stated that yen would be paid at the "official rate of exchange." The Japanese press at this time was carrying frequent statements by the Government of Japan that the official IMF parity rate was still 360 yen to \$1. However, this argument was not thought to have merit in view of directives from service comptrollers to disbursing officers to pay these contracts at the majority rate.³⁴

The JPCB viewed with alarm the Navy problem with the Pilot Associations and the equally serious problem of the Army with land transportation contracts. It was felt that some remedy other than consideration must be sought and

sought quickly to ensure continued performance under all the contracts. The vehicle studied was Public Law 85-804 which provides authority for granting relief to contractors in certain extraordinary situations. The law empowers the President to permit the agencies concerned with national defense (Secretary of Defense and the Secretaries of the Army, Navy and Air Force) to modify contracts without regard to other provisions of law concerning the making, performance, amendment, or modification of contracts. One of the types of relief under the law is making amendments without consideration or in reality, reformation of the contract. A finding that the national defense will be facilitated by an amendment without consideration can be made whenever an actual or threatened loss on a contract, however caused, will impair the productive ability of a contractor whose continued operation is essential to the national defense. In this case the loss was caused by actions taken by the U.S. as a sovereign and not as a contracting party and therefore relief in these cases depends on the equity or fairness doctrine.

The JPCB was well aware of the time-consuming process required to submit claims for relief under this statute. In view of this the idea was advanced that since the estimated volume of claims would be so great that authority should be requested from OSD through CINCPAC for a delegation

of authority below the secretarial level to consider and approve or deny contractors requests for contract amendments without consideration where revaluation had reduced the amount of yen payable to the Japanese contractor. A message was drafted and concurred in by the component commanders in Japan and coordinated with the U.S. Embassy.³⁵ The message assured that each case would be decided on its own merits applying the doctrine of equity and fairness. Each service would provide legal counsel to the board during the hearings. The message recommended that the authority be delegated to the senior procurement officer of each service and that since these officers were also members of the JPCB this would ensure that the authority would be at a high enough level to ensure uniformity of action. The JPCB requested that CINCPAC advise OSD of this request on a priority basis. The reply advised that claims under Public Law 85-804 were to be submitted in the normal manner up through service channels for hearing and decision. In retrospect the basis for this message was shaky. It was naturally assumed that like a U.S. business all the Japanese contractors would submit claims for relief. Based on the Japanese tradition of group action, one contractor would have been chosen to represent all the contractors and submit one claim. Then, depending on the outcome the group

would have decided on the next course of action. The possibility of ridicule was too strong for all of the contractors to have opted for a direct confrontation with the contracting officers in this area.

So by the end of September 1971 the situation looked grim for both sides. The yen was quoted at 332 to \$1 or an 8 per cent revaluation.³⁶ The policy received from higher authority was to make amendments to contracts only for adequate consideration and to assist any contractor who felt justified to submit claims against the U.S. Government via Public Law 85-804 or the ASBCA via the disputes clause. A further upward revaluation of the yen was predicted with newspaper accounts stating that major firms were using a 315 yen rate for medium and long term export contracts with the period of payment exceeding three or four months.³⁷

NSD Yokosuka began receiving letters from the contractors holding dollar contracts immediately after the revaluation. The common theme in all the letters was the request for the contracting officer to either change the contract to yen terms or pay the invoices at 360 yen to \$1 U.S. Appendix A and B are samples of the letters received from the pilot and tug service contractors. As shown most of these were short, polite, and to the point; please

change the contract to yen to agree with the published rates. The inference from these is that this problem was one the U.S. created and therefore it was only reasonable that the U.S. take unilateral action to avoid losses to the contractors. It is also interesting to note that of this group only one contractor, Hachinohe Kowan Unso K.K., alluded to ceasing performance. Appendices C through E are a few samples from other Navy contractors. The White Cross Company's argument was typical of many of the complaints; the cost of labor calculated for the contract is set and must be paid in yen so losses would result if performance continues. Their solution was for a fair sharing of the loss with the U.S. on a 50/50 basis.

The letter from Denki Kogyo Company best illustrates many of the points of all the letters: (1) we "requested that the payment conversion clause should have been modified"; (2) our proposal "did not include any contingency fee for a possible revaluation of yen"; (3) we "are aware of our responsibilities to the U.S. Navy"; (4) we signed the contract "in the expectation that you would make an equitable adjustment for us if the rate is actually changed"; (5) "the official rate of exchange...remains 360 yen to 1 dollar"; and (6) "application of a floating exchange rate...would not be conducive to the spirit of mutual confidence."

In answer to these letters the three services agreed on a "form" reply. This answer stated that the U.S. contracting officers were thoroughly aware and concerned with the problems resulting from the Government of Japan's decision to float the yen (underlining added by author for emphasis). It assured the contractor that this complex matter was being carefully studied to determine what courses of action were open within the limits of the contracting officer's authority and that when resolved the contractors would be informed. The reply contained a pat on the back for the loyal years of service and the amicable relationship enjoyed with the contractor. It ended with a subtle plea to continue performance by stating; "Your many courtesies are greatly appreciated by this command and it is hoped that effective business relationships will continue." This was known in procurement circles as the "Buy Time" letter.

The letter did indeed buy time but no satisfactory solution to the problem was found except that as each month went by more dollar contracts expired and went away. So far the contractors had continued to perform and the U.S. ordering activities were careful to hold to a minimum the required services and material under the old contracts. The yen rate had fallen to approximately 335 to \$1 on

1 October 1971 with the Bank of Japan actively controlling the rate of descent by buying and selling on the foreign exchange market. The argument still proposed by the contractors was that the official rate of exchange still remained at 360 yen to \$1 U.S. and this is what they should be paid under the written terms of their contracts.

In early November the Navy found a vehicle which was thought would get a ruling on this argument and with the interest and backing of the JPCB attempted to use a new route to higher authority for clarification of this point. The Ship Repair Facility (SRF) Yokosuka forwarded to NSD Yokosuka a letter from a contractor claiming reimbursement of 12,130 yen (\$33.69) on a small purchase order. The contractor, Daiichi Kansei Sangyo Company, had delivered a priority shipment of liquid nitrogen to SRF on 15 June 1971 as scheduled and had submitted his invoice on the same date. Through administrative error the invoice was not processed to the Disbursing Officer for payment until 24 August 1971. The invoice was thus caught up in the revaluation of 28 August and was paid at the floating rate of 338.55 yen. Both SRF and NSD felt the contractor had a valid claim since SRF readily admitted the clerical error in taking so much time in processing the invoice. The claim was submitted to the Navy Regional Finance Center,

Washington, D.C.³⁸ as a doubtful claim under the authority of the Naval Comptroller Manual, Volume 4, paragraph 046369, which requires that it be forwarded to the Genral Accounting Office (GAO) for direct settlement. It was hoped that GAO would rule on the question of the meaning of "official rate of exchange." This ruling by a party outside the Defense Department would then provide a precedent that could be used in the larger cases. The results of the case were long in coming and by the time of the decision events had overtaken it, but GAO in disallowing the claim stated that the official rate of exchange on the date of payment was the majority rate.³⁹

Claims were coming in to the services now using different avenues as though the contractors had studied all approaches available in the procurement regulations and wanted to ensure that each path was covered. This reinforces the idea of group action which was being taken by the Japanese contractors to find the best solution to the problem. The situation or case with the best chance of winning was put forth under each approach as a test case. Twenty-seven contractors submitted a formal request that their claims be heard by the Joint Committee through the Japan Contract Conciliation Panel.⁴⁰ The Navy had two cases, Kawasaki Heavy Industries⁴¹ and Japan Aircraft

Manufacturing Company,⁴² appealing the final decision of the contracting officer under the disputes clause of the contract to the Secretary of the Navy for a hearing before the ASBCA. The Army also had an appeal from a final decision of the contracting officer but along with the appeal was a request for relief under Public Law 85-804. (This case will be discussed in full in the next section).

On the international scene the finance ministers of the ten major western countries agreed to meet in Washington, D.C. on 17 and 18 December 1971 to solve the continuing monetary crisis. The news media stated that the Government of Japan felt that a revaluation of 15 per cent or more of the yen would "plunge the economy into a deeper, prolonged recession."⁴³ By the 10th of December the yen had risen to 323 to the dollar and major trading firms were quoting prices on the basis of 310 yen or the equivalent of a 16.13 per cent revaluation.⁴⁴ The Japan Economic Research Council urged the Japanese Government to set the rate at 320 yen with a 3 per cent margin up or down which would be a 12.5 per cent revaluation.⁴⁵ The day before the beginning of the conference which was to be known commonly as the Smithsonian Conference, Prime Minister Sato stated that Japan would seek a revaluation of around 15 per cent and would "never accept anything over 16.1 per cent

(310 yen to \$1). To do this Japan would accede as much as possible to demands for tariff cuts and import liberalization and would promise to pick up a greater share of U.S. defense costs."⁴⁶

Based on the resulting agreements reached at the Smithsonian Conference, the new official or par value for the yen was pegged at 308 yen to \$1 or an equivalent revaluation of 16.88 per cent. The new rates could fluctuate by a margin of 2.25 per cent.. Now that a new exchange rate had been set, procurement officials could now calculate definitively the contractors' losses. Their attention now focused on the claims being processed and the impact of the decisions. They had made it through December 1971 and so far no contractor had refused to perform under the dollar contracts. The Japanese contractors were proceeding on the basis of trust and loyalty, while the U.S. procurement officials were proceeding on the basis of law and regulations. The confrontation which had been avoided so long now had to come in the courts.

D. THE JUDGMENT

The yen revaluation problem was now in a new arena; that of the courts. The resolution of the claims and counterclaims can best be analyzed by following one case from beginning to ultimate decision. The author has

chosen the appeal of the Marubeni-Iida Company and Ohki Construction Company, a Joint Venture, as the vehicle to follow because this case was used by both the contractors and the U.S. Government to decide the issue. As this case moved through the administrative channels toward an impending hearing, all other disputes, claims and appeals were suspended pending the results of this one case. It was quickly recognized that the contractors would be content with the decision since all of the legal arguments as well as the equity claims were embodied in this one case. Again, this case must have been chosen by the group of Japanese contractors as the best case to put forward on the "world stage."

This contract was entered into on 24 June 1970 between the U.S. Army Engineer District, Far East, and the Joint Venture to construct a transmitter facility at Chitose, Japan. The contract called for payments of \$853,707 payable in four partial payments. The payments clause in the contract stated that "Payment will be made in yen based upon the official rate current at the time of payment."⁴⁷ Work was commenced and progressing as scheduled. Three of the four partial payments had been made at 360 yen to \$1. The fourth payment came due in September 1971 after the yen float and the contracting officer paid the invoice

at the majority rate of 337 yen to \$1. The contractor protested the amount received, claiming that it should have been based on 360 yen to one dollar and requested an additional 7,031,100 yen. In support of the claim the contractor enclosed a letter from an official of the Bank of Tokyo stating that the "official rate of exchange between the Japanese yen and the United States dollar remains 360 yen to one dollar" and that the float only "constitutes an abandonment of the .75 per cent of variance from the official rate which is allowed by the IMF."⁴⁸ It must be remembered that the Government of Japan was still maintaining that the "official rate" was still 360 yen to \$1. However, OSD had ordered U.S. officials to pay contracts at the floating rate based on the Joint Committee agreement that the "official rate" was now the majority rate. On 17 November 1971 the Army contracting officer issued a final decision under the disputes clause of the contract rejecting the contractor's claim and notifying him of his right to appeal within 30 days.⁴⁹ On 20 November 1971 the contractor notified the contracting officer of his desire to appeal the decision and to seek "appropriate equitable relief from the consequence of the yen underpayment resulting from the

ambiguous wording of the payment provision of the aforementioned contract."⁵⁰ With this wording the contractor was taking on the U.S. Government for all the Japanese contractors holding dollar contracts. This was quickly recognized by the Army and in their submission of the claim to the ASBCA noted "that the appeal notice also claims equitable relief under the provisions of ASPR Chapter XVII if legal relief is not granted by the ASBCA."⁵¹ This indeed was a precedent that had never been tried before in settling a dispute. The contractor was requesting an ASBCA hearing but if he lost the case he concurrently was submitting a claim for equitable relief under Public Law 85-804 for a hearing before the Army Contract Adjustment Board (CAB). Of course if the decision of the ASBCA was favorable to the contractor the equity claim would be withdrawn. It appeared to many on the U.S. side that the contractor was acknowledging that he had a weak case under the disputes clause and was in reality hoping for relief from the CAB.

The Army requested that the case be given priority on the docket since the decisions rendered would "govern payments to be made under numerous contracts executed" by the three services in Japan. The JPCB and CINCPAC joined in this request to OSD. In the separate portion of the submission under Public Law 85-804 the contracting officer

recommended that the CAB grant relief and make the contractor "whole," in other words that he be entitled to not only lost costs but profit too.⁵² The Army then submitted copies of the complete files to the JPCB for comment.

As can be imagined the actions taken by the Army caused much debate among the JPCB members. The Army contracting officer had gone on record officially as being in favor of equitable relief for a contractor holding a dollar contract. As much as the members might personally sympathize with the position of the contractors, the official position had been not to give up any rights of the U.S. Government. The JPCB on 30 November 1971 asked each service to develop a position on the policy of equity. It was felt that the JPCB must continue to stand united and that the services could not be allowed to go their separate ways on contract claims.

The basic Navy position was that each contract stands on its own merit, that it would be improper for the Navy to comment on a case to be decided by the Army CAB, and premature to argue the ASPR 17 case until the ASBCA has decided the appeal under the disputes clause of the contract. The Navy felt that a remedy existed under ASPR 17 and that contractors have every right to use it but the interpretation was that only costs could be recovered not profit.⁵³ Navy legal counsel was more adamant in his objections to what

the Army had done. Counsel felt that the two remedies should have been separated and decided in order. He also suggested that the Joint Committee obtain a formal statement from the Government of Japan that in fact the majority rate was the recognized rate of exchange. This could be used to fight any claim on the official rate of exchange argument.⁵⁴

The JPCB recommended to USFJ that the official policy not sustain the actions of the Army contracting officer. Public Law 85-804 states that a determination be made that relief would facilitate the national defense. Based on the evidence presented the facts in the case did not appear to warrant such a determination. Further the position that the contractors had been seriously hurt by the revaluation had not been sustained. The contractors were still performing their contracts and although a few claims had been submitted the majority of the contractors had remained silent after the first flurry of letters of protest right after the yen float. Each case must stand on its own and it is up to the contractor to prove that he has suffered severe losses and not just a reduction of profit.⁵⁵ This thinking did not consider the Japanese cultural heritage at all. It was based purely on U.S. experience with the profit motive. If the contractors were really hurting, they would be putting as much pressure as possible on the U.S. for relief.

Since they were not doing this, they must have hidden contingencies for a yen revaluation and therefore, were not in as bad shape as had originally been thought. Many officials started feeling that their sympathy for the Japanese contractor had been misplaced and that the U.S. had been made the fool. The idea that the Japanese contractor could be suffering heavy losses and still continue to perform was alien to their past experiences.

The JPCB recommended that the Army split the two claims and that consideration be given to a request to hold the ASBCA hearing in Tokyo which would facilitate the presence of witnesses for both sides.⁵⁶ The feeling of all the members was that the ASBCA case would be won easily by the U.S. The argument over the "official rate of exchange" was considered a weak one and without merit. This opinion was reinforced at the Regional Procurement Conference sponsored by CINCPAC when an OSD representative stated that the case would go for the U.S. The appeal under ASPR 17 was considered a grey area since the CAB's tried to be as fair as possible in dealing with foreign contractors.

The ASBCA hearing #16937 was held on 7 January 1972 in Washington, D.C. No witnesses were called from the JPCB or contracting agencies in Japan. The contractors presented three basic arguments contending that:

1. Under the Japanese Civil Code the parties are bound by the exchange rate current at the time of contracting, because the intent of the parties is payment computed at that rate.

2. Articles XIX of the Agreed Minutes, to the Status of Forces Agreement does not expressly authorize the contracting officer to employ a contract provision providing that the rate of exchange current at the time of payment should control, but does state that the "basic rate of exchange," which then had a value of 360 yen to the dollar "shall be used."

3. That the official rate of exchange was in fact 360 yen to the dollar at the time (21 September 1971) of the fourth partial payment.

The U.S. Government responded primarily to the third argument. The response was that the "majority rate" (floating rate) was the "official rate," because it was established by a Government of Japan — U.S. Joint Committee on 31 August 1971 and was specified as being for "official use."

The ASBCA rendered the following determinations and decisions on 6 April 1972:⁵⁷

1. It did not accept the first two contentions by the contractor cited above and these were rejected.

2. It did accept the third contention that the official rate of exchange of 360 yen to \$1 had remained unchanged by the yen float and awarded the contractor an additional payment of 7,031,100 yen. The Board stated that the Joint Committee has no authority to set the official exchange rate for the Government of Japan. Changing the rate is the right of the sovereign power only and the official rate of exchange of 360 yen to the dollar was in effect at the time of the fourth partial payment. The official rate of exchange was not changed until 19 December 1971 at the Smithsonian Conference, when Japan revised it to 308 yen to the dollar.

The ASBCA decision was announced in Japan on 22 April 1972 and as expected caused considerable shock.⁵⁸ This was the case no one thought the U.S. could lose. The event also demonstrated how well the informal communication chain was working among the contractors. Many of the Navy contractors holding dollar contracts came by the Purchase Office at NSD, Yokosuka, to express their appreciation for the assistance provided in helping them win the case. This was not spiteful but a genuine attempt to help us save "face" over losing the case.

The JPCB held an emergency meeting to discuss the decision, evaluate the impact and plan a coordinated course of action to implement payments. The JPCB requested CINCPAC

and OSD concurrence to start paying dollar contracts at the "official" rate and settling claims on the expired contracts. The estimated cost of these actions was \$2.5 million.⁵⁹ On 22 May 1972 OSD ordered all proposed payment action to cease.⁶⁰ The U.S. Government was filing an appeal of the ASBCA decision and until the motion for reconsideration was heard, contracts should continue to be paid at the majority rate.

The U.S. appeal was based mainly on the contention that the Board had erred in its interpretation that "official rate" meant the same as "basic rate." On 16 June 1972 the ASBCA found no merit in any of the U.S. government arguments and affirmed its original decision.⁶¹

On 26 June 1972 OSD approved the payment to the contractors at the official rates as set forth by the ASBCA.⁶² The yen crisis was over and only the implementation of the payment adjustments remained. Four days later on 30 June all dollar contracts in Japan expired as the fiscal year ended. The new contracts would all be expressed in yen.

VI CONCLUSION

In retrospect the most important aspect of the dollar crisis was not who won the case or why they won the case but that the Japanese contractors continued to perform under the contracts while absorbing substantial losses. Certainly the threat was always there that performance could cease at any time but a review of the cultural traditions of the Japanese would have shown that this precipitous action would have been "out of character."

Not only are the Japanese loyal and devoted to family and employer but the contractors had always been intensely faithful and honest in their dealings with their U.S. contracting officer. The long years of dealing with the same contractor for annual recurring requirements had established a bond of mutual trust in this relationship. As long as this trust was maintained the traits of self-discipline and self-sacrifice surfaced precluding any abrupt termination of performance. Had the contracting officers not shown at least a feeling of empathy for the contractor's problem the result might have been different since this would have caused the contractors to lose face.

There is also the aspect of group action and consensus decision-making. Prior to the yen revaluation the petitions

received by the three military services were signed by groups of contractors doing a heavy volume of business with that service. The contractors on the first Navy petition ranged from large conglomerates to small interior decorating shops in Yokosuka. Somehow this group of diverse businesses was brought together in coordinated action to appeal to the Navy to change the contract terms. After the revaluation it was readily apparent that the contractors affected were kept informed of all the actions going on to seek relief. The continued performance under the contracts had to have been approved by this group or association. Once this was decided upon no one contractor would have faced the rebuke of his peers by independently taking action against this decision. If one contractor had quit they all would have quit together. Another good example of the group behavior trait was the move to drop all other contractual disputes and let the Maribeni Case go forward as the test case. If the decision in the ASBCA case had gone against the contractor it is doubtful that any other contractors would have taken any further appeal action.

One could well ask what role the Government of Japan played during this drama. Certainly based on the close ties between government and industry, the government was kept fully informed of the actions being taken while giving the

appearance of being aloof from the controversy. Again the diverse groups presenting the first petitions had to have been brought together and formed. It would certainly have been easy for MITI to have arranged this since each service was forwarding copies of their contracts to them on a regular basis. Once the yen revalued it would have been to the advantage of the government for the contractors to continue performance. One can imagine the U.S. public reaction if the pilots association had refused to handle ships from Japan's closest ally. That peculiar sense of always being on stage and being judged in the eyes of the world probably prevented any moves that might have been considered hostile or not in the national interest.

The Government of Japan had strongly resisted any revaluation that would hurt her competitive advantage in world trade until the move was literally forced upon them by the currency speculators when the gold backing was removed from the U.S. dollar. The repeated assurances by Japanese officials reported in the news media that revaluation was an extreme last resort had convinced the Japanese people that the revaluation was being forced upon their nation. The smaller contractors were a part of this group while the large conglomerates with close government ties were prepared for this contingency. On

29 August 1971 the Mainichi Daily News reported that; "The steel industry reacted rather calmly to the new currency situation. Nippon Steel Corporation, Sumitomo Metal Industries, Ltd. and Nippon Kokan K.K., all major steel producers were not surprised at the floating of the yen because they had been informed of it in advance by banking and trading sources." This quote plus the advance actions taken by the shipbuilding industry to hedge against the revaluation show indeed that those industries at the top of the hierarchy were favored with inside knowledge to protect them as much as possible against economic losses.

Probably the most incomprehensible policies to the Japanese contractors were the U.S. insistence on consideration for contract modifications and reliance on formal procurement regulations. How could the U.S. provide complete oral assurances during negotiations that everything would be taken care of if the yen revalued and then turn around later and say that the written contract was the only valid agreement? How could the U.S. knowing that the contractor was losing money, ask for more money to change the contract terms? It was these diverse concepts that led both parties to the brink of destroying the solid relationships built up over the years. To the Japanese the conditions under which the contracts had been written

had changed and changed drastically. To them there was no question but that the U.S. should just provide them with new yen contracts under the terms of the new situation. They were willing to compromise as much as possible to avoid a direct confrontation only to be told that under U.S. policy there was no room for any negotiation or compromise. To many of the contractors the ASBCA hearing was looked upon as a play to provide them with an equitable resolution of their problems but following all the U.S. rules of the game.

This leadsto the conclusion that to understand the motivations of foreign contractors, one must have some knowledge of their cultural heritage. The normal recommendation to cure this deficiency is a school or training course. This normal panacea in this situation would be much too costly to establish and staff effectively. It seems more appropriate that the importance of thorough understanding of the cultural traits and business practices of the foreign country to which a procurement official is being assigned be stressed when the orders are issued. A suggested bibliography of applicable references in this area could be furnished with the orders. Any responsible official going into a new situation should be able to rise to this challenge and acquire a basic knowledge by self

study. The importance of the role of procurement officials serving abroad as ambassadors to the foreign business community dominates the future of U.S. economic relationships. The growing economic interdependency between nations is still the greatest key to world peace.

TOKYO KISEN KABUSHIKI KAISHA
No.211, Yamashita-Cho, Naka-Ku, Yokohama.
Yokohama Foreign Trade Bild.
Phone (681) 1723-5

Sep. 1st. '71

Messrs; COMMANDER MILITARY SEA LIFT FAR EAST

Gentlemen,

Payment in our contract, N 62649-70-D-0102 & N 62649-71-D-0093, has been made in former official exchanging rate, which is \$ 1 = ¥ 360. We always do all our tug services in yen currency. Although in this contract, dollar currency is adopted for your convenience, tug boat rate of this contract is settled on the basis of yen currency. Then, if floating exchanging rate or decreased exchanging rate is adopted, that brings much losses to us.

Therefore, we wish you to confirm that tug boat rate in this contract shall be exchanged in former official exchanging rate, which is \$ 1 = ¥ 360, or to amend tug boat rate in yen currency.

We shall very much appreciate to your kindly attention on this problem.

Sincerely yours,

/s/

S. Nakajo, Manager
TOKYO KISEN K. K.

TRANSLATION

15 September 1971

Purchase Department
U.S. Naval Supply Depot Yokosuka, Japan

Hachinohe Kowan Unso K. K.
3-7-2, Numadate, Hachinohe City,
Japan

Dear Sirs,

Coming into the early stage of fall season, it is our pleasure to presume that you are in good health and at the same time, we thank you very much for your constantly giving us favorable considerations.

Re: Pilotage and tug service contract
rates

Regarding the subject contract, we have had a contract with your Depot at your request and on behalf of individual pilots, however, due to the Yen flotation against the Dollar, we now find it difficult to continue performance of the contract. The reason is, as you know, the pilotage and tug service rates are all charged on an Yen basis and therefore, the contract unit prices must be revised to express in Yen figures or we may end up in breaching the contract and putting in a claim through the Agent. Vouchers for two vessels covering services performed in August are presently in our hands. Please give us instructions as to how these claims should be submitted at the earliest.

Respectfully,

DAIICHI KASEI SANGYO CO., LTD.

Telphone: 7-1,3CHOME, KANDA-JINBO.CHO
(264)8221 CHIYODA.KU,
TOKYO
(Head Office)

DATE 30 Aug 1971

To: Contracting Officer
US Naval Supply Depot, Yokosuka
From: Daiichi Kasei Sangyo Co., Ltd.
Contract: No. N62649-71-D-0097
Subject: Payment Clause of annual contract.

Dear Sir,

It is true that the present Yen and Dollar conversion of rate is the most hard problems in our company. We understand contract specified that payment shall be in accordance with the official rate of exchange at the time of payment is made.

We desire the payment clause of the contract should remain unchange untile end of contract period providing that the forcosted change of Yen and Dollar rate became around five (5) percent or less.

If this change took place over ten (10) percent or over, we shall be unable to perform smoothy delivery to the Government.

In view of the above situation, we appreciate if you would issue us Yen Delivery order in lieu of Dollar or kind consideration to this problem be given to us.

Yours Truly

/S/

H. Iida
Managing Director

15 Sept 1971

Masuru Okita
White Cross Co.
Iwakuni, Japan

Contract Officer
Naval Supply Department
Yokusuka, Japan

Dear Sir:

On 12 January 1971, I was awarded a contract to wash military aircraft stationed at MCAS, Iwakuni. My contract Number is N62649-71-D-0143. After local negotiations were completed, I commenced washing aircraft on 1 February 1971. The cost of washing these aircraft as submitted by me, in my contract bid, was based on the International Exchange Rate of ¥360 per one (1) United States Dollar.

Approximately ninety (90) percent of my monetary intake on this contract is expended in labor personnel cost.

On 28 August 1971, the Yen was allowed to Float on the International Market and subsequently fell below the previously established rate of ¥360 per one (1) United States Dollar. All of my expenses have remained the same. During the month of August, 1971, my Washing Service washed a total of \$1264 worth of aircraft under this contract. I am being paid at the yen rate as of 14 September 1971, due to a mix-up between the Station Contracting Office and the Disbursing Office. This is approximately six (6) percent below the previous rate of payment.

My contract expires on 31 December 1971. During this period of time, 1 September 1971 to 31 December 1971, I will lose a considerable amount of money if I continue to provide this service daily and be paid at the start of each month.

I would like to propose as a temporary change to my contract whereby the United States Government absorb fifty (50) percent of the loss difference between ¥360 and

COPY

Appendix D - Cont'd.

the new established rate of exchange and I will absorb the other fifty (50) percent loss.

Sincerely,

/s/

Masaru Okita

DENKI KOGYO CO., LTD.
Shin Tokyo Building
3-3-1 Marunouchi
Chiyoda-ku, Tokyo 100
JAPAN

Tel. 216-1671
Cable: ANTEDEKO TOKYO

3 September 1971
Ltr. No. 42124

- From : Denki Kogyo Co., Ltd.
- To : Contracting Officer
(62649) U.S. Naval Supply Depot
Yokosuka, Japan
- Subj : Payment at the rate of 360 yen to 1 U.S. dollar;
request for
- Ref : (a) Contract No. N62649-71-C-0052, "Operate and
maintain the U.S. Naval Radio Station (T)
Yosami for one (1) year from 1 October 1970
through 30 September 1971 on a monthly pay-
ment basis : \$24,440.00"
- (b) Contract No. N62649-71-C-0052, DD Form 1665,
page 8 of 11, Section K-3.0 Payment which
reads as follows;
"K-3.0 Payment: Payment will be made monthly
by the Officer in Charge, U.S. Navy Finance
Office, Yokosuka Japan, in Japanese currency
at the official rate of exchange at the time
payment is made."
- (c) Cost Breakdown for N62649-71-R-0014 dated 10
August 1970 attached to Contract Pricing Pro-
posal DD Form 633 of solicitation, Offer, and
Award No. N62649-71-R-0014. Remarks on the
Cost Breakdown read as follows:

Remarks:

In the event that the official rate of exchange
from U.S. dollar into Japanese yen would be
changed, payment should be made in Japanese
currency at the official rate of exchange at
the time of contract.

1. Prior to contract of Ref (a), Ref (c) was discussed between NSD representatives and Denki Kogyo representatives. Denki Kogyo requested that the payment conversion clause should have been modified to read as "at the time of contract" instead of "at the time of payment" from the fact that our proposal was made on the basis of actual expenses for the past year and it did not include any contingency fee for a possible revaluation of yen and to avoid a burden resulting from the revaluation if it occur. However NSD representatives replied that they were not in a position to mention the matter at that time. Denki Kogyo is well aware of the tremendous importance of NRS (T) Yosami to the United States commitment for the defense of the Western Pacific, and we are also aware of our responsibilities to the U.S. Navy to maintain and operate the Station. We signed Ref (a) in the expectation that you would make an equitable adjustment for us if the rate is actually changed.
2. On 3 September 1971, we had it from a source that payment of Ref (a) for the month of August will be made at a rate of floating exchange rates of a day previous to the time of which payment is made. We were also informed that the rate applied by U.S. Finance Office here in Japan as of 2 September 1971 was 338.50 yen to 1 U.S. dollar, approx. 6% loss with the official rate of exchange, 360 yen to 1 U.S. dollar. Whereas a legal official of a leading foreign exchange bank says that the official rate of exchange between the Japanese yen and U.S. dollar stipulated in Ref (b) remains 360 yen to 1 dollar, and the recent action taken by Japanese Government after U.S. President Richard Nixon's announcement of the new U.S. economic policy on 15 August 1971 to float the yen in its relation to U.S. dollar only constitutes an abandonment of the 0.75% of variability from the official rate which is allowed by the IMF.
3. Be the matter what it may, the payment conversion rate is of serious concern to us, the contractor to the United States Government. Application of a floating exchange rate or a possible revaluation of yen would be not conducive to the spirit of mutual confidence.

Appendix E - Cont'd.

4. In view of the foregoing, we sincerely wish to ask for your consideration on the payment rate of 360 yen to 1 U.S. dollar for Ref (a).

Your immediate reply on this matter will be highly appreciated.

Denki Kogyo Co., Ltd.

/s/

Isami Maehara
Managing Director

Copy to: Contract Administrator, U.S. NAVCOMMSTA, Japan
Officer in Charge, U.S. Navy Finance Office

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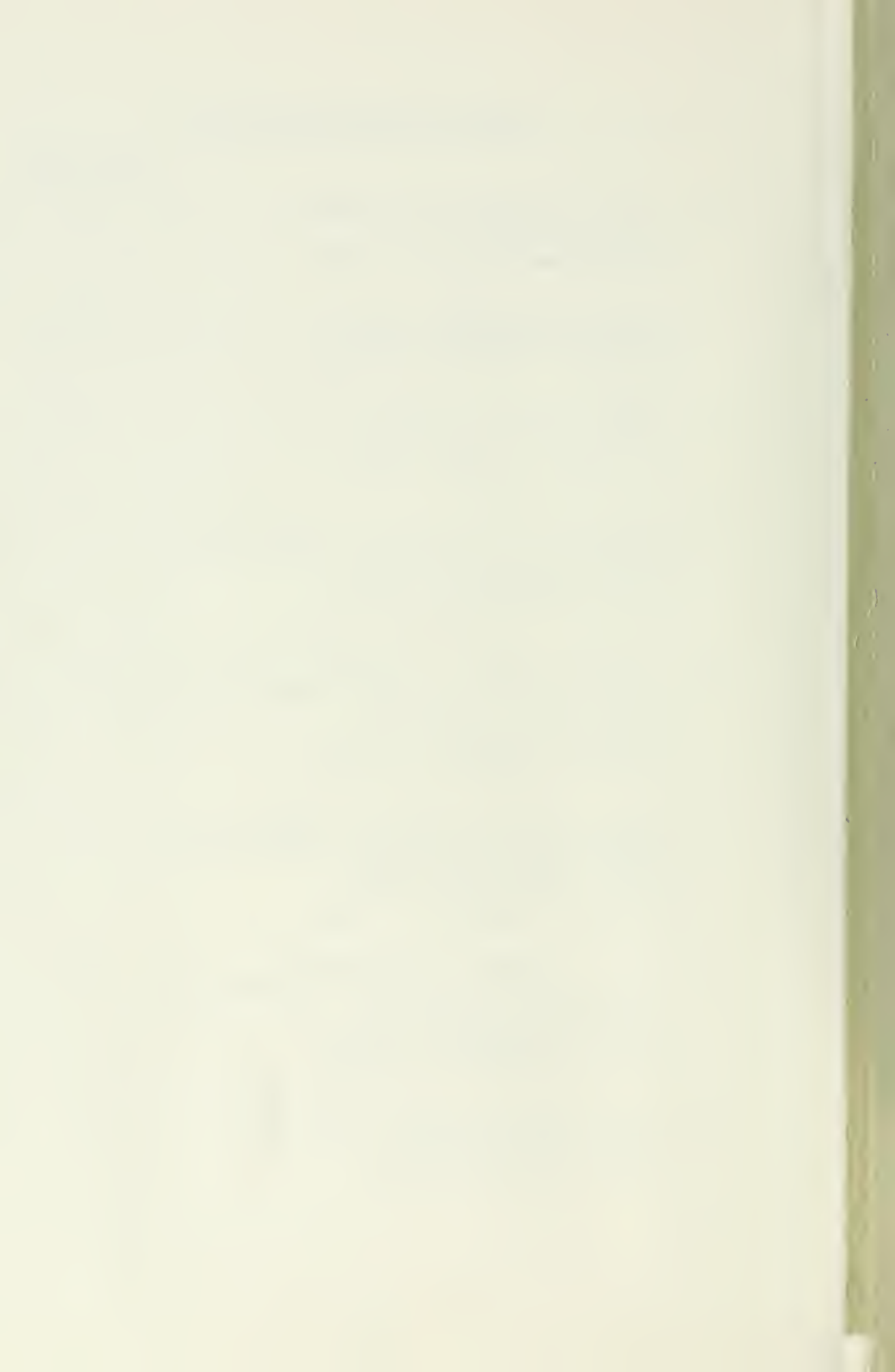
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