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RFD 315

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

February 17, 1959

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NOT FOR PUBLICATION

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Buying Dear to Save

Reed J. Irvine

The formal European convertibility moves of December 1958 were the coup de grace to the theory of the "dollar gap." This idea, which had been long dying, had underlain the curious postwar phenomenon of countries buying in the dearest markets in order to save money. This was known as "saving dollars" and was enforced by governmental regulations which barred or restricted imports from any country requiring payment in U. S. dollars while applying less rigorous restrictions on transactions with other countries whose merchandise was for reasons of price or quality less attractive to would be buyers. Another name for the practice is "dollar discrimination."

Japan is one of the countries that has long pursued this policy. The Japanese attitude until recently has been that it was good policy to spend sterling, the main currency used in trade with non-dollar countries, and accumulate dollar reserves. This attitude was a carryover from 1953 when Japan acquired large holdings of sterling that could not be converted into dollars. It persisted even though in recent years Japan has not earned enough sterling to meet requirements and has had to convert dollars to acquire sterling. It persisted also in the face of the fact that sterling, if earned in excess, could be freely converted into dollars in the transferable markets at a very nominal discount.

The recent European convertibility moves appear to have convinced Japan, that the once "soft" currencies were just as good as dollars for all practical purposes and that it made little sense to continue to discriminate between them and the dollar. It was initially reported that Japan would act in the first week of January 1959 to "merge" the dollar and other currencies into a single "convertible currency area". This would include all countries except Taiwan, Korea, Greece and Turkey, with which Japan still maintains bilateral clearing agreements. Disagreement within the Japanese Government delayed this move, but eventually the proponents of liberalization triumphed and the move became effective February 1, 1959. On the surface, this merger would appear to eliminate discrimination in Japan's foreign trade, but it now turns out to be something less than its label indicates. Actually, it only reduces the number of commodities which can be freely imported from all countries, except those in the dollar area, from 66 to 14.[1] Discrimination will remain in effect with respect to 14 commodities which are eligible for import under the Automatic Approval System from all countries except those that were classified as dollar countries prior to February 1, 1959.

While large in terms of the number of items, the liberalization is not very significant in terms of the value of trade as far as the U. S. is concerned. Imports of the 52 items freed from discriminatory restrictions totaled only $115 million in 1957, of which only $6 million came from the United States. Since it is probable that global quotas were available for items included in this list, the low level of these imports from the U. S. reflects the absence of any important U. S. exports among the 52 newly liberalized items. Imports of the 14 items which are still subject to discrimination totaled $656 million in 1957, of which $396 million, or 60 per cent came from the U. S.

Why discrimination was continued

The Japanese failure to go all the way in eliminating discrimination appears to be partly the result of having included on the automatic approval list a number of items imported mainly from the dollar area which they did not really want to decontrol. Putting them under automatic approval for all areas except the dollar area was not very significant. For example, 97 per cent of Japan's abaca is supplied by the Philippines, which was included in the dollar area. Allowing this commodity to be imported freely from all countries but the Philippines is largely a meaningless gesture in the direction of liberalization. In considering the complete elimination of discrimination, the question must have arisen as to whether commodities such as abaca, which had been

1/ Japan has two systems of allocating foreign exchange for imports. Quotas are assigned to specific categories of imports under what is called the Funds Allocation System. It is said that since March 1958 these quotas have been global, i.e., the exchange allocated may be used for import of the designated item from any country in the world. Under the Automatic Approval System, a fixed amount of foreign exchange is made available for the import of a fairly wide range of commodities with no limitation on the amount that may be used for any one item on the list. It has been the practice to designate the currency areas from which items included on the Automatic Approval list may be imported.

liberalized for all producers except the major supplier, should be returned to quota controls for all countries or whether discrimination should be continued. It was apparently decided that it would be better to continue to discriminate, even though this meant that the elimination of all distinction between the former "hard" and "soft" currency areas could not actually be effected.

A more significant step would have been to eliminate discrimination without reducing the number of items on the automatic approval list. This was not done for two reasons. First, it was feared that the lower prices available in the dollar area might substantially increase the demand for the restricted imports and result in a larger expenditure for imports than could be safely permitted. Second, it was feared that the reduction of imports from some of Japan's trading partners that would result from the elimination of discrimination might bring on increased discrimination against Japanese exports by these countries.

The first reason is most unconvincing in the light of Japan's strong balance of payments position. It is estimated that Japanese gold and foreign exchange holdings rose by over $300 million in the 12 months ending September 1958. During this same period, only about 25 per cent of the foreign exchange budgeted for imports was actually utilized. This indicates that demand for imports, or at least for some imports, was considerably less than had been estimated.1/

What non-discrimination might cost

How much such imports would increase if the discriminatory quota limitations were removed depends on the size of the price differential between dollar and non-dollar countries and elasticity of demand and supply. The appended analysis of the 14 commodities still subject to discriminatory treatment, provides some basis for estimating the costs and gains that would result if Japan eliminated the remaining discrimination against the dollar. This analysis indicates that the magnitude of the risk Japan would be running is extremely slight. Had all of these imports been completely freed from restrictions in 1958, it is doubtful that the total addition to the import bill would have come to more than $10 million. This assumes higher elasticity of demand than probably prevails. The estimates are of course subject to error. Not enough is known about quality differences, and the large rise in imports of waste cotton yarn and thread in 1958, when this item was liberalized, demonstrates that judgments on the basis of price differences alone can be far from the mark. However, in a year when Japan has increased holdings of foreign exchange by well over $300 million, it

1/ The provision of quotas in excess of demand might well nullify the discrimination existing in the automatic approval system. However, data are not available that would indicate how the excess foreign exchange allocations were distributed by commodity. The fact that most of the 14 items to which discrimination still applies have been imported at higher cost from non-dollar than from dollar countries is prima facie evidence that the quotas have operated to limit imports from the dollar area.

could hardly be maintained that the country could not afford the higher volume of imports that liberalization might induce. Even if the increase in imports were 10 times what is here estimated, Japan would still have enjoyed a substantial current account surplus.

If the risks that Japan would run in dropping discrimination completely are minor in terms of any increase in import expenditures, what of the risks on the export side? Would other countries increase their discrimination against Japan if Japan should liberalize vis a vis the dollar area? In considering this question we may exclude communist China, which is already discriminating against Japanese goods to the maximum degree possible, having halted trade with Japan completely.

There are very few countries in addition to China whose exports to Japan consist in any substantial measure of the commodities subject to dollar discrimination. The following table shows the largest non-dollar suppliers of the ten most important items and indicates the size of these exports compared to their total sales to Japan.

Chief Non-dollar Suppliers of Japanese Imports
Subject to Discrimination1/
1957

Commodity	Exporting country	Per cent of total volume imported	Value (In millions of dollars)	Value as per cent of country's total sales to Japan
Lard	Netherlands	85.0	1.8	11.4
Hops	West Germany	93.0	2.0	1.4
Cattle hides	Thailand	3.0	0.9	2.8
Soybeans	Thailand	0.5	0.2	0.6
Lauan	North Borneo	14.0	7.9	45.0
Waste cotton	India	54.0	1.4	1.4
Abaca	North Borneo	3.0	0.4	2.3
Steel scrap2/	Australia	5.0	15.0	4.1
	India	3.0	7.3	7.0
	New Zealand	2.0	6.9	25.4
Copper alloy	Hong Kong	24.0	6.3	23.6
	West Germany	9.0	2.8	1.9
Beef tallow	Australia	9.0	2.6	0.7
	New Zealand	5.0	1.3	4.8

1/ Excludes Communist China
2/ Based on the category covering over 98 per cent of the value of Japan's total imports of iron and steel scrap.

Only five of the above ten items can be said to represent a significant proportion of Japan's imports from any one of the non-dollar countries. These are lard, lauan, copper alloy scrap, steel scrap, and beef tallow. The countries involved are the Netherlands, North Borneo, New Zealand, Australia, Hong Kong and India.

Is it vital that Japan discriminate against the dollar area and maintain the volume of imports from these countries in order to sell to them? The trade statistics alone indicate a strong negative reply in the case of Borneo, Australia and New Zealand. In 1957, Japan imported far more from each of these countries than she sold to them. Imports exceeded exports 23 times in the case of Borneo, nearly 9 times in the case of Australia, and 3.5 times in the case of New Zealand. There is clearly no basis for restricting imports from the dollar area in order to promote a better balance of trade with these countries.

Hong Kong makes no effort to balance its trade bilaterally and does not employ discriminatory trade policies. These policies would not be changed if Japan should drop discrimination on imports of scrap copper alloys. It is hardly conceivable that the Netherlands, whose annual exports total $3 billion, would be so concerned with the possible loss of $1.8 million in lard sales to Japan that it would reintroduce discrimination as a reaction to Japanese liberalization. The same may be said of India with respect to her exports of steel scrap to Japan, and this is reinforced by the fact that imports of scrap from India declined by more than 80 per cent in the first half of 1958 simply because of reduced demand. India has not claimed any special privileges in the Japanese market to bolster her scrap exports.

It surely could not be maintained that West Germany, Thailand and similar countries that might encounter stiffer competition for two or three per cent of their exports to Japan in the event of liberalization would even consider reacting with demands that they be given special treatment, "or else". The argument that Japan must discriminate against the dollar to avoid being discriminated against by non-dollar countries simply will not hold water.

What discrimination costs

It would be unfortunate if this problem were approached only from the point of view of the additional cost in foreign exchange expenditures that might be incurred as a result of the elimination of discrimination. It is necessary to examine also the cost of discrimination. These will be apparent to anyone who examines the appended analysis, which reveals the price that the Japanese businessmen, consumer, and wage earners are compelled to pay by the policy of "buying dear to save." For example, in 1957 the cost of imported lard was over 65 per cent higher than was necessary, and it is believed that some of the lard, imported at this premium price was actually American lard repackaged in the Netherlands. Japan paid nearly 160 per cent more for hops than would have been necessary had the American product been imported, but American hops were on quota and it was the expensive German hops that were on the automatic approval list. These are but two of the examples. If overpayments of this type were forced upon a country as the result of the manipulations of private individuals it would be considered a scandal. And yet governmental policies that produce such anomalies have evoked surprisingly little public opposition in Japan and elsewhere.

It is probably not generally realized that to the extent the discrimination is effective, it forces the manufacturer or the consumer to pay substantially higher prices for these imported products than is necessary. This means that money is taken from the Japanese consumer for the benefit of suppliers in foreign countries who have no claim on the generosity of the Japanese people. It means that industrial costs are raised, making it more difficult for Japan to compete in export markets against producers who are not compelled by government regulations to buy their raw materials in high cost markets. It means that producers who have higher raw materials costs are less able to pay their employees better wages.

It is true that most import duties imposed by governments may have similar effects, but in the case of import duties at least the extra payment required goes into the country's treasury to help defray the expenses of government.[1/] In the case of higher costs resulting from discrimination the money goes to foreign businessmen to whom the Japanese Government says, in effect, "We don't care if your goods are overpriced. We actually prefer high prices and low quality because they will keep us from spending as much as we otherwise might." It is as though an individual pinched for money deliberately chose to do his shopping in the most expensive stores on the ground that the high prices would keep him from overspending. An individual who followed this course would hardly be considered sagacious. As national policy, it may have the merit of generosity toward favored foreign countries, but it is hardly in the best interests of the nation's own citizens.

1/ Or to the country's own citizens if the duties permit domestic producers to charge higher prices than would otherwise be possible.

The following is an analysis of Japan's trade in the items to which discrimination still applies.

Lard - The dollar area supplied only 8.5 per cent of Japanese lard imports in 1957. The U. S. price was over 40 per cent below that of the principal supplier, the Netherlands, which provided 85 per cent of the total. Netherlands lard enjoys no quality advantage that would justify the payment of a premium price by Japan. In fact, it is believed that much of the lard Japan imports from the Netherlands is actually U. S. lard repackaged by the Dutch. If this is true, the Japanese consumer is paying a very high price for Dutch packaging. It is reasonable to suppose that Japanese consumption of lard would increase substantially if the price were lowered 40 per cent. If the demand doubled over the 1957 level, which seems a generous estimate, the additional expenditure at 1957 U. S. prices would amount to about $400,000. This would not strain Japan's foreign exchange resources. Actually the elasticity of demand might be much less than this, and it is possible that Japan's foreign exchange expenditures for lard could actually be reduced at the same time imports were increased.

Hops - Over 93 per cent of the hops imported by Japan in 1957 came from West Germany. The U. S., the only dollar area supplier, provided 4.3 per cent of the total. However, the average cost of the hops imported from the U. S. was 63 per cent below the cost of the West German product. The premium price paid Germany reflects a preference of German-trained brewmasters for German hops. To the extent this is true in Japan, there would be little reason to restrict imports from the U. S. by a quota. If Japanese brewers are willing to use more American hops, the quota restriction is clearly forcing them to pay a high premium to West Germany unnecessarily. The consumption of hops is determined by the consumption of beer. The saving in the cost of production of beer that would result from a switch to American hops in Japan would probably be about one cent per gallon, hardly enough to result in a reduction in the retail price of beer that would significantly increase consumption. The demand for hops can therefore be assumed to be inelastic, and if Japan switched from German to American hops she could save over $1.3 million on the basis of the 1957 levels of import and prices.

Cattle hides - About 72 per cent of the cattle hides were imported from the U. S., Canada and the Ryukyus in 1957. The cost of hides imported from other countries was considerably above the U. S. and Canadian prices. For example imports from China, the second largest supplier, cost an average of ¥172,000 per metric ton compared to ¥103,000 per metric ton for U. S. hides. Thailand was the fourth largest source of supply with hides priced at an average of ¥206,000 per metric ton. This would indicate that the global quotas on hides were not adequate to enable the buyers to satisfy their demands in the cheapest markets in 1957. The buyers had to pay an average of 60 per cent more for the hides bought from other sources than would have been necessary had they purchased all their requirements in the U. S. and Canada. Since we don't know either what proportion of the cost of finished articles is accounted for by the cost of hides or what the elasticity of demand for these articles might be, estimates of the increase in imports that might result from the elimination of discrimination are no better than rough guesses. An increase of one-third over 1957 levels would mean an additional expenditure on hides of $3.3 million at 1957 U. S. prices. An increase of 50 per cent would mean an additional expenditure of less than $6 million. Neither amount would strain Japan's ability to pay. On the contrary, the lower costs would increase Japan's competitiveness and could lead to larger exports and reduced demand for imports of leather goods that might fully offset the expenditure for larger imports of hides.

Soybeans - During the first three quarters of 1958, Japan imported over 85 per cent of her soybeans from the U. S. In 1957 the U. S. supplied 71 per cent. In 1958, the average U. S. price was ¥36,083 metric ton compared to ¥35,900 for mainland Chinese soybeans, but the U. S. beans are of higher quality. About 1 per cent of the soybean imports came from countries whose prices were considerably above the U. S. price. For example, Brazilian beans were imported at an average cost of ¥46,586 per ton. However, China is the main competitor, and since the Chinese price is very close to the U. S. price there seems to be little reason to suppose that total imports of soybeans would greatly increase if buyers were as free to import them from the U. S. without quota restrictions as from other countries. This depends in part on the importance of the difference in quality between U. S. and Chinese soybeans. It is probable that the major result would be an increase in imports from the U. S. at the expense of other suppliers, rather than an increase in the volume of imports.

Lauan - Lauan logs are supplied chiefly by the Philippines, a dollar country. In 1957, 85 per cent of the lauan came from the Philippines at an average cost of ¥11,650 per metric ton. Most of the remainder was supplied by British North Borneo at an average cost of ¥10,600 per ton. If the demand for lauan were not fairly well satisfied at the present time, one would expect the prices charged by the marginal suppliers to be higher than the Philippine price. Since they are lower, there would probably be no great demand unleashed if Philippine lauan were removed from quota limitations. Since the lauan is processed in Japan for export, allowing the processors freedom in choosing their supplies would reflect favorably on the export position.

Abaca - Japan imports 97 per cent of her abaca from the Philippines and about 2.5 per cent from North Borneo. In 1957, the North Borneo price was 25 per cent above the Philippine price. This indicates that the restrictions on the import of abaca from the Philippines were causing buyers to turn to the more expensive Borneo product. Assuming that a reduction of 20 per cent in the market price might lead to a 25 per cent rise in the volume of abaca imported, Japanese expenditure for this item might increase by $2.6 million over the 1957 level. In the first half of 1958 abaca imports were running at an annual rate some $3.6 million under the 1957 level. Liberalization would probably not result in imports approaching the 1957 level.

Gypsum, uncalcined - This is a mystery item. The mystery is why it is on the list at all. In 1957, only one ton of uncalcined gypsum was imported from the dollar area. Total imports amounted to only

$440,000. Why it is considered necessary or desirable to permit imports freely from any country except those in the dollar area is difficult to see. It may be that there is a very small quota for gypsum and that larger imports from the dollar area might be obtained if the quota were increased or removed. The total likely demand for the product does not seem large enough to constitute an obstacle to relaxation. Even if the dollar area price were so low that demand were doubled, which is unlikely, the extra expenditure required would be only $440,000.

Cotton waste (of yarn and thread) - In 1957, 38.4 per cent of this item was imported from the U. S. at an average price of ¥80.5 per lb. and 54 per cent was imported from India at an average price of ¥59.3 per lb. Hong Kong provided about 6 per cent at ¥56.5 per lb. In the period March-September 1958, this item could be imported from the U. S. under automatic approval. This seems to have been responsible for the 95 per cent increase in imports of this item in 1958, which resulted in an increased foreign exchange expenditure of $2.8 million. This must reflect quality differences of great importance, since the buyers have in the past year shown a strong preference for the more expensive U. S. waste over the lower priced products of India and Hong Kong. However, the surge in imports from the U. S. after this item was placed on automatic approval may exaggerate the demand for the U. S. product, since importers may have built up stocks which were low because of previously existing restrictions and were possibly motivated by the fear that the decontrol might not prove lasting. If such fears existed, they were fully justified. Apparently alarmed by the added expenditure of $2.8 million in a period when total imports were falling sharply and the Government was increasing its reserves by about $300 million, the Government removed this item from automatic approval for the dollar area in the February 1st action.

Steel scrap - In the first three quarters of 1958, Japan imported 71 per cent of its iron and steel scrap from the dollar area. The U. S. price of ¥16,440 per ton was 14 per cent above the Indian price and slightly above Hong Kong's price. It is likely that higher U. S. quality more than compensates for the price differential, and freeing U. S. scrap from the quota might result in a shift in sources of supply. Given the current position of steel making materials inventories in Japan it seems doubtful that removing dollar scrap from quota limitations would result in a significant increase in total imports. However, when it is considered that scrap prices are about 50 per cent below 1957 levels and that Japanese imports of scrap during the first 9 months of 1958 were at an annual rate some $275 million lower than the previous year it would appear that Japan could well afford to run the risk of incurring a slightly larger import bill for scrap in order to secure the advantages of enabling steel producers to buy in the most favorable market.

Copper alloy scrap - In 1957, Japan imported 43,757 metric tons of scrap brass and bronze, of which 52 per cent came from the dollar area, mainly the U. S. and its possessions. The average cost was ¥212,000 per metric ton. The cost from Hong Kong, the next largest supplier was ¥216,000 and from West Germany, which ranked next, ¥250,000. The dollar area cost was 15 per cent below the German price. Since the cost of the scrap probably does not represent a high proportion of the cost of the products in which it is used, it seems reasonable to assume that a 15 per cent reduction in price would not produce a substantial increase in demand. A five per cent increase in copper alloy imports over the 1957 level would have cost Japan an additional $1.4 million at 1957 U. S. prices, but in the first half of 1958 the average cost of imports of this item was nearly 30 per cent below the 1957 level. In view of this the larger imports could have been purchased for an additional expenditure of $950,000. Actually the value of imports of this item in the first half of 1958 were at an annual rate $14.7 million below 1957. With complete liberalization imports of copper alloy scrap would almost certainly be far below the 1957 level.

Beef tallow - The U. S. and Canada supplied about 85 per cent of Japan's imports of beef tallow in 1957 and 1958. In 1957, the cost from the U. S. was 6 to 8 per cent lower than the cost from the next two largest suppliers, Australia and New Zealand. A 10 per cent rise in total imports would mean an outlay of about $2.5 million over the 1958 rate, but imports of tallow in 1958 were about $2 million less than in 1957.

Pig iron - The U. S. supplied 67 per cent of Japan's pig iron imports in 1957 at an average cost of ¥34,600 per ton. The average cost from countries other than the U. S. was ¥35,300. This very slight price differential indicates that there would probably be little increase in total pig iron imports if purchases from the dollar area were not restricted. Actually, pig iron imports fell very sharply in 1958 and were at an annual rate of only $340,000 in the first ten months of the year compared to $91 million in 1957. Given the current low level of imports it is all the more difficult to understand why it is considered important to discriminate against imports from the dollar area. Even if this were to result in a doubling of pig iron imports, which is most unlikely, the amount of additional expenditure would be well under one per cent of the reduction in the value of pig iron imports in 1958.

Vessels for scrap - The U. S. supplied only 18 per cent of the volume of these imports in 1957. The U. S. price was 63 per cent below that of Argentina, the largest supplier, but was above the average cost of imports from Australia, Korea, and Indonesia, and only slightly under that of the only other supplier, France. This is an item that is not available in unlimited quantities. The U. S. price is on the high side, if Argentina is excluded, and there would seem to be little reason to expect any great increase in total imports if restrictions on buying from the U. S. were removed. As is the case with other metals, Japanese expenditures for this item fell substantially in 1958.

Kapok seed - Japan imported a total of $1.8 million of this item in 1957, all from non-dollar countries, chiefly Indonesia and Thailand. Kapok and kapok seed do not appear to be exported in any substantial volume by dollar area countries and the reasons for discrimination on this item are obscure.