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Japan's Balance of Payments Prospects

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JAPAN'S BALANCE OF PAYMENTS PROSPECTS

Reed J. Irvine

Japan's balance of payments outlook for the immediate future is closely allied with military and political developments in the Far East. This may be equally true of her long run prospects, since it seems obvious that the relaxation of the international tensions symbolized by the Korean War is not in sight. The indefinite continuation of the Korean conflict, or its extension or transfer to other areas cannot be ruled out of the possibilities. Needless to say, this would profoundly affect the economies of Japan and other Far Eastern countries. In the event of the expansion of the Korean War, Japan's balance of payments problems would tend to be pushed into the background for the duration. However, should that conflict merely continue in its present inconclusive course, it is less certain that the Japanese would be freed of concern in this matter.

As long as the U. S. and other allied powers are militarily engaged in Korea, Japan seems assured of substantial foreign exchange earnings from the official and personal expenditures of their armed forces. However, it is quite possible that the prospect of indefinite prolongation of the Korean conflict will lead to efforts to shift part of the burden to Japan and to achieve economies in other ways which will tend to greatly reduce the profitability of these operations for Japan. This might well bring Japan's rapid accumulation of foreign exchange reserves to a halt. It is unlikely that reductions which would seriously endanger the stability of the Japanese economy would be made. However, even a continuation of the Korean War at its present level would not insure Japan against trade difficulties induced by a recession or the erection of barriers against her exports abroad or inflation at home. Even assuming an indefinite American involvement in Korea, Japanese prospects are not uniformly bright. A natural unwillingness to accept the idea that an indefinite continuation of the conflict is possible leads Japanese as well as Americans to the hope that the future will bring a settlement in Korea, which would permit the withdrawal or reduction of American and other allied forces in that area.

The Japanese are well aware of the fact that their economy has not yet been freed of dependence upon receipts of U. S. dollars not earned in the course of normal commerce. Through 1950, American aid was the largest source of these abnormal receipts. Its place has since been taken by sales of goods and services to U. N. forces (mainly American) in Japan and Korea. Imports, including American aid imports,

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exceeded exports by \$153 million in 1950 and \$683 million in 1951. During the first five months of 1952, the excess was running at an annual rate of \$450 million. Extraordinary receipts have more than covered these import surpluses. In 1950, American aid receipts reached \$253 million and income from the sale of goods and services to the U.N. forces in Korea totalled nearly \$50 million. In 1951, American aid declined to \$155 million, while receipts from U.N. forces special procurement rose to \$327 million. In addition to this, Japan received \$86 million for the maintenance costs of U. S. forces in Japan and \$211 million from the expenditures of allied personnel, clubs, and other organizations. Receipts from these sources totalled \$779 million, almost all of which was paid in dollars.

In the two years following the outbreak of war in Korea, Japan's foreign exchange reserves rose from the equivalent of \$341 million to \$1,161 million in spite of the large trade deficits incurred in this period. This rate of accumulation would appear to leave the Japanese a substantial margin for reductions in foreign exchange earnings, and it might be concluded that even fairly large cuts in Korean special procurement or other American spending in Japan could be absorbed easily. This, however, would involve a loss of dollar earnings, and it must be noted that Japan's reserves of dollar exchange increased at the annual rate of \$121 million in 1951 and \$177 million in the first half of 1952. Any substantial decline in earnings arising from the Korean conflict could easily plunge Japan into a serious dollar shortage even though it might not produce an over-all unfavorable balance of payments.

A settlement in Korea would not place Japan in this difficulty immediately. The withdrawal of the U.N. forces is unlikely to be executed hurriedly and the Japanese could expect continued earnings, even if at a declining rate, from this source for some time. Special procurement receipts would continue for sometime after the termination of hostilities, if only because of the lag of payments behind contracts which now amount to about \$150 million. This, along with accumulated reserves, would probably cushion the shock, but only temporarily.

It is also expected that peace in Korea will be followed by an internationally financed reconstruction program which will probably stimulate Japanese exports to that country. However, it is impossible to say what funds may be made available for this purpose and what percentage of the reconstruction goods may be purchased in Japan. The United States Korean Reconstruction Agency has received pledges of \$223 million for

its operations, but not all of this sum has yet been made available and a portion of the contribution has already been used for administrative purposes. UNKRA has not produced any up-to-date estimates of the amount which might be needed for Korean reconstruction. However, the magnitude of contributions pledged during the last two years indicates that the amount available for this purpose annually will be somewhat smaller than Japan's special procurement earnings last year. Japan will undoubtedly benefit from Korean reconstruction expenditures since she normally supplies a major portion of Korean imports. However, even should the rate of annual expenditure be planned to absorb an amount equal to the present total pledged contributions, the income accruing to Japan will fall considerably short of her current special procurement earnings. Moreover, Japan again might be expected to make a substantial contribution herself, cancelling out part of the gain from this source. Korean reconstruction will at best provide a temporary and partial solution for the Japanese problem.

Therefore, despite their impressive foreign exchange reserves, the Japanese have a serious balance of payments problem which should receive careful attention on both sides of the Pacific. Our policy of increasing dependence upon Japan as a stabilizing factor in the Far East can succeed only if a long-run solution to this economic problem is found.

#### Japan's problem in perspective

Past experience provides us with little or no comparable background to form a judgement of the magnitude of the problems Japan will probably face in the event of early Korean settlement. An examination of the problems and difficulties experienced in the far more favorable prewar years may, nevertheless, be instructive.

For example, it is significant that even prior to World War II Japan was rarely able to export as much as she imported. During the entire inter-war period, she achieved a favorable balance of trade in only four years, 1935, 1938-40. In the 1920-29 period, the gap between exports and imports was too large to be bridged by net invisible receipts, and Japan's international accounts were balanced by substantial gold and capital movements. The gap was narrowed in the following decade, but despite export surpluses in the four years mentioned, the cumulative balance remained unfavorable. However, the import surplus was small enough to be covered by Japan's substantial net invisible earnings. It is only necessary to ask whether the changes which have since taken place have strengthened or weakened Japan's ability to balance her trade to appreciate the seriousness of her future long-run problems. The 20 per

cent increase in population, the loss of territory and valuable nearby markets and supplies of import raw materials, the decline in demand for raw silk, the deterioration in her capacity to earn invisible income are the major points which attract attention.

Food supply

A larger population, of course, increases Japan's dependence upon food imports. Average Japanese imports of cereals in terms of quantity in 1950 and 1951 were 45 per cent greater than the annual average in 1936-38. Domestic production, however, exceeded the earlier period by only one per cent, as the following table shows:

<u>Japanese Cereal Supply</u>			
	<u>Crop years</u>	<u>Crop years</u>	<u>Per cent</u>
	<u>1936-38</u>	<u>1950-51</u>	<u>increase</u>
Domestic production	90,205	91,194	1
Net imports	<u>14,878</u> <sup>1/</sup>	<u>21,520</u>	45
Total	105,083	112,714	7

Source: Bank of Japan, Japanese Economic Statistics, 1951, pp. 290, 292-293, 338.

<sup>1/</sup> Includes figures on minor cereals from SCAP, Japanese Economic Statistics.

Cereal acreage had been expanded by slightly less than one per cent indicating very little gain in yield per acre. Barring a new revolution in agricultural practices, there is little hope that domestic grain production can be expanded to keep pace with the growth in population of about 1.5 per cent per annum. This means that grain imports may have to be increased by as much as 7 or 8 per cent a year if the present rate of per capita consumption of cereals is to be maintained. This would involve an increasingly heavy drain of foreign exchange for imports which cannot be directly converted into exchange earning exports. If it is true that Japan is approaching the limits beyond which little expansion of domestic food production is possible, she must either curb her population growth, suffer further deterioration in the composition of the national diet, or find new means of paying for steadily increasing food imports.

Loss of markets

Of more immediate importance than this is the loss to Japan of her major prewar markets in Asia and the decline of the American market for raw silk.

Asian markets - The following table shows the increasingly dominant role Korea, Formosa, and China played in Japanese foreign trade in the 1930's:

Japan's Trade with Eastern Asia and the U. S.  
as Per Cent of Total Trade

Year	<u>Korea</u>		<u>Formosa</u>		<u>China, Kwantung, Manchuria</u>		<u>U.S. &amp; Possessions</u>	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
1933	14	13	6	9	17	11	23	26
1936	18	14	7	10	18	11	18	24
1937	18	12	7	9	19	9	17	28
1938	23	19	8	11	30	15	12	25
1939	24	18	7	12	34	16	13	25
1951	1	0.3	4	3	0.4	1	14 <sup>1/</sup>	35 <sup>2/</sup>

<sup>1/</sup> Excludes special procurement for United Nations in Korea.

<sup>2/</sup> Includes United States Aid Shipments.

Source: Bank of Japan, Economic Statistics of Japan, 1951.

It will be seen from this table that by 1939, 65 per cent of Japanese exports went to these Asian countries and 46 per cent of her imports were obtained from them. Japanese industry developed in the 1930's largely upon the basis of the raw materials obtainable from these nearby Asiatic sources and the markets which they provided for finished Japanese goods of all types. The improvement in the Japanese balance of trade in that decade is largely attributable to the exploitation of these markets.

The above table also shows what a minute proportion of Japan's trade is now done with this formerly all-important area. It does not indicate, however, what this sharp decline means in terms of the volume of trade and the effect on the trade balance. We have already noted that imports of cereals have risen since prewar. Of equal or greater importance

is the fact that in 1936 over 90 per cent of Japan's rice imports, which exceeded 2 million metric tons, came from Korea and Formosa. In 1950-51, Japanese imports of rice from Formosa were only a little over 50,000 metric tons and Korea imported rice from Japan. Another important food item, beans and peas, came almost exclusively from China and Manchuria before the war. In 1950-51, however, this area supplied less than one per cent as much as the volume sent to Japan in 1936. The reduction in supplies from this area has forced Japan to rely largely on the dollar area for food imports in the postwar period, adding greatly to her trade deficit with dollar countries.

In 1936, the China mainland supplied one-third of Japan's imports of iron ore, three-quarters of her coal imports, and 28 per cent of her pig iron imports. In 1950-51, Japanese imports of iron ore from this area were less than one per cent of the 1936 volume, coal but 14 per cent, and pig iron imports were non-existent.

The same picture can be painted with respect to exports, but the over-all situation is perhaps best seen in the following table which compares prewar and postwar trade adjusted for price changes:

Trade with Selected Countries

Adjusted for Price Changes, as Percentage of 1936-38 <sup>1/</sup>

Country	1936-1938	1949		1950		1951 <sup>2/</sup>	
		Exports	Imports	Exports	Imports	Exports (8 mos.)	Imports (9 mos.)
China	100	0.4	6.0	2.8	11.9	0.8	6.1
Formosa	100	3.3	7.8	17.6	14.0	17.5	14.3
Korea	100	2.3	0.8	3.0	3.9	1.6	0.9
United States	100	15.3	72.7 <sup>4/</sup>	40.8 <sup>3/</sup>	59.2 <sup>4/</sup>	28.7 <sup>3/</sup>	71.3 <sup>4/</sup>
All Countries	100	14.0	28.6	26.6	33.6	29.0	52.8

<sup>1/</sup> Average monthly value of trade deflated by export and import unit value indexes with 1936-38 = 100.

<sup>2/</sup> 1951 figures are based on computations for eight months in the case of exports and nine months in the case of imports, as unit value indexes are not available for the latter part of the year. Computations for the entire year may be expected to show slightly different results. Omission of these months tends to exaggerate the recovery of trade with China and Formosa slightly and understate recovery of trade with Korea.

<sup>3/</sup> Excludes special procurement for U.N. in Korea.

<sup>4/</sup> Includes United States Aid Shipments.

Source: Bank of Japan Economic Statistics of Japan, 1951, p. 330, and The Far East Yearbook, 1941, p. 451.

The above table involves the deflation of Japanese trade returns by unit value indexes for all imports and exports. While this undoubtedly produces some distortion when applied to individual countries with their trade of varying composition, it does provide a rough indication of the drastic changes which have occurred. It is useful as an indication of the relationship between the level and pattern of Japan's trade, showing the extent of the decline in trade with East Asia and the effect this has had upon the recovery of her over-all trade.

The table shows the monthly average of Japanese exports for the first 8 months of 1951 running at a rate below 30 per cent of the 1936-38 average. Exports to China, Korea, and Formosa combined, however, were at a rate less than 3.5 per cent of the prewar period. <sup>1/</sup> The rate of exports to all other areas combined was over 53 per cent of the 1936-38 volume.

The rate of total imports in the first three-quarters of 1951 was a little over half the 1936-38 rate. Imports from China, Formosa, and Korea only, however, were lagging far behind, at a rate only 6 per cent of the prewar years. Excluding these three countries the rate of imports in the first three-quarters of 1951 was more than 78 per cent of 1936-38.

This approach fails to indicate difference in the degree of recovery of different components of trade. It is interesting to note that by weight imports of soy beans, sugar, raw cotton, pulp, hard and bast fibers, fertilizer and coal were less than 50 per cent as great in 1951 as in 1936. On the other hand, imports of crude rubber and ores were nearly equal to the 1936 figures while imports of cereals, phosphate rock, and raw skin were well in excess of them.

While it is clear that the loss of Korean, Formosan, and Chinese markets is not the sole cause of Japan's failure to recover prewar levels of trade or to achieve a more satisfactory balance between imports and exports, the importance of this factor is obvious from the above figures. Exports to other areas have not only failed to make up for this loss, but are themselves seen to be lagging behind prewar levels when valued at prewar prices. The United States has proved to be a substitute source of supply for many items, including soybeans, iron ore, and coal, but this is an unsatisfactory solution because it only worsens Japan's chronically unfavorable trade balance with the United States while increasing the cost of production of many industrial products using these expensive dollar imports.

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<sup>1/</sup> This would be even less for the entire year because of the sharp decline in Chinese trade in the last half of 1951.

Many, and perhaps most, Japanese businessmen are, therefore, eager to restore trade with the Chinese mainland. The hope of regaining a part of the Chinese market appears to outweigh any dislike they may have of communism, and the Japanese Government is now under heavy pressure from business and industrial quarters to relax its severe restrictions on Chinese trade. It is generally recognized, however, that even under the most favorable conditions, the prewar pattern of trade with the mainland cannot be restored. Japanese trade was then developed to a very large extent upon the basis of colonial domination and special privileges which no longer exist and cannot be recovered. The new regime in China may be expected to bar imports in any large quantity of textiles and other consumer items which made up a substantial part of China's prewar purchases from Japan. In 1950-51, when trade with China reached a postwar peak, textiles and fibers accounted for about 6 per cent of Japan's exports to China compared with over 18 per cent in 1936-38. On the other hand, metals and metal manufactures accounted for over 60 per cent in 1950-51 and only 16 per cent prewar. This may be considered indicative of the lines upon which Red China will want to trade in the future and without a very fundamental change in world or Japanese domestic politics, it is doubtful that a new Sino-Japanese trade pattern can be developed on this basis.

A peaceful settlement in Korea might pave the way for some expansion of trade with China and Korea. With respect to the latter, the volume of aid made available by United Nations members will be the determining factor for some time to come. In the case of China, the status of the "cold war" will in all probability continue to operate as a limiting factor of major importance. All these considerations strongly support the conclusion that trade with this area cannot be expected to equal prewar volume. Japanese must look elsewhere for markets and raw materials for her industries.

Raw silk -- Japan has suffered a vital loss of trade in its market for raw silk, for which the United States has always been the biggest customer. In 1936-38, Japanese raw silk exports averaged 64 million pounds a year, but since the war the maximum amount exported was 11,572,000 pounds in 1946, a drop of 72 per cent. In terms of value, raw silk exports reached a postwar peak in 1951 when total exports to all countries amounted to an equivalent of \$41.5 million, or only 37 per cent of the 1936-38 average. This decline is especially serious because of the importance of silk as a dollar export. Over 80 per cent of Japan's raw silk exports went to the United States in 1936-38, accounting for 57 per cent of all United States imports from Japan during that period. Average annual earnings from sale of silk to the United States in these years were \$95 million. In 1951, this figure had been reduced to only \$22.2 million, or less than a quarter of the prewar figure. In 1950-51, raw silk exports paid for only a little over 3 per cent of Japan's imports from the United States, compared with over 32 per cent in 1936-38.

Since the decline of silk is primarily the result of the great progress made by substitute synthetics, any substantial revival of the market for this product appears extremely unlikely. Nor does it appear at all probable that Japan will be able to produce another commodity capable of filling the place of silk as a dollar earner. As a raw material, silk was an ideal export since its production involved no foreign exchange cost and its marketing met with little competition or resistance in foreign markets. The fact that it still remains Japan's largest dollar earner despite the great set-back it has suffered, indicates how little progress has been made in compensating for the decline in its earning power.

### Decline in normal invisible earnings

Invisible income, apart from that derived from United States military sources, has been slow to recover its prewar importance, indicating another serious weakness in Japan's economic structure. In 1951, Japan had net debits of \$34 million for shipping, \$1.3 million for insurance, and \$4 million for interest and dividends. Personal and institutional remittances showed a net credit of \$15 million, and tourist and diplomatic expenditures, excluding the allied armed forces, a credit of \$2 million. If, for the sake of comparison, we inflate Japan's 1936 invisible earnings to compensate for price changes, we find that the comparable figures for that year, which were all net credits, were \$149 million for shipping and related services, \$10 million for insurance, etc., \$15 million for interest and dividends, \$65 million for emigrant remittances and \$20 million for tourist and diplomatic expenditures. <sup>1/</sup> These figures point up the magnitude of Japan's loss in these fields as a result of the war and the slowness of the recovery.

### Japan's dollar problem and solutions

Japan's heavy reliance on American imports has increased in the postwar period as a result of the reduction in the availability of imports from Asia. At the same time, the great decline in raw silk has further widened the gap between Japan's dollar imports and exports. In 1936-38, Japan's trade with the United States showed imports 83 per cent greater than exports. In 1950, they exceeded exports by over 120 per cent and in 1951 this had risen to 290 per cent, even though, as shown in an earlier table, the value of imports adjusted for price changes was below the prewar level. This large dollar trade deficit was possible only because of the United States aid, special procurement and other invisible earnings which Japan has enjoyed. It is obvious that Japan has a latent dollar

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<sup>1/</sup> The 1936 figures are here inflated by the U.S. wholesale price index for 1951.

shortage of alarming proportions, which would no doubt appear very shortly after the attainment of the settlement in Korea. The Japanese problem is not only to lift the general level of trade and secure an over-all balance, but also to achieve increased normal dollar earnings to offset the increased dependence upon American imports. This is a particularly important goal in this world of inconvertible currencies. At the present time, this can be done either through increased dollar exports, increased normal net invisible earnings, inflow of American capital, or renewal of some form of American aid. Convertibility of currencies, particularly of sterling, would, of course, greatly ease the situation for Japan by facilitating multilateral trade settlements. Inconvertibility, however, means that generally other nations have balance of payments problems similar to those threatening Japan. There is no reason to expect the sterling area to discover a solution to the problem of inconvertibility any more quickly than Japan, especially one which will simultaneously solve Japan's problems as well as its own. The strong U.S. balance of payments position is a basic factor in both cases.

Outlook for dollar exports -- Japan's prospects for securing increased dollar earnings from exports depend to a very large extent upon her ability to increase sales in the North American market, principally the United States. Although she settles her trade with 27 other countries in dollars, either on the basis of open account agreements or cash, most of these countries have dollar shortages of their own which act as a barrier to increased Japanese exports not matched by increased imports. Trade with hard currency countries other than the United States tends to be on too small a scale to encourage hopes of an export expansion sufficient to make a very large contribution to the solution of Japan's dollar problem. Brazil and Argentina, Japan's largest South American customers, both trade on an open account basis, minimizing the dollar settlement. Exports to these two countries rose markedly in 1951, but little advance was made elsewhere in the Western Hemisphere and there is no indication of any strong trend toward an expansion of Japanese exports in either North or South America.

The United States is Japan's largest dollar market, outranking all others combined. In theory, at least, the Japanese are free to expand exports to the United States without limit, and it is logical to expect a redoubling of efforts to increase sales to the United States should the dollar shortage emerge. The fact is, however, that Japan has already learned of the difficulties and dangers of aggressive invasion of American markets. There are few important products exported by Japan which would be welcomed in United States markets in substantially increased quantities. Items which have made good progress in the past, such as ceramics and tuna fish, have already given rise to pressure from domestic producers for increased tariffs. To avert complete exclusion from the American markets,

the Japanese tuna industry has imposed absolute limits upon the quantity of canned and frozen tuna which may be exported to the United States, thereby insuring little or no expansion of dollar earnings from this important dollar earning export.

Tariff barriers and the threat of increased protectionism may well prove to be an insurmountable obstacle to the Japanese efforts to sell more in the United States. Even in the absence of this obstacle, however, it is doubtful that the sale of products of Japanese industry could be multiplied to the extent necessary to reduce appreciably her trade deficit with the dollar area. In terms of dollars of constant value, Japan actually exported considerably less to the United States in 1951 than in 1950. Here, as in other dollar countries, the trend is not in the direction of a strong, steady expansion of Japanese export earnings.

#### Southeast Asian imports as a solution

There has been a tendency to regard the development of markets and the exploitation of raw materials in Southeast Asia as the one possible solution to the very grave trade problems confronting Japan. The Japanese themselves have been eager to take advantage of opportunities to trade with that area, and trade with Asia, excluding China, Korea, and Formosa has made a very strong recovery, surpassed only by Australia and Oceania. In both 1950 and 1951, these Asian markets provided the largest outlets for Japanese products and were second only to the Western Hemisphere as a source of Japanese imports.

This is encouraging progress, and it may continue, if at a diminishing rate. The realization of plans to exploit mineral resources in Southeast Asia, with the aid of Japanese capital, might well expand both Japanese exports and imports to this area. Plans for such exploitation are being discussed with respect to iron ore in India, Malaya, and the Philippines and with respect to nickel, coal, iron and lumber in Indonesia. Few operations have yet begun, however, and there are a number of serious obstacles in the way which might stop the execution of these plans.

Japan is not the only industrialized nation which hopes to profit from the development of this area. The British especially are firmly entrenched throughout most of Southeast Asia and cannot be expected to surrender their advantageous positions to the Japanese without a struggle. Malaya, for example, has until recently refused to permit the entry of their nationals, and the local authorities have insisted that Japanese capital is not required at present. Nationalism and anti-Japanese sentiment left over from the war is a strong bar to extensive Japanese investment. Some Japanese have expressed the fear that investments in the Philippines and Indonesia might be subject to confiscation as reparations payments and

until this issue is finally settled it may be expected to deter Japan from taking risks. In addition to this there is, of course, the general uncertainty and insecurity prevailing in many countries in this area which is today discouraging introduction of foreign capital from abroad. The possibilities of nationalization, and possible confiscation and discrimination, can no more be ignored by the Japanese than by any other investors. Japan does not have unlimited capital to pour into Southeast Asia. The largest over-all figure mentioned to date calls for investment of \$91 million dollars in this area over a five year period. The Japanese Export-Import Bank, the most likely source of funds for foreign investment, at present has less than \$30 million available for loans. The maximum maturity for its loans is set by law at 5 years. Lack of readily available capital for long-term loans is said to be delaying a \$55 million Japanese pig iron project in India. This same difficulty will doubtless handicap other schemes as well.

Assuming the loss or drastic curtailment of special procurement earnings, Japan would probably find foreign investment quite beyond her means. Her economy would no doubt remain heavily dependent upon dollar supplies of foodstuffs and raw materials which Southeast Asia could not supply. She then could ill afford the dollar imports required for the additional production needed for an overseas investment program. It is true that to some extent the investment would be dollar saving, but it is very easy to overlook the fact that Southeast Asia does not, and probably never will, produce in sufficient quantity most of the goods supplied to Japan by the United States in order to replace the latter as a source of supply. In 1950-51, cereals accounted for 25 per cent of Japan's imports from the United States, raw cotton equalled 37 per cent of the total value. Iron ore, which is one of the raw materials the Japanese are most eager to procure from Southeast Asia, comprised slightly over one per cent of imports from America in this period. Coal equalled 2.5 per cent.

Major dollar savings are to be sought mainly in terms of increased supplies of Southeast Asian rice and through a reduction in the price of sterling cotton, which will permit Japan to reduce her reliance on North American supplies of cereals and cotton. In 1951-52, the production of rice in Southeast Asia principal rice producing countries, Burma, Indochina, and Thailand, reached 98 per cent of the 1935-39 average. Exports, however, lagged considerably behind prewar. In 1951, Burma exported only 60 per cent as much as she did in 1937, Indochina exported about one-quarter as much, while Thailand, despite a 50 per cent increase in production, attained only 89 per cent of the 1934-36 export average. This reflects in part the increase in population of these areas and their increased domestic requirements. In the case of Indochina and Burma, it reflects both reduced production and transportation difficulties which will not be overcome until peace and order is restored in these countries. There is hope that, in the future, these countries will be able to make increasing quantities of

rice available to the rest of Asia. Unless rapid progress is made, however, it may be found that population in rice-short Asia will outstrip increases in supply, as appears to have been the case in the last three years. Moreover, development programs, designed to raise living standards in Southeast Asian countries, will tend to increase rice consumption in this area, further enlarging demand. As has been pointed out, Japan too will experience an increase in food requirements as her population grows. Japan's cereal imports from America approached 2 million metric tons in 1950-51. More than a gradual improvement in Asian supplies will be required to make a substantial reduction in these imports possible.

Japan is constantly endeavoring to switch from dollar to sterling imports where possible. In 1952-3, she expects to obtain nearly 58 per cent of her raw cotton from non-dollar areas. Price premiums on sterling cotton hinder progress in this direction, but there are grounds for hope that further advance will be made. Pakistan, the largest supplier in the sterling area, would like to sell Japan 120 million pounds more cotton than the latter is willing to take at current prices. Additional cotton is, therefore, available and indications are that Pakistan is being forced to bring prices into line with the world market. Lower prices would, of course, result in increased demand from other Pakistan customers and Japan could not expect to obtain this same quantity at world market prices. However, should Japan eventually find it both feasible and possible to increase its imports of Pakistan cotton by the indicated amount, she could save over \$30 million in dollar cotton purchases. Substantial dollar savings are, therefore, not impossible but their achievement will at best be slow and uncertain because of the increased demand for soft-currency cotton and the obstacles to increased production arising from the producing countries' needs for expanded food crop acreage.

The benefits Japan is likely to derive from investment in Southeast Asia must, therefore, be regarded as modest, both because of the hindrances which may be expected to curtail and retard present plans and the basic inability of this area to supply the bulk of Japan's import requirements economically.

#### Dollar earnings from Southeast Asian trade

As a colonial area, Southeast Asia was a rich source of foreign exchange earnings to the former colonial powers, just as Malaya is to Britain today. The raw materials produced in the colonies were sold in what are now dollar markets, while the colonial powers supplied the biggest part of their imports.

With the elimination of colonial domination, it has become possible for Japan to expand her exports in these areas at the expense of the former colonial powers. However, this has not meant that Southeast Asia has become a rich source of dollar exchange for the Japanese. The independent states in this area have demonstrated a strong propensity for spending their dollars in the Western Hemisphere. Even in 1951, when this area was still profiting from the price boom in raw materials, the area as a whole, excluding Malaya and Singapore, had an unfavorable balance of trade with the United States and Canada. Only Ceylon, Burma, Malaya, Pakistan, and Thailand have tended to **show consistently** an export surplus in trade with the United States, and all of these countries save Thailand are members of the sterling area dollar pool and are not free to trade with Japan on a dollar basis.

Despite the fact that Japan has a favorable balance of trade with Southeast Asia as a whole, this is of value to her only to the extent that she can use the net income to procure imports from other areas. In the case of Hong Kong, Ceylon, India, Pakistan, Burma, and Malaya and Singapore the balance is payable in sterling. Indonesia, Philippines, Thailand, and Indochina trade balances are supposed to be settled in dollars.

Japan may endeavor to supplant the United States as a supplier of this area to a larger extent, establishing a new pattern of triangular trade. She has had little success in this so far. Japanese capital goods, in many cases, are high in cost relative to the products of the western industrial nations. This, in part, stems from the obsolescence of much of the Japanese industrial plant and in part from the high cost of raw materials which must be transported long distances to Japan.

The Japanese have had high hopes that dollar expenditures in connection with American financed development programs in this area would be made on a fairly large scale in Japan. These hopes have yet to be realized. In the first half of 1952, **MSA** let contracts in Japan totalling \$2.7 million. This was more than \$2 million short of purchase requisitions, as Japanese bids were either too high or failed to meet specifications. In time, Japanese prices may be competitive, but it will be no easy matter to lower costs, and if Japan insists on payment in dollars it will be a long time before she will be able to supplant the United States and European nations as suppliers of capital goods in these markets.

On the other hand, the industrial development of these nations promises to make it increasingly difficult for Japan to sell her textiles and other products of her light industries as new competitors spring up and the importing countries turn protectionist to foster domestic industry. This is already a rapidly growing trend and the textile industry especially

is suffering from it. As the market for textiles narrows and competition becomes keener, we see the British taking action to exclude the Japanese from their colonial markets, thus aggravating the effects of the general contraction on the Japanese industry. In the long run, it is possible that Japan's position will be weakened rather than strengthened by South-east Asian development. It is certain that exploitation of this area offers no simple solution to Japan's problems.

#### Development of invisible income and capital inflow

If the outlook for Japanese trade offers little hope, a remaining alternative for Japan lies in the development of increased invisible earnings and the expansion of income on capital account. Private capital is flowing into Japan in increasing amounts, but it is still relatively insignificant as a factor in Japan's balance of payments. The total inflow in 1951 was reported to be less than \$13 million. As capital flow is determined primarily by opportunities for remittable return and not by the need of the recipient, it cannot be said that the outlook for large scale induction of foreign capital into Japan is bright, in spite of recent liberalization of the Japanese Foreign Investment Law. The generally discouraging long-run prospects faced by Japan raises doubts about her ability to maintain a liberal policy toward capital remittances in the event of the settlement of the Korean conflict. Capital may, therefore, continue to flow in but only for so long as the need for it in terms of the balance of payments picture is not great.

With respect to invisibles, shipping is being rapidly strengthened, and it is hoped that by 1960 Japanese bottoms will be carrying 50 per cent of Japan's foreign trade cargoes. This compares with a prewar rate of about 61 per cent. In 1951, the rate was only 31.4 per cent. Insurance may very well regain its position as a net earner of foreign exchange eventually, but other invisible items show little promise. Japan will in the near future be obliged to resume service on her private foreign debt and to negotiate a settlement on her GARIOA debt, both of which will result in a sharp rise in payments cancelling out probable gains in shipping and insurance. Emigrant remittances have declined as a result of the large scale repatriation of Japanese nationals since the war, and they may be expected to decline further with the passage of time and the progressive weakening of family ties. The outlook for tourist expenditures is more hopeful as the retention of American security forces in Japan will guarantee substantial earnings in this category, the level depending upon the course of military developments in Asia as already noted. Assuming a Korean settlement, it may be expected that receipts from this source will drop very sharply. As these receipts appear to be

running at more than double their pre-Korean rate, it is likely that they will be more than halved. As Japanese rearmament progresses and the need for United States garrison forces diminish, further decline may be expected.

The maintenance of American Security Forces in Japan, however, will involve large official expenditures for both goods and services. It is difficult to estimate the magnitude of income from this source or the period of its duration. As we noted earlier, it may do no more than partially compensate for the loss of direct U. S. aid, but this remains potentially the single largest source of invisible earnings available to Japan if a Korean peace settlement is reached.

### Reduction of imports

If the Japanese are unable to offset their trade deficits through an expansion of exports or other earnings, the alternative of import cuts remains open to them. It can be maintained that Japan has now adjusted to import and consumption levels far below prewar and that post-war experience indicates that it may be possible to stabilize trade at a level considerably lower than that attained in 1951. This possibility cannot be excluded, though its desirability may be questioned. A solution along these lines would probably imperil any program of increasing Japanese defensive strength and developing Japan as a stabilizing force in the Far East. In view of the unpromising outlook in other directions, however, it is not unlikely that Japan will be forced to resort to this as at least a partial solution.

### Conclusion

Hopes for the continued viability of the Japanese economy rest upon a combination of uncertainties, one of the most important of which is the volume of U. S. military spending in Japan and the immediate vicinity. Increased earnings of hard currencies from either merchandise or normal invisible exports are not highly promising because of insufficient competitive advantage in many Japanese industries. Recognizing the possibility that net invisible earnings might drop very sharply in the future, the Japanese are obliged to consider very carefully the possibilities of increasing dollar export earnings and switching to non-dollar sources of supply. These possibilities are at present limited by shortages and restrictions on trade. Elimination of the former appears to be a long-range problem, the solution of which is uncertain. The lifting of trade restrictions hinges upon complex political and military developments which are now unpredictable.

It is by no means clear that there is a "normal" solution to Japan's problems. It is certain, however, that in spite of the seeming strength of Japan's present position, the basic problems must be recognized as serious on both sides of the Pacific if we are to avoid the risk of a dangerous weakening of this important link in the non-communist chain of defense. Policies, which do not take this into account, will at best delay and at worst render impossible a satisfactory solution to the difficulties which may emerge with the attainment of peace in the Orient.