

MEMORANDUM To: National Advisory Council

From: The Staff Committee

Subject: Appropriation request for Economic Rehabilitation of Japan

1. The appropriation request

The Department of State has requested NAC consideration of an appropriation request for \$180 million prepared by the Department of the Army for the purpose of facilitating the economic recovery of Japan.

2. Summary of the Department of the Army program

The Department of the Army's appropriation request for \$180 million would provide imports from April 1, 1948 to June 30, 1949 as follows:

	<u>Millions of dollars</u>
Industrial raw materials for processing	125.6
Fodders, feeds	6.5
Machinery parts	3.0
End products (consumer's incentive goods, automotive and construction equipment and parts)	10.0
Cost of shipping	34.9
	<hr/> 180.0

The appropriation request is accompanied by a justification setting forth the relation of the above import program to the proposed GARIOA program for fiscal 1949 totaling \$375.9 million, and other essential imports totaling \$272.3 million to be financed from other funds and anticipated credits which may be available to the Japanese economy.

The justification sets forth a rehabilitation program, the economic objective of which is ultimately to achieve a "balanced economy" for Japan, thereby eliminating the necessity for continued foreign financial assistance. A further objective is to assure a firm economic basis for the permanent establishment of free institutions in Japan. Such an economy would be characterized by (1) a standard of living approximating 1930-34 levels; (2) industrial output 135 percent of 1930-34, and; (3) a small favorable trade balance by 1953 with imports on the order of \$1,400 million and exports on the order of \$1,500 million per annum.

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The justification indicates that, on the assumption that reasonably rapid progress is made towards Far Eastern stability, the goals set in most fields can be achieved by 1953. On the other hand, "failure of Far Eastern conditions to stabilize, and the continuance of political unrest and economic disorganization, will indefinitely postpone the fulfillment of the goals ... Under the unfavorable assumption that the situation will continue substantially as it exists today, industrial production is expected to reach a level of only 97 percent by 1953 of that prevailing in the 1930-34 period... A balance of trade is expected to be reached in 1953 under this unfavorable assumption, but the imports will be insufficient to maintain production and consumption at a satisfactory level". <sup>1/</sup> The justification points out that Far Eastern stability is of prime importance to Japan in terms of sources of raw material supply and market outlets, but does not discuss the probability of its achievement, or the measures necessary to bring it about.

On the basis of the favorable assumption above, the justification outlines an import program for the fiscal years 1949 to 1953 inclusive, export projections based thereon, and a plan for financing the indicated volume of imports. The import and export projections appear in summary form in Appendices A and B of NAC Staff Document No. 214.

Appropriated funds required by these estimates are as follows:

FY 1949	
GARIOA	\$376 million
Special appropriations <sup>2/</sup>	\$180 "
FY 1950	\$300 "
FY 1951	\$200 "
FY 1952	\$100 "
	<hr/>
	\$1156 "

The special \$180 million appropriation for the 15 months ~~ending~~ June 30, 1949, is described as an "economic 'shot-in-the-arm'" which, together with GARIOA imports for fiscal 1949 and in declining amounts in the three subsequent fiscal years, would enable Japan thereafter to support itself without further United States assistance in the form of appropriated funds. Additional imports, other than those financed with appropriated funds, would be obtained on credit or from the proceeds of exports. Credits to finance imports would be backed mainly by the Japanese gold and silver now held by SCAP. These assets would otherwise be available for the payment of occupation costs or reparations as might be determined by the Far Eastern Commission. At the end of fiscal 1953, these assets, if not previously expended in the repayment of credits not otherwise repayable, would still remain pledged in

<sup>1/</sup> Economic Rehabilitation Occupied Areas, page 21.  
<sup>2/</sup> For 15 months, April 1, 1948 - June 30, 1949.

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effect, according to the Department of the Army's projections. The justification does not indicate when these assets could be freed, and their ultimate application to the payment of occupation costs or reparations does not appear to be contemplated during the period under review.

The Department of the Army's justification does not discuss the implications of the possible establishment of a commercial exchange rate, or the domestic financial and monetary situation in Japan in relation to the proposed recovery program.

The alternative cost of continued appropriations for the prevention of disease and unrest over the fiscal years 1949 through 1953, at the proposed rate for fiscal 1949, is estimated by the Department of the Army at \$1,880 millions.

### 3. Domestic Financial and Monetary Situation

The Japanese financial and monetary situation is characterized by acute inflation, the basic causes of which are the large budgetary deficit financed primarily by the expansion of note issue, the sharp decline in industrial production and the deterioration in effectiveness of economic controls after 1945. In 1947 the currency in circulation more than doubled, while effective consumers' prices increased almost 2 1/2 times. Industrial production, which rose by 25 percent in 1947 over 1946, is still less half the level of industrial production in 1930-34. The maintenance of effective fiscal, commodity and price controls, which are indispensable if the inflation is not to get out of hand, has been subjected to persistent and severe strains. In the case of direct tax collections, the breakdown in the machinery of enforcement appears to have been recently averted only by the aggressive efforts of SCAP and the Japanese Government. While the Japanese Government in 1947 recovered some of the ground lost in 1946 in its controls over the supply of food and of other essential commodities and services, the pressure of over-all scarcities and the impact of the inflation on the efficiency of the government apparatus are undoubtedly imposing additional strains on the commodity allocations, rationing and price controls. The fact that Japanese fiscal and economic controls were relatively effective prior to 1945 gives rise to doubts as to the willingness of the Japanese to enforce adequate controls in the present situation.

### 4. Japan's international economic position

Japan's international economic position has undergone basic adverse secular shifts. With the disappearance of the yen bloc Japan at the same time lost almost all its external assets, the sources which had supplied its food deficit and a substantial part of its raw materials without a significant strain on its foreign exchange position, and the markets in which it occupied a preferred

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if not a monopolistic position. Its heavy industry has lost its mainstay with the destruction of the Japanese war machine. The substantial displacement of raw silk by nylon and rayon and the decimation of merchant shipping have resulted in a permanent sharp reduction in vital sources of foreign exchange. Its rapidly expanding population is increasing the size of its food deficit, even at current low levels of consumption.

In addition Japanese foreign trade is suffering from at least temporary dislocations as well as from the usual difficulties arising from the transition from a war to a peace economy. The countries of East Asia, including areas formerly in the yen bloc, are in the throes of acute political and economic instability and have serious foreign exchange problems of their own. Japan's former markets in Europe and Africa are dollar-poor countries, the expansion of trade with which may necessitate resort to cumbersome currency arrangements. Finally, the terms of trade have turned sharply against Japan and will continue to be unfavorable as long as world shortages in food and essential raw materials persist.

#### 5. Foreign exchange rate

There is no information presently available as to when a commercial exchange rate might be established or as to the level at which it should initially be fixed. Although there is no present fixed relation between the yen and dollar prices of imports or exports, the ratios of yen and dollar prices of individual export commodities are reported to range from about 50 to 1 to 750 to 1.

The establishment of a uniform exchange rate might adversely affect Japan's ability to export, while the establishment of a multiple rate would tend to perpetuate the present unfavorable terms of trade. However, the continued absence of an operative exchange rate will make the expansion of Japanese foreign trade to projected levels difficult to attain.

#### 6. Conclusions

A. Exports will fall substantially short of the goals projected by the Department of the Army without the early attainment of political and economic stability on the Far Eastern mainland and in Southeast Asia.

B. In any event, no program for the economic rehabilitation of Japan predicated on an expanding volume of industrial production and foreign trade could attain more than a modicum of success in the absence of effective fiscal and economic controls.

C. The fundamental changes in Japan's international economic position since 1945 have been so drastically unfavorable that even on the most favorable assumptions, the emergence of a viable self-supporting Japanese economy must necessarily be a protracted process.

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7. Recommendation

The Staff Committee recommends the following action for consideration by the Council:

The National Advisory Council is of the opinion that the Department of the Army's appropriation request for the economic rehabilitation of Japan is appropriate for the purposes of financing a program to increase the level of Japan's imports, expand its industrial output, and increase its ability to export. The National Advisory Council is of the opinion, however, that such a program should be accompanied by measures to achieve internal economic stability and effectively to enforce the economic controls necessary thereto.