

PROBLEMS
of
TRADE RECOVERY
IN JAPAN

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Foreword

THE following article on the problems of Japanese trade recovery should be of particular interest to readers in the Twelfth Federal Reserve District. Our District, covering as it does the entire Pacific Coast of the United States and thus all her western ports, is one in which foreign trade is a major industry. Out through our ports flow not only the products of the Twelfth District but also products drawn from virtually every state in the Union. In through our ports flow products from every corner of the globe, primarily raw materials necessary to the industry of the District and the entire national economy.

In the foreign trade of the District, trade with the Far East is by far the most important. During the immediate prewar years, while only 10 to 13 percent of the total United States foreign trade passed through Pacific Coast ports, a much larger proportion, from 33 to 37 percent, of total United States trade with the Far East passed through our ports. During the postwar period the importance of Far Eastern trade has continued, with Pacific Coast ports handling 33 to 47 percent of total United States commercial trade with this area.

In the Pacific Coast trade with the Far East, Japan was the most important single country in the immediate prewar period, accounting for 53 percent of our total Far Eastern trade in 1938. During the postwar period, Japan has relinquished its first position to the Philippines, reflecting the difficulties which have inhibited the recovery of Japan's foreign trade and also the fact that available trade statistics exclude shipments of relief and military cargoes on United States government vessels, which have been of considerable importance in the case of Japan. As the present obstacles to Japan's trade are gradually overcome, Japan should be able to resume its former position. Economic recovery in Japan, therefore, is closely connected with the economic climate in Los Angeles, San Francisco, Portland, Seattle, and our other port cities. In addition, as the article points out, recovery in Japan can have an important effect on recovery in the entire Far Eastern trading area. Thus, not only should we be concerned with Japan's recovery as a prerequisite to increased Pacific Coast-Japanese trade, but also with the fact that Japan can play an important role in increasing the ability of Asians in general to buy our goods and to supply us with necessary commodities.

In the present article it will be noted that the emphasis is placed on the problems of economic recovery in Japan, rather than upon a detailed analysis of Pacific Coast-Japanese trade. While it may appear rather remote to be considering such things as the movement of production and price indexes, efforts to control inflation, and trends in population growth in far-off Japan, a moment's reflection should reveal that these factors can, in fact, have an important effect along the waterfronts of our own Pacific ports. All trade is a two-way street. The volume of our trade with Japan is not only dependent upon our ability

to produce for export to Japan and our ability to purchase her products; it is equally dependent upon Japan's ability to purchase our products and to produce for our markets. A knowledge of what is going on at our end of the street is not sufficient, and we must know what is going on at the other end of the street if the trends and prospects for trade with Japan are to be properly evaluated.

The outstanding characteristic of our postwar trade with Japan is its imbalance and abnormal nature—abnormalities which cannot be appreciated without some knowledge of Japan's basic economic situation. For example, the major United States exports to Japan in the postwar period have been cereal grains and raw cotton. Our present relatively large exports of grain to Japan are abnormal and should be considered temporary in spite of the fact that Japan must continue to import large amounts of food to feed her large and growing population. Japan is presently dependent upon the United States for food imports because of the disruption and delayed recovery of food production in the Far Eastern countries which normally supply Japan with food in return for Japanese finished manufactures. A decrease in United States exports of food should be anticipated as recovery takes place in Far Eastern agricultural output. Similarly, in the case of our cotton exports, a knowledge of the Japanese textile industry would reveal that maintenance of our recent level of cotton exports may be questionable and any possibilities of increases are extremely limited.¹ Thus, by approaching the problem of our trade with Japan from the Japanese side, it is felt that a much sounder grasp of the trade situation is possible than would be obtained by a preoccupation with only our side of the picture.

It should be remembered that the population center of the world is in the Far East and consequently there also lies the largest potential market in the world, a market in which the Pacific Coast ports have a time and distance advantage over other United States ports. Yet, standards of living in the Orient are among the world's poorest. Poor countries are poor producers and poor customers. We here in the Twelfth District should have a vital interest in efforts to raise the standards of living and increase productivity in the Far East, for in the final analysis it will also mean an improvement in our own economic well-being and standard of living. It is perhaps ironical that this economic truism has for so long gone largely unnoticed and that it has finally been the political considerations coincident with the spread of communist imperialism that have brought us to recognize it. The Korean conflict has not changed materially the basic economic desirability of economic recovery and development in Japan in particular, and the Far East in general, but rather has served to point up its importance and to emphasize its urgency.

¹ This problem, while of long-run importance, is not of immediate concern to United States exporters of raw cotton in view of the small crop for the current season and direct Government controls on the export of cotton to assure a supply for defense and domestic needs.

PROBLEMS OF TRADE RECOVERY IN JAPAN

I. The Postwar Situation

For Japan, economic recovery and foreign trade recovery are virtually synonymous terms and one is impossible without the other. The United States has a vital stake in the revival of Japanese foreign trade. Most important, of course, is our general interest not only in the revival of Japan's trade, but in the revival of total world trade. More specifically, in the case of Japan there is in addition the very important fact that the Japanese occupation is costing the American taxpayer a considerable sum of money. To be exact, American aid to the Japanese people from the beginning of the occupation through March 31, 1950, amounted to \$1,778,000,000. Obviously, it would be to our advantage for the Japanese to become self-supporting at the earliest possible date.

Recently, the need for Japanese recovery has received a further urgent stimulus as a result of the Communist aggression in South Korea. Increasing production in Japan has now become a necessary adjunct to the carrying out of United Nations commitments in Korea. Japan is the main base for military and relief operations in Korea. The use of Japanese repair and supply facilities is essential, and they should be built up to a high point of efficiency. Any necessary materials that can be produced in Japan will save a long haul across the Pacific, and any services that can be rendered by the Japanese to United Nations forces will mitigate an American manpower shortage. Furthermore, Japan will now be able to supply United Nations forces and relief and reconstruction activities with necessary materials and services in return for United States dollars which formerly flowed to Japan on a gift or relief basis.

Politically speaking, the Korean conflict has made of vital importance the strengthening of Japan as a friendly area. Only 200 miles of sea separate Japan from the Union of Soviet Socialist Republics at the nearest point, and the main Pacific Russian base of Vladivostok lies only 450 miles across the Sea of Japan from the Japanese Islands. In addition, with a large part of the people of southeast Asia wavering uncertainly between communist and democratic allegiance, our accomplishments and failures in dealing with Japanese problems are being critically watched. If we are successful in rehabilitating Japan as an important trading nation under a free and democratic government, our influence in the Far East will be greatly strengthened and that of communism consequently weakened.

Japan even in prewar years was the most densely populated country in the world, if we measure density by the number of persons per square mile of arable land. This situation has been made more acute by the postwar increases in population and the loss of colonial sources of supply as a result of the war. Today, even under the most optimistic estimates, it is doubtful if domestic food pro-

duction could feed more than 65,000,000 of Japan's 82,500,000.¹ At the same time, possibilities of increasing domestic food production are extremely limited. Agriculture is one of the few sectors of the Japanese economy that has been returned to the prewar level. The techniques of intensive cultivation are well developed in Japan, and it is questionable if more than modest improvements could be made, and then only with large expenditures of capital and labor.

Thus, not only is the recovery of Japanese trade necessary for economic recovery, but it may truthfully be said that it is necessary for the survival of the Japanese people. Furthermore, in order to pay for these food imports Japan must export and in order to export she must import raw materials for processing. Japan, lacking indigenous raw materials, must pay for imports of food necessary to maintain her population primarily with the value added by her labor and capital equipment to imported raw materials. Japan's dependence upon imported raw materials for the prewar year 1936 is summarized in Table I.

TABLE I. JAPAN'S DEPENDENCE UPON IMPORTS OF RAW MATERIALS—1936

	Percent self-sufficient
Iron ore	16.7
Copper	63.2
Lead	8.2
Tin	28.8
Zinc	38.9
Bauxite	0
Sulphuric acid	14.1
Crude oil	20.2
Coal	90.9
Crude rubber	0
Salt	31.3
Phosphate rock	12.0
Raw cotton	0

Source: Jerome B. Cohen, *Japan's Economy in War and Reconstruction*, p. 111.

Prewar Japan held a dominant place in the Far East and she was able to pay for large imports of foodstuffs and raw materials by the export of manufactured products, by providing various services, and by the return on investments in the Asiatic areas that came under her control. Japan's most abundant resource was a large and well-disciplined labor force, but in addition she had other advantages. Large industrial concentrations such as the Mitsubishi and Mitsui interests were organized to engage in almost all lines of commercial endeavor. Japan possessed one of the largest merchant fleets, a world-wide banking system, and sufficient capital to purchase large amounts of raw materials at favorable prices. Also, it should be remembered that sizeable markets and sources of food and raw materials in Korea, Formosa, and Manchuria were under the direct control of Japan.

¹ The first postwar census taken in October 1947 revealed a total population of 78,627,000. Since that date Japan's population is estimated to have been increasing at the rate of 1,000,000 a year as contrasted to an annual increase of only 239,000 in 1940. The average annual birth rate per thousand population has increased from 31.2 for the prewar years 1932-36 to 34.5 for the period 1947-49. At the same time the average annual death rate per thousand population has decreased from 17.6 to 13.1 for the same periods.

With the end of the war in 1945 the economic position of Japan was drastically changed. Trade was virtually at a standstill, Japan's territory had been reduced to 43 percent of its former area, her merchant marine and also the other assets mentioned above had been destroyed. Over and above all of this was the physical damage to housing and industrial plant in Japan proper.

The index of industrial *activity* reached a low point of 48.6 in 1946 (1932-36=100) while the index of industrial *production* (which excludes the production of electricity and gas) was only 33.1 of the 1932-36 base. Table II traces the movement of production during the postwar period.

Occupation policies

While space does not permit a detailed analysis of the first five years of the Allied occupation, at least a passing reference should be made to the relationship between the occupation authorities and the Japanese government, and particularly to occupation policy as regards economic recovery.

Our occupation policies in Japan differ from our policies in Germany primarily in that there was no government at the end of the war in Germany, and the military government had full responsibility for all governmental functions. In Japan, on the other hand, the government continued to function though subject to orders from the Supreme Commander Allied Powers (SCAP). In other words, occupation policies have been carried out through the Japanese government and for the most part not directly by SCAP. This does not mean that Allied control has been any less complete but merely that we have ordered the Japanese government to carry out certain policies and reforms rather than carrying them out directly.

The final authority in Japan under the occupation is the Far Eastern Commission (FEC) consisting of the eleven countries which were the principal Allies in the war against Japan. In order to act, however, a majority vote of the members is necessary as well as the votes of the United States, United Kingdom, USSR, and China. SCAP, however, has been authorized to deal with "urgent matters" by issuing interim directives, and in fact most occupation policies have been put into effect in this manner. Such directives are referred to FEC for review after issuance but are to remain in effect unless FEC votes otherwise. Any attempt to change one of these directives is subject to veto by the United States, however. SCAP, therefore, has been unhampered in putting policies into effect with the exception of three reserved subjects on which a decision by the FEC is necessary. They are: questions concerning a change in the regime of control, fundamental changes in the Japanese constitutional structure, and a change in the Japanese government as a whole.

Initially, economic recovery was not stressed as a mission for SCAP, and the first two years of the occupation were characterized by extremely low levels of economic activity, and inactivity in economic matters on the part of

TABLE II. INDEXES OF INDUSTRIAL PRODUCTION AND ACTIVITY¹—
JAPAN, 1937, 1946-50
(1932-36=100)

	1937	1946	1947	1948	1949	June 1950 ^p
Industrial activity	143.0	48.6	57.1	74.1	93.5	109.6
Utilities	131.0	122.5	137.7	150.8	171.7	186.0
Industrial production ...	145.8	33.1	40.2	58.1	77.2	93.7
Mining	127.1	56.4	74.2	90.1	104.1	111.8
Coal	128.5	57.9	77.3	95.7	107.8	110.9
Manufacturing	147.8	30.6	36.4	54.5	74.2	91.6
Durable	173.4	41.0	48.6	75.2	100.7	110.9
Metals	147.1	16.1	26.5	48.7	87.8	128.6
Machinery	203.8	60.8	64.8	98.2	114.5	103.8
Stone, clay, and glass	141.8	23.1	34.6	50.2	84.3	105.6
Forest products..	140.8	65.8	87.8	100.6	107.3	90.2
Nondurable	131.0	22.4	27.0	38.1	53.4	78.1
Textiles	116.8	10.2	15.5	18.1	23.4	39.8
Chemicals	172.4	27.0	34.5	56.0	80.6	123.7

¹ Weighted by value added by manufacture. Industrial activity includes the production of utilities, which is excluded from the figure for industrial production.

^p—preliminary.

Source: SCAP, Economic and Scientific Section, Programs and Statistics Division, *Japanese Economic Statistics*, Bulletin No. 41, Feb. 1950, Bulletin No. 46, June 1950.

the occupation authorities. It became increasingly apparent, however, that the economic burden of occupation would grow intolerable if this passive policy on economic matters were continued. It was feared that Japan's dependence on United States relief appropriations might be continued indefinitely unless steps were taken to promote recovery of her trade. In April 1948, a committee which included Paul Hoffman and Undersecretary of the Army William Draper was sent to Japan to survey its economic problems. This committee recommended that Congress approve an economic recovery program for Japan, and that such a program should provide funds needed to restore the flow of necessary imports of raw materials. While this recommendation was not approved in its entirety, Congress did relax the restrictions on the use of funds appropriated and permitted their use to finance imports of raw materials.

In December 1948, SCAP issued a directive setting out a program for economic recovery and stabilization. This was followed in January 1949 by the arrival in Japan of an economic mission headed by Joseph M. Dodge, a Detroit banker, which was to plan and supervise the stabilization program. Shortly thereafter, a second mission headed by Carl Shoup, a Columbia University tax expert, was sent to Japan to set up an effective taxation system.

On the Japanese side, under SCAP pressure and encouragement, concrete steps have also been taken. In May 1948, the Economic Rehabilitation Committee, with the prime minister as chairman and the director-general of the Economic Stabilization Board as vice-chairman, was established to formulate a full-fledged program of economic rehabilitation. This program was published in May 1949. It set forth the minimum goals which must be reached to assure a self-supporting Japan by 1953, the date tentatively set for the termination of United States economic assistance.

Recovery problems

While the restoration of industrial production has been hindered primarily by the drastic reduction in imports of

raw materials, which will be discussed at a later point, there were, in addition, formidable physical problems of restoration and conversion. Physical destruction of plant may be conservatively estimated at 30 percent of over-all plant capacity, including war industry capacity that would be of limited usefulness for peacetime production. However, during the past five years considerable progress has been made and it is doubtful if operable capacity is a serious limiting factor today. Similarly, reparations in the form of removals of Japanese industrial potential had not been serious prior to 1949 when the United States made a unilateral announcement that no further reparations removals would take place. Since the effect of reparations was more psychological than real, the United States declaration undoubtedly had a significant effect on Japanese confidence.

In spite of many difficulties the recovery of production has been very encouraging. In June 1950, the index of industrial activity reached a postwar high of 109.6 percent of the 1932-36 average, and the index of industrial production (which excludes utilities) stood at a recovery high of 93.7. Table II above shows the movement of various production indexes for the postwar period. It should be remembered in using such indexes based on the 1932-36 period that there has been a 20 percent increase in population over the base period and allowance should be made accordingly.

From the end of the war through 1948, recovery in the Japanese economy was handicapped by severe inflationary pressures. Table III below shows the movement of "effective prices," that is, the weighted average of official and black-market prices of consumer and producer goods. The reason for the rapid increase in prices has been the result of a complex of factors which have involved, on the one

hand, an increase in the money supply resulting from an expansion in government debt and the note issue of the Bank of Japan and, on the other, an extremely limited supply of goods resulting from low levels of both production and imports.

To a large extent, at least in the early stages, Japan's monetary inflation was the result of either unwillingness or inability of the government to carry out a tax collection program to curb the excessive demand for the supply of consumer goods available. After the period of wartime stringencies, the government, unstable within itself, was unwilling to undertake unpopular programs. Coupled with this lack of will was the fact that the Japanese tax collection machinery was inadequate and the price control system ineffective. The ineffectiveness of the price control system reflected, in addition to a lack of competence in the government, an impossible supply situation. The effective food ration in Japan had been scaled down progressively, and by the end of the war was at a level below that necessary for minimum subsistence. The result was that the bulk of the Japanese families were forced to supplement their rations by resort to the black-markets where prices at one time were approximately 25 times the official prices. Expenditures for food constituted from 65 to 70 percent of total consumer expenditures. Rising prices, particularly black-market prices, created pressure for wage increases. Wage increases resulted in increases in the cost of production and led to demands for increases in official prices. The liberal attitude on the part of the government in granting price increases intensified the problem because it gave employers little incentive to resist wage demands. In addition, the government, through the Reconversion Finance Bank, followed a policy of granting loans to business firms to cover operating deficits, thus further reducing the incentive of employers to deny wage increases.

II. Recovery Measures

The Dodge program

Early in 1949, as indicated previously, the occupation authorities took the initiative in efforts to stabilize the Japanese economy. The economic mission from the United States under Joseph M. Dodge initiated a drastic deflationary program which included a sharp reduction in governmental expenditures (chiefly through a reduction in the outlays for price subsidies and through the dismissal of substantial numbers of governmental employees) and prohibited loans by the Reconversion Finance Bank. The result of the restriction of government expenditures and credits was to obtain a "super balanced budget" in which current revenue was sufficient to cover not only current expenditures, but also to retire a substantial amount of government debt.¹

¹ The national debt of Japan has increased from 178 billion yen in September 1945 to 506 billion yen at the end of the last fiscal year (March 31, 1950), this increase reflecting not only an increase in government services and reduced revenue, but also the rapidly increasing cost of providing government services during the inflationary period. For the fiscal year 1949-50, the Japanese budget was balanced. For the current fiscal year ending March 31, 1951, a retirement of 135 billion yen of debt is provided for. Eighty-five billion yen of the total will be provided for out of the general budget and the remaining 50 billion yen will come from counterpart funds (by sale of goods provided by United States grants).

TABLE III. INDEXES OF EFFECTIVE PRICES¹—JAPAN, 1946-49
(1948=100)

	Consumer goods	Producer goods
1946	27 ²	26 ³
1947	57	48
1948	100	100
1949	138	153
1949		
January	133	141
February	136	141
March	140	144
April	141	146
May	143	152
June	138	154
July	141	149
August	141	154
September	140	158
October	137	164
November	131	164
December	134	167
1950		
January	136	169
February	130	171
March	128	170
April	124	171
May	126	n.a.
June	124	n.a.

¹ Average prices used in the index calculations are those weighted according to the quantities purchased at official black-market or free-market prices.

² August to December only.

³ December.

n.a.—Not available.

Source: Statistics Department, Bank of Japan.

On the revenue side, the Dodge program has been supplemented and aided by the United States Tax Mission under Carl Shoup which arrived in Japan shortly after the Dodge group and undertook a program to revise the Japanese tax system. The Shoup recommendations, which were enacted with some modifications, constituted a comprehensive plan to make Japanese taxes more equitable and more easily enforceable. Enforcement has been improved through the efforts of SCAP's Internal Revenue Bureau.

In addition to a balanced budget, the Dodge program included the establishment of a Counterpart Aid Fund similar to that established in the European ECA countries. All proceeds from the sale of imports furnished under United States aid programs are to go into the Counterpart Fund, which is under the supervision of SCAP. Through the control of the flow of the counterpart funds back into the Japanese economy, either directly or through commercial banks, it is expected that an anti-deflationary weapon will be available in case deflationary pressures should accumulate faster than is considered desirable under the "disinflationary" program.

The final aspect of the Dodge program was the creation of a single exchange rate of 360 yen to the dollar, which was made effective on April 25, 1949. It is when we consider the exchange rate and prices that perhaps the real emphasis of the stabilization program becomes apparent. It is now fairly generally conceded that the primary objective is to reestablish the principle of competitive prices based on supply and demand or, in other words, a free-price system. From 1930 up to the time the SCAP reforms were undertaken the Japanese economy had been increasingly diverted from an economy in which the pricing system determines the allocation of resources. Prices were arbitrarily controlled for so long that the structure of relative prices has been highly distorted. The price of steel, for example, at one time was one-quarter of its cost of production, the balance being made up by a government subsidy. Wage rates held no relation to the supply and demand for labor, and the rate of interest had virtually lost all sensitivity. The result has been that the disequilibrium of the Japanese economy has been artificially maintained and aggravated.

Space permits but a brief reference to the controversy which has been raging in Japan over the Dodge program. On the question of stabilization, opposition to the program does not arise over the effectiveness of the program in arresting the upward spiral of prices. This is not a contested issue. For all practical purposes the Japanese inflation has been conquered, at least for the time being, as reference to Table III indicates. The difference of opinion exists primarily over the advisability of enforcing such a rigorous program of deflation in the face of such a low level of economic activity. The issue boils down to a question of whether the stability should come first and recovery later, or vice versa, the former view being the one currently applied.

On the question of encouraging free competition and the establishment of a free-price system, it is much too early to say whether or not it will have the desired effect of strengthening those industrial and commercial sectors that are required for the economic reconstruction of Japan. Commenting on this question, Shigeto Tsuru, formerly vice-minister within the Economic Stabilization Board and a recognized authority on postwar Japanese economic problems, has this to say:

"When the present 'disinflationary' program was launched early in 1949, the positions occupied by various industries or enterprises were by no means all alike; they stood, as it were, on an extremely zigzag starting line which gave advantages to those that had benefited from the many years of inflationary disequilibrium. In the long run the race would separate the economic from the wasteful, the efficient from the inefficient, the sound from the unsound, but in the short run it might redound to the advantage only of those that occupied favored positions on the starting line. Thus the question is how long the economy will be able to withstand the purgative period of 'disinflation' while at the same time performing the demanding tasks of reconstruction."¹

Foreign exchange rates

With regard to international transactions the problems have been complicated by the fact that during the war period there was no trade with the outside world and no effective exchange rate, with the result that many Japanese domestic prices had shifted so as to bear no relation to those outside. The adoption of a free exchange rate at the end of the war would have found some Japanese costs extremely low and others extremely high, with the result that some export industries would have come to a standstill while others already at full capacity would be fruitlessly stimulated. The easy solution through changing the exchange rate was ruled out by these extremes and also by the need for imported foods and raw materials. To depreciate in order to foster exports would have made essential imports prohibitively high in cost. Appreciation, on the other hand, while it would reduce the cost of imports, would at the same time close many export markets.

The initial decision by the occupation authorities was to continue the insulation of the domestic economy from world markets by a monopoly of exchange. All foreign trade was carried out in foreign currencies, and the yen paid and received by Japanese traders were handled through a special account under SCAP control which was supplemented by government grants. While no exchange rate existed prior to April 1949, there was, in effect, a multiple exchange system. For example, an application for an export permit would include a yen selling price and a dollar purchasing price and thus an implicit exchange rate was established. These yen-dollar rates differed for various types of commodities and varied all the way from 60 yen to the dollar to 900 yen to the dollar. In practice, the yen prices paid to exporters were intended to cover the cost of production, with the result that during

¹ Shigeto Tsuru, "Toward Economic Stability in Japan," *Pacific Affairs*, December 1949.

the inflationary period, with constantly rising costs, this procedure amounted to a continuous devaluation of the yen. Yen prices of imports, on the other hand, had no relation to the foreign purchase price and on the contrary were fixed according to the official price of similar indigenous goods. The large excess of imports, largely United States aid items, resulted in a considerable flow of yen into the foreign exchange account and thus made it possible to pay exporters at relatively high rates of exchange. Thus, the general pattern which resulted was one of very low rates of yen to the dollar on imports and, conversely, high rates on exports.

The actual effect of this system of implicit exchange rates was two-fold: a hidden or implicit counterpart fund was in existence long before the explicit counterpart fund was established in April 1949; this hidden counterpart fund was used to subsidize exports and imports.¹

This system of exchange rates and its hidden subsidies to exports frequently brought complaints of "dumping" from other countries, which may, or may not, have been justified in the technical sense. Furthermore, such a system was bound to bring complaints of discrimination between Japanese industries or enterprises. No matter how diligently SCAP applied this complex of rates, the impartiality with which the rates were established would be questioned by those producers who received relatively less favorable terms. It became increasingly apparent that such a cumbersome procedure was in itself undesirable, and moreover the tendency for yen prices to deviate further and further away from overseas prices would make it more and more difficult to establish a single rate of exchange the longer such a measure was postponed.

In April 1949, when the 360 yen to the dollar rate was set for all exports and imports, the implicit multiple exchange rates probably averaged about 100 yen to the dollar. The setting of this single exchange rate, therefore, constituted, in effect, a devaluation of the yen. In order to prevent hardships both to industries which were dependent upon imports and also to consumers, subsidies were applied out of the counterpart fund to prevent price increases or at least to cushion the increase which would result from the application of the new exchange rate.

The basis upon which the new exchange rate was calculated has not been revealed. One method, however, of estimating the correct or equilibrium rate of exchange between two currencies is to compare their relative domestic purchasing powers. That is, by comparing the purchasing power of the yen in Japan with the purchasing power of the dollar in the United States we can arrive at a ratio which will give us at least a crude measure of the correct rate of exchange. On the basis of such a measure the yen equivalent of the dollar would have been

¹ For example, if the theoretical equilibrium rate of exchange were 100 yen to the dollar, then an import item might be purchased abroad for \$100 and sold in Japan, not for ¥10,000, but for ¥5,000; while an export item might cost ¥5,000 in Japan and yet be sold abroad, not for \$50 but for \$30. The difference in each case constitutes a subsidy.

105 in 1946, 238 in 1947, and 406 in 1948.¹ While such a measure of purchasing-power parity is admittedly not conclusive, it nevertheless indicates that a devaluation was called for and also, perhaps, that a larger devaluation than the 360 yen to the dollar was indicated at that time.

The establishment of the single exchange rate was accompanied by considerable pessimism in certain quarters in Japan. However, a surprisingly large number of industries adjusted rapidly to the new costs indicating that there had been considerable profit margins under the old system. Nevertheless, there has been increasing pressure in Japan for a further devaluation of the yen or additional subsidies, and the wave of devaluations which accompanied the devaluation of sterling in the autumn of 1949 has been used as an additional argument.

III. International Trade

Changes in the pattern of Japanese trade in the postwar period

Looking at Japan's postwar trade as compared to prewar trade we see that there have been fundamental changes in both the geographic and commodity patterns. The balance of merchandise trade and its geographic and commodity distribution are summarized below in Tables IV, V, and VI. During the prewar period the countries of Asia accounted for over half of Japan's imports and exports. Since the war, on the other hand, Asia has been taking nearly as large a proportion of Japan's reduced volume of exports, but has contributed a much smaller proportion of her imports. The most significant shift obviously has been the increased importance of the United States as a source of imports. It is this shift which has greatly aggravated Japan's balance of payments problem. There has, however, been considerable improvement on this score. While in 1946 the United States supplied 97.5 percent of Japan's imports, this percentage had decreased to 64.2 percent by 1949.

Fundamental dislocations in the commodity composition of Japan's trade also are apparent. Before the war, approximately 75 percent of Japan's imports represented raw materials for her industry; since then, only 45 percent of Japan's imports have consisted of industrial raw materials. Food imports, on the other hand, have become relatively more important. In the postwar period, Japan's food imports have accounted for approximately 50 percent of the total, in contrast to 20 percent in the prewar period.

Measures taken to increase trade

During the initial period of the occupation, Japan's ability to import was limited to the amount of United States aid, which has been approximately \$430,000,000

¹ Figures quoted were computed by Shigeto Tsuru and appear in the source previously cited. Purchasing-power parity between the yen and the dollar was arrived at by taking the ratio of the effective price index in Japan (weighted index of official and black-market prices) to the United States cost-of-living index, both rebased on the 1932-36 average and multiplied by 3.42 yen, which was the average yen-dollar market rate in this base period.

TABLE IV. JAPANESE MERCHANDISE TRADE
(millions of United States dollars)

	Exports	Imports	Import balance
1930-34 (average)	717.0	774.6	57.6
1937	1,205.9	1,372.1	166.2
1946 ¹	103.3	305.4	202.1
1947	173.6	526.1	352.5
1948	258.3	682.6	424.3
1949	511.0	901.7	390.7
1950 (Jan.-June)	322.2	454.0	131.8

¹ September 1945 through December 1946.
Source: U. S. Department of Commerce, *Foreign Commerce Weekly*, December 26, 1949, September 18, 1950.

annually.¹ These imports constituted food imports for the main part, and up to June 1948 the only appreciable imports of raw materials consisted of cotton from the United States. These cotton shipments were financed by a revolving fund credit between SCAP and the Commodity Credit Corporation. While expectations were that this measure would be of great assistance in promoting Japan's trade recovery, the results actually were disappointing. The primary reason was that SCAP was required to repay the loan to the CCC in dollars, although exports of finished cotton manufactures to the United States were prohibited, while at the same time Japan's customary textile markets in the Far East were experiencing a serious dollar shortage and could not make dollar payments. A rapid decline in Japanese textile exports in the last quarter of 1947 led to an agreement which permitted Japan to sell cotton textiles for sterling and other soft currencies. At the same time it was realized that if Japan's dependence upon United States relief was not to be prolonged indefinitely, steps would have to be taken to increase Japanese exports. As a result of this belated realization, \$50 million of United States aid to Japan was allotted during the fiscal year ending June 30, 1949, for the specific purpose of purchasing needed raw materials for Japanese industry. For later periods increasing amounts were earmarked for raw materials procurement.

One of the most important factors in the recovery of Japan's trade thus far has been the negotiation of a series of trade agreements. The first of these agreements was a payments agreement with the sterling area signed in August 1948. This agreement provided for the settlement of balances in dollars at the option of the creditor at six-month intervals. Subsequently, trade agreements have been negotiated with 17 other countries, for the most part bilateral barter agreements, and a second sterling agreement has been concluded. In view of the difficulties coincident with the non-convertibility of currencies, these trade agreements have been very important in expanding the volume of Japanese trade. It is true of course that the

¹ Total United States aid to Japan during the occupation (in millions of dollars):

	Grants	Credits	Total
1946	188	121	308
1947	450	75	525
1948	388	20	408
1949	426	48	474
Total	1453	263	1716

necessity of a bilateral balancing of trade has limited the scope of trade. Also, the fear of accumulating a deficit which would have to be settled in dollars has tended to increase trade controls rather than decrease them. Only among the participating countries in the sterling area is there some scope for an increase in Japanese multilateral trade. Nevertheless, as an expedient it has been very successful, as illustrated by the fact that 68 percent of Japan's total exports in 1949 went to countries with which trade agreements have been concluded, while at the same time 30 percent of her imports have come from these sources.

Trade prospects

The problems associated with increasing the flow of raw material imports in order to stimulate exports are in reality not only a matter of increasing the absolute level, but also of finding sources of raw materials other than the United States and thus eventually alleviating the dollar problem. Although, during the prewar period Japan's imports of cotton and petroleum from the United States were financed by exports of silk and shipping services to the United States, it is extremely doubtful if this balance can once more be established. While an expansion of other exports to the United States is certainly possible, it does not presently appear that they can reach the necessary volume. This expansion and development of alternative sources of raw materials logically should take place in Japan's natural trading area in the Far East. Unfortunately, the development of trade with Southeast Asia is handicapped by the delays in establishing stability and economic recovery in that area. In the case of the Communist areas of the Far East, the growth of trade is contingent upon political developments. Revival of Japanese trade with China and Manchuria is particularly critical in Japanese recovery plans. A reference to Table V will indicate the importance of China, Manchuria, and Kwantung for the prewar year 1937. This area took approximately 20 percent of Japan's exports and supplied 10 percent of Japan's imports. In addition, imports from this area were of great strategic importance, particularly in the case of high grade coking coal. Since the end of the war, with its customary supply of coal from Kailan in North China cut off, Japan has had to go as far afield as Norfolk, Virginia, to obtain necessary supplies. A small amount of Kailan coal has started to flow into Japan as a result of a barter trade agreement with Communist China, but the amount is far less than that which is needed. The difficulty with present arrangements with Communist China has been the fact that the Chinese have demanded steel and other potential war materials in exchange for their coal, the export of which has been prohibited by the occupation authorities. The prospects for Japanese-Chinese trade are exceedingly poor, and the few favorable developments, such as the above-mentioned coal agreement have been more than offset by the Korean incident. Some solution to the problem of restoring this

TABLE V. GEOGRAPHIC PATTERN OF JAPANESE TRADE, 1937, 1946-50
(percent of total value)

	Exports						Imports					
	1937	1946 ¹	1947	1948	1949	Jan.- May 1950	1937	1946 ¹	1947	1948	1949	Jan.- May 1950
North America	15.8	75.0	11.8	26.5	18.3	27.6	28.8	97.5	91.9	76.2	65.6	50.1
United States	15.3	75.0	11.6	25.4	16.4	24.4	26.6	97.5	91.9	64.7	64.2	46.2
Other	0.5	..	0.2	1.1	1.9	3.2	2.2	..	..	11.5	1.4	3.9
Asia	60.6	23.5	57.0	51.7	50.7	49.6	46.5	2.4	5.8	14.4	18.1	30.0
Korea	17.6	14.3	10.9	6.9	3.1	3.1	12.0	0.1	0.5	0.7	0.4	2.4
India and Pakistan	7.1	..	4.9	3.5	16.0	2.2	9.4	..	1.9	4.1	3.2	2.4
Formosa	6.6	4.6	5.9	1.6	0.6	5.8	8.6	1.6	1.0	3.6	2.4	8.1
Manchuria	5.2											
Kwantung	9.5											
China	4.3											
Indonesia	4.8											
Malaya	1.7	..	2.4	2.4	2.9	0.4	2.8	..	1.0	1.6	2.3	1.2
Hong Kong	1.2	3.8	8.1	6.7	5.4	3.2	0.1	0.7	0.8	0.5	0.1	..
Other	2.6	0.8	11.3	8.7	15.5	20.3	1.3	..	0.4	2.2	5.4	9.7
Europe	7.2	1.0	23.2	12.2	15.6	11.4	7.9	0.1	2.2	3.3	7.6	3.7
United Kingdom	4.0	1.0	11.7	6.4	8.3	3.3	2.2	0.1	1.7	0.8	0.6	0.6
Other	3.2	..	11.5	5.8	7.3	8.1	5.7	..	0.5	2.5	7.0	3.1
South America	2.6	..	0.1	0.7	0.6	2.0	3.5	..	..	2.0	0.8	4.4
Africa	3.7	..	5.0	7.7	11.5	6.3	4.1	..	..	2.8	4.7	3.2
Australasia	2.1	0.5	2.9	1.2	3.3	3.1	4.5	..	0.1	1.3	3.2	8.6
Not classified	8.0	..	..	..	..	..	4.7	..	..	..	..	..
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

¹ September 1945 to December 1946.

Sources: U. S. Department of Commerce, *Foreign Commerce Yearbook*, 1948, and *Foreign Commerce Weekly*, Dec. 26, 1949. SCAP, Economic and Scientific Section, *Japanese Economic Statistics*, Bulletin No. 46, June 1950.

natural trade must be found for full economic recovery to take place in Japan, and pending more favorable developments in the political sphere, recovery efforts will be under an appreciable handicap.

With respect to food imports, and particularly the development of alternative sources for United States food imports, an additional problem is presented by the fact that many of the former food surplus areas in the Far East also have to contend with the problem of swollen populations and may in fact find that even with increases in production, they no longer have food surpluses available for export. This is not to say that sufficient potential food production does not exist, but rather that a considerable length of time will undoubtedly lapse before many of these areas will be able to export food to Japan in any quantity. The situation has been made even more unfavorable by recent developments in Korea and Formosa, two of the most important of Japan's former food suppliers. Just prior to the Communist attack, South Korea had sent its first postwar shipments of rice to Japan. Needless to say, even with an early end to the hostilities, it will be some time before production can be restored. Formosa, with her population greatly swollen by Nationalist refugees and military personnel, and with the possibility of attack by the Chinese Communists, must be ruled out for the present as an important source of food for Japan.

It is hardly necessary to go into detail on the problems which stand in the way of rehabilitation of the various Far Eastern countries. The usual statement of the situation which runs in terms of the upsurge of nationalism, political unrest, Communist aggression, and so forth, is quite well known. However, there is one obstacle to recovery in this area—particularly Southeast Asia—which all too seldom is given consideration. This factor is the destruction of the former network of commercial

and financial interconnections which facilitated trade between Japan and the rest of the area.

It has not been appreciated how seriously the former political, administrative, and commercial framework was damaged by both the Japanese conquest and the period of unrest and strife which has followed. This general breakdown of administrative machinery has been reflected in the inability of the new central authorities to restore law and order, and the wholesale resort to currency inflation which in large part reflects the inability to raise revenue by taxation. Added to this should be the consequences of the large-scale removal or departure of key technical and administrative personnel in many of these countries.

While United States programs of assistance have played an important role in postwar Far Eastern trade, such assistance has been on an individual country basis, with separate programs for Japan, Korea, the Philippines, China, and Formosa. An over-all program for the Far Eastern area is being advocated in many quarters, including our State Department, Japan, and the British Commonwealth. Furthermore, it is generally accepted that the area needs a long-range development program rather than short-run aid in recovery. The program would be tailored to the needs and limitations of the area. In any such program of recovery Japan could play a key role, contributing as her share manufactured products and capital equipment, and in turn providing a market for raw materials and foodstuffs. Such a revival between Japan and the rest of the area would result in a general increase in production and, therefore, in the ability to expand trade with European and American areas. This revival would help to alleviate the worldwide problems presented by the existing imbalance of world trade.

TABLE VI. COMMODITY COMPOSITION OF JAPANESE TRADE
(percent of total value)

	Exports					Jan.- May 1950
	1937	1946 ¹	1947	1948	1949	
Textile fibers and manufactures ²	32.3	59.2	72.8	56.5	51.4	50.0
Coal	0.6	9.6	4.7	4.3	1.1	1.1
Machinery	4.1	0.9	4.1	5.0	10.5	7.5
Metals and ores	5.2	14.1	2.8	5.8	13.3	18.7
Other exports	57.8	16.2	15.6	28.4	23.7	22.7
Total	100.0	100.0	100.0	100.0	100.0	100.0
	Imports					
	1937	1946 ¹	1947	1948	1949	
Food and products	18.5	55.8	56.1	46.4	40.3	46.4
Textile fibers and manufactures	26.7	34.7	15.7	22.2	23.4	31.3
Petroleum and products..	6.5 ³	3.4	7.2	7.6	6.0	5.3
Fertilizer and fertilizer materials	2.4	3.1	12.8	5.7	4.7	6.3
Salt	0.6	1.5	2.3	3.8	n.a.	n.a.
Ores and metals	21.8	n.a.	0.1 ⁴	1.8 ⁴	5.8	2.1
Other imports	23.5	1.5	5.8	12.5	19.8	8.6
Total	100.0	100.0	100.0	100.0	100.0	100.0

¹ September 1945 to December 1946. ² Cotton yarn and fabric, raw silk and fabric, and rayon yarn and fabric. ³ Oils, fats, and waxes. ⁴ Iron ore only. n.a.—Not available.

Sources: United States Department of Commerce, *Foreign Commerce Yearbook*, 1948; Office of International Trade, *International Reference Service*, "Economic Review of Japan, 1948 and 1949;" SCAP, Economic and Scientific Section, *Japanese Economic Statistics*, No. 46, June 1950.

Conclusion

Specifically, what are the areas of possible expansion of Japanese trade? It would seem logical for Japan to concentrate in the production of commodities which use relatively large amounts of her most abundant factor, labor. It would further appear that the textile industry would be particularly well suited. Textiles constituted Japan's most important prewar export and during the postwar period have resumed this position of relative importance although at a much lower absolute level. In 1949, textiles constituted 51 percent of Japan's total exports. Unfortunately, however, Japan's textile industry, while formerly its most important, is now the weakest spot from a recovery standpoint. As Table II shows, the index of textile production in 1949 was only 23.4 percent of the 1932-36 average, far below that of any other major industry.

Textiles undoubtedly will continue to play an important role in Japanese export trade, but it is doubtful if prewar outputs can be reached. On the contrary, a declining relative importance of the textile industry should be anticipated. Table VI indicates that textile exports have

decreased from 72.8 in 1947 to 50 percent for the first five months of 1950. Possibilities of expanding the silk industry are limited by the competition of synthetics. The production of rayon, of which Japan was the world's largest producer in the prewar period, has been established and entrenched in many countries of the world, particularly in Europe. In the case of cotton textiles, the significant fact is that nearly all of the "underdeveloped" countries, in which Japan normally has had her best markets, have themselves plans for the development of their own cotton textile industries. As these countries carry forward plans for diversification and industrialization, the textile industry will be given first priority, and as a consequence Japan's markets will shrink.

A much more promising effort, and the one currently being emphasized, would be for Japan to concentrate on heavy industry, steel, machinery, and chemicals. Japan's natural trading area in the Far East provides a ready market for such industrial goods, and this area is at present prevented from obtaining such goods in desired amounts from the United States because of shortages of dollar exchange. Japan's transportation advantage should also place her in a strong competitive position over European producers. Such a development would be mutually beneficial, because most of the raw materials for the production of such industrial goods could be obtained within the Far Eastern trading area in which she would in turn sell her finished products.

In appraising Japan's immediate situation, it is probable that with greatly increased labor costs and other production costs, Japan may very well have lost her competitive advantage in low-priced consumer goods. She has also lost her former special advantages of cheap shipping and centralized banking and marketing facilities. At least for the present, Japan might well concentrate on relatively low-priced machinery, machine tools, and other durable capital goods needed by other Far Eastern countries in undertaking programs of economic development. By so doing, not only would Japan's economy benefit, but also current efforts to raise the standard of living in the Far East, under the United Nations and the United States Point IV programs, would be materially assisted.