Cabinet

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SAN FRANCISCO

Monthly Review

In this issue

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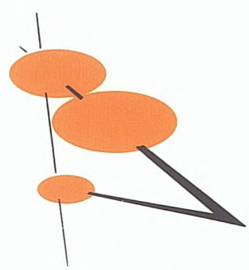


July 1971

Rising Sun, Expanding Trade

. . . Whatever the state of the debate over Japan's economic policy, there is no arguing about the facts of its trade boom.

Government: People and Pay

. . . About 18 percent of all nonfarm civilian workers are employed by government agencies — mostly by state-and-local agencies.

***Editor:* William Burke**

Rising Sun, Expanding Trade

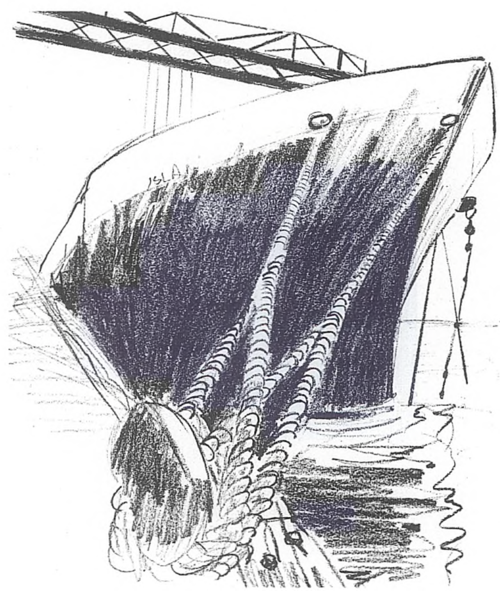
Although Japan escaped the international financial crisis of last May, it is now facing a problem of its own in its economic relations with the U.S. and Western Europe. The problem centers around Japan's spectacular export expansion, which has led to large and continuing balance-of-payments surpluses and a rapid growth in its exchange reserves.

Japan's favorable trade position, critics say, has been brought about through its highly coordinated economic system, which combines some significant import restrictions at home with an aggressive sales effort abroad. However, it should be added that the Japanese economy has also obtained a competitive advantage through its emphasis on high technology and product quality, along with its dedication to high rates of investment and productivity growth. Japan is concerned lest complete liberalization of its own sizeable market be demanded as the price of continued unhampered access to the U.S. market. This issue is particularly sensitive in the political context of the Senate debate over the future status of Okinawa. Reductions in Japanese import controls have taken place, to be sure — though more may still remain than in most other industrialized countries. The question is how fast and how far such liberalization should proceed in a world that quite generally hesitates to adopt a completely free trade policy.

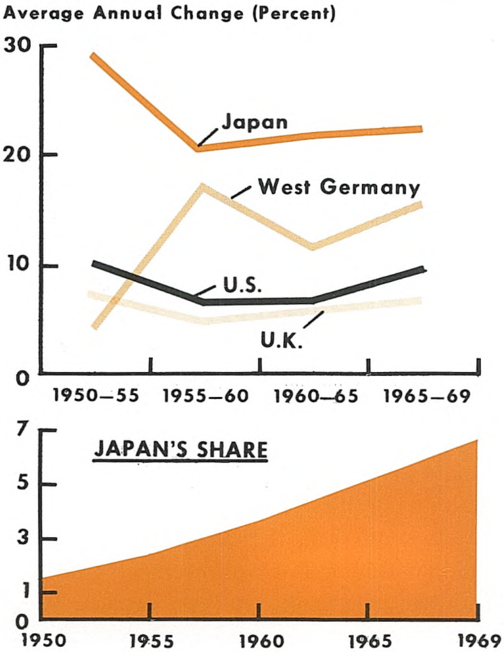
Japan also is disturbed by an apparent climate of distrust in Europe, created perhaps by a belief that a flood of Japanese products will descend upon European markets if U.S. trade barriers are raised against those products. But whatever the state of the current debate, there is no argument about the facts of Japan's trade boom.

With $19 billion in merchandise exports in 1970, Japan is the world's fourth largest exporter. For two decades Japan has outstripped the world's other major trading nations in rate of export growth, while its imports have grown at a slightly lower rate. Its export trade began to boom in the early 1950's — thanks both to the inevitable post-World War II recovery and to the stimulation of Korean-war spending — and the boom has continued almost without let-up ever since. Between 1965 and 1970, exports expanded at an 18.0-percent average annual rate.

Consequently, Japan's share in the export trade of the non-Communist world jumped from 1.5 to 6.6 percent over the past two decades. West Germany similarly increased its share from 3.6 to 12.0 percent in the same time-span, while in contrast, the U.S. share dropped from 18.6 to 15.6 percent, and Great Britain's share from 11.5 to 7.2 percent.



Japan outpaces its trade rivals to gain larger share of world trade



Large payments balance

Japan's export drive has helped it gain a large surplus in its international accounts in recent years. The current-account balance — the balance on goods, services and unilateral transfers — exceeded $2.0 billion in both 1969 and 1970. The basic balance — the balance on current account and long-term capital — reached $2.0 billion in 1969, but then fell to $0.4 billion dollars in 1970 because of increasing long-term investment outflows.

The substantial balance on merchandise trade was the major cause of this sharp improvement in Japan's balance of payments. The merchandise-trade balance reached $4.0 billion in 1970 — more than twice the level of the 1965-68 period, and in sharp contrast to the sometimes substantial import balance of earlier years.

Japan has run an ever-increasing deficit on services during the last decade. The figure reached $1.8 billion in 1970 as debits exceeded five times the level of a decade ago, reflecting increased outlays for transportation and insurance. At the same time, it has run a consistent modest deficit on transfers over the same period. In this connection, Japan has benefitted from substantial U.S. military expenditures during the last two decades, with receipts last year reaching $661 million, the largest amount since Korean War days. Altogether, Japan has received $10.4 billion in U.S. military expenditures since 1948, plus $2.1 billion in economic aid in the 1945-51 period.

The basic balance has been affected by substantial long-term investment outflows in recent years, offsetting to some extent the large merchandise-trade balance. Net capital outflows had been relatively modest in most earlier years, but jumped to $1.6 billion in 1970, double the highest earlier figure (1967). The outflows have been associated with increased trade credits, loans and direct investment abroad.

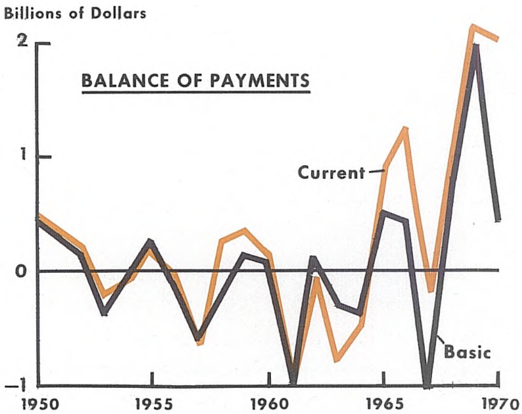
Thriving import trade

A substantial import trade, of course, has been necessary to support the thriving export trade, and to supply a rapidly growing domestic economy which is exceedingly poor in basic resources. Last year, imports provided 99 percent or more of the domestic supply of iron ore, crude oil, bauxite, rubber, cotton and wool, and Japan remains seriously dependent upon many other basic raw materials as well.

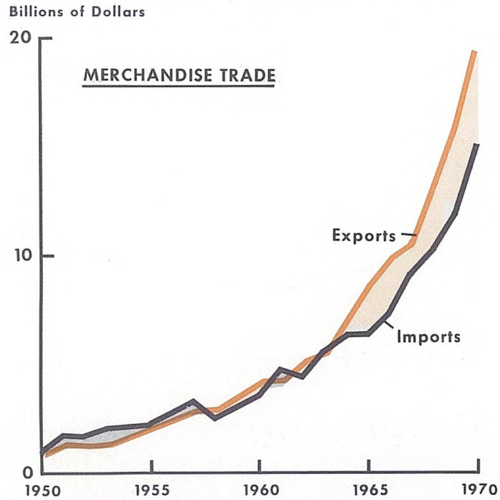
Japan's merchandise imports quadrupled in dollar terms over the past decade to $15.0 billion (f.o.b.) in 1970. Imports of some basic raw materials, such as iron ore, wood, crude oil, and coal increased at a much faster pace in both volume and value terms, while imports of other materials, such as natural rubber, wool and cotton increased at a relatively modest pace.

Food, fuels, ores, wood and machinery increased more than proportionately to Japan's total imports over the past decade. Altogether these categories accounted for 49.8 percent of the total in 1960 and 66.8 percent in 1970. Food imports were up from 12.2 to 13.6 percent of

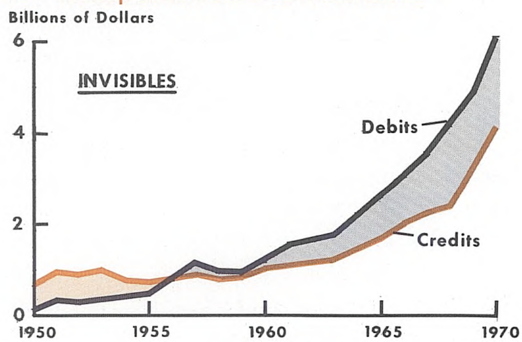
Japan's balance of payments improves sharply in recent years



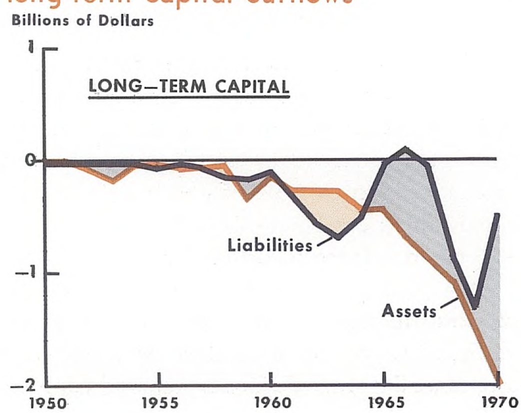
. . . largely because of recent accelerated pace of export trade



. . . offsetting expanded outlays for transportation and insurance



. . . as well as substantial long-term capital outflows



total imports, despite Japan's increasing self-sufficiency in rice. Fuels were up from 16.5 to 20.7 percent, and lumber and metal ores (except scrap metal) increased from 14.7 to 25.3 percent. In contrast, the share of textile fibers dropped from 17.6 to 5.1 percent over the past decade, reflecting a trend toward increased use of synthetic fibers, and industrial raw materials as a group (excluding lumber and ores) slipped from 20.1 to 10.2 percent of the nation's total imports.

Japan diversified its trading pattern somewhat over the past decade as two major sources, the United States and Southeast Asia, suffered declines in market shares. These shifts reflected a redirection of coal purchases to Australia, of oil purchases to the Mid-East and the U.S.S.R., and of machinery purchases to Western Europe.

The U.S. accounted for 34.6 percent of Japan's imports in 1960, but for 29.5 percent in 1970. The Southeast Asian nations saw their share drop from 20.4 to 16.0 percent over the same period. Larger shares, however, were gained by Western Europe, the Communist nations and the Mid-East oil countries. The share of the EEC-EFTA countries rose from 8.2 to 9.9 percent, the Communist nations from 2.8 to 4.7 percent, and "other Asia" from 9.5 to 12.1 percent.

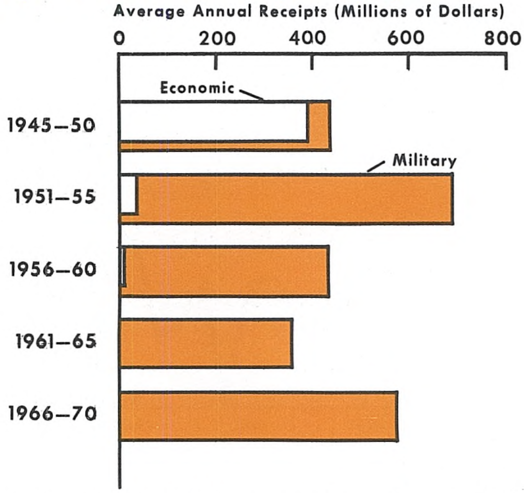
Despite its reduced share of the Japanese market, the United States still ranks as Japan's dominant foreign supplier and a still growing supplier in absolute terms. U.S. merchandise exports to Japan increased sharply over the past decade, from $1.5 billion in 1960 to $4.7 billion in 1970. At the same time, this flow makes Japan the second largest market for U.S. products, accounting for one-tenth of total U.S. exports in such categories as lumber, coal, cotton, petroleum products, wheat, soybeans, feed grains and business machinery. And in many areas its purchases are increasing dramatically; last year alone, U.S. sales to Japan of such products as aircraft, coal, cotton and computers increased by 60 percent or more.

Even so, Japan now relies upon an increasingly diverse number of countries for its import needs. Canada provides nonferrous metal scrap, wheat and lumber, while Western Europe provides pharmaceuticals, machinery and other high-technology products. Southeast Asia (especially Malaysia, Singapore, the Philippines and Indonesia) provides primary products, such as lumber, iron ore and crude oil. Australia, which is second only to the U.S. as a major supplier, provides wheat, wool, iron ore and coal. Latin America, especially Mexico and Brazil, provides cotton, sugar and ores, and South Africa sells corn, iron and copper ores, and pig iron. In addition, the U.S.S.R. supplies lumber and metals, and China provides soybeans, coal and iron ore.

Thriving export trade

Japan's merchandise exports almost quintupled over the past decade to $19.0 billion (f.o.b.) in 1970. As the shifts in Japan's import composition indicate, the structure of its export trade has changed significantly — away from such traditional industries as textiles and towards such sophisticated durable-goods industries as metals and machinery. To be sure, textile exports doubled in value over the past decade, but the growth was concentrated in synthetics, while exports of cotton, silk and rayon fabrics dropped at least two-thirds in volume terms. In striking contrast,

U. S. military (formerly economic) spending bolsters Japan's payments



steel exports and ship exports jumped seven-fold in tonnage terms, and the number of automobiles exported increased 22 times.

Textiles accounted for 30.2 percent of Japan's export value in 1960, but for only 12.5 percent a decade later. The metals share rose from 14.5 to 19.7 percent, the machinery-equipment share from 16.5 to 32.1 percent, and the transportation-equipment share from 9.0 to 14.2 percent. Last year the export trade took 76 percent of Japan's total production of ships, 67 percent of its sewing-machine production, 49 percent of its synthetics, 48 percent of its cameras, 43 percent of its TV sets and 21 percent of its motor vehicles.

Japan's export trade similarly has shifted toward the major industrial nations and away from the less-developed countries. Southeast Asia's share of Japan's exports has dropped from 32.2 to 25.4 percent over the past decade, and Latin America, Africa and the Middle East have also suffered a relative decline. Meanwhile, the U.S. share has risen from 27.2 to 30.7 percent over the ten-year period, and Japan has also increased its exports to the Western European market, from 9.9 to 12.2 percent, and to the Communist nations, from 1.8 to 5.4 percent of total exports.

Japan's merchandise exports to the U.S. market soared from $1.2 billion in 1960 to $5.9 billion in 1970. Exports of textiles and iron-and-steel products, formerly dominant in U.S.-Japan trade, have had a limited growth in recent years, partly because of "voluntary" quotas on Japanese imports into this country. Japanese textile products accounted for only 1.3 percent of total U.S. textile consumption last year — although making up a substantial share of certain submarkets — and over time have accounted for a declining share of U.S. textile imports. On the other hand, exports of other products to the U.S. market have increased sharply in recent years. As a result, the U.S. now takes one-third of Japan's exports of autos, one-half of its radio and electronic-calculator exports, and almost all of its color TV exports.

Canada buys iron and steel, autos, clothing and machinery from Japan, while Western Europe takes ships, iron and steel, textiles and radios. The East Asian nations, primarily South Korea, Hong Kong and Taiwan, are heavy buyers of finished goods, such as steel, vehicles, synthetic fabrics and fertilizers. Australia, which buys more than it sells to Japan, is a major purchaser of motor vehicles, steel and consumer goods.

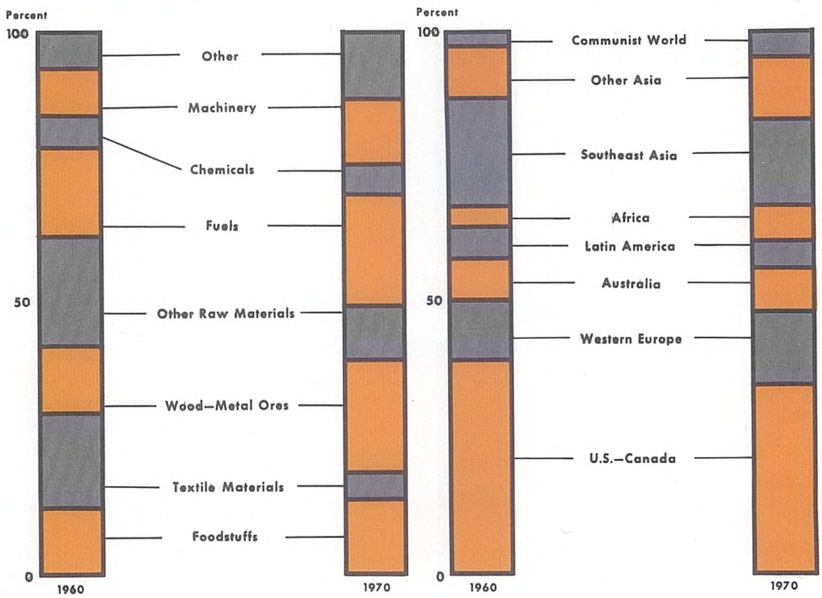
Latin America purchases machinery, ships and vehicles, and South Africa buys textiles, machinery and clothing. Liberia, as a "flag of convenience" nation, is a major ship purchaser. The U.S.S.R. buys clothing and iron-and-steel products, while China purchases steel, machinery and chemical fertilizers. (Because Japan does not have diplomatic relations with China, trade is conducted through a "memorandum trade" agreement renewable each year between a private Japanese delegation and the Peking government.)

Much attention has been paid to the causes of Japan's super-rapid growth of production and trade, which has resulted in an average annual growth rate of 11 percent in real GNP, twice that of most other industrial nations. Among other factors, the expansion has benefitted from the nation's intense attention to savings and investment flows. With the aid of an extraordinarily high savings rate, policymakers have directed a rising share of GNP to capital formation, and with the imaginative use of new (foreign and domestic) technology, they have directed investment funds into the most advanced modern industries.

Growth: import policy

The very rapid expansion of manufacturing industries has created a heavy reliance on foreign trade to provide the necessary raw materials, and

Food, fuels, ores, wood, machinery account for rising share of Japan's imports . . . U.S. suffers declining market share



increasing raw-material imports have required an expansion of exports to pay for such imports. At the same time, policymakers have developed a number of measures to support the export expansion and to channel the flow of imports.

Japan's import policy in the past two decades has been marked by a gradual move from restrictionism to liberalization. Still, one constant feature has been the import-licensing system operated by the Ministry of Finance and the Ministry of International Trade and Industry (MITI). Under international pressure, however, Japan over the past decade has begun to liberalize this process by lifting direct quantitative controls for many imports.

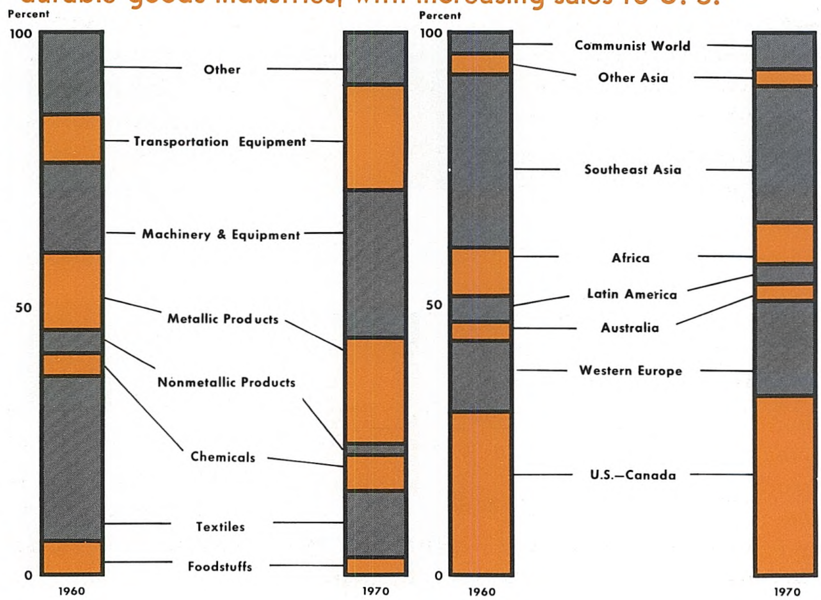
Tariff policy has been another major element in the overall trade plan. Since the development of the 1951 tariff, duty-free entry has been permitted essential raw materials, but a high schedule of tariffs has been set for a wide range of manufactured goods. The import-liberalization plan of 1960 did not entail tariff changes; instead, the government continued to utilize tariffs as a protective device for domestic industries, despite the reduction of some levies during the Kennedy round.

More recently, however, with the sharp expansion of Japan's foreign-exchange reserves — from $2 billion to $6 billion in the past 3½ years alone — and with the increasing foreign criticism of Japanese restrictionism, Japan has liberalized its import policy somewhat further. By October of this year, its remaining import quotas are scheduled to be reduced to levels comparable to those of West Germany. Tariffs also have been cut substantially this spring, with large reductions on almost 2,000 dutiable items, although such reductions are not required under Kennedy-round negotiations until 1972. Indeed, according to Japanese Ambassador Ushiba, "With the rapid dismantling of our quota restrictions, and the further reduction of our tariffs, Japan is probably as open a market as the U.S. is today and in some areas, such as textiles, it is far more open."

Growth: export policy

Japan's export-promotion drive has included a number of devices — tax deductions on income earned from exports, special interest rates on short-term export bills discounted by the Bank of Japan, and favorable terms on long-term export financing by Japan's Export-Import Bank. The government also provides insurance on several types of risk for which private insurance is unavailable, and through the semi-independent Japan External Trade Organization (JETRO), provides exporters with marketing, advertising and public-relations services.

Structure of export trade shifts toward sophisticated durable-goods industries, with increasing sales to U. S.



To carry out export-expansion plans, MITI constantly confers with company representatives about the allocation of resources, and through "administrative guidance" even sets minimum sizes for industrial plants. The Ministry of Finance, through the Bank of Japan, meanwhile funnels funds to areas with the highest growth potential. Thus, government policies work to concentrate new investment in those areas where world demand is highest — for example, heavy machinery, chemicals and high-precision products. Also, by backing the extremely high use of corporate debt to finance growth, the Ministry of Finance and the Bank of Japan play a key part in setting the pace and direction of expansion, and thereby help stabilize a business system devoted to high growth.

Since Japanese companies normally finance their expansion plans by borrowing about 80 percent of their total capital, debt service is a major operating cost. Moreover, Japan's paternalistic labor policy fosters an unusually dedicated and productive work force with little turnover and few layoffs, so that labor costs are more nearly a fixed charge than in most other countries. With a high break-even point set by such fixed labor costs and debt costs, new facilities are operated at capacity and products are moved into the world market at low prices. Moreover, about 10 percent of total exports are financed by government bank credits at low interest rates.

Japan's foreign trade is dominated by a number of general trading companies, the ten largest of which handle two-thirds of the nation's imports and one-half of its exports. These trading firms mobilize the combined forces of manufacturers, banks and government agencies, and are day-to-day leaders in Japan's trade drive overseas. Also, export cartels sanctioned by MITI are formed by domestic competitors to limit competition among Japanese firms in overseas markets.

Growth: investment policy

Trade policy is increasingly supplemented by investment policy, designed both to protect sources of supply and to expand export markets for Japanese products. To obtain access to import sources, Japan invests in forest land in Alaska, oil-drilling sites in Saudi Arabia, copper mines in Canada, Peru and the Philippines, iron-ore sites in Malaysia and Chile, and coal mines in Australia. To get around the threat of restrictions on Japanese exports, Japan puts manufacturing plants in low-wage countries, such as auto-assembly plants in Thailand, Mexico and Brazil and textile mills in Korea, Taiwan, Thailand, Malaysia, Singapore and Brazil.

Japan has pledged to raise the level of "economic cooperation" aid to the less-developed countries from the recent level of $1 billion to $4 billion by 1975. However, the move towards increased foreign assistance is closely related to Japan's export-promotion drive. Today, export credits account for about one-half of the level of aid payments.

Japan's position today is not completely enviable, since it is faced not only with a counterattack against its foreign-trade offensive, but also with new and difficult problems in terms of its domestic economy. At home, the nation is undergoing a Japanese-style recession — a reduction in the growth rate to levels which other countries would label a boom. At the same time, it is encountering substantial increases in cost associated with its drive to No. 3 status worldwide.

Consumer demands for more housing, more roads, and more environmental controls, plus political demands for an expansion of its military forces, will all create intense pressures on domestic resources — as will also labor's demands for wage increases in excess of productivity gains. These long-repressed domestic demands could force a reallocation of resources now going into the export drive, but this result is far from certain, especially in view of the stunning performance of the past two decades.

Paul Ma

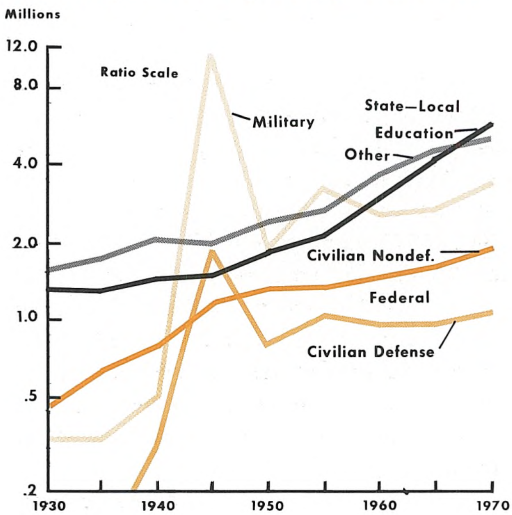
Government: People and Pay

In 1970, 12.6 million civilians held government jobs — almost 18 percent of total nonfarm employment — and another 3.2 million were in uniform. Local governments, particularly in primary and secondary education, were the largest employers, with more than 4 million jobs provided by the schools alone. Other local-government employment — a mixture of everyone from the local bus driver to the social worker, street cleaner and fireman — totaled 3.2 million, and the state governments accounted for 2.7 million more.

Federal government (civilian) payrolls also totalled 2.7 million in 1970. Almost all were in the executive branch, since the legislative and judicial branches account for only 37,000 workers between them. The Department of Defense employed about 1.0 million, the Post Office 725,000, and sizeable numbers were also found in Agriculture, Health-Education-Welfare, and the Veterans Administration.

Federal employment was highly concentrated geographically, with 313,000 in the Washington, D.C. metropolitan area and 312,000 in California — 92,000 in San Francisco-Oakland, 69,000 in Los Angeles, and about 30,000 each in San Diego and Sacramento. The next largest (but considerably smaller) concentration was in New York State, with 180,000 employees. In the West, Washington followed far behind California with 55,000 Federal employees (Regional data are for December 1968).

Employment gains sharpest in state-local area, especially education



Carrying The Mail

The post office is properly a mercantile project. The government advances the expense of establishing the different offices, and of buying the horses or carriages, and is repaid with a large profit by the duties upon what is carried. It is perhaps the only mercantile project which has been successfully managed, I believe, by every sort of government.

Adam Smith —
The Wealth of Nations

These figures are considerable, but they are less impressive than the record of growth. During the 1960-70 period, 4.2 million civilian jobs were added to public payrolls. The rate of growth was 51 percent — one new job for two old ones — as compared with 27 percent for private payrolls. In addition, the armed forces expanded by 674,000, growing by over 1 million from 1960 to 1968 and declining by 347,000 in the following two years.

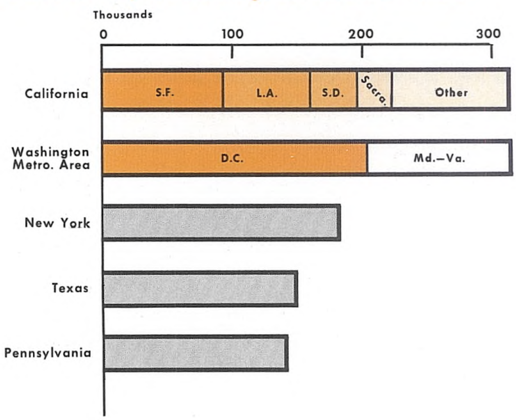
The largest increase was in local government

(2.6 million), but the fastest rate of growth was in state-government employment (74 percent). In comparison, Federal employment grew slowly, particularly in the Department of Defense. This reflected the increasing importance of grants-in-aid and transfer payments, as opposed to direct employment of Federal-government workers.

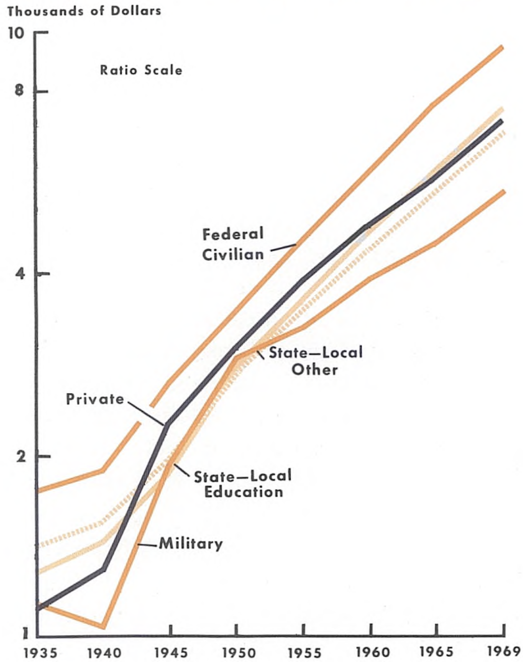
The statistics show the largest employment growth in public education, especially at the local level, but increasingly at the state (generally college) level. In education alone, employment jumped from 2.8 to 5.2 million over the decade, as the baby boom entered and made its way through the schools. College enrollments soared, encouraging a demand for additional teachers and staff at growing and new (particularly community) colleges throughout the nation. Teachers were in short supply, and school districts competed for new graduates and induced prematurely-retired married women back into the labor force. And salaries increased, helped along not only by the competition for staff but also by a shift in the public-education mix. In 1960, fewer than one public-school employee in five worked for state governments, but in 1970, more than one in four was a state employee and was more likely to teach college than primary school.

Federal civilian employees have the highest

Federal employees concentrated in California, Washington metro area



Average pay now rises faster in government than in private industry



average pay levels — $9,445 in 1969, according to Commerce Department data. Military pay averages somewhat lower — $5,491 in 1969. However, the two pay increases since 1969, plus the proposed $2.7 billion package (or about $1,000 per military man) would bring the average up to about the $7,000 level and thereby narrow the earnings gap.

State-and-local earnings averaged $7,529 for educational workers and $6,963 for other employees in 1969. Their earnings have long been below those in the Federal government, but the spread has narrowed in recent decades.

Since 1949, earnings in public education have exceeded those in other state-and-local government — just the opposite of the relationship during the preceding 20 years. Recently, however, the nationwide taxpayers' revolt has tended to limit raises in both sectors, but especially in the educational field, so that the differential has narrowed.

Adelle Foley

Western Digest

Rise in Prime Rate

Most major banks boosted their prime rate — their key business-loan rate — from 5½ to 6 percent in early July. The rate had reached a low of 5¼ percent in March, but the downtrend was soon reversed because of sharply rising rates in the money market, which boosted the banks' own cost of funds . . . Major Western banks also raised their rates on home mortgage loans in recent weeks. But at the same time, they increased from 4 to 4½ percent the interest rate paid on regular passbook-savings accounts.

Expansion in Bank Credit

Large District banks expanded their bank credit by $1,327 million in June. Loans increased by $747 million, but only $86 million of that gain came from business loans. Mortgage financing and loans to nonbank financial institutions accounted for two-thirds of the loan increase, and consumer instalment loans also rose sharply. Banks also added substantially to their holdings of both U.S. Treasury and municipal securities . . . On the deposit side, banks gained $1,049 million in demand deposits adjusted but suffered a decline in the time-and-savings category, as a larger-than-seasonal runoff in public time deposits wiped out gains in passbook savings and other private deposits.

Rise in Housing Starts

Western housing starts jumped 16 percent in May to a 472,000 annual rate, but starts elsewhere dropped slightly during the month. To date in 1971, starts have averaged 450,000 units annually in the West. This is 70 percent above the depressed early '70 pace, and is higher even than the previous (1963) record. At that earlier peak, housing activity was stimulated by a sharp increase in population-based demand — a stimulus which is now lacking.

Rise in Lumber Prices

Lumber and plywood prices — especially lumber prices — again moved upwards in June after a temporary period of weakness. In the first three weeks of the month, prices of Douglas-fir studs rose about 7 percent to a range of $88-89 per thousand board-feet, but they still remained well below the peaks of early 1969. The recent price uptrend was attributable to a combination of stable production and rising orders, and the latter in turn reflected the strong nationwide housing demand and dealers' needs to replenish inventories.

Decline in Steel Output

Production declined at Western steel mills in June, faster even than it did elsewhere. Late in the month, Western production was off 13 percent from the year-ago pace, while output elsewhere stayed 4 percent ahead of a year ago. Hedge-buying as a protection against a possible strike on August 1 tapered off much earlier than expected this year, as users attempted to complete their inventory build-up in advance of price increases effective June 15 and July 1.