1959

American Trade with Asia and the Far East

Robert J. Barr

東

Marquette Asian Studies I

Marquette Asian Studies are published for the

Institute for Asian Studies at Marquette University

AMERICAN TRADE WITH ASIA AND THE FAR EAST

ROBERT J. BARR, EDITOR

Professor of Economics, Marquette University

The Marquette University Press

Milwaukee, Wisconsin

1959

All opinions expressed in the individual papers
are those of the authors' own
and are not to be construed as necessarily representing
the positions of the agencies with which the authors
are associated, or of Marquette University.

Library of Congress Catalogue Number: 59-8090

Manufactured in The United States of America

Table of Contents

Preface

THIS volume of essays on United States trade with Asia and the Far East deals with a timely subject the import of which cannot be overemphasized. The extension of the Reciprocal Trade Agreements Act in 1958 for an unprecedented four-year period and the increasing awareness in this country of the expansion of the foreign economic relations of the Soviet Bloc countries, which were hitherto of little quantitative importance in world trade, have provided the setting for the symposium. While the essays do not constitute a handbook or pretend to offer a blueprint of foreign economic policy from the point of view of any particular country, their scope is sufficiently wide and their authorship suitably varied so that the airing of the problems confronting United States trade in Asia and the Far East through these pages may well fulfill a special function in the present international situation and in the face of what we believe to be the American mood that something positive be done.

The essays were first presented at a Conference on American Trade with Asia and the Far East held on April 17-18, 1958 at Marquette University under the auspices of the Institute for Asian Studies in cooperation with the Marquette Management Center. These have been edited by Professor Robert J. Barr who has also contributed the introductory chapter in which the principal issues are outlined. In so far as this volume is found useful by its readers, credit should go to its editor, the individual authors, and the Marquette University Press.

Yuan-li Wu
Director, Institute for
Asian Studies

Introduction

THE FOLLOWING papers explore the factors influencing the nature and volume of United States trade with Asia and the Far East.* In a restricted setting, this exploration could be pursued by examining the demands of the various countries for imported commodities, and the productive potentialities of these countries for exportable commodities. But this would not be adequate for the countries under survey at the present time.

Asian countries exhibit a diversity of economic and social conditions. Some of them, recently released from colonial status to independence, aspire to full membership in the world community of nations, and particularly to living standards rapidly rising to approach parity with the rest of the world. Some, long accustomed to unchanging economic, social and political patterns, are now affected by Western ideas of progress and democracy. Some wish to achieve a greater degree of economic independence and self sufficiency. Finally, some lie under the threat of external aggression.

All nations, and especially the Asian nations, are determined to subject to conscious control the direction and velocity of their domestic

* The term "Asia and the Far East" includes the following countries: India, Pakistan, Ceylon, Burma, Thailand, Vietnam, Laos, Cambodia, Malaya, Republic of Indonesia, Republic of the Philippines, Republic of Korea, Hong Kong, Taiwan, Japan, Australia and New Zealand.

development. No nation is any longer willing to allow its economic fortunes to be determined either by other nations upon which it has become economically dependent, or by the play of undirected economic forces. Nations supplying raw materials to the world are insisting upon a greater degree of stability in their markets. The ferment of progress is a heady stimulant whose results are not always predictable. The threat of aggression distorts the normal development of economic life.

Underlying all the other problems of the area is the great problem of food for the teeming populations. Agricultural development is of urgent necessity. Counterbalancing the obstacles to this development which leap to mind are advantages of rich natural endowment, and in some countries, an almost virgin frontier comparable in a measure to that of the United States in the last century.

Hence in a broader setting the explorations of United States-Asian trade problems necessarily include consideration of a whole range of factors in their application to the specific conditions of the countries under review. Consequently, the papers explore the objectives and methods of consciously elaborated domestic development plans and programs. They explore requirements inherent in these plans, the balance, consistency and attainability of their objectives and the reasons why attainments have fallen short of objectives if they have done so. They explore the peculiar difficulties facing colonial economies in their attempts to diversify production and trade and in so doing to develop commercial, industrial and financial institutions, entrepreneurship and saving. The tensions both between the Asian nations and others, and between classes and groups within the Asian nations themselves are the subject of some consideration, though it is obvious why problems of this sort, important as they are, could not receive adequate consideration in the space available in this volume and under its title.

Attached to the main body of papers is a series of background papers which aim to present a summary of the factual information pertinent to the subject.

* * *

It may be worthwhile to analyze here a little more fully the problems which present themselves in a study of the "factors influencing the nature and volume of American trade with Asian countries."

From the standpoint of the United States the aspects of trade with Asian countries are: (1) the commodity composition of our imports from and exports to those countries; (2) the countries to which we export and from which we import specified commodities; (3) the proportions which this trade bears to our total trade, and to our trade with other specified regions and countries. The same analysis can be made for each of the Asian countries, from its standpoint, of its trade with the United States, or with the world as a whole, or with specified regions or countries. And in setting forth the present status of this trade, its origins and likely course of development should be discussed.

International trade is a network of interdependent movements of commodities, services and funds. Like all true networks, the individual elements enter relationships of mutual dependence and determination, not only with each other but with the network as a whole. It is also clear that each element at any particular moment is what it is because of historical circumstances. Finally, a little thought will produce the conclusion that consistency is the fundamental rule of the international trade network. That is to say, an individual movement seen from the sending or from the receiving country is an identity; a flow in one direction must be balanced by an opposite flow of an equally valuable asset in the other; each nation's total outward flows must balance its total inward flows. It would, however, impose an unnecessarily restrictive condition on the magnitude of the flows to require that each nation's outward flows must balance its inward flows with *each other nation individually*.

A simple illustration may clarify these remarks. The invention of the automobile resulted in a rapidly increasing demand for rubber. From Brazilian seeds grown in Kew Gardens, rubber trees were planted in Malaya, and the dominant element of the United States-Malayan trade pattern was determined — a combination of adventitious circumstances, conscious planning and natural endowments. The flow of rubber from Malaya to the United States was accompanied by a flow of other commodities from the United States to the United Kingdom and a flow of still other commodities from the United Kingdom to Malaya. Since the values of these commodity flows were not identical, the balance was achieved by payments of United States dollars earned by British-owned rubber plantations in Malaya first to the United Kingdom and ultimately to the United States. Thus, omitting numerous complicating details, the trade and payments pattern between the United States, the United Kingdom and Malaya developed in response primarily to an originally French invention. The subsequent invention of synthetic rubber — itself a combination of adventitious circumstances, conscious planning and "natural" economic progress — produced strains in this sub-network necessitating numerous adjustments. As a rule, the strains and adjustments are accompanied by profits to some, losses to others — to individuals and to countries — and thus tend to create conflicts of interest which spread over from economic to political and social relationships.

It should be noted that the international network of trade and payments is duplicated in detail by similar internal networks within each country.

As a first classification of factors determining trade we may take: (1) those natural advantages of countries and regions of which Ricardo spoke when he first clarified the theory of international trade; (2) those adventitious (historical) circumstances which the economist may note but which may not necessarily originate within the economic world; (3) those purposefully elaborated development plans which have become so numerous in postwar years and which impose upon the network a pattern different from that which would arise solely from the background of natural endowments; and (4) those requirements of consistency imposed by the nature of trade and payment networks, internal and international.

The first two classes of factors, important as they are, lie on the periphery, or outside, the area of economic science. It is with the last two classes that we are primarily concerned. Thus more elaborate discussion of their characteristic problems is called for. Yet certain natural and historical factors have been so important in forming the present structure of Asian economies and trade that a discussion of their nature and effects is also in order.

The dominant influence on some of the Asian countries under review is colonialism. This means that the economic potentialities of the colonial area were developed primarily in subservience to the demands of the economically advanced industrialized countries of the world — not necessarily solely the demands of the metropolitan center though these of course were often of great weight. It means also that the bargain that was struck as remuneration was often disadvantageous to the colonial area — though here certain consideration must be given to the notoriously "adventurous" character of many early concessions and the fact that losses as well as great profits emerged. What is really at issue is the fact that "contracts" which turned out to be unduly disadvantageous to the colonial area could not easily be revised since one of the contractors was not really free and equal. It means also that the people of the colonial area were not seriously accorded the equal rights of full copartners in the economic development of their areas. Here too, however, we must recognize the contemporaneous existence of similar disparities in class privileges within advanced industrial nations — disparities which have only lately been reduced or eliminated.

All this is well known but is here brought out into the open to emphasize the reason why certain types of problems have emerged in the former colonial areas of Asia. It is understandable that not only the *fact* but also the *sign* of their former dependence must be abolished. And since this sign is the excessive and unbalanced development of the raw material sector of the economy, this unbalance must be redressed by compensatory hurried development of the industrial sector — in the course of which it may be forgotten that the raw material sector was perhaps the one exhibiting the greatest existing comparative advantage. Not only former colonial areas, but independent though underdeveloped areas have been affected by the drive for industrialization.

Another influence has not yet had as significant results as may be expected in the future. Prices of raw materials (the commodities which Asian countries typically export) fluctuate with greater amplitude than those of manufactured products (the commodities which Asian countries typically import). Also, the volume of raw material imports by industrial countries varies in the same direction as their prices. Consequently, the terms of trade and the level of productive activity of Asian countries are excessively unstable. The demand is insistent that some control over these matters be exercised by international agreement.

The effort to accelerate diversification and industrialization puts demands upon government coordinating agencies, central banking systems, financial institutions related to the flow of savings-investments, entrepreneurship and labor training institutions which would strain even advanced economies. All of these institutional establishments must undertake tasks of great magnitude involving highly seasoned judgment and extensive statistical fact finding, in circumstances where these resources are inadequate. It is no wonder then that honest misjudgments as well as naive blunders have resulted in misdirection of effort, domestic inflation and balance of payments crises. Even advanced economies have not always made better records in these respects. Positive, and sometimes more emotional than wise, efforts are made to change the direction of trade away from the former metropolitan center toward countries which did not participate in the former economic and political dominance of the colonial area. Economic stress is then created in all three areas. Above all, in view of the generally low level of productivity and savings potential, is the necessity of a massive flow of capital from advanced nations, preferably private capital. Yet private foreign capital has been perhaps justifiably timid about embarking upon the needed investments in public utility or even industrial installations in the conditions of resurgent independence in the postwar world.

The reverse side of the diversification-industrialization program is that of agricultural production. Conditions of land ownership inherited from the past, techniques of agricultural production and allocation of land and labor resources to nonfood crops for export, have conspired to hold many Asian countries on a subsistence level. It is true that some countries have produced a surplus to alleviate the deficits of others. The region as a whole, however, has produced little agricultural food surplus above a subsistence level. In conjunction with dense and rapidly growing populations, the effort to industrialize has sometimes got out of balance with the base in agricultural food production. Here again everything must be done at once — changes in land occupation, ownership and exploitation, in social custom, in technique and in capital investment.

Not all the Asian countries fall into the group of former colonies. Another historical condition is the result of the war with its disruption of prewar international economic relations and physical destruction of productive facilities. Not to be overlooked are population movements — influx of refugees, displacement and loss of skilled manpower.

Productive facilities must be re-established when savings potentials have been impaired; market connections must be re-established when commercial rivals have successfully penetrated one's former preserves. A prime requirement for this sort of rehabilitation is again a ready flow of international investment funds. In the long run the flow of private funds is to be hoped for, but in the meantime international institutions were established to facilitate the process. However, even these arrangements have proved inadequate to the severe postwar circumstances and extraordinary governmental assistance has proved necessary. The form in which government aid has been extended has in its turn raised difficult problems.

Finally, another circumstance has affected some of the countries under review, that is, technological developments and in particular the development of industrially produced substitutes for natural products of the area, e.g., synthetic rubber and synthetic textile fibers. Not to be overlooked in this sector also is the development of material-saving processes, e.g., thinner tin plating. Also worthy of note here is the application of machine methods to the production of agricultural products, in special circumstances and usually in conjunction with government pricing schemes, resulting in an "unnatural" temporarily reversed flow of agricultural products from industrialized to underdeveloped countries. These circumstances have produced problems of enforced and hurried structural adjustment and of strained competitive relationships — in some sense they have produced an "upside down" international world.

Upon this already troubled scene in recent years has come the threat of further deliberate disturbances arising from politically inspired Communist trade maneuvers. The direction which commodity trade would normally take under the influence of cost-price considerations is distorted, placing additional adjustment strains upon the economies of the countries involved, strains which are made more tense by the fear that at any moment the trade relationships will again be disturbed and further adjustments will thus be called for. Associated with the threat of trade war is that of military aggression, direct or indirect, although this factor is more limited in the range of countries affected *at the moment*. Both these threats introduce considerations of military as well as economic assistance, primarily from the United States.

Although former colonial areas have been especially forward in promoting development plans, other nations also participated in this characteristic postwar phenomenon. The essence of a plan is the conscious direction of economic progress along certain selected lines, generally in the industrial sector as this is the sector of the economy which most obviously distinguishes the developed from the underdeveloped countries. Results of this redirection of economic effort include shifting direction and commodity composition of trade: new imports — particularly capital goods which are likely to come from different countries of origin; possibly reduced exports — at any rate in the short run lessened production of former export goods along with increased consumption of domestic production. The effort to accelerate investment very likely exceeds the domestic saving potential and can only be accomplished by the import of foreign capital, lacking which domestic inflation results. Altered cost-price relationships, exchange difficulties and modified import and export demands are a consequence. An attempt to accommodate to or control all these difficulties may be made by restrictive commercial policy; in fact, such restrictive policy may from the beginning be a part of the controls by means of which the development plan is executed. And it goes without saying that monetary and fiscal policy of a high order of effectiveness is required if disastrous consequences are to be avoided.

The special role of the United States in relation to these problems follows both from the historical role which this country has played in Asian affairs, and the position it occupies at the present juncture of being the largest reservoir of capital. Our imports from Asian countries have been the natural products of the specific areas, typical products of their climate — tea, spices, rubber, jute, etc., but also including tin; and other "artificial" products of economic development — silk, handicraft articles of wood, fiber and other materials. Our exports were usually smaller in total than our imports and extended over a wide range of products. These relationships have changed. Except for silk, the commodity composition of our imports remains substantially what it was with some increases in mineral raw materials, which, after all, are the commodities in which these countries possess great natural advantages. It is in the overall balance of trade and in the composition of our exports that significant changes have taken place. Specifically, the Asian countries have come to the United States for capital goods, for investment capital and for agricultural products. We have developed a substantial export surplus and have extended economic and military aid in large amounts as partial compensation.

The problems which arise in this connection are those of commercial policy (our own as well as Asian) by which those trade and capital movements are facilitated which further the aims of general policy, and those are hindered, which interfere with achievement of these aims.

The wide range of problems raised by the circumstances mentioned in the preceding paragraphs may be brought into focus in relation to the "rule of consistency." It is not simply that a particular country must make an adjustment once and for all to a new condition of its economic life. The adjustment made involves other adjustments in its domestic economic arrangements, and each of these in turn is likely to constitute a change in the conditions facing other countries. Thus, any disturbance is transmitted from its point of origin throughout the trading system; and its effect is finally absorbed by a diffused and complex set of adjustments including those intended to insulate a country from disturbances and adjustments in its trading partners.

In the large, the general effects of postwar events have been to distort the prewar trade and payments network as follows:

1) First have come a series of structural changes in the pattern of domestic production as adjustments to technological changes, accelerated diversification and industrialization.

2) Second have come shifts in the direction of trade which are, on the whole, surprisingly small considering the powerful incentives at work, though one may venture to guess that the prewar pattern was so firmly founded on natural endowments that only a long course of development could produce substantial change.

3) Third have come shifts in the commodity composition of trade, mainly in imports into Asian countries, in response to efforts at industrialization.

4) Fourth have come changes in the total volume of trade in response to unsettled domestic affairs, restrictive practices and diversion of resources from export lines to lines for domestic consumption.

5) Following upon many of these changes have come balance of payments difficulties.

6) Problems of adjustment to economic forces of cost-price relationships are frequently severe enough in all conscience; when exacerbated by the political forces of politically inspired trade war their magnitude is often enhanced beyond the adjustment capacity of the normal economic mechanisms.

One may be forgiven for being dismayed at the magnitude of all these problems, but the following papers push on to concrete proposals for their amelioration or solution. No panaceas are offered. But people who wrestle intimately with the problems, as have all the authors of this collection of papers, come away from their experience with practicable and effective suggestions for improvement. It is the purpose of these papers not only to lay bare the problems which beset the development of American trade with Asia and the Far East, but also to propose policies to private business and to official organization which might facilitate this development in the belief that the enlargement of this trade would benefit the peoples of all countries.

The political climate of America's trade with Asia

The Honorable Clement J. Zablocki

Member of Congress

THE CHANGING ROLE of the United States in the world economy, together with the impact of the tremendous military, political and sociological developments of the past two decades, call for a better understanding, on our part, of our foreign trade and assistance policies, and of their effects upon the lives and aspirations of countless other peoples.

I am particularly conscious of the fact that much more light needs to be shed on the complex issues of our trade with other nations. In this respect, the specialized, regional approach should prove especially helpful. It should be helpful to our businessmen — to our industry, to our investors, to our importers — whose interests are increasingly affected by the issues of foreign trade. It should be helpful to our citizenry at large — to the millions of men and women throughout our land who at times fail to appreciate the full impact of foreign trade on their own welfare. And it should prove of great value to our government, and to the governments of the nations with whom we trade, because governmental policies can greatly encourage, or impede, the growth of trade and its consequences.

THE STRATEGIC IMPORTANCE OF FREE ASIA

Asia and the Far East is a vitally important area with which I have become familiar through my work as the Chairman of the Subcommittee on Southeast Asia, the Far East, and the Pacific, of the United States House of Representatives.

The strategic importance of this area to the Free World, and to the United States in particular, cannot be overemphasized. The balance of power between the Free World and the Communist bloc may very well lie in the arc which stretches from India, Pakistan and Afghanistan on the west to Japan and Korea. These nations, located on the periphery of the Communist bloc have a population of a billion and one-half, possess rich resources of raw materials and have an overwhelming industrial production potential. The conquest of this region by the Communists — be it military conquest or domination through subversion, infiltration or economic penetration — would give the Communists the raw materials and the industrial production potential which would bolster their drive for world domination.

Let us make no mistake about this fact: it is essential to the Free World that the arc of defense and cooperation in the Pacific hold firm, and that the independence of the Far East and Southeast Asia be fully preserved and strengthened.

A realistic appraisal of American foreign trade and assistance policies with respect to Asia and the Far East must be made against this background. An appraisal based on any other premise can lead to mistaken and dangerous conclusions as far as the security of the United States and of the Free World is concerned.

OUR GOVERNMENT'S POLICY

Our government's policy with respect to the free nations of Southeast Asia and the Far East is firmly based on the recognition of the strategic importance of that region to mutual long-range security. The United States has embarked upon a long-range program of assistance in the Far East — assistance intended, first, to halt the spread of Communism, and secondly, to bolster the internal strength of the countries which stand as bulwarks against this threat to democratic ideals and world peace.

The cardinal principle of our foreign policy programs with respect to this area has been to aid the peoples of the Far East to help themselves. Some people, either misunderstanding or wilfully misinterpreting our objectives, have charged that the United States is trying to dominate the free nations of that region. Such is not the case. We have not attempted to defend them with our own troops and military equipment, to feed them with our own food, and to support them with our own money. Such forms of assistance would defeat our overall objectives. Instead, we have tried to give the peoples of the Far

East, through their governments, a better opportunity of improving their lot in life. We are giving them such an opportunity by sharing with them our technological "know-how," by aiding them in solving their own economic problems, by making development capital available to them, by encouraging wider trade and through other means.

To date, by far the largest portion of our assistance to this region has consisted of direct military aid and defense support. Our purpose is to strengthen the economies of those countries, to assist them in getting economic development under way, and, in the meantime, to bolster their defense capacity, at least for a "holding" operation. We have embarked upon this course in full understanding of the fact that we are all engaged in the common cause of defense against the inroads of the Communists and our programs are designed to accomplish our collective security objectives in the most effective and economic way.

In our efforts to help the nations of Southeast Asia and the Far East to help themselves, our trade policy plays a vital role. This is an area in which private enterprise, and private investment, can contribute greatly to the success of our over-all national objectives.

THREE POINTS TO BE MADE

With this background, I would like to comment, first of all, on the general characteristics of our trade with Asia. Secondly, I shall briefly review the political aspects of this trade — both from the standpoint of our own government, and from the standpoint of the governments of the free nations of the Far East. Finally, I shall outline my personal observations and suggestions as to the ways in which our national policy can be better implemented, and our trade with Asia expanded, by positive action on the part of our government and on the part of the governments of the nations with which we are trading.

GENERAL CHARACTERISTICS OF TRADE WITH ASIA

The trade of any area depends on many factors, among which the stage of economic development of the area is of particular significance.

When we consider the nations of the Far East, two things come to mind, immediately: one, their large resources of raw materials; and, secondly, their teeming populations. These two elements, combined with an intense desire to attain a higher level of living, can produce economic progress and industrialization, when aided by favorable government policies and the availability of capital. Such economic progress is the ambition of the countries of the Far East.

Apart from industrially-developed Japan, however, most of the countries of that area are still in the early stages of economic development. Their general economic conditions have been favorable in recent years and they have achieved widespread gains in production, particularly in newly-developing industries. Their earnest efforts to improve the plane of living of their peoples have begun to show encouraging results.

The value of trade in this region has been increasing, with imports amounting to $10.7 billion dollars, and exports to $8.8 billion, in 1956. One-third of this volume is traded within the region. Of the remaining trade, about 25 per cent is with northwestern Europe, and about 20 per cent with the United States. The balance — about 21 per cent — is scattered among the Latin American countries, Canada, Africa and, to the extent of about 5 per cent, with the Communist bloc. The area, as a whole, has a trade deficit which has been rising in recent years.

American trade with Asia includes many commodities, with Japan, the Philippines, India, Korea, Pakistan, Indonesia and Taiwan accounting for the bulk of the transactions. In 1956, our exports to that area amounted to $2.7 billion dollars while our imports were less than $2 billion. We have an export surplus with respect to our major trading partners in the Far East, with the exception of Indonesia, Malaya, Thailand and Ceylon. That export surplus, as I mentioned, applies also to the area as a whole.

The trade deficit which the free nations of Southeast Asia and the Far East are experiencing together with their dire need for capital, have direct bearing on many of their governmental policies.

THE POLITICAL CLIMATE IN THE FAR EAST

Most countries in this part of the world have two firm objectives. In the first place, they are determined to preserve their political and economic independence, not only from the Soviet Union, but also from the United States or any other nation. Secondly, they are anxious and determined to speed up their own economic development. Foreign trade policy is important to them from both points of view.

The urgent need for substantial amounts of development capital, necessary if they are to fulfill the mandate imposed upon them by their peoples, often places the governments of these countries in a tough spot. Their countries' export earnings are insufficient to pay for consumption imports and development capital from abroad. They are, consequently, faced with a dilemma.

They may be unable to increase their exports to the nations of the Free World for one of many reasons: barriers to expanded foreign markets, embargoes, fluctuations in foreign demand, inability to produce more, and the like. On the other hand, they are reluctant to grant any concessions, or to make any commitments to foreign governments and to foreign private capital which could be interpreted as infringements of their sovereignty.

To solve this dilemma, they have turned in their search for markets and for capital to the Communist bloc, adopted various trade restrictions, and at times imposed onerous regulations upon foreign enterprise within their boundaries. Some of these practices have done little to encourage American and Western European capital to participate to a greater extent in the economic development and industrialization of this region.

There is a special factor which the free countries of the Far East — and Japan in particular — have had to face, and which is directly related to the policies of our government. I refer to our embargo on trade with Red China and Communist Korea, and on our restrictions on trade in strategic goods with the rest of the Communist bloc.

THE POLITICAL CLIMATE: UNITED STATES POSITION

Our over-all foreign policy is based on the assumption that the United States has one real enemy in the world: international Communism. We further believe that the Communists are striving for world domination, either through military conquest or through less overt, but equally effective programs and policies.

We have, therefore, used our foreign aid and trade policies to halt Communist expansion and to strengthen the free nations of the world against Communist subversion and aggression. Further, we have used those policies — and particularly our trade policy — to prevent the Communist bloc from receiving any strategic or vital goods from the free world. Our allies in the North Atlantic Treaty Organization, and other recipients of our Mutual Security assistance, have cooperated with us in this embargo on the shipment of strategic goods to the Communist bloc.

It would be unrealistic to presume that the restrictions on trade with the Communists, and particularly the total embargo on trade with Red China and Communist Korea, have no effect on the free nations of Southeast Asia and the Far East. In some instances, these restrictions have disrupted their normal channels of trade, and barred them from at least potential markets in contiguous territories dominated by the Communists.

The effect of our foreign assistance and trade policies is particularly conspicuous when we consider the case of Japan. Industrially speaking, Japan is more highly developed than other countries in the Far East. Fundamentally, however, the economy of Japan is in a sensitive position. Her principal resource is the skill and industriousness of her people. She is greatly dependent on other countries for raw materials and for markets. Japan has been called the "Great Britain of the Orient."

If Japan is to survive, and to provide a tolerable plane of living for her people, she must export. Southeast Asia, unfortunately, does not have the purchasing power to buy the goods which Japan must sell. The only other possibilities are to trade with the West — or to turn to Red China and Soviet Russia.

Thus far, Japan has cooperated in refraining from expanding her trade with the Communist bloc. At the same time, she has been importing more goods and services from the United States than we purchase from her. In 1956, for instance, Japan exported $547 million dollars' worth of goods to the United States, while her imports from the United States amounted to $887 million. We had a net *export* trade balance with Japan in that year of $340 million.

By virtue of her strategic position, and her industrial production capacity, Japan is important to the United States and to the Free World. At the same time, our restrictions on trade with the Communists are necessary from the standpoint of our over-all strategy against the Communist menace. A constructive solution to the resulting problem would rest, it would seem to me, on the adoption by our country of a more realistic trade policy — a trade program which would effectively support our national policy goals not only by restraining trade with the Communists, but also by vigorously promulgating wider trade opportunities within the Free World.

The United States, working in cooperation with other free nations, should strive more actively, it seems to me, to assist Japan in selling her merchandise in the free world's markets. This does not mean that we should throw our markets open to unlimited quantities of Japanese goods. Such a course could hardly be considered as a remedy. I believe, however, that with some imagination and good will we could evolve some formula that could afford wider Free World market opportunities to Japan, at the same time diffusing the competitive effects over the entire economy instead of allowing a few vulnerable domestic industries to bear the full impact of Japanese exports.

The political climate in this country toward United States continued and expanded trade with Asia is characterized by some rigid and rather shortsighted attitudes. We use our trade policy, and rather effectively, to prevent the Communists from being strengthened in their plans for world domination by obtaining strategic goods in the Free World. At the same time, we tend to forget at times that trade is a two-way street. Our trade policy could use more imagination, and more flexibility, in effectively implementing our national security policy by actively stimulating trade and investment within the Free World.

SOME SUGGESTIONS FOR UNITED STATES TRADE POLICY

To this end, I should like to submit some suggestions which, operating within the established framework of our national policy, may help to increase private participation in the economic development of the free countries of Southeast Asia and the Far East, and to stimulate a greater volume of trade with that important region.

In our democracy, as in many countries of Asia, public opinion has an important effect on government decisions. As our first objective, therefore, I would suggest that greater effort be exerted to promote public interest in, and understanding of the issues and benefits which can follow from a well-coordinated trade policy.

As far as direct government action is concerned, I have two specific suggestions.

First, I believe that there is a need for the simplification, and better coordination with our allies, of United States restrictions on trade with the Communist bloc. At present, the United States system of economic defense and strategic trade controls rests on four basic documents: the Export Control Act, controlling goods which originate in, or pass through, the United States, administered by the Department of Commerce; the Foreign Assets Control Regulation, governing all transactions with Communist China and North Korea, administered by the Treasury Department; the Transaction Control Regulations, governing all transactions with the Communist-dominated countries of Eastern Europe, also administered by the Treasury; and the Mutual Defense Assistance Control Act, known as the Battle Act, administered by the

International Cooperation Administration. The Battle Act provides for the termination of United States military, economic or financial aid to countries exporting strategic goods to the Communist bloc.

The scope of these different controls is extensive, and the maze of regulations, licensing requirements, penalties and the like, confronting American businessmen interested in doing business with Asia and the Far East, is at times discouraging. It seems to me that much of the red tape attendant upon the administration of these trade controls could be reduced, and that the restrictions which have to be maintained for strategic reasons could be simplified and better coordinated with other free nations.

Secondly, I would recommend that our government implement the often-expressed conviction that private investment in the Far East and in Southeast Asia can appreciably contribute to the attainment of our nation's foreign policy objectives. To this end, it would appear advisable to provide closer coordination between our government programs in that region with the goal of increasing private investment in Southeast Asia and in the Far East. A close review of our Federal tax policies, relating to business transactions abroad, also seems to be indicated. In this respect, the differential treatment of Americans doing business, for instance, in South America, as compared with those doing business in Southeast Asia and in the Far East, should be reviewed.

I believe that modern reforms along the lines which I have suggested would help in assuring greater, and more effective, participation of private enterprise in the economic development of our friends in Southeast Asia and in the Far East.

OUR ALLIES CAN ALSO CONTRIBUTE

Action on the part of the United States government, however, can achieve only a part of our objectives. In order to encourage private enterprise, and foreign trade, to make maximum contribution to the economic development of the free nations of Southeast Asia and of the Far East, the governments of those nations may wish to review and reconsider some of their own policies.

American businessmen who trade with that area, and who have invested there, appear to have three major complaints. First, they are somewhat discouraged by quota and other barriers intended to limit the importation of foreign *consumer goods*. Secondly, they complain of *high taxes,* apparently administered at times in an arbitrary manner, and of various *restrictions* imposed by the governments of those countries on foreign enterprise operating within their boundaries. And, thirdly, they point to problems which arise because of the uncertainty about future governmental *nationalization policies,* and casual attitude toward the sanctity of contracts.

Some steps have already been taken to remedy the situation. I am confident that, with patience and good will, even greater progress can be achieved in removing these deterrents to wider, more active participation of private capital in the important task of developing the full economic potential of the free peoples of Southeast Asia and of the Far East.

CONCLUSION

The technological developments of our age have helped to overcome the barrier of distance, and brought the United States into much closer contact with the free peoples of other continents. Simultaneously, however, these developments, as well as the military and political problems of our era, have greatly increased the interdependence of the entire free world.

In full understanding of our interdependence, we should strive to attain an ever higher degree of peaceful cooperation within the Free World in solving our mutual problems — be they military or economic in nature.

There is still much to be done to improve the plane of living of free men and women everywhere. I am certain, however, that the enthusiasm with which the free peoples have tackled this task is one of the brightest characteristics of our age.

If we proceed in an enlightened, realistic manner, I believe that the future will have rich rewards in store for all of us. I am particularly confident that the United States will find the stimulus to even greater progress for our own people in the economic and political advancement of our friends across the Pacific.

Oceania's place in United States foreign trade

Warren J. Holmes

Manager of Sales,
Engineering Products
Allis-Chalmers International

I WILL TRY to brief and point up the overall position of United States trade with the total area here under study — Australia, New Zealand, Borneo, Singapore, Malaya and Hong Kong. To do this, of course, requires some reference to trade statistics. I cannot claim precise accuracy for the resultant data to be presented. Except for Australia and New Zealand, comprehensive trade figures are hard to come by. Borneo, Sarawak and the like, do not seem to be too much interested in compiling such material. It can be observed, however, that in the broad sense certain relationships can be determined. Further, I believe decent conclusions can be drawn.

Comparing United States trade in the six areas under study with our country's Asian trade as a whole gives us a result that is reasonably acceptable. But comparing this trade with United States world-wide trade, the area, business-wise, takes on much different and smaller proportions.

Trade dollars do not tell the whole story of the strategic materials of the area such as its tin, rubber, oil and base metals. Trade dollars also take no recognition of the impact resulting from that trade on local economies, peoples and politics. Totaling up and reckoning trade dollars, therefore, is simply a means of gauging the pace of business and in only one way defines the significance of the commerce involved.

When considering the total trade of the area under study we should keep in mind that all of the political entities are within the sterling bloc. They have a general and overall import policy which establishes that hard-currency exchange can only be had for goods which are not available from soft-currency areas, and particularly from the sterling area. At one time, when there was stringent dollar management, the term "not available" was literally interpreted as meaning "physically unavailable." Today this has been liberalized somewhat by the import authorities sometimes taking into consideration the price, delivery and quality of the soft-currency goods vis-a-vis goods from the United States. The net result of this liberalization, however, has not meant any startling improvement in our exports to these countries. Our Malayan trade is a good example. There was a heavy unbalance in favor of Malaya at a rate of better than one to four in 1957. Through its rubber and tin Malaya has been the strongest dollar earner in the sterling bloc. With its independence, there is the hope that Malaya will press for greater use of its earnings for purchases in the United States — Malaya's best single customer.

A change in Malaya's buying habits will not substantially alter the overall trade pattern of this group. One example points this up. In 1956, United States exports to Australia and New Zealand totaled about 270 million dollars. We bought from them about 165 million. Total trade 435 million dollars. The United Kingdom at the same time was selling Australia and New Zealand over 1.1 billion dollars worth of goods and rightfully bought about a billion dollars worth of Australian and New Zealand products. Total trade, 2.1 billion dollars or about five times the volume of business the United States did. There is no real basis for believing United States traders will make any sustained inroads into this United Kingdom-Australian-New Zealand trade pattern if we count on supply only from the United States.

To place our trade with Oceania in proper perspective let's consider these latest figures:

a) Total United States exports to the area were $390 million.

b) Total United States exports to all of the Asiatic countries, as covered in this volume, were about $2.6 billion.

c) Thus this territory, dominated by British trade, absorbed 15 per cent of our total Asiatic exports.

d) But compare these $390 million with a total United States export trade of about $19 billion and we find this area accounts for only slightly more than 2.0 per cent of our country's overall export business.

As for imports:

a) Total United States imports from the area were $425 million.

b) Total United States imports from all of the Asiatic countries were $1.85 billion.

c) This group of six entities thereby provided 23 per cent of our total Asiatic imports.

d) When compared to total United States imports, however, the area supplied about 3.4 per cent of our national requirements.

On an overall export-import trade basis, Australia, New Zealand, Borneo, Singapore, Malaya and Hong Kong accounted for just over 2.5 per cent of our world-wide two-way trade. Not too significant as a statistic! But please remember this 2.5 per cent is only a statistic. The content of the trade and other considerations have much more meaning.

To assign a further proportion to our trade with Oceania, let us compare it with the business we do with some of our foreign trade partners in Latin America. For example, our two-way trade with Colombia is in the same class dollar-wise as our trade with Oceania. Colombia is much smaller in population and land area. But in Colombian trade the United States takes the dominant role both as a buyer and a supplier comparable to that of the United Kingdom in Australia and New Zealand. United States' two-way trade with Brazil alone or with Cuba alone is about one and a half times the volume we do with all of Oceania. We do about twice as much business with Mexico as we do with the six countries of the group under study. And one last comparison; United States trade with our number one partner in Latin America — Venezuela — is carried on at almost three times the dollar volume we do in Oceania.

United States trade with Latin America does in some measure dwarf our business with the countries of Oceania. But American foreign traders cannot stand by and hope good things will just happen to them in the area. Here is a statistic that deserves our consideration. The global imports from all sources of this group of six countries reached an interesting 4.7 billion dollars in 1956. The United States having sold only 390 million dollars worth of this total means we only obtained about 8 per cent of the business available. We ought to be looking for ways and means to improve our national position. We know who is getting the bulk of that business — the United Kingdom. And they are doing it primarily via a money blockade. There is one sure way of running such a blockade and that is to be equipped to operate in the currencies available.

Many United States companies are already on the move in that direction. They are either supplying the market from United Kingdom facilities or they have set up in Austraila as my company has. The value of such an investment is not necessarily measured in terms of the profit return on the investment itself. We have found that once we start up in a country this operation stimulates trade, in other of our product lines, between the factories in the United States and the foreign country of our new operation. In effect, we begin to sell more Milwaukee-made goods in the country in which we have made the investment. Additionally, we can ship products from the new operation to third country areas to which we could not previously sell from Milwaukee.

At the time of making a foreign investment the question arises, of course, as to the remission of profits in dollars to the parent company. It is the usual practice that new manufacturing operations in foreign countries must receive the sanction of the foreign governments. At that time arrangements are made for the remission of profits in dollars. It isn't always possible to get a firm guarantee as to the availability of dollars for this purpose. But in any event it has been our experience, up to this time, that we do not accumulate enough in the way of profits to allow for remittances to the parent company. Our capital requirements for foreign operations have regularly been beyond our foreign earnings. The day can be expected, however, when profit dollars will be returned to the United States.

Given reasonable conditions and stability, United States business — just as we and others are doing — will be prepared to use its capital, its talents and its machinery to the benefit of the host country. Decisions to move in are not easily made at this time. But it would seem we are approaching the point of whether to jump now or later. This may not be the propitious "now" but the day will come when United States business, if it is to fully participate in the important Oceania trade, will have to become resident in the area. We think the future and the prospects are great — and we are betting our money on it!

United States trade with Australia and New Zealand

Allen G. B. Fisher

Chief Editor,

International Monetary Fund

FOR MANY YEARS the most important exports of Australia and New Zealand have been wool and wheat, dairy produce and meat, fruits, and certain minerals such as lead. The experience of both these countries shows that a high degree of dependence in international trade upon primary products is quite consistent with the establishment, and, indeed, with the steady improvement, of high standards of average real income. Standards of living in Australia and New Zealand compare very favorably with those in the most advanced industrialized countries. Indeed, if the distribution of the working population can be taken as a reliable criterion, Australia and New Zealand might themselves be regarded as already fairly highly industrialized. The proportion of the total working population that earns its income from farming and other primary production in Australia and New Zealand is now less than 20 per cent. It is, however, mainly in relation to production of this kind that Australia and New Zealand have the greatest comparative natural advantages. The concentration of their export trade upon the goods mentioned above is thus entirely in accord with the principle that the concrete details of the trade relations between any two countries always depend in the first place upon the conditions which make it advantageous in each of the countries concerned to specialize in one or another type of production. The importance of the part played by these commodities in the economic life of Australia and New Zealand is a natural consequence of the natural conditions of these countries — their climate, soil, temperature, mineral resources and the like. And on the foundations thus laid by nature, the ingenuity of men has, by the application of the results of scientific research, built a highly efficient structure of production.

History too, however, is usually important in determining where a country's exports shall be sold. To some extent it may be a matter of chance where exporters first find a satisfactory market outlet for their products. But after a trading link has once been established and been proved to be mutually satisfactory, the mere fact of its existence creates at least a presumption that it will be continued, whatever may have been the original reasons for building it up. Buyers and sellers who have become accustomed to mutually beneficial commercial relations are not likely suddenly to change their habits. The exports of Australia and New Zealand will obviously most easily find a market in countries whose consumption habits and standards of living create a brisk demand for them. But which of these countries actually provides the best export outlet has inevitably been much influenced by the history of Australia and New Zealand, countries which were colonized more than a century ago mainly by immigrants from the United Kingdom, and accustomed at many stages of their history to being largely financed by capital imports from the same source. It was natural for these immigrants to deal first with their friends in the country of their origin, and today the United Kingdom still provides the largest export market for both Australia and New Zealand. In recent years around 30 to 40 per cent of Australian exports have been sold in the United Kingdom; the corresponding ratio for New Zealand's exports has been close to two-thirds. The habit of buying British goods is also at least as firmly rooted in Australia and New Zealand as the habit of buying Australian wool and New Zealand butter is in the United Kingdom. During the last few years between 40 and 50 per cent of Australia's imports have come from the United Kingdom, and for New Zealand, the percentage has been around 55.

Whatever "natural" tendency there may have been for Australia and New Zealand to cultivate close trading relations with the United Kingdom, this tendency has been considerably strengthened by two deliberate acts of policy. First, during the Great Depression of the thirties, when export markets everywhere were shrinking, there was a desperate endeavor in every part of the world to build up protective walls around such markets as were still open. For the British Commonwealth this endeavor took the form of the organized system of imperial preference embodied in the Ottawa Agreement of 1932. Both Australia and New Zealand had already, for a number of years before that time, granted significant tariff preferences designed to increase the proportion of their imports that were purchased in the United Kingdom. At Ottawa an effort was made to systematize these preferential arrangements, and to extend them so that Commonwealth exports would also receive preferential tariff treatment in the United Kingdom. The drive for the extension of imperial preference came at that time mainly from the Dominions, which were faced with the consequences of catastrophic falls in the prices of their staple exports. It was indeed always doubtful whether there was not some tendency to exaggerate the advantages likely to accrue from preferential tariff treatment for exports such as wheat, of which the total volume produced by the Commonwealth countries was so great that a substantial part of it had to find a market somewhere else. It has since been more widely understood that in some circumstances an apparently simple straightforward preference may be rather delusive. It would be rash to generalize confidently about the current balance of public opinion on imperial preference. Some of the export preferences which have been granted to the Dominions still give them significant advantages. Some recent discussions, however, leave the impression that enthusiasm for the maintenance of imperial preference is now more evident in the United Kingdom, where it can be regarded as a means for maintaining steady market outlets for some United Kingdom manufactures.

Since the outbreak of World War II a second important influence has affected the geographical distribution of Australian and New Zealand trade. During the war it was an urgent necessity for all the members of the British Commonwealth that demands for goods that had to be paid for in currencies other than sterling did not exceed the limited supplies of these currencies, and in particular of United States dollars, that were then available. All the members of the sterling area accordingly agreed that during the war they would apply similar measures of exchange control so that the foreign exchange available at any time to the sterling area should be spent in the most efficient way. These sterling area arrangements were maintained after the end of the war, when earnings of foreign currencies, and in particular of United States dollars, were still far from sufficient to pay for all the imports that otherwise might have been thought desirable. The same basic exchange controls are still in operation today, though, as world trading conditions have improved, their rigor has been much relaxed and there is no longer the sharp distinction that once existed between the restrictions imposed on imports from dollar countries and those imposed on other imports. The general effect of these controls has been to limit in varying degrees the freedom of importers to do business with the United States and other parts of the dollar area, while trade with countries in the sterling area and with other parts of the world where payment in sterling is acceptable has been much freer.

This is the general background within which the development of United States trade with Australia and New Zealand should be examined. Even for a dynamic growing economy it is obviously important to avoid, if possible, any sudden collapse of old traditional trade channels. The trade problems that are really important for such an economy, however, if its growth is to be rapid and effective, are those which are directly related to the conditions under which relatively new trade connections might be developed. The actual marginal trade expansion, upon which economic growth largely depends, may not be very large in comparison with the total which includes the old reliable stand-bys, the continuance of most of which can be taken for granted. Its real significance, however, is not adequately indicated by its size. What happens at the margin of expansion will to a substantial extent determine the health of the economy as a whole. Neither Australia nor New Zealand has lost interest in the possibility of further expansion of their United Kingdom trade, and it would obviously be very foolish for them to do so. At the moment, one of New Zealand's most pressing concerns is the current threat to the maintenance of its dairy produce exports to the United Kingdom. On any long-run view of economic development, however, steadily increasing attention should be paid to the development of the trade of the two countries with the rest of the world outside the British Commonwealth. There has been growing interest in the expansion of markets on the continent of Europe and in Asia, and, as both Australia and New Zealand still find that dollars are harder to earn than sterling, their trading relations with the United States necessarily have special importance in this development.

When we seek to examine the influences which have hampered and still hamper expansion of trade with the United States, we shall find that we are also in fact probing into the problems raised by the criticisms frequently made in this country both of the sterling area as it operates today and of the policy of imperial preference. At least in broad outline United States policy has as a major objective the restoration over as wide a field as possible of a freely functioning multilateral system of international trade. The sterling area and imperial preference have often been regarded as obstacles to the attainment of this objective. Many people in Australia and New Zealand would agree that a multilateral trading system is a proper objective for international policy. The adjustments that would be necessary in the world as it exists today if the attempt were made to adapt policy to the requirements of a pure multilateral system would, however, in their view be much too disturbing to be contemplated in any immediate future. It is important to understand the facts that are held to justify this attitude.

There has, of course, always been a significant volume of trade between the United States on the one side and Australia and New Zealand on the other. There has often also been a tendency for the volume of United States exports to these countries to exceed substantially the volume of their exports to the United States. Australian exports to the United States have recently averaged around $126 million per annum, nearly 7 per cent of Australia's total exports, and imports from the United States have averaged around $200 million, or some 12 per cent of Australia's total imports. The trend in New Zealand has been more irregular, with exports to the United States in some years well above New Zealand's imports from that country. During the five-year period 1952-56 New Zealand's exports to the United States averaged about $50 million per annum, rather more than 7 per cent of total exports, and slightly exceeded the average annual value of New Zealand's imports from the United States. But, in neither Australia nor New Zealand is the volume of imports from the United States as great as it would be if purchases could be made freely, unimpeded by trade barriers and import restrictions of various kinds. Some of these barriers and restrictions have been erected on the Australian and New Zealand side. These will be examined in another part of our discussion. They are not unimportant, but it is not unfair to direct attention particularly to the barriers on the United States side. In the present state of world economy, the ability of Australia and New Zealand to increase their purchases in the United States depends very much on their success in selling an increasing volume of their export products in countries which pay United States dollars for them. And far and away the most important of the markets in which dollars are paid for imports is the market in the United States itself.

In considering the directions in which outlets might be sought for the expansion of their international trade, Australia and New Zealand have already been giving increasingly serious attention to exports of certain manufactured goods. Australia is pressing in this direction in its trade with some of the Asian countries, and New Zealand has ambitions, for which there is a good foundation, ultimately to become an important exporter of woodpulp and woodpulp products. However important these trends may be for long-run general economic development, they have little significance in relation to the expansion of trade with the United States, where in nearly every kind of manufacturing activity the domestic producer has very great competitive advantages. If Australian and New Zealand exports to the United States are to be expanded, they will certainly for many years be in the form of primary products. The exporter must always be alert to the necessity of adapting his product to the changing requirements of his market. It may be that the kind of product that is suitable for the United States market is not precisely the same as Australian and New Zealand exporters have been in the habit of sending abroad, but when all the necessary adjustments have been made, most of any expansion that may take place during the next few years in their exports to the United States will probably be in exports of the same staple items as have dominated the trade of these countries in the past.

It is obviously in the interests of Australia and New Zealand to increase their dollar earnings, and thus make it easier to increase their dollar imports and at the same time to diminish and eventually to eliminate the discrimination against dollar imports that is at present believed to be unavoidable. There is nothing mysterious or esoteric about the impediments which, according to Australian and New Zealand views, are slowing down the desirable trend. The two sore points which invariably arise in discussions of this question are the United States tariff and the United States policy of agricultural surplus disposal. The concern frequently expressed about the tariff is not confined to actual tariff rates or to details of tariff administration. Several of the customs duties payable on some of the most important exports from Australia and New Zealand are at present of no great importance. There is, however, often a fear, which a careful reading of current United States tariff history does nothing to allay, that it may be risky for an exporter to be highly successful. If he penetrates too deeply into the

United States market, the pressure to exclude him by raising the tariff against him may become irresistible.

The wide variety of problems which have to be faced in expanding Australian and New Zealand trade with the United States may be conveniently illustrated by brief comments on the position of wool, of dairy produce, of meat and of lead. We shall conclude with a reference to agricultural surplus disposal which affects mainly wheat for Australia and dairy produce for New Zealand.

For both Australia and New Zealand, wool is much the most important export. In recent years it has accounted for about half the total value of Australian exports. In New Zealand, the proportion has been about one-third. The great long-term question for wool producers is the relation of their product to synthetic substitutes. There has been a good deal of intelligent adaptation to the problems created by the invention of substitutes, and in some postwar years wool growers have done very well. In contrast with some other primary products, the marketing of wool is still organized on strictly competitive lines, most of the output being disposed of at auctions in Australia and New Zealand to which buyers come from all parts of the world. The reports of these auctions make frequent references to the activities and influence of United States buyers, and wool has often accounted for more than 90 per cent of the total value of Australian exports to the United States. United States demand for wool is, however, obviously always to some extent influenced by the United States tariff on imports of wool. In 1947, the United States duty on finer wools was reduced by 25 per cent, from 34 cents per pound, established in the Hawley-Smoot tariff in 1930, to 25.50 cents. A substantial stream of trade flows over this barrier; it does not, however, for that reason cease to be a barrier.

For New Zealand, exports of dairy produce, and particularly of butter and cheese, are only slightly less important than exports of wool. They constitute about 30 per cent of the total. For Australia, the ratio has been around 6 per cent. Here, straightforward customs duties are for the most part low and of no great importance. Much more significant and effective as a check upon any increase of sales in the United States market has been the imposition of import quotas, the purpose of which is to prevent the entry into the United States of imports that might endanger the support prices that have been accorded to producers of dairy products. The quotas are generally related to the volume of imports in some standard period, which may mean a period back in the thirties. The quotas have to be arbitrarily fixed when they are to be applied to a new product for which no standard reference period can be found in the past. The allocation of quotas, combined with a vigorous marketing policy, has given New Zealand a substantial fraction of the permitted United States imports of dairy produce. The quantities involved are, however, quite small in comparison with either total United States consumption of dairy products, or with New Zealand's exports to other countries. The system, moreover, comes pretty close to imposing a complete ban on the further expansion of trade, including the development of market possibilities for new and improved products.

Meat accounts for nearly one-quarter of New Zealand's exports. For Australia, the proportion is about 7 per cent. As for dairy produce, customs duties are not at present a serious problem. There has been more trouble in adapting the New Zealand and Australian products to the requirements of the United States sanitary and health regulations, to which both imported and domestically produced meat are required to conform. There is obviously every reason for exporters to make themselves thoroughly familiar with the regulations imposed in the country where they hope to sell their exports. So long as there is no reason for suspecting that the real motive behind sanitary or health regulations is protective, there can indeed be no serious criticism of them. In the last resort, the customer is entitled to decide what he wants, and in this case he makes his decision through the medium of sanitary and health regulations enforced by law. In relation to such a commodity as meat, however, a good deal of discretion is necessarily left to the inspectors, and this may mean that trade seems to be subjected to arbitrary and unpredictable decisions. Difficulties that seemed acute some time ago are, however, being gradually overcome. Subject to the penalties to which too successful exporters may expose themselves, the current prospects for trade in meat are reported to be encouraging.

Australia's exports of base metals amount to rather more than 5 per cent of her total exports. Of these, lead is the second most important dollar earner, bringing in recently around $20 million a year. The claims which are currently being pressed upon the United States administration for an increase in the import duty on lead have an obvious relevance for forecasts of Australia's capacity to increase its dollar earnings.

It is not at all easy to make practical suggestions about what might or ought to be done to deal with these problems, and perhaps in any event this is not the place to make any such attempt. Even where changes in commercial policy receive serious attention, the fashion these days favors nothing more radical than piecemeal amendments of the current practice, the effects of which are nearly always difficult to summarize in a crisp, brief statement. For the purposes of the present discussion, it is sufficient to outline the facts as they are at the present time.

Finally, something should be said about the problem of agricultural surplus disposal. This problem has little bearing upon any direct trading relations between the United States and Australia and New Zealand. It may have, however, a very important bearing upon the trading relations of Australia and New Zealand with third countries, and therefore with the prospects for rebuilding a sound structure of multilateral trade. There has developed in the United States a substantial surplus of agricultural produce which cannot be sold here at the prices guaranteed to producers by the government. Various means have therefore been sought to dispose of these surpluses elsewhere on more or less favorable terms. These disposal efforts may constitute an alarming threat to other potential competitors who would like themselves to operate in the same markets and are eager to do so on strictly competitive terms. The problem is certainly not an exclusively United States problem. Today there are few, if any, countries prepared to allow their agricultural production to develop on strictly competitive lines. Everywhere the interests of some sections of the farming population have been protected by devices of one kind or another, and the emergence of surplus production is merely one symptom of this philosophy. Criticisms of United States policy should, moreover, be tempered by the recollection that to some extent the growth of agricultural surpluses in the United States was a consequence of the strenuous efforts made to solve the special problems of widespread war and postwar food shortages. If these efforts had not been made, the course of world recovery from the dislocations inflicted by the war would have been much less satisfactory. Even today there are still many countries where the standards of food consumption are deplorably low, and humanitarian sentiment can scarcely withhold approval from action taken to relieve famine and malnutrition. However, it cannot be seriously maintained that such considerations as this today constitute the most important force behind the surplus disposal program. The program is, in fact, a direct result of measures taken primarily to protect the interests of domestic farmers. Such protection may be a legitimate objective of public policy, but the steps taken to implement it naturally cause concern in other countries where it is felt that some of the benefits which normally they might have expected to enjoy as a result of productive activity based on strict attention to efficiency may be frustrated by the unpredictable gifts or near-gifts of a surplus disposal program. If the United States sells wheat or dairy produce on favorable terms in countries where the Australian or New Zealand exporter is trying to build up a market on a sound competitive basis, the effects upon Australian and New Zealand trade as a whole may be not unlike the direct effects of a high United States tariff or a prohibitive import quota. A thorough discussion of this problem would carry us far beyond the reasonable limits of this paper. It should be sufficient here to register the fact that it is a real problem, and that the persistence of Australian and New Zealand criticisms of the policy adopted by the United States should not be interpreted as implying any insensitivity to the urgency of the needs of the poorer countries which are sometimes in part satisfied by surplus disposal transactions.

The essence of the situation, from the standpoint of Australia and New Zealand, may be summed up as follows. The United States is often concerned to proclaim to the rest of the world the virtues of free enterprise. It preaches the gospel of efficiency. If the tenets of this gospel are thoroughly digested and applied, it is implied, all other things will be added unto you, and your international trade troubles will disappear. Australia and New Zealand find, however, that when it comes to detailed questions of trade with the United States, their efforts to apply the gospel of efficiency do not receive an unqualified welcome. No one can reasonably expect a sudden reversal of policy trends which have now been powerful for many years, but it is not unreasonable to press for a gradual movement away from the hampering limitations that in the United States have been placed on effective market responses to efficient production elsewhere.

Progress in Commonwealth East Asia and American trade prospects

Frank H. H. King

Economist,

Chinese Economic and Political Studies Program,

Harvard University

COMMONWEALTH East Asia comprises six distinct political entities — the sovereign Federation of Malaya, the British protected state of Brunei and the Crown colonies of Hong Kong, North Borneo, Sarawak and Singapore. As we survey the over-all problem of American trade with Asia, the $3 million worth of trade which, for example, North Borneo had with the United States in 1956 might hardly seem worth discussion.[1] Yet each of these territories is a potentially expanding market, each has its own economic hopes, its plans, and its problems and in each American trade and investment may play a role which, to the territory itself, could well be vital.

Commonwealth East Asia has a tradition, inspired by the British, of free enterprise. The fulfillment of the peoples' desire to modernize, to industrialize and to enjoy the high standards of living which such progress promises has been planned within the context of this democratic and liberal economic philosophy. The nationalism which has inspired the Federation's course to independence or *Merdeka,* which is causing unrest in Singapore, and which is awakening even in the more undeveloped areas of Borneo, is not essentially unfriendly to Western enterprise nor fanatically exclusive. American investors and traders have been invited to play a role in the economic development of this

The author wishes to acknowledge the facilities made available to him through his association with the Center for East Asian Studies, Harvard University. In preparing this paper he has been kindly assisted by last minute observations from the governments concerned and also from the Bureau of Foreign Commerce of the U.S. Department of Commerce.

[1] Figures in this paper have been rounded for ease of presentation. More accurate statistics are available in the statistical sources cited in the bibliography. All figures are from government sources, the United Nations' ECAFE *Economic Survey* or from U.S. Department of Commerce publications.

area, and they will surely gain, as will all the world, from the higher standards of living which the people of Commonwealth East Asia eventually achieve.

I shall devote the major part of my paper to the Federation of Malaya, and, secondly, to Singapore. I shall group the three Borneo territories next and, finally, discuss the economically important city-state of Hong Kong with its flourishing industries and entrepot trade.

I

The basis of the Federation of Malaya's economic prosperity and growth is to be found in her current five-year plan, which calls for a total capital expenditure of $376 million, including $43 million for defense and unallocated reserves, and a consequent recurrent expenditure of $30 million by 1960. This plan is typical of those of the other Commonwealth territories in that it is designed to provide the economic and social overheads without which, under present world conditions, rapid economic development would be unlikely and private investment would be unprofitable.[2]

The development plan allocates $333 million to economic and social development of which 58 per cent is for the economic sector, with priority for those primary industries which are responsible for the country's relatively high income. Rubber replanting schemes receive the largest single allocation. Replanting with improved stock and new planting of rubber are projects designed to increase national income; but stability through diversification is also a goal, and replanting includes the use of alternative crops including cacao, coconuts, coffee, oil palms, hemp, paddy, pepper, pineapples, ramie and tea. The government also intends to encourage stability by reorganizing the rubber market to prevent unnecessary speculation, while research by the industry should continue the series of improvements both in quantity and quality with the expectation that the market for the natural product

[2] Hong Kong does not have a development plan as such, but it has a program of rural improvement and a series of individual public works projects which are, in fact, a development scheme. The government of Hong Kong appears to dislike the term "plan," but an economist cannot help but question whether the colony's present prosperity was not in some sense planned, even though the role of private enterprise was basic and vital. For details of the plans see *The Colombo Plan* (Sixth annual report), Cmnd 315, (H.M.S.O., 1957) and the *Report on Economic Planning in the Federation of Malaya*, (Kuala Lumpur, 1957).

will consequently improve while costs are kept competitive.[3] The tin industry has been hampered by the activities of Communist terrorists but conditions are rapidly improving. Production, however, is regulated by Malaya's adherence to the International Tin Agreement.

The government also plans improvements in drainage and irrigation, in the road and railroad network, in port improvement and telecommunciations. A hydroelectric scheme to generate up to 85,000 kw is dependent upon current negotiations with the International Bank.[4] Of the $106 million allocated to the social sector, 32 per cent is for improvements in education, housing and health, with $32 million going to education alone, a basic prerequisite for an industrial labor force.

How does this ambitious program affect the United States?

The investment policy of the Federation has been stated as follows:

> To encourage and safeguard the investment and re-investment of local and overseas capital required to promote this expansion not only of secondary industries but also of primary export industries on which the general prosperity of the country depends. The government will welcome the assistance of overseas capital in such development, particularly in fields of industry in which local capital and technical knowledge are at present insufficient. The government will especially welcome industrial projects in which overseas capital is associated with local capital.[5]

This policy statement should be read in conjunction with the Development Plan and with the other concrete steps the Federation is taking to encourage investment. The Colombo Plan is providing an

[3] Rubber output is already reported as increasing due to the production of higher yielding trees. "Malayan Business Uptrend Retarded," *Foreign Commerce Weekly*, January 13, 1958. Some 1.5 million acres have been earmarked for new planting under the five-year plan, but as noted in the text some former rubber areas may be replanted with other crops to implement the diversification program.

[4] In 1956 total Federation production of electricity, including purchases from Singapore, was 82 million kw hours. Singapore production was 36 million kw hours. For details on Federation loans, see *Foreign Commerce Weekly*, January 13, 1958.

[5] A statement by H. E. Dr. Ismail bin Dato Abdul Rahman, Malayan ambassador to the United States, when he was minister for commerce and industry, quoted in *Foreign Commerce Weekly*, August 26, 1957.

Industrial Development Advisor.[6] The federal government will co-operate with the state governments in the planning of industrial estates and factory sites.[7] They will promote research facilities and are now establishing an Industrial Development Finance Corporation with an initial capital of $5 million to provide medium and long term loans to new industry.[8] Tax exemption on the income and dividends of certain new industries for five years, exchange provision for the remission of profits and the repatriation of capital are additional financial inducements.[9] And, with a wider view, the prime minister of the Federation has proposed that undeveloped Asian nations draw up a joint charter guaranteeing "justice, rights and interests" for private foreign investors.[10]

The trade statistics of the Federation of Malaya include those for the Crown colony of Singapore. Total Malayan exports for 1957 were $1.39 billion; imports totaled $1.46 billion, an unfavorable balance more than covered by the income from invisibles.[11] The United States share of this trade in 1957 was 4 per cent of the imports or $55 million and 5 per cent of the exports or $64 million. Our share in Malaya's import trade has been fairly stable over the past few years, but the value of her exports depends upon the prices of tin and rubber. The most important items of our export trade to Malaya appear to be: petroleum

[6] The Colombo Plan for Co-operative Economic Development in South and Southeast Asia is not a development plan in the sense usually understood, but rather a coordinating concept through which member nations can discuss their national plans, receive from other members economic and technical assistance, and consider common problems. By June 30th, 1957 the United States had given assistance to Colombo Plan nations of over $3 billion, none of which was allocated to the nations discussed in this paper. Now that the Federation is sovereign, it may seek aid outside the Commonwealth.

[7] Under the federal constitution, land is a subject reserved for state legislation. However, there is a National Land Council and there are other constitutional provisions to allow the federal government sufficient power to acquire land for approved development schemes.

[8] *Malayan Bulletin,* February 25, 1958. The capital is mainly supplied from non-government sources.

[9] Cf. *Interim Statement of Industrial Development Policy,* No. 30, 1957. See also the Pioneer Industries (Encouragement) Ordinance, No. 13, 1957 for the Colony of Sarawak.

[10] Report in the *Christian Science Monitor.* H. E. Dr. Ismail bin Dato Abdul Rahman's paper printed in this collection, provides the latest and most authoritative position of the federation government on foreign investment.

[11] Balance of payments data are not available for any of the territories involved. However, estimates for Malaya were made by the International Bank Mission in their *The Economic Development of Malaya* (Baltimore: Johns Hopkins University Press, 1955).

products, $4.6 million; fabrics, both cotton and synthetic, $4.3 million; tractors and tractor parts, $3.7 million; cigarettes, $3.4 million; and oranges, waste paper, paperboard and old newspapers, detergents, parts for construction, hoisting, conveying and mining machinery, air conditioning units, refrigerators, fountain pens, and other metal manufactures. We are also successful in selling excavating and levelling machinery, accounting and calculating machinery, tin plate waste and scientific equipment.

The direction of Malaya's trade has shown no important changes in the past five years. Eighteen per cent of Malaya's imports come from the United Kingdom and 38 per cent from Sterling Area countries. Some 60 per cent originate in Asia and the Far East. China accounts for 4 per cent; Japan, for 6 per cent. Malaya's economic connections with the United Kingdom, including direct British investment in the country and the sterling basis of the currency, explain in part the important role played by the United Kingdom in her trade. There is no reason to suppose that this pattern will change solely for political reasons.

Malaya's import trade with China is mainly in foodstuffs, but manufactured goods from the mainland, selling far below cost, are finding their way into the markets of Southeast Asia. For example, in 1957 China shipped $125 thousand worth of sewing machines into Malaya. These goods have an initial fascination for the Chinese consumer, who, regardless of his political affiliations or his loyalties to Malaya, is quite naturally proud of the achievements of fellow-Chinese on the mainland. Thus far, however, the shipments have more political than economic significance and do not as yet appear to constitute a threat to America's Malayan trade.[12]

Japan's exports of fabrics to Malaya totalled $36 million in 1957 compared with $4 million from the United States and $3 million from China. Galvanized sheets worth $7 million and sewing machines worth $2 million were imported from Japan. There is competition in East

[12] As noted below in the section on Hong Kong, China is exporting not only for prestige but also for foreign exchange. However, the initial attraction of her products rests in part upon nationalistic sentiments, on pride in the fact that China is at last competing with the industrial nations. Recently China and the Soviet Union bought up Malaya's growing rubber stocks (*Foreign Commerce Weekly*, January 13, 1958), and the United States may expect to see Malaya's trade with mainland China expanding, although lack of foreign exchange will limit China's ability to continue her rubber purchases unless political factors dominate her policy.

Asia between the United States and Japan for certain types of capital equipment, but Japan is unable to supply all needs, and Japanese investment in Malayan development may even mean an increased demand for American goods.

Singapore and Penang are free ports, but the Federation levies duties the intensity of which for 1956 imports was 16 per cent. At present the tariff, which may be increased, is for revenue only, but the government is considering tariff protection for local industries.[13]

Although administered separately, Singapore has always been integrated economically with the Federation. To a great extent this is still the situation, but the Federation is now sovereign and it is apparent that certain readjustments in the economic relations of the two terriories will be attemped. Singapore, however, must continue as an important port for the Federation, since the new port developments there are only sufficient to keep up with the normal increase in trade.[14] The role of Singapore as a banking center for Malaya and the future of the now uniform monetary system will depend upon decisions soon to be taken relative to the founding of a Malayan central bank or banks.[15]

[13] American investors and traders should also know that income tax is at 40 per cent for incomes of $11,700 or over. See (*Foreign Commerce Weekly*, November 20, 1956). Tax policy in the past been generally pan-Malayan, because of the free communication between the Federation and Singapore. If regulations restrictive of Singapore-Federation commercial relations should be increased, however, the Federation would be freer to pursue its own tax policy.

[14] Singapore has traditionally served as the wholesale distributing center for Johore and certain other southern Malayan districts. For example, the currency note requirements of Johore banks were met from Singapore rather than Kuala Lumpur. If taxes and immigration restrictions are increased, however, this pattern may be changed, and Johore Bahru itself may become more important as a commercial center. Already industrial expansion has been reported; see note 19 below.

[15] For additional information on this subject, see G. M. Watson and Sir Sidney Caine, *Report on the Establishment of a Central Bank in Malaya* (Kuala Lumpur, 1956); P. W. Sherwood, "The Watson-Caine Report on the Establishment of a Central Bank in Malaya," *The Malayan Economic Review*, II, 1 (April, 1957) and my "Notes on Malayan Monetary Problems," *ibid*, III, 1 (April, 1958). Although different currencies would be unnecessarily costly and confusing, there is no reason why their basic soundness should be destroyed or why they could not be kept at a relationship which varied within the limits now set by the cost of internal transfers. No concrete steps have been taken to implement this report; the Federation's Central

Singapore trade has already been considered in pan-Malayan terms. Focussing now on local problems of the colony's economy, it is apparent that the small size of the territory and the peculiar political problems make sound development essential. Yet the future is uncertain. Her entrepot trade is dependent in large measure on political considerations, and many of the new nations of Southeast Asia would prefer to keep their trade out of the hands of the Singapore middleman. The prohibition of the Indonesian barter trade alone is said to be costing the port some $10 million in trade this year.[16] Unless unreasoning nationalism is absolute, however, the economically strategic position of Singapore combined with her financial and other commercial facilities, including extensive harbor improvement schemes, insures that the colony will continue as an important entrepot port and that large shipments to Southeast Asia will be broken down there for distribution to the secondary ports of the Federation, to British Borneo, Vietnam and Cambodia, Thailand, Indonesia and Burma.[17]

The Singapore government's development plan has not been published in the same detail as has that of the Federation. However, its spirit is the same, and it includes such projects as improvement of the harbor and the Singapore river, the expansion of electricity, water, gas, telephone, sewage disposal and flood prevention facilities, low cost housing, building and improvement of roads, the building of schools and hospitals, and agricultural and industrial research and training. The stage, at least, is being set for economic expansion and industrial

Banking advisor (Mr. Willcock, formerly of the Commonwealth Bank of Australia) has only recently been appointed.

[16] This estimate is given in the *Malayan Bulletin,* January 25, 1958. Presumably, it assumes that the order will be enforced.

[17] Singapore-Indonesian relations have not been good, and Indonesia has been reported to be buying from, e.g. African suppliers, goods which were in Singapore and which were shipped to Indonesia via an African port. The origin of the goods was not realized! However, this antipathy to the middleman is not confined to Indonesia; in fact, it is one basis of the antagonism between the Federation and Singapore. It is a manifestation of the old conflict between city and country. Many Federation politicians would like to see the head offices of companies dealing with Malaya moved from Singapore to the Federation, and all shipments diverted to Federation ports. They would prefer to have a Federation central bank and currency, and a wholly Federation tax system. Many of these moves would be costly not only to Singapore but also to the Federation, and, in many cases, practical considerations will prevent their implementation. But the trend should be noted and watched.

development. But it is in the field of industrial development that Singapore faces further difficulties. Labor unrest has discouraged long-term investment and capital has moved to Hong Kong.[18] The political trend is not encouraging for the private sector, and the possibility of Federation protective tariffs account for a tendency to consider industrial expansion in the Federation rather than in Singapore, despite the latter's cheaper access to overseas markets.[19] These negative factors must, however, be weighed against the many positive features of the colony's economy — its capital resources, the availability of its labor force, its commercial connections and the proved success of several new industrial enterprises.

Based upon this general survey of the Malayan economy, I shall now make several comments on specific problems which appear to be of interest to American investors and traders.

Although Malayan development programs are based on a liberal economic philosophy and upon the concrete heritage of such British accomplishments as rule of law at one extreme and good railways at the other, the peninsula has also inherited an economy heavily dependent upon the fortunes of natural rubber and tin. In this sense it is economically unbalanced. With the exception of Malay peasant holdings, the domestically-owned economy is largely, although not exclusively, in the hands of the Chinese; in this sense it is communally unbalanced.[20] The development plan of the Federation goes far to correct the extreme hazards of the former, but the communal problem is not so easily solved. The Federation has so far avoided the arbitrary and excessive communal legislation of some other Southeastern Asian nations, although there are provisions both in the constitution

[18] Labor unions in Singapore have become to a large extent the tools of political parties. This is especially true of the so-called middle road unions dominated by the Peoples Action Party. The unions affiliated with the Singapore Trade Union Council support the less radical government party, the Labour Front, and their activities have been more related to the problems of industrial relations. However, officials of the International Council of Free Trade Unions in Singapore have charged that the die-hard opposition of some foreign firms to labor unionism or to the reasonable demands of moderate unions have forced labor into the hands of more radical unions which may be Communist infiltrated.

[19] For example, a $700,000 power-operated textile mill and a foam rubber factory have recently been established in Johore. *Malayan Bulletin,* January 25, 1958.

[20] For a discussion of communal problems in the economy, see my *The New Malayan Nation* (New York: Institute of Pacific Relations, 1957).

and in statute which are designed to insure that the imbalance does not grow. Thus the question is whether the Chinese will accept the political and economic compromises of the constitution, whether the course of Federation politics will be dominated by the present conservative politicians and whether the growing political and economic power of labor will be used to win concessions within the framework of a free enterprise system.

A newly sovereign nation might have been expected to react against the former imperial power thus presenting a trade opportunity for other nations. This has not been the case, and American businessmen will have to base their competition on the usual economic propositions of price, quality and delivery. As a sovereign nation, the Federation's bargaining position relative to the allocation of dollars from the sterling area pool should be much stronger, especially since Malaya continues to be the area's largest dollar earner. However, this will not in itself mean an expansion of American trade since Commonwealth East Asia has already been able to buy almost all the dollar area goods it desired, either directly through normal dollar permits, or indirectly through Hong Kong, where the payments were made in sterling and the imports financed in the Hong Kong open-dollar market.[21] In 1957 almost one-half of Malaya's United States imports were shipped through Hong Kong. The procedure adds from 5 per cent to 20 per cent to shipping charges,[22] and, therefore, to this extent, an increased dollar allocation would allow a larger percentage of American imports to be shipped directly and offered at lower prices. This is one potential source of trade increase. Another is to be found in the requirements of the development plan itself, and the ending of the government's tie with the Crown purchasing agents in London.

Yet this is a time of change in Malaya and, therefore, an opportunity for reassessment of individual trade and investment relations. A distinction must be made between securing new and sound commercial relations with the area and expecting an immediate increase in the sale of a particular product.

Malaya's foreign trade has traditionally been conducted through agency houses, commercial firms with local knowledge which handle many types of goods varying from automobiles to marine insurance,

[21] For commercials details, see the *International Trade Reporter, Import Export Controls Manual,* Singapore section.

[22] *Ibid.*

from rubber to shipping. The general criticisms, sometimes uninformed and unfair, have been that the larger of these houses rest on the profits of a few famous products and do not push all their lines and that their mark-ups are excessive. An American manufacturer should be careful, therefore, to select his local agents not only on the basis of the fame of their name, a fame which may have been achieved in other fields. Small but enterprising Chinese or Malay firms may be more capable of establishing a market for some new product than the older houses, and growing nationalism may suggest that this is wise for other than the normal business reasons.[23] Local agents may also be aided by manufacturer's representatives, especially where technical advice is required by consumers. And, finally, since price rather than quality is often a decisive factor in competition with, for example, Japanese products, the policy of burdening agents with costly inventories and parts should be reviewed. A centrally located Asian supply depot, in Hong Kong or in Singapore, maintained at the producer's expense or shared by all Asian agents can in these days of rapid transportation provide a substitute which the American businessman may wish to consider.

Although nationalism has not aroused such intense sentiments in the Federation of Malaya as elsewhere in the non-Western world, it would be wrong and even unfair to underestimate it. Federation policy statements indicate that the government welcomes foreign investment but makes it clear that the government expects foreign business to associate as much as possible with local capital and local labor. The use of local employees in only minor clerical positions will not long be tolerated whatever the declared policy, and American business must be prepared to employ local citizens in executive positions. This requires a new outlook, the elimination of old-style managers who think in "treaty-port terms"; it makes a sound personnel policy the basis of business success. But even the company wishing to employ local executives will have difficulty. First, there is no pool of trained personnel, and not all companies can institute training programs, especially

[23] Size is obviously not a sound criterion. Many of the larger Agency Houses either have specialists most capable of handling a particular line or subsidiaries which are designed to service a particular type of product. However, these specialists are not always available in the smaller branch offices of the Agency Houses where sales may well be increased. The important point is that thorough investigation of all possibilities should be made rather than relying on names and past reputations.

since graduates may leave for competitive positions. Secondly, the practice of paying local personnel lower wages for the same job under whatever guise — for example, housing provisions, expatriation allowances — is no longer sound. It is bound to create two classes of employees based not on ability or work performed but on nationality. Such distinctions can lead to nothing but trouble for foreign business.

A serious political problem in democratic Asia today is the lag between the supply of and demand for young men partially trained in modern-type occupations. Their opportunities in government are limited; the economies are not as yet sufficiently developed to absorb them all in modern enterprise. They naturally resent their exclusion from foreign companies which often, in the first stages of development, form an important part of the private sector of the economy. And these are the politically articulate young men.

In conclusion to this section on Malaya, it appears that the long-run prospects are good, though continual reinterpretation of the political trends is always necessary. But as the U. S. Department of Commerce reports:

> The outlook for U.S.-Malayan trade and investment relations in the near future is somewhat less favorable than the long-run prospects. At present, lower rubber prices and cutbacks in tin production are causing an economic slowdown. Recently private purchasing power and Government revenues have declined, and the Federation Government has decided to curtail proposed 1958 expenditures under the 5-year Development plan.[24]

The Malayan economy is subject to such changes, however, and Americans should not be deterred from taking this opportunity in the immediate post-merdeka period to review our trade and investment relations with the area.

II

Political changes may soon be expected in the three territories of British Borneo. At present administered separately, they may be joined in a loose federal union of very limited powers with a single governor general or high commissioner ruling in the Queen's name with three sets of advisors. He would be responsible for certain inter-

[24] Paul A. Mayer, "Malaya," *Foreign Commerce Weekly*, April 7, 1958, p. S-14.

territorial activities such as defense and external relations, internal security, communications, civil aviation and meterology, posts and telecommunications and, as they are already combined, the judiciary and the geological survey. Later perhaps, trade and customs, banking and currency, and certain specialist services would be federalized.[25]

The most important single problem is the uneven distribution of wealth. Throughout the last century Sarawak and North Borneo appropriated the territory of the once powerful Sultanate of Brunei leaving it an area of only 2,226 square miles and, as it turned out later, oil, production of which in 1956 was valued at $103 million. Total revenue for the state in 1956 was estimated at $39.0 million compared with $8.9 million for North Borneo and $15.3 million for Sarawak. Therefore, it is likely that, unless oil is discovered in the two adjacent colonies — and explorations there continue — the three territories will each control their own revenue and be independent governments.

The development plans of these territories call for the opening up of virgin territory and the improvement of communications and transport, the building of air strips, and improvement in agriculture as well as for the social overheads so essential in this sometimes primitive area. American exports can and do play an important role in supplying the development needs of these territories but American trade is primarily affected by exchange difficulties.[26] Like other sterling area countries they are restricted in the volume of dollar goods which can be bought and, except for goods imported via Hong Kong, they are limited to the essentials required for the execution of the development plans. These include equipment in the field of bauxite mining, transport and road construction, and outboard engines for the movement of goods and passengers over the river networks of Brunei and Sarawak. American manufacturers are urged that such equipment requires professional and technical advice and that local agents or representatives

[25] *A Monthly Survey of Commonwealth and Colonial Affairs,* No. 56 (February, 1958), pp. 7-8. Published by the Conservative Research Department, London. One possible capital for such a federation would be the free-port island of Labuan, strategically located with access to both Brunei and North Borneo, although a little remote from Kuching. Once a separate Crown colony, it became part of the Straits Settlements until 1946 when it was joined with North Borneo. But so far this is speculation.

[26] For many of the comments on American trade with Borneo, I rely on correspondence from the governments concerned. There is very little published information available.

capable of handling such matters should be appointed. For consumer goods, agents in Singapore may suffice, although, in view of the increasing volume of direct shipment from Hong Kong, agents there should watch the Borneo market.

Direct investment in Brunei is bound by the very strict immigration laws in effect, but then Brunei is not short of capital and rather requires more local private enterprise to offset the necessary role which the state must play in the development of such an economy. In North Borneo and Sarawak, legislation is in effect giving certain tax and exchange privileges to pioneer industries, for these territories are, like the Federation, too dependent upon the fluctuations of primary exports — for example, rubber, pepper and timber.

Thus the future of American trade and investment in British Borneo is one of expansion limited by exchange problems and by the rate of development. Although not dramatic in view of the overall problem, any American trading with Southeast Asia should be careful to cover the Borneo market, for its potentials, especially in certain specified fields, are improving.[27]

III

Hong Kong with an area of a little less than 400 square miles and a population of nearly two and a half million has witnessed an industrial revolution unparalleled in Asia. When United Nations and United States embargoes against China threatened her traditional entrepot trade, Hong Kong mobilized her assets, and changed not only the direction of her trade but also the emphasis of her economy. Her assets were, first, her traditional banking and port facilities, secondly, the thousands of refugees — many of whom brought both industrial skills and capital with them from China and especially from Shanghai — and, thirdly, a sensible government which placed economic problems first on its priority list.

Today, Hong Kong may have the highest per capita income in Asia, despite the conditions in which thousands of refugees must still live.[28] Hong Kong has become an important source of low-priced

[27] This very brief survey has hardly done even comparative justice to the Borneo territories. Reference is made to the annual reports of the three territories which are available through H.M.S.O. in London or the British Information Services in New York. The Colombo Plan report also gives details of the economies.

[28] National income statistics for Malaya and Hong Kong, both contenders for first position, are not complete and some speculation is involved in their

consumer goods and a market for both consumer goods as local incomes rise and for capital goods as industry expands. With 3,000 factories employing 150,000 workers and an additional 200,000 workers in cottage industries, Hong Kong's industry may now be supporting some 50 per cent of the population.[29] In addition, of course, her entrepot trade continues to grow, although its direction has changed to include all the countries of Free Asia. Hong Kong is a capitalist state and an example not only to the Communist economies but also to those neo-capitalist countries whose businessmen look continually to government for assistance.

The total of Hong Kong's import trade in 1957 was $888 million; its export trade $520 million — the difference being easily accounted for on invisible account. Some 40 per cent of her export trade consisted of locally produced manufactures including in their order of 1957 importance: textile products, enamelled household utensils, footwear, electric flashlights, lacquers, varnished and prepared paints, linen, metal lanterns, preserved fruits, plastic articles, iron and steel, aluminum ware, vacuum flasks and cement. Export to the United States of locally manufactured goods, especially of clothing and a great variety of miscellaneous manufactured articles of a kind that used to be imported from mainland China, has steadily increased. Since Hong Kong's typical industries are small concerns lacking an export department, it has often proved easier to deal with a Hong Kong merchant house familiar with the market.[30]

calculation. In addition, the concept of national income in an economy where foreign owned mines and plantations predominate is subject to question when it is used in comparison with economies of a different nature. But see Ronald A. Ma and Edward F. Szczepanik, *The National Income of Hong Kong, 1947-50* (Hong Kong and London: 1955); F. Benham, *The National Income of Malaya, 1947-49* (Singapore: 1951) and the International Bank Mission, *The Economic Development of Malaya.*

[29] P. Y. Tang, "This is Hong Kong." *Trade Bulletin* of the Hong Kong Department of Commerce and Industry (February, 1958), pp. 58-60. Mr. Tang is the governing director of the South Sea Textile Manufacturing Co. Ltd. and Mayfair Industries Co. Ltd.

[30] For detailed information on trade with Hong Kong, including exchange regulations, certification of origin, Hong Kong trade names, shipping, etc., see the authoritative *Commerce Industry and Finance Directory* of the Hong Kong Department of Commerce and Industry. Hong Kong maintains trade representatives in Tokyo and London and further information can be obtained by writing the Department of Commerce and Industry or the various chambers of commerce, including the Hong Kong Junior Chamber of Commerce.

United States trade with Hong Kong and participation in this great industrial growth has been hampered by American trade restrictions on business with China. These restrictions included Hong Kong, since onward shipment to the mainland was difficult to control. At the same time the sale of Hong Kong products in the United States was hampered by treasury presumption of the China origin of certain goods. Our exports to Hong Kong slumped to less than $40 million in 1952. They have been rising since then, reaching approximately $90 million in 1957, with total trade at $127 million. This increase has been made possible by the improvement of trade controls under which the illegal trading of American goods with the mainland has been checked.

Hong Kong has never been so British-oriented in its trade concepts as have Singapore and the Federation. This is partly because of the long tradition of American trade with China through Hong Kong and the larger percentage of Chinese merchants and industrialists in Hong Kong having personal contacts with the United States. Since the war, there has been the additional factor of the absence of the usual sterling-exchange restrictions on American imports, providing, of course, they were financed at the open-market rate which usually ran at least 1 per cent above the official rate.

However, the 1957 trade statistics show that Hong Kong obtained 22 per cent of its imports from China, 15 per cent from Japan, 13 per cent from the United Kingdom, and only 10 per cent from the United States. (The percentage of our share of the Malayan import trade for 1957 was 4 per cent.) The dominant position of China is due to the large exports of food to Hong Kong, but there is an increasing export of Chinese manufactured goods, partly for prestige purposes but also to earn foreign exchange, and the importance of these exports which are in part re-exported to countries of Southeast Asia may be increasing.

In 1957 the United States ranked fourth as a source for Hong Kong's imports, fifth as a market for her total exports, and fourth as a market for her locally manufactured exports.[31] But the United States still finds Japanese competition severe, especially in textiles, certain

[31] This is based on figures given in the *Trade Bulletin* (February, 1958). The *Foreign Commerce Weekly* states that the United States ranked third (rather than fourth) as a source of Hong Kong imports, but the figures given by the Hong Kong Government do not support this. See F. Dubas, "Hong Kong," *Foreign Commerce Weekly,* April 7, 1958, p. S-12.

building materials and a wide range of other industrial and consumer items. The United States is able to compete in such items as sewing machines, air-conditioning equipment, refrigerators, various appliances, office equipment, certain chemicals and plastics materials, lubricants, some lines of building equipment, pharmaceuticals, processed foods, artificial fabrics and yarns, and certain finished textile items. The Hong Kong market is highly competitive; there are no tariff barriers on most imports, and exchange controls, as applied, permit the Hong Kong customer to make the world his shopping place. To sell Hong Kong one must have the right product quoted at the right price at the right time.

The stakes are high, however, for Hong Kong is a re-export center through which the American trader may reach certain dollar-short countries.[32] We have already seen how some 50 per cent of Malayan imports from the United States have been transshipped through Hong Kong for exchange reasons. And although the rate of industrial growth may fall somewhat in 1958, American direct investment in Hong Kong is still possible and its potentialities should be fully considered, for in a sense, Hong Kong is the key to the trade doors of Free Asia.

BIBLIOGRAPHY

WTIS — World Trade Information Service of the U.S. Department of Commerce.

HMSO — Her Majesty's Stationery Office. HMSO publications are available by purchase at the British Information Services, Rockefeller Center, New York.

The works listed below are those consulted for the preparation of this paper. However, those marked * contain extensive bibliographies which provide the basis for specialist reading into all aspects of the political, economic and cultural life of the area. There are, in addition, two bibliographies of general interest: Bruno Lasker, *Books on South-east Asia* (New York: Institute of Pacific Relations, 1957); and Arthur Hazlewood, *The Economics of 'Under-Developed' Areas* (London: Oxford University Press, 1954). The latter is annotated.

U. S. Government publications can be obtained from the Super-

[32] Payment in sterling for goods of American origin is allowed at the discretion of the Hong Kong exchange control, and at present this is permitted only for Hong Kong's traditional trading areas (Taiwan, Hong Kong, Macau and South Korea) and Commonwealth East Asian Territories. Thus the relevance of the text is confined to this area.

intendent of Documents, Washington 25, D.C. and from U. S. Department of Commerce field offices.

Allen, G. C. and Audrey G. Donnithorne, *Western Enterprise in Indonesia and Malaya,* London: 1957.

Background to Malaya Series: *The Economy of Malaya,* T. H. Silcock. *Problems of the Malayan Economy,* Lim Tay Boh. Institute of Pacific Relations, New York.

**Checklist of World Trade Information Service Reports and Other Current Publications,* U. S. Department of Commerce: Washington, D.C., January 20, 1958.

*Colonial Annual Reports. Annual Reports are published for each colonial territory and are available through HMSO, London. Included in the series are: Hong Kong, North Borneo, Brunei, Sarawak, Singapore, and until independence, the Federation of Malaya. The departments of each government also publish reports.

Dubas, Floyd, "Hong Kong," *Foreign Commerce Weekly* (April 7, 1958), pp. S-11 and S-12.

Establishing a Business in Hong Kong, WTIS, part 1, No. 56-2, U. S. Department of Commerce: Washington, D.C., 1956.

Establishing a Business in Malaya, WTIS, part 1, No. 56-31, U. S. Department of Commerce: Washington, D.C., 1956.

Far Eastern Economic Review (weekly), Hong Kong.

Federation of Malaya, *Interim Statement of Industrial Development Policy,* No. 30 of 1957. Kuala Lumpur, Government Press, 1957.

Federation of Malaya, *Monthly Statistical Bulletin of the Federation of Malaya,* Kuala Lumpur, Department of Statistics.

Federation of Malaya, *Report of the Industrial Development Working Party,* Kuala Lumpur, 1957. This document is the basis of the Federation's industrialization program.

Federation of Malaya, *Report on Economic Planning in the Federation of Malaya in 1956 and on the Outcome of the Financial Talks held in London from December the 21st, 1956 to January 10th, 1957,* Kuala Lumpur, 1957.

Fiennes, D. E. M., *Report on Rural and Industrial Development Authority, 1950-1955,* No. 16 of 1957, Kuala Lumpur, 1957.

*Ginsburg, Norton, and Chester F. Roberts, Jr., *Malaya,* University of Washington Press: Seattle, 1958.

Hong Kong Government, Department of Commerce and Industry, *Commerce, Industry, and Finance* (annual), ("The official guide and directory on commerce, industry and finance in the British Crown Colony of Hong Kong"), Hong Kong.

Hong Kong Government, Department of Commerce and Industry, *Trade Bulletin* (monthly). Contains articles and monthly trade statistics as well as lists of Hong Kong products and other economic information.

Import Tariff System of Malaya, WTIS, part 2, No. 56-52. U. S. Department of Commerce: Washington, D.C., 1956.

International Bank of Reconstruction and Development, *The Economic Development of Malaya,* Johns Hopkins University Press: Baltimore, 1955.

International Trade Reporter, Export Shipping Manual, Bureau of National Affairs, Inc.: Washington, D.C.

International Trade Reporter, Import and Export Controls Manual, Washington, D.C.

King, Frank H. H., "The Hong Kong Open Market," *Economics and Finance in Indonesia* (November, 1954), pp. 754-63.

———., "Malaya Faces Independence," I. "Strains on the Internal Economy" and II, "Future of the Sterling Link," *The Banker,* CVI (May and June, 1956).

———., *Money in British East Asia,* HMSO: London, 1957.

———., *The New Malayan Nation: A Study of Communalism and Nationalism,* Institute of Pacific Relations: New York, 1957.

Land Transportation in Malaya, WTIS, part 4, No. 55-1, U. S. Department of Commerce: Washington, D.C., 1955.

Licensing and Exchange Controls . . . Hong Kong, WTIS, part 2, No. 56-64, U. S. Department of Commerce: Washington, D.C., 1956.

Malayan Economic Review (semi-annual), Singapore.

"Malayan Independence Arouses Trade and Investment Interest," *Foreign Commerce Weekly,* August 26, 1957.

Mayer, Paul A., "Malaya," *Foreign Commerce Weekly,* April 7, 1958, p. S-14.

Preparing Shipments to Hong Kong, WTIS, No. 55-76, U. S. Department of Commerce: Washington, D.C., 1955.

Preparing Shipments to Malaya, WTIS, part 2, No. 56-71, U. S. Department of Commerce: Washington, D.C., 1956.

Singapore, Government of, *Malayan Statistical Digest of Economic and Social Statistics, No. 1, 1958,* Singapore, 1958.

Singapore, Government of, *Malayan Statistics of External Trade* (monthly), Singapore.

Trade-mark Protection in Hong Kong, WTIS, Part 2, No. 55-25, U. S. Department of Commerce: Washington, D.C., 1955.

United Kingdom, *The Colombo Plan. Sixth Annual Report of the Consultative Committee, Saigon, Viet Nam, 1957,* Cmnd. 315, HMSO: London, 1957.

United Nations, Economic Commission for Asia and the Far East, *Economic Survey of Asia and the Far East,* published annually, usually in April of the following year, Bangkok and New York. (See especially the 1955 and 1957 editions.)

Windett, A. S. *The Changing East.* LPE Papers, No. 5. London: London Press Exchange (110 St. Martin's Lane, W.C. 2), 1957. This is already out of print and I have been unable to obtain a copy, however, it may be important and is said to contain "information on changing Eastern policies re foreign trade and what British exporters should do about it."

The trade of the United States with Australia and New Zealand

Enrique Lerdau

Bureau of Economic Affairs, United Nations

THIS PAPER WILL discuss some of the determinants of the exports of the United States to Australia and New Zealand.[1] First the growth of the market as a whole will be examined and then the composition of imports will be cursorily described. Finally, and mainly, an analysis of the determinants of the share — past and present — of the United States in this market will be presented.

I. THE SIZE OF THE MARKET

There are considerable similarities in the experience of Australasia and of North America in matters concerning natural population growth. Their birth rates at present rank somewhere between the very low ones of western Europe, and those of most underdeveloped countries, where they are very high[2] (see table 1, p. 62), while their death rates are among the lowest in the world.

But while the natural growth rate has been close to that of the North American countries,[3] the actual rate has been consistently higher, and the difference between the actual rates of the two areas has grown

[1] The term "Australasia" will be used synonymously with the addition of these two countries, a mistake perhaps forgivable in a symposium entitled "American Trade with Asia and the Far East."

[2] The statement is obviously an oversimplification, (a) because the birth rate in India, for example, is, in fact, lower than in Canada, and (b) because there are significant differences in the rates of different underdeveloped countries.

[3] United States and Canada.

considerably in the postwar decade (see table 2, p. 62). The difference between natural and actual rates, besides discrepancies in measurement and computation, stems from the appreciable migration into Australasia, especially Australia, since the war.[4]

This migration has had profound impacts on the region in many respects. The inflationary pressures of the postwar period can in part — only in part — be explained by it. The requirements for investment in housing, public utilities and capital goods of all types which were needed for the immigrants, found expression in high levels of demand in the private sector and in government policies — especially fiscal policies — which added to rather than offset these pressures. There were also more subtle changes which, although they are less easily quantified and demonstrated, may have greater long-term significance. Although the largest single group among the immigrants was that of British origin, it was considerably less than one-half of the total in the case of Australia and, in the case of both countries, considerably less than the proportion of the persons of British descent to the population as a whole. The net effect was therefore to make the populations more heterogeneous in culture, religion, consumption standards, labor habits, skills, entrepreneurial talent, etc. than they had been hitherto.[5]

It is difficult to predict the future course of population growth with tolerable accuracy even under favorable circumstances; when a major factor in it is immigration, it becomes next to impossible. It seems a definite part of Australian policy to stimulate immigration from Europe and North America. But while in the past it has been possible to absorb this inflow, and while on the long-run it will continue to be

[4] According to the 1954 census of Australia, out of a population of 9 million, 1.3 million were born outside Australia and out of these over 0.5 million had come within the last five years while almost 0.6 million had been there for over fifteen years. The arrivals during 1950-54, at an annual rate of 100,000, therefore represented an addition of about 1.1 per cent per year, or almost as much again as the natural additions to Australia's population. In New Zealand, 1952-54, the contribution of immigrants to total population, while less spectacular, was still substantial: at about 0.75 per cent it was half as much again as the natural rate.

[5] Persons of United States descent were a minor group among the total number of immigrants. But for what a personal judgment may be worth: it would seem to me that their impact in setting consumption standards and affecting the direction of demand has been out of proportion to their small number. This might not have been so, however, had it not been for the impact of a large number of United States servicemen during World War II, who were stationed in the area.

possible, situations can be envisaged in which the existence of domestic unemployment would provoke strong resistance to such a policy especially from labor. Traditionally the outflow of migrants from the United Kingdom has occurred in waves directly related to cyclical declines in business activity there, and has served, in fact, as an important factor in bringing them to a halt.[6] But there is little likelihood nowadays of anything but a rapid transmittal of depressions from the United Kingdom to Australasia, so that potential immigrants may be most willing to move when there is least willingness to receive them, and vice versa. This argument does not apply with the same force to migration from continental Europe but even there the desire to emigrate may continue to fall as the memory and the effects of World War II recede. In New Zealand, where the unexploited natural resources per head are considerably less than in Australia, it is difficult to see how a long-term continuation of the past rate of immigration can be maintained without reducing appreciably the rate of growth of real income per head.[7]

The rapid postwar population growth was accompanied by an even more rapid expansion of output. In 1956 the real national income of Australia was 22 per cent and that of New Zealand 41 per cent above the 1948 level. In the United States, in the same period, it rose by 32 per cent. But again it is difficult to speculate about the continuation of this trend. On the one hand, it is of course linked to the future of population growth itself. On the other hand, since both countries have extremely high proportions of their national income deriving from foreign trade, to make a prediction about the course of income growth involves forecasting the future terms of trade among other things. It is well known that the experts in this field differ widely; we have on one hand Dr. Prebisch's theory of a persistent tendency of primary commodity prices to deteriorate *vis-à-vis* industrial products and, on the other, Mr. Colin Clark's forecast of a long-term improvement of the terms of trade of primary commodities. For our purposes, more limited speculations are appropriate: wool and butter are not likely to share fully in such an improvement even if it came about, since they will probably be under pressure from man-made substitutes for a long

[6] See Brinley Thomas, *Migration and Economic Growth* (Cambridge: Cambridge University Press, 1954).

[7] Cf. Horace Belshaw, *Population Growth and Levels of Consumption* (New York: Institute of Pacific Relations, 1956).

time. Wheat, on the other hand, ought to be in a less vulnerable position if the growth of income and population in the poorer countries continues anywhere near its postwar rate. In any case, as long as foreign trade continues to loom as large as it has traditionally in the national incomes of both countries, their income growth rates will be strongly affected by those of their trading partners, namely the industrial countries.

Contrary to what happened in the United States, imports in Australia and New Zealand in the postwar period rose at a somewhat faster rate than did real national income. But while this in itself might promise a continued rapid rise in the demand for imports, it also has less promising implications for the suppliers of imports inasmuch as it may imply more spectacular declines in the volume of imports in times of falling incomes. The empirical evidence is far from satisfactory, but some estimates indicate price and income elasticities in the neighborhood of unity for New Zealand.[8] The true form of the import demand function may be considerably more complicated, being closer to a Duesenberry-Modigliani "ratchet" function, but this could only operate downward, in the absence of exchange reserve constraints. For members of the sterling area such constraints are likely to remain operative for a long time, so that the "simple" income-import relation may be more realistic, although it may not be the one that describes best what would happen in a free market without public intervention.

II. THE COMPOSITION OF TRADE

Broadly speaking, the structures of trade of Australia and New Zealand are similar. In 1956, exports of food and crude materials accounted for over 85 per cent of total exports in both countries while imports of manufactured goods and machinery represented around 60 per cent of total imports (see table 3, p. 63). In both cases the New Zealand figure is the higher one, representing the less diversified—and diversifiable — character of the New Zealand economy, i.e., the fact that its natural resource endowment puts a more restrictive absolute limitation on the extent of possible industrialization.[9]

[8] See A. Harberger, "Some Evidence on the Price Mechanism in International Trade," *Journal of Political Economy,* (December, 1957); and my "Economic Policy for A Dependent Economy," *Southern Economic Journal,* (July 1956).

[9] New Zealand is roughly self-sufficient in coal but has only insignificant other mineral resources, so that a considerable part of its industry represents

Australia's export structure is somewhat more diversified, but both countries depend on the export of wool, meat and dairy products, with wheat and sugar added in Australia. On the import side, besides the two major categories mentioned, both depend on foreign petroleum and its derivatives, although some promising strikes of oil have been made in Western Australia. The primary sources of these imported fuels are Indonesia and the Middle East.

In both countries electrical machinery, appliances and transport equipment constitute about 60 per cent of the imports of this group, while machinery, especially power generating equipment, makes up the rest (see table 4, p. 64). As for other manufactured goods, a surprisingly large proportion is made up of textiles, especially cotton fabrics[10] (see table 5, p. 65). Beyond this, iron and steel in various forms of semimanufacture, especially girders, bars, plates and sheets are of considerable importance.

In their geographic structure of trade, both countries show considerable concentration, although Australia less so than New Zealand (see table 6, p. 66). In both countries the United States is a relatively marginal supplier and customer, for reasons that will be discussed in section III. In both countries the United Kingdom is the chief source of imports and purchaser of exports, but in New Zealand its role as customer is, proportionally, twice as large as in Australia.

III. THE SHARE OF THE UNITED STATES

What accounts for the low share of the United States in the Australasian market? At first glance the question may seem naive, since a number of obvious explanations come to mind, but it is just the multiplicity of such "obvious" explanations, that creates considerable difficulty. For, although they are not necessarily mutually exclusive, it would seem desirable to attempt to assess them individually and, if pertinent, at least rank them in order of importance.

(1) American Restrictive Practices

It is tempting to explain away the low level of Australasian imports from the United States by the inability of these countries to sell their

assembly, rather than manufacture. Australia, on the other hand, has a steel industry using domestic coal and iron.

[10] Surprising in the sense that the textile industry is typically one of the first to develop in primary exporting areas. See *Processes and Problems of Industrialization in Under-developed Countries,* Department of Economic Affairs, United Nations, 1955.

products in the United States: wool, dairy products and meat are all so heavily protected in the United States that (comparative costs to the contrary notwithstanding) relatively little is imported from these highly efficient producers.

But Australia and New Zealand are members of the sterling area and it is not necessary for any one country to balance its accounts with each individual trading partner. It would, in principle, be quite possible — and was in fact quite normal in the past — for a group of countries to run permanent trade deficits with a given currency, provided these deficits could be financed out of the surpluses earned elsewhere.[11] The ability of Australia and New Zealand to buy in the United States, according to this reasoning, is therefore not limited by their sales to this country, but rather by the total amount of dollars which the rest of the sterling area is willing and able to let them have for the purpose. American trade restrictions, the argument would run further, cannot be blamed therefore for the low volume of sales to this particular area except inasmuch as they limit the total dollar earnings of the rest of the world, or in a world of limited convertibility, of the sterling area.

The argument seems to me convincing as far as it goes but there is a major qualification to it which much reduces its relevance. The geographic location of Australia and New Zealand tends to make them terminal points for transportation services. Thus, if they were to sell a great deal less to the United States than they bought, it would imply that ships would have to return empty from there, with the corresponding rise in over-all transport costs, since freight charges for shipments from the United States to Australia would have to be high enough to cover the costs of a round-trip rather than a one-way voyage. The price disadvantage to which this would put American goods might be appreciable on many items. One need not press this argument too far (after all, Australasian exports are far bulkier per dollar of commodities transported than Australasian imports) but that it is of some relevance is evident from the relative lack of shipping ties. In fact, transportation is only one — albeit the most important — item in this argument. The whole structure of service industries that are ancillary to foreign trade, is very much oriented to trade with the United Kingdom than with the United States: banking, insurance, brokerage, etc.,

[11] See League of Nations, *The Network of World Trade* (Geneva: 1942), for an account of the traditional pattern.

are all in the hands of houses that are able to spread their overhead by servicing two-way trade. And while again important other reasons exist for this, it does not seem unreasonable to suggest that the lack of Australasian sales to the United States contributes its share.

(2) The Dollar Shortage

As was stated above, the over-all lack of dollars in the sterling area is a major limiting factor on purchases from the area and the occasional statements of intent of the Annual Conference of Commonwealth Prime Ministers are eloquent testimony to the fact that import control policy has been handled with this in mind. In other words, when some members of the sterling area were net dollar earners and others net dollar spenders, (since the dollar reserves of all are under pressure) administrative policy in all countries was expected to restrain dollar imports. As far as the postwar shares of the United States in Australasia's imports are concerned, it is therefore entirely reasonable — on logical grounds — to think that they might have been higher if the sterling area as a whole had been in a stronger position.

But to throw the whole burden of causation on this factor will clearly not do since it would assume a number of unacceptable premises:

a) First, it would assume that the United States share in the area's imports was very much larger in times of no noticeable dollar shortage for the sterling area. Reference to tables 7, 8 and 9 (pp. 67-69) will show that this was not so, if 1937 is taken as an acceptable comparison. In Australia, the United States share was 16 per cent, while in 1956 it was 13 per cent. In New Zealand the relevant figures were 12 and 8 per cent. While a decline did occur, the prewar figures were not high enough not to raise precisely the same question for that period as that under discussion for the present: what accounts for the low American share?

b) Furthermore, to take the postwar dollar shortage as the only or even the principal causal variable would imply that in its absence the United States share would be very much higher, but it tells us nothing as to the approximate actual proportion. This we could only know if we had information on two further unknowns: the total demand of Australasia for each of the major commodity groups and the relative advantage or disadvantage of the United States (over Great Britain, we may say for simplicity's sake) in each of these same commodity groups. Only then would it become possible to estimate what the "proper" share of the United States would be under conditions of free currency convertibility and non-discriminatory import policies in Australasia.

(3) Empire Preference

The last set of considerations mentioned above suggests a further line of inquiry. To what extent is the low share of the United States merely a consequence of preferential treatment of goods of British origin in the importing countries?

Both countries have granted preferential tariff treatment to goods produced in the British Commonwealth for a long time.[12] But it was the 1932 Ottawa Agreement that made the margins of preference significant and firmly established the principle of Imperial Preference and Reciprocity. While it was a depression phenomenon it has continued to exist after the war, perhaps partly because opinion on both sides was that sooner or later depression conditions would reappear.

Both Australia and New Zealand are signatories of the General Agreement on Tariffs and Trade and as such accord the United States, another signatory, most favored nation treatment. But "most favored" refers to countries other than members of the Empire.

It is impossible to give a perfect estimate of the over-all degree of preference without weighing each rate by the value of the goods imported under it — an experiment of manifest impracticality in this context. An acceptable alternative would be to take the total duties collected on imports from the United States as a proportion of total imports from this country and compare the result with the same ratio for imports from the British Empire. The result would be an approximate measure of the degree of preference. But even for this the necessary data are not readily available.

It is however possible to take selected duties on important commodities so as to gain a rough impression of the degree of preference (see table 10, p. 70). The rates chosen seemed fairly representative of most others in their relations to each other and, in the event, cover rather important categories. The impression one gains from them is that the degree of preference on many commodities was significant enough to turn the price advantage to British goods, but at the same time was not important enough to overcome really overwhelming differences in the relative costs of production or in the qualities of products. It does,

[12] In New Zealand the Preferential and Reciprocal Trade Act was introduced in 1903.

however, seem a safe inference that the preference system is a more important factor than the dollar shortage in the list of possible explanations of the low share of United States goods in the Australasian market.

(4) Costs and Demand

As was suggested earlier, another possible chain of events might exist which, if observable, could account for the phenomenon under discussion. If it were to be shown that the structure of demand in the importing countries happens to be such that most of their expenditures on imports happens to be made on commodity groups in which the United States is not well able to compete, this in itself would give an explanation — the most satisfactory one for an economist — of the low relative level of United States exports to the area.

To make this term "not well able to compete" operational it would at least have to mean "where the c.i.f. price is higher for the American product than for all competitors who are able to deliver the necessary quantities." Preferably it should mean more than this, namely, a statement about the relations of labor productivity and wages plus a statement of capital efficiency relations and the cost of capital in the United States and its competitors. Ideally, in other words, money price ought to be analyzed by components in terms of individual factor productiveness and factor prices. No usable data of the latter kind exists although a judicious use of input-output tables ought to be capable of producing approximations to it.

There are, however, some data on relative labor costs and productivities in some industries for Great Britain and the United States, and in view of the overwhelming importance of the former in this market, there seems little objection to using such information. The data are prewar and cover only certain industries, so that only tentative answers can be expected from such an approach.

The industries in which the United States seemed to have a clear advantage in 1937 over the United Kingdom, inasmuch as the output per worker was decidedly more than double that of the United Kingdom (the premise being that money wages in the United Kingdom were about one-half of those in the United States at existing exchange rates), included radio and valves, pig iron, automobiles, glass containers, tin cans, machinery, paper, electric lamps, rubber tires, soap, biscuits and matches.[13] In a world of no product differentiation and, less unreasonably in view of the small Australasian market, constant marginal costs, the United States in 1937 ought to have supplied all of Australasia's requirements in these products. If it had no advantages in any other industry the United States should have supplied nothing more. The proportion of actual imports of such products to total imports would then give the "correct" United States share, if no other influences had been at work. A generous estimate of these proportions yields about one-third for Australia in 1937-38 and the same figure for New Zealand in 1937. The rather surprising conclusion emerges that even without any other factors interfering with the flow of trade, the share of the United States would not have been even one-half of total imports into the area.

The oversimplification of this argument is perhaps too obvious to be spelled out in detail. For one thing, only manufactured goods are included in the study, so that the advantage of American tobacco, to take one example, is suppressed. For another, the trade statistics are not comparable enough with the industrial statistics to give more than the merest indications of orders of magnitude. Again, product differentiation is vital in some industries: automobiles are the most obvious example. Other theoretical objections could also be cited. Nevertheless I believe that the conclusion is warranted, that even under non-discriminatory trade policies the British share in this area would have been larger than the American one, simply because the area happens to want so many commodities in which British prices were lower, i.e., British disadvantages in labor productivity were not great enough to offset lower wage rates.

(5) Historical Factors

There is another set of factors, the least tractable to quantitative appraisal, that needs consideration. They might be called historical or institutional factors and are, in my opinion, of more than slight importance. Some have already been noted, and some more may now be mentioned.

[13] See G. D. A. MacDougall, "British and American Exports, A Study Suggested by the Theory of Comparative Costs," *Economic Journal,* (December 1951), using data from L. Rostas, *Comparative Productivity in British and American Industry,* (Cambridge: Cambridge University Press, 1948). The industries covered accounted for about one-half of total British exports.

The ties between Great Britain and this area have historically been so close that the flow of trade is to a considerable extent determined by the past rather than the present. The fact that it was British capital that installed much of the existing fixed capital equipment implies that spares and replacements for many items must be bought in the United Kingdom because of questions of size and other specifications. The railroads are narrow gauge. Electric appliances run on a different voltage than the American ones. Houses, typically not centrally heated, require many room heaters of types not common in the United States. In many instances, in other words, the past installations simply predetermine where purchases for replacement are made.

The links with the United Kingdom furthermore have built up national preferences so that often among identically priced products, the British one will be preferred. It is possible for a toothpaste to advertise "Buy X toothpaste and be British to the teeth," because it does thereby appeal to a socially accepted value. British magazines and newspapers are read more than American ones, hence British advertising is, on an equal expenditure basis, more visible.

All these factors are important. But they ought not to be overstressed. Product differentiation also works in another direction. American automobiles have, I think, in the consumer's eye an advantage which is, at the very least, no smaller than their true excess value over British ones when one views automobiles as mean of locomotion rather than expressions of one-upmanship. American films, provided they conform to a certain stereotype, seem to be assured of a good market, regardless of critical dispraise. Other examples can easily be found of instances where consumers' product differentiation favors the American rather than the British product, although on balance no doubt the reverse is true.

The generalization might be ventured that the competitive disadvantage of American products in the eyes of the consumer tends to be least in relatively new industries in which no strong tradition of trade with the United Kingdom yet exists. These traditions, as was mentioned earlier, are supply as well as demand traditions. Where there is no well established structure of import houses, often branches of British firms, with traditional links to British suppliers, insurers, brokers, etc., American products are more likely to compete successfully. One inference from this would be that the tie to Great Britain, as far as institutional preference is concerned, is bound to weaken gradually. How much this will tend to increase the American share in the market however is, I think, determined by the other factors, mentioned earlier.

(6) Conclusions

Of all the factors mentioned, I therefore conclude that the single most important one is the structure of demand in the importing countries combined with the structure of costs in Great Britain and the United States. This alone would, in the prewar days, have accounted for a United States share of less than one-half and perhaps no more than one-third. The divergence between these figures and the actual shares appears to have been caused primarily by Empire preference and what have been called historical and institutional reasons. American import restrictions on the exports of this area have probably played a smaller role than the other factors mentioned. The postwar dollar shortage is probably the main factor responsible for the further decline of the American share after the war,[14] but this decline itself could not be so very large simply because the United States share was already rather low before the war. Before these conclusions could be more firmly established or refined by assigning quantitative weights to each of the factors mentioned — as opposed to a mere ranking — much further research would be necessary.

[14] The assumption being that the more rapid rise of American productivity during the war was roughly offset by more rapidly rising United States wages and by the devaluation of sterling.

TABLE 1. *Natural Rate of Population Growth and Components, Selected Countries, 1956*

	Birth rate	Death rate	Natural growth rate
	(Per thousand of population)		
Australia	22.5	9.1	13.4
New Zealand	24.7	9.0	15.7
Canada	28.0	8.2	19.8
United States	24.9	9.4	15.5
France	18.5	12.5	6.0
United Kingdom	16.1	11.7	4.4
India	27.4	11.6	15.8
Malaya	45.5	11.3	34.2
Chile	35.4	11.9	23.3
Mexico	46.2	13.7	32.5
World*	34.0	18.0	16.0

Source: United Nations, *Demographic Yearbook, 1956,* and *Monthly Bulletin of Statistics,* February 1958.

*Average 1951-55.

TABLE 2. *Selected Rates of Population Growth (Per cent per year)*

	1930-40	1945-56	1930-56
Australasia	0.9	2.3	1.5
Australia	0.9	2.2	1.5
New Zealand	0.9	2.3	1.5
North America	0.7	1.7	1.2
Canada	1.1	2.3	1.6
United States	0.7	1.7	1.2
India	1.3	1.3*	1.3**
World	1.1	1.2***	1.2**

Source: United Nations, *Demographic Yearbook, 1956.*

*1945-55.

**1930-55.

***1940-55.

TABLE 3. *Australasia: Trade by Major SITC Commodity Groups, 1956*

	Australia		New Zealand	
	Value (£A million)	Proportion (per cent)	Value (£NZ million)	Proportion (per cent)
Exports: total	833.5	—	272.5	—
Food	275.6	33.1	156.9	57.5
Beverages and tobacco	2.3	0.3	0.1	—
Crude materials, inedible (except fuel)	434.7	52.2	107.7	39.5
Mineral fuels, lubricants, etc.	10.9	1.3	—	—
Animal and vegetable oils and fats	5.9	0.7	2.2	0.8
Chemicals	8.2	1.0	2.2	0.8
Manufactured goods	68.9	8.3	2.4	0.9
Machinery and transport equipment	18.8	2.3	0.4	0.1
Imports: total	743.9	—	235.4	—
Food	30.8	4.1	19.9	8.5
Beverages and tobacco	14.5	1.9	5.4	2.3
Crude materials, inedible (except fuel)	66.4	8.9	9.4	4.0
Mineral fuels, lubricants, etc.	92.9	12.5	18.8	8.0
Animal and vegetable oils and fats	4.7	0.6	0.6	0.3
Chemicals	43.7	5.9	15.5	6.6
Manufactured goods	205.6	27.6	77.7	33.3
Machinery and transport equipment	236.1	31.7	67.3	28.8

Source: United Nations, *Yearbook of International Trade Statistics, 1956.*

TABLE 4. *Australia and New Zealand: Composition of Imports of Machinery and Transport Equipment, 1956*

SITC Code		Australia		New Zealand	
		(percentage)			
7	Machinery and transport equipment		100		100
71	*Machinery other than electric*		42.3		41.9
711	Power generating equipment	21.8		—	
712	Agricultural machinery	5.1		—	
713	Tractors other than steam	6.7		—	
714	Office machinery	2.5		—	
715	Metal-working machinery	5.5		—	
715 01	Cutting tools	(3.0)		—	
715 02	Others	(2.5)		—	
716	Machinery n.e.s.	15.3		—	
716 03	Construction and mining	(3.6)		—	
72	*Electric machinery and appliances*		17.9		20.7
721 01	Generators, motors, transformers	(7.5)		—	
73	*Transport equipment*		38.6		37.3
731	Railway vehicles	2.6		—	
732	Road motor vehicles	30.0		—	
734	Aircraft	3.5		—	
735	Ships and boats	2.5		—	

Source: United Nations, *Yearbook of International Trade Statistics, 1956.*

TABLE 5. *Australia and New Zealand: Composition of Imports of Manufactured Goods*

SITC Code			Australia	New Zealand
			(percentage)	
6	Manufactured goods classified by material		100	100
64	*Paper, paperboard and manufactures*		12.2	8.0
641 01	Newsprint	(5.8)		
65	*Textile yarn, fabrics, etc.*		45.1	38.1
651	Yarn and thread	6.8		
652	Cotton fabrics	16.0		
653	Miscellaneous fabrics	9.2		
653 05	Synthetic and spun glass fabrics	(5.0)		
656 01	Bags and sacks for packing	(4.6)		
66	*Non-metallic mineral manufactures*		6.8	6.0
664	Glass	2.1		
666	Pottery, household	1.9		
68	*Base metals*		22.4	26.2
681	Iron and steel	17.9		
681 04	Girders, bars, etc.	(4.5)		
681 05	Universals, plates, sheets, uncoated	(2.4)		
69	*Manufactures of metals*		10	15.8

Source: United Nations, *Yearbook of International Trade Statistics, 1956.*

TABLE 6. *Australia and New Zealand: Geographical Structure of Trade, 1956*

Trade with \ Trade of	Exports		Imports	
	Australia	New Zealand	Australia	New Zealand
United Kingdom	33	65	43	54
Canada	1	1	3	3
Australia	—	3	—	14
New Zealand	5	—	1	—
Malaya	—	—	2	1
Hong Kong	2	—	—	—
India	2	6	3	1
Ceylon	1	—	1	1
Sub-total, principal Commonwealth	44	75	53	74
Belgium-Luxemburg	3	2	1	1
France	9	6	2	1
Western Germany	5	4	4	3
Italy	4	2	1	1
Netherlands	1	2	2	1
Sub-total, principal continental Western Europe	22	16	10	7
Japan	11	1	3	1
United States	7	7	13	7
Total, countries shown	82	99	78	90

Source: United Nations, *Yearbook of International Trade Statistics, 1956,* vol. 1.

TABLE 7. *Australia and New Zealand: Prewar Proportions of Imports of United States Origin to Total Imports*

	Australia 1937-38	(Percentages)	New Zealand 1937
Electrical machinery	15		17
Agricultural machinery	27		45
Metal working machinery	24		45
Iron and steel plate and sheet	50		5
Automobile chassis	34		18
Automobile bodies and parts	12		18
Textile piece goods	—		1
Gasoline	19		33
Kerosene	20		—
Lubricating oil	92		73
Total	16		12

Source: United States Department of Commerce, *Foreign Commerce Yearbook.*

TABLE 8. *Australia: Imports from the United States and All Areas, Selected Commodity Groups, 1956*

SITC Code		Total	From United States	Percentage
		(Millions of dollars)		
074	Tea and mate	0.9	—	—
121	Tobacco, unmanufactured	27.3	20.3	74.4
231	Crude rubber, etc.	33.8	6.7	19.8
312	Petroleum, crude and partly refined	117.8	—	—
313	Petroleum products	90.1	14.4	16.0
512	Organic chemicals	26.0	2.2	8.4
641	Paper and paperboard	55.7	1.0	1.8
651	Textile yarn and thread	31.4	0.2	0.6
652	Cotton fabrics	73.8	0.2	0.3
653	Miscellaneous fabrics	42.0	0.5	1.1
656	Made up textiles, n.e.s.	24.9	0.1	0.4
681	Iron and steel	82.2	10.2	12.4
699	Manufactures of metals, n.e.s.	41.9	3.3	7.9
711	Power generating machinery	48.9	11.8	24.1
713	Tractors, other than steam	35.3	16.1	45.6
715	Metal working machinery	28.9	9.4	32.5
716	Machinery, n.e.s.	81.2	22.5	27.7
721	Electric machinery	94.7	10.0	10.6
732	Road motor vehicles	157.4	18.3	11.6
734	Aircraft	26.5	9.4	35.5
899	Manufactures, n.e.s.	24.5	2.8	11.4
	= 68.7 per cent of total imports in Australia	1,145.0	159.4	13.9
Total imports, f.o.b.		1,666.2	221.3	13.3

Source: United Nations, *Commodity Trade Statistics,* January-December, 1956 (Series D, vol. VI, No. 4).

Note: Imports chosen were those accounting for more than £ A 10 million (1.3 per cent of total exports).

TABLE 9. *New Zealand: Imports from the United States and All Areas, Selected Commodity Groups, 1955*

	Total	From United States	Percentage
	(Thousand £NZ)		
Wheat	4,920	—	—
Raw sugar	4,021	—	—
Tea	2,684	—	—
Beverage spirits	2,332	—	—
Tobacco, unmanufactured	2,087	2,053	98
Woven cotton piece goods	7,489	206	3
Rayon piece goods	4,026	155	4
Woolen piece goods	3,747	—	—
Woolen carpets	2,166	—	—
Motor and aviation spirit	9,888	384	4
Diesel and fuel oils	4,055	21	1
Iron and steel:			
Pipes, tubes, fittings	2,459	13	1
Plate, sheet, hoop, strip	7,907	203	3
Wire	2,620	16	1
Bar, rod, billet, bloom, pig	3,262	128	4
Copper	2,329	2	—
Electric motors and parts	2,575	49	2
Insulated cable and wire	2,706	1	—
Elec. switchboards, switches	2,152	78	4
Radio and radar apparatus	2,365	26	1
Tractors and parts	4,724	1,751	37
Raw, synth., reclaimed rubber	2,240	58	3
Newsprint	2,451	—	—
Books, magazines, newspapers, music	2,887	228	8
Motor cars	16,106	622	4
Commercial motor vehicles	3,637	141	4
Railway and tramway vehicles and parts	3,244	1,628	50
= 45 per cent of total imports	111,085	7,763	7.0
Total imports	250,661	21,305	8.3

Source: New Zealand Yearbook.

TABLE 10. *New Zealand: Selected Tariff Rates under Empire Preference and Most Favored Nation Agreements*

	EP	MFN
Motor vehicles, c.k.d.	5%	40%
Motor vehicles, assembled	15%	50%
Cultivators, harrows, plows, drills	10%	35%
Reapers, binders, harvesters, mowers	3%	3%
Other agricultural implements	3%	25%
Dairying: churns	3%	25%
Dairying: others	3%	3%
Electric batteries	15%	35%
Electric appliances for electro-plating, electro-chemistry, etc.	Free	15%
Rails	Free	20%
Iron (angle, bolt, rod, rolled girders, etc.)	Free	20%
Iron (sheet, plate)	Free	20%
Wire, plain or barbed	Free	10%

Source: Customs Department, *The Customs Tariff of New Zealand*, Wellington, 1949.

A new government looks at American investment

His Excellency Dr. Ismail bin Dato' Abdul Rahman

His Malayan Majesty's Ambassador to the United States of America

AS THE REPRESENTATIVE of the Government of the Federation of Malaya, I am very glad to have this opportunity of presenting the attitude of my government toward American investment. I would like first of all to describe to you briefly the economic and financial position of the Federation of Malaya before the country became independent and the problems that the newly independent country faces in the field of economic development.

Before August 31, 1957, the Federation of Malaya, as a dependent territory of Britain, was probably a classic example of the working of the colonial economic system. The country's chief function was to play a complementary part to the larger and dominant economy of Britain. It produced the raw materials which the manufacturing industries of Britain needed. Large tracts of land were alienated on attractive terms for the production of rubber, palm oil and copra and the mining of tin, iron ore, a little of coal and gold. The development of the basic services — roads, railways, electricity, drainage, telecommunications, harbor and port facilities — was undertaken primarily to facilitate the production of these raw materials for export. As a market for the manufactured goods of foreign countries, particularly Britain, the country offered a constantly expanding market for machinery and equipment, textiles, tinned foodstuffs and other consumer goods which a country needs, dependent as it was on imports for its food supplies. Preferential rates of import duties for goods from the British Commonwealth encouraged these imports. Foreign import houses, particularly British, had a virtual monopoly of the import trade, as well as the export trade, functioning in association with Asian traders only for the wholesale and retail distribution of the imported goods. The financing of the import and export trade, until quite recently, was in the hands of foreign, mainly British, banking houses with their local managers and executive staff being all European.

The monetary system was again a classic example of the automatic working of the colonial financial machinery. The local currency was fully backed in cash and other Sterling investments purchased over the years from the revenue of the country and deposited in London. These assets, used as 100 per cent cover for the currency, were considerable. All other funds of the government, such as the deposits of the country's Post Office Savings Banks, are invested in London and it is only quite recently that the legislation concerning these was amended to permit the investment of a part of these funds locally in the country.

The budgetary system was also typical of the financial practice of the colonial system. The balanced budget was almost an article of faith with the colonial financial officers. Revenue was mainly from indirect taxes and it was only quite recently that income tax was introduced into the country. If revenue was insufficient to meet essential social services, such as schools and hospitals, and the development of basic public services, the colonial power would meet the deficits in the budget by means of grants or loans, through such forms as the Colonial Development and Welfare Acts of the British government. And dependent as the country was on a few export products, whose prices on the world markets are subject to wide fluctuations, revenue was also subject to its ups and downs.

There was no economic planning as we know it today, and in fact, far from having a department of statistics, the services of qualified statisticians were until very recently considered a luxury by the colonial treasury officials of the government. And it was not until the end of 1950 that the government employed as economic advisor an official who has fully adequate economic and financial qualifications. Even in the case of rubber production, for example, the major industry on which the economy of the country depended, planning to improve its efficiency was not undertaken or a major replanting project started until this decade.

That briefly is the broad economic and financial picture of the Federation of Malaya before independence. The general problem faced by the country when it became independent was one of reorientation, from a colonial economy to that of a fully sovereign and independent entity. Our population is a growing one, at a rate as high as 3 per cent a year with a high proportion of the lower age groups. Between two-thirds and three-fourths of the country remain undeveloped, mostly under jungles, and while it might be economically and politically expedient for the former colonial power to develop only the accessible western part of the country, it is no longer so for the new independent elected government which is answerable to the electorate. Economic and social development, moreover, has to be more evenly spread throughout the country instead of being largely concentrated in the urban areas of the country. Roads, electric power, postal facilities, schools and hospitals have to go into these rural regions and must not remain, even in magnificence and splendor, only in the urban areas. This is particularly so when the population has become far more settled than it was some years ago. Some diversification of the economy has to be undertaken in order to provide employment for the growing population and to lessen the dependence of the economy on too few export products.

To undertake the economic development of the country in keeping with its changed status as an independent country, the financial resources of the country are, of course, not unlimited, so that a system of priorities has to be established. But first there would have to be a review of needs and potentialities and studies have to be undertaken. To a certain extent this was accomplished and the report of the mission from the World Bank three or four years ago was invaluable to us. I should mention that it was not without opposition and much difficulty that we were able to have a visit from the World Bank mission. Next, a system of priorities calls for planning in the economic and financial field. This in turn requires certain tools. After some difficulty, we are enlarging and modernizing our department of statistics. A population census was undertaken last year and a survey on the cost of living, both in the urban and rural areas, has recently been completed.

At the same time, the financial mechanism which has worked for nearly two centuries and which has now outlived its usefulness, needs to be overhauled. It is no longer possible for us to have a monetary system which is purely automatic in its working. It is no longer possible for the independent government to have abosolutely no control over the volume and character of credit in the country, particularly when it has to undertake economic development of the country on a considerable scale. We have to have a central banking machinery to control and regulate the currency and to function as the bankers' bank. The difficulties of setting up a Central Bank are apparently immense, particularly in view of the fact that we have a common currency with Singapore which is a separate government and remains a British colony.

We have decided out of our own free will to remain in the Commonwealth of Nations and in the sterling area. The great bulk of our foreign trade is with countries in the Commonwealth of Nations, particularly Singapore which takes about 40 per cent of our total trade and the United Kingdom which takes 15 per cent. Our trade with the United States and Canada accounts only for about 10 per cent of our total trade. Although Malaya has a persistently favorable balance of trade with the dollar and European currency areas, she has an uncertain balance with other countries, particularly Indonesia and Japan. Malaya has played a vital part in the postwar history of the sterling area and her contributions to the overseas earnings of that area, in the sale of rubber and tin to the dollar and other non-sterling areas, have been greater than those of any other single member of the sterling area. Our country, together with Singapore, has had a substantial overall surplus on our balance of payments for several years past. Our surpluses with America and Europe have been converted into sterling and have not merely paid off our deficits with softer currency areas, such as Indonesia and Japan, but have released a large surplus of dollars for use by other members of the sterling area. Technically speaking, Malaya could establish the Malayan dollar as an independent currency. Since all our reserves are held in sterling, an independent Malayan dollar would have to be closely linked to Sterling, at least until adequate reserves could be built up in the dollar area. This, however, would take many years and it would depend also on the prices of our rubber and tin as well as on the extent to which other countries, such as Indonesia, with which Malaya has adverse trade balances, demand settlement of these balances in dollars. If Malaya left the sterling area, she would no longer be able to have, as she now has, the advantage of the convertibility of the Malayan dollar with all currencies except those of the dollar area. Those countries with which Malaya has trading surpluses would no longer automatically allow her to convert those surpluses into sterling for spending elsewhere as they do at present, while the countries with which Malaya has deficits, would press for settlement of these deficits in American or Canadian dollars. All this would not only impose a serious burden on the machinery of government, it would also be bound to lead to some interruption in the free flow of trade. Dependent as we are on the export of rubber and tin for our dollar earnings and because of our need to import a great deal of capital equipment for the economic development of the country, the risk involved in leaving the sterling area is too great for us to take, however strong we are at present in our payments positions with other countries, particularly the dollar area. Indeed, because of this strong position, we are able to import direct from the dollar area any goods which we consider essential and indirectly through Hong Kong any other goods from the United States or Canada. To remain in the sterling area, therefore, is to enjoy an important measure of economic security and freedom in trading relationships with other countries in the sterling and the European areas, at the expense of accepting some limitations in our relationship with the dollar area.

Our decision to remain in the sterling area does not mean that we wish to preserve the previous pattern of our foreign trade. We have now become a contracting party to the General Agreement on Tariffs and Trade and we are beginning a series of trade negotiations with a number of countries, starting with Australia. We have informed other Commonwealth countries that we wish to review the existing system of Commonwealth tariff preferences which have not worked to our advantage. In some respects, the preferential treatment given to imports from Commonwealth countries adversely affects our revenue, handicaps local industry and places undue barriers to our trade with such countries as Japan and the United States.

Our decision to remain in the Sterling Area also does not mean that we wish to preserve the traditional sources of our private and public capital and to limit the inflow of investment from the United States, the largest source of capital in the free world today. As I have mentioned, our population is growing rapidly and a large part of the country remains undeveloped. We badly need a large amount of capital to undertake the economic development of the country, capital which the local sources are unable to provide in sufficient quantities. It is the policy of my government to encourage foreign investment in the Federation of Malaya, particularly for industrial development. Legislation is now being prepared to attract pioneer industries by giving tax-free holidays to such industries up to a period of five years. Remittances of profits and repatriation of capital are assured and my government has agreed to enter into agreement with foreign governments, including the United States, to guarantee foreign private investments in the country. On the other hand, we would like to see that foreign investment is associated as much as possible with local interests and that our own nationals are trained and absorbed into the management of industrial ventures in the country.

The government itself for its part has embarked upon a program of basic development which is essential if we are to attract foreign investment in the industrial development of the country. In its development plan, the government has decided that its capital expenditure should be allocated in the proportion of 60 per cent to the economic sector for the increase of productive capital, the stimulation of output and other productive activities; 30 per cent to the social sector for the development of health, education, housing and other social services; and 10 per cent to the government sector for the building and improvement of offices, government housing, houses for our labor, etc. In our objectives for the economic development of the country, first priority is given toward improving the efficiency of the rubber and tin industries, which are the twin pillars of our economy, the construction of an adequate port near Port Swettenham, the nearest port to Kuala Lumpur, our capital, and the encouragement of industrial development. Under the latter, negotiations have been going on for the setting up of an Industrial Development (Finance) Corporation to provide financial facilities for the industrial development of the country.

As far as the economic development of the country is concerned, the present government of the Federation of Malaya, which is the first elected government of the country, has embarked on a policy of free enterprise. In spite of the examples in the independent countries around us in South-East Asia, we consider that we should give private enterprise the opportunity to develop the country. We have large numbers of small enterprises in the country; almost half of the acreage devoted to rubber-growing, for example, which is the biggest primary producing industry, is small holdings of less than 25 acres owned by the small farmer. The spirit of free and private enterprise has even permeated some of our labor plantation workers. Moreover, our own people, particularly those of us who are of the Chinese race which is the dominant trading influence in the country, are essentially of an individualist character, like the American people. It is in his nature to use his individual ingenuity and skill to venture into the commerce and industry of the country, beginning in a small way and perhaps succeeding through his own efforts in an atmosphere of free competition.

I should mention, however, that although the commerce and industry of my country have been successfully developed, largely through British capital and under the previous British regime, we would wish to see that private capital change its character. Under the previous colonial rule, private capital has prospered because of its methods which the colonial system permitted. It was in certain respects restrictive in character; the import and export trade, for example, was almost entirely the monopoly of a small group of foreign companies. Now that the country has become independent, private capital has to change its character and to adapt itself to the changing circumstances in the country if it is to survive.

It is for the reason that American private capital has all the inherent characteristics of being modern and adaptable that we would welcome American investment in the Federation of Malaya. Free competition, for example, is the basic concept of your industrial and trading economy. Your government frowns on trusts, rings and cartels. Your large industrial enterprises readily accept their obligations to their labor employees. I understand also that American companies, having branches and agencies in foreign lands, prefer to have the nationals of these countries as their representatives as a matter of policy. In my country, it is only very recently that foreign firms are beginning to take in our own nationals into their executive levels. Moreover, and this is becoming quite important to us as an independent nation, we wish to diversify the sources of our foreign capital. The main traditional source of foreign capital has been the United Kingdom and we feel it would be much safer if we are not too dependent on one principal source. The United States as the biggest source of capital would, therefore, be an obvious one to which we should turn.

I would end by saying that as a newly independent country we have many problems to solve; one of our chief problems is the private financing of our economic development, particularly in the industrial field. We would very much welcome American investment in the Federation of Malaya and we feel sure that the private investment of your capital in my country would be to our mutual advantage.

Changing trade patterns as underdeveloped areas become developed

V. S. de Beausset

Former Resident Project Manager on Taiwan,
Manager, Process Division,
The J. G. White Engineering Corporation

ALTHOUGH MANY people may visualize Taiwan (Formosa) as a very small island in the Pacific, by population this province of China is comparable to a number of the countries in Asia. Taiwan has a population of about 11,000,000 people. It has all the problems, and more, when compared to the other countries in Asia. It has limited resources, a tremendous annual population increase — 3 per cent — and very few sources of capital other than United States aid. It is a rugged country with 60 per cent of the land consisting of a mountain range running its entire length with peaks up to 14,000 ft. This mountainous area is relatively unpopulated. It is a land of earthquakes and typhoons, beautiful scenery and, most fortunate of all, a very industrious people. More importantly, Taiwan is the seat of the Central Government of the Republic of China, whose aim is to ultimately retake the mainland from the Communists. As a result, military expenditure totals 70 to 80 per cent of the entire central government budget. When comparing the problem of the development of Taiwan with other countries, therefore, it is found that the difficulties are equal to, if not greater than, the others. In the discussion of the industrial development of Taiwan which follows, the problems of the supply and financing of direct military items, will not be taken into consideration.

It is my opinion that, if it were not for this extraordinary military burden, Taiwan could be considered as having become a developed rather than underdeveloped area by the end of 1957. By this, it is meant

The cooperation of the J. G. White Engineering Corporation in making Mr. de Beausset's contribution possible is gratefully acknowledged.

that all types of basic and consumer industries have been established or started, that agriculture has been well developed to supply the island's needs, universal education is well established and the group diseases have been suppressed. Continued growth and improvement is, of course, required, which is true of any area. In 1949-1950, however, Taiwan was truly underdeveloped. Let us look, therefore, at conditions and trade at that time to understand the subsequent changes that have occurred.

The Japanese had done considerable development there prior to and during the initial period of World War II, particularly in agriculture, including irrigation, communications, and some industries like aluminum and magnesium. Most of these efforts were destroyed by bombing, typhoons and general lack of maintenance during and immediately after the war. From 1945 to 1949, the Government of the Republic of Chnia was preoccupied with rehabilitation and Communist revolution on the mainland, thus very little was done on Taiwan. Its development really began in 1949, when Chen Cheng, the present Vice President and Premier, was sent there as its Governor.

Prior to the war this area was an exporter of agricultural products, mostly to Japan, but after the war it was short of food. For the food it exported to Japan, it used to get textiles, manufactured goods and consumer items in return. From 1945 to 1949, practically nothing was traded with Japan or any other country. By 1949, the estimated value of total imports was $34,900,000 and the exports was $33,900,000. These are Bank of Taiwan figures but they do not show the true picture since there were a great many supplies brought in from the mainland by evacuees and others. An estimate of the actual minimum import needs made a year later was about $200,000,000 per year. This was estimated on the basis of a minimum standard of living for the populace. The deficiency was made up through United States economic aid. The government had established a strict austerity program, prohibiting all imports of semi-luxury items and limiting imports on others. For example, the tax on new automobiles, sedans, was about $800 per year. In looking around in 1949, most of the people didn't have leather shoes, and winter jackets were made from gunny bags for almost all workers and farmers. In 1949, I saw the One-Hundred and Second Regiment, after being retrained, head off to defend Quemoy Island, just off the mainland. Their clothing consisted of T-shirts, shorts, straw hats and straw sandals. In other words, here was an economy at an extremely low level.

What was the trade picture at this time? What was imported and what was exported? The major imports were textiles and chemical fertilizers, plus a small amount of machinery to rebuild and build up some of the key industries and services. Realizing the importance of development, the Chinese Government had started their policy of industrialization in 1949. The textiles came from Japan and the chemical fertilizers mostly from the United States. By 1950, out of a total import figure of $123,000,000, food and fertilizer were valued at about $30,000,000, textiles and related products at about $35,000,000, machinery, industrial products and vehicles about $14,000,000 and crude oil and gasoline products at about $5,000,000. As stated before, the major imports were food and clothing. By 1950, rehabilitation efforts began to improve agricultural conditions, particularly sugar, and this export was about $70,000,000, with rice, tea, salt, citronella oil and bananas making up most of the balance. All this was not a very impressive trade picture but is one that I feel is generally representative of an underdeveloped country (usually one or two main exports). Were it not for United States aid, the only trading with such an area would be textiles, fertilizers (or food) and little of anything else, or hope for anything else, since that was all the money they had.

Taiwan could not support itself, but the government was anxious to develop the area, so that it could do so in the future. How does a government develop its country? Where does it start? How does it keep such development within bounds of available exchange, etc? What would be the effect on trade?

The methods and the route taken in Taiwan, with variations, shouldn't be too different from those to be followed, or being followed, in other areas with limited arable land and a rapidly increasing population. Through studies made by the Chinese and the J. G. White Engineering Corporation, who are their consultants, it was decided that some degree of industrial development was the answer.

The first steps were to determine the availability of capital, of skills, training capability for additional skills and the determination of the effects on the economy, such as inflation. After some study and by trial and error, the investment in development in Taiwan was set at $40,000,000 to $60,000,000 per year, about half of which was in local currency. During the first few years this was found to be a limiting amount in many ways. Some people there (industrialists and builders) will argue that it was too small and others (economists and bankers worried about inflation) thought it too large. This capital came from earnings of traders and from existing industries, from overseas Chinese, from landlords, and from the government, but the major portion from United States aid. The development did not start with those amounts, in the first years it was much less, but gradually grew to those amounts and more or less stabilized there in the last four years.

Once the policy was set and limited capital became available, there was the question of what to do with it. The first thing was to avoid, or at least reduce, the prestige projects at the initial stages. Projects, such as huge hydro-electric schemes, integrated steel mills, and automobile plants, take too much out of a small country in the initial development phases; the beneficial effects don't reach the people and the general economy soon enough. In Taiwan the Chinese got down to the root of the problem and began to develop the textile and fertilizer industries in order to supply food and clothing for the local market. This initial concentration on major needs for the local market is what we believe to be a natural development. In other words, here is an assured market, so this could be the pattern used in other areas also.

In 1949 our company estimated that the populace needed about $45,000,000 worth of textiles per year. This was figured at very low living standards, one pair of pants, and shorts at that, per year, plus the other needs. You can see from their foreign exchange earnings in 1949 that the $34,000,000 would not go very far in the supply of this one item alone. In order to get enough food, the agriculturalists estimated that $25,000,000 worth of chemical fertilizers had to be imported. To develop production of chemical fertilizers is complicated and takes much capital, but textiles are relatively easy and quick. The Chinese had the skills for this and some machinery had been brought over from the mainland. Some United States aid cotton diverted from the mainland was also available. We estimated that 150,000 spindles could supply the initial needs. The Chinese Government appointed a special committee to direct the development, and work started. With relatively no foreign exchange to buy imported textiles, material that did get into the country was sold at a very high price. Very high profits were assured for those companies that got set up first. Work proceeded rapidly and in two years a number of factories were built, totalling about 150,000 spindles.

How does the development of the textile industry, as the initial step, affect trade patterns with the United States? Taiwan became an importer of raw cotton. As other countries repeat this process and their living standards increase, they will use more textiles and the demand for cotton will increase all over the world. You might ask "What about textile machinery?" There was not much business here initially for the United States manufacturer. American machines are designed for production of high grade textiles and for as complete an automatic operation as possible. Compared to non-automatic machines, say from Japan, we found at that time that they cost about three times as much. Labor in countries like Taiwan is readily available, but capital is scarce and high grade textiles (fine counts) were not initially required. Japan, in this case, controlled the textile machinery exports to Taiwan. Another big advantage of the textile industry as the first development in countries where foreign exchange of any type is really short, is the large and quick capital return possible on the investment. For this industry, raw material is a major cost and it is easier to arrange short term financing for raw material than for capital equipment. The consequent large capital return to the textile manufacturers in Taiwan was used by them for further industrial development and tended to broaden the development base. So, in a few years, good textiles became available at stable and low prices and had a pronounced effect on improving the living conditions and stabilizing the economy.

As the textile industry was developing, the government then turned toward the production of chemical fertilizers. During the early stages of World War II, the Japanese had set up some carbide furnaces on Taiwan, evidently to be used to produce acetylene for synthetic fuel. In one area they had a production of 11,000 tons per year of calcium cyanamid fertilizer. Also, they had two small superphosphate factories. These were what we would have called completely destroyed by bombing, but the Chinese engineers remelted and rebuilt the machinery and put it back into operation. The fertilizer needs for the island were estimated at 90,000 tons of nitrogen per year and 36,000 tons of phosphate. The island produced 2,000 tons of N and 5,000 tons of P_2O_5 in 1948. To make up this differential becomes quite an undertaking when you consider that it costs about $300 to $600 to build a plant for each one annual ton of fixed nitrogen, but the Chinese started in. They kept costs down by initially building two cyanamid plants before they went into the regular ammonia plants, again plowing back earnings from the lower cost units and building bigger, more modern units later.

During the years from 1949 to 1957, other industries, primarily with a short range effect, also were developed. This balancing step was important to broaden the industrial base and reduce inflation pressure as a major long range industry was being built. It is my opinion that each type of industry or plant shown in the listing below as having been developed on Taiwan in these years should be similar to that which could be undertaken in other countries with only a slight variation due to different raw materials and crops.

The big export industry for Taiwan was sugar which was developed specifically for the Japanese market by the Japanese prior to the war. To compete on the world market, the yield per acre had to be doubled. Only the profitable mills were kept in operation and improved and, finally, extensive by-product development from sugar and sugar materials was undertaken. These products included protein yeast, hog and chicken feed, celotex board, resin wood substitute, all types of paper and paper board, fuels, etc. These improvements enabled the country to produce some of the world's lowest priced sugar.

Mining was developed, concentrating principally on coal, but gold, silver and copper mining was expanded, principally for export. The solar salt fields were improved. More drilling was undertaken for oil and natural gas, but little additional supplies were found. Pyrite and sulfur deposits were opened up, even if small and of low grade, primarily as raw material for the fertilizer industry.

The small topping unit at the oil refinery was expanded into modern facilities, including hydroforming and cat cracking to supply civilian and military needs, mostly from imported crude.

The chemical and paper industries were improved and greatly expanded. The food processing industry, such as pineapple, beers and wines, vegetable oil, fish canning and vegetable dehydration, were well established.

The rebuilt aluminum factory was expanded to make all types of finished aluminum products. Old cement mills were improved and new ones built. The small steel bar plants were expanded, cast iron pipe was made, shipbuilding was undertaken, and numerous small items of machinery, instruments, toys, automotive parts, plastics, bicycles, tires, tubes, shoes, glass, insecticides and handicraft items were manufactured.

To provide power to all these factories, transportation and communications had to be expanded to meet requirements and this was a major portion of the development on Taiwan. Power alone took up 30 to 50 per cent of the yearly development funds available. For the entire island, about 70 per cent of all power generated went to industries, a very high ratio showing the extent of the development taking place. At all times, careful limitation of total expenditures for these services had to be maintained since these facilities by themselves did not add productive units to the economy. Only as these were utilized by manufacturing plants and personnel, did they contribute to the economy. When these services are in short supply or limited, it is a great temptation to expand them to meet requirements 100 per cent, plus adequate reserve capacity, which would upset the balance on the use of available funds.

All these manufactured items were primarily aimed at local demand; rapid development was most important in order to supply this demand for a sufficiently large portion of the average necessities or wants of the population. By this method, along with sharply limited imports, inflation was more or less controlled. Every effort was made by the government in putting whatever capital was available into those industries that would result in an overall balanced development. Along with heavy industry, such as fertilizers and chemicals, light industry was expanded. The rather quick return on capital from these light industries was reinvested and, during the long period of construction of the heavy industry, supplies were available to absorb the increased purchasing power. This procedure was quite different from the method of industrialization used by Communist countries and even countries like India. Nehru told the Indian National Development Council on January 21, 1956:

> If you want India to industrialize and go ahead, you must industrialize and not bother with adding little factories producing hair oil and the like. You must go to the root and the base on which you will build the structure of an industrial India. Therefore, it is heavy industry that counts.

We think that the balanced development, not just heavy industry, was a major factor in the successful industrialization of Taiwan.

By 1956 and 1957, the results of the development that had taken place began to show up as changes in the trade pattern. In 1957, exports were valued at $170,000,000, quite different from the $34,000-000 of 1949. Imports totaled $252,000,000 with United States aid supplying $99,000,000 of the total value of the imports. The major items of import and export and their variation by 1957 was as follows:

IMPORTS

1. *Soya Beans* From 1950 to 1954, imports increased rapidly from about $5,000,000 per year to $15,000,000, but in subsequent years, as varieties suitable for local growing conditions were developed, this dropped to $10,000,000 by 1957. That figure could possibly keep decreasing as local production of beans and substitutes increases.

2. *Wheat* Importation of wheat also increased rapidly until 1954, then began to decrease. The import value was about $16,000,000 in 1954 and about $11,000,000 in 1957. As population grows, local production of food may decrease this figure in the immediate future, but after that it will probably increase.

3. *Raw Cotton* In 1949, this import was negligible, since finished textiles were imported. By 1957, the cotton imports totalled $18,-000,000. We estimate this will continue to increase in the immediate future and then slow down as synthetics are developed locally.

4. *Fertilizers* Even with some local production coming on the line in increasing quantities each year, the annual imports were about $20,000,000 per year from 1950 to 1956. In 1957, they began to drop and as the big units being built come on the line in 1958 and after, these imports will be sharply curtailed.

5. *Medicine, Drugs, etc.* As living standards increased, these imports increased rapidly till they reached a figure of over $6,000,000 in 1952. As local repacking units and some production came on the line, this remained at about that figure even though local consumption increased.

6. *Chemicals* This reached a figure of $5,000,000 in 1957, and, even though local production increases steadily, this import item will probably continue to increase.

7. *Galvanized Sheets and Wires* This reached a peak in 1952 with total imports at about $3,000,000 and then decreased as local production met local needs.

8. *Textile Machinery and Parts* These imports reached a peak of

about $4,000,000 in 1953, when the industry was being established. Imports decreased thereafter, totalling only about $2,000,000 in 1957.

9. *Machinery and Parts* This will be a big and continually growing item, even as local production takes over the manufacture of certain items. In 1950, the imports totaled about $2,000,000 but were $15,000,000 in 1957.

10. *Vehicles and Vessels* These imports totaled about $7,000,000 or $8,000,000 each year since 1950. Local production of jeeps and scooters as well as vessels, plus the strict import control on such items, have kept the total from increasing even though the demand is there.

11. *Crude Oil and Diesel Fuel* This steadily increases, primarily for military purposes. Imports were over $2,000,000 in 1950 and over $20,000,000 in 1957.

12. *Remaining Import Items* These are quite varied and usually small in any one category. In 1950, the figure was about $50,000,000, and in 1957 it was $65,000,000.

EXPORTS

13. *Sugar* In 1950, the exports were about $55,000,000 and in 1957 this increased to over $100,000,000.

14. *Rice* These exports vary in the $15,000,000 to $20.000,000 range each year.

15. *Others* These consist of tea, citronella oil, cement, coal, salt, bananas, canned pineapples, cotton piece goods, ores, metals and some metal products. By 1957, coal exports were stopped since it was needed locally, but the other items are generally increasing each year.

This is the general picture of how the trade patterns changed in this initial development period on Taiwan. As the development continues, the changes will be more pronounced on machinery imports and the exports of processed products. Exports are a major problem since they must be increased to balance the foreign exchange shortage now made by United States aid. The living standards could be decreased to live within present earnings, but already they are very low. Therefore, considerable thought has been given to increasing exports from Taiwan. I feel that this could best be developed by concentrating on higher cost items requiring a lot of labor. For example, the Aluminum Company used to make only ingots and costs were high. This was changed to include the manufacture and export of fabricated aluminum products and the company operated much more profitably and export earnings increased. Also, many of these countries that want to grow don't mind doing unpleasant work. In this category, I think of galvanizing, which requires work around the hot and fuming dip tanks. Steel for Taiwan and even areas in the vicinity could stop off and be galvanized there. In Taiwan, because of the raw material situation, the chemical industry will perhaps develop into the major heavy industry on the island. Another possibility that I think has a lot of merit is research. The Chinese engineers and scientists have a special aptitude for this work. I believe that the research efforts of many Western industries can be economically and efficiently supplemented by research staffs on Taiwan. Many of the interesting side leads that are uncovered by United States researchers and developers that are dropped in order to follow the main objective could be picked up and economically carried forward in countries like Taiwan. Although the initial development of Taiwan has been well accomplished and could serve as an excellent pattern for other areas, continued development is still required. After the major imports are manufactured locally, the next step, exports, is quite difficult, since the competition is not only local but world wide. We feel, however, it can be accomplished.

Thoughts on the yen-dollar exchange rate

Martin Bronfenbrenner

Professor of Economics, University of Minnesota

THERE ARE THREE elementary points with which I like to preface any discussion of Japanese trade and exchange problems.

The first point is that, contrary to most American opinion, *many* Japanese, including *most* urban Japanese, feel themselves worse off than they were before World War II. The index of industrial production reached 255 per cent of its 1934-36 average in November of last year for a population only 120 per cent of its 1934-36 level. Agriculture has lagged, however, and much of the industrial output serves as a substitute for imports which are no longer available, or which Japan can no longer squeeze from the Empire at bargain prices. Aggregate income per capita is slightly above the best prewar year (1937), but this slight aggregate increase is compounded of a substantial rise in the rural areas and a somewhat smaller fall in the cities. Welfare, moreover, is not entirely a matter of current income; Japan suffered capital losses from wartime destruction and loss of her overseas Empire amounting to 40 per cent of her total capital, and these losses have been restored only partially.

My second point relates to the reason Japan needs to export. One hears a great deal of loose talk that Japan must export because Japanese workers' and farmers' incomes are too low to buy back the products Japan produces. This is convenient doctrine for those who want to exclude Japanese competition from American markets; we may expect to hear it occasionally as long as we live. It has, however, the minor disadvantage of being almost 100 per cent false. The reason Japan must export is that she must import some 20 per cent of her staple food supply, plus most of the raw materials for all her principal exports (except silk, fish and pottery products), and needs exports to pay for these imports. For those not repelled by statistics, a few specific commodity percentages may be interesting. Japan imports about 11 per cent of her rice, 46 per cent of her wheat, 88 per cent of her iron ore, 28 per cent of her coking coal, 97 per cent of her petroleum, 61 per cent of her soy beans and 79 per cent of her salt. Japan is, like Great Britain, minus coal and iron; her basic assets are almost limited to man power and electricity. The essential nature of her imports and exports makes the price elasticity of both her import demand and her export supply much less than they would otherwise be.

My third preliminary point follows at once. Any increase in Japan's standard of life makes Japan's foreign exchange problem not less but more acute. It increases Japan's demand for imports, especially food and textile fibers, as the Japanese eat and dress better. At the same time it decreases Japan's supply of exports of almost every kind, because the Japanese themselves buy more of these things. The better Japan lives, the more trouble she has in paying for imports. Japan's *Jimmu Keiki* ("biggest boom in history") foundered in just this way in 1956-57. Let me give you a running quotation from the London *Economist* (March 8, 1958) on this precise point.

> As the hectic boom progressed, the swollen demands of industry for imported raw materials came up headlong against Japan's inability to pay for them by selling enough exports. As the reserves of foreign exchange fell, the government was forced to slow the economy down.
>
> This experience was a sample of the dilemma Japan faces. The nation's industry can give the Japanese a steadily improving standard of life — if Japan can pay for enough raw material from abroad. If it cannot, the same process may occur again and again; first an acceleration of investment and production, to keep pace with the population statistics, and then a painful thud as the balance of payments runs into trouble.

If you look at the figures for recent years, Japan's balance of payments does not look particularly precarious. After losing $194 million of foreign exchange with the end of the Korean War in 1953, she accumulated $887 million in the next three years. These figures conceal one major difficulty, namely Japan's dependence on "special dollar receipts," arising almost entirely from the presence in Japan of United States forces which are now being reduced in partial accordance with Japan's desires. If it were not for these special dollar receipts, which represent "thirty pieces of silver" to many Japanese, the price of reduced independence, the balance of payments figures for 1953-56 inclusive would have shown Japan losing a total of $2,874 million of foreign exchange. Japan hopes to eliminate them by 1960. Much of the expansion of Sino-Soviet bloc trade is intended to finance their elimination, chiefly by replacing imports from America by cheaper Chinese produce.

Given this unhappy situation, can it in any way be remedied by exchange rate manipulations? The yen-dollar rate, keystone of Japan's foreign exchange system, was set at 360 yen to the dollar in April 1949, following nearly three years of inflationary chaos. There has been no depreciation since, despite the devaluation of most competing Commonwealth and European currencies at least once during the period under review.

There has been a certain amount of sentiment in Japan in favor of devaluation of the yen, to permit Japan to increase exports by cutting their dollar prices. There have occasionally been suggestions that upward revaluation might be in order, to decrease import costs by lowering their yen prices. But since devaluation would raise import prices in yen, while upward revaluation would raise export prices in dollars, the advantages and disadvantages of these two proposals have cancelled each other out and nothing has been done along either line. Rather, some export industries have been favored by a number of special *ad hoc* devices: specially low interest rates, preferential access to credit, special tax treatment, preferential award of profitable import licenses for unrelated products, and so on.

I am not a specialist in international trade and finance, but let me try to take you part way into the complex theory of the relations between exchange rates and balances of payments. The most important variable in this case, I think, is the foreign or dollar demand for yen, relative to the price of yen in terms of dollars, i.e. the reciprocal of the yen-dollar rate. If this demand can be expressed as a curve, as in the two parts of Figure I, the total amount of dollars obtained at any exchange rate is the rectangular area under the curve. If the dollar price of the yen is 1/360, as at P, total dollar receipts are (OP x OQ).

If, as in Figure I-a, the demand function for yen (meaning Japanese goods) is *elastic* in dollar terms, a fall in the dollar price of the yen, say to 1/400, or P′, will increase total Japanese dollar receipts, since (OP′ x OQ′) is an area larger than (OP x OQ). This is the nub of the case for devaluation when, as in the Japanese case, her export supply and import demand are both inelastic, so that we need not concern ourselves with them to a first approximation. But if, as in Figure I-b, the foreign demand for yen (meaning Japanese goods) in dollar terms is *inelastic,* dollar receipts can be increased by an upward revaluation of the yen, say to 1/300 or P″, since (OP″ x OQ″) is an area larger than (OP x OQ). This is the nub of the case for upward revaluation under the same conditions.

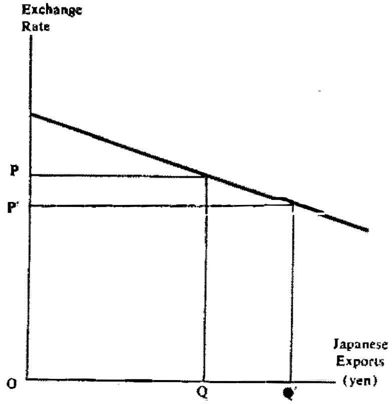

Figure I - a

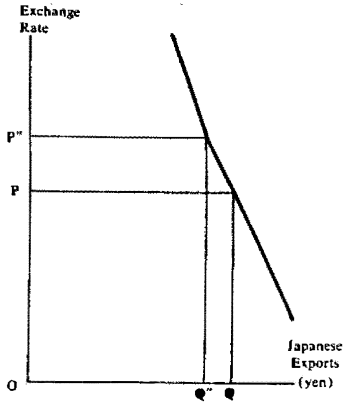

Figure I - b

My diagnosis of the Japanese difficulty, the reason why Japan has hesitated to tamper with the exchange rate, is drawn as Figure II. If Japan devalues, the yen prices of imported raw materials will rise. The yen prices of imported foodstuffs will also rise, and yen wage rates will rise with them. The result is that the dollar prices of Japanese exports will fall little if at all after these adjustments take place, little more will be taken in the world market, and accordingly, the demand curve will be inelastic below OP. In the diagram, (OP′ x OQ′) is less than (OP x OQ), and nothing is accomplished.

Now consider an upward revaluation, to lower the yen prices of imported food and raw materials. The trouble here is that yen prices of Japanese exports will probably not fall. Money wages in most export trades are held up by powerful trade unions, and money prices of many export products are likewise administered by monopolistic or cartel arrangements of various kinds. If the yen prices of Japanese exports do not fall, their world or dollar prices will rise when the yen is revalued upward. If the dollar prices of Japanese exports rise, the

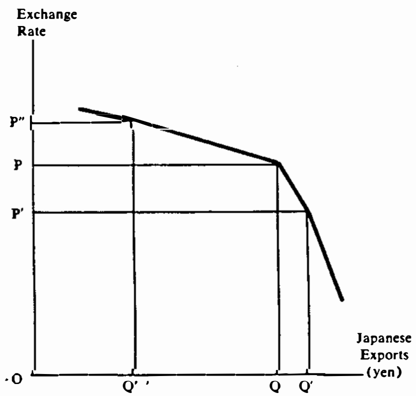

Figure II

quantity sold with fall off drastically, since most of these exports are highly competitive with British, German, Indian, or American products, not only in these countries themselves but all over the world. On the diagram (Figure II), the demand function for yen is therefore drawn as elastic when the yen is priced above OP. There is a kind of kink or corner in the neighborhood of the existing exchange rate. (OP″ x OQ″), like (OP′ x OQ′), is less than the initial receipts (OP x OQ). There is little scope for overall exchange rate manipulation.

This sort of situation is probably not unusual. It is commonly dealt with by economists interested in oligopoly problems, but is not often considered in treatments of international exchanges. It has, I suspect, played its part in inspiring many experiments with direct import controls, with exchange controls and with multiple exchange rates. It is the last of these alternatives, namely a simple double exchange rate, which I should like to consider for Japan — not the Japan of

1958 perhaps, but for the Japan of 1960 if "special dollar receipts" decline and trade with the Soviet-Chinese bloc proves a disappointing substitute.

Specifically, consider two proposals. Proposal 1: Pay all exporters a generalized export subsidy of, say, 40 yen for each dollar of exports, either anywhere in the world or specifically to convertible-currency areas. This would give these exporters the advantage of a 400-to-1 exchange rate in permitting them to cut dollar prices while maintaining yen prices. It would not entail any offsetting rise in the prices of imported staple food and industrial raw materials. Or as an alternative, Proposal 2: Pay all importers of the major industrial raw materials (and possibly also some staple foods but definitely not other consumption goods) a subsidy of, say, 40 yen for each dollar of imports. This would provide to Japanese exporters the advantage of a 320-to-1 exchange rate in cheaper raw materials. It might also provide Japanese workers the advantage of cheaper food and higher real wages, without the disadvantages of a cheaper yen in international markets.

Of these two double-rate proposals, the first, or generalized export subsidy, seems somewhat preferable on balance. The government gets more for its money, focussing the subsidy directly on exports, whereas import subsidies also assist imports which get into the domestic market. Conflict is avoided with the downward rigidity of yen cost prices and wage rates, which we have said might be maintained despite import subsidies. Conflict is also avoided with the Japanese farm and mining blocs, which are interested in high food and mineral prices to build up domestic products. Of course, an export subsidy discommodes domestic consumers by diverting production to exports rather than domestic sales. Furthermore, the export-subsidy plan is clearly a type of "exchange dumping" which would arouse a greater volume and vehemence of foreign denunciation than import subsidies, which, strictly speaking, are not dumping at all. Urban support for the taxation necessary for a subsidy would also be easier to obtain if, as in the import subsidy case, it could be linked with lower food prices. Finally, an import subsidy would cost less, since only selected imports rather than total exports would receive it.

Like any other subsidy, this one must be paid for. In many such cases, financing might be by taxes on luxuries, especially imported ones. Economists give the name "selective depreciation" to policies of subsidizing some exports or imports by taxes on others. Selective depreciation is, however, impractical in Japan because taxes on such imports are extremely high already. Most of the financing must be by considerably broader-based methods — either tax increases, or open inflation, or suppressed inflation with direct controls, or some combination of the three. This is true even though its net cost may fall short of the gross by making possible the elimination of some of the special gadgets and favors to particular export industries which we have mentioned before. How the Japanese might choose to divide the cost of an export or an import subsidy between taxation, inflation, and controls I have no idea — but taxation to rescue the balance of payments should be easier to sell the Japanese, dependent as they are on international trade, than it would be to a more self-sufficient country like the United States.

The International Monetary Fund, I have been assured informally and anonymously by a high ranking member of the Fund bureaucracy (not Dr. Liang or Professor Fisher), would look with extreme disfavor on either of these types of exchange rate at the present time. (It is not entirely clear how this disapproval would be translated into effective sanctions.) But when and if the reduction of Japan's special dollar receipts brings into the light of day a "fundamental disequilibrium" in Japan's balance of payments, modification of the Fund's attitude may be anticipated with a good deal of confidence, barring better solutions along more conventional lines.

The main arguments of this paper usually provoke a crucial question. It may be phrased somewhat as follows: "What do your proposals, either or both of them, accomplish which cannot be accomplished by economic pressure on Japanese wage and profit rates (which are higher in many export industries than in the rest of the economy) or on Japanese practices of hiring surplus labor?" To which I must answer, nothing and yet everything. On paper, nothing; in fact the deflationary orthodox proposals are simpler and neater. In practice, everything. These proposals preserve what has been called the "social equilibrium" of Japanese society. They resolve conflicts particularly between the wage rates and labor practices necessary for Japanese international equilibrium and the wage rates and labor practices necessary to conform to Japanese ethical notions of industrial fair dealing. As a result, they may preserve Japanese capitalism under circumstances where orthodox proposals require revolution from the Right to avoid revolution from the Left if they should be attempted in the near future.

Trade relations of the United States with China (Taiwan), Japan and Korea (South)

C. C. Liang

Advisor,

Asian Department,

International Monetary Fund

THE TRADE OF the three countries of China (Taiwan), Japan and Korea (South) with the United States has both common features and divergent trends. Taking the three countries as a whole, one outstanding fact is that they occupy a very insignificant place in the supply of United States imports. During the six year period from 1951 to 1956 for which complete and consistent trade data are available, their total exports to the United States amounted to only 3.4 per cent of total United States import (see Table 1). Comparative data for the prewar trade of Taiwan and South Korea are not available. It is known, however, that Japan by itself provided 6.6 per cent of total United States prewar (1937-38) import. With regard to United States exports, the share of these three countries for the recent six year period amounted to 5.4 per cent, not counting United States exports under the aid program for which a country classification is not available. While the true United States export situation with respect to these three countries is somewhat obscured by the aid program, the obvious fact remains that they are more important to the United States as markets than as sources of supply.

The small volume of exports from this part of the Far East, and especially of exports to the United States, is due to many special developments. As is well known, Japan lost much of its prewar territories after the war. Both China and Korea have suffered from the loss of control of much of their domain. All three countries sustained great war damage and have to support a population which is growing

TABLE 1. *Percentage Share of China (Taiwan), Japan and Korea (South) in the Total United States Exports and Imports**

	China (Taiwan)		Japan		Korea (South)		Total	
Year	Export	Import	Export	Import	Export	Import	Export	Import
1937	—	—	8.6	6.6	—	—	—	—
1938	—	—	7.8	5.8	—	—	—	—
1937/38 Average	—	—	8.2	6.6	—	—	—	—
1948	—	—	2.6	0.9	—	—	—	—
1949	—	—	3.9	1.2	—	—	—	—
1950	—	—	4.1	2.1	0.2	**	—	—
1951	0.3	0.1	3.9	1.8	0.3	**	4.5	1.9
1952	0.4	0.1	4.1	2.2	0.6	1.8	5.1	4.1
1953	0.5	0.1	4.3	2.4	0.6	0.3	5.4	2.8
1954	0.6	0.1	4.5	2.7	0.6	0.2	5.7	3.0
1955	0.7	0.1	4.2	3.8	0.8	0.1	5.7	4.0
1956	0.5	0.1	4.6	4.4	0.9	0.1	6.0	4.6
1957 (Jan.-Oct.)	0.5	0.1	6.0	4.6	1.3	**	7.8	4.7

*Imports include silver; export of military and economic aid are included in totals but are not included in country figures.

**Less than 0.1%.

Source: Direction of International Trade, United Nations.

rapidly as a result both of natural increases and of the repatriation of refugees. Their progress in production techniques has lagged much behind that of the United States. This is true not only for Taiwan and South Korea but also for Japan, which, after the long period of war and isolation during the first postwar years, has not been able to keep up with current technological advances. Annual exports to the United States from Taiwan and South Korea have been of the order of only a few million dollars in recent years. The principal export of Taiwan is sugar. Taiwan is one of the ranking sugar export countries of the world, but the comparative rigidity of the United States sugar import quota system has strictly limited Taiwan's prospects of satisfying some of the tremendous United States demand for sugar imports. Trade relations with South Korea have been a new postwar development for the United States, inasmuch as before the war trade between the two countries was negligible. United States postwar imports from Korea have consequently been limited to a small amount of a few Korean products such as tungsten, raw silk and bristles. The percentage share of Japan in United States imports, which has been increasing in recent years, reached 4.6 per cent in 1957 (Jan.-Oct.). It is still below the prewar figure of 6.6 per cent (see Table 1). In addition to the general influences mentioned above which have limited exports from the Far Eastern region to the United States, Japanese exports have also been affected by the loss of some of Japan's prewar trade advantages, such as cheap labor and the cartelization of its foreign trade. Those exports have also been affected by the decline in demand for Japan's principal prewar export, raw silk, which before the war accounted for about one-half of Japanese exports to the United States. On top of these unfavorable developments, Japanese trade now has to face sales resistance against Japanese products in the United States, especially with regard to textiles, tuna fish, porcelain, plywood and silverware. Last, but not least, the postwar cost and price relationships in these three countries may not always have been such as to give their export products competitive advantages in the United States market.

The problem of United States exports to this region is much more complicated than that of imports. In the first place, United States aid exports cannot be accurately appraised because no data are available to show how they have been distributed among the countries in receipt of aid. Even excluding aid exports, the United States has increased its exports to this region from 4.5 per cent of United States total export in 1951 to 7.8 per cent in 1957 (Jan.-Oct.) (see Table 1). The imports, other than aid, of these three countries from the United States have increased much more than their exports. The result has been large trade deficits in their commercial trade account (i.e., not including aid imports) with the United States (see Table 2). In recent years the trade position of Japan has been more favorable than that of Taiwan and South Korea; Japan's exports to the United States have nevertheless covered only about 30 to 50 per cent of its imports from the United States (see Table 3). In the first 10 months of 1957, Japan had a big trade deficit with the United States of $925 million.[1] The trade deficits of Taiwan and South Korea were offset by United States aid while those of Japan were met by United States and United Nations military expenditures.[2] The reasons for these large exports from the United States to these countries are mostly the same as those mentioned above as an explanation of the small volume of United States imports from them. The list should however be supplemented by reference to some additional factors. The high import demand in these countries is partly due to their great need for both defense and development, and they practice very little of the discrimination against dollar goods that is common in other countries with similar payments difficulties.

It seems to follow from all these considerations, that no significant reduction of imports by these countries from the United States is likely. With regard to their exports, some increase appears possible and there may therefore be some improvement in their trade balances with the United States. To what extent this can become a reality and in what way the volume and pattern of trade between these countries and the United States will be affected, depends on a variety of factors. Some of these factors are related to the policies of the United States, some are contingent on economic development in the three countries concerned while still others are quite beyond their control and have their origin in the world outside.

One of the most important of these factors is the trade policy of the United States. It has been the firm desire of the United States Government to help friendly countries stand on their own feet economically so that they can contribute to the full employment of the

[1] This figure is from Japanese sources (Table 3) and is different from that presented in Table 2 which is based on United States statistics.

[2] United States investments in these countries have so far not been an important factor in financing their trade deficits.

TABLE 2. *United States Trade with China (Taiwan), Japan and Korea (South)**
(In millions of United States dollars)

Year	U.S. Total Trade Export	U.S. Total Trade Import	Trade with China (Taiwan) Export	Trade with China (Taiwan) Import	Trade with Japan Export	Trade with Japan Import	Trade with Korea, South Export	Trade with Korea, South Import	Trade Balance with: China	Trade Balance with: Japan	Trade Balance with: Korea
1937	3,349.1	3,083.6	—	—	288.5	204.2	—	—	—	84.3	—
1938	3,094.4	2,19[illegible].9	—	—	239.6	126.7	—	—	—	112.9	—
1937/38	3,221.8	2,522.0	—	—	264.1	165.4	—	—	—	98.7	—
Average											
1948	12,650.5	7,194.3	—	—	324.7	62.6	—	—	—	262.1	—
1949	12,051.0	6,622.3	—	—	467.5	81.9	—	—	—	385.6	—
1950	10,275.1	8,852.1	—	—	416.4	182.0	22.5	2.3	—	234.4	20.2
1951	15,032.0	10,967.3	41.0	6.0	597.6	2[illegible]5.0	45.4	3.7	35.0	392.6	41.7
1952	15,191.3	10,784.6	60.3	5.6	621.7	235.2	93.6	18.4	54.7	386.5	75.2
1953	15,773.6	10,968.3	82.0	6.7	670.5	263.4	96.0	29.9	75.3	407.1	66.1
1954	15,106.4	10,295.0	94.2	5.5	679.9	279.8	87.0	19.7	88.7	400.1	67.3
1955	15,546.7	11,457.3	107.0	6.4	647.8	431.9	127.0	6.1	100.6	215.9	120.9
1956	19,066.0	12,736.5	104.6	7.9	894.6	557.8	167.4	9.7	96.7	336.8	157.7
1957 (Jan.-Oct.)	17,488.6	10,783.6	87.0	6.9	1,042.2	500.0	223.3	3.6	80.1	542.2	219.7

*Imports include silver; exports of military and economic aid are included in totals but are not included in country figures.
Source: Direction of International Trade, United Nations.

TABLE 3. *Japan's Trade with the United States, 1937, 1938 and 1948-57 (In millions of United States dollars)*

Year	Total Trade Export	Total Trade Import	Trade with U.S. Export	Trade with U.S. Import	As % of Total Export	As % of Total Import	Trade Balance with U.S.	Exports to U.S. as % of Imports from U.S.
1937	914.8	1,089.9	188.1	366.0	20.6	33.6	–177.9	51.4
1938	766.5	759.0	124.0	261.1	16.2	34.4	–137.1	47.5
1937/38 Average	840.7	924.5	156.1	313.5	18.6	33.9	–157.4	49.8
1948	258.6	682.6	65.7	441.4	25.4	64.7	–375.7	14.9
1949	510.6	899.8	83.6	575.8	16.4	64.0	–492.2	14.5
1950	820.1	969.9	183.0	427.0	22.3	44.0	–244.0	42.9
1951	1.354.5	1,955.0	189.7	687.3	14.0	34.5	–497.6	27.6
1952	1,272.9	2,028.1	234.3	768.3	18.4	37.8	–534.0	30.5
1953	1,274.8	2,409.6	233.9	757.5	18.3	31.4	–523.6	30.9
1954	1,629.3	2,399.4	282.9	849.1	17.4	35.3	–566.2	33.3
1955	2,010.8	2,471.6	457.1	774.0	22.7	31.3	–316.9	59.1
1956	2,495.4	3,229.6	551.5	1,067.3	22.1	33.0	–515.8	51.7
1957 (Jan.-Oct.)	2,320.5	3,720.9	491.6	1,416.3	21.1	38.1	–924.7	34.7

Source: Direction of International Trade, United Nations.

world's resources and become useful members in the councils of the free nations. The interests of the three countries in the Far East region have been of particular concern to the United States. Ever since 1934 the Reciprocal Trade Act, passed in that year, has been an instrument used by the United States in order to expand world trade and to promote world economic welfare. At the same time the United States has not been too critical of the policies of protection and sometimes of discrimination practiced by other countries when there appeared to be legitimate reasons for such measures. Very recently, however, there has been some change of thinking in the United States with a tendency toward more protectionism for American industries. The "Buy American" provision with regard to government procurement was introduced for the reason of national defense and security. There are various kinds of informal restrictions, particularly against certain Japanese products. In order not to provoke any increase of import duties on Japanese products, Japan has "voluntarily" imposed a quota on its exports of textiles. A revival of protectionism in the United States would have very unfortunate consequences. An example might be set which other countries would follow, and in the end this might mean that the United States would retreat from its economic leadership of the world. There might be a setback to the trade not only of the three countries in the Far Eastern region but of the whole world. Restrictions upon imports from any individual country may indeed fail to produce the expected benefits even for the United States industries most directly affected. For the restrictions may merely intensify competition with United States exports in third markets. This point has not always been given sufficient attention. Let us take Japanese trade as an illustration. Japan has succeeded in recent years in promoting a greater volume of exports to Latin America, and it has also a plan to increase its exports to Southeast Asia. United States restrictions upon Japanese imports are likely to intensify Japan's efforts to push exports in these two regions, and this might mean a reduction of imports by these regions from the United States. Nor would Japan's increased export earnings from other regions necessarily lead to an increase of Japanese imports from the United States, because under present circumstances such export earnings may not be in the form of convertible currencies. It is true that Japan must import raw materials before it can export, but Japanese demand for imports might be diverted from the United States to some third countries. In order that the three countries in the Far East region should absorb more imports from the United States, apart from aid, they must first be able to earn more United States dollars. Their chief hope for achieving this lies in a liberalization of United States imports of Far East products, such as Taiwan sugar and tea, Korean minerals and raw silk and Japanese textiles and fishery products. This might necessitate more than a mere extension of the Reciprocal Trade Act by the United States.

The ability of these countries to import United States goods may also be improved by an increase in some of their invisible earnings, such as those from shipping. This is particularly important for Japan. Before the war, Japan's net earnings from shipping exceeded its trade deficit. In each year during the postwar period it has had to make net payments on this account. In 1956, Japan's net payment for transportation amounted to $303.2 million (see Table 4). On the other hand, Japan has rapidly become the world's largest shipbuilding country. The tonnage of its merchant marine has recovered to more than half the prewar peak tonnage of 8 million tons. Taiwan has also made progress in ocean shipping. Its gross earnings from shipping have increased from $3.1 million in 1955 to about $16 million in 1957. At the present time, there is a United States regulation which reserves 50 per cent of any United States financed cargoes to American bottoms. In view of the large volume of United States aid goods going to the Far East, a liberalization of this provision would enable both Japan and Taiwan to increase their transportation receipts.

The future volume of United States exports (including aid exports) to the three countries in the Far East depends very much on aid policy. The high value of United States exports to this region in the past has been made possible by the large amount of aid and of American military expenditures. From 1948 to 1957, American aid of $871 million was authorized for Taiwan and of $1,181 million for South Korea. Similar American aid authorized for Japan has been small, but Japan's annual exchange receipts from foreign government military expenditures have been very large, reaching a figure of $803.3 million in 1953. These receipts have since been on the decline, but in 1956 they still amounted to $498 million (see Table 4). In view of the great importance of American aid in sustaining United States exports to these countries, it must have been very gratifying to them that the administration has urged the public to support a larger budget for the United States aid program. A related question is the United States program for disposal of surplus agricultural products. This program has been subjected to unfavorable comment in certain countries. It is interesting to note that the three countries in the Far East region are all beneficiaries of this program. The American surplus products, such as cotton, grains and tobacco, are their deficit items, and through the surplus disposal program they can be obtained on a loan basis. There will indeed be a continuing need for many of these products in all these countries.

Many countries are very much concerned about economic fluctuations in the United States. The impact of such fluctuations on the economy is different in each of the three countries with which we are concerned. Taiwan's exports of sugar and rice are less sensitive to world cyclical fluctuations than Korean exports of mineral products. Japan has the advantage of a great diversification of exports with respect both to their destination and to their composition.

It is quite natural that the prospects of United States trade with

TABLE 4. *Certain Invisible Items in Japan's Balance of Payments, 1950 to 1956*
(In Millions of United States Dollars)

Invisible Items	1950 Credit	1950 Debit	1950 Balance	1951 Credit	1951 Debit	1951 Balance	1952 Credit	1952 Debit	1952 Balance	1953 Credit	1953 Debit	1953 Balance
Foreign Travel	21.3	0.9	20.4	8.9	4.4	4.5	8.2	5.0	3.2	10.0	7.0	3.0
Transportation	16.5	134.5	-118.0	41.0	255.7	-214.7	71.4	223.4	-152.0	76.6	247.0	-170.4
Investment Income	0.3	5.9	- 5.6	1.1	6.4	- 5.3	6.1	11.0	- 4.9	11.8	34.9	- 23.1
Government Military Expenditures*	153.6		153.6	624.2	—	624.2	787.8	—	787.8	803.3	—	803.3
Total	191.7	141.3	50.4	675.2	266.5	408.7	873.5	239.4	634.1	901.7	288.9	612.8

Invisible Items	1954 Credit	1954 Debit	1954 Balance	1955 Credit	1955 Debit	1955 Balance	1956 Credit	1956 Debit	1956 Balance
Foreign Travel	11.2	6.8	4.4	14.3	8.1	6.2	16.5	12.3	4.2
Transportation	89.7	255.9	-166.2	127.4	276.0	-148.6	209.8	513.0	-303.2
Investment Income	8.2	47.0	- 38.8	14.1	55.5	- 41.4	27.3	66.1	- 38.8
Government Military Expenditures*	602.3	—	602.3	505.2	—	505.2	498.0	—	498.0
Total	711.4	309.7	401.7	661.0	339.6	321.4	751.6	591.4	160.2

Source: *Balance of Payments Yearbook*, Vol. 8 ,1950-54 and Volume 9, November 1957 issue.

*The entries cover sales of goods and services to military personnel stationed in Japan, sales to United Nations forces under the special procurement program in connection with the Korean war, and, for 1952-54, United States expenditures for the maintenance of forces in Japan.

Japan, Taiwan and South Korea should also be affected by economic developments within each of these three countries. The first consideration is their development plans. Export promotion is one of the most prominent objectives of the Five Year Economic Plan of Japan, effective from 1958. Japan's share of world total export was only 2.7 per cent in 1956 compared with 3.9 per cent in 1937. Japan has now some idle capital equipment capable of producing more exportable goods. The value of Japan's exports during the next five years is expected to increase by 10.5 per cent every year. Exports to the United States are expected to increase and competition in the world market between Japan and the United States will be intensified. In the second Four-Year Plan of Taiwan, in effect since 1957, certain import substitutes, such as fertilizer, are to be developed, and the production of new export commodities is to be promoted. Commercial imports from the United States may decrease somewhat. Whether Taiwan will succeed in promoting more exports to the United States is difficult to assess. Its principal export, sugar, as mentioned above, is affected by one single factor, the American import quota system rather than by anything else. Korea's development plan is still at the stage of deliberation. The general thinking is that Korea will put more emphasis on the development of mining and fishery. Any success in this direction may create the possibility of exporting more Korean mineral and fishery products to the United States. The mere availability of more export goods, however, does not necessarily result in a better payments position as so much depends on the cost-price relationships of goods to be expected, which in turn hinges on the implementation of a stabilizing fiscal and credit policy. Apart from the question of the price level, marketing is also an important problem. Korea, strictly speaking, is a newcomer in the postwar world market, and not many countries have yet familiarized themselves with the export products of Taiwan. Even in Japan, the technique of promoting exports is still behind that of some other leading trading countries. Japan should place more emphasis on the appeal of quality and finish than on price cutting and should prefer the creation of distinct new designs to mere imitation of popular patterns. However, great efforts have been made by Japan to overcome its previous shortcomings, and great hopes center around the efforts made by the Japanese External Trade Recovery Organization (JETRO).

Progress in international economic relations in certain directions can be brought about only by the collaborative efforts of the trading partners. Foreign investment is one of these. Promotion of foreign investment by the United States in this region depends, on the one hand, on the creation of a good economic atmosphere in the capital-receiving countries and, on the other hand, on the willingness of the investing countries to take risks. The United States has increased its foreign investment in recent years, and in 1956 total United States direct foreign investment reached $3.6 billion. However, not much of this has gone to the Far East region. The largest recipient of United States investment among the three Far East countries was Japan, with an inflow of direct investments from the United States of $16 million in 1956. Japan and Taiwan have each enacted a foreign investment law, the provisions of which are considered to be quite liberal with regard to the kind of industries open to foreigners, guarantees against expropriation, and the right to repatriate capital and transfer profits. Legislation for encouraging foreign investment is now under study in Korea. Japan has had large credits from the Ex-Im Bank, totaling $693 million up to the end of 1957. China has also had loans from the Ex-Im Bank, totaling $222 million. Korea has not yet had any loan from this source. These loans have been effective in promoting United States trade. Heavy purchases by Japan of United States cotton had much to do with several loans of $60 million granted to Japan in previous years. Tourism is another factor of some importance in United States-Far East economic relations. The three Far East countries have not yet had any considerable share of the United States tourist dollar. The chance for strengthening their invisible receipts through the development of the tourist trade again depends on the mutual efforts to be made by both the United States and the Far East countries. Much work has been done by the latter to make travelling there more attractive. If more facilities and encouragement were to be provided to tourists on the United States side, an important contribution could be made to the development of a better balance in the payments accounts of these countries with the United States.

The trade between any two countries cannot be divorced from economic developments in the world at large. In this regard, some recent significant events will not fail to have their impact on United States trade with the Far East. One of these developments is the European Economic Community which is to establish a free market among six European countries and a common tariff in association with some other countries. The impact of this arrangement will fall more on Japan than on Taiwan or South Korea, since Japan has had a sizable volume of trade with the member countries of this common market. If Japanese exports to these countries should be checked, export shifts to some other markets, including the United States may become a necessity for Japan. A second world development is the increasing trade offensive by the Soviet bloc. The volume of East-West trade has been on the increase in recent years. However, this does not affect Taiwan and South Korea at all since these two countries are both dead set against any trading with the Soviet bloc. Japanese imports from the Sino-Soviet bloc have increased from $24 million in 1951 to $103

TABLE 5. *Japanese Trade with the Sino-Soviet Bloc, 1951-57 (In millions of United States dollars)*

(1) *Japan's Exports*

Year	Export Total	Soviet Bloc Value	Soviet Bloc As % of Total Imports	Bloc European	Satellites European	U.S.S.R.	China Communist
1951	1,357.7	5.8	.4	*	*	0	5.8
1952	1,272.9	0.8	.1	0.2	*	0.2	0.6
1953	1,274.8	4.6	.4	0.1	0.1	*	4.5
1954	1,629.3	24.1	1.5	5.0	5.0	*	19.1
1955	2,010.6	39.5	2.0	11.0	8.9	2.1	28.5
1956	2,500.6	73.3	2.9	5.9	5.1	0.8	67.4
1957	2,320.4	54.9**	2.4	9.4	5.2	4.2	45.4

* Less than $50,000.

** Includes shipments to North Korea valued at $0.1 million.

(2) *Japan's Imports*

Year	Total Import	Soviet Bloc Value	Soviet Bloc As % of Total Exports	Bloc European	Satellites European	U.S.S.R.	China Communist
1951	2,047.9	24.0*	1.2	2.2	2.2	**	21.6
1952	2,028.8	17.9	.9	3.0	2.5	0.5	14.9
1953	2,409.6	37.8	1.6	8.1	6.0	2.1	29.7
1954	2,399.4	48.4	2.0	7.6	5.3	2.3	40.8
1955	2,471.4	89.1	3.6	8.3	5.2	3.1	80.8
1956	3,229.7	102.5***	3.2	10.9	8.0	2.9	83.6
1957	3,720.5	97.1***	2.6	14.4	4.0	10.4	71.3

* Includes imports from Outer Mongolia of $200,000.

** Less than $50,000.

*** Includes imports from Outer Mongolia, North Korea, and North Viet-Nam.

Source: International Cooperation Administration: *Mutual Defense Assistance Control Act of 1951,* 6th, 8th and 10th Report to Congress.

million in 1956. Japanese exports to this group also increased during the same period from $6 million to $73 million (see Table 5). It snould be noted that the balance of Japanese trade with this bloc has always been passive. The total import surplus for the six years from 1951 to 1957 amounted to $171 million. The bulk of Japanese imports from this bloc consisted of soybeans, coal and iron from Mainland China. In fact, these things can also be supplied to Japan by the United States. The Soviet bloc has pushed its trade by means of bilateral trade agreements, which have proved to be an effective weapon for attaining the objectives of Soviet policy. They permit trading to be conducted by one single government agency, include aids and loans in one blanket deal and obliterate the necessity for using cost and price as a basis for trade transactions. The West, including the United States, has yet to think out an effective means to counteract this trade offensive. Some other countries, such as Germany and Italy, have also had programs for aid in order to promote trade. Possibly, these programs may also affect United States trade relations with countries in the Far East. Finally, another important question in the wider field of international finance is exchange convertibility. Much of the present unnatural pattern of trade is due to the existence of inconvertible currencies. Japan has concluded several bilateral agreements which aim at bilateral balancing of trade with its trading partners. When more currencies in the world become convertible, the extent of trade for which bilateral balancing is sought will be reduced, and the volume and pattern of Japanese trade with the United States may be quite different. This may not be true for Taiwan or for South Korea which have no bilateral payments agreements with countries outside the Far East region.

The essential facts of the trade relations of the United States with China (Taiwan), Japan and Korea (South) may be summarized as follows: Because of various special postwar political and economic developments, each of these countries has had a high import demand for United States commodities, a relatively low level of exports to the United States and consequently sizable trade deficits with the United States. A large volume of import demand is likely to be maintained by all three countries for some time to come, particularly in view of their great need for defense and development. The prospects for increasing their exports to the United States appear favorable. Much depends on United States trade and aid policies, the movement of foreign capital, the economic development plans and fiscal and credit policies of the Far East countries, the convertibility of currencies, the common market movements in the outside world and the trade offensive of the Soviet bloc.

American interests in Pakistan: conditions and outlook

Svend Laursen

Professor of Economics, Brandeis University

I

PAKISTAN IS AT the moment going through the slow and painful process of transforming its economy in order to create the preconditions for economic development. Some progress has already been made in the years since independence. Various basic facilities have either been created or expanded: railways, ports, communications, electric power, etc. Dams are being built and various large-scale irrigation projects are in the process of being completed. In the private sector of the economy, several industrial and commercial establishments have been started and, to mention only two examples, the country is now self-sufficient in textiles and is becoming an important exporter of jute goods.

While these achievements are of obvious importance, the economy is still far from the state that economists describe as self-generating growth. Per capita incomes are exceedingly low — not more than $50 on an annual basis — and, what is perhaps more important, up to the present time they have not shown an upward rising trend. While industrial output is expanding, agricultural production is lagging. As a result, the country is going through a serious food crisis which has retarded the execution of the first five-year plan. Partly associated with the failure of agriculture to meet the rising demand, but also because of financial reasons, inflationary tendencies have been rather strong in recent years. What these tendencies reflect is a great strain on the country's resources, a strain which poses difficult problems of adjustment.

II

All of this will probably sound familiar or should I perhaps say all too familiar. Development is not a simple and smooth process; historically it has always been associated with various strains and stresses. In that respect Pakistan certainly is not an exception. At this time I would like to single out one particular problem which will undoubtedly be present for some years to come: Pakistan's external commercial and financial position.

From the point of view of the development effort, the issue presents itself the following way: During the next several five-year plans the demand for imported goods for the development program can be expected to increase. At the present time the average foreign exchange component of the major development projects is at last 50 per cent. As domestic industry expands, this percentage will perhaps decline somewhat. On the other hand, and this is the more important trend, as the growth process gains momentum and the size of the plans increases, a larger volume of imports of "development" goods becomes a necessity. While the import trend clearly will be rising for these goods, it may perhaps be argued that savings can be accomplished in imports of nondevelopment goods. It is true that there have been such savings in the past, especially in the imports of textiles, but further gains on this front are bound to be of limited importance outside the field of food imports. Imports of consumer goods are already cut to the bone, and if anything, they can be expected to rise with increasing population and incomes. Even more important, as the industrial base is broadened, this will of necessity lead to a higher volume of imports of raw materials and spare parts.

What this means, then, is that an acceleration of Pakistan's development will require a growth rate in the export sector high enough to provide the foreign exchange for imported capital goods. Leaving aside for the moment the question of foreign aid, the rate at which the domestic economy can grow will clearly depend upon the extent to which it is possible to develop export markets. Unless the export sector can keep pace with the domestic economy, tensions and imbalances will appear. This, I believe, will become a key issue in Pakistan's future development.

III

How likely is it that this problem can find a satisfactory solution? While it is by no means impossible that oil will be found, I shall leave this possibility out of consideration and limit myself to the situation as it presents itself today. One element in the solution is obvious: an energetic attack on the food problem. Because of the food crisis an increasing proportion of aid imports consists of wheat and rice rather than of vital raw materials and development goods. Secondly, the country is using considerable amounts of its own foreign exchange for food purchases abroad. Needless to say, this recent development has upset the external balance and threatened the normal functioning of the economy as well as the development program. If nothing else, it highlights the importance of broadening the food base. Until that objective has been securely achieved the attempt to develop the economy will encounter constant dangers.

On the export side the prospects will, at least for some time to come, depend upon the markets for cotton and jute, the two traditional export products. Without going into any detailed analysis or projection for these two fibers, which account for more than 70 per cent of Pakistan's commodity exports, it is unlikely that they alone will be able to carry the financing of the development program. It is true that in recent years exports of both cotton goods and jute goods have shown a sharply rising trend. The thing to keep in mind, however, is that in both cases exports of the manufactured goods rather than the fibers add comparatively little to total export receipts. This is so because the cost of the fiber is such a high percentage of the final value of these products. The difference between exporting burlap bags and raw jute is not great.

This brief analysis of export earnings is clearly incomplete since it does not include any mention of potential exports of other commodities. Some so-called secondary exports, such as sports goods, have done well in recent years. The point here is that they are starting from a low absolute level and, at least for some years to come, their contribution to total export earnings will not be considerable.

To finish this part of the argument, I anticipate on the one hand an increased demand for imported development goods and on the other, exports which will display a slower rate of growth — still, of course, leaving out of consideration the possibility of the discovery of oil.

IV

Since it seems unlikely that Pakistan's exports will provide a sufficient foreign exchange margin for development, it may be asked what other sources of external finance will be available. One such source is foreign private investment. However, up to now these investments have not been large. Some machinery and other equipment has been imported directly by foreign investors, especially in connection with drilling of gas wells and the building of pipe lines. At the present there is also considerable scope for investments in connection with the exploration for oil. Even so, the official estimate of the contribution such investments can make during the Plan period 1955-60 is quite moderate — roughly $100 million. An amount of this magnitude will add about 5 per cent annually to Pakistan's own export earnings.

At the moment an interesting attempt is being made to stimulate foreign investment through tax incentives. The United States government or, more specifically, the Senate Committee on Foreign Relations, is contemplating a taxation convention with Pakistan* which in one important respect differs radically from the present arrangement. If this new provision is approved by the Senate, it is very likely that it will also be embodied in conventions with other nations. If for no other reasons it deserves brief consideration.

Under the present system, which was introduced in 1918, an American corporation receiving income from foreign sources is given credit in the United States for income taxes paid in the country where the income originates. Assume, for example, that the foreign income is $100 and that the tax paid abroad on this income is $20. The American investor will then only have to pay $32 in United States taxes ($52-$20). His total tax burden is of course then $52, or the same as on income earned domestically. Let me only add that the law makes a distinction between foreign income earned by a branch and by a subsidiary. In the former case, the income is taxed when earned, in the latter only when the income is remitted to the United States. For this reason the subsidiary has become the predominant form in foreign business operations since the arrangement in fact means an interest-free loan extended by the government to the corporation until remittance is made.

A chief purpose of this legislation is to eliminate double taxation. In those cases where the foreign tax is less than the United States rate, there is no double tax or, more accurately, the total tax burden

*Ratified by the Senate July 9, 1958 with a reservation made necessary by the intervening lapse of the Pakistan tax concession law—see below Part V, (Ed.)

is limited to 52 per cent, the same as the tax on domestic income. On the other hand, if the foreign rate is higher than the domestic, which is the case in Pakistan, the foreign investment is, other things being equal, less attractive than a domestic one. While the purpose of the tax credit system is clear enough, I would like to mention that one of its economic implications is that the United States Treasury is, in fact, helping or subsidizing the country in which foreign investments are made. This is so for the simple reason that the treasury accepts as a fact that foreign governments will collect revenues at the source which would otherwise have been collected at home.

V

So much for the present system. What about the new proposal in the tax treaty with Pakistan? The central idea or argument is that in those cases where foreign governments want to make tax concessions in order to attract foreign capital and know-how, the effect is often nullified because the investor loses the benefit of the tax credit. In other words, while he pays less abroad his domestic taxes will increase correspondingly. Specifically, the government of Pakistan exempts from its income tax for a certain period, profits up to 5 per cent of invested capital earned by a manufacturing corporation over a certain minimum size. This provision has the effect of reducing the Pakistan tax on a United States corporation investing in Pakistan. While a certain part of the foreign tax is "spared," our domestic rate on branch income will go up immediately while a higher domestic tax is levied on subsidiaries at the time foreign earned income is remitted to the United States.

It is this principle the treaty with Pakistan proposes to alter. It is stated in the treaty that for the purpose of our foreign tax credit a United States corporation shall still be treated as having paid the Pakistan tax which was spared, that is, which was in fact not paid. It can apply a credit for the so-called "ghost" tax against its United States tax on income from Pakistan. As far as the present tax concession in Pakistan is concerned, the proposal in the treaty may imply as much as a 14 point tax reduction. Cases are easily imaginable where other tax concessions, in Pakistan or elsewhere, will have the effect of reducing the United States rate to zero.

In my opinion the tax credit device, as it has functioned up to the present time, is a sound one. In the first place it has eliminated double taxation on corporate income earned abroad. Secondly, and this is perhaps not always appreciated enough, the United States government through this device is giving substantial aid to underdeveloped countries since the tax credit permits revenues to be collected in the foreign country without any deterrent effect on the flow of capital to these countries. While I fully approve of both these objectives, I have some serious misgivings about the new provision in the proposed tax treaty with Pakistan.[1] It represents a radical departure from the present system which is perhaps not fully realized:

1. The tax credit as it operates today maintains the principle of equity or nondiscrimination. It does so because it eliminates double taxation and thus places taxation of foreign and domestic earnings on equal footing as far as the United States income tax is concerned. While the formula maintains the basic principle that a United States citizen is taxable on his world-wide income, it does recognize the right of foreign countries to tax incomes at the source. The formula does this by striking a balance between domestic and foreign tax claims on the American investor. The new proposal on the other hand introduces an element of discrimination in American taxation: if adopted it will mean that corporate incomes earned at home will be taxed at a higher rate than those originating abroad.

2. Not only will the proposal discriminate against domestic investments, it will also have the effect of favoring those countries which make tax concessions although their tax rates, after the concession, are not less than those in other countries which have not offered similar incentives, say, because their rates were already lower.

3. The proposal does not apply to all types of income earned abroad; patent and know-how royalties are not benefitted. Here again we have an example of unjustified discrimination.

4. The formula does not distinguish between a tax concession made on incomes derived from new investments and those on investments which have already been undertaken. By including this latter group the proposal is providing them with a windfall profit. Available statistics show that the beneficiaries will be a handful of large corporations.

[1] A very penetrating criticism of the proposal has been made by Stanley S. Surrey, professor of law, Harvard Law School. See his "Current Issues in the Taxation of Corporate Foreign Investment," *Columbia Law Review*, LVI (June 1956), 815 and his statement of August 9, 1957 before the United States Senate Committee on Foreign Relations. The next few paragraphs are greatly influenced by his argument.

5. Up to now, tax treaties have on the whole been prepared by technicians. There is a very real danger that the new formula, if adopted, will result in intense lobbying activities with United States foreign investors and tax concession countries establishing a united front.

6. Finally, it ought to be mentioned that the proposal introduces a new procedure in tax policy: According to the present procedure, tax rates are, of course, determined in the course of legislative action which includes both the House and the Senate. The implication of what is now proposed is that tax rates on corporate income earned abroad will be determined by treaty action rather than legislation.

VI

It may be argued that even if these various criticisms are accepted as being valid, they are only of secondary importance and that the decisive question is to make private investment in Pakistan more attractive. While I am all in favor of stimulating such private investments in underdeveloped countries, I am by no means persuaded that tax concessions along the lines in the treaty with Pakistan will yield the desired results. There are a great many factors deterring American investments in such faraway countries as Pakistan. I shall not bother you with a listing of all of these factors. Let me only mention one: a general lack of knowledge among potential American investors of investment opportunities in Pakistan. The possibilities are clearly there; the real question is how to transmit this information to foreign investors. While it is true that taxes do play a certain role in the potential investor's calculations, it is, I believe, a minor one. This is at least the way I interpret the available material on foreign investment incentives.

VII

From my argument up to this point two conclusions can be drawn:

1. Unless oil is discovered it is unlikely that the export sector of the Pakistan economy will show a growth rate sufficiently high to finance an accelerated development program; and

2. Although foreign private investments may go up in the future, it would be unrealistic to expect this source of finance to cover more than a small part of total development requirements.

From this general argument I am hence forced to conclude that for some time to come a substantial amount of foreign aid will be indispensable. There is, of course, nothing new about this situation.

For some years now Pakistan has relied heavily on such aid. Broadly speaking, it can be said that what limited progress has been made so far has been financed almost exclusively through foreign aid. Apart from the Korean boom years, foreign exchange earnings have been just sufficient to finance normal import requirements; they have not provided a margin for development. It is both in Pakistan's own interest as well as in ours to accomplish a gradual tapering off of foreign aid. Unfortunately the prospects for such a development are not very good, at least not within the next decade or two.

There is one additional point I should like to make in conclusion. The experience of a great many other countries tells us quite clearly that self-sustaining economic growth requires an annual minimum rate of saving and capital formation at least equal to 10 to 12 per cent of the national product. In Pakistan today the rate of saving and investment is not more than one-half of this minimum requirement. With an annual population increase of about 1½ per cent, it follows that the economy is only succeeding in standing still. Development in the sense of increasing per capita income has not as yet taken place. And now I come to what I consider a crucial point in the present situation: Pakistan's military establishment is year in and year out absorbing something like 6 to 7 per cent of the national product. For a country this poor it may well be an excessive burden to carry. If a major part of the resources that are now being used by the military could be converted into development goods, it would be possible for Pakistan to achieve an annual rate of capital formation sufficient to bring about self-generating growth. Or put another way: the present combination of military and economic targets is excessive in relationship to the country's resources. One or the other program must be cut in order to bring total requirements into line with available resources. This is the crucial decision which Pakistan must face up to. It is not too much to say that the economic future of the nation will depend upon the outcome of that decision.

Problems of private investment in India by American firms

George Rosen

Center for International Studies,
Massachusetts Institute of Technology

AS OF THE END of 1955 the total long-term private business investment in India by American firms and individuals totalled 455 million rupees (approximately 100 million dollars). This was almost entirely direct investment and was concentrated in two fields — manufacturing industry and trading — with about 40 per cent in the former and 50 per cent in the latter. The great bulk of the private investment in manufacturing is in the oil industry with Standard-Vacuum and Cal-Tex Companies owning refineries which will, on their completion, represent an investment of over 60 million dollars. Although the United States is the second largest source of foreign private business investment in India, it is far exceeded by the United Kingdom — the total American private investment was only about 12 per cent of the British investment in 1955. However, this country is probably the main potential future source of private business investment in India.

The major question an American firm must answer before deciding whether to make an investment in India is whether it would pay to do so. This in turn breaks down into several other questions: Will it pay more than if the American firm expands its foreign trade with India? How does investment in India compare with further investment in the United States, or in other countries? Is there much difference between the short-run and long-run opportunities for gain by foreign trade or investment?

What are the foreign trade possibilities for American firms? Under this Second Five Year Plan, and the one that will follow it, it is hoped to raise the annual per capita income of 400 million Indians from about $50 to approximately $100. While this is still a very low individual figure, nevertheless the total result in an economy of so great an absolute size will be large. At the end of the Plan periods the Indian population will obviously consume a much greater volume of consumer goods. There may also be some increase in the demand for consumer goods in the development period, but this is unlikely to be very significant. In the development period there will be a large demand for imports of capital goods — especially machinery, chemicals, and industrial raw materials. However, at the end of the Plan periods India hopes to internally produce most of its own larger requirements of capital equipment and industrial raw materials. It also may be able to export these to other countries.

How will this development affect American exports to India? I think there will be a greater short-run demand for imports of American capital equipment, but this increase will not be great. In 1955 and 1956, American machinery in India was being undersold by as much as 25 to 50 per cent by comparable machines produced in England, Japan, Germany, Sweden and Switzerland. This is the main reason Indian firms are not enthusiastic over American loans that have "tied purchase" requirements. It is possible that American-owned firms producing machines in Europe or Japan can compete on price terms; in such cases the price factor would be less important. However, there are machines which countries other than the United States simply do not produce — for example, the Barber-Coleman winding machine for cotton textiles — and either the promised gains from their use or the pressure of fashion leads Indian firms to import them. The demand for this type of machinery will probably increase, but this is a specialty product.

With respect to consumer goods, the demand prospect in the short run is not good simply because, if the planning is effective, imports of such goods will be kept to a minimum. After fifteen to twenty years I expect there will be greater demand for American consumer goods, but I think again this will be for specialty goods such as Cadillacs, expensive refrigerators, etc. The bulk of manufactured consumer goods that Indians can buy can be produced at lower price elsewhere; and it is doubtful that American firms will be producing the cheaper varieties which can sell in India.

In the case of both consumer and producer goods in any case, if recent experience is any guide, Indian producers will be given strong protection either by tariffs or direct import controls. In such cases, imports to meet demand will not be very important. This means essentially that American firms, to maintain their present positions in the Indian market, or to gain from the growth in the market that is to be anticipated, will, almost of necessity, have to invest directly in India. There may also be some advantages in setting up a plant in India which would be able to export to other countries of Asia.

If this is so, will it still pay an American firm to invest? What are the problems of investing? What are the profit rates in India? And what are the tax provisions in India? I am not going to discuss American taxes on the profits remitted here, nor am I going to attempt to compare profit rates in different countries.

First, it is essential to discard one psychological bogey. The Indian government has as a goal a "socialistic pattern of society." This is essentially a welfare state idea. There has been no nationalization of existing manufacturing industry except in the case of one manifestly inefficient and corrupt firm; there have been nationalizations of some banks and insurance companies, but compensation was fair, and there were reasonable grounds. Under a treaty signed with the United States in 1957 it is possible for an American firm to insure against nationalization without adequate compensation. Certain industries such as atomic power, defense and transportation are reserved to the government, but in other industries, including steel, private firms are expanding; and the government has in fact withdrawn the threat of nationalization after ten years.

The main effect of government policy in the Five Year Plans has been to provide an increasing, and almost guaranteed, demand for industrial capital equipment and the raw materials for industrial expansion. Since 1954, the private sector has been expanding at a very rapid rate, largely by plowing back profits. In fact, the expansion of the private sector is contingent upon both the government continuing to provide demand, and expansion of the government projects which private firms cannot, for one reason or another, carry out — public utilities, railroads, irrigation, and hydroelectric projects, and the large government steel works. I will end this discussion of nationalization by quoting from a report of the Federation of British Industries to British firms on investment in India, as of 1956.

It will be seen that for all the paternalism of its approach and its committal to State ownership in important spheres of the economy it is difficult to accuse the Government of India of any neglect of measures to encourage and promote private enterprise in industry. In the . . . Ministries of the Government which are concerned with industrialization the outlook which prevails is markedly empirical and pragmatic and generally speaking quite untinged by an doctrinaire preference for State action for its own sake. The attitude of mind is rather that the job to be done is one that is beyond the resources of privately owned industry as it exists in India, and one that must subserve certain broad social aims which have long since been achieved in Western industrialized countries whether they are capitalist or socialist. To the extent that private industry is willing and able to play its part it is to be encouraged to do so, but the Government is not willing to extend that encouragement so far as to wait upon private industrial initiative where it considers that development is urgently required, or to give it a completely free hand in an economy which is admittedly a controlled one.

This quotation also indicates the main characteristic of the existing economic structure in India — that is, its system of controls. For an American businessman these are not unfamiliar, since in many respects they resemble those in force here during the war years. There are controls over entry, controls over expansion, controls over imports, controls over foreign exchange use, controls over scarce raw materials, controls over many prices and controls over labor. Many of these are necessary; others reflect the welfare-state goal — all require dealing with government departments for permission. Indian firms of large size know how to operate within these controls. For a new firm there are other problems — the requirement of "progressive manufacture of the product within India," which means that by the end of a certain period of time the product must be entirely produced rather than merely assembled in India; the natural policy of "Indianization" of the firms' executive personnel in India, which means that there must be a program to train Indians to take responsible positions with the firm, and that they must be given responsible positions. With respect to the latter requirement in the past ten years, far more Indians have moved into middle-executive and scientific positions in foreign firms, while the number of foreign personnel in top positions has remained roughly constant. With respect to most of these controls the foreign firm deals with the Ministry of Commerce and Industry, and the Finance Ministry. It is important to see the responsible officials in these ministries who can make decisions; the outlook of these officials is pragmatic. If the government feels an investment is sufficiently desirable, there is evidence it will be prepared to make numerous concessions. (For example, the three oil companies building the refineries signed contracts with the government in 1951 under which they retained all the voting stock, were assured of a protected market and were guaranteed against nationalization for a period of twenty-five years.) Today with the critical foreign exchange situation, the government is particularly willing to encourage private foreign investment in those areas that are consistent with Plan goals. Finally, foreign firms are given privileges which are unavailable to domestic firms. The most important of these are the free convertibility of foreign exchange for repatriating both profits and capital.

A related question is one of the type of investment in terms of participation with Indian firms. The government strongly prefers joint foreign-Indian investment, and in 1948 and 1949, policy statements announced that it would prefer an Indian majority. This policy has never been implemented by legislation and has in fact been waived very frequently in practice. There are also some advantages in a foreign firm associating itself with a reliable Indian firm. The large Indian firms have operated successfully within the network of controls and know how to function within the system. In terms of public relations, especially if a long-run investment is planned, it is also helpful to have some Indian participation.

What has been the rate of return in Indian firms in the past five years? The Reserve Bank of India has made estimates which are based on the published balance sheets (which may understate profits) of 750 private Indian companies. It found that profits after taxes averaged approximately 8 per cent on a net worth from 1950 to 1955 (it was over 9 per cent in 1955). This does not include "managing agent's commission" which is considered a "cost item" in Indian accounting, but is really largely a profit; if this were included, it would raise the rate of return by about one-third. As another measure, "gross profits before taxes" (which includes managing agent's remuneration) averaged 9 per cent on gross sales, and 9 per cent on *total* net capital employed, from 1950 to 1955 (over 10 per cent in 1955). These averages include both profitable and unprofitable companies, efficient and inefficient with the rates for the profitable ones unquestionably much higher. Also since 1955 there is every reason to believe that profit rates in private industry have continued to increase. The rate of growth in industrial production has increased each year since 1951, and the investment carried out by the private organized industrial sector in the first years of the Second Plan up to September 1957 had already apparently reached two-thirds of the total projected for this sector for the entire five years of the Plan. With a large and almost guaranteed government demand for the output of the cement, steel, machinery and chemical industries especially, profits may be expected to be high for a reasonably efficient firm in these industries.

How do profit rates for foreign-owned companies compare with those for Indian companies? The Indian Tariff Commission made a study of prices of rubber tires and tubes in 1955. The two largest producers are foreign companies: Dunlop (an English firm), and Firestone. This study estimated that from 1946 to 1953 profits *before taxes* (after some adjustment) for Dunlop ranged from 18 to 37 per cent on total net capital employed; for Firestone the profits on total net capital employed were higher, ranging from 48 to 77 per cent. The companies concerned felt that these figures exaggerated the rate of return; nevertheless, it does present an order of magnitude on foreign investments *before taxes*. It also raises a problem all companies must face — that is, the possibility of periodic investigations, if the industry is tariff protected, and with only a few firms in it. This particular investigation concluded that the profits were too high and recommended a reduction in the selling price to a "fair" level.

While profits may be potentially high in India, it is necessary to raise the question of taxes in that country. In any general discussion it is only possible to say that this is a most complex field, into which any firm planning investment must do its own investigation. Recently the Indian National Council of Applied Economic Research published a monograph entitled "Taxation and Foreign Investment" which summarized most of the relevant material. In general, the burden of Indian taxation on both individuals and on foreign corporations working in India is heavier than in many of the capital-exporting countries and also heavier than in many other countries competing for foreign investment. However, there are tax exemptions on some profits for new firms in certain desirable industries for limited time periods; there are extra depreciation allowances; there are tax exemptions on income of "technicians" and on perquisities. The effects of the new expenditure and wealth taxes are very slight. The relationship of these taxes to United States income taxes are complex and has to be explored if a company desires to transmit profits home rather than plow them back in India.

At present there are no restrictions on transmission of profits or repatriation of newly invested capital beyond the normal ones of permission from the Reserve Bank. In fact, in one or two cases during the past year, when there has been a serious foreign exchange crisis, American firms have deliberately tested the government's willingness to permit convertibility, and the government has allowed repatriation very quickly. Under the recent treaty between India and the United States it is also possible for an American firm to insure against suspension of convertibility.

I conclude by summarizing what should be kept in mind:

1. The Federation of British Industries concluded that

> When every allowance is made, however, for the worst that can be foreseen, the basic fact remains that Indian industrialization has been set in motion. Its course may be rough or smooth, slow or fast, but it is set . . . [The] assumption . . . that in fifteen or twenty years time India will have become a major industrialized country is not an empty one. On the contrary it is the only safe working assumption that British firms can make.

2. The Indian government's policy is to protect domestic producers, and as industrial output expands it will be more difficult to import competing goods. This means that direct investment will probably be necessary to protect the existing market, and potentially larger market.

3. The opportunities for making money in India by new investment in expanding manufacturing fields (especially machinery and chemicals) are good. The Indian tax rates are high, but there are special allowances and exemptions; convertibility is freely permissible. There are serious problems of operating a business in India. Nationalization is *not* one of them, but there are numerous controls and require-

ments which must be met. However, the Indian government does desire foreign investment, and there is certainly a fund of respect for American firms. If the Indian government wishes an investment enough, it can, it has, and it will waive some of these requirements. In many cases it would be desirable to invest jointly with a reputable Indian firm that has dealt successfully with the government and to whom some of the burdens of operating in India can be shifted. The Federation of British Industries finally concluded that India has in the past given every evidence that it "is prepared to welcome foreign investment on terms which are not unreasonable, have been conscientiously adhered to, and compare well with those enforced by other underdeveloped countries."

India's international financial difficulties

Yves Maroui

Economist,

Division of International Finance,

Board of Governors of the Federal Reserve System

MOST OF THE countries of Asia including India are engaged in heroic efforts to break the vicious circle of economic and social forces which have resulted in a chronically low level of per capita income. Low per capita income is responsible for these countries' low level of savings. These savings finance a relatively low amount of investment which, given the rate of growth of population, tends to accomplish little more than the maintenance of the per capita income level. The problem is to raise per capita income and to promote its continued rise at a rate comparable to that achieved in more fortunate countries.

To solve this problem, many of these countries have embarked upon large and growing investment programs under the overall direction of the state and with a great deal of direct participation by the state. Unfortunately, in many cases, the effort undertaken has been greater than could be financed from available resources, domestic and foreign, and inflation has set in. Miscalculations, erroneous assumptions about the costs of the programs, or about the availability of domestic or foreign resources, have usually been to blame, but resort to inflation has also been to some extent deliberate in the belief that a faster rate of development would result. In all cases, inflation has led to international financial difficulties.

The international financial difficulties which India is facing today can largely be explained in these terms. They illustrate vividly the enormity of the problem of economic development when the rate of growth of population is high and the income base is small. They de-serve careful consideration, not only for the lessons which may emerge and which those interested in problems of economic development may find useful, but also because a study of these difficulties may help American businessmen engaged in day to day dealings with India, government officials concerned with the formulation of United States policy toward India, and the public at large anxious to gain increased understanding of India.

THE RECORD, 1951-56

In India, population is growing at an estimated rate of about 1.5 per cent a year. The 1951 population was nearly 357 million and the 390 million level should be reached before the end of 1958. For the year ended March 1956, national income in 1948-49 prices was estimated at 104.2 billion rupees (about $21.9 billion), giving a per capita income of 272 rupees (about $57). In that year, consumption of foodgrains amounted to only about 400 pounds per capita. Domestic savings were only about 6 per cent of national income and the rate of investment, including investments financed by foreign resources, was only slightly higher. Unemployment and underemployment remained tragically high.

Although the living standards of the Indian people were quite low in 1955-56, an encouraging improvement had occurred over the preceding five years. The estimate of national income in constant prices just given was 17.7 per cent higher than in 1950-51 and the per capita income was 10.5 per cent higher. The index of agricultural production was about 19 per cent higher and that of industrial production about 40 per cent higher. Low though the rates of saving and investment may have been in 1955-56, they too were higher than in 1950-51.

The momentum of the economy which these figures reveal was partly attributable to the weather, as the droughts of 1950-52 were followed by good monsoons in 1953-55. However, it was also the result of the first five year plan, which extended from April 1951 to March 1956. Under the plan, a deliberate effort was made to increase production and to develop the basic facilities (mainly power) needed for further growth. The central and state governments spent about 15 billion rupees on public investment projects and an additional 4.6 billion rupees (not labeled investment) on other activities included in the plan. Private investment in this period totalled 16 billion rupees, making total plan outlay 35.6 billion rupees (about $7.5 billion).

The progress of this period was achieved under conditions of financial stability. Wholesale prices fell in the last half of 1951 and early in 1952 following the inflationary upsurge of the Korean war boom. Thereafter they fluctuated narrowly, except for a steady decline in 1954 and the first half of 1955 and an ensuing recovery. At the end of the plan period, in March 1956, wholesale prices were no higher than in 1949, a record matched by few other countries in the world.[1]

Price stability was not purchased at the price of external imbalance. The balance of payments remained in approximate equilibrium during the last four years of the plan following a large deficit in 1951 associated with the Korean inflation and its aftermath. At the same time, import and exchange restrictions, which had been tightened as part of the post Korean readjustment, were gradually relaxed.

This record was made possible by the fiscal and monetary policies followed by the authorities. The budget deficits, largely occasioned by growing developmental expenditures, were mostly financed in non-inflationary ways. Inflationary financing, such as drawing down of cash balances and direct sale of treasury bills to the central bank, remained moderate, at least in the first four years of the plan. Over the five year period, it amounted to about 4 billion rupees (about 20 per cent of the total public outlay under the plan), of which about 1.7 billion rupees was incurred in the last year of the plan alone. The central bank, after withdrawing its support of the government securities market and raising the discount rate in November 1951, undertook open market sales of securities on a significant scale, particularly in 1953 and 1954. Under these policies, private bank credit as well as time and savings deposits of banks rose moderately after 1953, following the post Korean readjustment. In March 1956, money supply was only about 10 per cent higher than five years earlier.

THE SECOND FIVE YEAR PLAN

The remarkable performance of the Indian economy during the first five year plan led the Indian authorities to adopt a much more ambitious investment program for the ensuing five year period (April 1956-March 1961). They decided that a total of 62 billion rupees should be invested under the second five year plan, twice the amount invested under the first five year plan. An additional 10 billion, not labeled investment, was also to be spent on activities included in the

[1] In the United States, wholesale prices were about 15 per cent higher in 1956 than in 1949.

plan, making total outlay under the plan 72 billion rupees, again about twice the total outlay incurred under the first plan. Of the proposed total outlay, the central and state governments together undertook to spend 48 billion rupees, about two and a half times the amount spent by them in the first plan. Private enterprise was to spend the remainder, 60 per cent more than it spent under the first plan.

The inventory of projects included in this plan differed from that of the first plan in that emphasis shifted sharply from agriculture to heavy industry. The relative share of the proposed total public outlay allocated to the development of industry and mining was nearly four times that of the first five year plan while the relative shares of all other sectors was lower, except for a small increase in the relative share going to transportation and communications. For all sectors, however, the absolute amount to be spent was well in excess of the amount spent during the first plan.

Only about half of the public outlay was to be financed from taxation and by borrowing from the public. Another quarter was to be borrowed from the Reserve Bank of India. Another 8 billion rupees ($1,680 million) represented foreign exchange requirements, and the balance was to be raised from the profits of state owned enterprises. Resources available to finance the private investment outlay were only partially indicated and included a substantial dependence on bank credit expansion. Foreign exchange requirements of the private sector were estimated at 3 billion rupees (about $630 million). To meet the foreign exchange requirements, it was planned to draw down foreign exchange holdings by 2 billion rupees ($420 million) and to obtain the balance of 9 billion rupees ($1.9 billion) from abroad as loans or grants from foreign governments or international organizations, and as foreign private investment.

From the outset there were doubts as to whether the available resources would be adequate to finance the plan. The yield expected from taxation, borrowing from the public, and profits of state-owned enterprises appeared to have been estimated somewhat optimistically. The assistance required from abroad was more than three times the amount received from this source during the first five year plan and, as such, seemed to be well above what might reasonably be expected to be available. It was clear that, should these doubts become realized, borrowing from the Reserve Bank would have to be larger than planned. Even the planned amount of such borrowing seemed certain to generate inflation, since it amounted to about three times the amount of inflationary financing incurred during the first five year plan.

Moreover, the proposed total outlay was soon raised when it was estimated that the public investment program would cost at least 7 billion rupees (about $1.5 billion) more than originally planned. This was the result of price increases, inclusion of additional projects and correction of certain underestimated items. Included was an upward revision of the foreign exchange requirements by 4 billion rupees ($840 million). In spite of this revision, the foreign exchange cost of the public investment program was estimated at only about 21.5 per cent of the total and probably remained significantly understated.[2] Resources to finance this increase were not indicated but it seemed clear that foreign sources were counted on to cover the rise in the foreign exchange requirements. This would raise the total assistance expected from abroad to 13 billion rupees (more than $2.7 billion), a sum even more unlikely to be available than the original requirement of 9 billion rupees. Although nothing was said to this effect, greater reliance on borrowing from the Reserve Bank than originally planned seemed to be implied.

While the financial feasibility of the plan appeared open to question, the objectives which it aimed to achieve seemed relatively modest. The proposed overall outlay was expected in five years to raise national income by 25 per cent, to increase per capita income by 16 per cent and to create only about as many new jobs as there would probably be new entrants to the labor force. No attempt was to be made in this plan to reduce the large amount of unemployment and underemployment which have plagued India for a long time.

It seemed reasonable enough to undertake merely to prevent any further increase in unemployment and underemployment even though it was known that this would call for the creation of nearly twice as many new jobs as the first five year plan was thought to have created. The projected rate of growth of national income also seemed reasonable in the light of the employment objective. It is true that this rate of growth exceeded the rates achieved by the developed economies of the West. However, since unemployment was understood to have increased during the first plan in spite of an increase in national income

[2] The import content of development programs of underdeveloped countries has frequently been around 50 per cent of the total cost of the program. In some cases, it has been higher.

of nearly 18 per cent, it was thought that the attainment of the employment objective would require a more rapid rate of growth than was achieved in the first plan. The apparent ease with which national income was raised by 18 per cent during the first plan made it seem as though the rate of growth projected for the second plan would be attainable. The relatively modest nature of the objectives was given as a justification for disregarding the warnings about the financial feasibility of the plan.

While these objectives might have been sought with a somewhat smaller outlay, the Indian authorities desired to lay the basis for future development by making a special effort to expand heavy industry. Since this did not involve the creation of much additional employment in relation to the outlay involved, it was decided to stress handicraft and small scale production of consumer goods, at the expense of factory production of these goods, in the belief that this would make up the deficiency in job creation. Both of these decisions had the effect of raising the outlay needed to bring forth the desired addition in total output. The expansion of heavy industry required large amounts of capital, while handicraft and small scale production of consumer goods was relatively less efficient than factory production.

As had been feared, the attempt to carry out this plan and the resulting boom in private investment and consumption brought on a sharp increase in inflationary pressures. The growth of public and private investment spending increasingly financed by Reserve Bank advances to the government and by bank credit expansion boosted money incomes. The resulting increase in effective demand outstripped the rise in domestic production so that prices rose, imports increased sharply and foreign exchange reserves began to fall rapidly.

FISCAL POLICY

The public investment program extended and intensified the public investment activities of the first five year plan. It involved rapidly rising public expenditures, as a result of which the budget deficits, which had begun to grow in the latter part of the first five year plan, grew further.

A courageous attempt was made to increase revenues through taxation. Excise duties on cotton cloth were raised in September 1956. A supplementary budget, adopted in December 1956, revived the capital gains tax which had been in effect briefly after World War II and raised the dividend tax and certain import duties. At the same time, businesses were required to deposit with the Reserve Bank sums equal to specified percentages of their depreciation and other company reserves. The 1957-58 budget, adopted in August 1957, raised a number of excise and import duties as well as certain postal rates, increased the corporate income tax rate, cut sharply the exemption level on the personal income tax, and introduced a new tax on railway fares, a wealth tax and a personal expenditure tax. Including tax increases adopted by several of the States of the Indian Union, these various measures are estimated to yield an additional tax revenue of about 1.5 billion rupees ($315 million) per year.[3]

In spite of this, the combined operations of the central and state governments continued to yield increasingly large deficits. Although non-inflationary means of financing (e.g. borrowing from the public and foreign assistance) yielded growing amounts, these were not enough to prevent a sharp rise in inflationary financing, principally government borrowing from the Reserve Bank of India. As shown in the following table, the inflationary impact of government activities, which was negligible in 1953, grew sharply each year thereafter until, in 1957, it was estimated at 4,822 million rupees ($1,013 million),

TABLE 1. *Inflationary Impact of Government Operations in India Since 1953**
(In million dollars equivalent)

	1953	1954	1955	1956	1957
Reserve Bank credit to government	—81.5	—2.9	+228.5	+566.2	+904.5
Scheduled bank holdings of govt. securities	+26.9	+25.0	+78.1	—42.8	+143.4
Other bank claims on government	+1.9	+4.6	+12.2	+3.6	—28.7
Government currency circulation	—6.3	—4.2	+12.6	—4.8	—5.5
Government rupee balances	+97.4	+122.6	+14.7	—6.5	—1.0
Net inflationary impact	+38.4	+145.1	+346.1	+515.5	+1,012.7

Source: Reserve Bank India Bulletin (various issues)
* Change measured from figures as of last Friday of year.

[3] The personal expenditure tax did not become effective until April 1, 1958.

about 96 per cent larger than in 1956, nearly three times the 1955 rate, and nearly seven times the 1954 rate.

MONETARY POLICY

At the same time, a monetary policy of controlled expansion was adopted toward the private sector. Under this policy, credit for productive purposes along lines consistent with the five-year plan was allowed to expand, while credit for speculative purposes was curbed. The principal restraining instrument of the policy was a regulation applying to advances against foodgrains, sugar, and, for a short time, cotton textiles. With respect to these advances, the regulation set the maximum percentage of the value of the collateral which banks would be allowed to lend and fixed ceilings on the total of such loans as well as on individual advances.

This policy of selective credit restraint, first introduced in the spring of 1956, was reinforced, in August 1957, by a request to the banks from the governor of the Reserve Bank that they bring down the overall level of advance by 10 per cent by mid-October from the level of early August. It was understood that banks which did not do so would find it more difficult to borrow from the Reserve Bank when the next seasonal increase in the demand for credit got underway. The banks were told to comply without reducing credit to the productive sector, in a continued attempt to limit the applicability of the restraining action to speculative activity.

A further measure of restraint was introduced by moderate increases in the Reserve Bank lending rates to banks. There were four such increases between March 1956 and May 1957, and the overall result was to raise the lowest lending rate from 3 to 4 per cent. However, the effect appears to have been limited. While the higher rates brought about some tightening of the money markets, the liquidity of the banks was never so strained as to retard significantly the growth of advances. In part, this is because the growing recourse by the government to borrowing from the Reserve Bank bolstered bank liquidity at an increasing rate. But in addition, the Reserve Bank increased its credit to the banks by 805 million rupees from March 1955 to March 1957, nearly tripling it. This provided the basis for more than 40 per cent of the 2,839 million rupee expansion in bank credit which occurred in these two years.[4]

[4] The calculation is based on these facts: for several years, about two-thirds of

Since early in 1957, there has been a substantial accumulation of rupee funds in commercial banks to the credit of the United States Government as the Indian Government began paying for United States surplus agricultural commodities imported under a PL 480 agreement.[5] The commodities so imported were put on the market, the Indian Government being reimbursed from the proceeds, so that the transaction resulted in a transfer of funds from the public to United States accounts. In the process, however, bank liquidity increased to the extent that the public paid for the commodities with currency. In addition, it increased even when the public paid with demand deposits, since the United States Government placed the funds in time deposits against which banks are not required to hold as large a minimum reserve ratio as they are against demand deposits. As it turned out, the expansion of bank credit was smaller in 1957 than in 1956, both in absolute

additions to money supply each year have taken the form of currency, and about a third has been in bank deposits. For scheduled banks, each year in the last several years, about 60 per cent of additions to bank deposits have been in demand deposits and about 40 per cent in time deposits. Scheduled banks are required to maintain balances at the Reserve Bank equal to 5 per cent of demand liabilities and 2 per cent of time liabilities. Given the 60-40 ratio of demand and time deposits, this means that the effective overall reserve ratio for scheduled banks is about 3.8 per cent, (i.e., 60 per cent at 5 per cent and 40 per cent at 2 per cent). For cooperative banks, the effective overall reserve ratio works out at about 1.7 per cent. The rise in Reserve Bank credit of 805 million rupees in two years may be broken down into a 661 million rise in credit to scheduled banks and a 144 million rise in credit to cooperative banks. Given these facts, the expansion coefficient, A, is calculated as follows:

$$A = \frac{1}{1-(1-R)\times(1-C)}$$

where R is the applicable reserve ratio and C is the percentage of leakage through increased currency circulation. On this basis, the expansion coefficient for scheduled banks is 1.465. For cooperative banks it is 1.48. The expansion of bank credit made possible by the growth of Reserve Bank advances to the banks works out at $1.465 \times 661 + 1.48 \times 144 = 1{,}187$ million rupees.

[5] PL 480 provides for the disposal of United States surplus agricultural commodities. Under Title I of this law, these commodities may be sold for foreign currencies. The United States reserves some of the proceeds of such sales for its own uses and makes the rest available to the foreign country, partly as a loan and partly as a grant. Under a Title I agreement signed in August 1956, the United States is providing India with agricultural commodities valued at $360.1 million over a three year period. Of the rupees paid by India, $72 million equivalent is reserved for United States uses, $234 million equivalent is to be loaned to India and the balance given to India as a grant for development.

terms and in relative terms, while liquidity created by continued government borrowing from the Reserve Bank grew more rapidly. As a result, the banks which, for a number of years before 1957, had been net sellers of government bonds and had received increasing advances from the Reserve Bank, were able to reverse this trend. They used nearly half of the total increase in their deposits in 1957 to reduce their indebtedness to the Reserve Bank and to buy government bonds. Had the rupee funds arising from PL 480 sales been deposited in the Reserve Bank instead of in commercial banks, it is unlikely that the banks would have increased their holdings of government bonds or reduced their debt to the Reserve Bank, and the expansion of bank credit would probably have been much the same. On the other hand, the decline in reserve bank credit to the banks by nearly 30 per cent since March 1957, which was made possible by the decision to deposit these funds in commercial banks, involved a weakening of the influence of the Reserve Bank over the money market.

On balance, monetary policy toward the private sector appears to have been more expansionary than it was restrictive. It is true that advances against foodgrains were largely stabilized in 1957, but such advances account for only about 5 per cent of total bank credit and other advances continued to expand. Overall bank credit to the private sector, which had risen by 12.5 per cent in 1954 and by 14.4 per cent in 1955, expanded by 25.6 per cent in 1956 and by another 14.6 per cent in 1957. At the end of 1957, the level of bank credit outstanding was nearly double what it was four years earlier. Industry, particularly the iron and steel, engineering, and cotton textile industries, received about half of the additional credit granted by banks in these four years and another large share went to traders in non-agricultural commodities, especially traders in cotton textiles, and in machinery, engineering and chemical products.

DEMAND AND SUPPLY

Money incomes rose as public and private investment spending increased. However, part of the increase in incomes went into time deposits, thereby mitigating somewhat the inflationary pressures. Between the end of 1953 and the end of 1956, time deposits of banks rose by 1,411 million rupees (about 38 per cent), but this was only about 42 per cent as much as bank credit expanded in this period. In 1957, they rose more than bank credit, but this was due to the accumulation of PL 480 funds to the credit of the United States Government. Excluding this factor, they rose less, although they probably offset bank credit expansion to a greater extent than in each of the previous three years.

It is not known to what extent, if any, the rising money incomes went into private hoards. Such hoards generally take the form of precious metals, which are largely smuggled into the country since their import is prohibited. It is also probable that the sectors of the economy where transactions have generally been on a barter basis are increasingly adopting money as a means of exchange. Nevertheless, it seems clear that the increase in money incomes generated a substantial rise in effective demand.

To some extent, the goods for which demand was rising could be and were being produced domestically. Industrial production, which had risen about 40 per cent during the first five year plan, continued to rise. In the third quarter of 1957, it averaged about 50 per cent more than in 1951. Its rate of growth, however, appeared to be relatively stable at 7.5 to 8.5 per cent a year in the last four years, whereas the growth of effective demand seemed to be gathering momentum.

At the same time, agricultural production rose less than 8 per cent from the crop year 1953-54 to the crop year 1956-57, the bulk of this rise being concentrated in the last year. Production of food-grains actually fell about 4 per cent from 1953-54 to 1954-55 and did not recover this loss until 1956-57 when it exceeded the 1953-54 level by barely 1 per cent. While the production of fibers and of sugar cane rose sharply, that of tea appeared to have leveled off and that of oilseeds held well below its peak of 1954-55.

Not only did the domestic demand-supply situation appear to be getting out of balance, but in addition, an increasing part of the rise in effective demand was directed toward goods that could not be purchased except abroad. This was particularly true of a broad list of capital goods needed to carry out the investment program. As a result, not only did prices rise sharply, but in addition the international payments position deteriorated.

PRICE DEVELOPMENTS

Wholesale prices, which had begun to rise in May 1955 after a steady decline over the previous twelve months, continued to increase in 1956. In eighteen months, the rise amounted to 23 per cent and affected all commodity groups. In November 1956, food articles were about 30 per cent higher than in May 1955, industrial raw materials were about 26 per cent higher, intermediate manufactured products were 16 per cent higher and finished manufactured goods were about 8 per cent higher. The rise of wholesale food prices reflected in part the lower output of foodgrains in the crop years 1954-55 and 1955-56 than in the crop year 1953-54, but the fact that the upward trend of prices affected all sectors suggests that the increase in effective demand was largely to blame.

In 1957, wholesale prices levelled off. There was a brief spurt in May, June and July, but this was followed by a steady decline in the last five months of the year. The decline extended into 1958 and in March, wholesale prices were 1 per cent lower than a year earlier, 7 per cent lower than at their peak in August 1957. Wholesale prices of food articles, industrial raw materials and intermediate manufactured products, in particular, were significantly lower. In part this resulted from the steady arrival throughout this period of large shipments of surplus agricultural commodities from the United States and the recovery of foodgrain production in the crop year 1956-57 to a new record level, but, more important, it reflected the fact that the impact of inflationary pressures was being fully absorbed by the balance of international payments and the reserves of foreign exchange.

THE INTERNATIONAL PAYMENTS POSITION

The balance of payments position, which had been one of approximate equilibrium in 1953, 1954 and 1955, deteriorated sharply in 1956 and 1957. The current account deficit grew steadily until, for the six months ended September 30, 1957, it ran at an annual rate of 5,956 million rupees (about $1,250 million).[6] In this six month period, the annual rate of imports was about 58 per cent higher than in the corresponding period of 1955. At the same time, exports showed almost no gain above the levels of 1955. As a result, the trade deficit rose from about 650 million rupees ($137 million) in 1955 to about 2,100 million rupees ($440 million) in 1956, and to an annual rate of about 3,485 million rupees ($732 million) in the first nine months of 1957.[7]

[6] Excluding the return to the United States of large amounts of lend-lease silver.

[7] Based on customs figures. Since July 1956, the payments deficit on merchandise account has been much larger than the trade deficit recorded by the customs, reflecting the fact that heavy payments were being made for merchandise not currently being delivered. Advance payments on orders for capital goods are known to have been substantial. Most of these advance payments were undoubtedly required by the sellers, but some were probably

TABLE 2. *Indian Foreign Trade, 1954-57*

Quarters	Exports: Value (In millions of rupees)	Exports: Percentage change from same quarter of previous year	Imports: Value (In millions of rupees)	Imports: Percentage change from same quarter of previous year	Trade balance (In millions of rupees)
1954 - I	1,319	—.5	1,321	—1.0	—2
II	1,134	—5.2	1,520	—7.9	—386
III	1,434	+10.0	1,595	+7.3	—161
IV	1.740	+16.9	1,740	+40.2	0
1955 - I	1,628	+23.4	1,709	+29.4	—81
II	1,325	+16.8	1,624	+6.8	—299
III	1,611	+12.3	1,581	—.9	+30
IV	1,513	—13.0	1,815	+4.3	—302
1956 - I	1,645	+1.0	2,028	+18.7	—383
II	1,316	—.7	1,917	+18.0	—601
III	1,423	—11.7	2,101	+32.9	—677
IV	1,658	+9.6	2,101	+15.7	—443
1957 - I	1,637	—.5	2,280	+12.4	—643
II	1,455*	+10.6*	2,617	+36.5	—1162*
III	1,646*	+15.7*	2,455	+16.8	—809*
IV	1,536*	—7.4*	2,182	+3.9	—646*

Source: International Financial Statistics * Estimated. Official figures are believed to include shipments of silver to the United States in repayment of silver obtained from the United States during World War II under a lend-lease agreement. Adjustment made on the basis of United States data on receipts from India under the agreement.

The increase in imports was the most spectacular manifestation of the rise in effective demand. The bulk of it represented sharply stepped up deliveries of machinery, metals and metal products, and the arrival of surplus agricultural commodities from the United States beginning in November 1956. Imports of machinery, metals and metal products accounted for about 86 per cent of the rise in total imports from 1955 to 1956 and may explain as much as 40 per cent[8] of the rise from 1956 to 1957. These imports, largely on private account, were used primarily in the expansion of facilities and for current production. However, a significant accumulation of inventories is reported to have occurred in 1956 and the first half of 1957. The shipments of United States surplus agricultural commodities, which appear to account for somewhat more than 50 per cent of the rise in total imports from 1956 to 1957,[9] were originally intended to build up stocks, but are said in fact to have been to a large extent put on the market to fight rising food prices.

The deterioration of the trade position was largely financed by drawing down foreign exchange reserves. Between April 1, 1956 and the end of 1957, India's foreign exchange reserves were in fact reduced by 4,486 million rupees ($942 million), more than twice the amount by which it had been planned to reduce them in the five year period beginning April 1, 1956. In addition, India drew $200 million from the International Monetary Fund in three installments in February, March and June 1957. Other assistance in this 21 month period totalled about $600 million, including $126 million drawn on International Bank loans,[10] about $136 million in the form of United States aid and an estimated $259 million representing the value of the shipments of United States surplus agricultural commodities already mentioned.

The bulk of this assistance, including the IMF drawing, 80 per cent of the drawings on IBRD loans and practically all of the United States agricultural surplus commodities, came in 1957. Without it, and without the very extensive utilization of foreign exchange re-

instigated by Indian buyers, partly reflecting a flight from the pound sterling in connection with the Suez crisis. Throughout this period, India has continued to earn a surplus on invisible account.

[8] Author's estimate.

[9] Author's estimate based on United States data on such shipments.

[10] Repayments of $6.5 million were also made to the Bank in this period, making net Bank assistance to India in this period $119.5 million.

serves,[11] wholesale prices would surely have continued to rise in 1957. Foreign exchange reserves and foreign assistance thus acted as cushions for the Indian economy. Their availability made it possible to face the growth of domestic demand with the minimum of internal price strains. But surely it could not be said that inflationary pressures were absent in 1957 and early 1958. Effective demand had reached a level at which it could be sustained only so long as the drain on foreign exchange reserves could continue and new foreign assistance could be obtained.

REMEDIAL MEASURES

To deal with the growing crisis, the Indian authorities began by tightening import restrictions. Import quotas were cut January 1, 1957, for 509 relatively nonessential items. At the same time, it was announced that, in general, import licenses for capital goods would be issued only to businessmen who either (1) secured foreign capital investment at least as high as the proposed imports, or (2) obtained credits from foreign suppliers, or (3) proposed to pay with the proceeds of loans from foreign and international lending institutions. Two types of supplier credits were specified; one provided that payment before shipment should not exceed 20 per cent of the f.o.b. price, the balance to be paid in seven annual installments; and the other limited initial payment to 10 per cent, the balance to be paid after the project had become a going concern, in installments not to exceed the net saving or earning of foreign exchange realized through the operations of the new plant.

On July 1, 1957, the open general licenses for imports were abolished, except on certain imports from Pakistan. In addition, a moratorium on issuing new licenses was enforced during the third quarter of 1957, except for raw materials and for capital goods procured under deferred payment arrangements. Beginning October 1, 1957, the import of a wide range of consumer goods was banned and quotas for many others were cut sharply.

The effect of these restrictions was to bring about some decline in imports beginning in the third quarter of 1957. Concurrently the demand for bank credit abated somewhat since importers unable to secure licenses no longer needed funds. Inventories accumulated earlier began to be drawn down, thereby providing a cushion thanks to which the

[11] About 51 per cent of the total decline in reserves in this 21 month period occurred in 1957.

restrictions did not immediately bring about an upsurge in prices. Due to the high level of outstanding licenses which remain valid, imports may be expected to continue at a high level for some time. The bulk of these licenses is reported to be for the import of machinery and raw materials.

Besides tightening import restrictions, the Indian authorities undertook a comprehensive review of the Five Year Plan itself. They decided to reduce the physical targets in such a way as to ensure that the total public outlay on the plan would not exceed the original estimate of 48 billion rupees. They established a set of priorities for the projects included in the plan and announced that they would concentrate on what they called the hard core of the plan (steel, coal, railways and certain power projects) and on such other projects as were so close to completion that the cost of completing them was low relative to the benefits to be derived from them. Other projects were to be implemented only as resources permitted.

At the same time a concerted effort was made to secure increased foreign resources to finance the uncovered foreign exchange cost of the hard core of the plan estimated at about 7 billion rupees ($1,470 million). So far (April 1958) additional asistance has been announced by the United States, Western Germany and Japan. In addition, the Indian authorities made clear their intention to devote the country's remaining foreign exchange holdings to the support of the plan if necessary. The minimum reserve of foreign exchange which the law required the Reserve Bank to hold was reduced from 4 billion rupees ($840 million) to 3 billion rupees ($630 million) in August 1957, and to 850 million rupees ($178.5 million) in November 1957. Even this latest minimum may be eliminated altogether under procedures provided for in existing statutes.

CONCLUSION

It is too early to tell whether sufficient foreign resources will become available to finance the foreign exchange cost of the reduced plan. Even if they do, it remains to be seen whether internal inflationary pressures will thereby be fully absorbed. The past rate of spending on the plan suggests that public expenditures must rise sharply in the next three years if the projected five year expenditure total is to be reached or even approached. At the same time, there is little scope for further increasing government revenues. Under the circumstances, the Indian authorities may find it difficult to carry out their recent decision to reduce the extent to which the plan would be financed by advances from the Reserve Bank, unless foreign assistance well in excess of the amount now sought is forthcoming.

If the authorities undertake to approach the projected five year expenditure total of 48 billion rupees under the plan, internal inflationary pressures may be expected to continue and the need for severe import restrictions will remain. If on the other hand the authorities decide to bring the inflationary pressures to an end by further readjusting the plan, it may eventually be possible to relax import restrictions. In either case, however, the level of Indian imports is likely to be lower than it was in 1957.

India's biggest supplier is the United Kingdom. The rest of Western Europe considered as a unit has recently become as big a supplier of India as is the United Kingdom, largely on the strength of a large increase in imports from West Germany. Including the United Kingdom, Western Europe supplied about 50 per cent of India's imports in 1956. The United States provided only about 12 per cent of the total. Indian import cuts are likely to be made on a nondiscriminatory basis since its foreign exchange shortage is a generalized shortage rather than a shortage of any one currency. Therefore United States exports may be affected about in proportion to the total decline in Indian imports.

United States suppliers of machinery, vehicles and metals, the principal United States nonagricultural exports to India, have fully shared in the increase in Indian imports. In 1956, shipments of these products to India, representing about half of total United States exports to India, were valued at about $132 million, two and a third times as much as in 1953. They accounted for nearly twice as large a percentage of total Indian imports as in 1953, a performance almost as good as the improvement in the overall position of Western Germany as a supplier of India. On the basis of data for the first nine months, it appears that some decline in these exports may have occurred in 1957. As import cuts and the readjustment of the plan assume their full effect, further declines seem inevitable, but the relative share of the Indian market held by United States suppliers need not fall if the terms offered to Indian buyers, including credit terms, are kept as attractive as those offered by other suppliers. At the same time, United States foodgrain exports to India are likely to be maintained close to the level of 1957, as the PL 480 agreement of 1956 continues to be implemented. What happens thereafter will depend in part on whether or not a new PL 480 agreement is negotiated.

In the long run, however, Indian economic growth will provide the basis for a renewed rise in imports in which United States suppliers may share. The potential of the Indian economy is enormous and neither the government nor the people are disposed to leave it unexploited. Progress may not, at first, be as rapid as they would like, but as they solve the many problems which confront them, particularly the population problem, and as they adopt wise policies, there is no reason why the rate of progress cannot eventually rise so that the vicious circle of poverty will at last be broken.

The Indians have a long, hard road to travel and they know it. They have begun the journey with democratic institutions and with a system of government which respects the basic freedoms of the people and their human dignity. If they can reach a satisfactory and a sustainable rate of development with these institutions and this system of government, they will probably have done more to rehabilitate democracy in the eyes of other Asian countries than can be done by any other means.

Ceylon's trade with the United States: A pattern of crisis and policy

Theodore Morgan

Professor of Economics, University of Wisconsin

AMONG THE three countries of India, Pakistan and Ceylon—Ceylon is the smallest; but in its problems and possibilities, it invites study as a model of the kinds of issues that underdeveloped countries face.

In the last several years, United States exports have been lower to Ceylon, per capita, than to Pakistan, but considerably higher than to India. Relatively heavy United States aid to Pakistan is one explanation of the comparison; another is the comparatively high income level of Ceylon, and perhaps its long pattern of net dollar earnings.

Compared to population, United States imports from Ceylon are very large indeed—about as much as from Pakistan, with nine times the population; and one-seventh that of India, with some 42 times the population. The explanation lies mainly in the United States taste for, and ability to buy, the high quality Ceylon teas; to a much lesser extent, it lies in United States purchases of rubber. From these two commodities alone come over 90 per cent of Ceylon's foreign earnings. Our total purchases from all three countries show much stability, though the downswing of 1954 in the United States had its effect in a moderate parallel downswing in imports from each country.

Economic and financial policy in each of these countries is intimately concerned with the amount of foreign assets. *Within* a country, even a highly inflationary policy—of rising money supply and rising money incomes—can be sustained for years without meeting any clear block. The experience of Chile, Brazil and other Latin American countries give example. But any such policy that involves as well rapidly falling foreign assets demands that prompt corrective measures be undertaken for the simple reason that countries, like individuals, can spend only so long as they have something to spend.

Hence the fall in Indian foreign assets, from Rs 7.8 billion at the end of 1955, to Rs 4 billion last February (with a further concealed loss due to upward revaluation of gold balances in this period), is the clearest evidence possible of crisis in the development plan—that is, of the need for taking some action to check the drain. Pakistan has sustained a more moderate drain, with foreign assets falling by only about 18 per cent between 1956 (Rs 1.7 billion) and last February (Rs 1.4 billion).

Ceylon—with which I will be concerned primarily in the rest of this paper—has gone through remarkable experience with its foreign assets in recent years, with corresponding effects on the volume and types of its trade.

Like other countries, Ceylon has been spending as much as it can on imports and other foreign charges. There is nothing reprehensible in this; in fact, to quote one eminent economist, probably the clearest root of economic progress lies in the persistent tendency of people to spend more than their incomes! Ceylon's effort to spend no more than its income is rendered difficult by the fact that its foreign earnings from exports are highly variable. Tea and rubber provide over 90 per cent of foreign earnings and their prices fluctuate widely. The price of tea is nearly three and a half times higher than in 1938, that of rubber four times higher. (At the same time the import price index is up four times.) But the price of tea rose 42 per cent between 1947 and the peak price of 1950; fell 9 per cent in two years; rose 30 per cent in four years (to 1956), and fell almost 30 per cent to winter 1957. As for rubber: its price rose nearly 250 per cent between 1947 and the Korean War peak of 1951, and fell 60 per cent to winter 1957.

What does one do in the face of this instability? The students at the University of Ceylon are convinced that the way out is to *diversify*. But diversification carried on for its own sake means that the economy is on the average poorer, in order to avoid the risk of occasionally falling on bad times. The students do not phrase the issue in this tougher and accurate way.

The problem is the greater for Ceylon, in that half of Ceylon's staple food (rice) is imported, and so must be paid for out of foreign earnings. The problem has been still greater in that this newly independent democracy during the 1940's had had a rice subsidy integrated into its budget, which at the maximum—in fiscal 1951-53—was absorbing one-quarter of the government's revenues. So far as our inquiries at the time made out, this is a world's record for a consumer subsidy.

Add to this the claims of an ambitious development program, aimed at increasing Ceylon's production at least as fast as the population is rising (about 2.7 per cent a year) and it is easy to understand how Ceylon's foreign assets could fall from Rs 1185 million at the end of 1951, to Rs 607 million at the end of 1953. (Rs 450 million had been estimated by the International Bank for Reconstruction and Development Mission as a reasonable minimum.)

Notice the advantages with which Ceylon could meet these problems of rapidly falling foreign reserves and intractable needs for food imports for a steadily growing population. The country was reasonably united, quite peaceful, had no serious issues with its great neighbor, India; in addition, it had a sharp comparative advantage in tea production, and a fully competitive position in rubber. It could meet its problems objectively: there was no antagonism to the British or other former colonial powers, it had trained leaders and an effective civil service. There was at the same time considerable Socialist sentiment among the intellectuals in the university, and to some extent in government also. These intellectuals had received, to a remarkable degree, their bent from the London School of Economics and the eloquence of Harold Laski. There was both a Stalinist Communist movement, and a Trotskyist group of size.

In such circumstance, a Central Bank can strengthen the resolution of the minister of finance, and educate the public. It can do the latter by its monthly bulletins, annual reports and by clear essays in the editorial pages of the newspapers. It can do the former by pressing for more taxes, if possible, and for less spending in any case, on every possible occasion. One of the main functions of a Central Bank, when the government is over-spending, is to wheedle and coax and badger toward a check to expansion—*though* at last resort and if commanded, it must create money to finance government spending. This the Central Bank did, from the conviction both *that* Ceylon could not continue waiting and hoping for an improvement in its terms of trade, while its foreign assets ran out; and also *that* even if the terms of trade did improve (or if depreciation or more drastic exchange restrictions were resorted to), the basis issue still remained that resources that should go to meet the needs of development were being swallowed up in consumption, that is, tomorrow's food was being eaten up today.

Meanwhile, (and this is an illustration of how the United States did much damage through a mistaken policy) rubber purchases in Colombo for the United States stockpiling program were cut sharply. (The buying policy was to offer no higher a price in Colombo than was paid in Singapore; but there was a long standing margin of a fraction of a cent a pound higher price in Colombo; and so the United States policy led to little rubber being actually sold to the United States.) Hence United States dollar earnings dropped sharply.

Ceylon has been, and is, in the sterling area but somewhat uneasily so. It has often been disposed to retain more dollars to its credit in New York, out of its dollar-area-surplus, than the Bank of England was inclined to think proper. Hence the loss of dollar earnings hurt, in those days when sterling was less nearly convertible than now—more than if dollars had been regularly all turned in for sterling balances.

Ceylon was rescued from its crisis by three events. The first, curiously enough, was an offer from Communist China. Ceylon was not in the United Nations, having been blackballed by Russia. Hence it was not bound by the strategic materials embargo of United Nations members against Communist China. In 1952 China offered to swap Ceylon rubber for China rice at advantageous terms—a gain over world market prices of about $20 million dollars a year. No democratic government, and especially that of a poor country, would find it easy to reject such an offer. Ceylon accepted. The second event involved the sharp cutting of the rice subsidy by Ceylon in 1953. The government for the time being weathered the resulting political storm and a trial insurrection staged under partly Communist inspiration. Some other contracting monetary and fiscal measures were carried into effect. Finally, the terms of trade improved: the prices of imports fell somewhat, and the prices of tea and rubber rose. External assets doubled between the end of 1953 and 1956 (though since they have fallen again by about one-sixth).

And so here was a trade crisis in a small and new nation, solved by a combination of external factors (the foreign contract and world price changes) and domestic economizing.

What is the current position and prospect? The present government, headed by Prime Minister Bandaranaike, is socialist-minded. It came into office with the support of a surprising combination of three groups: (1) a nationalist (Sri Lanka) party, plus a Singalese Language Front that has merged with the Sri Lanka party; (2) a Trotskyist party; and (3) most crucially, the Buddhist priesthood. Mr. Bandaranaike is a moderate who says, "I pray God that this country will not have a Communist government. I want equality of justice for all."[1] His supporters seem to think that nationalization of foreign-owned estates is desirable—but with compensation, and not now.

His highly vocal Minister of Agriculture, Philip Gunawardena, holds views more alarming to private capital:

> I consider myself a Leninist . . . All private enterprise in Ceylon must totally disappear . . . The threat of the United States' trying to grab Ceylon by force for Wall Street is a real one. Of course I believe that.[2]

The consequence of such views is that capital is being withdrawn from Ceylon. Investors are afraid their holdings are not safe. Foreign investors, especially, worry about discriminatory taxation and other legislation, and they fear possible restrictions on the transfer of profit. Capital withdrawal exists despite the fact that ministers in the present government have often stated that they would welcome foreign investment in certain fields. *The Economist* estimates that $78 million (Rs 370 million) were withdrawn in the years 1953 through 1956. Offsetting this outflow, $4.2 million (Rs 20 million) came into the country in the same years.[3] The net loss for these four years has therefore been about $74 million (Rs 350 million), or over one-third of Ceylon's total current foreign assets.

The data available in this country for Ceylon's 1957 balance of

[1] New York Times, November 25, 1957, p. 10.

[2] *Ibid.*

[3] *The Economist,* (September 1957), p. 1038. Profits were excluded from this count; provident fund and insurance premiums included.

The actual balance of payments figures in these years for net private capital outflows are Rs 163 million, and for net capital outflows attributable to official and banking institutions, Rs 362 million. These data are based on exchange control records, and hence have a bias toward understating capital outflows. The *Economist's* correspondent evidently thought that about half of the Rs 362 million—that is, Rs 187 million—represent capital withdrawals. (Sources: *Annual Reports* of the Central Bank of Ceylon, and various Central Bank Bulletins.)

payments suggest a checking of the capital outflow.[4] On the other hand the outlook for private capital investment does not seem to have improved: in the fall of 1957 two Canadian insurance companies with large ventures in Ceylon decided not to undertake new ventures there.

Suppose Mr. Gunawardena and other left politicians could have anticipated the results of their publicized statements in losing for Ceylon so much of the foreign assets that might have gone into economic development. Would they nevertheless have persisted in them? It is a curious question of politics and national interest.

The Ceylon Government have sometimes seemed rather to favor the selling off of British tea estates, and of British-owned shares, to Ceylonese. But this trend does draw down foreign assets that otherwise would be available for putting into economic development. The government recently embargoed the sending to London of money that had been received from the sale of British-owned estates. Such a policy diminishes, in the short run, a burdensome symptom of the disease of lack of investor confidence, at the expense of aggravating both the symptom and the disease in the longer run.

Where does Ceylon go from here?

One policy is to give up reliance on private investment, foreign and perhaps domestic, to try to insulate the economy completely against capital outflows, and to press forward rapidly with socialization measures for the tea and rubber estates and other businesses. One argument for such a policy is that the efficiency of government administration is greater than that in most underdeveloped countries. But my own estimate of the result is that, at the best, there would be ahead for Ceylon many years of sharply lower average incomes. For the efficiency of well-trained private estate managers, and the effectiveness of the judgment of private investors, are not to be underestimated.

The other policy is for the government to assure foreign and domestic investors indisputably that their investments will be secure. This policy could be the more effective since Ceylon is well removed from the borders of Communist states—in contrast with, say, Vietnam, Burma and South Korea. The result would be a reversal of the capital

[4] The most recent Central Bank *Bulletin*, that for February, 1958, carries tentative balance of payments estimates through the first three quarters of 1957. The totals that far, for private capital outflow, are Rs 37 million; and for "official and banking institutions" capital *inflow*, Rs 143 million.

flow—and not only more capital, but also more technical skills for Ceylon—with prompt beneficial effects on Ceylon's real income.

The present ambivalent government measures and sentiments bid fair to make the worst of both worlds.

Aside from this issue of confidence and capital flows and productive skills, Ceylon will continue to spend abroad as much as its foreign earnings will permit. Some one-third of Ceylon's gross national income originates in exports, matched by an equal flow of imports.

The Ceylonese must decide on and work for their own future. Their essential problems lie in their rapid population increase and their need for rapidly increasing efficiency in agriculture. Such increased efficiency is technically very possible, and implies among other things, a major effort in public education.

Aid is once again being provided by the United States, after an embargo of several years' duration under the Battle Act, caused by Ceylon's shipment of the "strategic good," rubber, to China. Such aid gives the Ceylon government more chance to experiment and to improve policies, and so to increase efficiency in planning and executing economic development measures.

Development plans in Asia

H. W. Singer

Bureau of Economic Affairs, United Nations

THE COUNTRIES OF South and South East Asia, with the exception of Thailand, all have development plans or programs of one sort or another. This is surely a significant phenomenon considering that these 14 countries range in their political and economic philosophy from the extreme left of Communist Mainland China through the moderate left of Social-Democratic India or Burma through the moderate right of Pakistan or Japan to the conservative philosophies of the Philippines or Taiwan. The first fact to notice therefore is that development planning is universal, and that it is not a matter of political or economic philosophy.

What would a Western observer make of this phenomenon? It would be easy to make light of it. It could be called a fashion, or a demonstration of "keeping up with the Joneses," or a symbol of nationalism, or a meaningless ritual, etc. It would not even be too difficult to support such views with quotations from the development plans themselves since these are sometimes somewhat naive or primitive; lack essential statistics or other information or are based on somewhat hopeful assumptions.

Yet such an attitude would be neither farsighted nor sensible. It is better to take the development plans seriously, and treat them as the expression of something new and significant. They express an acceptance by the Asian countries of two fundamental propositions: (1) that the progress of the economy can be a matter of research, analysis, human action based on reasoning, rather than of preordained events or revealed philosophical or religious patterns, and (2) that by looking at the economic environment as a whole, by looking at both policies and at investment projects as a whole, one can improve their total efficiency by forming consistent and complementary patterns or "packages" of such policies and projects.

Both these ideas are essentially Western ideas: the belief that human action based on reason can mold the social environment and gain command over niggardly nature, as well as the belief in the complementarity and integration of dispersed action in social life. The difference is that in North America or Europe, with our developed economies, we are taking automatic economic progress, an increased capacity of overcoming nature's scarcities by human action, and the formation of broadly based complementary patterns of investment and policies so much for granted that we do not, as a rule, consider it necessary to embody such aspirations in a deliberate program. Note, however, that when it comes to questions of individual policy decisions, whether relating to private business decisions or to the preparation of public policy measures, we do go through exactly the same process of preparing a complete conspectus, perhaps a market survey or a sales budget or a production or development program for the business unit concerned, or hearings designed to bring to light in one single focus the possible repercussions of contemplated measures.

A short review of the main advantages and benefits which the technique of development programming can bring also amounts to a review of the reasons why underdeveloped countries have been encouraged by such organizations as the United Nations, the International Bank, or the Colombo Plan to evolve development programs.

In the first place, a development program forces a government and a country to make some sort of choice between a number of objectives: Is the objective to create employment opportunities for a rapidly growing population? Is it to mitigate or abolish mass poverty in its worst form? Is it to diversify away from the heavy preponderance of agriculture? Is it to reconstruct a war-disrupted economy? Is it to make a new economy viable, as for instance in the cases of Korea or Vietnam, Laos, Cambodia or Taiwan or even Pakistan? Is it to deal with a chronic problem of instability, either external or internal? Is it to raise consumption in the near future? Is it to lay the foundations of long-term growth, by creating the essential economic infra-structure of transport, power, etc.? Is it to improve welfare by better health or education? Is it to industrialize as fast as possible? Is it to solve a foreign exchange crisis, or to utilize existing assets or perhaps reparations from Japan? Is it to reduce internal differences between different income classes or social groups or different regions of the country? This is a long list but by no means complete. A development program confronts a country with the need to make a choice, and the different Asian countries have made characteristically different choices. But the very process of making a choice is important. A country should know, and the outside world should know, what it is that is wanted, and what it is that a country is prepared to give up, at least for the time being.

The development program should force a country to think in terms of a balance between available resources—which may, of course, include prospective foreign aid—and national ambitions. This confrontation of limited resources and unlimited ambitions admittedly is often evaded in development programs, but the very exercise of such a confrontation can be valuable. The idea of budgeting is basic to development programming—the more familiar fiscal budget is part of it, but so is the idea of national income, of savings-investment budgets, of foreign exchange budgets, and of commodity balances for such strategic items as food, clothing, steel, coal, fertilizers, etc. The habit of formulating programs has already had an effect in drawing attention most forcibly to the great need in Asia for exploring, surveying, testing and mapping out the sources of raw materials as well as of energy and of the soil itself.

The savings-investment balance is perhaps the most crucial of all. With the exception of Japan, and perhaps Burma, all the countries have a low savings ratio, both private and public. Economists have characteristically differed on the reasons: overconsumption, low incomes, lack of institutions, lack of incentives—all have their champions. Others pin their hopes on public saving, an increase in taxation—but here again the difficulties are formidable; the nature of subsistence farming, problems of administration, the question of incentives (tax holidays), the incidence on savings.

The best hope lies perhaps in a high marginal rate of savings and taxation—but this is a somewhat question-begging road to economic development, in the sense that *if* you could get your development first then you could finance it without inflation—a sort of aggregative pump-priming. Unfortunately, the first step of increasing real supplies and real income is the great barrier, and pump-priming of the normal kind is peculiarly ineffective and even dangerous in underdeveloped countries.

As against these limited resources there stand the multiple claims of which the countries of Asia are all too conscious: (*a*) to produce the structural change which they desire, away from an 80 per cent agricultural economy, in the name of "industrialization," and the creation of an economic framework corresponding to this change; (*b*) to expand agriculture, to supply food, raw materials, exports to the new industries; (*c*) to solve their marketing deadlock by a simultaneous advance in different directions, through investment "packages" and "balanced growth"; (*d*) to build up foreign exchange reserves, and invest in import substitutes; (*e*) to raise consumption levels as a political, social and humanitarian requirement.

These formidable claims *have* to be reconciled with the scarce resources. If they are not, either inflation or a foreign exchange crisis or both will result, and in either of these two cases the efficiency of investment is reduced—probably below what it would have been without the attempted "development."

A development program, then, is an essential reminder of the needs of proper administration. The individual investment projects hatched by individual government departments and individual business sectors may form an aggregate which may be either too large or too small for the total available resources or which may be in need of some fitting together, like the pieces of a jigsaw puzzle. Similarly, the bits and scraps of policy proposals which come from this source or that need to be looked at together, and in their impact on each other. In doing this it should often become apparent that the summation of individual projects is likely to vastly exceed the available resources, and it is also likely to be reduced in efficiency by unnecessary overlapping, competition for scarce resources and isolation. The very need to justify projects or policies by their favorable impact on the economy as a whole can have beneficial effects. In the process of development planning, groups or committees have arisen in the Asian countries whose job it is to think about the aggregate effect of what is proposed, and develop methods of cutting the coat according to the cloth by methods other than the blunt instruments of across-the-board slashing or the worse than blunt instrument of galloping inflation. Admittedly, again, the process of combining and cutting down policies and projects is often either avoided or very crude—but no development program of any degree of realism can fail to impress at least the need for such processes.

A development program—provided that it is realistic, and that people trust the government to carry it out—can give a whole economy a sense of moving forward. Such a sense of moving forward may be of crucial importance in an economy where people's expectations may have been shaped by a long history of stagnation and low-level equilibrium. Unless there is some knowledge that other business projects are also going forward, that purchasing power is expanding, that essential public services are improved or going to be provided, many promising investment projects which otherwise could be undertaken even within available resources may appear to be too risky or unprofitable, and the resources may instead be frittered away in speculation, monuments, or in building up bank accounts abroad. For this purpose of creating a sense of moving forward, it is not sufficient that a development program exists, it must also be communicated to and underwritten by the general population. It is perhaps no accident that India (where this process of communication and grass roots participation has perhaps gone furthest) is also the country where there has recently been a tremendous and largely unforseen private investment boom. Even though this present investment boom has been quite unforeseen in the second Five-Year-Plan, and though it has led to great foreign exchange difficulties and threatens to upset the apple cart, let there be no mistake about the essentially desirable and healthy feature of this boom. It is a vote of confidence in the Indian economy and the Indian government based on the fairly successful conclusion of the first development plan. Once this sense of moving forward is created, the inherent high productivity of investment in the capital-short economies of Asia comes into its own—but so does the constraint of scarce resources, especially in foreign exchange. It should be noted, however, that while such a private investment boom can create immediate foreign exchange difficulties, it would also seem to offer much better assurance that external assistance, if it does come forward, will be more effectively used than is the case in a stagnation-ridden economy where this sense of moving forward has not been created.

This takes me to my next point in describing the potential benefits from a sound development program. By laying open the intentions and ambitions of a country, by describing the investment opportunities in relation to available resources, by indicating the methods by which development is to be financed and the extent to which domestic resources can be mobilized, a development program can give to foreign investors in the economy, whether they be aiding or loaning governments, private investors or the International Bank, a degree of assurance of constructive use for any assistance given such as would not be available merely from an examination of individual projects. To give assistance merely on the basis of individual projects suffers from a fatal weakness: the soundness of a project is largely a function of the soundness of the economy as a whole; and in any case, external assistance never helps with the sound high-priority project to which it may be ostensibly tied. Rather, it is the marginal project which is really involved and the soundness of the assistance depends upon the soundness of the marginal project. If a man comes to you and wants your assistance to educate his brilliant son and tells you that this is the most important thing in life to him, you will be rightly suspicious of him. If this is so important to him, would he not find the money himself and economize elsewhere? Perhaps what you really finance is this man's drinking and gambling which he otherwise would be forced to give up. Hence, any banker will want to look at a man's total expenditure pattern. It is not different with countries, and a proper development program provides the only sensible basis for such a banker's examination. This does *not* mean that tying assistance to sound projects is useless. On the contrary, it can have great practical and educational value.

Of course, the habit of development planning also has its dangers, and these have perhaps been more publicized than the advantages. In development plans, there is often a somewhat unreal distinction between development and growth. The very fact of defining a segment of government activity as "developmental," and therefore implicitly another segment as "nondevelopmental," is misleading. Government activities designed to maintain law and order are just as important to development as building a dam or railway; the construction of a fence or drainage ditch by a small farmer on his own land in his spare time is as much development as the installation of generators or turbines; an improvement in people's literacy or schooling or skill or health is as essential for development as new installations. Yet, development plans tend to concentrate on capital formation as against increases in productivity, on tangible things as against intangible things, on measurable things as against unmeasurable things. Furthermore, as I have already mentioned, the development plan — that visible expression of "the revolution of rising expectations" — may all too easily become a shopping list of everything that is desirable, including the kitchen sink.

Development plans, since they are the product of a government which normally has to justify itself to be re-elected, may be too short-term in their orientation. You remember what Keynes said: "In the long run we are all dead." That is certainly true of governments, and not such a long run either. Hence, a tendency to neglect the importance of building up the foundations of economic growth which may make the economy more flexible and elastic in the future; hence, also, a tendency to spread investment too wide and too thin in order to give something to every social group, to every region, to every shade of opinion with electoral pull. Hence, the tendency for showy, impressive, monumental things. Politics and economics are uneasy bedfellows.

Development plans may tempt governments to neglect things which are beyond their range of planning, and must be taken as given, like the monsoons and hurricanes. I refer here to the unpredictable ups and downs of world markets and world prices for the primary commodities on which most of the Asian countries depend for their export earnings — those economic monsoons and hurricanes sweeping over Asia.

One could add to this list of weaknesses in present development plans, but I do not wish to conclude on this note. The weaknesses can be remedied. The Asian countries, under the auspices of the United Nations Regional Commission in Bangkok (ECAFE) as well as under the auspices of the Colombo Plan, are getting together to exchange their experiences, regarding the best way of setting about the business of drawing up and carrying out development plans, to avoid the more obvious incompatibilities in their respective plans, and to learn from their mistakes. We can do much to help in these efforts to make this approach (which in any case has come to stay) as constructive as possible. We have all reason to help. In the last resort, we have special moral responsibilities, quite apart from our general humanitarian as well as commercial motives. We have brought to Asian countries disease control and death control. This has certainly contributed immensely to human welfare but the resulting explosion in the rate of population growth also has faced Asian countries with new economic problems and forced them out of their economic traditionalism. Their development plans are the expression of a "revolution of rising populations as much as a revolution of rising expectations." Having forced them to run to keep in the same place, it seems a natural duty to help them in developing their capacity to run. We are giving to Asia the benefit of our technological development but this also is a double-edged gift. The technological development of the West has become increasingly capital-intensive or mechanized; it is not ideal for the needs of poor overpopulated agricultural countries with rapidly increasing populations. We should help to adjust technologies to the specific needs and resource endowments of Asia.

Thirdly, we have done next to nothing to help the underdeveloped countries to weather those economic monsoons and hurricanes which I mentioned earlier, of sharply fluctuating world markets and prices of their primary commodities on which they depend for their foreign exchange. Over the past year, we have seen once again the spectacle of falling commodity prices, and it is not unreasonable to consider this fall partly at least a reflection of our attempts in the West to preserve internal stability and combat inflation. Let us realize what this means to the underdeveloped economies of Asia. It is not easy to plan when you sit in a rickety boat tossed about by heaving waves.

We thus have good reasons to encourage the movement of national economic self-expression through better development programs, to build upon their constructive features, to try to remedy their weaknesses and thus to help in making them a success.

The world economy is not a game of poker, nor of musical chairs. It is much more like a party of mountaineers, roped together on their way to higher peaks.

American trade with the Philippines

Reed J. Irvine

Division of International Finance,
Board of Governors of the Federal Reserve System

THE PHILIPPINES IS the one Asian country with which the United States has something akin to a blood relationship. From 1898 to 1946, the seven thousand odd islands making up the Philippine archipelago were an American possession, acquired from the Spanish as spoils of war. American embarrassment at acquiring new territory in this way was reflected in the oft-forgotten fact that we paid $20 million, a fifth of the asking price, to the defeated Spanish as compensation for the Philippines.

The Filipinos did not exactly welcome the new colonial power with open arms. We had to fight for two years to subdue Filipino opposition before American dominion could be firmly established throughout the islands. At the same time a most heated debate raged in this country over the desirability of our moving into Asia as a colonial power. Some American business interests aggressively favored the move, regarding the Philippines both as a profitable market and as a possible base for tapping the even larger market of neighboring China. The opposition was mainly based on moral grounds, many feeling that colonialism was inconsistent with American principles and that territorial aggrandizement by conquest was morally indefensible.

The appeal of empire won out, and American enterprise and investment, combined with the introduction of reciprocal free trade between the United States and the Philippines in 1909, produced a remarkable expansion of production and economic activity in the islands.

It has been claimed that the Philippines made greater economic progress under three decades of United States rule than under three centuries of Spanish domination. Philippine exports rose from an annual average of $12.7 million in the decade from 1880 to 1889 under the Spanish regime to $128 million during the years preceding World War II, a ten fold increase. Comparing the same periods, imports rose from $10.6 million to $120 million.[1]

The increase in trade reflected an increase in investment, production and incomes. With American capital and enterprise leading the way, the sugar industry was modernized, and by the 1930's the volume of sugar exports was more than triple the peak reached under the Spanish. The export of coconut products was insignificant under the Spanish, but it was developed into the second largest export before the war and has since become the largest. The main export during the Spanish era, abaca, was passed by both sugar and copra, but exports were expanded, and in the decade before World War II reached a level two and a half times as great as in the last decade of Spanish rule.[2]

The expansion in production and trade brought a rising standard of living for the Philippine people. Unlike Korea, which under the first twenty years of Japanese domination experienced a sharp reduction in per capita consumption of the preferred staple food—rice, the Philippines enjoyed an increase in per capita rice consumption. (Rice is the staple food for 75 per cent of the population.) The larger volume of imports consisted in large part of consumer goods. In 1939, at least half of the total imports by value could be so classified.[3]

In addition to becoming an important supplier of food and raw materials for other countries, mainly the United States, the Philippines developed into an important market for the products of other countries, again mainly the United States. In 1939, nearly 70 per cent of the imports into the Philippines came from this country and we took three-quarters of the Philippine exports. The biggest import items were cotton textiles, iron and steel manufactures, petroleum products, machinery and parts, tobacco and foodstuffs. The Philippines was, after Japan, our largest customer in Asia, buying more from us than

[1] "American Philippine Trade Relations," *Report of the Technical Committee to the President of the Philippines,* Washington, 1944, pp. 5, 22.

[2] *Ibid.* pp. 38-40, 70, 90.

[3] Mary A. Pugh, *Preliminary Economic Survey of the Philippines* (Washington, D. C.: United States Department of Commerce, 1943), p. 57.

China, whose tempting markets had been one of the chief factors luring us into our colonial venture in the Far East.

Despite the undoubted benefits which accrued to both sides from this trade, the Filipinos waged an unceasing campaign for independence. Until the late 1920's the independence movement appeared to have little hope of immediate success, but the depression of agricultural prices that followed World War I brought demands from the American farm bloc for protection from Philippine competition. The most vocal interests in this campaign were the sugar growers, the producers of fats and oils and the dairy industry. When efforts to secure tariff protection from Philippine commodities failed, the farm bloc shifted its attack and demanded independence for the Philippines, with the object of eliminating the trading advantages enjoyed by the Philippines as a United States possession.

This campaign met with success, since it harmonized with the expressed desire of the Filipinos for independence. The first independence bill was enacted in 1933 over the veto of President Hoover. Its provisions were dictated chiefly by American rather than Philippine interests and it was less than enthusiastically welcomed by the Filipinos. They were successful in securing the consent of the United States to some slight changes and the bill as modified was reenacted as the Tydings-McDuffie Act of 1934.

This legislation provided for the establishment of a transitional government, with full independence to be granted on July 4, 1946. A five year transition period from free trade to complete elimination of preferences was decreed. This was rather one sided. It provided for gradual imposition of export duties on Philippine exports to the United States during this period but gave the Philippines no right to charge any duty on United States imports until independence was achieved. Additional immediate quota restrictions on Philippine imports into the United States were applied under the Jones-Costigan Act and the Agricultural Adjustment Act of 1934.[4]

It has been charged that our colonialist policy distorted Philippine economic development, retarding industry and leaving the Philippines ill-prepared for independence. The Philippine leaders had opposed the introduction of free trade with the United States from the beginning

[4] Grayson L. Kirk, *Philippine Independence* (New York: Farrar and Rinehart, 1936), pp. 73-135.

because they feared that it would result in the country's becoming so closely linked with the United States economy that independence would be harder to achieve. There is some sense and a good deal of nonsense in these arguments. It is probably true that it would have been difficult for the Philippines to accept independence if this had involved immediate and complete loss of the rights and privileges enjoyed in the American market. This, however, has never been contemplated, even under the prewar independence legislation. Both that legislation and the Bell Trade Act which replaced it following World War II provided for a transitional period to ease the shock of the loss of free entry into the American market.

The deterrent to industrial development in the Philippines did not consist of any prohibitions laid down in Washington similar to the prohibitions that the British had once imposed on the North American colonies. Anyone was free to develop whatever enterprise suited his fancy in the Philippines. All that was required was the capital, the know-how and confidence that the product could successfully compete with imported goods. The fact that the Philippines produced sugar and copra rather than cotton textiles or iron and steel was because entrepreneurs believed the economic returns were greater in these lines. The fact that fish caught in Philippine waters were far more expensive than fish transported thousands of miles across the ocean to Manila reflected the fact that labor and capital could not be as efficiently employed in fisheries in this area as they could in agricultural pursuits.

The fact that this relationship was partially the result of preferences enjoyed by some Philippine agricultural commodities in American markets means only that these preferences tended to raise the level of Philippine incomes above what would otherwise have been possible. That the Filipinos have been most anxious to postpone the termination of these preferences is additional proof of this fact.

What the Filipinos have been most anxious to eliminate has been the other side of the free trade coin—the exemption from tariffs enjoyed by United States exports to the Philippines. It might be said that what was wanted was the right of every sovereign nation to establish tariff barriers to divert resources into less economic uses. This has for so many years been cited by Filipinos as a panacea for all their problems, that the Philippines is today one of the most protectionist minded countries in Asia.

The Filipino leaders are intent upon effecting a change in the economic pattern of the country. They are dissatisfied with dependence upon the traditional exports, sugar, copra, and abaca and the commodities that have gained greatly in importance in the postwar period, minerals and logs and lumber. They hope to develop new industries in the Philippines that will either replace imports or provide new exports. They have chosen to use the weapons of protection and subsidy to hasten the realization of these dreams.

The failure of the Philippine economy to achieve a firm footing in the postwar period led the Philippine leaders to begin to press for a revision of the Bell Trade Act in 1952, two years before the scheduled termination of the free trade period. What was desired was the right to introduce a greater degree of protection against American goods together with prolongation of the free access of Philippine exports to the American market. New negotiations were held which resulted in the Revised Trade Agreement, adopted in 1955.

This agreement now governs Philippine-American trade relationships. It provided substantial concessions to the Philippines in stepping up the rate at which American goods would become subject to Philippine tariff duties and slowing down the application of United States duties to Philippine products. From the beginning of 1956 until the end of 1958 the Philippines were entitled to impose a duty on United States imports equal to 25 per cent of the duty applicable to imports from other countries. Beginning in 1959 this will rise to 50 per cent, in 1962 to 75 per cent, in 1965 to 90 per cent, and after January 1, 1974 the full Philippine tariff will apply to American goods. The era of preferences will have been terminated.

The progression in the percentage of United States duties applicable to Philippine goods is much more gradual. Through 1958 5 per cent of the full duty was chargeable and from 1959 only 10 per cent will be chargeable. In 1965, when the Philippines will be levying 90 per cent of the full duty against United States goods, this country will be imposing only 40 per cent of our full duty on imports from the Philippines. However, this rises to 60 per cent in 1968, 80 per cent in 1971 and 100 per cent in 1974.

The Revised Trade Agreement also provided for the elimination of the 17 per cent tax on foreign exchange adopted in 1950. The latter was replaced by a 25 per cent import tax which applied to imports from the United States as well as other countries. It was provided that this tax would be reduced by 10 per cent annually as revenues from duties charged on imports from the United States rose. The rate of the import tax now stands at 13.6 per cent and it will be eliminated by 1966.

American exporters still enjoy a substantial preference in the Philippine market, but it is going to disappear at a fairly rapid rate. Since the shipping cost for a ton of general cargo from an East Coast port to Manila is about four times the rate from Yokohama, Japan, the tariff preference will not in many cases offset the higher shipping cost, even now. The fact that the Philippines last year adopted new legislation imposing higher duties means that the margin enjoyed by American goods is somewhat greater than formerly, but our future trade will depend very largely upon the effort that American businessmen are willing to make to retain a major share of the Philippine market.

They will start with certain advantages—Philippine familiarity with American goods, brands and specifications being perhaps the most important of these. However, this alone will not save the market. Aggressive salesmanship and strong price competition can be expected from other countries, including Japan, Hong Kong and European lands. The appeal of Japanese goods has already been demonstrated by the fact that Japan's share of the Philippine market has risen from 6 per cent in 1954 to 12 per cent in the first nine months of 1957, despite the handicaps imposed by the preferential treatment accorded American goods and Philippine reluctance to permit Japanese businessmen into the country.

It is very doubtful that the United States can long continue to supply as high a percentage of Philippine imports as was the case in the past. Indeed the percentage has already begun to slip, falling from 68 per cent in 1954 to 55.5 per cent in the first nine months of 1957. However, the Philippines is a country with great potential for growth, and the coming decades may well see a considerable expansion of total imports as well as a switch in the pattern of trade. It is quite possible that in the long run while the percentage share of the United States in the Philippine market declines, the total volume of our exports will rise.

Whether this happens will depend in part upon the attitude of American businessmen toward working and investing in this area. This in turn will depend in large part upon the economic policies of the Philippine government. The climate in the Philippines has never been as attractive to foreign investors as might be desired. Even when the islands were an American possession without any problems of stability or exchange control, the Philippines were not looked upon as a particularly good field for investment in spite of the undoubted natural wealth to be found there. American capital, for example, found employment on a much larger scale in areas as similar to the Philippines as Cuba and Hawaii.

Total American investment in the Philippines in 1940 was estimated at $258.6 million, 60 per cent of total foreign investment in the Philippines. This represented only 1 per cent of the total foreign investment of the United States.[5] The main obstacles to greater capital inflow appear to have been restrictive land laws and uncertainties created by the independence movement. The attitude of the "Philippines for the Filipinos" had been nurtured by years of nationalist agitation, and this was not calculated to breed optimism in the minds of potential investors about the treatment they were likely to be accorded if and when independence was achieved.

The Philippines will constitute an expanding market for American goods only if the natural wealth can be efficiently exploited and the productivity of the people increased. What is required for this is an adequate supply of new capital combined with vision and enterprise. Unfortunately, the climate for private foreign investment in the Philippines has deteriorated in the postwar period. Far from attracting the large amounts of new capital required, the policies adopted have actually repelled foreign investment and have even led many residents of the country to attempt to get funds out of the Philippines and invest them elsewhere. The policies that have created this unfortunate situation are in part traceable to the nationalistic distrust of foreign capital that has its roots in the long campaign for independence. This accounts for the fact that the Philippine constitution restricts the development of certain natural resources and public utilities to corporations having 60 per cent Filipino ownership. Americans are guaranteed the same rights as Philippine citizens by the "parity provision" of the constitution until 1974, but this was forced upon the Philippines through the Bell Trade Agreement. Discrimination against alien capital is quite obviously widely accepted as sound policy in the Philippines even though it cannot at present be practiced against United States capital.

[5] *Report of the Technical Committee to the President of the Philippines, op. cit.* p. 229.

As long as a basic hostility to foreign capital exists, investors will tend to be repelled rather than attracted.

In addition to this, the climate for foreign investment in the post-war period has been worsened by uncertainties about the future of the currency and the administration of foreign exchange controls. Exchange controls have been used as a protective device to encourage manufacturers to undertake production in the Philippines, and as a result, a substantial amount of private capital, some of it foreign, has been invested in assorted manufacturing enterprises in the Philippines in recent years. Though highly profitable, few of these enterprises have developed any export potential or the ability to survive without subsidies and protection. On the other hand, it would be impossible to measure the amount of investment that has been discouraged by the existence of controls, but it is no doubt substantial.

The Philippine use of exchange controls presents difficulties for the businessman, whether he be trader or manufacturer. The administration of the controls tends to be capricious. A plant that may have been warmly welcomed one year may find itself in difficulty a few years later because it hasn't qualified for an allocation to import replacement parts or even adequate supplies of raw materials. Balance-of-payments crises are recurring affairs in the Philippines and have necessitated frequent changes in allocations for imports. The most recent switch came in December 1957, when very severe import cutbacks were announced as a means of meeting the foreign exchange crisis. Some relaxation has since taken place, mainly because of the outraged protests of the business community.

The foreign investor is subject to the additional hazard of having his right to remit profits curtailed and having his capital frozen. These uncertainties have tended to make the Philippines unattractive to foreign investors in spite of the advantage offered of a stable and friendly government and a labor force of good quality. However, American businessmen who know the country well believe that it has rich potentialities. The Philippines should be capable of sound manufacturing development as well as considerable improvement and expansion in agriculture, fisheries and the extractive industries. The labor supply is good. The Filipino worker is intelligent and reasonably industrious. Although there appears to be surplus labor, wages computed at the present exchange rate are out of line with other Far Eastern countries and are held up by a minimum wage law. Adjustments which would bring both Philippine prices and wages into line with those of other countries would provide a far sounder foundation for the development of new industries and the exploitation of resources than the existing network of government controls.

The immediate outlook is not bright. In its efforts to spur rapid development the government has pursued unsound financial policies in recent years. Last year, foreign exchange payments for imports and services greatly exceeded current earnings, with the result that foreign exchange reserves were seriously depleted. Some efforts have been made to curb imports, but the government appears to be less than fully aware of the types of measures that are required to put the economy on a sound footing. An appeal for large scale United States aid is likely, but this, if granted, would probably delay the adoption of the required measures, and would therefore only postpone the day of reckoning.

On the positive side it must be noted that Philippine export earnings have held up well. It is one of the few countries in Asia that has managed to increase exports since 1952, the others being Japan, Ceylon, Malaya and Singapore. The elimination of duty-free entry into the United States market does not pose as great a problem for the future of Philippine exports as might be imagined. In the first place the Philippines is already much less dependent upon the United States market than was the case prior to the war. In 1956, only 54 per cent of her exports were sold to us as compared with 83 per cent in 1938. In the second place, about 36 per cent of Philippine exports to this country are on the free list and will be in no way affected by the gradual application of tariffs provided for under the Revised Trade Agreement. Finally, sugar, which constitutes about 40 per cent of the value of Philippine exports to this country, should be able to retain its share of the market even when subject to the tariff. When it is considered that the Philippines is physically well suited to the production of sugar, that sugar workers there are paid only 15 per cent of the wages of sugar workers in Hawaii, and that shipping charges from the Philippines to the East Coast are actually lower than the rates applicable to sugar growers in Hawaii who are compelled to use American bottoms, it is not conceivable that the Philippines could be priced out of the United States market by the imposition of a half cent a pound duty.

Other countries have demonstrated that ambition to develop economically at too fast a rate and perhaps in directions that are not entirely sound, can endanger not only economic progress but the living standards already attained. Whether or not the Philippines will pursue this course or switch to a policy that will stress a sustainable rate of growth and place more reliance on foreign capital and know-how cannot now be foreseen. However, the expression of interest in this area on the part of American capital could be influential in steering the country toward the latter course. American business can do much in bringing to the people of this area an awareness of what American capital might mean to them, as well as an understanding of the conditions that will have to be created to attract foreign capital in significant amounts.

Prospects for American trade with Indonesia

Douglas S. Paauw

Associate Professor of Economics, Lake Forest College

INDONESIA IS RICH in natural resource endowments but poor in terms of national product per capita. Human and natural resources are used ineffectively because Indonesia's capacity to introduce improved technology has been retarded by low rates of domestic capital formation. The volume of international trade per capita is relatively small; its growth has tended to follow inflows of foreign capital for developing sources of raw material supply for industrial countries. Low rates of domestic saving and capital formation have restricted the growth of exports supplied by domestically owned firms. Similarly, aggregate demand has been small and relatively stagnant so that Indonesian markets have not offered large and profitable outlets for foreign products.

Indonesia's abundant but virtually untapped reserves of natural resources, her large population and the existence of uninhabited frontier areas present favorable prospects for rapid economic growth. These conditions also indicate latent capacity for a rising volume of international trade, if the present barriers to economic growth can be overcome. As a major supplier of industrial products and an important market for raw materials, the United States would be likely to share a large part of growing Indonesian foreign trade.

At the present stage of her economic development, Indonesia is not an important trading partner from the point of view of the United States. Indonesian demand for American products has fluctuated greatly, and less than 1 per cent of American exports have gone to Indonesia in recent years. Generally speaking, Indonesia is not even an important supplier of primary products for the American market. The important exceptions are tin and crude natural rubber; about one-fourth of United States' imports of these strategic raw materials comes from Indonesia. Only a small part of United States' import needs for petroleum—Indonesia's most important export—are supplied by Indonesia. Alternative sources of supply of tin, natural rubber and other United States' imports are available; Indonesian trade is not a matter of critical importance for the American economy or national security.

The reverse is not true, however. The United States is Indonesia's most important trading partner. In 1956, the United States was Indonesia's second customer, absorbing about 16 per cent of Indonesian exports (by value). Netherlands ranked first with 19 per cent while Japan was third with 9 per cent. As a source of supply for Indonesian imports the United States was first in 1956, providing about 16 per cent of the total, followed by Japan (15 per cent) and the Netherlands (10 per cent). These facts support the view that the United States would very likely become an important beneficiary should Indonesia expand her share of Free World trade.

Gunnar Myrdal has argued with considerable force that expansion of profitable trade relations between developed and underdeveloped countries requires greater economic integration.[1] The concept of integration as a prior condition to improvement of trade includes two important facets: (1) national integration as opposed to national disintegration, and (2) international integration as opposed to international disintegration. Myrdal perceives an implicit danger in this approach, however, noting that we cannot assume that greater national integration among trading partners will necessarily promote a more vigorous and gainful pattern of trade. The two may conflict, and Myrdal observes that processes of national integration in both developed and underdeveloped countries have, by and large, hampered rather than promoted international integration since the end of World War I.

Myrdal's provocative analysis provides a useful framework for studying the underlying factors which are apt to determine the future of trade between a developed country—the United States—and an undeveloped country—Indonesia. Despite the author's misgivings about venturing into a discussion of essentially noneconomic problems, such an approach appears to be the only realistic basis for analyzing Ameri-

[1] Gunnar Myrdal, *An International Economy:* (New York: 1957).

can prospects for trade with Indonesia. Extrapolations from records of past trade are apt to be misleading unless the more basic determinants of trade are explored. In Indonesia, the processes toward national integration and disintegration now underway dominate political and economic performance. More important, the results which emerge from the interplay of these forces may well reshape the contours of Indonesian trade from their historical (colonial) pattern into something quite different. While it is clearly too early to reach final conclusions about the implications of post-independence instability for Indonesian economic development and trade, analysis of the underlying forces toward integration or disintegration is the only key to gaining even partial insight into a situation which is hopelessly complex when superficially viewed.

Myrdal defines integration in terms of equality of opportunity. Some of the conditions for progress toward this goal, in Myrdal's words, are:

> The emergence of a community with ever freer social mobility, based on a fuller realization of the norms of equality and liberty. In this community there must be a growing social cohesion and practical solidarity. The members must increasingly come to feel that they belong together and have common interests and responsibilities, and they must acquire a willingness to obey rules that apply to the entire community and to share in the cost of common expenditures decided upon by political process. This political process must assure an ever wider participation on the part of all citizens.[2]

Our analysis proceeds on the assumption that future trade relations between the United States and Indonesia depend more on Indonesian progress toward economic integration and the character of such integration than upon similar changes in the United States. It is possible that this assumption contains an element of ethnocentric orientation; it may even be a defense against subjecting one's own culture to the cold and uncomfortable knife of objective analysis. On the other hand, the assumption that the dynamics of Indonesian society will have greater weight seems to be supported by at least common sense

[2] *Ibid.*, p. 11.

observation. Since Indonesian independence, the volume and composition of American-Indonesian trade have, in fact, been determined largely by Indonesia's capacity to export and cyclical fluctuations in world demand for Indonesia's exports. Since Indonesia's capacity to export has remained relatively constant, Indonesia's total export earnings have risen or fallen mainly in response to fluctuations in the prices received for basic exports such as rubber, tin and copra. Similarly, Indonesia's imports from the United States have shown a strong response to the amount of foreign exchange made available to Indonesian importers. When high world prices for primary products have made more foreign exchange available, or when the government has allowed an expansion of imports by reducing foreign exchange reserves, the percentage of total imports obtained from the United States has risen. When less foreign exchange has been available for importing, the percentage spent in the United States has fallen.[3] In technical terms, Indonesian demand for American exports has shown a high elasticity to availability of foreign exchange for import purposes. This is particularly significant in view of the fact that Indonesia has not had a dollar shortage problem. Rather, reduction in supplies of foreign exchange for import has tended to induce a shift of demand from American to lower price markets, even though this usually implied quality deterioration. This suggests that the growth of Indonesian demand for United States products is singularly dependent upon Indonesia's obtaining a rising volume of foreign exchange earnings, not offset by deteriorating terms of trade.

Indonesia's leadership has not yet squarely faced the problems of expanding the volume and diversifying the structure of exports which was inherited from colonialism. A broad attack upon these problems stands high on the reform agenda of the same Indonesian leaders who fought and won the Revolution. When action is ultimately taken on these problems it will be significant only if export diversification becomes an adjunct to a comprehensive development program. The adoption and prosecution of such a program, however, awaits progress on the more basic issue of Indonesian economic integration. We reach the conclusion, therefore, that Indonesia's trade with the United States—in fact with Western developed countries as a whole—will tend to follow traditional patterns until Indonesian integration produces basic decisions

[3] cf., Statistics on the geographical pattern of Indonesian trade presented in *The Report of the Bank Indonesia,* 1953-54, pp. 88-89 and *ibid.,* 1956-57, pp. 118-19.

on the nature of the society to be molded from the fragments bestowed upon Indonesia's leadership by a colonial heritage. In the process of conquering the forces of disintegration set in motion by the withdrawal of colonial power, Indonesia's economic relations with the outside world may be in a constant state of flux. We must be cautious, therefore, not to generalize or predict from what are essentially transitory phenomena. Deflection of domestic energies in solving the fundamental problem of integration may well tend to reduce the volume of Indonesian trade with all countries (with the possible exception of those which seek to exploit local instability by encouraging purely political trade).

Indonesia's foreign trade during the first seven years of independence (1950-1956) reflects the essentially stagnant nature of Indonesian political and economic life prior to the appearance of events (beginning in 1956) which culminated in civil war and subsequent economic chaos. Following the transfer of sovereignty in the last week of 1949, Indonesia entered upon a period of rehabilitating her economy after almost a decade of political turmoil. The economic goals of the new Republic, however, have been expressed predominantly in terms of policies to destroy the vestiges of the colonial economy by "Indonesianization" of the existing productive apparatus rather than by economic development which could not fail to displace the economic hold of colonialism and its supporting groups. The economy has felt a series of abrupt shocks as a result of these Nationalistic policies, but we cannot observe progress toward effective economic development. The most that can be said is that while the economy may have become somewhat more Indonesian in name, its basic structure has not become less colonial. In terms of the economy's performance, the evidence attests only to rehabilitation. Agricultural output was intermittently expanded, but Indonesia has not reached self-sufficiency in food. National income has grown fitfully, but when put into per capita terms, production for domestic use and exports have failed to raise the standard of living above prewar levels. Statistics on the economy's net investment rate suggest that capital formation was scarcely adequate to maintain output per capita between 1951 and 1955 and that the rate of net investment has fallen since 1953.[4]

[4] cf., Douglas S. Paauw, "Savings, Investment and Inflation during the Pre-plan Period (1951-1956)" (Mimeographed, to be published as Chapter 3 in a study on Financing Economic Development in Indonesia). pp. 5-6.

Similarly, the structure of Indonesian exports shows no evidence of domestic economic development. With the exception of sugar, an important prewar export that has virtually disappeared from the export account in the postwar period, the variety of Indonesia's exports has changed little since 1938. Rubber, oil, tin and copra continue to be the major export products, but changes in their relative contributions reveal more narrow export specialization in a few primary products. In 1939, these four exports produced 57 per cent of total foreign exchange earnings. By 1956, their contribution had grown to 77 per cent, with rubber alone representing 40 per cent.[5] This is perhaps the most basic evidence of the society's failure to exhibit economic progress so far as its trade with the outside world is concerned. Indonesia has continued to produce primary products for export, and her specialization in a few, largely unprocessed, goods has increased rather than diminished.

Stagnation in Indonesia's export industries—or mere rehabilitation as opposed to structural change—is also apparent from the behavior of the physical volume of exports. To get useful data on this variable, petroleum exports have been eliminated since changes in exports of these products have, in Indonesia's case, little to do with domestic economic development. Moreover, disposal of foreign exchange proceeds from petroleum exports have been subject to special arrangements with the petroleum companies. With this omission, we reach the conclusion that the Indonesian economy has failed to expand the physical volume of exports since independence. Excluding petroleum, exports are still well below the volume generated by the colonial economy just prior to World War II. The postwar high was recorded in the export boom year, 1951. Data on export volume, compared to the base year, 1939, are presented in Table I.

Although the failure of the Indonesian economy to increase its volume of exports, and to diversify their composition can be attributed to the continuation of domestic economic stagnation, somewhat closer scrutiny of specific problems may be helpful. Indonesian literature suggests that the Indonesian leadership is both aware of and concerned about stagnation in the export industries. This literature emphasizes two basic problems: (1) failure of Indonesian exports to compete qualitatively with exports from other primary producing countries, and (2)

[5] *Report of the Bank Indonesia*, 1956-57, pp. 116-17.

TABLE I

Volume of Indonesian Exports, 1938 and 1950-57*

	Thousand tons	Index number (1938=100)
1938	4927	100
1950	2420	50
1951	3009	62
1952	2421	50
1953	2594	53
1954	2857	57
1955	2716	55
1956	2508	51
1957	2315	47

* Excluding petroleum and petroleum products; Source: *Reports of the Bank Indonesia.* (Published annually.) The index of crude petroleum products is: 1938: 100; 1950: 87; 1951: 101; 1952: 115; 1953: 138; 1954: 146; 1955: 159; 1956: 165.

inability of export producers to maintain relative profits positions by offsetting rising labor costs by technological improvements.

In part these immediate problems in the export industries are related aspects of an unfortunate Indonesian attitude toward foreign enterprise. As a strong, government-supported labor movement has demanded and obtained rising wages and greater fringe benefits from foreign plantation and mining enterprises, some modern export industries have found profits so jeopardized that they have been forced to curtail their operations. Uncertainty about the future status of foreign enterprise in Indonesia has also deterred cost-reducing improvements and expansionary capital investment in these enterprises. Some of the slack has been taken up by a shift from estate production to smallholders' exports. The latter are generally inferior in quality and hence command lower foreign prices. This is precisely what has happened, for example, in the rubber export industry. In 1938, estate exports of rubber were slightly greater than small-holders' exports; throughout the period since independence, on the other hand, the volume of smallholders' exports of rubber has been almost double that of estates. Natural rubber has also encountered increasingly stiff competition from synthetics; the same observation could be generalized to explain the failure of other traditional exports to reach their prewar volume—fibers and coal may be cited as additional examples. In other cases, exports have failed to reach prewar volumes because independence and subsequent population growth have resulted in greater domestic consumption. This is true for sugar, which ranked fourth as a producer of foreign exchange in 1938, and for such traditional colonial exports as tobacco, spices, tapioca, tea and palm oil.

This cursory survey does not exhaust the causes of stagnation in Indonesia's export industries which have, with the exception of petroleum, failed to attract foreign investment since colonial times. It does suggest, however, that Indonesia will probably not be able to significantly expand her share of the world market until greater diversification of export products is achieved and the growth of exports is deliberately encouraged in a general development effort. Here a caveat should be added. Successful diversification will involve substitution of processed goods for primary products, and, in addition, the development of new export industries to replace those exports for which world demand is secularly falling or stagnant, e.g., natural rubber. Neither objective can be accomplished without accelerating capital formation, accompanied by the introduction of improved technology and increased supplies of human skills. This is tantamount to arguing that expansion of Indonesian foreign trade, with accompanying social gains, cannot be attained without a broad attack upon the problem of economic stagnation.

This conclusion brings us back to the nub of our argument. Abstracting from the many particular problems that have plagued Indonesia's foreign trade, Indonesian prospects for obtaining a greater share of world markets—and increased trade with the United States—will be determined by the degree of integration attained by Indonesian society and the purposes for which the resulting energies are harnessed. Prognostication on these basic issues, however, requires consideration of the noneconomic parameters that lie behind economic change.

It seems fair to assert that Indonesia's leadership has consistently sought an easy formula to encourage superficial national integration without resolving the basic problems obstructing Indonesian unity. The clear mandate desired from the first national election in 1955 as an escape from prolonged parliamentary temporization, initiation of a sanguine but almost painless Five-Year Plan in 1956 and the forced break with the Dutch over the West Irian issue can be best understood in this light. The national elections, however, served only to heighten the society's political polarization and brought even greater political indecision than before. The announcement of the Five-Year Plan, without the capacity to bring it into effect, did little to rally national support around a central social goal. The last-ditch effort to divert internal controversy to an external issue by dramatizing the West Irian dispute, and the subsequent eviction of the Dutch, failed to halt the political fragmentation of the Republic. Meanwhile, Indonesia's leadership has avoided coming to grips with the problems that have consistently impeded progress toward the society's integration. The central government's reluctance to face the issue of its relationship with the provinces demanding autonomy, as provided by Indonesia's constitution, is a case in point.

Indonesian integration and the formulation of prime social goals were temporarily hastened by the nationalistic fervor which accompanied the struggle for independence. The Indonesian elite emerged from this long struggle with a vision of a society to be built in conformance with traditional, almost intuitive Indonesian conceptions of democracy[6] With the coming of independence, there was a rather wide measure of agreement among Indonesian leaders about the kind of social and economic integration they envisioned for the future. Apart from extremists of the right and left, Indonesian leadership acquiesced in accepting the short-run prospect of a mixed economy organized along socialist, cooperative and capitalist lines. This superficial unanimity postponed to the future settlement of the basic shape of the society's economic organization. The capitalist sector, virtually synonymous with foreign enterprise, was regarded as a necessary but temporary evil.[7] The cooperative sector was viewed as the main avenue through which traditional Indonesian society could partake of the fruits of independence in the immediate short-run, and dramatic growth of this sector was anticipated. In the longer-run, virtually all of Indonesia's leadership hoped to erect a more genuinely socialistic economy, although the rate at which socialization should proceed came to be a moot political issue differentiating party groupings.

Economic development came to be accepted among Indonesia's

[6] As formulated by Sukarno, for example, in terms of *pantja sila* and *gotongrojong*. For details of the *pantja sila* see George Mc. T. Kahin, *Nationalism and Revolution in Indonesia*, (Ithaca: 1952), pp. 122-23.

[7] Kahin, *op. cit.*, p. 476.

political elite as a major social goal.[8] To some, eventual realization of economic development represented the second stage of the revolution. To many others, social and economic progress were construed to be almost automatic consequences of political independence.[9] This superficial acceptation of economic development, it might be noted, led to the adoption of economic policies which have tended to confuse economic progress with redistribution of income and ownership. "Benteng" policies and "Indonesianization" programs have proved to be disappointing in promoting general economic improvement, and these failures help to explain why economic development goals have not cemented Indonesian integration. "Often," observed Sjahrir, "we hear the people's complaints that independence had not brought what they hoped for — improvement and progress in all fields of life. Many people also say that the freedom we achieved until now has brought improvement and progress for a small segment of our community — the politicians and educated people who now occupy places which were formerly the monopoly of the colonialists — while for others the situation has grown worse."[10]

This view leads to the suspicion that the leadership's early diagnosis of Indonesia's problem of economic development may have been a shade too superficial to serve as a basis for a program promoting national integration. Stripped of its usual emotional embellishment, the Indonesian elite's analysis of the causes of economic stagnation may be summarized in a few propositions. Indonesia's long history as a colony is given central importance. The heritage of an underdeveloped economy with positions of economic power awarded to the Dutch and their supporting minorities was construed to be the result of conscious imperial design intended to further the end of colonial exploitation. Undesirable export specialization in primary products, worsening terms of trade, unequal distribution of income and heavy profit remittances

[8] This conclusion emerges from a statement of findings by Mr. John Rodriguez who interviewed many political leaders about Indonesia's social goals. Of all the objectives mentioned, Mr. Rodriguez reports that concensus about the importance of economic development was greatest.

[9] For example, Sujono Hadinoto, former Minister of Trade and Industry (1951), observed that "national freedom is the gateway to prosperity. The social structure and the way of life we seek can only be realized after the achievement of independence." Quoted in Kahin, *op. cit.*, p. 323.

[10] Sutan Sjahrir, and others, *Symposion Tentang Kesulitan-Kesulitan Zamen-Peralihan Sekarang,* (Symposium on the Difficulties of the Present Transition Period), (Djakarta: 1953), p. 13.

to the mother country — all were consequences of the past victimization of a colonial economy by a metropolitan ruler.[11]

In adopting this diagnosis of Indonesia's economic backwardness, the elite was already formulating its agenda for economic reform. It was believed that political sovereignty would provide the power to break the grasp of the Dutch and the favored minority groups upon the Indonesian economy. The policies through which Indonesian enterprise should be encouraged to replace non-Indonesian control, however, began to force a split among the small Indonesian elite where relative agreement had existed at the more abstract level. One group urged that the society's economic goals could be best realized through economic and social development along Western lines. Through the efforts of Western-trained intellectuals, such as Dr. Sumitro, a beginning was made toward realizing this objective early in Indonesian independence. An "Urgency Industrialization Program" was adopted as a first step to alter the warped, colonial structure of the economy. Opposition to this sound but unduly optimistic approach culminated in the espousal of a fundamentally different approach during the tenure of the first Ali Sastroamodjojo cabinet (1953-1955). Spearheaded by Minister of Economic Affairs Iskaq, this group sought to displace foreign and minority dominance in economic activity by weighting political and economic advantages in favor of Indonesian entrepreneurs. Unfortunately, this approach tended to aggravate frictions between Java and the Outer Islands. By and large, Javanese entrepreneurs have been the beneficiaries of government largesse, and development of the Outer Islands has been overlooked in the heat of the struggle to strangle foreign enterprise (particularly Chinese and Dutch trading positions) on Java. Whatever else the "Indonesianization" programs have done, it seems clear that they have failed to promote the integration of Indonesian society.

During the years of independence which led up to the recent crisis, the dichotomy in the leadership's views about economic development became increasingly pronounced. By 1956, one Western observer, Benjamin Higgins, distinguished two major groups among "politically active and articulate Indonesians." One group was described as "economics-minded,"

[11] This analysis can be seen, for example, in Sujono Hadinoto, *Ekonomi Indonesia Dari Ekonomi Kolonial Ke Ekonomi Nasional*, (Djakarta: 1949).

> led by relatively young (sometimes foreign-trained) intellectuals who attach high priority to economic and social development of the country, who feel that this development must follow Western lines in large measure, and who are willing to cooperate with the West, at least to the extent of seeking Western technical and capital assistance from the West, in order to achieve this goal.

The second group was described as "history-minded,"

> a mixture of Communists and of a larger number who are nationalist, conservative (in Western terms), and isolationist. Its leaders attach highest priority to 'completion of the revolution' in the sense of eliminating the control over Indonesian national life exerted by foreigners through economic activity. While favoring economic and social development, they attach great importance to the retention of the national culture, language and religion and to abolishing the remnants of foreign influence. The attitudes of this group spring in large measure from the country's long history of resistance to foreign invaders, culminating in the postwar revolution.[12]

At the time of Higgins' writing, he also noted a second cross-party split: "the Outer Islands against the Center." Higgins' analysis of these basic differences in the orientation of Indonesia's leaders appears to have been remarkably perceptive. From our point of view, emphasis upon growing polarization of the political elite is helpful in shedding light on what might superficially appear to be puzzling temporization on the central issues of economic development and the devolution of political power from the center to localities. In 1956, Indonesia announced its first Five-Year Plan for the development of the economy, and details of the nature and scope of the Plan were subsequently published. Later events suggest, however, that Indonesian society was not sufficiently integrated to enable the government to launch the Plan; policies inimical to the success of the Plan continued to dominate the political scene. Throughout 1957, Indonesian political leadership wrangled over the adoption of President Sukarno's proposals for

[12] "Indonesia's Development Plans and Problems," *Pacific Affairs*, XXIX, (1956), 19.

"guided democracy" which some Indonesian leaders believed would seriously impair representative government in Indonesia.[13] This conflict widened the rift between the two leadership groups and broadened the areas of disagreement to include a choice between pro-Communism and anti-Communism, a choice which Indonesia had previously sought to avoid by pursuit of an "independently active" foreign policy. The dispute over "guided democracy" also tended to promote coalescence between the two sets of issues which had previously been relatively unrelated: centralism versus regional autonomy and economic development versus "Indonesianization." The pro-Western, development minded group began to join forces with the leaders who sought greater regional autonomy while the supporters of "Indonesianization" of the economy have tended to endorse centralization of political functions in Djakarta at the expense of local autonomy elsewhere. This polarization among Indonesian leadership was given considerable impetus by the withdrawal of Vice-President Hatta from the government in late 1956. As a relatively pro-Western, moderate Sumatran, Hatta had undoubtedly restrained the Outer Island dissidents from directly challenging central authority so long as he was believed to be representing the viewpoint of this group in the Central government. Hatta's resignation was followed by declarations of partial autonomy in several areas of the Outer Islands. Hatta's retirement from the active political arena found him as the leader of the opposition to Sukarno's proposals to circumscribe Indonesia's constitutional government.[14]

The Indonesian army played a major role in bringing to a head the conflicts implicit in the dichotomy of the political elite's basic social values. Significantly, much the same ideological cleavage has existed among the army's top officers since the "October 17, 1952 Affair"; and a similar sharpening of issues has evolved during the past few years.[15] The resentments of dissident army officers who have been highly critical of Central government policies—particularly on the matter of inclusion of Communists in the executive branch of the government—found a natural merger with local dissatisfactions in the Outer Islands. This merger led to the proclamation of autonomy from

[13] cf., Justus Van Der Kroef, "Guided Democracy in Indonesia," *Far Eastern Survey,* XXVI, (1957), 113-24.

[14] *Ibid.,* p. 116.

[15] Justus Van Der Kroef, "Instability in Indonesia," *Far Eastern Survey,* XXVI, (1957), p. 54.

Djakarta by military leaders in several outlying provinces and replacing central control with autonomous government by military junta. It is significant to note that the first autonomous junta, constituted in Central Sumatra on December 20, 1956, was reported to enjoy almost complete support from local officials and the civilian population.[16] This junta, known popularly as the Banteng Council, developed into the focus of resistance to the Central government. It became a rallying point for Indonesian leaders from many areas, including Java, who embraced ideological positions opposed to those apparently held by leaders of the parties with the greatest national power.

There are indications that the widening ideological cleavage among Indonesia's leaders and the ascendance of the history-minded group led to a course which placed prospects for economic development—and even economic stability—in greater jeopardy. The Djuanda Cabinet was willing to countenance a wholesale eviction of Dutch civilians over the unrelated issue of the future status of West Irian. This step will inevitably increase the difficulty of the task of economic development; it may well place the capital requirements for a program adequate to break the cycle of economic stagnation beyond the reach of the Indonesian economy. The loss of Dutch entrepreneurs has reduced output, and foreign exchange earnings have fallen. These consequences have produced greater economic and political instability, problems which have been the predominant national concern since 1956.

The widening rift between the two ideological camps has also bred indecision on major reforms which must be undertaken before the development Plan can be seriously begun. A foreign investment law, essential to insure at least moderate increases in the inflow of foreign capital to prosecute the plan, has been before the Indonsian Parliament for four years but favorable action has been obstructed by involvement with issues which lie at the basis of Indonesian political ambivalence.[17] Reform of Indonesia's tax structure, which must be used as a major source of development finance—to say nothing of coping with inflation—has long been studied by Indonesian fiscal experts. Decision on this issue, however, concerns the problem of central-local relationships, and no cabinet, much less Parliament, has yet been able

[16] *Ibid.*, p. 52.
[17] Higgins, *op. cit.*, p. 121.

to devise a means of escape from this political *cul-de-sac*. Similarly, it has become politically impossible to plan for the participation of local communities in the national development plan pending some legal arrangements for inter-governmental fiscal relationships. Yet, in a country with Indonesia's historical background, this sector must clearly play a major role in the financing and prosecution of development projects — if a democratic model of development is to be successfully followed.

While Indonesia's leadership has procrastinated in moving toward a solution of these fundamental problems obstructing national integration and economic development, efforts to build a "national economy" by replacing foreign entrepreneurs with Indonesians proceeded apace. Discriminatory and restrictive measures against Chinese and Dutch enterprises accompanied measures to encourage Indonesians to replace them. Liberal distribution of import licenses to Indonesians, freedom from restrictive government regulations, and outright provision of capital and credit were used to weight competitive advantages in favor of indigenous entrepreneurs. The "economics-minded" leadership, viewing this trend with alarm, has been openly critical. Sjafruddin Prawiranegara, the former Governor of the Bank Indonesia, and always an outspoken critic of bad government, declared:

> As a result of the substitution of foreign capitalists by Indonesian capitalists, enterprises which were formerly well run now deteriorate. . . . This transition is being stimulated by the government through the issuance of licenses and credits, which amounts to a large extent to so much squandering, even though it is admitted that of 100 beneficiaries . . . only 10 or 20 adequately utilize the chances offered them.[18]

Former Vice-President Hatta has frequently deplored these nationalistic excesses since *benteng* policies came to the fore five years ago. Last year (1957), he charged that millions of rupiah of public funds were being wasted by businessmen in league with politicians, most of whom lack any commercial acumen.[19]

It is impossible to conclude that the last few years' events have advanced Indonesian integration. Conditions in which to launch a program for a take-off to sustained economic growth have not improved.

[18] As quoted in Van Der Kroef, "Instability in Indonesia," *loc. cit.*, pp. 56-57.
[19] *Ibid.*, p. 57.

In addition to the present political instability, the threat to short-run economic stability is greater than at any time since independence. The government deficit, which has consistently been a primary source of inflationary pressures, is greater than ever before — about 8 per cent of national income. Prices are reported to have risen by 50 per cent during the past year.[20] Foreign exchange and gold reserves have fallen to far below their legal minimum as Indonesia has lost foreign exchange at a more rapid rate than any other country during the past two years. As economic stability and civil strife have become the paramount problems, the current Five-Year Plan has been virtually abandoned.

These events do not augur well for the growth of Western trade and investment in Indonesia. Without the persistent efforts of American petroleum companies to make a success of their Indonesian operations in spite of great difficulties, Indonesian trade with the West would already be smaller in volume than two decades ago. Until national integration is achieved, we may expect a continuation of this unfavorable trend. Even if integration is achieved, the question of whether development will follow lines consistent with international comparative advantages or autarchic patterns will remain. Expansion of Indonesian trade and investment relations with countries of the Free World will demand that Indonesia choose to develop in an atmosphere in which xenophobia and excessive nationalism are held in restraint. Indonesia's economic endowments provide the basis for considerable economic growth and vigorous and mutually profitable trade with the outside world. Whether or not this comes about, and when, depend on the success of Indonesia's leadership in providing social cohesion with a democratic basis, and proceeding with a sound development program.

Some remarks, leading to prognostication on this fundamental question, seem to be called for by recent events which have occurred in Indonesia. The 1958 crisis appeared to draw the lines of ideological controversy so sharply that a dominant coalition of leadership groups, capable of wielding effective national power, may emerge. A number of Indonesia's most promising members of the "economics-minded" group joined the rebel government in Sumatra. This includes the former Governor of the Bank Indonesia, Sjafruddin; former Finance Minister Sumitro Djojohadikusumo, who had long urged a responsible

[20] Greg McGregor, "Indonesia Sinks to Economic Low," *New York Times*, August 3, 1958.

approach to economic development; and Burhanuddin Harahap, a former Premier (1955-56), who during his brief tenure, initiated sweeping political and economic reforms to reduce government corruption. Other political leaders representing the same position — Mohammed Natsir, a leader of the Masjumi party; former Vice-President Hatta; the Sultan of Djokjakarta (Hamengku Buwono) — while critical of the drift away from parliamentary government and excessive centralization of political functions, found their political influence temporarily eclipsed. The long-standing rift in the army's leadership also followed lines drawn by the civil war; the anti-Communist, development-minded group tied their fate to the Rebel government in Central Sumatra. This includes many who had long voiced their criticism of procrastination, corruption and anti-Westernism in Djakarta: Colonels Lubis, Simbolon, Husein, Sumual and Warouw. One of Indonesia's most brilliant and pro-Western army commanders, Colonel Kawilarang, was relieved of his command of West Java in 1957 and sent to Washington as a military attaché. Kawilarang's reassignment was interpreted to be a move to avoid opposition to Sukarno's concept of guided democracy. In early 1958, Colonel Kawilarang left his post in Washington to support the cause of the Rebels.

The fact that an important part of Indonesia's top leadership joined the group resisting the Central government by armed force, or supported the principle of their defiant opposition, seems to indicate that the crisis was something more than an expression of mere local dissatisfaction or a purely military shakeup. While the 1958 conflict may not have been the definitive struggle between the two ideological groups so clearly demarcated within Indonesia's political elite, the recent civil war can hardly fail to weaken prospects for economic growth, despite the apparent Central government victory. An important segment of Indonesia's development-minded leadership has been lost for purposes of National reconstruction. Yet such leadership appears to be the scarcest of key resources essential to the launching of a successful program of economic development.

Economic stabilization, as well as economic development, requires the resurgence of an economics-minded group in positions of national leadership. The civil war of 1958 has brought the Indonesian economy to the brink of disaster. Government expenditures for military purposes have continued to grow, while tax revenues have fallen. Deficit financing through the central bank has produced severe inflationary pressures; a combination of rising prices and lagging wage levels have reduced real income among wage earners by 35 per cent.[21] Foreign exchange reserves have fallen far below the minimum which Indonesians themselves consider to be a safe buffer stock against short-run fluctuations in export earnings. Indonesia's balance of payments position has been precarious for the past several years, but it is now so distorted that substantial external assistance is the only alternative to dangerous reductions in domestic consumption of foodstuffs and other necessities. While Indonesia was near self-sufficiency in rice supply a few years ago, maintenance of the present lower levels of per capita consumption will require the import of 700,000 tons of rice this year.

A realistic analysis of the causes of Indonesia's unfortunate political and economic situation should place considerable emphasis upon the liabilities with which Indonesia entered her new state of independence in 1949. The terms of independence involved large annual foreign exchange obligations to the Netherlands. Indonesian nationals emerged from colonialization with little stake in the Westernized, capital-intensive sector of the economy. Indonesia's present leadership had virtually no experience in top government positions. The political and economic instability which the world has witnessed in Indonesia, therefore, are merely symptoms of a basic readjustment in Indonesian society. They reflect the growing pains of a newly independent country without much capacity for short-run growth.

There are encouraging signs that the domestic turmoil associated with civil war may lead to a new effort to achieve national integration through effective action on the home front and a foreign policy more cooperative with the West. In recent months Prime Minister Djuanada's government has made an effort to weed out from positions of power the individual leaders who have been most objectionable to the opposition groups.[22] The Central government has also demonstrated a new willingness to make concessions to the Outer Islands' demands which led to revolt. A financial agreement between the Central and Regional governments has recently received Cabinet approval, and the Central government has announced a plan to allow localities to retain a part of the foreign exchange proceeds from regional exports.[23] If the way

[21] *Ibid.*

[22] Tillman Durdin, "Indonesia Facing Many Problems," *New York Times*, July 20, 1958, p. 6E.

[23] *New York Times*, July 30, 1958.

to reconciliation of Central and Local government differences can be further opened, prospects for national integration will brighten. Djakarta officials have also appeared to place emphasis upon adopting a general program to restore economic stability through a sound approach to economic policy.[24] Finally, relations between Indonesia and the United States have improved during mid-1958 as a result of moderation of official attitudes expressed by both countries. A veteran New York Times correspondent in Indonesia writes that:

> the (Indonesian) government hopes for new foreign credits and other economic aid, particularly from the United States . . . Its foreign policy is still predicated on nonalignment with either the Communist bloc or the West, but the outlook is for more cooperative relationships between Jakarta and the West than there has been.[25]

The United States faces a new challenge in Indonesia. Substantial American economic assistance to promote the task of stabilizing the economy, and later for economic development, might well tend to alter the present uneasy balance of domestic forces toward integration and disintegration so that a greater measure of general social progress would be possible. If the United States accepts the challenge, prospects for a more vigorous and mutually beneficial pattern of trade between Indonesia and the United States would tend to become progressively better.

[24] Greg McGregor, "Indonesia Sinks to Economic Low," *loc. cit.*
[25] Tillman Durdin, "Indonesia Facing Many Problems," *loc. cit.*

Trade and investment possibilities in Thailand

His Excellency Thanat Khoman

Ambassador of Thailand
to the United States of America

As REPRESENTATIVE of Thailand in the United States, I always welcome the opportunity of reviewing the possibilities of trade, investment and other activities in the field of business which already exist in Thailand or may offer themselves in the future to prospective American investors or business interests.

Before I arrive directly at the core of the problem, however, let me briefly review the conditions which now prevail in Thailand, so that their knowledge may help in the understanding of the whole situation.

In the first place, calls for bids for the large amount of machinery and equipment we need in Thailand to implement our development projects have already been made by government departments in Thailand. Included is equipment needed for the construction of a large hydroelectric barrage for which the International Bank for Reconstruction and Development has loaned my country a sum of $66 million.

Secondly, I feel compelled to put you on guard against the obsession of huge markets represented by a multitude of hundreds of millions of people, who are pressing hard on the meager resources of their land, so that little if anything, is left for exchange with the outside world. My country may have a population of only 21 million, consequently it seems to offer only a small market to foreign business, but if we take into account the per capita income of our population, it will be realized that its purchasing power is proportionately larger than that of some of the big countries in the area. Thus it can be said that even though the population of Thailand is only one-eighteenth of another country in the region, our national income amounts to as much as one-eighth of the income of the same country. Naturally, this income is modest compared with the economically advanced nations of Europe and America. That is why, if we try to give a comparative picture, we have to do it in relation with countries in the same area.

But more importantly, the Southeast Asia region which includes Thailand contains resources on which the world depends. Besides foodstuff and especially rice which Southeast Asia produces abundantly and exports to feed the deficit nations of Asia, this region holds an important place in the production of rubber, tin and other minerals such as tungsten, lead, zinc, copper, manganese, as well as petroleum products. By contrast, other regions of Asia seem to have a much less considerable share in the supply to the world of international commodities. Consequently, their trade relations with the rest of the world cannot assume the same significance as in the case of Southeast Asia.

Furthermore, although Southeast Asia and Thailand may not have such a huge resource in manpower as the other two big nations of Asia, China and India, our people are better educated; their literacy rate is the highest in the whole of the Asian continent. In consequence, they should be more apt to receive technological training and provide the skilled labor necessary for the operation of any industry.

Finally, even though my country figures as recipient of foreign aid from the United States, the United Nations and other agencies such as the Colombo Plan, the amount of aid it has received is comparatively smaller than that given to other countries of similar size and population. On the contrary, we have borne proudly our share of the cost of our development as may be seen by the loans amounting to some 110 million dollars which have been granted us by the World Bank. In other words, we are also paying our way toward our development and do not depend exclusively on outside help.

After giving the background information which, in my estimation, seems necessary for the understanding of the problem of trade and investment, let us now try to consider what elements are essential and perhaps indispensable for the normal development of trade and investment. In my opinion, there are at least three elements. They are: favorable political climate, adequate administrative policy and setup and, finally, human and material resources.

When I come to these elements, it is obvious that I can speak for my country and my country alone.

With regard to the first element, those who are familiar with my country for having lived there either in official or private capacity know for certain that Thailand has been and always wants to be friendly with the United States and the West in general. Whatever internal changes may take place, this basic and fundamental policy of the Thai nation will not be affected, unless, of course, the United States or the West modifies its policy. At present, many treaties and agreements bind our two countries, the most important of which, for our present purpose, is the agreement whereby investments from this country are guaranteed against all risks of nationalization or expropriation. American investors, therefore, are fully protected in their investments.

As regards the Thai government itself, I can assert categorically that my government believes in the free enterprise system as much as any other country of the free world. It has not fostered socialism and it has not emphasized Communist achievements in economic or industrial fields on the one hand and made urgent appeals to the investors in the free world on the other. Our trade with Communist countries is practically nonexistent and where it exists it is confined to nonstrategic materials, in conformity with our obligations to our allies and as a member of the United Nations.

It is true, some may say, that the government in Thailand is engaging in or has some businesses of its own. But any one who is familiar with the conditions in Thailand and in Southeast Asian countries in general will be able to see without difficulty that the lack of capital or the slow process of capital formation in those countries creates the necessity for government intervention. If the government should decide to leave the field of business entirely to private initiative while private concerns have no means of their own to do it, there will be no industries at all. But the present government has made it a clear policy of its own that the very moment private business can take over, it will completely and irrevocably withdraw itself from such business. In support of this policy, the government of Thailand has made deep and substantial cuts in funds allotted to the running of factories or industrial concerns owned by the government.

A passage of the International Monetary Fund comments on Thailand:

> It is the general policy of the Thai Government to seek industrial development in the private sector, and to concentrate the Govern-

ment's development efforts on the provision of social overhead facilities and services, especially in the field of transportation, power and irrigation.

As to the second element which can help in the promotion of foreign trade and investment, namely adequate administrative policy and setup, the Thai government has adopted a number of measures to attain that objective. In the first place, foreigners and nationals of Thailand alike are allowed to make remittances abroad, for family maintenance or study or travel, without any kind of authorization up to a certain sum ($146 a month). Over and above those sums, foreign concerns are also allowed to repatriate not only their earnings but also their capital back to their original countries. The only formality they have to comply with is to obtain authorization from the Central Bank of Thailand which exercises control not to prevent expatriation of capital but for statistical purposes. In some cases, when remittances are too substantial, the Central Bank may ask that these remittances be spread out in successive installments in order not to create harmful fluctuations in the exchange rate of the national currency. But never has the Central Bank refused to authorize bona fide repatriation of dividends or capital to foreign enterprizes. This has been confirmed by a report of the International Monetary Fund. Such a liberal policy with regard to exchange control where it exists is not so common in our present world. Thailand, I think, can afford to do that, because her financial position is basically sound and our national currency is backed by some 90 per cent reserves of gold and hard currency, mainly United States. dollars. It is also of interest to note that these reserves were increased during the past few years.

In regard to new enterprises, whether foreign or domestic, there are legal provisions known as the Industrial Promotion Act exempting them from customs duties on machinery imported and from income tax for a prolonged initial period. These tax holidays and other measures which exist also in some other countries desiring foreign investments, are designed to encourage foreign investors. In Thailand, they begin to show beneficial effects.

These incentives and encouraging measures for the promotion of foreign trade and investment, coupled with the guarantee agreement which the Thai government has signed with the government of the United

States should provide, so to speak, an iron-clad protection to American business interests.

May I come now to the third element, namely, the human and material resources. As I have said before, although my country does not possess a vast reservoir of human resources as some other Asian countries, our population is comparatively well educated. Provided with adequate training, our people can undertake any technical job as well as any other people in the world. There is no such thing, in my view, as the inherent incapacity of a certain race or a certain people to perform technical works. The example of Japan is, I believe, sufficient to convince any one who may have doubt about it.

Our material resources, both tapped and untapped, are also abundant. The high-grade iron ore deposits north and south of Bangkok, the capital city of Thailand, are being exploited on a small scale by a private Thai firm and possibly also with the co-operation of a well-known West German steel concern. Another Japanese firm has joined with Thai interests to exploit shale oil. So far, few if any American firms have shown any disposition or interest in these fields. Other resources which I have mentioned earlier are being exported abroad as raw materials. Those are tin and rubber as well as some other minerals. They can, of course, be processed in Thailand with savings on freight charges which, as we all know, are extremely high. This is what we intend to do.

What do we want in Thailand in terms of trade and investment? First, and as far as our agricultural products and especially rice are concerned, we want to preserve and expand our traditional markets in the same manner as the United States wants to keep its traditional markets in this hemisphere. For the other main items of our exports, such as rubber and tin, we would like to see as do some of our Asian neighbors such as Malaya, a reasonably stable price maintained. We are apprehensive, and I think justly so, of the strong and devastating competition offered by some synthetic manufacturing processes. For us, these products which we export form the mainstay of our economy upon which the livelihood of millions depends. A few cents fluctuation in price can cause untold sufferings to hundreds of thousands of families, while a more diversified economy of an industrially advanced country can absorb without too great effects even the shock of a mild and temporary decrease in income. It is clear, therefore, that for Thailand and other Asian countries placed in a similar position, the expansion of our foreign trade is a vital question on which depends our very existence, not to speak of our healthy and normal growth. Consequently, we are willing to bear our share of responsibility and to go to a great extent to satisfy legitimate demands.

At the same time, we also realize that trade alone, especially trade based on exports of primary commodities, can never endure the benefits that our people are entitled to expect. The undue dependence on far-away markets beyond control or influence, or in fact under the control of others whose interests are not necessarily concordant with ours, cannot and should not be accepted as an adequate life insurance for our nations. The real solution lies in gradual and orderly industrialization of our economy. Such a conclusion, as you may well understand, is not motivated by reasons of national pride or prestige, the prestige of possessing one's own industries, but truly by reasons of necessity, the necessity of our own survival. A nation that depends for its likelihood on exports of primary commodities to foreign markets will not only be impoverished because the income derived from the exports of raw materials will never match the high and always rising costs of manufactured goods it requires for its consumption and development, but, worst of all, it will be subject to the whims and fluctuation of foreign markets and may prosper or starve as a result of administrative ukases which may be decided upon by some foreign nations.

On the other hand, I think I need make it clear that in pointing to the necessity for the undeveloped nations to diversify their economy and engage in some form of industrialization, I do not advocate self-sufficiency or what some European economists might call "autarky." Such a course of action would, in my opinion, be detrimental to undeveloped nations and may even hamper their normal and healthy development. What those nations must try to do is to strike a happy balance between production of primary commodities and the setting up of basic industries and processing industries, especially those which can make use of raw materials locally available, so that the sharp fluctuations in the prices of raw materials in markets abroad may be cushioned off and their intensity reduced on national markets by the existence of such industries.

This is what my country intends to do and I do not believe we are alone in thinking in those terms. However, our financial and technical capacity is limited and whatever efforts we may exert ourselves will never be sufficient to enable us to attain our objective. Outside participation is therefore invited and welcome, especially from countries which are friendly to us and whom we can trust.

What do the nations which invite outside participation have to offer? In the case of Thailand, I have already outlined the conditions which outside investors and especially American investors will find in my country, namely (1) a government and people friendly to the United States; (2) abundant natural resources, and (3) relatively educated human resources from which industries can draw an adequate labor supply. But most important of all, foreign and particularly American investors will find an almost virgin field for their operations. The industries now existing are so few and so undeveloped that they cater only to a small fraction of our national needs, the balance of which has to be satisfied by imports from abroad. New enterprises, therefore, will not have to face any kind of competition from local industries and can fully develop their productive capacity to meet ever growing demands.

Furthermore, what Thailand can offer which other countries cannot is its centrally strategic position in the heart of surrounding markets of Southeast Asia. Once you are in Bangkok or generally speaking in Thailand, you are placed at a distance of about two hours plane flight in all directions from five other capital cities of Southeast Asia. That explains why many commercial firms, international organizations and diplomatic missions have chosen to establish themselves at Bangkok and from there radiate to the other countries of Southeast Asia. Therefore, those enterprises which may open up in Thailand will be able to supply not only the Thai national market, but also the close-by markets of the surrounding nations of Southeast Asia with a total population of some 180 million people. This, you will agree, is hardly a negligible proposition. Therefore, a new enterprise or a new industry centered at a base where the national government is friendly and as much dedicated to the concept of free enterprise as that in its homeland, can set itself up and take advantage of the enormous local needs as well as the growing demands of the whole region.

American industries, because of their immense productivity, appear to have come to a point of satisfying the normal local consumers' demands. If such is the case, would it not be wise for America to start thinking of developing markets abroad which will be able to absorb some of American products. Asia and Southeast Asia in particular, for reasons I have already pointed out, seem to be the logical and normal markets for overflowing American products. At present, they cannot properly perform such a role, because of the low income of their population. But if adequate development is brought about through trade and investment in some fields of industries which, incidentally, are different from the more advanced industrial activities of the United States, greater income will be created in those parts of the world which will enable their population to buy manufactured products from the United States. Such an idea is not as theoretical as it appears at first sight, and if it can be properly explored and put into application, many of my American friends with whom I discussed this idea seem to agree with me that it can produce the desired results and bring mutual benefits to both the United States and Southeast Asia.

Another practical problem which seems to present an obstacle to the implementation of a program of foreign or American investment is the lack of predetermined conditions, well known in advance to foreign investors and offered to them by the host country. This point suggested to me by both government and private circles, is certainly well taken and I am ready, as far as I am concerned, to present to the authorities of my country any reasonable concrete suggestions. For the moment, I can say that my country has no objection to working out a reasonable standard statute to be offered to foreign traders and investors, in addition to the conditions relating to tax and customs duty exemption and repatriation of earnings and capital which are already known to foreign investors in Thailand and of which they have been taking advantage for some time already. Such a statute will have necessarily to be general in nature and character leaving the conditions specific to any trade or industry to be spelled out in detail by negotiation between those industries and the authorities concerned themselves. Such an obstacle, if it is one, can be surmounted and even easily removed if the two sides, the host country and the foreign trader and investor, seek mutual benefit and not one-sided and somewhat monopolistic advantage. Thailand for one will go a long way to meet any reasonable and legitimate demands of foreign investors and traders. If those who come to her are animated by regular business considerations and not by some adventurous spirit of "making a fast buck," as we say here, my country is willing and ready to co-operate with them for mutual benefit. What we want from abroad, therefore, is not those fly-by-night businesses, but the sound, steady, and long-range business activities which will develop our own national resources, our productivity and consequently the income of our people. Such development will bring benefit not only to the investors or traders themselves, but also to the land of their origin which will find a growing market for its products.

Some of the countries which are not so friendly to the United States have clearly seen the advantages I have tried to outline and have already made important inroads in Asia. Should the United States and the free nations continue to neglect these warnings, this country, and indeed the whole world, may one day wake up and find that the field is already taken up by their challengers and antagonists.

Thailand, through her representative, can categorically and sincerely affirm that she prefers to do business with the United States and the free world, if the latter are animated by the same desire and the same willingness to agree to the reciprocity of our interests and reasonable conditions in carrying out mutual obligations as well as in sharing benefits. But if we were asked to exceed these limits and to yield to foreign traders and investors one-sided or monopolistic advantages, my country, much as it desires to have foreign investments, will not be able to accept. The time of colonial-type exploitation is, I believe, completely superseded by economic co-operation on the basis of equality and profit sharing. On this basis, Thailand invites traders and investors of the United States and the free world to come to her soil. I hope they will hear and heed our appeal for the mutual advantage and benefit of our respective nations.

The significance of Asian trade to the United States

Robert J. Barr

Director,
Milwaukee International Trade Institute,
Professor of Economics,
Marquette University

THE ACCOMPANYING tables are intended to display some of the leading structural relations and recent trends in United States trade with Asia and the Far East. The explanatory note preceding the tables indicates sources and limitations of the data and special meaning of some terms. It is to be noted that this paper is an analysis from the viewpoint of the United States and on the basis of United States trade returns. Many details of the trade are commented on in other papers from the viewpoint of the trading partners of the United States.

Asian countries supply the United States with substantial proportions of a dozen or so commodities, some of which are of considerable importance to the United States. These countries take a lesser volume of United States exports which range over a large variety of commodities. United States exports to these countries show an increasing excess of exports in recent years. Conditions which determine the trade are the natural endowments of the Asian countries, their increased pace of development, technological changes in the United States and United States aid and agricultural policies.

United States imports from Asian countries are concentrated in a group of a dozen or so commodities. Table I shows that 10 commodity subgroups listed account for about half the total imports from the Asian countries — 45 per cent in the two end periods and 65 per cent in 1948. These same commodities, however, accounted for only 12 per cent to 17 per cent of all commodities imported into the United States. Import trade with Asian countries is concentrated on fewer commodities than import trade in general. The relative importance of Asian countries as the origin of United States imports has declined from 26 per cent in 1938 to 15 per cent in 1955-57 of total imports. In 1938, 78.3 per cent of these commodity subgroups came from Asian countries; in 1955-57 this proportion had fallen to 57.1 per cent. This figure is affected by the decline in the proportion of rubber and tin originating in Asian countries and by the fact that rubber and tin in 1938 were a more significant component of the commodities listed than they were in 1955-57: 59.1 per cent as against 37.6 per cent. On the other hand, other commodities assumed increasing importance. While total United States imports increased more than six times in value between 1938 and 1955-57, imports of ferroalloys increased more than 15 times, lead nearly 260 times and wool more than 10 times. These three commodities accounted for only 4 per cent of listed imports from Asian countries in 1938 but 24 per cent in 1955-57.

Description of the export trade cannot be so readily condensed since a larger number of commodities are involved and concentration on a few is less notable. The listed commodities accounted in 1938 for a third of total exports to Asian countries; in 1957 this proportion had increased to more than one-half — an indication of the shift in commodity composition of United States export trade to Asia. The listed commodities have accounted for more than one-half of total exports. The relative importance of Asian countries as destinations for United States exports has slightly declined; these countries now account for less than 15 per cent of total United States exports.

The more important commodity classes were as follows, with exports to Asian countries as a percentage of exports to all countries: cotton unmanufactured, 25.7 per cent; petroleum and products, 20.4 per cent; medicinal and pharmaceutical preparations, 24.6 per cent; machinery and vehicles, 17.9 per cent. These commodities in 1938 constituted 55.6 per cent and in 1955-57, 39.0 per cent of all exports to Asian countries. Notable increases in proportions of exports destined for Asian countries occurred in the two subgroups, grains and preparations, and cotton unmanufactured, a result doubtless of aid and agricultural surplus disposal policies (Public Law 480). It is notable also that exports of autos, parts and accessories to the world between 1938 and 1955 increased nearly five times while these exports to Asian countries increased only two and a half times.

The United States balance of merchandise trade with Asian countries shows a large export excess in postwar years. The ratio of imports to exports was 77 per cent in 1948 and 74 per cent in 1955-57. The largest excesses occurred with Japan, Republic of Korea and Taiwan. The surpluses with India, Pakistan and Republic of Philippines were also substantial, that of the latter however being much reduced from 1948.

Countries with which United States trade showed a substantial excess of imports are British Malaya, Republic of Indonesia and Thailand; smaller import excesses occurred with Ceylon and New Zealand. These excesses of imports are attributable to United States imports of rubber, tin, tea, spices and wool.

In point of magnitude, Japan, except in 1948 before postwar economic conditions had been fully established, is our largest source of imports, accounting for almost a third of total imports from Asian countries; it is likewise the largest market for our exports, absorbing more than one-third of total exports to Asian countries. The largest single item of trade with Japan is presently the United States export of unmanufactured, and the import of manufactured cotton.

United States aid has been a significant factor in recent trade with Asian countries. In the period 1955-57, one-half of all nonmilitary net grants and credits went to Asian countries, more than 60 per cent of this portion to Republic of Korea and Vietnam, Laos, Cambodia, and 30 per cent to Taiwan, Pakistan, Japan and India.

The principal factors determining the character of United States trade with Asian countries may be briefly summarized:

1. The United States imports are predominantly products or raw materials in which the region has a natural advantage — rubber, tea, spices, jute, tin, ferroalloys and lead.

2. Technological changes in the United States have reduced the relative significance of our dependence upon Asian countries for rubber and tin, but other changes, together with depletion of United States domestic mineral sources have increased our dependence upon the region for ferroalloys and lead.

3. There has occurred a net diversion of origin of United States imports away from Asian countries, not only for the commodity classes listed in the tables, but for all commodities; the commodities listed, however, constituted in 1955-57 the same proportion of all imports from Asian countries as in 1938.

4. The United States aid programs together with crop failures

in Asian countries are responsible for significant increases in the proportion of exports of grains and preparations and cotton manufactures going to the region.

5. Of the important group of machinery and vehicle exports, Asian markets absorbed a smaller proportion of United States exports in 1955-57 than in 1938.

6. While the commodity classes listed constituted a slightly smaller proportion of total United States exports in 1955-57 than in 1938, they constituted a substantially larger proportion of our exports to Asian countries.

Explanatory Note to Accompany Tables 1-5.

Sources of data for the tables are:

United States Department of Commerce, Bureau of the Census.

Foreign Commerce and Navigation of the United States, 1938

Foreign Trade Reports, FT 100, FT 120, FT 410, FT 420, Annual Summary volumes, 1948, 1955, 1956, 1957.

Foreign Grants and Credits by the United States Government, December 1957, March 1958.

Survey of Current Business, April 1958, pp. 20-24.

The term "Asian countries" or "Asia and the Far East" for the purposes of this paper is taken to include the following countries, as designated and defined in the above foreign trade reports: India, Pakistan, Ceylon, Burma, Thailand, Vietnam, Laos, Cambodia, British Malaya, Republic of Indonesia, Republic of Philippines, Republic of Korea, Hong Kong, Taiwan, Japan, Australia, New Zealand. Certain territories are not identical throughout the period of comparison used in this paper: Republic of Korea and Taiwan would be included in the Japanese returns for 1938. The following territories have been considered equivalent for the pre and postwar comparisons: British India to India plus Pakistan; Siam to Thailand; French Indo-China to Vietnam, Laos and Cambodia; Netherlands Indies to Republic of Indonesia; Japan including Chosan and Taiwan to Japan.

Because of the changes in territory it is in some cases impossible to make pre and postwar comparisons and so these are omitted. In other cases the changes of territory do not seriously distort the comparison. The same statements apply to some of the commodity classifications. The returns are also somewhat distorted by sampling procedures for small-valued shipments and by exclusions of special category commodities — these matters are explained in the Introduction to the Foreign Trade Reports where detailed references are given. For the descriptive purposes of this paper, and especially for the percentage statements, these distortions are not of significant proportions.

The particular years were selected to represent the typical prewar, early postwar and recent trade. The returns for these years are believed to be dominated by the more fundamental and at least semipermanent rather than by the accidental determinants of trade.

A recent excellent brief summary and analysis of United States foreign trade, with which the present analysis of trade with Asia may be compared, is given in House of Representative Ways and Means Subcommittee on Foreign Trade Policy, *Compendium of Papers on Foreign Trade Policy,* 1957, United States Department of Commerce, "The Role of Foreign Trade in the United States Economy," pp. 15-22, and "Recent Developments in United States Foreign Trade," pp. 23-37.

TABLE 1. *United States Imports for Consumption from Asian Countries, Principal Commodities, Selected Years, Proportion of Asian to Total Imports and of Listed Commodities to all Commodities (Values in Millions of U.S. Dollars)*

Commodity (Schedule A Commodity or Subgroup No.)	Year	Total .US. Imports for Consumption	U.S. Imports from Asian Countries Total	% of Total U.S. Imports
Rubber, milk or latex;	1938	129.5	126.4	97.6
crude n.e.s.	1948	309.1	294.9	95.4
2011000; 2013000	1955-7 av.	396.1	354.7	89.5
Tin, bars, blocks, pigs,	1938	44.9	38.5	85.7
etc.; ore. 6550000;	1948	134.8	98.6	73.2
6551300	1955-7 av.	152.8	102.5	67.1
Tea, n. s. p. f.	1938	18.3	17.4	95.1
1521000	1948	45.1	42.1	93.3
	1955-7 av.	55.4	50.7	91.5
Jute & manufactures	1938	37.5	31.2	83.2
Subgroup 37	1948	171.6	162.9	94.9
	1955-7 av.	110.7	97.2	87.8
Ferroalloys	1938	18.0	2.6	14.4
Subgroup 63	1948	86.8	10.8	12.4
	1955-7 av.	277.7	72.2	26.0
Lead, ores, flue dust &	1938	0.5	—	—
matte, n.s.p.f.; pigs &	1948	89.4	12.2	13.8
bars. 6503000; 6505000	1955-7 av.	129.7	28.5	22.0
Mica, block Muscovite	1938	0.5	0.4	80.0
over 15¢/lb.; films &	1948	14.0	12.2	87.1
splittings over 12/10,000	1955-7 av.	7.2	3.8	52.8
in. 5560940; 5561800				
Wool, unmanufactured	1938	22.6	7.0	31.0
Subgroup 40	1948	307.6	122.9	40.0
	1955-7 av.	271.2	97.9	36.1
Goat & kidskins, dry &	1938	12.0	3.7	30.8
salted; green or pickled.	1948	40.8	13.8	33.8
0241000; 0242000	1955-7 av.	20.2	7.5	37.1
Spices	1938	11.1	3.8	34.2
Subgroup 21	1948	30.9	14.7	47.6
	1955-7 av.	36.1	16.4	46.0
Total above Commodities	1938	294.9	231.0	78.3
	1948	1,230.1	785.1	63.8
	1955-7 av.	1,457.1	831.4	57.1
Total All	1938	1,949.6	508.4	26.1
Commodities	1948	7,038.4	1,203.6	17.1
	1955-7 av.	12,281.7	1,825.2	14.9
Commodities Listed	1938	15.1	45.4	
Above as per cent of	1948	17.5	65.2	
All Commodities	1955-7 av.	11.9	45.6	

Abbreviations:

n.c.l.: no comparable listing
n.e.c.: not elsewhere classified
n.e.s.: not elsewhere specified
n.s.p.f.: not separately provided for
x sc: except special category

TABLE 2. *United States Imports for Consumption from Asian Countries, Selected Groups, Selected Years, with Indexes of Value, 1938=100.*
(Values in Millions of U.S. Dollars)

Group	Year	Total U.S. Imports for Consumption		Total U.S. Imports From Asian Countries	
		Value	Index	Value	Index
Total All Groups	1938	1,949.6	100	508.4	100
	1948	7,038.4	361	1,203.6	237
	1955-7 av.	12,281.7	630	1,825.2	359
Group 2. Vegetable	1938	292.7	100	175.6	100
products inedible except	1948	780.2	267	465.9	265
fibers & wood	1955-7 av.	770.1	263	470.6	268
Group 3. Textile Fibers	1938	280.8	100	154.0	100
and manufactures	1948	863.6	308	364.8	237
	1955-7 av.	1,000.6	356	426.9	277
Group 6. Metals and	1938	158.7	100	41.0	100
Manufactures except	1948	832.7	525	133.5	326
Machinery & Vehicles	1955-7 av.	2,219.3	1,398	296.2	722

TABLE 3. *United States Exports of Domestic Merchandise to Asian Countries, Selected Subgroups and Group 7, Selected Years; Proportion of Asian to Total Exports and of Listed Commodities to all Commodities.*
(Values in Millions of U.S. Dollars)

Commodity Group or Subgroup Number	Year	Total U.S. Exports	U.S. Exports to Asian Countries	Exports to Asian Countries as % of Total Exports
130 Grains and Prepa-	1938	223.5	4.6	2.1
rations	1948	1,704.7	266.6	15.6
	1955-7 av.	1,215.5	321.3	26.4

TABLE 4. *United States Exports of Domestic Merchandise to Asian Countries, Selected Subgroups and Group 7, Selected Years, with Indexes of Value, 1938 = 100. (Values in Millions of U.S. Dollars)*

Commodity Group or Subgroup Number	Year	Total U.S. Exports		Total Exports to Asian Countries	
		Value	Index	Value	Index
Total All Commodities	1938	3,057.2	100	518.0	100
	1948	12,532.1	410	1,567.3	303
	1955-7 av.	18,286.0	598	2,476.3	478
130 Grains and Preparations	1938	223.5	100	4.6	100
	1948	1,704.7	763	266.6	5,796
	1955-7 av.	1,215.5	545	321.3	6,985
330 Cotton unmanufactured	1938	224.3	100	57.6	100
	1948	511.0	228	53.3	91
	1955-7 av.	754.8	366	268.2	466
513 Petroleum and Products	1938	388.6	100	79.3	100
	1948	657.1	169	66.1	83
	1955-7 av.	625.9	161	81.0	102
Group 7 Machinery and Vehicles	1938	848.8	100	151.8	100
	1948	3,718.7	438	313.1	206
	1955-7 av.	6,380.3	752	574.6	379
850 Medicinal and Pharmaceutical Preparations	1938	17.1	100	4.2	100
	1948	193.2	1,130	30.6	729
	1955-7 av.	252.2	1,475	44.6	1,062
865 Chemical Specialties	1938	29.0	100	3.3	100
	1948	156.6	540	12.8	381
	1955-7 av.	454.8	1,578	71.7	2,174

TABLE 5. *United States Balance of Merchandise Trade with Asian Countries, Selected Years, and Net Nonmilitary Grants and Credits, 1955-57. (Values in Millions of U.S. Dollars)*

Country	Year	U.S. Imports for Consumption	U.S. Exports of Domestic Merchandise	Excess Exports + Imports −	Net Nonmilitary Grants and Credits
India	1938	58.0	33.4	− 14.6	
	1948	267.7	297.5	+ 29.8	
	1955-7 av.	211.2	283.6	+ 72.4	41
Pakistan	1938	Included in India			
	1948	24.9	17.0	− 7.9	
	1955-7 av.	34.8	102.6	+ 67.8	75
Ceylon	1938	16.3	1.3	− 15.0	
	1948	52.5	19.3	− 33.2	
	1955-7 av.	32.5	9.8	− 22.7	—
Burma	1938	0.2	2.3	+ 2.1	
	1948	1.7	4.5	+ 2.8	
	1955-7 av.	2.0	5.9	+ 3.9	—
Thailand	1938	0.3	3.3	+ 3.0	
	1948	49.2	16.3	− 32.9	
	1955-7 av.	95.5	56.5	− 39.0	28
Vietnam, Laos, Cambodia	1938	7.2	3.1	− 4.1	
	1948	3.3	14.3	+ 11.0	
	1955-7 av.	27.3	61.7	+ 34.4	291
British Malaya	1938	112.1	8.8	− 103.3	
	1948	269.5	81.8	− 187.7	
	1955-7 av.	217.7	41.0	− 176.7	—
Republic of Indonesia	1938	68.8	27.5	− 41.3	
	1948	76.9	91.5	+ 14.6	
	1955-7 av.	205.3	108.0	− 97.3	8
Republic of the Philippines	1938	94.2	86.3	− 7.9	
	1948	227.5	467.8	+ 220.3	
	1955-7 av.	256.5	341.2	+ 84.7	20
Republic of Korea	1938	—	—	—	
	1948	—	—	—	
	1955-7 av.	6.1	186.8	+ 180.7	301
Hong Kong	1938	3.4	21.0	+ 17.6	
	1948	3.6	82.9	+ 79.3	
	1955-7 av.	22.4	64.6	+ 42.2	—
Taiwan	1938	—	—	—	
	1948	1.0	5.7	+ 4.7	
	1955-7 av.	7.6	105.3	+ 97.7	99
Japan	1938	131.6	238.8	+ 107.2	
	1948	59.7	322.9	+ 263.2	
	1955-7 av.	521.9	918.6	+ 396.7	59
Australia	1938	8.8	68.8	+ 60.0	
	1948	131.8	113.8	− 18.0	
	1955-7 av.	168.3	197.2	+ 28.9	—
New Zealand	1938	7.4	23.4	+ 16.0	
	1948	32.8	33.9	+ 1.1	
	1955-7 av.	55.4	30.4	− 25.0	—
Total All Asian Countries	1938	508.4	518.0	+ 9.6	
	1948	1,203.6	1,567.3	+ 363.7	
	1955-7 av.	1,825.2	2,476.3	+ 651.1	922
Total All Countries	1938	1,949.6	3,057.2	+ 1,107.6	
	1948	7,038.4	12,532.1	+ 5,493.7	
	1955-7 av.	12,281.7	18,286.0	+ 6,004.3	1,811

The relationship between United States-Asian trade and American foreign investment and technical assistance programs

R. N. Christiansen

Manager,
Foreign Trade Department,
Marshall and Ilsley Bank

FOR THE PURPOSE of this discussion the Asian countries will be considered as those belonging to the United Nations ECAFE group excluding the China mainland. The period since the late war has seen the rise of twelve new countries in Asia, all encouraged and in most cases actively supported by the United States in their struggle toward independence. With the possible exception of Japan, all of the countries in the ECAFE group base their economies on agricultural and extractive industries. Exports to the United States consist primarily of petroleum, rubber, teak, coconut products, tea, hides, tin, fish, chromite, abaca, spices and rice. In most of the countries, one, or at best two, of these primary commodities are the chief means of acquiring foreign exchange. Imports from the United States into these countries have consisted chiefly of consumer and industrial goods with the chief exception being agricultural exports under our PL 480. During 1957, the United States trade with Asia consisted of imports amounting to $1.7 billion and exports of $2.86 billion, 13 and 15 per cent respectively of the United States total trade.

Two key points stand out as having affected the balance of this trade in the last ten years. The first, concerning exports from Asia, is that the primary commodities produced there and exported have all been victims of severe price fluctuations. Variations of up to 15-20 per cent in a year's time have not been unusual. The volume of these exports has fluctuated in almost a parallel manner. The result has been an unstable foreign exchange return to the individual countries and a resultant imbalance in their payments accompanied by dislocations in the internal economy. Secondly, the price of exports from the United States has risen almost continuously in the last ten years. The pressure of the rising United States price structure on the manufacturer here has resulted in higher and higher export prices on the commodities required by Asia. This squeeze, namely an uncertain foreign exchange return for the Asian countries and the steadily increasing cost of the goods they wish to import, is further aggravated by problems of population increase and inadequate food supplies. Almost without exception, Asian countries have tried to remedy their reliance upon exports of one or two primary commodities by industrialization. The problem of increased industrialization is fraught with all too numerous road blocks. The import of capital goods and know-how is only the first step in solving this problem. Centuries old patterns of social and economic reform must necessarily be disrupted and such progress calls for knowledge far beyond the simple ability to manufacture and distribute industrially produced goods.

It is axiomatic, however, that industrialization is brought about by the import of capital goods and/or know-how and that these imports must be paid for by exports. Asia's share of the world's exports has declined from 10.7 per cent in 1950 to some 6.6 per cent in 1957. Further, private commercial investment in Asia by American firms has been strikingly limited. Even in Japan, the most highly industrialized country in Asia, while the number of accepted investments has been high, the total dollar value of these investments has been low. In most instances, investments have merely complemented existing industries and have not produced new exchange earners or conversely exchange saving production facilities. From the standpoint of its trade with Asia, the United States is faced with the enigma of Asia's continually growing population clearly aware of its need to buy the consumer and industrial commodities best produced here, yet at the same time frustrated by rising prices in the United States, as well as Asia's disability in selling commodities at steady prices which would make for economic development and an accompanying rising standard of living.

In order to fill this gap in trade between the United States and Asia, the United States has undertaken an extensive program of foreign aid. In 1956 this aid amounted to $1,600 million and in 1957 approximately $1,790 million. Of this, military supplies and services amounted to $643 million and $819 million respectively and other aid to $959 million and $972 million respectively. Only about $100 million of the total aid can be considered as private capital investment, half of which probably consisted of reinvested earnings produced by some $700 million presently invested in Asia by United States private entities. The International Cooperation Administration's grants and loans amounted to $460 million during 1957 while the Export Import Bank of Washington, D.C. authorized credits totaling about $260 million. The remaining balance was chiefly made up by the economic aid portions of our Mutual Security Program. The major portion of United States aid in recent years has come from our export of agricultural commodities under PL 480. These commodities went toward filling the gap in the supply of foodstuffs. The majority of the Asian countries are traditionally net importers of foodstuffs. Two years of crop failures in India and increased populations of other countries have resulted in a need for vast amounts of rice and wheat which normally would not be required. The Eximbank cotton loan to Japan and similar shipments of cotton to India have been yearly features of this disposal of our surplus agricultural stores. The balance of the Eximbank loans has been spent to purchase industrial goods primarily of a development nature. Large projects for power development, land reclamation and irrigation programs have been featured in recent years. Loans of this type have been the chief source of sales of American industrial products to Asia.

On the face of it our aid in terms of both loans and grants amounts to a sizeable figure and has been increasing over the last five years. Unfortunately, however, foreign aid in total and United States foreign aid in particular has not been sufficient to make up the difference in balance of payments dislocations caused by the severe fluctuations of basic export commodity prices. The United Nations Economic Survey of Asia and the Far East for 1957 clearly states that:

> . . . the average year-to-year fluctuations in the export earnings of Asian primary exporting countries were in all cases above 10 per cent, foreign aid received by these countries amounted to no more than around 5 per cent of their total export earnings in the postwar period.

While general statements always bear the burden of possible inaccuracy when applied to a specific situation, this does not appear to be the case when one reviews the area country by country, commodity by commodity. Without fail, actions by the individual governments such as export tariffs, import tariffs, foreign exchange restrictions, fixed and multiple exchange rates, government stockpiling programs, fixed internal wage rates and other similar control measures have been unable to produce a stable balance of payments situation. International commodity agreements such as are presently enforced for wheat, tin and sugar have not been successful. Price differences within the agreements due to the lack of homogeneity of the products controlled continue to thwart the best efforts resulting from the agreements.

Unfortunately the area of solution to the problem of increasing United States trade with Asia does not lie simply in the problem of competitive export prices for our goods. Indeed, the problem does not lie wholly in the area of economics. While a stable, healthy economy in the United States would serve as a reliable base for the sale of Asia's primary exports and steady prices would be an important factor in increasing United States-Asian trade, this solution is not sufficient to alleviate the problem. Foreign aid and chiefly United States foreign aid is and will continue to be an absolute requirement. Admittedly an easing in world tensions could divert substantial amounts of our military aid into the social and economic areas. While this would be a most welcome change, its possibility in the immediate years seems rather remote. Concentration of a sizeable portion of the aid extended toward increasing local production of foodstuffs through intensive and extensive methods of cultivation would be one first step and a most fruitful one. This, coupled with apportioning of aid into the development of industries designed to process the traditionally exported raw materials and thereby to encourage a greater use of the all too numerous labor force in adding value to export products, could produce the greatest economic progress in the shortest period. Lastly, a technical assistance program such as has been begun in India based on country to country needs should prove most beneficial for the long term.

While we accept the fact that private investment can show the greatest short run results, it appears, in solving the problem of aid and trade between the United States and Asia, that government programs intelligently planned and executed are the only practical means of effecting a long run solution. Unfortunately, government to government programs are too frequently the children of vested political interests with the resulting tendency towards large scale projects of a monumental nature. Industrialization in Asia must be accomplished on a highly selective basis through government financial aid and technical assistance and through the encouragement of private entities to invest whenever possible. A straightforward, step-by-step program, tightly administered, will achieve the desired results to the benefit of all concerned.

Problems of marketing Far Eastern products in the United States with special reference to Japan

Laurence P. Dowd

Director, Michigan Business Executives Research Conference,
Lecturer in Marketing and Foreign Trade,
School of Business Administration,
University of Michigan

INTRODUCTION

THE CAUSES OF and cures for the current international economic problems of the Far East have consumed reams of paper and many hours of discussion in the last few years. That conditions of trade in which imports have totalled an annual amount nearly twice that of exports cannot continue indefinitely has received much attention. Economists, usually emphasizing "pet" theories, have proposed nearly as many solutions as there are economists. Most of these proposals have turned on the need to remove restrictions on the import of Far Eastern products into the United States, on the encouragement of more foreign investment in Asia, or on the admittance of the nations as full members of various international economic and financial agencies. Some, especially "leftish" theoretical economists, have advocated as the solution a greatly expanded trade with Communist China and the Communist area in general. Some, and even perhaps all, of these "pet" theories may have validity; but they tend to be expounded somewhat unrealistically. They do not explain how their proposals can be achieved in practice. They do not point out, for instance, that the United States government is strongly politically influenced by special interest groups and that the practical possibility of lowering restrictions is very remote. They do not point out that Communism exists only for the benefit of the Communists. They do not understand or discuss the difficulties of business organizations which in themselves have no direct influence over governmental policy. They do not mention, perhaps most important of all, that in the final analysis trade depends upon successful selling by individual business firms.

In this paper no "pet" economic theory will be proposed. Rather, economic and political theories and policies will be accepted as they exist—and probably will continue to exist for some time in the future—and the problems of the individual business organization engaged in trying to export to the United States will be emphasized. As these are discussed, solutions, where such are possible, will be suggested. Remember, however, that if the problems of individual firms can be recognized and improvements made, a major step will be taken by the resultant increase in successful, efficient trade toward solving the international economic problems of the Far East.

The comments which follow are based not only upon the writer's experience and knowledge as a professor of marketing, but also on practical experience in foreign trade, including such activities as membership on the Board of Trustees and the Merchandising Committee of the Washington State International Trade Fair Corporation, an organization established for the primary purpose of increasing Far Eastern imports into the United States, and a past presidency of the businessmen's foreign trade association of Seattle. They also summarize reports received from businessmen regularly engaged in trade with the Far East.

Some General Economic Considerations

Before particular export problems are discussed some general economic considerations must be mentioned because of their influence on solutions of the practical problems. First, the Far East generally is faced with an ostensibly serious situation in the absence of modern capital equipment. As a result, much production is carried on with outmoded machinery or must even rely upon handicraft for the creation of export commodities. Yet, surprisingly, in part this may be a benefit rather than a hindrance. Second, for a number of reasons typical enterprises are operating under unduly high costs of production. This only naturally tends to cause an impairment in the quality of products. Third, business is hampered by some unrealistic economic policies, many of which unfortunately were recommended to the governments by American economic advisors who had no knowledge of basic economic conditions in the Far East. Fourth, all countries are highly dependent upon commodity trade to achieve equilibrium in the balance of payments. Unlike other areas, few "services" can be rendered to others. And fifth, the area is faced with important changes in the nature of world demand, changes which must be accepted as there is no way in which they can be influenced. For instance, American women today prefer nylon stockings to silk with the resultant loss of the previously highly important market for raw silk; synthetic rubber is gradually replacing natural rubber; and consumers today want high quality products of original design rather than the cheap imitations of American products which sold so extensively in the 1930 decade.

All of these make it difficult for the countries concerned to develop their export potential. But it makes it more vital that there be a thorough understanding of marketing methods and techniques and that intensive effort be devoted to the marketing of their products in the United States, for only by doing so can these difficulties be overcome.

Marketing Research

Significance of Marketing Research — To plan marketing programs effectively, especially in foreign countries, it is necessary to know what products customers desire, how many they desire, why they buy, where they buy and other similar facts. The importance of such research as an essential of successful selling cannot be stressed sufficiently.

One of the most important export problems of producers in the Far East has been a failure to recognize this need for marketing research or to use it extensively. To date, only a few firms have done anything at all which even remotely could be so classified.

The results of not using this essential tool are readily observed. For example, in the last decade in the United States there has been a notable increase in the knowledge of foreign products as a result of a number of factors, including residence of service personnel overseas and increased interest in the Far East in our educational system. Consequently, American consumers have come to desire products of the Far Eastern civilizations and cultures. Yet quality products of those civilizations are not available in more than limited quantities. No longer does the consumer want large quantities of cheap imitations of American produced products; but Far Eastern producers, particularly those in Japan, still tend to concentrate on these cheap imitations.

Some Essential Aspects of Marketing Research — One of the most essential bases for successful selling is to develop products in accordance with consumer desires. Few firms in the United States try to market a product without a considerable period of study concerning appropriate design. From numerous inspections of Far Eastern products at international trade fairs both in the United States and in Japan there is ample evidence that little product research is undertaken. Changes in desires in the last twenty years — in fact, even in the last five years — have not been recognized. Not only do products continue to be predominantly imitations of American products, but also they are imitations of products which have not been purchased in large quantities for some period of time.

Only a modicum of research would quickly reveal the current consumer preference for products of other cultures. And such research would have disclosed the more important fact that there are no restrictive tariffs imposed on such products, for they do not compete with American production. Hence, exports of these derivatives of well-developed civilizations, produced by highly skilled craftsmen, would not only add immeasurably to foreign currency earnings but also would provide a maximum of employment for a skilled labor force.

An aspect of product design necessary for consumer acceptance is correct naming and packaging. Since a large part of total retail buying in the United States today is done on a "self-service" basis, packaging must be such as to attract the customer in the self-service store. Many hours and many dollars are spent even by small manufacturers in arriving at a "brand name" which will be acceptable and will stimulate purchasers to buy. Even more research is devoted to packaging. Only a few Far Eastern products are marketed with appealing brand names or contained in attractive packages. Commonly a plain paper or wooden box is used which detracts from the salability of the merchandise rather than adding to it.

Another important objective of marketing research is to establish a sound price policy. It is axiomatic to American manufacturers and sellers that product prices must be similar to those of competitors and discounts or allowances granted to middlemen must be in accordance with established practices. Of course, if a product is priced too high it will not sell. But more important, a commodity which is priced too low also will not sell, for a low price indicates to buyers that it is of poor quality, and American consumers no longer want low quality products. Moreover, and of particular significance to Far Eastern producers, an unduly low price for a product is considered by competitors to be prima-facie evidence of dumping with consequent pressure placed on the government for import restrictions. An outstanding example of this occurred not long ago in textiles. The Japanese textile industry produces large quantities of well made fabrics. As a result of failure to engage in research as to proper prices to charge in the American market, products were being sold at prices substantially below those of American manufacturers. Strong pressure for restrictions were exerted, and this pressure was temporarily alleviated only by the Japanese government imposing "voluntary" restrictions on exports. Had the Japanese textile industry undertaken marketing research to determine appropriate prices and established a sound price policy as a result of the findings of this research, there would have been no move for import restrictions.

Marketing research is further essential in determining ways of creating a desire for products. Desire for specific products is fundamentally created by advertising. Few Far Eastern exporters have discovered the essential need for advertising for marketing success; those which have engaged in advertising have paid little attention to appropriate appeals to stimulate demand. Commonly, advertising by Far Eastern producers has consisted merely of listing the company name and products produced. This differs widely from methods and techniques used in the United States. Furthermore, American techniques change rapidly as new ways of stimulating demand are discovered. Yet as far as can be determined no research is being conducted by Far Eastern firms to ascertain ways in which they can utilize advertising more effectively.

The foregoing paragraphs summarize merely a few ways in which marketing research can be of great value to producers and exporters from the Far East. There are many others which cannot be discussed here because of limitations on the length of this paper. However, these paragraphs will serve to point out that, though marketing research is absolutely essential, it is not being utilized to develop the all important American market.

Problems of Marketing Research — It may appear difficult for a business organization in the Far East to engage in analysis of the American market. The great majority are small and have available only limited financial resources. Moreover, few businessmen are experienced in marketing research methods. However, there are a number of ways in which it can be done even by small firms.

There are in existence in the United States a number of firms which specialize in marketing research for manufacturers and middlemen. They adjust their charges for their services depending upon the extent of the program desired. This may range from a few dollars to many thousand. Some of these firms maintain offices in the leading cities of the Far East and would welcome the opportunity of carrying out a project for a Far Eastern producer. Any enterprise seriously considering developing its sales in the United States can easily contact one of these specialist research organizations. Their names and addresses are available from many sources.

A more immediate method of utilizing the benefits of research is through seeking the advice and assistance of American sales outlets. They want to carry products which will sell, and will readily advise as to what must be done to make products salable. They will advise on kinds and styles of merchandise which are selling well including such things as appropriate packaging. But from information furnished the writer by a number of American organizations specializing in selling Far Eastern products, rather than seeking advice, many Far Eastern producers have been unwilling to accept suggestions forwarded to them. Recommendation for creation of new designs have been refused, proposals to share jointly the costs of advertising have been turned down, and suggestions as to the best market area in the United States in which to concentrate sales of products have been ignored.

A preliminary form of marketing research could be carried on at no expense. In every major city in the countries concerned there are American cultural centers. These centers maintain extensive libraries of periodic publications which show not only products currently in demand but also contain articles explaining successful marketing methods. For those desiring information on the techniques of marketing research, almost all have the latest textbooks on the subject. Moreover, in all the embassies and most consulates there are economic and commercial libraries which contain many highly useful reference volumes. For instance, one volume which the writer has found in almost all the libraries referred to is a United States Department of Commerce publication, *Market Research Sources*. And all have another extremely valuable publication by the Department of Commerce, *Selling the United States Market*. But it is interesting, though disturbing, to note that these cost-free sources of information are not being used by those to whom they would prove most useful. Inquiries made of a large number of businessmen not only in Japan but also in other countries have revealed that few had ever been in a cultural center or an embassy commercial library, and those who had visited these sources had done so for purposes other than engaging in research concerning marketing of products in the United States.

Until the need for marketing research by Far Eastern businessmen is recognized, and until some preliminary education is furnished as to simple, elementary ways in which research can be undertaken and utilized, the export potential of the Far Eastern nations to the United States will not be adequately developed. If and when it is recognized that continuous study is necessary concerning marketable products and methods of marketing products, a long step will have been taken to reduce existing serious dollar shortages and remove the necessity of drastic dollar exchange controls.

Product Distribution

Let us turn now to another problem of marketing Far Eastern products in the United States. This is the physical distribution of products. It is apparent from discussions with a large number of Far Eastern businessmen that a general belief exists that all that is necessary is to produce; and once the products are created buyers will come to purchase. As Peter Drucker ably pointed out in a recent article, one of the most common weaknesses of underdeveloped areas is a failure to provide for adequate marketing of products.[1] "Yet marketing occupies a critical role in respect to the development of . . . 'growth' areas. Indeed marketing is the most important 'multiplier' of such development." Even Japan, which is by far the most advanced of the Far Eastern nations, has not recognized the significance of providing appropriate means of physical distribution.

Domestic Channels of Distribution — One of the major shortcomings of producers in the area is continued reliance on traditional domestic channels of distribution. With few exceptions, exports are sold through "trading companies" rather than directly to importers. Though a few of the trading companies have modernized their methods slightly, conservatism and traditionalism continue to dominate their business activities. Study of their marketing policies indicates that they are reluctant to handle the sale of products other than those which sold readily in the nineteen-thirties and for which orders can be obtained without exerting any extensive sales effort. Moreover, rather than going out and promoting the sale of the products they tend to sit and wait for buyers to come to them. Until manufacturers abandon these

[1] "Marketing and Economic Development," *The Journal of Marketing*, XXII, No. 3 (January, 1958) 252-59.

tradition-bound organizations and directly promote sales in foreign countries, or until they can convince the trading companies to give up their traditional conservatism, their export potential will not be developed to the fullest.

Foreign Channels of Distribution — In the years since World War II many reliable foreign businessmen have visited the Far East to place orders and establish dependable channels of distribution. But unfortunately there have also been a large number of unreliable businessmen. They are what can only be called "carpet baggers." These latter businessmen have been interested only in making a quick profit for themselves without regard to the effect on the economies of the exporting countries or on the long run development of export potential. Most of these carpet baggers have not had established sales outlets in the United States and were basing their activities on an opportunity to make a quick profit by buying cheap and selling dear.

Businessmen in the Far East, unacquainted with fundamental marketing principles and unable to see the need for long range sound market development rather than merely making quick sales, commonly accepted the offers received without questioning the implications involved. As long as payment was tendered at the time an order was placed no questions were asked. They did not realize that such buyers should have been required to furnish financial references and other evidence of reliability as is normally provided by reliable American importers. Nor did they see that, rather than developing export trade, these unreliable importers were tending to destroy export potential through failure to establish sound channels of distribution.

Typically, Far Eastern exporters consider the United States as one market rather than a number of separate and distinct markets. Moreover, they do not analyze the relation of their productive capacity to the size of the market with the result that as demand develops they find they cannot fill orders received within time limits specified. When, as a result of delayed deliveries of promised quantities, orders are cancelled and importers refuse to engage in further business, they do not understand that the fault lies in poor selection of channels of distribution rather than in decline in market demand.

Striking in Far Eastern exporters' selection of channels of distribution is an almost universal insistence on selling through importers located only in the major eastern American cities, particularly New York and Chicago. With only a quick, superficial glance at population distribution and business organization they tend to believe these are the best outlets for their commodities. Consequently, there is a tendency to concentrate on establishing contact with buyers in those areas and to disregard other parts of the country. Actually, in many instances attempting to develop channels of distribution only through New York and Chicago is an extremely unwise policy. In the first place, should an undeveloped market exist in these areas for their products, it would probably be far in excess of productive capacity. But more important, by focusing in the eastern half of the United States they are competing with European producers, many of whom have far more experience in selling to the United States. Breaking into the market in the face of such competition is extremely difficult.

The Middle West and Far West remain largely an untapped market for Far Eastern products; yet it is a market which is potentially highly desirable and in which channels of distribution could be established easily. Because of the distance from Europe, producers in that area have tended to prefer to let the West remain a latent market, at least up to the present. Because of the geographical proximity of the western part of the United States to the Far East, substantial distribution cost savings could be effected. Moreover, as a result of closer cultural contacts with the Far East there has been a larger penetration of products of that area into the mode of living than has occurred in the eastern part of the United States. And Far Eastern products are better suited to the simplified, functional styles of Western homes and dress.

One final problem which stands out in foreign channels of distribution for Far Eastern products has been a tendency to insist on selling only through large national wholesalers or retailers. Inquiries received from small, though reliable, regional wholesalers located in cities in such states as Wisconsin and Minnesota are frequently ignored. Japanese producers and exporters in particular appear uninterested in developing sales outlets other than such large organizations as Macy's, Sears Roebuck, Woolworth's, or the Allied Mercantile Corporation. Yet these organizations are not suitable for developing the exports of those products having the greatest potential for a balanced economy. Local or regional wholesalers would be much more suitable for market development of fine quality products of the essentially handicraft processes.

Other Marketing Problems

In addition to inadequate marketing research and lack of attention to appropriate channels of distribution there are a number of other problems which tend to limit the market development possibilities for Far Eastern products. It is impossible to present all of them fully; but they should be mentioned at least briefly.

Quality Maintenance—Most domestic purchasing in Far Eastern countries is based on physical inspection of commodities offered for sale. Hence, variations in quality are permissible as they can be observed readily. As a result, far less emphasis is placed on quality control than in American production. One of the most frequently expressed difficulties in buying from Far Eastern sources has been the failure to secure products of uniform quality. In fact, some American marketing organizations now are reluctant to buy Far Eastern products because of previous unfavorable experiences. Far Eastern producers must be made to realize that, since American buyers usually order on the basis of specification or sample, quality control must be carefully observed.

Delivery — In Far Eastern markets there is much less variation in volume of sales throughout the year than is usual in the United States. Time of delivery is of less importance and marketing organizations are set up with the expectation of irregular delivery. American buyers place orders and specify delivery dates in anticipation of peak selling seasons; a failure to receive delivery by the time specified can prove quite disruptive. A number of importers have advised the writer that one reason they prefer to buy from European sources is that promised delivery dates are frequently ignored by Far Eastern sources, with commodities arriving some time after the selling season has passed. Considerable education is needed on the necessity to deliver at promised times and especially on the importance of not accepting orders unless it is certain that a specified delivery date can be met.

Guarantee and Servicing — It is relatively uncommon when buying commodities in Far Eastern markets to receive a guarantee or have the seller provide for servicing. Rather, a policy of *caveat emptor* still tends to persist. With a few notable exceptions, such as the guarantees and servicing facilities of the Canon and Nikon cameras, this policy carries over into exporting. But the American buyer knows that from time to time products of even the best production methods will have defects or need servicing. Unless confidence is established by furnishing guarantees, buyers will hesitate to place orders. Abandonment of *caveat* *emptor* in exporting will serve in large measure to build up confidence in Far Eastern products and stimulate increased purchasing by American importers.

Price Maintenance — In Japan at least, and it is believed in other Far Eastern countries, the one-price system is almost as universal as in the United States. Of course, "discounting" of prices is practiced as it is in the United States; but with few exceptions stores in Japan follow a one-price policy quite closely. Japanese sellers, having had experience with American tourists and the carpet bagger importers, seem to have come to believe that price negotiation is expected when doing business with the United States. Partly because of this and partly because of an inadequately developed system of cost accounting and cost controls, an initial price will be quoted which they believe to be the highest they might secure. If this price is not accepted, it will be lowered until a sale is made. They apparently do not realize that confidence will not be created by failing to adhere to a one-price system. Furthermore, Japanese business closely guards business secrets, especially prices paid for purchases. They apparently do not realize that much price information is exchanged in the United States between otherwise close competitors. When it is determined that sellers are quoting different prices to buyers in the same class, reliable American firms tend to lose confidence and hesitate to place orders. Reliable American businessmen can be a great help to the inexperienced Far Eastern exporter if they will do their utmost to educate their sources of supply on the adverse effects of entering into price bargaining.

Conclusions

Of all the aspects of business in the underdeveloped nations of the Far East marketing is perhaps the most underdeveloped. Yet with few exceptions, future economic development rests upon successful export marketing of their products. At the present time their export potential is being seriously limited because of problems created through lack of knowledge of modern marketing methods. Education in marketing cannot come overnight and is not easily acquired. Moreover, education will not develop until the need is clearly recognized.

Although adequate capital accumulation is an essential problem of all the countries, it is no greater a problem than adequate market development. But up to the present time attention of economists and other experts has been centered in discovering means for providing for capital accumulation. A shift in emphasis is now needed to place equal responsibility on developing efficient marketing methods. And as the United States is the most advanced nation of the world in development of marketing methods, the initiative must come from this source.

Initial steps in marketing education must come from American businessmen doing business with the Far Eastern countries. Suggestions for the direct solution of the problems discussed in the previous pages, including correction of existing disruptive or uneconomic practices, can easily be made. As the importance of marketing research, appropriate channels of distribution, quality controls, delivery, sound price policy and other aspects comes to be recognized strong stimulation will be provided for internal education by governmental agencies and educational institutions — education almost totally lacking at present.

Finally, as the benefits of improved marketing methods in exporting are observed, these same methods will come to be adopted in domestic marketing. At that time the marketing multiplier in economic development will begin to exert its full force and the countries of the Far East will experience an era of unprecedented economic advancement.

Economic growth and foreign trade of Asia

William E. Gordon

Associate Professor of Economics, Simpson College

POTENTIALS DISCERNIBLE IN 1920's

THERE WAS ALMOST universal dependence on agricultural production in all countries of Asia in the decade immediately preceding the first world war. Total needs for subsistence of the many were great. So were the demands for conspicuous consumption by the rest. Most processes of production were backward, as measured by standards in industrialized Western countries. Exceptions were to be found in some Japanese industries. In the larger countries, India and China, goods such as textiles, chinaware and jewelry, in the production of which more of artistic skill than technical or mechanical efficiency was required, had become well known in international trade.

The use of savings for investment for production of goods and services had not been widely institutionalized. This may be explained, in part, in terms of scarcity of money and a propensity to conserve savings. Many loans were secured by property or other tangible assets, but even so, interest rates for most purposes were very high. It is also true that demand for savings for investment was deficient, relative to needs of income.

Surprisingly, several of the countries were able to achieve an excess of the value of exports to the United States, Britain and other countries over the value of imports. However, the difference was not largely used to purchase capital goods. In nearly all of the countries harsh restriction of consumption of the one class and self-denial most objectionable to the other would have had to be imposed if savings were to increase at reasonable rates.

The shortage of vitally needed savings may be better explained in terms of tradition and culture than in economic terms. Inherited status in most Asian societies had precluded or severely narrowed possibilities for distinction by individual initiative and achievement, and most of the higher education had been of a philosophical character.[1]

There were other specific reasons why the contributions of Asia to world trade in this period consisted mainly of agricultural and unprocessed mineral products. There was no lack of mineral and potential power resources in Asia, taken as a region. In fact, the countries of the region are complementary in so far as availability of these resources is concerned. As reasons for the slow rates of economic growth we are to set down instead: *(a)* lack of skills, *(b)* shortage of capital, *(c)* traditions which emphasized community solidarity and well-being more than individual initiative and achievement, *(d)* colonialism, which required accelerated production of some goods for export without processing or with only the preliminary stages done, and *(e)* a sense of sufficiency.

Three examples drawn from widely separated areas of Asia may be given in some detail: Australia, Indonesia and India. It will be shown that relatively late or limited development or underdevelopment in each of these countries has been due to one or more of these causes.

Australia: About 70 per cent of Australia's exports between 1900 and 1914 consisted of wheat, wool and metals. The country was dependent on imports for most manufactures. Home factory production was limited largely to woolen textiles, clothing and foodstuffs. The war of 1914-1918 was to prove that this dependence, mainly on Britain, was not inevitable. But the industrial activities of Australia during the war also proved that a country which industrializes prematurely may attain to an apparently significant position in international trade only to have it wrested away by competitors.[2] Trade diversion results and countries which had participated in promoting the premature growth may lose much of their gains.

In the immediate prewar era Australia had a sufficient proportion

[1] Maurice Zinkin, *Development for Free Asia* (London: Chatto & Windus, 1956), pp. 6-7, 179, 207.

[2] Kate L. Mitchell, *Industrialization of the Western Pacific* (New York: Institute of Pacific Relations), pp. 241-42.

of the prerequisites for industrialization, but lacked some essential skills, and also drive. But under pressure of sheer need, due to isolation, manufacturing was accelerated. By 1920 the value of manufactured goods produced in a year had increased from £63.3 million to £81.4 million. But more important than this was the fact that heavy industry had been fairly established. From 1921 until the depression after the first world war manufacturing processes made the largest contribution to the value of production.

However, the hastily established wartime industries were unable to compete, even in the home market, with reviving British and foreign export industries, and as early as 1921 the government resorted to tariff protection which was extended to a wider range of industries in the late 1920's. Moreover, high cost of industrial production, a consequence of mushroom growth, required Australia to practice price discrimination in favor of external markets, if the country was to establish an export trade in manufactures. There appears to be no evidence, however, that this was practiced as policy, but the export trade in manufactures was negligible at the end of the 1920's. The largest single group of items was raw materials and pastoral goods.[3] The beginning of industrialization in textiles and metals was not an initial failure. It is clearly evident that the setback which Australia suffered was due to insufficiency of skills.

Indonesia: The Dutch had established a "culture system" in this group of colonies as far back as 1830-1870. A land revenue was exacted in the form of export crops, and additional quantities of these crops were purchased by the government at prices calculated to bring large profits when the goods were resold. The only other form of production encouraged under this, the Van den Bosch Plan, was subsistence crops. The plan worked so well that the Dutch treasury, enriched by the revenue from land, had difficulty in finding ways of increasing its expenditure on the same scale. The Dutch, at home, were not a very enterprising people and seemed to lack the initiative necessary to use effectively all the new revenue obtained from sale in Holland of the crops collected as tax and the quantities purchased at government prices. So the plan conceived by Joannes Van den Bosch under pressure from William I to get more profit out of the East Indies re-

[3] *Ibid.*, pp. 242-43.

sulted, in conspicuous part, in the famous Treasury surpluses, which were rather embarrassing.

The plan was ill-conceived. Importation of the cheap agricultural products, of which coffee was the most sought after, could have resulted in reduction of Dutch cost of living and consequently production costs, if there were a wide variety of these products or if they included some of the main articles of consumption or raw materials for production. Coffee could not make much of a contribution of this character.[4] But more important still was the fact that apart from shipping, in which the Dutch were unusually competent, they were not establishing many industries that seemed destined to occupy any significant competitive place in world markets. Holland has grown up mainly as an efficient agricultural country, with some manufacturing industries, using farm products.

The peculiar form of prosperity generated by government enterprise in Indonesia actuated Dutch businessmen to claim a major role. At the same time a change in organization of production was socially desirable, for the prosperity which was enjoyed in the colony was not shared by the growers of the crops compulsorily produced. Thus, a "Liberal System" was instituted which allowed private enterprise to acquire plantations formerly managed by the government. A conflict then arose between planting and manufacturing interests. The planters could gain by paying low wages and exporting the products, but the manufacturers, particularly of cotton goods, were interested primarily in markets, which, it was held, could be expanded by increase in wages. Hence, chambers of commerce emphasized welfare, which became the economic objective of an "ethical policy" which succeeded the liberal policy. Thus at the beginning of this century development by modern means was avowed as essential policy for promotion of welfare, which became mixed with ethics.[5]

Nevertheless the Dutch government's interest in developing modern industries, or even in improving handicrafts, flagged, up to the end of the 1920's. Netherlands India was still to be preserved as market for Dutch manufactures. What capital investment there was in the

[4] J. S. Furnivall, "Colonial Policy and Practice," and A. M. Joekes, "Developments in the Administration of Indonesia," in *Colonial Administration by European Powers* (London: Royal Institute of International Affairs, 1946), pp. 21-23, 220-23.

[5] *Ibid.*, pp. 223-26.

1920's was shared by several foreign countries, the largest investments being those of Holland, Britain and the United States, in that order. More than half of the external capital was invested in agriculture and most of the rest in transportation, extractive industries and banking.

The main products were sugar, rubber, tea, coffee, oil palms, tobacco, cinchona and coconuts. It was an unbalanced economy, based on foreign needs of raw materials and a few other products. While dependence on exports was great there was not a sufficient variety of goods exported for substantial competition in foreign markets when the prices of some declined. Thus Netherlands India's economy became very vulnerable to fluctuations in world prices. Even Dutch government officials were gravely concerned about its unstable character.[6] Inevitably, in the world depression of the early 1930's the value of Indonesian exports fell very low, by as much as 67 per cent, while their volume declined by 17 per cent. This meant, in effect, that a very unfavorable change in the terms of trade had taken place.

The trade of Netherlands India need not have come to this pass. Its people, particularly the Javanese, are industrious. The soil and climate are most favorable to tropical agriculture. There was a very considerable export trade in sugar with India while the United States imported $2,500,000 worth of kapok annually. Indonesia was third in the world as an exporter of tea, the world's most important source of quinine, the major tobacco-producing area in the East Indies, and the chief producer of rubber. To these palm oil may be added, as a growing industry, in the 1920's.[7] The United States also imported rubber, copra, tapioca and spices.

But manufacturing industries had not achieved much more than to supply the home market with basic needs, except in the production of hats. Bergsmark makes the paucity of mineral resources a sufficient condition for minimizing the prospects of industrial growth. This could be true of any country in the short run. Thereafter the development of skills and the rate of increase in productivity may become the decisive factors, as they have been in Japan. The Japanese home market is now approximately the same as Indonesia's, in terms of population although not of income. Agricultural productivity is in the main greater,

[6] Mitchell, *op. cit.*, pp. 197-200.

[7] Daniel R. Bergsmark, *Economic Geography of Asia* (New York: Prentice Hall, Inc., 1935), pp. 306-07, 314-18.

but there is greater diversity of substantial crops in Indonesia. And as an industrialized country Japan is very deficient in minerals.

India: The potentials of India, which were clearly discernible in the 1920's, are little realized even today. It was amply evident that India was not a country whose well-being depended only on agricultural improvement and only negligible industrial activities. This had been its type of economy so long, under colonialism, that it was widely assumed that the country could have no other. Actually the potentials for industrial growth, as could be seen in the 1920's, were impressive:

a) The cultivated land of India was approximately nineteen times that of Australia. This was less than proportionate, but Australia was able to export more agricultural products than India. The country's 300,000,000 acres of arable land made it, potentially, a leading agricultural country, but only in some fields did performance justify its place among leaders. Toward the end of the 1920's India was the world's second largest producer of cotton and sugar cane and was producing 95 per cent of the jute entering international commerce. It was among the largest producers of tea, grain, sorghums, flax, rice, barley and corn, and fifth largest producer of wheat.[8]

b) India's industrial possibilities in the 1920's could have been seen in the variety and quantities of mineral resources, the large proportion of raw materials in this country's exports, and the population of 350,000,000, which could become the second largest market in Asia.

In Bergsmark's work, published in 1935, India was credited with possession of "the materials that go to build up commerce." He was satisfied that "the products of the geographical regions are sufficiently varied to encourage domestic trade," and there was excess for export. A comprehensive picture of industrial activities is presented. The number of workers in manufacturing industries in the late 1920's and early 1930's was about three times the number so engaged in the British Isles. There were artistic tastes of a high order, but industry generally was at the workshop stage.[9]

Works of a less geographical character than Bergsmark's, and of more economic and social interest, show the possibilities of development more fully. They note, for example, that mineral resources include superior quality iron ore equal to three-fourths of the reserves in the United States, large deposits of manganese, bauxite, chromite,

[8] *Ibid.*, pp. 172, 186, 196.

[9] *Ibid.*, pp. 240, 227-30.

mica, copper, coal and other minerals. India also possesses sources of hydro electric power second only to those of the United States. Largely because of these resources and a heritage of skilled craftsmanship, one of the later writers, Kate Mitchell, reached the conclusion that India was, potentially, "one of the most powerful industrial areas of the world."[10] This was much the same as Hubbard's evaluation four years earlier.[11]

Why, then, was India's industrial progress so slow? The answers seem obvious: lack of capital was noted earlier as a disadvantage in Asia as a whole, insufficient variety of skills, a capacity to endure privation, and, most important of all, colonialism. Lack of skills, and capital are not very satisfactory explanations, for an Indian iron and steel industry was started as early as 1911, and we have seen that arts and crafts had been developed, although large-scale production was not typical. The slow rate of progress from the cottage and workshop to the modern factory has been due largely to colonialism.

Before India became a British colony there was a widely distributed handicraft industry which, with agriculture, provided modest living standards. Colonialism severely disturbed this without improving it, until wartime needs made improvement imperative but for reasons other than Indian needs. Instead of importing surplus raw materials from India and investing there in more efficient production of them and selling manufactured goods to workers engaged in such production, which could have been temporarily viable, Britain enforced almost free entry of her manufactured goods, raised high British tariffs against Indian products and restricted Indian trade with other countries. An outstanding example of the change in the character of India's foreign trade was cotton. India had exported cotton goods to the world for centuries but became an importer of 25 per cent of British cotton exports.[12]

The British economic policy was probably more successful than could be hoped for. Many handicraft skills were lost to India. This vital part of the country's economy was virtually destroyed in some areas and no manufacturing industries were established which replaced the craftsmen by workers with factory skills. Thus India's production

[10] Mitchell, *op. cit.*, pp. 275-77.

[11] G. E. Hubbard, *Eastern Industrialization and its Effect on the West* (Oxford University Press, 1938), p. 304.

[12] Mitchell, *op. cit.*, pp. 279-80.

in some areas became one-sided and the economy resembled that of Netherlands India, but more needlessly unbalanced. The policy not only impoverished the country, thus making it a lesser market for British manufactures, but also created the delusion that India must always be in the main a producer of food and raw materials. That misconception still exists.

It has been mentioned that British wartime needs in the East in 1914-1918 brought a change of policy in favor of Indian industrial development, but imperial tariff preference which became the dominant colonial policy from the late 1920's was unfavorable to this change. This well-known policy, which culminated in the protective decisions reached at the Imperial Economic Conference held in Ottawa in 1932, required India, as other colonies, to give tariff preference to British manufactures in exchange for British preference given to Indian raw materials. Thus was India's dependence on raw materials again emphasized, while Indian manufacturing industries, such as they were, had to compete with British industries at technical disadvantages.

It was obvious that the British policy was directed to the most advantageous competition possible, with Indian and foreign industries in the Indian market, when the depression set in. This was part of an empire-wide effort to secure a larger part of a smaller world trade. It was impossible of success. The prices of many Indian products fell very low, so that exports to India could be increased only if British prices were reduced.

Ceylon: Separation of Ceylon from India, as a region, does not seem to be fully justified, but there was little choice if India was to be kept distinct. Ceylon had gained a place in international markets mainly by exporting rubber, tea, graphite (which declined in competition), coconut products, cinnamon and citronella oil. As a British colony it did not find a market for most of its exports in Britain. The United States was a large buyer of Ceylonese rubber and tea.

Siam: Of this country's products which were traded internationally, teak was very important to Europe as a rot-resisting timber; rice was an important source of wealth, largely as an export to other Asiatic countries. Tin and rubber also entered international trade. Manufacturing had hardly begun, in the 1920's. Trading interest in the United States was small.

Malaya: Until quite recently a British colony, this country is well known as a major source of rubber and tin. The United States had become the largest importer, mainly of rubber. The consequences of expansion of production of synthetic rubber to rubber-producing countries were probably greater in the case of Malaya than in that of Indonesia or Ceylon. A partial analysis of this is given in a later section.

French Indochina: This country was an exporter of rice in the 1920's, and, of lesser importance, coal and rubber. As in Siam and Malaya, the prospects for manufacturing seemed to be almost entirely prospects for establishment of light industries.

Philippines: These islands, too, had essentially an agricultural economy in the 1920's, but as a colony of the United States they had made more progress than European colonies in Asia. Although there was restriction of trade, the United States, as the metropolitan country, took most of the exports and the Philippines were thus able to consistently achieve an excess of the value of exports over the value of imports. The exports were mainly such agricultural products as sugar, hemp, coconuts, coconut oil, tobacco and timber. There was mutual tariff preference, but the preference could hardly have had serious adverse effects, for the Philippines were thus assured of a very large market and the United States was the most efficient producer of many of their imports. Thus prices in the United States, of both Philippine exports and imports, remained the main determinants of the terms of trade.

The islands were better endowed with the material prerequisites for manufacturing industry than most if not all of the countries in this region of Asia. Typical industries were homecrafts, such as needlework, and some factories processing agricultural products. The Philippines possessed iron ore, but the quantities had not yet been established. Sources of water power existed.

Japan: The story of dependence on agriculture in the 1920's could be repeated here. The two most important items in the external commodity trade of this country were raw silk, for which the United States was the best market, and raw cotton, for which Japan was one of the best markets of the United States. But Japan had begun to make active use of the resources it had for industrial development, and by the end of the 'twenties there was a significant increase in exports of manufactured goods and imports of raw materials.

The most valuable resources were coal, copper, and sources of hydro-electric power. In addition, climatic conditions were favorable to the production of raw silk. But there were some deficiencies which were serious disadvantages. The first of these, in order of indispensability, was the supply of iron ore.

Industrial growth started with a double dependence on foreign countries: for metals which were most essential, and for markets. The latter is always to be expected when a country industrializes faster than its population acquires new tastes. The dependence was somewhat offset by three advantages: (1) production at home, by intensive cultivation, of about 90 per cent of the food consumed, (2) a large labor force which could be quickly trained, and (3) active government aid to and support of industry.[13] It is also to be observed that the textile industry, in which Japan was gaining most of her industrial successes, required less steel than other industries which were less important then.

Exports other than raw silk were tea, paper, camphor, menthol and fish products.

Industrialization in Japan was accomplished under more government control than is generally known. This began with the rise of the Meiji after 1868. Government ownership included railways, postal, telegraph and telephone services, dockyards, clothing factories, and monopolies of tobacco, camphor and salt. Moreover, extensive control of industrial financing was instituted. This was done by giving government financial support to twenty-five special banks, which enabled the government to appoint personnel and control policy, including determination of priorities.

The beginnings of industrial competition within Asia could be seen in the 1920's, even though there was little variety in industrial production there, outside of Japan. China was both market for, and a competitor of Japan, in the production of raw silk; and India, a large source of raw cotton, showed evidence of becoming an equally strong competitor of Japan in the production of cotton textiles. With increased industrialization in both India and China it could be foreseen that the rising prominence of Japan in the silk and cotton industries would be effectively challenged.

It was also evident that Japan was fast becoming a serious competitor of both Britain and the United States in the export of cotton-piece goods. The Japanese exports of this commodity rose to 2.8 times the United States exports and 40 per cent of the exports of Britain.[14]

[13] Bergsmark, *op. cit.,* pp. 413-15.
[14] *Ibid.,* pp. 415, 419, 431.

In fact Japanese sales of cotton-piece goods increased to such an extent that it was decided to exclude them at the Imperial Economic Conference held in Ottawa in 1932. Tariffs and quotas were later used for this purpose in British colonies although the measures also applied to United States cotton goods, in some colonies, as part of the total foreign supply. The measures failed because the Japanese gained in world markets as a whole.[15]

Formosa: Formerly Chinese, this island was captured by the Japanese in 1894 and made a colony of the typical European model of the eighteenth-nineteenth century. By 1929, Japanese capital virtually monopolized all industry and mining, and averaged about 50 per cent of all investments in agriculture, commerce, communications and fisheries. Most of the Chinese, who constituted 94 per cent of the population, had to earn their living by work in mines and factories. This was a consequence of monopoly in industry and active government support of monopoly in Japan. Japan made the country a source of raw materials and food, largely rice and sugar. Other exports of Formosa were tea, bananas, camphor, coal and ores.

Formosa's trade with Japan increased rapidly, and the sugar production demanded by Japan made the Japanese self-sufficient in this product. This was accomplished by means of subsidy and tariff[16] so that the sugar trade did not result in all the gains which were possible from it, through competition, for the countries in the area which had obtained the best results.

The Japanese, in adopting the well-known European colonial policy of obtaining raw materials and foodstuffs from colonies by the cheapest means possible, discriminated, in effect, against Indonesian sugar which was obtainable at half the price of the sugar produced in and imported from Formosa. Thus the self-sufficiency was achieved at the expense of the Chinese workers in Formosa and the Japanese consumers.

The large increase in sugar production in Formosa, so that it might be sold in Japan at artificially high prices, was unfavorable to world trade in sugar, for toward the end of the nineteenth century world sugar production was already becoming excessive.

[15] Japanese exports had increased by 326 million square yards by 1938, while British exports had declined by 615 million square yards. See F. V. Meyer, *Britain's Colonies in World Trade* (Oxford: 1948), p. 84.

[16] Mitchell, *op. cit.*, pp. 49, 50, 55.

Korea: Japan made a colony of Korea, too, in 1910, and ordered production there so as to conform to the same policy that was applied to Formosa. At first the country was a large exporter of rice to Japan. It became one of the largest suppliers, and rice was its principal export. Others were iron ore, soy beans and raw silk, which became an important Korean industry in the 1920's. Its imports were typically those of a colony. Its external trade was monopolized by Japan.

There was, however, a significant difference. Industrial growth was permitted because this was expedient for Japanese imperial plans in China and in Korea itself, and Korea's proximity to China and its power resources, textile skills and some achievements in the textile industry were favorable conditions. It seems that the plan had a two-fold objective: first, to accelerate extractive production in Korea for the purposes of light industries there and in China, and secondly, for use of heavy Japanese industries at home. There seems to be difference of judgment as to the stage to which such a plan was carried by the Japanese. Thus Hubbard, in discussing the industrial future of Japan gives it no space, while Kate Mitchell emphasizes it.[17]

Japanese industrial control in Korea was not dissimilar to their control in Formosa. In the 1920's, Korean capital investments were already giving way in remarkable degree to Japanese capital in a wide range of Korean industries. With freedom in Korea and administrative change in Formosa, Japan has had to face a large decrease in its measure of self-sufficiency. The Japanese seem to have realized since that they had little choice in industrial planning, in so far as foreign markets were concerned. It was evident in the 1940's that they were unlikely to enjoy the same rate of increase in world textile markets that they had in the late 1930's. As far as Asian markets were concerned, two directions for progress appeared to remain: (1) supply of capital goods to newly industrializing countries in Asia, and (2) diversification of manufacturing industries so as to increase exports to these countries. In both, increasing competition with the United States and Europe was inevitable.

II

PERIOD 1930-1949: PAINS OF GROWTH AND DIRECTIONS OF CHANGE

Resources and Uses

Several countries of Asia faced a difficult problem of allocation

[17] Hubbard, *op. cit.*, ch. III; and Mitchell, *op. cit.*, p. 58.

of resources, toward the end of the 1940's, when outputs of food and other agricultural products varied from 86 to 94 per cent of prewar production. There are several explanations: (1) China had not recovered from the ravages of war and there were floods and other causes which slowed the rates of production; (2) because of wartime impositions and expediencies, India, Indonesia, Japan and Pakistan were able to produce only prewar quantities of coarse grains; (3) Indonesia and the Philippines, for similar reasons, produced much less than prewar quantities of sugar.[18]

The consequent shortage of food caused priority to be given to investments in irrigation. This enforced use of resources of itself delayed progress in industrial production of goods traded internationally.

The following is a summary of the mineral resources and their uses, in the countries in which they were found in significant quantities. It is to be observed that in 1949 geological surveys had not been completed in some of the countries:

Coal: China, India and Indochina (in this order of importance). China's reserves were estimated to be second only to those of the United States. Coal had been found in several other countries of Asia, but most of it is of low grade. In India, about 5,000,000 tons p.a. and in Indochina an unspecified quantity are used for other than metallurgical purposes.

Petroleum: In Indonesia (including North Borneo, Brunei and Sarawak), production in 1949 exceeded the prewar rate and justified at least consideration of plans to build a large modern refinery.

In Burma (including Assam and Thailand) it was not yet possible to resume commercial production. Estimates could not be made with reasonable accuracy.

Pakistan: in moderate quantities.

China: the United Nations' Survey included the following statement: Northwest China might become "one of the most important oil-bearing zones of the world."

Oil Shale: China was the first of Asian countries to produce oil from shale. It was estimated in 1949 that the reserves of oil in this form were 521,000,000 tons. A plant had been constructed for the production of 70,000 tons per annum, and

[18] United Nations, *Economic Survey of Asia and the Far East, 1949*, pp. 3, 5-6.

there were by-products of ammonium sulphate, crude paraffin and coke.

Oil shale was also found in Burma and India, possibly in commercial quantities.

Iron Ore: It was estimated that the iron ore deposits in Asia were 10,000 million tons, of which China and India possessed two-thirds. China had reserves estimated at 4,179 million tons, including 103 million tons of high grade ore. This excluded 10 million tons in Taiwan (Formosa). India's ore was reported to include numerous high-grade hematitic bodies.

The Philippines: 21 million tons hematitic and magnetic ores and 1,000 million tons of laterite.

Malaya exported as much as 2 million tons per annum before World War II. One deposit was estimated at 30 million tons.

Indochina had planned to produce 400,000 tons per annum.

North Korea was far better supplied than South Korea, but estimates did not appear to be satisfactory.

Burma had several deposits but it was not clear that their quality or even quantity had been satisfactorily estimated.

Ceylon had some deposits, which had not been estimated.

Japan was very deficient.

Manganese: India: about 29 million tons, of which large quantities had been exported to Japan, which was deficient.

Philippines, Indochina, Thailand, Burma, Malaya and Indonesia also had deposits.

Molybdenum: China had the largest known reserves in Asia, about eight million tons.

Nickel: Large deposits had been found in Indonesia, and there were some deposits in the Philippines. It was reported that in both countries, taken together, millions of tons of laterite ore existed which contained 0.7 per cent of nickel.

Titanium: Ilmenite is the "chief ore" of titanium. It is used in the manufacture of alloy steel and high-grade paints. India was one of the largest producers in 1949. The total reserves of India, Ceylon and Japan were estimated at 250 to 300 million tons.

Tungsten: China was the most important producer in the world and in Asia, and the Soviet Union was China's principal market. Other producers and exporters were Burma, Malaya, Indochina, Thailand and Korea.

Vanadium: There were substantial deposits in India and other countries of Asia. Japan was deficient.

Source: summarized from United Nations' report cited, pp. 332-50.

Asia is rich in nonferrous metals too:

Antimony: China was the world's largest producer since 1920. Japan's small reserves were nearly exhausted at the end of the 1940's. There were then some deposits in Thailand and Indochina.

Copper: This and zinc were the only minerals of which Japan was one of the major producers in 1949. The Japanese reserves were estimated at 2,750,000 metric tons. Other producers were the Philippines, India, Korea, Burma and China. The resources of India and China were not being exploited on a large scale.

Lead and Zinc: Burma led in the production of lead and Japan in zinc. China was a small producer of both. Indochina was a large producer of zinc and Thailand a considerable producer of lead. Indian reserves were reported to be small, but further surveys seemed necessary.

Tin: Most of the world's reserves of tin had been found in Asia, mainly in Malaya, Indonesia, Thailand, China, Burma and Indochina. Malaya was the world's largest producer. Japan, a large consumer, had small deposits.

This study was not intended to include all nonmetallic minerals, yet it may be added that with the exception of sulphur, commercial quantities of nearly all of them were to be found in Asia in the late 1940's, and the larger quantities of most of them were reported in India and China.

The minerals listed here include nearly all the more important minerals traded internationally, as listed by the League of Nations.[19] Some valuable minerals found in Asia, such as manganese, were not included in the League's list as being among the 23 most important products in world commodity trade. When two important nonmineral products of Asia, cotton and tea, are added, 12 of the 23 are found to have been listed. Asia's share of the exports of some of them was

[19] See *Network of World Trade*, p. 30.

not large, and the quantities produced in each of the countries of the world, whether Asian or not, were not separately listed.

Evidence of Industrialization

It must have been realized in reading Section I that in the 1920's the United States' share of Asia's foreign trade was less than it would have been but for colonial connections of European countries, and possibly more than it might have been without the United States' colonial connection with the Philippines. In the period to be studied in Section III, 1951-1956, some changes in the direction of the external trade of Asiatic countries are to be expected, as results of emergence of several of the countries from a colonial status, and for other reasons such as financing by the United States. We may therefore fruitfully examine some evidence of these changes in the immediate postwar period.

The table below shows changes in production in major industries between 1938 and 1949. They are to be considered with due reference to difficulties and disadvantages already mentioned.

Major Industrial and Mineral Production in ECAFE Countries, 1938 and 1949

(Thousands of Metric Tons)

			Relative Change: 1938=100	
Product	*1938*	*1949*	*Japan Excluded*	*Japan Included*
Coal	70,294	50,396	72	79
Electricity (million KWH)	2,710	5,550	205	151
Tin Concentrate	103	100	97	97*
Iron Ore	7,717	3,193	41	48
Pig Iron	1,572	1,572	100	87
Steel Ingots and Castings	984	1,380	140	72
Cement	1,952	2,615	134	78
Cotton Yarn ..	985	817	83	59
Sulphuric Acid		95	....	....

* Japan's production of tin concentrate was negligible.

Source: United Nations, *Economic Survey of Asia and the Far East,* 1949, p. 22.

Changes in production usually precede or occur simultaneously with major changes in the direction of trade. Therefore, due attention is to be directed to the former, in the late 1940's, when Asian countries were endeavoring to reconstruct their economies. Because of the emphasis on the ECAFE countries, in the most reliable sources of information, and as these countries include those which will be most important, industrially, in the future, we shall be concerned mainly with this group: India, China, Indochina, South Korea, Indonesia, Malaya, Pakistan and the Philippines. Data on production in Japan will be used mostly for purposes of comparison because its greater progress has placed that country in a separate category.

Some reasons for the slow progress shown have already been given in this Section, and we are to be mindful also of the five reasons given in Section I. For further comparison with Japan, with due allowance for the circumstances of that country then, it may be mentioned that industrial activity in Japan, as shown by the Index, was 94 in 1949. The base period used was 1932-1936.

Some of the changes shown might have been reflections of alternative growth. For example, the decline in coal production might have been due to the increased use of electrical power in India, Pakistan, the Philippines and Thailand.

It is also necessary to consider the number of these basic products in the output of which each country, with a substantial potential internal market for consumer goods, achieved a significant increase:

a) China accomplished this in the production of four of these nine basic products: coal, tin concentrate, iron ore and cotton yarn.
b) India's ratio was seven of the nine: coal, electricity, iron ore, pig iron, crude steel, cement and cotton.
c) Pakistan had a ratio of two to nine: coal and electricity.
d) Indonesia, also two: coal and tin.
e) The Philippines, four: coal, electricity, iron ore and cement.

These ratios will assume more significance later, and perhaps most in Section III. However, it may be observed here that, with the possible exception of the Philippines, the countries which had the larger ratios were the ones which will be shown, in a subsequent period, to have accomplished most in industrialization.

As some of these basic products are used to produce machines, and forecasts or estimates of future trade with other regions must be potential internal markets; and *(b)* the ability of these countries to obtain foreign exchange with which to import capital goods, with some reference to the ability of other countries in the area which are differently endowed and which adopted different trade policies in the immediate postwar period.

The main factors seem to be: (I) absorptive capacity for their products in the countries producing capital goods, world competition in supplying them, and prices; (II) variety of exports; (III) sufficiency of production for internal markets; and (IV) total assets possessed.

Of the five countries selected, China has to be excluded again for lack of information. This makes for unreality, because of the large and varied mineral resources, very large potential internal market, and the beginnings of industrial production, notably textiles, iron ore and pig iron, steel ingots and heavy chemicals. Also, China had established considerable trade with some ECAFE countries: Burma, Hong Kong and Thailand.

India's deficit of $526 million was due mainly to decline in the rate of production of jute, which was not offset by increase in exports of cotton and cotton textiles. In less degree it was due to a decrease in demand in the United States. Another important cause was increase in imports of capital goods. It seems, therefore, that factors (I) and (IV) were the most effective for the purpose of obtaining foreign currency with which to import capital goods.

India's deficit may be compared with the surplus of $103 million achieved by Burma, which is not one of the selected countries. First, the Burmese surplus was of a negative character. It appeared as a result of a people's decision to live within their income, in so far as imports of manufactures were concerned, rather than to seek to develop with any sense of urgency, viz. by obtaining loans to purchase capital goods. It is to be noted, however, that Burma's exports had declined by $39 million from the total for 1948. Also, imports of its main export, rice, into the United States, had been decreasing since 1935-1938. None was imported into this country in 1948-1957, and European imports were greatly reduced in the same period. Then petroleum products, which were second in order of value of Burma's exports, could be sold in international markets only very competitively.

Burma was still a typical exporter of raw products. Its supply of iron ore was still doubtful. It possessed some tungsten, copper and tin, but of the minerals listed in this Section, Burma was a large producer of lead only, and it had only one other relatively minor export, cotton. Yet Burma would have had to depend mainly on factor (IV) to raise foreign loans.

There being no other large surplus with which to compare deficits of any of the selected countries, we proceed with the discussion of Pakistan, Indonesia and the Philippines.

Pakistan's deficit of $158 million was a result of an almost constant value of exports in 1948 and 1949, and a very large increase in imports in the latter year, including capital goods. The decline in jute production has already been noticed. Raw jute was Pakistan's second most important export, and India was practically the whole market. Therefore, the decline in India's exports of processed jute could have meant even greater adversity to Pakistan than to India. Imports of raw jute into Europe decreased greatly in 1935-1938 and 1948-1951, while imports into the United States increased only slightly. And imports of processed jute into both Europe and the United States declined in the same period. Pakistan's only export of comparable value, raw cotton, had no market in the United States. And the European market, in quantity terms, was incomparably larger in 1928 than in 1948-1951. As cotton is sold very competitively in international markets, Pakistan could hardly depend on this crop to earn a large part of its foreign currency, when world production was rising again in the late forties and early fifties.

Therefore, dependence on factor (I) was greatest in so far as export of jute was concerned, and dependence on (IV) was considerable.

Indonesia's export surplus of $27 million in 1949 was remarkable. It was a change from a deficit of $36 million in 1948. Of its seven more valuable exports, petroleum, which was the first in 1938, as a percentage of total exports, and second in 1950, was not listed by the United Nations as having a market in the United States or in Europe. Rubber, the second in 1938 and first in 1950, found a rising market in both the United States and Europe, but it had to be sold in competition with rubber from several other countries of Asia, especially Malaya. This country's other important exports, copra and palm oil, tea, sugar, tobacco and tin, also were sold competitively. In the importing countries there were shortages in the supplies of rubber and tin but it is unlikely that eager buying produced any very favorable price effects. The shortages were explained by the United States Department of Commerce as relative to potential rather than to actual demand.[20]

The explanation given by the United Nations was that Indonesian output of petroleum, vegetable oils, rubber and tin increased rapidly and there was a "slackening of United States demand,"[21] a situation in which there could have been competition among sellers.

At the end of the 1940's, then, Indonesia could depend on factors (IV) and (II) and, in lesser degree, on factor (I) for purchase of capital goods.

The Philippines' large deficit of $416 million had become characteristic of its external trade. This is to be explained with reference to its trade relations with the United States. Sugar, which was 43 per cent of total exports in 1938 was only 15 per cent in 1950. The percentage of copra and coconut oil, however, had risen from 23 to 54 per cent. Abaca, the only other principal export, had increased from 9 to 12 per cent.

Reserves of iron ore, manganese, nickel and copper had been found, but as the main imports of the United States from the Philippines did not include these, they could not be regarded as immediate means of obtaining capital goods. However, as Japan is deficient in practically all minerals except copper, the Philippines could obtain Japanese capital goods by export of some of these products.

The United States could be expected to sustain a large Philippine deficit indefinitely for reasons of defense, but on economic grounds alone reliance on factor (I) would be doubtful, for purposes of earning foreign currency, largely on account of world overproduction of sugar and United States investments in sugar at home and in Cuba. The three other factors were not much more dependable.

Japan has to be placed in a separate category, as a matured industrial country. Its deficit of $355 million and paucity of material resources were not light disadvantages, but the country possessed numerous industrial skills and already had achieved a wide diversity in manufacturing. In the period studied in this Section, Japan had already established large foreign markets and was able to obtain materials from several foreign sources, including large supplies of raw cotton from the United States.

20 *Survey of Current Business,* (March, 1948), p. 21.
21 *Ibid.,* p. 21.

Ratios of Asia's Trade to World Trade

The absolute changes in the total annual values of Asia's foreign trade appear to be more reliable information than the ratios of these values to values of world trade, for the largest ratios have appeared when the totals of world trade were smallest, in 1928 and 1938. This is particularly true of exports, in the period of this Section. In the case of imports, the ratios for 1949 and 1951 are comparable with those for 1928 and 1938. The following table shows these relationships:

Trade of Countries of Asia and the Far East in Relation to World Trade

(Billions of Current Dollars 1953)

	1928	1938	1949	1950	1951	1952
World Imports	33.6	22.9	59.2	58.9	80.8	79.9
Asian Imports	4.6	2.8	7.3	6.2	9.9	9.6
Percentage	13.7	12.2	12.3	10.6	12.2	12.0
World Exports	30.8	20.5	54.3	56.1	75.9	71.9
Asian Exports	4.8	3.0	5.4	6.8	9.7	7.4
Percentage	15.4	15.0	9.9	12.1	12.8	10.3

Source: United Nations, *A Study of Trade between Asia and Europe*, 1953, p. 1.

To attempt to show all the causes of fluctuations in the ratios and in the totals would be a fruitless effort. Explanation of the failure of Asia to maintain its ratios of world trade as trade increased, after 1949, has already been furnished in part, in terms of rates of recovery from the effects of war, and so on. To these must be added the competition of other regions in external markets for Asian exports, in Europe, the United States and in Asia itself.

So much for generalization. A study of trade in the principal commodities exported should yield specific evidence. For this purpose the table below should be helpful. In its compilation, the trade records of British Borneo were included with those of ECAFE countries already mentioned: Burma, Ceylon, India, Pakistan, Indonesia, Indochina, Malaya, Philippines and Thailand.

The United Nations estimated exports of these products as approximately 80 per cent of the total exports of the ten countries in 1938, 1950 and 1951, and placed them in the following order of importance: rubber, jute and jute products, fats and oils, tea, rice, cotton and cotton products, tin, metal and other concentrates, petroleum and derivatives, tobacco and pepper. Thus it can be seen that the principal exports of Asia consisted almost entirely of raw materials and semi-processed products, up to seven years ago.

Export Trade of Ten Asian Countries by Principal Commodities
(Percentages based on 1953 value and total values in millions of 1953 dollars)

Commodity	*Percentage share of total exports* *1938*	*1950*	*1951*
Food Products			
Rice	9.4	6.2	5.4
Vegetable Oils and Seeds:			
Coconut Oil	1.1	1.5	1.6
Copra	2.5	4.4	4.6
Soybeans	....	....	....
Groundnut	2.1	0.2	0.1
Palm Oil	0.7	0.7	0.7
Linseed and Linseed Oil	1.0	0.3	0.2
Groundnut Oil	0.1	0.6	0.1
Total	7.5	7.7	7.3
Sugar	4.1	1.0	1.1
Aromatic Crops			
Coffee	0.4	0.4	0.4
Tea	10.5	7.5	6.5
Tobacco and manufactures	2.1	1.1	1.0
Pepper (other spices)	0.4	1.6	1.1
Natural Rubber and Fibre Crops			
Cotton and manufactures	5.3	7.2	5.5
Jute and manufactures	8.3	9.1	14.4
Hemp/abaca	0.8	0.9	1.1
Rubber and manufactures	14.1	27.1	29.7
Coir Fibre	....	0.1	0.1
Tin			
Metal	3.2	3.3	2.9
Concentrate	1.9	1.5	1.2
Metallic Ores	1.7	0.3	0.1
Petroleum and Derivatives	8.0	4.5	4.1
All Other Commodities	22.3	20.5	18.1
	100.0	100.0	100.0
Value (millions of dollars)	1,709	4,764	6,460

Source: United Nations, *A Study of Trade Between Asia and Europe*, 1953, p. 11.

This evidence although not conclusive as to the rate of industrialization five years after the war, is nonetheless of considerable usefulness. When it is taken together with the disclosure in the table that the values of most of the principal commodities exported in 1951, as percentages of the value of total exports, were less than, equal to, or only slightly greater than the percentages for 1938 or 1950, it does appear that need of improvement in productivity was very great.

It is to be observed at once, however, that the evidence was not equally significant for all the countries. While the value ratio of exports of rice to total exports, in 1951, was 13 per cent less than in 1950 and only slightly more than one-half the 1938 ratio, Burma's ratio in 1950 was 35 per cent greater than in 1938. Rice was a principal export of two other countries in the group selected, Indochina and Thailand, and the ratios for these countries had declined in 1950 by 6 per cent and 4 per cent respectively. In Burma the increase offset in part the ratio decline of 25 per cent in exports of petroleum products and 10 per cent in metals and ore. In Indochina there was a ratio decrease of 14 per cent in exports of maize. Of the three principal exports only that of rubber increased, by 12 per cent. In Thailand the relatively small decrease in the export ratio for rice was offset by an increase in the ratio for rubber, but there was a large decrease in the ratio for tin.

The export value ratio for petroleum and derivatives for all the selected countries, for 1951, was 9 per cent less than for 1950 and 49 per cent less than for 1938. The effect on the external trade of Burma was severe. In Indonesia it was less. The 1950 export ratio was 5 per cent less than that for 1938.

The 1951 ratio for all countries, for rubber and manufactures, was more than double the 1938 ratio, and 2.6 per cent greater than the ratio for 1950, which was 13 per cent greater than that for 1938. Five of the ten countries were affected, all favorably. This showed that stability of the foreign markets for, and of the price of, rubber in the short run, and expansion of these markets as well, were among the most important immediate needs of Asia in the early 1950's. The five countries affected were Ceylon, Indonesia, Indochina, Malaya and Thailand.

The importance of the rubber exports, as a percentage of total exports, differed widely from country to country. For example, the 1959 ratio for Malaya was 76 per cent. In Indonesia the increase in ratio was from 20 per cent in 1938 to 50 per cent in 1950. But Ceylon had only a modest increase of 4 per cent.

There remain to be discussed (1) the shares of importing countries in the principal exports of the countries of Asia, (2) the principal exports which the United States and other industrialized countries sent to Asia, (Japan is here included for reasons of comparison), and (3) the products of Asia most needed or sought in the United States.

In reading the data immediately following this paragraph it may be well to keep in mind some known facts: *(a)* the main part of the Western European market for Asian goods in the period which this Section covers was the United Kingdom, France and Germany, and these countries had greatly to reduce external trade in 1940-1945, *(b)* the United States' trade with Asia had to be reduced in the latter part of this period, but recovery in the United States required much less time, *(c)* Japanese external trade, too, had to be curtailed, and recovery seemed to require less time than Western Europe needed but more than was necessary for the United States, and *(d)* some countries of Asia which were not involved in military operations needed time for recovery from the consequences of restricted trade. For these reasons, mainly, the fluctuations shown between 1938 and 1951 occurred:

Imports of Selected Products from Asia Into Western Europe and the United States (Thousands of Tons)

Commodity	*Western Europe* 1928	1935-38	1948	1949	1950	1951	*United States* 1928	1935-38	1948	1949	1950	1951
Food and Feeding-stuffs												
Rice	855	1074	73	105	153	151	12	10	..	..	..	..
Beet and cane sugar	87	140	14	2	9	29	524	855	219	479	427	619
Soybeans	1286	714	12	7	38	372	..	..	..	..	..	..
Groundnuts	985	807	57	23	111	73	..	..	..	..	..	..
Groundnut Oil	1	15	21	19	12	66	..	..	..	..	..	..
Copra	447	372	294	367	341	680	174	202	405	386	423	408
Coconut Oil	37	41	77	83	61	113	132	156	48	52	63	51
Palm Oil	8	82	78	140	157	136	14	118	..	10	..	16
Oilcake and Meal	366	592	90	54	66	84	71	107	13	45	65	59
Aromatic Crops												
Tea	208	229	189	219	171	198	29	34	40	40	48	36
Coffee	65	48	2	4	10	10	23	12	..	..	1	1
Tobacco	45	55	15	21	31	27	..	..	..	..	..	..
Natural Rubber and Fibres												
Natural Rubber	99	306	446	406	489	614	388	495	723	646	784	705
Raw Jute	560	523	250	284	346	464	91	77	75	62	75	106
Jute Yarns and Manufactures	58	120	127	87	47	82	258	439	247	216	199	158
Hemp and similar Fibres	132	140	52	50	58	57	66	69	49	30	46	75
Raw Cotton	237	257	112	73	93	68	..	..	..	..	..	..
Raw Wool	29	26	12	14	16	15	30	18	17	11	20	6
Raw Silk	14	5	1	2	2	2	38	27	3	1	4	3
Other Commodities												
Tin (metal and concentrate)	..	41	23	22	36	49	..	62	57	57	68	22

Source: United Nations, *A Study of Trade Between Asia and Europe*, 1953, p. 129.

Some of the consequences of the fluctuations, to individual countries, are to be added to the general explanations:

1) Imports of rice from Asia into Western Europe recovered very slowly and were still relatively small in 1951. This was adverse mainly to Burma, Indochina and Thailand, for rice was the principal commodity export of these countries, both in 1938 and in 1950. However, the ratio of exports of rice to total Burmese exports rose from 44 in 1938 to 79 in 1950. The ratios for the two other countries decreased considerably. It was obvious that new imports into the United States and increase in the imports into Europe were desirable, but in the early 1950's production and export of rice within Asia as a region were deficient and rice became very expensive.

2) The same analysis could be applied to the Western European market for tea, but it would have been much less true of the United States. It was true of coffee in both markets, due, of course, to South American competition.

3) Imports of natural rubber increased rapidly in Western Europe and in the United States, but while the increase in European imports was sustained in all the years for which information was given by the United Nations, except 1949, and was great in 1950-1951, the imports into the United States in 1951 were considerably less than in 1950. It has already been shown that rubber is a principal export of Ceylon, Indonesia, Indochina, Malaya and Thailand, and it is known that all these countries are concerned about the competition of synthetic rubber in the United States. In so far as it is true that any choice to produce more synthetic rubber and import less natural rubber was made by the United States instead of individual producers, security could have been the sole reason, since reduction of imports from Asia, as elsewhere, must result at some time in reduction of exports. Moreover, the short-run market prospects for Asian producers might not diminish considerably for any appreciable time. For these countries, with the possible exception of Thailand, do not seem to have any ideological preference for markets, so that a diminishing market in the United States and Europe might be offset by an increasing market in the Soviet Union and/or China, in addition to whatever sales were possible in Japan.

4) Imports of raw jute into Western Europe were recovering in 1950-1951, but imports in 1928 were still much larger. Imports of jute yarns and manufactures in 1951 were larger than in 1928, but this

increase did not seem sufficient to offset the decline in the imports of the raw jute. United States imports of raw jute had increased, but imports of yarns and manufactures had decreased by several times the difference in weight. In terms of value, the difference was of course greater still. The countries affected were India and Pakistan. The decrease in sales was due in large part to decline in production of jute. In this case as in some others, stability of markets in the importing countries could have had only a limited effect in sustaining incomes in the exporting countries. It is impossible to escape always from the hazards of dependence on a very few export crops to obtain a wide range of essential imports.

5) The rapid decline in imports of raw cotton into Western Europe may be explained in part as a consequence of increased output of cotton textiles in India and China, partly as due to slow recovery of markets for European textiles, when Japanese competition was rising again at the beginning of the 1950's. The United States was not an importer, but an exporter of raw cotton, largely to Japan, in that period. The Asian countries to which cotton was one of the most important exports in 1950 were Burma, India and Pakistan, but India had long been exporting cotton textiles, so that the value of Indian raw cotton as an export was to be expected to decrease. Japan had regained some of its export markets for textiles in Asia, for example in Indonesia, where the United States was an effective competitor with both Japan and the United Kingdom.

For a study of the exports of Western Europe, the United States and Japan, to Asia, the following table of selected data should suffice as an aid for the present purpose, the main interest being in industrialization and related significant change:

Exports to Asian Countries from Western Europe the United States and Japan
(Millions of dollars at constant 1950 prices)

Commodity	*Year*	*Western Europe*	*United States*	*Japan*
Food, drink and tobacco	1928	91.6	101.9	53.4
	1938	76.8	39.4	69.6
	1949-51	112.1	182.4	4.3
Crude and finished steel	1928	164.8	39.3	0.7
	1938	50.9	37.9	....
	1949-51	77.1	42.7	16.9
Iron and steel manufactures	1928	113.9	10.9	5.8
	1938	74.7	6.9	10.4
	1949-51	83.6	16.5	5.1
Nonferrous metals and manufactures	1928	18.2	11.2	3.0
	1938	26.5	10.1	0.2
	1949-51	28.5	17.1	1.0
Electrical goods and apparatus	1928	31.1	12.9	....
	1938	39.5	14.6	5.8
	1949-51	61.4	39.3	5.0
Other machinery	1928	184.8	34.1	2.8
	1938	142.1	38.2	67.2
	1949-51	214.6	99.5	29.3
Transport equipment including tires	1928	87.1	52.8	2.9
	1938	75.0	72.5	3.0
	1949-51	149.8	83.7	7.1
Textiles	1928	768.5	41.1	264.9
	1938	251.4	54.5	274.8
	1949-51	280.0	146.9	147.2
Chemicals	1928	106.1	23.6	....
	1938	86.5	24.9	....
	1949-51	139.1	112.9	....

Source: United Nations, *A Study of Trade between Asia and Europe,* 1953, p. 132.

These items were selected for the purpose of this paper. Some sub-items and some other items were excluded as unimportant or less important for the discussion that follows.

If the total values of exports of Western Europe, the United States and Japan were compared it would be seen that while the value of Western Europe's exports was greater than that of the United States, the value of the United States' exports to Asia had increased in 1951 to double the value for 1928, while the values of European and Japanese exports had declined. Also, the increase which the United States enjoyed was very much greater than the total decrease in Japanese and European export values combined.

A trend in exports to Asia appeared discernible. If we put aside for a moment the trade in food and drink and some other items, and consider mainly textiles, metals, fertilizers (which are included with chemicals) and a few other commodities, we should see some evidence of such changes in the content of Asian imports (other than Japanese) from the most industrialized countries, as would be a consequence of industrial progress in Asia. We may again take as examples countries with substantial potential internal markets, India, Pakistan, Indonesia, the Philippines and China.

Exports of *crude and finished steel* from the United States and Japan increased, especially the Japanese exports, while European exports declined. This change may be explained in terms of differences in freight costs and price competition. Of all these countries only the Philippines imported a larger value of these products in 1951 than in 1928.

Iron and Steel manufactures: There was a large decline in Asia's imports from Europe. Imports from Japan also decreased, but imports from the United States increased. The Philippines was the only country to import a larger value of these products too.

Nonferrous Metals and Manufactures: Imports from both Europe and the United States increased. Those from Japan declined. India's and Pakistan's imports, taken together for 1949-1951, were of a larger value than for 1928. Those of the other countries, except China, increased.

Electrical Goods: Imports from the United States increased threefold, those from Western Europe doubled, and imports from Japan declined (from 1938). India's imports of these and other machinery increased significantly, Indonesia's had recovered and reached the rate in 1928; imports into the Philippines increased largely, while those of China were much less. Imports of electrical goods and other machinery from Western Europe were still greater than those from Japan and the United States, but the rate of increase of imports from Europe was less.

Transport Equipment: India and Pakistan were importing a large part of the increase. Indonesia's imports had declined, the Philippines' increased and China's decreased.

Textiles: The great decline in exports from Western Europe and the considerable decrease in Japan's exports (from 1938) were not offset by the rapid rise in exports from the United States. There was an almost corresponding decrease in Indian imports, even when Pakistan's share was added to India's. Indonesia's imports, too, were less and China's very much less. Only the Philippines had increased imports.

Chemicals: The increase in imports from the United States was greater than the increase from Western Europe. Japan did not export any of these products to Asia. A very large part of these exports went to India and Pakistan. In 1949-1951, Indonesia's share was the same as in 1928. The Philippines' imports were more than quadrupled. China imported considerably less than in 1928.

Placed in order of value importance (at the constant 1950 prices), the six most important imports of eleven countries of Asia (India, Pakistan, Ceylon, Burma, Malaya [including Singapore], Indonesia, Indochina, Thailand, the Philippines, Hong Kong and China) from Western Europe, the United States and Japan, in 1949-1951, would be (1) *textiles* (consisting largely of yarns and tissues of cotton and of silk, and artificial fibres), (2) *machinery* (including electrical goods), (3) *food, drink and tobacco*, (4) *chemicals*, (5) *crude and finished steel*, and (6) *iron and steel manufactures*. Retaining the years selected for comparison, 1928 and 1949-51, we find the following significance:

a) Imports of *textiles* by the eleven countries from the United States, Western Europe and Japan had declined by about one-half due to recovery of and increase in production in Asia. The United States had a two-fold share in the exports to Asia: first, as a large exporter of raw cotton to Japan, and secondly, as a competitor of Japan and Western Europe. For example, the United States' share in exports to Indonesia in 1951 (at the constant 1950 prices) was $42.4 million worth, and Japan's $51.1 million. Of the rest of the total of $121.7 million imported by Indonesia from the five most important exporters to that country, the United Kingdom's share was $3.9 million. This may be a partial explanation of Britain's active efforts to increase textile exports to China.

b) The largest increase was in imports of *machinery*. This increase was to be seen in the imports of all but three of the eleven countries. The exceptions were Burma, Indonesia and China. Also, the decrease in Burma's imports was relatively small, by comparison with imports in 1938. Indonesia's was very small. China's was large, but the value of that country's imports in 1938 was two and one-third times the value for 1928.

c) There was a fairly large increase in imports of *food, drink and tobacco,* but the difference was smaller than the sum by which the imports of these items in 1928 exceeded imports in 1938.

d) A large increase in imports of *chemicals,* too, was widely distributed among the eleven countries. The exceptions were Indonesia, which barely maintained its imports, and China, whose imports declined considerably, but were double in value the imports for 1938.

e) There was a large decrease in imports of *crude and finished steel.* This was noticeably greater in the imports of the larger countries, India and China. But there was some increase in the imports of smaller countries, such as Thailand, Indochina, Ceylon and the Philippines.

f) Imports of *iron and steel manufactures* were comparably less. The distribution was similar to that of *crude and finished steel,* but in this case Indonesia has to be included among the larger countries importing less. To the smaller countries importing more there must be added Malaya (including Singapore) and Hong Kong.

III

PERIOD 1951-1956: REAL INTEREST OF THE UNITED STATES

Evidence of Needs

The final Section of this paper may well begin with a discussion of the United States' needs of Asia's goods. This arrangement is appropriate especially in view of the fact that Asia's needs of some of the principal exports of the United States were shown at the end of the previous Section. It will be shown presently that of the twelve Asian products which are most essential to the United States, all but three — tea, pepper and coconut oil — are raw materials. Greater quantities of these raw materials will be required in Asia as industrialization proceeds and markets expand, particularly in the larger countries. Larger markets should afford the United States more opportunities for export, when trade is free or not unduly restricted. It is difficult to think of prosperity in Asia through industrialization, and, at the same time, of smaller markets there for United States' machinery and durable consumption goods. The United States may have sufficient markets in Asia to pay with commodities for its needs of Asian goods for a long time. In fact, the manner of taking payment for exports, if less of the raw materials needed should be available, is a much more important consideration. The prospect is to import more of Asia's processed goods.

There are several factors which limit United States' imports from Asia and would limit exports more than at present, but for loans from the International Bank, the Export-Import Bank, and, we may add, the International Finance Corporation:

a) rates of increase of consumption in the United States, of the products which are Asia's principal exports. The meaning of consumption here includes use in the processes of production. If, as *Business Week* economists have been forecasting in special reports to business executives, production in the United States by 1975 will be for 650 million customers abroad and 200 million at home, then we should expect imports from Asia to be greatly increased, as the main form of payments. But if, as they also forecast, most United States' foreign investments are to be made, inevitably, in Canada, South America, the Middle East, Africa and Australia, then Asia's share would be only supplementary.

b) Competition from other countries or regions in markets in the United States.

c) Competition of United States' producers.

d) Asia's capacity to earn imports: this must be determined in any country by first, ability to produce and export, and secondly, eligibility for loans for purchase of producers' goods which would improve its productivity and consequently its ability to export.

With due reference to these factors, the real needs of the United States, in the early 1950's may be stated precisely:

United States Needs of Principal Exports of Asia

Commodity	*Percentage of Total Needs, imported from Asia*	*Limits Imposed*
Natural rubber	89	(a) The rate of increase must be expected to decline because of decrease in the rate of output in the motor vehicle industry. (c) U.S. synthetic rubber is a competitor.
Manganese	27	(b) Competition of foreign countries, mainly Ghana, place an important limit on imports from Asia, most of which come from India.
Tin	54	(b) Competition of other countries, mainly Bolivia, is effective.
Mica	88	(a) Most imports come from India. There is little competition, therefore any increase in imports depends on use in U.S.
Burlaps	95	(b) This Indian export, too, has little competition.
Abaca or manila	65	(b) Competition is considerable.
Hides and skins	20	(b) Imports are from India. Competition is great.
Tea	73	(b) India and Ceylon have competition in the U.S. market.
Pepper	93	(b) From India and Indonesia. Competition from outside of Asia is small.
Coconut Oil	94	(b) Ceylon, Indonesia, Malaya and the Philippines have little competition in the U.S.
Chromite or chrome ore	13	(b) The Philippines have much competition, from Turkey and elsewhere.
Tungsten ore	10	(b) There is little competition.

Sources: International Development Advisory Board, *Partners in Progress,* (March, 1951); and United Nations, *A Study of Trade Between Asia and Europe,* (November, 1953).

The extent of competition in the United States involves internal markets which the United States is prepared to concede, as may be necessary, so that Asia might pay for more exports with commodities.

In so far as we regard needs of Asia's products as vital or essential, and some of them are not obtainable in quantity from other regions, our imports must depend on production and use in Asia. Of the dozen products listed, the United States imports of only five which may be considered vital amounted in 1950 to 30 per cent or more of total needs. These are natural rubber, manganese, tin, mica and burlap.

Of the principal exports of Burma, Ceylon, India, Pakistan, Indonesia, Indochina, Malaya, the Philippines and Thailand, which are most of the countries usually selected by the United Nations as examples for purposes of economic studies and reports, six are not included among vital or essential needs of the United States as listed in the sources mentioned above. These are rice, petroleum products, cotton and cotton manufactures, sugar, tobacco and maize. Rice and cotton are not produced in Asia in sufficient quantities for a large export trade outside of that region. The shortages may be overcome but the United States is a producer of both these products and a large exporter of cotton and cotton manufactures, even to Asia, so there is little prospect of any considerable imports of them. Moreover, the United States is also a producer of the remaining four principal products of Asia, which are not deemed essential or vital by the authorities quoted.

It is also noticeable that mineral imports from Asia are mostly manganese and tin, and that the quantities are, respectively, less than 30 per cent and only slightly more than 50 per cent of total needs. It is obvious, then, that imports of minerals, too, from Asia are not likely to increase in large measure in the short or intermediate run because of imports from other sources and production in the United States.

Need and Progress of Industrialization

There is thus only one course for the future of the external trade of Asia (with the exception of Japan) with the United States and Western Europe, but it may be a broad one. Since the products now available for export will not enable Asian countries in the ECAFE group to obtain any large increase in incomes, they must diversify production as speedily as possible, utilizing larger quantities of these products and exporting less of them. This affords greater rather than less opportunities for direct investments in individual countries, conceived for growth as well as for the benefit of the investors.

There are two forms of investment which are, possibly, being overlooked: (1) production of equipment which can be employed effectively on small farms, and (2) machinery for small-scale processing units, both for the countries discussed in this Section and Section II, and also for those discussed more briefly in Section I. The demand is likely to increase quickly because several ECAFE countries have adopted a policy of supporting small producing units and small farms are typical in many areas. Also, because transition from the workshop to the factory stage of production will evidently not be a very short-run process, particularly in the smaller countries which are least endowed with resources.

Since industrialization in different degrees and for different objectives will become inevitable in practically all the countries of Asia, the evidence of its progress in 1951-1956 should be examined here for indications of the main directions of investment and comparison of growth in the main industrial areas. By the mid-1950's it had become clear that the agricultural base in several of the countries and in the region as a whole was adequate as a prerequisite for industrialization. For example, cereal production in the ECAFE countries increased by 10 per cent above the average for 1934-1938. This included an equal percentage rise in the output of rice, and it was nearly equal to the rate of increase of world production although production in some other countries had recovered earlier than in Asia.[22]

There are broad similarities in the industrialization, especially in the larger countries. The rates of growth must be expected to be greater than individual initiative, as has been noticed in Section I, would have achieved. In the period between the end of World War II and the early 1950's lack of individual initiative became a lesser disadvantage. But more important than this for growth was increase in public investment, which substituted for private investment in varying degrees and also stimulated it.

The three main industrial areas of Asia (excluding Australia), Japan, India and China, have been rapidly expanding textile production. India has surpassed Japan in the production of cotton-piece goods. By 1951 Indian exports of these goods, within the region, were much

[22] United Nations, *Economic Survey of Asia and the Far East,* 1954, pp. 1-3.

larger, as a ratio of Japan's, and its exports to countries outside exceeded Japan's. In 1954 Japan's regional exports were less and India's had increased, while India's excess of exports over Japan's, to other regions, was greater. Production in China increased rapidly in the early 1950's. the rate of output seemed sufficient for competition with India and Japan but there were no recorded exports, probably because of the large internal market.

Japan is the leader of the three in iron and steel production, producing 7.6 million tons, or 70 per cent of the region's total, and was increasing its rate of output. China became the second largest producer of steel in the region in 1954. The data published for China were 3 million tons of pig iron and 2.2 million tons of steel ingot. India's capacity was less than 2 million tons of pig iron, and its production of steel ingots was 1.5 million tons.

In the production of electric power, too, Japan leads, but rates of increase in India and China have been very great, 46 and 64 per cent, respectively, whereas the rate of increase in Japan, which already had an output incomparably larger than either, was 9 per cent.

Japan produced 50-60 per cent of all cement made in the ECAFE countries, in 1954. The rate of increase in production was 21 per cent. China, reported as the second largest producer, had increased its output by 100 per cent in six years. In about the same period India's output had increased by 50 per cent.

The engineering industry may show the most significant changes: in Japan the value of products of engineering was 15 per cent of the total for manufactures. In northwest China it was 14 per cent. The index number for engineering industries in India was 131 in 1954, 100 in 1948. The table which follows shows a wider range of industrial production:

Index Numbers of Production
(1948=100)

	Weight	1949	1950	1951	1952	1953
CHINA (Taiwan only)						
Industrial production	100	157	175	184	238	323
Public utilities	8.6	124	168	192	202	214
Electricity	3.8	101	123	152	168	186
Mining and Quarrying	3.7	87	86	106	138	121
Coal	1.8	98	85	100	139	145
Manufacturing	87.7	166	182	189	249	348
Food	29.1	221	215	147	198	336
Textiles	14.6	193	276	421	660	918
Chemicals	8.1	104	130	216	238	263
INDIA						
Manufacturing and mining	100	98	97	108	119	125
Mining (coal)	12.0	106	107	115	122	120
Chemicals & allied trades	4.9	114	129	145	204	260
Metal manufactures (not machinery)	9.3	108	114	119	121	114
Engineering and electrical goods	5.6	121	146	189	170	190
Textiles	61.4	90	82	90	100	102
Cotton textiles	43.5	91	84	93	104	110
Jute	16.5	85	77	80	87	80
Paper	1.5	105	111	135	140	142
Manufacture of non-metallic mining products (not coal and petroleum)	1.7	107	149	171	173	229
Manufactures of wood	0.2	89	93	132	168	114
Food (sugar)	3.5	93	91	104	139	120
INDONESIA (1938=100)						
Export products						
General	..	69	89	105	108	108
Estate	..	46	49	63	71	75
Peasantry	..	103	194	228	184	156
Mining	..	85	93	103	116	132

JAPAN						
Industrial Production	100	124	142	193	213	261
Public utilities	4.3	113	122	134	146	160
Manufacturing & Mining	95.7	130	153	210	232	284
Mining	12.9	115	121	138	142	153
Manufactures	82.8	131	156	219	244	304
Nondurable	47.8	134	190	254	298	375
Textiles	17.1	128	186	261	298	345
Chemicals	16.7	140	203	277	332	423
Durable	35.0	134	147	220	230	281
Metals	12.9	176	242	360	386	459
Machinery and transport equipment	14.6	124	117	184	191	248
PHILIPPINES (1952=100)						
Manufactures	..	..	..	..	100	113
Nondurable	..	..	..	..	100	111
Tobacco products	..	..	..	..	100	114
Textiles	..	..	..	..	100	96
Footwear and wearing apparel	..	..	..	..	100	116
Chemicals	..	..	..	..	100	111
Durable manufactures	..	..	..	..	100	118
Stone, clay and glass products (including cement)	..	..	..	..	100	108
Metal products	..	..	..	..	100	152
Electrical appliances	..	..	..	..	100	96

Source: United Nations, *Economic Survey of Asia and the Far East,* 1954, p. 201.

The table is, of course, quite incomplete; China (other than Taiwan) had to be excluded for reasons already given. Data for Pakistan would have been helpful, and one of the countries of intermediate area and population, such as Thailand, must have shown progress well worth inclusion for comparison.

The data presented here should be studied with reference to the roles of governments, as public planning and investments are to be met with in practically all the countries. The opportunities indicated must be regarded as opportunities to contribute, through private investment, to the success of broad plans for growth. Dependence on private initiative is still less in most of the countries, than on state planning. Although private enterprise is welcomed, there are controls and restrictions, particularly in Southeast Asian countries. There seems to be three very prevalent reasons: a tradition of authoritarian politics, inadequate and therefore unreliable entrepreneurship for the responsibilities of development, and intellectual relations with the West at a time when state responsibility and state planning were emphasized.[23]

The industrial structures indicated in the table above appeared to be quite established, as judged by the results for 1955. In the final table which follows, information for 1956 is included, partly by estimating. The main importance of this table is that it enables us to discern a change in the content of Asia's external trade which may become very important within a decade.

Composition of Imports

Value (in millions)

	Consumption goods	Materials for consumption goods	Materials for capital goods	Capital goods
ECAFE REGION (U.S. dollar)				
1954	3,144	2,478	889	1,427
1955	2,983	2,770	975	1,648
1956 (first half)	1,560	1,529	673	1,035
Burma (kyat)				
1954	476	174	59	264
1955	362	170	67	261
1956 (first half)	181	69	42	158

[23] Claude A. Buss, "Economics and Diplomacy in Southeast Asia," and Charles J. Shohan, "National Economic Planning," in *Southeast Asia in the Coming World* (John Hopkins Press, 1953), pp. 90-91, 97-99.

Ceylon (rupee)				
1954	952	128	130	186
1955	890	142	164	233
1956 (first half)	448	82	75	148
India (rupee)				
1954	2,366	1,759	633	1,797
1955	1,441	2,031	556	2,746
1956 (first half)	632	1,034	357	1,902
Indonesia (rupiah)				
1954	3,051	1,418	459	1,977
1955	2,641	1,535	670	1,902
1956 (first half)	2,302	777	530	1,299
Japan (yen)				
1954	252,419	412,705	125,824	72,677
1955	240,071	457,778	134,706	56,477
1956 (first half)	108,434	276,212	117,570	34,878
Malaya (Malayan dollar)				
1954	1,669	624	454	389
1955	1,905	904	539	474
1956 (first half)	1,062	441	287	291
Pakistan (rupee)				
1954	162	187	129	398
1955	206	164	155	412
1956 (first half)	133	81	87	166
Philippines (peso)				
1954	460	168	112	225
1955	519	181	125	272
1956 (first half)	188	79	63	155
Thailand (baht)				
1954	3,248	665	565	2,186
1955	3,476	794	763	2,166
1956 (first half)	1,674	409	383	1,295

Source: United Nations, *Economic Survey of Asia and the Far East,* 1956, p. 185.

The figures given for 1956 must be approximately doubled. When this is done it becomes clear that while the value of imports of consumption goods into several of the countries were about the same in 1956 as in 1954, the values of imports of materials for production of these goods were considerably greater. There is indication, therefore, that the ratios of imports of consumption goods to total consumption had declined. So we should have expected the accompanying evidence of a large increase in imports of materials for the production of capital goods, and of capital goods as well.

This change is to be observed in the figures for most of the individual countries, and it is most noticeable in the data for the countries where industrialization is increasing most. Even in the figures for some countries where industrialization is proceeding only moderately the trend is discernible, and it is to be seen in the values of imports into the ECAFE region as a whole.

The Soviet ''Economic Offensive'' in Asia and its effect on United States-Asian trade

Yuan-li Wu

Director, Institute for Asian Studies,
Associate Professor of Economics,
Marquette University

I

INTRODUCTION

ONE OF THE international economic issues that has lately begun to command increasing interest, thanks to Soviet achievements in other fields and to the popular press, is the so-called economic offensive of the Soviet Bloc. Realization of the fact that the Soviet Bloc[1] has intensified its foreign economic activities, particularly in the less developed countries of Asia and the Middle East, has already posed some hard and searching questions to this country as to the effectiveness of American foreign economic policy and the manner in which adjustments in the latter may have to be made. Obviously, the economic actions of the Soviet Bloc, insofar as they do represent a conscious policy and are integrated with foreign policy in a broader sense, may continue to gather momentum as time passes. Thus the problems for the United States, both as the only effective political counterpoise to the Soviet Bloc and as a leading nation in world trade, have probably only just begun. In these circumstances, the need for carrying out a searching appraisal and analysis of this "offensive" should be quite obvious and will need no further supporting argument.

Parts of this paper were presented to the 1958 annual meeting of the Association for Asian Studies at New York City.

[1] The term Soviet Bloc is used here to indicate what is sometimes described as the Sino-Soviet Bloc. The European Bloc thus includes the USSR and the European satellites—Albania, Bulgaria, Czechoslovakia, the Soviet Zone of Germany, Hungary, Poland and Rumania. The entire Soviet Bloc also includes North Korea and, since 1955, North Viet-Nam, but the extra-Bloc trade of the last two areas is unimportant so far.

Although newspaper reports have tended to highlight the spectacular and have thus concentrated publicity on a few cases where actual or potential competition between the United States and the Soviet Union appears on the surface, such instances merely serve to dramatize a development originating from the Soviet Bloc which, in order for it to constitute a "threat," must at once be broader and more sustained.

In other words, if, for instance, the Soviet offer to build a steel mill in India with an annual capacity of one million tons and the vague talk about the construction of the Aswan Dam were merely isolated examples, the evidence of a Soviet "economic offensive" would not be conclusive. The problem assumes a different dimension only when a determined effort on a broad front to strengthen the economic relations of the less developed countries with the Soviet Bloc can be discerned.

II

PRIMA FACIE EVIDENCE OF THE SOVIET BLOC'S "ECONOMIC OFFENSIVE"

That there is strong evidence of the Soviet Bloc's intention to maneuver itself into a favorable economic position vis-a-vis some of the less developed nations and to make itself indispensable may be seen in two respects. Limiting ourselves in this paper to the Asian countries only, we may first point to the fact that credit and technical assistance arrangements have been made with some of the Asian countries not only by the Soviet Union itself, but also by the European satellites and Communist China. As examples we may cite the offers of credit and technical assistance by East Germany, Poland, Hungary and Czechoslovakia to India and Indonesia and similar aid provided by Communist China to Burma and Cambodia, as well as a Chinese grant to the Kingdom of Nepal. All of these were made during the last few years.[2] That there is a conscious and concerted effort to lure the Asian countries with financial and technical assistance can hardly be denied. In the second place, partly as a result of these pacts, but to an even larger

[2] For a comprehensive listing of the trade and aid agreements concluded by the Soviet Bloc with Asian countries see the Council for Economic and Industry Research (CEIR) study on "Foreign Assistance Activities of the Communist Bloc and Their Implications for the United States" prepared for the Senate Special Committee to Study the Foreign Aid program, 85th Congress, Washington, D.C., 1957. Cf. also the various reports to Congress by the Administrator of the Mutual Defense Assistance Control Act of 1951.

extent due to the operation of the many trade and payments agreements between the Asian countries and the Soviet Bloc, there has been a sizable increase in the volume of trade between them. This claim may, in the first instance, be substantiated by studying the available trade statistics of the Asian countries for recent years. In a study of these statistics several factors should be fully considered, however.

First, to be meaningful, a comparison of the flow of trade between non-Communist Asia and the Soviet Bloc at different dates must be based on a judicious selection of the time period to be examined. For our purpose we have chosen to make the comparison between 1952 and 1956. The 1956 figures are used simply because they represent the most up-to-date complete returns available at this writing. On the other hand, the year 1952 is used as the initial benchmark for a number of reasons. First, if a specific date is to be chosen to mark the launching of the recent foreign economic efforts of the Soviet Bloc, the International Economic Conference held at Moscow in April 1952 would probably present a most convenient and logical starting point. Moreover, at least one major reason for the Soviet Bloc's efforts in this field was the adoption of countermeasures in the face of the tightening of export controls by the United States and the Western world in 1952. Although postwar American export controls directed against the European Soviet Bloc dated from the end of 1947, while the present 15-nation Consultative Group at Paris and its Co-ordinating Committee (COCOM) were organized as early as January 1950 to exercise international export controls, the Mutual Defense Assistance Control Act (Battle Act) of 1951, which imparted a sense of seriousness and urgency to American export control and facilitated its extension to a multilateral basis, did not go into full effect until January 24, 1952.[3] It was only in April 1952 when the Moscow Economic Conference was in full swing that the international lists of commodities subject to total embargo or quantitative control began to resemble closely the American security lists at that time. Thirdly, as far as the Asian countries are concerned, trade with the Soviet Bloc has largely consisted of trade with Communist China. Here again, although the United Nations decision to impose an economic embargo on Communist China and North Korea was reached in May 1951, the China Committee

[3] For a historical sketch of the United States and international export control systems see the Ninth Report to Congress under the Mutual Defense Assistance Control Act of 1951.

(CHINCOM) of the Paris Consultative Group was established only in September 1952. As we have pointed out in another connection,[4] Communist China's trade with the free world actually took a significant spurt during 1951 in anticipation of further trade controls by the Western world following America's lead in introducing economic sanctions at the beginning of the year. Finally, 1952 was also the last year preceding the five year plan (1953-1957) of Communist China during which radical changes in the structure of the economy and less radical, but nonetheless significant changes in the country's foreign trade potentials took place.

Next, bearing the preceding observations in mind, we are probably justified in stating that whatever changes there may have been since 1952 in the economic relationships between the Asian countries and the Soviet Bloc in general and Communist China in particular, they are not the outcome of a single factor, but actually reflect the result of several diverse, though related, developments. The reaction of the Sino-Soviet entente, along with the European satellites, to the free world's trade controls which gained in effectiveness in 1952; their autonomous and aggressive efforts to cultivate economic relations with the Asian countries and regions, especially those that have "neutralist" political tendencies and/or are not really parties to the UN embargo; the economic growth of Communist China and the attending changes in the composition and volume of its imports and exports; the economic conditions of the Asian countries themselves, and the successive revision and relaxation of the international export control system — all these have contributed to the expansion of Soviet Bloc trade with Asia. Thus it would be an oversimplification to attribute this trade expansion entirely to the "economic offensive" of the Soviet Bloc although it remains to be seen whether the other factors have not been in part fostered and exploited by the Bloc's maneuvers.

[4] Yuan-li Wu, "Communist China's Trade with the West," *The Pacific Spectator,* Stanford, 1953.

TABLE I — *Trade Between Selected Asian Countries and Areas with the Soviet Bloc — 1952 and 1956. (Values in Millions of U.S. Dollars.)*

Importing Countries

	Communist China			European Soviet Bloc			Total Soviet Bloc		
Exporting Countries and Areas	1952	1956	Index for 1956 1952=100	1952	1956	Index for 1956 1952=100	1952	1956	Index for 1956 1952=100
Burma	0.1	14.4	14400.0	....	20.3		0.1	34.7	34700.0
Ceylon	26.0	38.3	147.3	2.9	0.2	6.9	28.9	38.5	133.2
India	10.2	13.8	127.5	6.2	36.5	588.7	16.4	50.3	306.7
Indochina	0.1	....		....	....	....	0.1	....	
Indonesia	(a)	11.7		9.8	11.9	121.4	9.8	23.6	240.8
Japan	0.6	67.4	11233.3	0.2	5.9	2950.0	0.8	73.3	9162.5
Malaya	(a)	7.8		30.3	34.4	113.5	30.3	42.2	139.3
Pakistan	83.9	15.9	19.0	35.7	4.5	12.6	119.6	20.4	17.1
Hong Kong	91.0	23.8	26.2	....	—		91.0	23.8	26.2
Aggregate	211.9	193.1	91.3	85.1	113.7	133.6	297.0	306.8	103.3
Total (Excluding Hong Kong)	120.9	169.3	140.0	85.1	113.7	133.6	206.0	283.0	137.4

Exporting Countries

	Communist China			European Soviet Bloc			Total Soviet Bloc		
Importing Countries and Areas	1952	1956	Index for 1956 1952=100	1952	1956	Index for 1956 1952=100	1952	1956	Index for 1956 1952=100
Burma	2.4	22.2	925.0	0.3	15.3	5100.0	2.7	37.5	1388.9
Ceylon	6.9	28.1	407.2	1.1	1.6	145.5	8.0	29.7	371.3
India	34.0	21.5	63.2	6.4	52.2	815.6	40.4	73.7	182.4
Indochina	7.4	4.1	55.4	0.8	0.1	12.5	8.2	4.2	51.2
Indonesia	1.9	30.2	1589.5	3.4	14.5	426.5	5.3	44.7	843.4
Japan	14.9	83.6	561.1	3.0	10.9	363.3	17.9	102.5	572.6
Malaya	39.5	43.1	109.1	3.0	5.3	176.7	42.5	48.4	113.9
Pakistan	3.7	8.8	237.8	13.9	2.3	16.5	17.6	11.1	63.0
Hong Kong	145.3	181.7	125.1	1.3	0.5	38.5	146.6	182.2	124.3
Aggregate	256.0	423.3	165.4	33.2	102.7	309.3	289.2	534.0	184.6
Total (Excluding Hong Kong)	110.7	241.6	218.2	31.9	102.2	320.4	142.6	351.8	246.7

(a) indicates "under $50,000"
.... indicates "no information"
— indicates "nil"
For 1956, "Indochina" refers to south Viet-Nam
Source: "Values Series," International Economic Analysis Division of The Bureau of Foreign Commerce, Department of Commerce.

Thus qualified, a comparison of the trade statistics of the Asian countries in 1952 and 1956 shows the following results:

1) In the case of imports from the Soviet Bloc, the total value rose by 84.6 per cent between 1952 and 1956 (from US $289.2 million to $534.0 million) if we include as importing nations and areas Burma, Ceylon, India, the Indochinese states outside Communist control, Indonesia, Japan, Malaya (and Singapore), Pakistan and Hong Kong. These areas constitute the entire group of free-Asian countries other than Thailand, the Philippines, Taiwan and South Korea, none of which reports any direct, overt trade with the Communist countries, as well as Afghanistan which we shall disregard for our present purpose. If Hong Kong is excluded, inasmuch as a sizable portion of its imports is for re-export, total imports of the remaining Asia countries listed above from the Soviet Bloc increased even more rapidly, i.e., from $142.6 million in 1952 to $351.8 million in 1956, or by 146.7 per cent.

2) As for individual Asian countries and areas, of the nine listed, imports from the Bloc rose during this period from 13.9 per cent in the case of Malaya to a whopping 1,288.9 per cent in the case of Burma. The only exceptions to this rule of spectacular advances were Indochina and Pakistan, the former attributable to a contraction of the reporting area to southern Viet-Nam, the latter reflecting the indirect effect on Pakistan's imports of a drop of cotton purchases by the European Soviet Bloc possibly as a result of switching their business to Egypt and an even larger drop of cotton imports by Communist China following the expansion of China's domestic cotton production.

3) In the case of exports to the Soviet Bloc, the increase between 1952 and 1956 was 37.4 per cent or from $206.0 million to $283.0 million if exports from Hong Kong are disregarded. If Hong Kong is included, the change was an increase of only 3.3 per cent, believed to be due to the expansion of South and Southeast Asia's direct exports to mainland China, thus bypassing the Hong Kong entrepot.

4) For individual countries with the exception of Hong Kong and Pakistan which suffered a drop of 73.8 per cent and 82.9 per cent respectively in their exports to the Bloc during this period, the increase ranged from 33.2 per cent in the case of Ceylon to 34,600 per cent in the case of Burma. (The latter's exports to the Bloc rose from a mere $100,000 in 1952 to $34.7 million in 1956.)

These general observations on Asia's trade with the Soviet Bloc as a whole may now be further supplemented by the following points dealing with trade between the Asian countries and the major components of the Soviet orbit; namely, Communist China and the European Soviet Bloc, the latter including the USSR and the European satellites. In this respect we may note:

1) In the case of exports from the Asian countries, between 1952 and 1956, of the nine countries and areas all but Ceylon followed a common upward trend both in their exports to Communist China and in their exports to the European Soviet Bloc. Even in the case of Ceylon, although exports to Communist China in 1956 exceeded the corresponding figure in 1952 and 1955, they were actually much smaller than in 1953 and 1954. Thus one might say that the exception was more illusory than real. As for imports from Communist China and the European Soviet Bloc, all the Asian countries and areas under consideration save India, Pakistan and Hong Kong exhibited a common trend during this period. Hong Kong's declining import volume from the European Soviet Bloc may be safely disregarded as it was never large. As for India's imports from Communist China, the apparently smaller volume in 1956 as compared with that of 1952, in contrast to the large increase of India's imports from the European Bloc, conceals the fact that there was actually a rising trend from 1953 on.[5] The apparently divergent trends followed by Pakistan's imports from the European Bloc and the corresponding imports from Communist China can perhaps be explained by China's need to narrow the gap between her trailing exports to Pakistan and her much larger but fluctuating import volume from Pakistan, the latter being directly influenced by the size of China's own cotton and jute crops. Thus, allowing for these relatively unimportant exceptions, it may be said that Communist China and the European Soviet Bloc showed the same general movement in their trade relations with the Asian countries under consideration.

2) Although the European Bloc plays the leading role in expanding trade between the entire Bloc and the free world, the dominant position in Asia is occupied by Communist China.

[5] See the Mutual Defense Assistance Control Act reports for figures in 1953-1955.

TABLE II — *The Role of Communist China in Asia's Trade with the Entire Soviet Bloc — 1952 and 1956.*

	Exports to Communist China as Per Cent of Exports to the Soviet Bloc		Imports from Communist China as Per Cent of Imports from the Soviet Bloc	
	1952	1956	1952	1956
Burma	100.00	41.5	88.9	59.2
Ceylon	90.0	99.5	86.3	94.6
India	62.2	27.4	84.2	29.2
Indochina	100.0	....	90.2	97.6
Indonesia	....	49.6	35.8	67.6
Japan	75.0	92.0	83.2	81.6
Malaya	....	18.5	92.9	89.0
Pakistan	70.2	77.9	21.0	79.3
Hong Kong	100.0	100.0	99.1	99.7
Aggregate	71.3	62.9	88.5	79.3
Total (Excluding Hong Kong)	58.7	59.8	77.6	68.7

.... indicates "no information"

Source: "Value Series," International Economic Analysis Division of the Bureau of Foreign Commerce, Department of Commerce.

As Table II clearly shows, of all the Asian countries and areas under consideration, India was the only one that imported more from the European Bloc during 1956 than from Communist China. In the case of exports from the Asia countries in 1956, Burma, India, Indonesia and Malaya presented the four cases out of nine that showed a larger volume of exports to the European Bloc than to Communist China. Moreover, only in the case of Burma and India do we observe during this period any appreciable deterioration of the relative position of Communist China vis-à-vis the European Bloc both as a customer and as a supplier. In most other cases, the Chinese were able to improve upon their initially favorable position relative to the European Bloc. It is not hard to explain the exceptional cases furnished by India and Burma as the concentrated effort of the USSR and the European satellites in offering them credit, grants and technical assistance far exceeded similar efforts that were made in other Asian countries,[6] and one is

[6] CEIR, *op. cit.*

strongly tempted to suggest that the larger imports of Burma and India from the European Bloc were essentially a result of the extension of economic aid by the European Bloc while, in the case of India at any rate, the larger exports to the European Bloc were to a considerable extent a consequence of the growth of imports from the same quarter.

Accordingly, we may summarize our preliminary findings by stating (1) that on the basis of the trade statistics of the nine Asian countries and areas in 1952-1956 there is, with the exception of Pakistan, a notable to spectacular advance in the volume of trade with the Soviet Bloc as a whole; (2) that the same trend is seen both in trade with the European Bloc and in trade with Communist China; (3) that Communist China enjoys a predominant position in the expanding trade between the Soviet Bloc and its Asian trade partners, the only significant exceptions being Burma and India; (4) that in the case of Burma and India the dominating position of the European Bloc is probably attributable to the latter's greater economic assistance programs; and (5) that the decline of Hong Kong's exports to the Soviet Bloc, primarily Communist China, is a result of China's diminishing dependence upon the British colony as an enterpot and should not therefore be interpreted as an exception to the general trend. Clearly, even though these developments cannot be wholly accounted for by the "economic offensive" of the Soviet Bloc, and that of Communist China in particular, they are sufficiently suggestive of a deliberate "offensive" as to challenge the imagination.

III

A CLOSER LOOK AT THE GROWING ECONOMIC TIES BETWEEN ASIA AND THE SOVIET BLOC

However, one must not be carried away by the "impressive" gains of Soviet Bloc trade and immediately jump to the conclusion that strong economic ties have already been established with the Asian countries.

First, let us dispose of a fairly simple matter by pointing out that the rapid growth of trade with the Bloc was possible partly, if not only, because the initial volume of trade was extremely small. The aggregate exports of the nine Asian countries and areas to the Soviet Bloc in 1952 amounted to $297 million only or no more than 4.6 per cent of their total exports to the world. If Hong Kong is excluded, their total exports to the Soviet Bloc in 1952 ($206 million) would be less than 3.5 per cent of their total exports to the world. Similarly, the aggregate imports from the Soviet Bloc (including Hong Kong's imports) were $289.2 million in 1952 or only 3.5 per cent of their aggregate imports from the world. If Hong Kong is excluded, the corresponding ratio in 1952 would be about 1.9 per cent of their aggregate imports from the world. It is not surprising, therefore, that a high rate of growth could be achieved within a short time.

However, one should immediately note that although the ratio of the aggregate exports of these Asian countries and areas to the Soviet Bloc had dropped by 1956 to less than 4.1 per cent if Hong Kong's exports to the Bloc are included, the ratio, excluding Hong Kong, had risen to slightly over 4 per cent as compared with less than 3.5 per cent in 1952. The ratio of aggregate imports from the Bloc to total imports from the world in 1956 reached 5.9 per cent including Hong Kong or 4.2 per cent excluding Hong Kong. Compared with the 1952 figures — 3.5 per cent including Hong Kong and only 1.9 per cent excluding Hong Kong — there were definitely some very significant advances in the relative sense.

TABLE III — *The Relative Importance of Trade with the Soviet Bloc in the Foreign Trade of Selected Asian Countries.*

	(Millions of U.S. Dollars) Exports to World		Imports from World		Exports to the Soviet Bloc as Per Cent of Total Exports to World		Imports from the Soviet Bloc as Per Cent of Total Imports from World	
	1952	1956	1952	1956	1952	1956	1952	1956
Burma	266.1	242.7	192.5	197.4	(a)	14.3	1.4	18.9
Ceylon	315.5	364.3	357.5	342.3	9.2	10.6	2.2	8.7
India	1303.3	1272.1	1688.0	1715.5	1.3	3.9	2.4	4.3
Indochina	116.7	42.0	448.4	210.7	0.1	..	1.8	2.0
Indonesia	907.5	882.0	924.0	853.1	1.1	2.7	0.6	5.2
Japan	1272.9	2500.6	2028.8	3229.7	0.1	2.9	0.9	3.2
Malaya	1239.7	1360.9	1256.9	1356.8	2.4	3.1	3.4	3.6
Pakistan	532.5	340.2	609.7	355.0	22.5	6.0	2.9	3.1
Hong Kong	507.3	561.7	661.4	799.1	17.9	4.2	22.2	22.8
Aggregate	6461.5	7566.5	8167.2	9059.6	4.6	4.1	3.5	5.9
Total (Excluding Hong Kong)	5954.2	7004.8	7505.8	8260.5	3.5	4.0	1.9	4.2

.... indicates "no information"

(a) indicates "under $50,000"

Source: "Value Series," International Economic Analysis Division of the Bureau of Foreign Commerce, Department of Commerce.

As of 1956, the Soviet Bloc was among the most important trading partners of only two Asian countries; namely Burma and Ceylon. It supplied Burma with 18.9 per cent of the latter's total imports in that year and took 14.3 per cent of the latter's total exports. Communist China was primarily responsible for Burma's imports from the Bloc while the European Bloc was primarily responsible for Burma's exports to the Bloc. In the same year, the Soviet Bloc was responsible for 10.6 per cent of Ceylon's total exports and 8.7 per cent of the latter's total imports, with virtually the entire trade carried on between Ceylon and Communist China.

Certain factors in the Bloc's trade with these two Asian countries resemble each other closely. The Ceylon trade is conducted principally under a five-year, renewable barter agreement between Ceylon and Communist China providing for an annual exchange of 50,000 tons of Ceylonese rubber for 270,000 tons of rice with any balance to be settled in sterling. As a result of this agreement, rubber exports to the Soviet Bloc averaged about 50 per cent of Ceylon's total rubber exports in 1954-56.[7] Because of the large rubber export which was especially attractive to Ceylon at the time the agreement was first put into operation in 1953, as the price paid for the rubber was higher than the then world market price while the price of rice was lower, China's sterling indebtedness to Ceylon increased gradually, reaching, according to the London *Economist*,[8] 13.5 million pounds ($37.8 million) by 1957. When the renewal of the agreement was under discussion in 1957, China was in a position to demand another long-term agreement, as well as more favorable terms, by using this debt as a bargaining counter. To quote the *Economist:*

> Ceylon now risks losing this credit balance and the Chinese market if it refuses the Chinese demand, but by accepting, will have to restrict its imports from other countries, disregard its GATT obligations and become more vulnerable to Chinese pressure in the future.

The Burma trade follows a similar pattern except that in this case Burma's problem began with a rice surplus which could not be profitably disposed of on the world market. Confronted with an estimated export-

[7] *The Economist*, London, August 31, 1957, p. 675.
[8] *Ibid.*

able surplus exceeding 2 million long tons in 1955,[9] Burma was understandably receptive to suggestions from Communist China and the USSR each to purchase 150,000 to 200,000 tons of rice from Burma annually. These figures were subsequently incorporated in separate trade agreements with the two principal Bloc countries in 1955, and the USSR quota was later raised to 400,000 tons per annum.[10] The rice sale to the USSR led to sizable imports from the European Soviet Bloc, including the notorious case of hardened cement blocks on the Rangoon docks when they arrived during the monsoon rains. Even in the smaller deal with Communist China, while the latter was supposed to provide 60 per cent of the value of the imported rice in Chinese exports, 20 per cent in re-exports of goods of Russian and Eastern European origin and 20 per cent in sterling, protracted negotiations by the Burmese in Peking in 1955 failed to find enough Chinese goods to buy, and it was under these conditions that the much-vaunted sale of Chinese textile machinery was finally concluded with Burma.[11]

The experience of Burma and Ceylon, reminiscent of Nazi Germany's machinations in an earlier decade,[12] points to the conclusion that countries depending upon the export of a few primary products and therefore vulnerable to the latter's often large price fluctuations are usually in an unenviable bargaining position in dealing with large foreign state trading organs. On the one hand, they are often lured by the apparent attraction of long-term bulk purchases. On the other hand, the possibility of their trading partners' sudden withdrawal of a bulk purchase, which the government trading agencies are capable of doing, and the need to settle credit balances owed by their trading partners, which readily accumulate as a result of the domestic pressures to export, tend to increase their dependence on their trading partners. This effect of long-term bulk purchase of some key export commodities by the Soviet Bloc can be serious even though the amount directly involved

[9] *Far Eastern Economic Review,* Hong Kong, July 28, 1955, Vol. XIX, No. 4, p. 110.

[10] CEIR, *op. cit.* See also the *Oriental Economist*: *Monthly Statistical Bulletin,* Tokyo, September 1956, pp. 10-11.

[11] *Far Eastern Economic Review,* Hong Kong, February 24, 1955, Vol. XVIII, No. 8, p. 250 March 31, 1955, Vol. XVIII, No. 13, p. 408; and July 28, 1955, Vol. XIX, No. 4, pp. 109-110.

[12] Yuan-li Wu, *Economic Warfare,* (New York: Prentice-Hall, 1952), and especially the Tariff Commission's study quoted therein.

may be relatively small when compared with the volume of the exporting country's total exports to the world.

IV

ECONOMIC INTER-DEPENDENCE AND STATISTICS OF THE DIRECTION OF TRADE

A country's economic dependence upon imports from another country may be measured by the extent to which domestic consumption and production would immediately suffer if such imports were no longer available, the cost at which alternative sources of supply, domestic or foreign, could be developed, and the length of time required for making the adjustment. Similarly, a country's economic dependence upon exports to another country may be measured by the extent to which domestic income and employment would immediately suffer, the cost at which alternative markets or areas of production can be found, and the length of time required to make the adjustment. This concept of a country's economic dependence upon another may be applied generally except in those cases where the principal economic activity consists of transit trade such as Hong Kong and, to a lesser extent, Malaya and Singapore. Bearing in mind the qualitative importance that some commodities might possess in an economy even when they are traded only in very small quantities internationally and given the economy's ability to make adjustments in production and consumption, it is of course true that the degree of a country's economic dependence upon another varies with the volume of its imports from the latter that are actually retained for its own consumption or further production and the volume of its exports to the latter that actually originate from the stream of its own production. The question is whether in the case of the Asian countries and areas the direction of trade statistics we have can provide such a quantitative index, and in what way it may have to be modified.

As we examine the statistics that purport to show a country's direction of trade, we can readily see that as far as export statistics are concerned, the inclusion of re-exports, without subjecting the previously imported goods to any substantial transformation, would be a source of overstatement. In addition, if the direction of trade is based on the consignment method so that a partner country is credited with an export if it is the country to which the goods are directly consigned, the recorded export trade data would tend to be overstated in so far as there are some exports which are credited to the partner country but which are destined for further shipment to a third country and are not recorded as goods in transit. On the other hand, the recorded export figures tend to be an underestimate in so far as there are indirect exports to the partner country via some third country. In theory, these inaccuracies would not arise if the production-consumption basis is used in recording the direction of trade so that exports are credited to the partner country only if the latter is actually the country where the goods are ultimately consumed or substantially transformed. But in the case of exports this is not necessarily true in practice as the exporter is frequently not aware of the final destination of his shipments, this being so especially when the exports are primary products. The possibility of inaccuracy increases if there is some special incentive for the exporters to make false reports on purpose, such as the existence of an embargo of certain types of exports to a particular country. Under such conditions the same reasons would prevail for the possible overestimate or underestimate of exports as mentioned under the consignment method.

As for the crediting of imports to a particular country, the degree of economic dependence tends to be overstated when the consignment method is used if the recorded imports include imports that actually originate from a third country but are credited to the partner country as the latter happens to be the place from which the goods are last directly consigned. On the other hand, the consignment method tends to underestimate imports from a partner country by omitting indirect imports via a third country. These sources of inaccuracy do not exist if the production-consumption basis is used so that imports are credited to a partner country only if the latter is the primary origin of the imports. Since it is generally easier to determine the primary origin of imports than the place of consumption of exports, the possibility of inaccuracy through ignorance is minimized. But it should be added, regardless of the basis of crediting imports to a partner country, where the system of general imports is used, the import data tend invariably to overstate the degree of the country's economic dependence on a partner country if some of the imports are destined for re-export without substantial transformation. Fortunately, this source of overestimate is unlikely to be large except when we deal with countries having a large entrepot trade. But in such cases, especially if the entrepot trade is the main economic activity, our concept of economic dependence no longer applies.

According to their respective national statistics in the case of the nine Asian countries and areas under study, Ceylon did not include re-exports in reporting exports in 1956 while Indonesia and Vietnam followed the practice of recording "special exports" only. All the other countries and areas include re-exports in their reported export trade. The same applies to the Philippines and Thailand which have not been included in our analysis. As for the basis on which destination and provenance are determined, India follows the consignment method in both exports and imports, while Burma, Ceylon, Hong Kong, Japan, Pakistan and Thailand use the consignment criterion in exports only. Malaya and Indonesia employ the consumption-production criterion throughout.[13]

On the basis of the practice of these individual countries, the logical conclusion seems to be that as far as imports from the Soviet Bloc are concerned the figures reported by India tend to understate the extent of its trade and hence the degree of its economic dependence on the Bloc as a whole mainly because of the existence of indirect imports from Hong Kong.

In regard to exports, Japan's exports to the Bloc tend to be understated because any re-exports that may be included tend to be small while there may be a fair amount of indirect exports via Hong Kong. On the other hand, Malaya's reported exports to the Bloc may be an overestimate to some extent as the volume of re-exports tends to be fairly large in view of the area's entrepot trade while actual, if not reported, indirect exports to Communist China via Hong Kong have in all probability declined following the lifting of the rubber export embargo in mid-1956. As for Burma, Ceylon, India and Pakistan, two opposite influences prevail. First, some indirect exports to Communist China via Hong Kong undoubtedly exist. Second, there may be some re-exports included in the reported exports to the Bloc in each case. Lastly, in the case of Ceylon and Burma, a portion of these exports to the Bloc may eventually end up in third countries. Thus, Burmese rice shipments credited to China may actually find themselves in Ceylon while some of the primary products shipped to Communist China may be re-exported or transshipped to the USSR. Accordingly, only if we assume that the indirect trade via Hong Kong is larger than the other two items combined can we conclude with some assurance that the

[13] See United Nations, *Direction of International Trade,* Vol. VIII, No. 7, pp. 326-28. Cf. also R. G. D. Allen and J. Edward Ely (ed.), *International Trade Statistics* (New York: John Wiley & Sons, 1953), where the criteria reported are somewhat at variance with the later UN publication.

reported export figures to the Soviet Bloc of these countries are underestimates. While such an assumption is probably correct, the element of conjecture cannot be removed entirely. But it is fairly safe to say that with the possible exception of Malaya and excluding Hong Kong it is exceedingly unlikely that the reported exports of all the remaining countries are overestimates of the true volume which must be considered in evaluating the economic interdependence of the Asian countries with the Soviet Bloc.

Thus we may summarize our findings by stating that both with respect to exports to the Bloc and with respect to imports from the Bloc, if Hong Kong is excluded, the total reported figures for the remaining countries and areas are probably underestimates, but certainly not overestimates, the probability being somewhat stronger in the case of imports from the Bloc. The inherent overestimate in the case of Hong Kong, in the sense the term is used here, is irrelevant as Hong Kong's main economic role is still that of an entrepot. To this general conclusion we may append the note that the underestimate in the reported figures applies also to Thailand and the Philippines.[14]

Since the underestimate, in so far as it exists, is due to indirect trade via Hong Kong, and since such indirect trade is mainly with Communist China, it follows further that Communist China's relative importance in the Bloc's trade with the other Asian countries must also have been understated. In view of the fact that Communist China's share in this trade is already large on the basis of recorded statistics, it will be well to examine the Chinese trade efforts a little further.

V

COMMUNIST CHINA'S POLICIES AND PROBLEMS IN TRADING WITH THE REST OF ASIA

While it would be a serious mistake to regard Communist China's growing trade with other Asian countries entirely as one of the natural results of an expanding economy, it would be equally fallacious to treat it as the outcome of a carefully engineered Chinese plot and nothing else. Moreover, insofar as Communist China's deliberate policy has been responsible for the actual pattern and trend of non-Communist

[14] A report in *Far Eastern Economic Review*, Hong Kong, October 4, 1955, Vol. XXI, No. 13, p. 435, indicated the presence of a fairly flourishing smuggling trade between Communist China and the Philippines. Thailand's trade with Communist China has been conducted indirectly but actively through Hong Kong.

Asia's trade with the Chinese mainland, the basic structure of this policy has not remained stationary. This very flexible policy has therefore not always taken a consistent course in dealing with the individual Asian countries.

There is little doubt that the predominant motives in Communist China's attempts to develop trade with other Asian countries immediately after 1951 were, first, to beat the embargo and secondly, to earn foreign exchange to add to its then depleted reserves. As Ceylon was not yet a member of the United Nations and did not agree to the embargo, the rubber-rice agreement with China was a natural outcome, especially as the terms of trade appeared to be extremely favorable to Ceylon at that time.[15] The desire to replenish the Communist state's coffers with foreign exchange, on the other hand, clearly account for the policy to permit exports to Hong Kong and Japan to exceed the level of Chinese imports from these two areas year after year.[16] Since the Hong Kong currency earned can be converted into United States dollars on the free market, while the credit balance with Japan can be settled in sterling, China's purpose is well served in this manner.

Moreover, as long as Chinese exports to Japan are greater than Chinese imports from Japan, the impression is given that the Chinese market is by no means limited by China's ability to pay and the small volume of trade between Japan and China can then be blamed upon Japan's participation in the embargo. Perhaps a similar consideration entered into Communist China's calculations in allowing Indonesia to build up a fair-sized indebtedness to China which it must then try to settle through the export of rubber and possibly also oil and tin, all of which were banned items.[17]

If the cultivation of Indonesia's trade is built upon the latter's desire to expand its export of a few primary products, the same may be said

[15] *Far Eastern Economic Review*, Hong Kong, March 31, 1955, Vol. XVIII, No. 13, p. 408; May 26, 1955, Vol. XVIII, No. 21, p. 671; October 20, 1955, Vol. XIX, No. 16, p. 508; and November 24, 1955, Vol. XIX, No. 21, p. 659.

[16] The several semi-official trade agreements between Communist China and Japanese businessmen have always provided for a trade turnover in which exports and imports are equal on paper. Actual experience has consistently resulted in much larger Chinese exports than Chinese imports, a situation which Communist China could easily have put a stop to if it had desired to do so.

[17] *Far Eastern Economic Review*, Hong Kong, July 5, and 12, 1956, Vol. XXI, No. 1, p. 29 and No. 2, p. 62.

of China's dealings with Burma, Malaya and Ceylon. With the lifting of the ban on rubber exports to the Chinese mainland by Malaya and Indonesia the rubber and rice exchange was turned into a more attractive proposition for China and a questionable blessing to Ceylon. Under the same conditions, the Malayan businessmen's mission to Peking in 1956 was induced to sell rubber to China without any Chinese guarantee that the product would be used for nonmilitary purposes only.[18] The case of Burma's rice barter with Communist China and the European Bloc has already been mentioned.

A few seemingly curious phenomena stand out in the labyrinth of trade agreements that Communist China has set up with its neighbors. Thus, cement was imported from Japan at the same time it was sold to Hong Kong and Malaya,[19] while rice was purchased from Burma when it was being sold to Ceylon. One may well wonder why, for instance, neither Ceylon nor Burma undertook to effect a triangular exchange in a way similar to that engineered by the Chinese. The only logical explanation would appear to be that Communist China, by virtue of its monopolization of foreign trade by the state and its control of domestic prices, is able to pay higher prices for imports and to accept lower prices for its exports, absorbing the loss domestically through the government budget or allowing the export producers to be indirectly subsidized by the buyers of imports while hoping to offset the external loss through future manipulations of the payments and barter agreements, such as by holding up export shipments.

In fact, in order to gain a larger political or economic objective, Communist China is reported to have employed many of the known techniques either to reduce foreign competition or to exploit a local semi-monopoly and an inelastic demand. Trade reports from Hong Kong have, for instance, repeatedly mentioned the practice of Chinese "dumping" of light manufactures and other consumer products in Thailand and Indonesia with its detrimental effect on Hong Kong's own exports.[20] The same effects are also felt by Japan in Southeast Asia.

[18] *Far Eastern Economic Review*, Hong Kong, October 18, 1956, Vol. XXI, No. 16, p. 515.

[19] *Far Eastern Economic Review*, Hong Kong, October 25, 1956, Vol. XXI, No. 17, p. 541.

[20] *Far Eastern Economic Review*, Hong Kong, July 5, 1956, Vol. XXI, No. 1, p. 29.

[21] *Far Eastern Economic Review*, Hong Kong, August 23, 1956, Vol. XXI, No. 8, p. 257.

Similarly, Chinese rice was reportedly sold in Malaya in 1956 at well below the price of both local and imported Thai rice.[21] On the other hand, Communist China is accused by Hong Kong to have time and again held up shipments of live hogs and other farm products to the colony in order to secure higher prices and greater profits.[22]

Lest the above instances should convey the impression that Communist China's external economic relations are managed without a hitch, let us quote the Communist Minister of Trade in his statement to the Chinese Communist Party's Eighth Congress in September, 1956:

> Sometimes when a temporary surplus was found in certain products in the country, the foreign trade departments were immediately requested to export them. As an example, in 1954, the reduced output in agriculture affected the production and earnings of certain industrial undertakings, and capital construction projects were curtailed. So in 1955 there was found a surplus of such items as steel products, cement and pig iron. This was only a temporary phenomenon. But the production departments were afraid lest there be accumulated stocks, and repeatedly requested the foreign trade departments to export the said items in quantity in order to support domestic production. However, by this year, when the high tide of socialism arrived, the domestic needs for those items greatly increased, and there was a request for the revision of the export plans which had already been decided upon.[23]

According to a recent article in the Communist *Ta-kung pao,*[24] 31.5 per cent of China's exports in 1957 consisted of products of industry and mining as compared with only 17.9 per cent in 1952, and there is a great deal of evidence that products of light manufacturing, as well as a few simple engineering products, are now entering the Chinese export market. There are certain advantages to produce consumer products for export,[25] and the progress of China's industrialization has definitely enhanced China's export capability. Given this background and the apparent decision of the Soviet Union to give more

[22] *Far Eastern Economic Review,* Hong Kong, July 26, 1956, Vol. XXI, No. 4, p. 124, and November 15, 1956, Vol. XXI, No. 20, p. 642.

[23] *Jen-min jih-pao* (People's Daily), Peking, September 28, 1956.

[24] Article by Wang Ti, *Ta-kung pao,* Peking, October 13, 1957.

[25] Yuan-li Wu, "Communist China's Economic Challenge," *Current History,* January, 1957.

impetus to the strengthening of economic ties with the less developed countries of Asia and the Middle East for political ends, it is indeed not surprising that we should find developments in China's external economic relations that lend support to such a policy. But as the Communist foreign trade minister has pointed out, fervent and capricious activities in foreign trade do not always reflect astute and devious planning. Occasionally, at any rate, they are actually the result of poor planning.

VI

THE SHORT-TERM EFFECT OF SOVIET BLOC TRADE WITH ASIA ON THE UNITED STATES.

From the point of view of the United States, the preceding appraisal of the Soviet Bloc's "economic offensive" in Asia and its basic techniques calls neither for hysterical alarm nor for indolent complacency. Obviously, the Bloc's expanding economic relations with Asia must have certain economic effects on the United States, and these must now be assessed.

We may begin with a short-term analysis, assuming that the economic structures of the Asian countries in question remain relatively unchanged and that there is no spectacular economic development. Within this framework a series of questions may then be posed. Would trade between the Asian countries and the United States be appreciably larger in the absence of the former's trade with the Soviet Bloc? Would there be a change in the nature of their trade with the United States? What conclusions, however tentative, can be drawn from the developments between 1952 and 1956? As a matter of convenience we may deal with the problem of the degree to which trade with the Soviet Bloc has substituted for potential trade with the United States by first considering the case of Asian exports and then the case of Asian imports.

In selecting one foreign country in lieu of another to sell one's products to (or to place one's orders in), the principal considerations are prices (allowing for quality differences), availability or usefulness of the means of payment involved, established contacts, and extra-economic preferences. Disregarding any extra-economic preference for the Soviet Bloc on the part of the Asian countries, we can readily see that established trade contacts, even up to the end of our period, would tend to favor the United States. There is relatively little information on the prices of imports from the Soviet Bloc as compared with United States prices, and we are perforce unable to take this factor into consideration. Thus the chief economic factor is reduced to a problem of payments.

If exports to the Soviet Bloc result in smaller exports to the United States, given the same volume of "compensatory financing,"[26] the smaller dollar earnings would tend to lead to lower imports from the United States while the higher exports to the Soviet Bloc would induce larger imports from the Bloc. Similarly, it may be argued that if imports from the Bloc should result in lower imports from the United States, the smaller demand for dollar expenditures may lead to smaller exports to the United States while the larger demand for rubles or the JMP would lead to larger exports to the Bloc and hence a smaller export capacity to the American market. Thus, where currency inconvertibility and trade agreements necessitate bilateral balances, it is not inconceivable for an all-round reduction of trade between the Asian countries and the United States to originate either through an initial substitution of Soviet Bloc products for United States products or through the substitution of Soviet Bloc markets for the American market.

There are, however, some good reasons to believe that we can go beyond the preceding general proposition. First, for most Asian countries bent on economic development, the demand for United States capital goods and other materials is probably so high that while imports from the Soviet Bloc may replace specific imports from the United States, they are not an active restraining factor in limiting the total volume of dollar imports. Rather, dollar imports are limited by the volume of exports to the dollar area, which is true especially in countries having a deficit balance on current account with the United States, and by the desire to increase dollar balances because of their convertibility, which is generally true even in countries enjoying a favorable balance on current account with the United States. The widespread practice of exchange restrictions against dollar imports in Asian countries testifies to this situation. Secondly, even if total imports from the United States are in rare instances reduced as a result of imports from the Soviet Bloc, the desire to increase dollar holdings alone would preclude any serious weakening of the desire to export to the United States. Any reduction of exports to the United States would have to be explained by a reduction of the capacity to export to the dollar area following the expansion of exports to the Soviet Bloc. The key to the

[26] This should be interpreted to include any planned net addition to the country's foreign exchange assets.

problem appears to be whether the Soviet Bloc market has taken Asian exports away from the American market. What can be said on this possibility?

Since a full examination of all the exports to the Soviet Bloc from the Asian countries in question is beyond the scope of the present paper, we shall limit ourselves to the principal exports of a few countries on which data are readily available. Furthermore, we shall assume that the "substitution effect" on potential exports to the United States may be judged according to (1) whether the particular export is one of the Asian country's "important" exports to the United States, (2) whether its export to the Soviet Bloc is larger than that to the United States, and (3) whether its export to the Bloc has increased since 1952. A commodity is regarded as one of the country's "important" exports to the United States if its value approaches, say, 5 per cent (arbitrarily chosen) of total United States imports from that country that year. To simplify description and classification the following number code is used:

I. . . . an "important" export to the United States
II. . . . not an "important" export to the United States
A. . . . export to the Bloc exceeding that imported by the United States
B . . . . export to the Bloc less than that imported by the United States
i. . . . 1956 export to the Bloc greater than the corresponding value in 1952
ii. . . . 1956 export to the Bloc less than the corresponding value in 1952

We further reserve the A category for commodities that are imported by the United States in noticeable quantities. Goods that are imported in negligible amounts by the United States or are not imported at all and that otherwise fall into the A category are described by A^1. Thus the "substitution effect" on the United States may be ranked for individual commodities as follows:

Large positive effect. . . . . IAi
Some positive effect . . . . IBi, IIAi, and IIBi
No effect. . . . . IIA^1i

The remaining four categories (IAii, IBii, IIAii and IIBii) may be treated as cases where the "substitution effect," if any, may have actually worked the other way, i.e., against the Soviet Bloc, and, as we shall see, are of no practical significance in our case.

The five largest (in value) commodity exports to the Soviet Bloc from Japan, India, Malaya and Ceylon and the three largest commodity exports from Indonesia are individually examined for 1956 and classified according to the preceding grouping. These commodities constituted respectively 36.7 per cent, 30.2 per cent, 95.4 per cent, 100 per cent and 91.1 per cent of the above five countries' total exports to the Soviet Bloc. The result is rather illuminating, to say the least:[27]

	Japan	*India*	*Indonesia*	*Malaya*	*Ceylon*
IAi					Rubber
IBi			Rubber	Rubber	
IIAi		Goat skins Shellac, pepper			
IIBi	Woolen and worsted fabrics				
IIA¹i	Calcium superphosphate, cement, ammonium sulphate, synthetic yarns and threads	Iron ore, tobacco	Copra, Sugar	Coconut oil, copra, oil bunker	Cocobeans, coconuts, pepper, coir
IBii				Tin	

Apparently, by far the largest group of important exports in 1956 from the five Asian countries examined was composed of items little if any of which was imported by the United States at all and it is doubtful that more, if any, could have been sold to the United States if they had not been exported to the Soviet Bloc or if they had been exported in smaller volumes. As for all the other commodities, exports of which to the Soviet Bloc showed an increase between 1952 and 1956, one must also refrain from jumping to the conclusion that curtailment of exports to the Soviet Bloc would have meant larger exports to the United States in value terms. Where the United States demand is relatively important in the world market and where price elasticity may be small, curtailment of exports to the Soviet Bloc may simply result in a collapse of prices and even a smaller dollar volume of exports to the United States. This consideration is particularly relevant in the case

[27] The original Asian export figures which are not given here are based on the Country-by-Commodity Series of the United States Department of Commerce. The corresponding United States import figures are based on the Bureau of the Census, United Statese Department of Commerce, *United States Imports of Merchandise for Consumption, Commodity by Country of Origin,* Report No. FT110, 1956.

of rubber. Nor should one overlook the potentially restrictive effect of the sentiments of United States manufacturers whose products may compete with these Asian exports. Finally, the state of business expansion and government purchases (for stockpiling, for instance,) in this country cannot but be a decisive factor. While these conclusions must remain essentially tentative, it would appear that the most important impact of Asia's expanding export trade to the Soviet Bloc lies in the development of complementary economic relationships between the two areas, marked by an increase in the number of exports the Soviet Bloc will, while the United States will not, purchase.

To the extent that the limited volume of Asian exports to the United States independently of the "substitution effect" of exports to the Soviet Bloc acts as a restraint on the expansion of United States exports to Asia, it is obvious that the latter could be increased if credits or grants were available. The relevant point in this connection is whether the Soviet Bloc's offers of credit to the Asian countries have in any manner reduced the volume of U.S. investments and grants in the same area. More precisely, the question is whether specific projects in Asian countries now receiving Soviet aid would have received American capital in one form or another on comparable terms had Soviet Bloc assistance been unavailable. Lack of detailed information on the terms of such agreements with the Soviet Bloc precludes an unequivocal answer on this point. But a plausible conjecture is that few of the projects receiving Soviet capital are such that American private capital would have been forthcoming on terms that would be even remotely comparable to Soviet terms and that only governmental credit or grants might have been made. Moreover, there might conceivably be some projects that are receiving Soviet instead of United States aid for the simple reason that regardless of its availability the latter has never been sought. Such cases would, however, have to be explained by political considerations on the part of the Asian countries and not by economic factors.

VII

THE LONG-TERM EFFECT OF SOVIET BLOC TRADE WITH ASIA ON THE UNITED STATES

It remains to be seen whether the long-term effect of the Soviet Bloc's economic and technical assistance to some of the Asian countries in their economic development is more detrimental to United States trade with Asia than the short-term effect apparently has been. This is particularly significant inasmuch as the Bloc's grants and credits to Burma, Cambodia and Indonesia alone amounted to an estimated minimum sum of $165.4 million during 1956 and 1957 alone while similar aid to India had reached an estimated cumulative total of $368 million by the end of 1956.[28] It is reasonable to assume that such aid has not been provided for humanitarian reasons. But granted that some political and economic advantage may accrue to the Bloc, the question here is whether United States trade will suffer as a result.

Let us assume that in the long run the Asian countries now receiving Soviet Bloc aid will find themselves economically more developed in the *minimal* sense of a higher national output, with or without a *per capita* increase, marked by the successful completion of at least some of the projects in which aid receipts have been employed and the consequent transformation of the economic structure through the reallocation of available resources. Such economic development has both its trade-creating and its trade-destroying effects. If, as one may safely assume on the basis of past experience, the net effect should be trade-creating, there is no *prima facie* case for projecting that this expanded trade would fall upon one country instead of another or that, as far as the United States and the Soviet Bloc countries are concerned, it would be apportioned between the two according to some formula based on the relative volumes of assistance they have individually provided in the past. Thus it is at least *theoretically* possible for economic development in Asia promoted by Soviet Bloc assistance to benefit United States trade with Asia even more than it will benefit the Bloc's own trade with Asia. (The same possibility, of course, also exists for United States aid indirectly to benefit the Bloc's trade with Asia!)

However, we are compelled to take a less sanguine view if as a result of the Bloc's economic and technical aid to the Asian countries there is a political reorientation so that discrimination against United States trade will increase. Alternatively, discrimination against trade with the United States may be increased if Soviet Bloc trade succeeds in rising to such a level as to give the Bloc sufficient leverage to exert economic pressure toward this end. Finally, United States trade with Asia will suffer if the Bloc's economic assistance helps to transform the economies of the Asian countries in such a way that expansion of trade

[28] See United States Department of State, *The Sino-Soviet Bloc Economic Offensive in the Far East*, February, 1958; also CEIR, *op. cit.*, 1957.

with the United States would be economically unprofitable. The last point is worthy of another moment of thought.

As far as we know, a common feature of most economic aid agreements between Asian countries and the Bloc is the provision of loan repayments in commodities which are the debtor countries' traditional exports and of which they often have surpluses that cannot be profitably disposed of elsewhere. While the Bloc's offer of long-term purchases with or without price stabilization may appear to be a blessing in the short run, the long-term effect on the Asian countries may be the further expansion of the same industries. On the one hand, this will increase their dependence on the Bloc as a market and hence as a source of imports. On the other hand, it will weaken the drive for export diversification on which greater capacity to export to the United States depends. If the demand for capital goods import can be satisfied by the Bloc, and if any increase in the demand for consumer goods import consists mostly of demand for goods that do not belong to the "luxury" trade which the United States is in a better position to supply, this failure to expand the capacity to export to the United States may be accompanied by a lessened demand for imports from the United States. The dollar shortage suffered by some of the Asian countries would then disappear, but only because they have become economically aligned with the "ruble bloc."

Fortunately, none of these effects are inevitable. The United States' own policy in facilitating the expansion of imports from Asia, its policy in stepping up economic aid to the Asian countries aimed at both development and export diversification, and the maintenance of a high level of economic activity at home will do much to counter the Soviet Bloc's efforts. One takes pleasure in noting that all these policies can be defended on grounds independently of the exigencies of the Soviet "economic offensive."