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# Economic Growth and Foreign Aid

by Professor Karel Holbik, Boston \*

**Japan's metamorphosis from a less developed country to one of the world's most important industrial nations was closely connected with increasing foreign pressures. Where did they result from and what will be their consequences for the country's economic policy?**

Japan's postwar dramatic emergence to the incredible position as the world's fastest growing economy (with an average annual growth rate of 17 p.c.) was made possible by certain domestic forces as well as by the country's international economic relations<sup>1</sup>. Should the Japanese have indeed discovered or developed during the past two decades the ability to grow economically at high rates, the consequence of this could not be underestimated in any part of the globe, be it industrialized or still in the process of economic development (see Table 1).

**Table 1**  
**Six Dimensions of Japan's Economic Miracle**  
(period 1960–1970)

	GNP (bn of yen)	GNP per capita (yen)	Industrial Production <sup>1</sup>	Exports (\$ mn)	Imports (\$ mn)	Internat. Reserves (\$ mn)
1960	15,499	160,000	58	4,055	4,491	1,823
1970	70,984	551,000	214	19,318	18,880	4,399 <sup>2</sup>

<sup>1</sup> Index, 1965 = 100. <sup>2</sup> 1971: \$ 15,235

Among the internal economic factors supporting Japan's impressive achievements there is labor productivity which, together with nominal wages, almost doubled between 1965 and 1970; intensified use of capital; an ingenious substitution of technological innovations, manpower utilization and foreign trade expansion for deficient natural resources; a high rate of capital formation (accounting for one-third or more of the GNP) a very substantial portion of which has been financed from personal savings; and a high degree of cooperation between major enterprises on the one hand and commercial banks and the national government on the other hand. Probably no other government in the free world can be justifiably referred to as a "factor of production". Its role

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<sup>1</sup> In 1970, Japan's GNP with \$ 197 bn ranked second among the free world nations; the GNPs of the USA and West Germany amounted to \$ 977 bn and \$ 186 bn, respectively. However, in terms of its national income per capita (\$ 1,800), Japan ranked only 17th in the world. Recent gains in this income have been severely burdened by inflationary pressures.

in the country's economic efforts and activities is that of a pillar, not of a crutch.

Japanese history is largely responsible for the nation's reputation that it has traditionally considered the rest of the world, and Asia in the first place, as an economic colony from which to draw raw materials and to which to export "a river of finished products". The composition of Japan's exports and imports as it appears in Table 2 below leaves no doubt as to its dependence on both the markets of (primarily) the Western more developed countries (MDC's) and the supplies of the less developed countries (LDC's). To give a few examples, by 1975, Japan is projected to be 100 p.c. dependent on imported aluminium, nickel and uranium, 90 p.c. on imported iron ore, 86 p.c. on imported coal, and 74 p.c. on imported natural gas.

**Table 2**  
**Commodity Composition of Foreign Trade**  
(in \$ mn)

Commodity	Exports		Imports	
	1960	1970	1960	1970
Foodstuffs	256	648	548	2,574
Raw Materials	154	352	2,208	6,677
Mineral Fuels	16	48	742	3,905
Manufactures	3,614	18,116	986	5,633
Others	15	154	7	91
Total	4,055	19,318	4,491	18,880

During the early postwar years the war-ravaged Japanese industry was incapable of manufacturing for export; the nation was industrially underdeveloped. In fact, during the period of recovery (1946–52) and normalization (1953–58) Japan employed the so-called poorer-country privileges to protect domestic industries against foreign competition and to control foreign exchange. It also found it necessary to employ labor-saving methods and to practice import substitution. Accordingly, the Japanese remained intent on producing domestically goods which minimized purchases of other countries' products.

During those years Japan's role in world markets was that of a marginal supplier of consumption-oriented light manufactures which were exported

to the MDC's of the West. In relation to them, Japan was an LDC. But in relation to the Asian LDC's, which by the end of the 1950's absorbed one-third of its exports, Japan was an MDC exchanging its relatively capital-intensive manufactures for those countries' primary commodities required by its growing production capacity. For example, between 1950 and 1970, Japanese imports of iron ore rose from 1.4 mn ts to 102 mn ts (60 p.c. of which was acquired in Australia, India, Malaysia and the Philippines) and those of crude petroleum rose from 1.5 mn ts to 196 mn ts.

This situation created an image of a Japan dominant over East and Southeast Asia but dependent on the West, especially the United States. It was probably from this perspective that emerged a popular Japanese outlook that, if Japan could turn the scale of trade balances with the USA in its own favor, it could modestly claim to be a developed country. In fact, during the 1950's, nothing annoyed the Japanese more than the nation's LDC status. Thus the economy's spectacular economic growth during the 1960's supported Japan's successful bid to become an MDC.

In contrast to its frequent balance of payments crises in previous years, Japan began accumulating foreign exchange reserves at a rate which became rather embarrassing to the country. While it coped with a trade balance deficit of \$ 558 mn in 1961, it had a surplus of \$ 3,963 mn in 1970. Almost inevitably, in the course of that decade Japan's long-term capital outflow rose from \$ 11 mn to \$ 1,591 mn.

### Costly Consequences of Progress

These improvements in Japan's economic conditions and status were accompanied by some costly obligations that were bound to exert a lasting effect on its economic policies. Japan lost not only its exemptions in the International Monetary Fund (Article 8) and in the General Agreement on Tariffs and Trade (Article 11), but after it joined the Organization for Economic Cooperation and Development, it also pledged to make a quick transition to free trade and to participate in OECD's Development Assistance Committee (DAC), and thus to contribute to Western efforts to help the Third World countries. In addition, Japan had to agree to preferential arrangements for imports from these countries within the framework of UNCTAD. Japan became a "rich" nation.

These events resulted in Japan facing the 1970's with the challenge of continuing its domestic economic growth without the protection provided to the less developed areas. Now, Japan must achieve such growth while shouldering its obligations as an MDC. The external pressures to which

it has been exposed can be detected in the geographic composition of its foreign trade which reveals not only the remarkable expansion of its exports as well as imports, but also its positive trade balances with Asia, the US, Europe, and Africa.

Gradual internationalization of the Japanese economy in the 1960's (about 20 p.c. of its GNP depend on external trade) resulted in two important imbalances, i.e. those with Asia and the USA. In the eyes of the Asian LDC's, Japan has grown to be the "Colossus of the North" in the Asian context. To the US, Japan became a dollar-hoarding creditor.

**Table 3**  
**Geographic Composition of Foreign Trade**  
(in \$ mn)

		1960	1970
Total	Exports (X)	4,055	19,318
	Imports (M)	4,491	18,881
Asia	X	1,458	6,033
	M	1,367	5,553
USA	X	1,102	5,940
	M	1,554	5,560
Europe	X	538	3,363
	M	488	2,555
Africa	X	352	1,423
	M	164	1,099
S. America	X	180	596
	M	145	976

The implications of the nation's new economic status have been far-reaching. Japan has had to relax import restrictions and modify its controls on capital transactions. As a consequence, direct investment by other nations has been liberalized, restrictions on foreign portfolio investment have been reduced, and Japan's capital outflow has been intensified. Japanese banks expand their overseas operations and "take-overs" of foreign enterprises by Japanese companies are becoming more frequent.

### Investments Abroad

The funds which the Japanese have earned through favorable trade have begun to be channeled into overseas investment. In fact, the Japanese appear to have decided that the only way in which to protect their own self-interest, i.e. to assure the future flow of foreign raw materials, is to create stable economies all across Asia by putting Japanese production facilities in those countries. Investment in factories abroad would also trim the growth of Japan's foreign exchange reserves — much to the delight of Western nations. Although these nations received in December, 1971, the called-for 17 p.c. revaluation of the yen, Japan's trade surpluses have continued to rise. The revaluation proved ineffective because export prices increased only mildly and

these increases have been absorbed by Japanese exporters. In addition, some higher prices stimulated productivity. On the other hand, the anticipated import cuts did not materialize. In 1973, the international financial community still asks, "Will the defense of the yen" necessitate another revaluation?

It is noteworthy though that it is not just external pressures that Japan is responding to. Other reasons, in the form of domestic pressures, have also stimulated foreign investment, such as rising wages, air and water pollution, lack of space for the construction of new industrial plants, etc. Further, to correct the external trade imbalance, the government has made an effort to raise internal consumer demand. The latter is likely to expand if the national authorities succeed in "remodeling the Japanese archipelago" through public spending on urban needs and other social welfare programs.

**Table 4**  
**Recent Trends in Japan's Far East Trade**

(First 9 months, 1972; in \$ mn)

Country	Exports	Imports
Indonesia	821.5	407.7
South Korea	332.6	663.1
Taiwan	296.6	774.9
Philippines	341.8	314.9
Singapore	87.9	450.8
Thailand	188.4	361.3
India	300.0	172.3
Malaysia	280.1	174.3
Pakistan	83.8	44.7
Australia	1,544.1	518.8
New Zealand	171.2	111.2

From 1960 to 1970, Japan assumed a major role in trade and investment in South Korea, Taiwan and much of Southeast Asia. Recently it has declared that it does not want to be left out of the expected reconstruction of Vietnam. Attracted by the favorable tax treatment offered by local governments to establish export industries, some Japanese companies already operate industries abroad which turn out semi-finished goods to be exported back to Japan. For example, one leading company in the electrical-machinery field has two such wholly-owned factories in Taiwan. Another company in the synthetic textile field operates a weaving and dyeing plant in Taiwan which exports its yarns to Hong Kong where, at a subsidiary of the same Japanese company, they are knitted into finished products for export. Ishikawajima-Harima Heavy Industries, Ltd. recently began building 15,000 ton freighters in Singapore — for export. Three other firms are joining with outside investors to build a \$ 500 mn petroleum-chemical refinery in Thailand whose output is largely to be exported. Producers of Noritake china plan to build a factory in Thailand using

local raw materials and intend to export the entire output. Clearly, however self-serving this overseas investment is, it also responds to the desires and needs of the Asian LDC's.

**Table 5**  
**Total Net Flow of Resources to LDC's 1961-71**

(in \$ mn)

	1961	1971
Japan	381	2,141
USA	4,549	7,045
West Germany	847	1,915
France	1,406	1,656
United Kingdom	899	1,570

Japanese determination and pledge to do everything possible to head off world pressure for another revaluation of the yen go far to explain why the nation's net outflow of long-term capital has kept expanding, and why it quadrupled in 1972 to a record of \$ 4.46 bn. In order to reduce the conspicuous accumulation of their international reserves, the Japanese have recently also decided to curb exports of radios, tape recorders, electrical appliances, cameras and similar products. Nevertheless, it is with apprehension and anxiety that the nation's traders view resurgent protectionism in the USA and Western Europe.

#### Japan's Development Aid

The above described international economic strength of Japan invited still another pressure on its economy, i.e. that of foreign aid, which the country is obligated to extend to LDC's by virtue of Japanese membership in the DAC. In this respect, too, the nation's performance has been exceptional, as the following tabulation demonstrates. In fact, Japan became in 1971 the second largest aid donor and its aid equaled 0.96 p.c. of the Japanese GNP, i.e. it approached closely the OECD and UNCTAD target of 1 p.c.

**Table 6**  
**Official and Private Aid Allocated in 1971**

(in \$ mn)

Asia	1,083
Of which SE Asia	369
Near East	95
Africa	145
America	281
Europe	51
Oceania	32

Yet, this remarkable record is not free of peculiarities. One of them may be seen in the small proportion of grants in total official aid. While the respective percentage for all DAC nations equals 59 and is exceeded by some donors, it is only 33 in Japan's case. Further, the terms of Japanese private bilateral loans tend to be less generous

than those of the other major DAC donors. The average maturities of those loans are 22 years, the average interest rate is 3.5 p.c., and the average grace period is 6–7 years. Japan's technical assistance and multilateral investment are minimal.

In view of the reasons touched upon above, it is understandable that Japan's self-interest is best served when the lion's share of its private foreign aid (export credit and direct investment) is extended to five Asian countries, namely, India, Indonesia, Pakistan, South Korea and Taiwan, although a total of 27 countries are recipients of Japanese development assistance. The relative importance to Japan of the different developing areas finds expression in Table 6.

Japan is destined to be the most developed Asian nation for many years to come. Although the economic gap between it and that continent's LDC's can be expected to widen further, its potential adverse effect on international relations will be reduced if Japan amends its policies of economic and inward-looking nationalism of the last decade. An economic symbiosis between Japan and the rest of Asia is not only desirable, but inevitable. Japan, more than any other country, can accomplish a great deal by its constructive assimilation into the world trade and monetary communities. This objective is well served by the progressing liberalization and internationalization of the nation's economy as well as by the greater geographical diversification of its exports.

## Trade Relations with the Communist Countries

by Bernd Kunze, Hamburg \*

**After the Federal Republic of Germany, Japan is the second largest trade partner of the Communist countries as a whole and of the Soviet Union and the largest partner of the People's Republic of China. It has only been in recent years that Japan gained this formidable position in the trade with the East.**

Japan's exports to the Communist countries went up in 1972 by 25.5 p.c. against the previous year, to \$ 1,441.3 mn. The imports from the countries of the Eastern bloc increased in the same year by 29.9 p.c. to \$ 1,225.1 mn. This means that 5 p.c. of Japan's total exports (1971: 4.8 p.c.) and 5.2 p.c. of its total imports (1971: 4.8 p.c.) went to, and respectively, came from the Communist states. In 1960 Japan's importance as a trading partner for the Eastern bloc had still equalled only that of Belgium/Luxembourg, Denmark or The Netherlands. But in the beginning of the sixties Japan made great efforts for an expansion of its trade with the Communist countries. While the Japanese government especially strengthened its contacts with the COMECON-states, it also modified the export restriction valid in the COCOM-orbit<sup>1</sup> in 1960 and, on April 26, 1961, lifted the stipulations for barter

transactions in the trade with most state-monopoly countries, and allowed cash transactions. The result was an increase of Japan's imports from the Socialist states by 79 p.c. in 1961 and by 114.4 p.c. in the following year. Ever since, there has been a permanent growth of the exchange of goods between Japan and the state-monopoly countries. Only in 1969 Japan curtailed its imports from the Soviet Union temporarily because of the exports not having been considered adequate in 1967 and 1968. Japan's trade balance with the People's Republic of China has been showing a surplus since 1965 whereas the trade with the COMECON-states resulted during the period under review in a deficit with the exception of the years 1962 and 1972 (see Table 1).

There was, during the last 10 years, simultaneously a relatively big change in the regional structure of Japan's trade with the East: in the early sixties the Soviet Union had clearly been Japan's biggest trade partner, but since 1965 the People's Republic of China has — interrupted only during the Cultural Revolution — been occupying this

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<sup>1</sup> COCOM = Coordinating Committee: a merger of the NATO-countries excluding Iceland but including Japan for the purpose of preventing the export of goods of strategic potential to the Communist world.