Report No. 82-67 E

JAPAN'S INTERNATIONAL TRADE PATTERNS, INSTITUTIONS, AND POLICIES

by
Dick K. Nanto
Analyst in International Trade and Finance
Economics Division

CRS

CONGRESSIONAL RESEARCH SERVICE
THE LIBRARY OF CONGRESS

March 15, 1982

The Congressional Research Service works exclusively for the Congress, conducting research, analyzing legislation, and providing information at the request of committees, Members, and their staffs.

The Service makes such research available, without partisan bias, in many forms including studies, reports, compilations, digests, and background briefings. Upon request, CRS assists committees in analyzing legislative proposals and issues, and in assessing the possible effects of these proposals and their alternatives. The Service's senior specialists and subject analysts are also available for personal consultations in their respective fields of expertise.

ABSTRACT

Japan's aggressive export drive and chronic balance of trade surplus with the United States has generated considerable interest in the Japanese international trading sector. This paper presents an overview of Japan's performance in its trading relations. The paper begins with a discussion of the development, size, and importance of Japan's international trading sector. It then examines the composition, institutions, and policies for trade. This is followed by a review of Japan's balance of payments, capital flows, value of the yen, and direction of trade.

CONTENTS

JAPAN'S INTERNATIONAL TRADE PATTERNS, INSTITUTIONS, AND POLICIES

In many respects, international trade is the lifeblood of Japan's economy. For a country long on people but short in natural resources, the international economy offers much needed sources of supply and markets not available domestically. Japan's participation in the greater world economy enables it to enlarge the scope of its economic activity and to enhance productivity, efficiency, and economic well-being. As Japan discovered during its 250 years of seclusion, an island economy practicing autarky imposes constraints on its own economic progress and standard of living.

This paper presents a broad overview of Japan's international trade and balance of payments. It begins with a discussion of the development, size, and importance of Japan's international trading sector. It then examines the composition, institutions, and policies for trade. This is followed by a review of Japan's balance of payments, capital flows, value of the yen, and direction of trade.

SUMMARY

Japan ranks third among the world's largest exporting nations (after the United States and West Germany) and accounts for about 7 percent of all trade of non-Communist countries. As a percentage of gross national product, however, Japan depends less on foreign markets than many other industrialized countries. In 1980, Japan exported 15 percent of its GNP, which was less than that reported for Australia, France, Italy, West Germany, and Canada. The United States at 10 percent, however, exports a smaller share of GNP than Japan.

Specific Japanese industries, however, are heavily dependent on export markets. Exports, for example, account for about half of the output of Japan's automobile, machine tool, and television receiver industries and approximately three-fourths of the production of watches and cameras.

Japan's imports, moreover, include critical raw materials, energy, and food essential to the well-being of the nation. The perception in Japan, therefore, tends toward the position that the country is heavily dependent on foreign trade.

Such dependence on imports of essential commodities has been a major concern to policymakers. In addition, the economic disruptions of the 1970s added a new dimension to Japan's perception of its security. Japan now tends to view threats to its national security as more likely to occur in the economic than military sphere. Its definition of national security tends to take a wider meaning to include interruptions in supplies of raw materials, sudden price hikes, rapid changes in currency values, and food embargoes.

Japan's institutions for trade include the powerful Ministry of International Trade and Industry (MITI), which holds primary responsibility for formulating and implementing economic policy dealing with both international trade and

domestic industries. It does coordinate policy with other ministries and the Prime Minister, but its interests lie mainly in enhancing the strength of domestic industry. MITI maintains close relations with businesses and factions within the Liberal Democratic Party and seeks a consensus on matters of policy.

Japanese integrated trading companies serve as middlemen, financiers, intelligence gatherers, and developers. The largest nine firms handle more than half of the nation's imports and nearly half of the exports. They maintain large staffs abroad and also engage in considerable third-country trade, including the handling of an estimated 10 percent of all U.S. exports.

Japan's methods for promoting exports has taken two paths. The first has been to develop industries that initially could manufacture products that would substitute for imports in the domestic economy and then become efficient enough to sell them abroad. The second was to provide incentives for firms to export. Most export incentives, however, were dropped during the 1960s and 1970s as Japan's balance of trade improved. The problem of the 1980s for Japan appears to be more of restraining exports than of promoting them.

Japan's import policies have been undergoing considerable liberalization from the protectionist decades of the 1950s and 1960s. Under the recent Multilateral Trade Negotiations, the average tariffs on industrial imports are scheduled to decline from 5.0 to 2.5 percent. This compares favorably to the drop from 6.1 to 4.2 percent in the United States and 6.3 to 4.6 percent for the European Economic Community. Japan, however, still maintains rigid import quotas or high tariffs on agricultural products, leather, and other politically sensitive items. Problems with standards, customs procedures, and other nontariff barriers, also appear to keep imports of manufactured goods at relatively low levels.

During the 1960s and 1970s, the value of Japan's merchandise exports grew at an average annual rate of 18.9 percent to reach the equivalent of \$129.8 billion in 1980. Exports were drawn into world markets by economic liberalization abroad, low prices for Japanese products, and a widening recognition of high quality in certain items. They were pushed into world markets by domestic recessions and saturation in home markets.

Japan's imports consist mainly of mineral fuels--including petroleum--(50%), food (10%), raw materials (9%), and machinery and equipment--including automobiles--(7%). Exports consist primarily of machinery and equipment (63%), metals (16%), chemicals (5%), and textiles (5%).

Japan prefers to measure its balance of merchandise trade with shipping costs included in the values of imports. By this measure, in recent years, it has incurred trade deficits only following the two major oil crises in 1973 and 1979. If imports are valued on a free-on-board basis, Japan has had no merchandise trade deficit since 1963.

In terms of the balance on current account, Japan recorded deficits in 1973-75 and 1979-80. As for the capital account, since the mid-1960s, long-term capital flows have generally been negative (net outflow of long-term investment funds), while short-term capital flows have usually been positive. A cumulative surplus has accrued in Japan's balance of payments, which has increased its reserves of gold and foreign exchange from \$2 billion in the late 1960s to \$25 billion in 1980.

The value of the yen has fluctuated greatly since the gradual shift to floating exchange rates that commenced in 1971. From 360 yen per dollar in 1971, the yen appreciated to 265 yen per dollar in 1973 before the impact of the oil crisis began to be felt. By 1976, it had weakened to 297 per dollar but regained strength over 1978 to reach 219 yen per dollar in 1979. With the jump in oil prices in 1979, however, the yen again weakened and fell to 227 per dollar in 1980. In 1981, it has fluctuated between 205 and 239 yen per dollar.

Japan trades with nearly every country of the world. In 1980, 47 percent of its merchandise exports went to non-Communist, developed countries, 46 percent to developing countries, and 7 percent to Communist countries. The United States with 24 percent of Japan's exports was the largest customer, followed by West Germany, South Korea, Taiwan, and China with less than 5 percent each.

Japan's supplier countries reflect its needs to import food, energy, and raw materials. In 1980, developing countries supplied 60 percent of Japan's imports with half of that coming from the Middle East. Developed countries provided 35 percent and communist countries 5 percent of Japan's imports. The United States with 17 percent and Saudia Arabia with 14 percent were the leading exporters to Japan. Other major exporters were Indonesia, the United Arab Emirates, Australia, and Canada.

The structure of Japan's trade gives rise to international trade friction. In most cases the countries that export energy, food, and raw materials to Japan cannot absorb an equal amount of Japanese exports of finished products. This means that bilateral trade is usually not balanced. Japan is forced to run large trade deficits with countries providing essential imports while running surpluses with large market economies, such as the United States and those of Europe, who can buy Japan's exports. The resulting political friction is a major challenge for Japanese policymakers.

I. TRADE DEPENDENCY

Japan is one of the great trading nations of the world. With imports and exports of merchandise totalling $272 billion in 1980, Japan is the third largest trading nation after the United States and West Germany. Among non-Communist countries, Japan accounts for about 10 percent of the trade of the industrialized nations and 7 percent of all trade. 1/

As a percentage of gross national product, however, Japan exports less than other major trading countries of the world. In 1980, for example, it exported 15 percent of its GNP compared with 18 percent for Australia, 20 percent for France, 23 percent for Italy, 28 percent for West Germany and the United Kingdom, 30 percent for Canada, and 57 percent for the Netherlands. The United States, at 10 percent, however, exports a smaller share of its GNP than Japan. 2/

In terms of overall markets, therefore, Japan is less dependent on foreign trade than many other industrialized countries of the world. For specific industries, however, international export markets are extremely important. Exports account for about half of the output of the Japanese automobile, machine tool, and television receiver industries and about three fourths of Japan's production of watches and cameras. 3/

In export-oriented industries such as these, international markets allow firms to achieve economies of large-scale production, volume sales, and world-wide feedback for product improvement and to mitigate demand fluctuations by balancing domestic and foreign sales according to economic conditions.

1/ International Monetary Fund. International Financial Statistics, Aug. 1981. p. 46-7.

2/ Ibid.

3/ Bank of Japan. Economic Statistics Monthly, April 1981. p. 133-4, 153-4. Japan Economic Journal. Industrial Review of Japan/1981. p. 46ff.

In terms of critical raw materials, moreover, Japan is highly dependent on international trade. Japanese imports of food account for about half of the population's caloric intake and about 30 percent of the value of total food consumption. 4/ Japan also depends on imports for nearly all its crude petroleum, iron ore, lead ore, copper ore, bauxite, wool, and cotton. It imports about 75 percent of its coal and zinc ore. 5/

Such dependence on imports of food and critical raw materials has been a major concern to government policymakers. Economic disruptions of the 1970s, moreover, added a new dimension to Japan's perception of its economic insecurity. These disruptions include the U.S. suspension of dollar convertibility in 1971, the oil crises of 1973 and 1979, and the U.S. embargo on soy bean exports in 1973. 6/

As Japan began the decade of the 1980s, therefore, such import dependence and recent history of international economic disruptions caused many policymakers to consider threats to the country's national security more likely to occur in the economic than military sphere. This focus on economic rather than military considerations was facilitated by the U.S. nuclear umbrella, which provided protection against large-scale warfare. Japan's definition of national security, therefore, tends to take a broad meaning to include interruptions in supplies of raw materials, sudden price hikes, rapid changes in currency values, and food embargoes.

4/ Japan. Economic Planning Agency. Economic Outlook, Japan '81. Tokyo. Economic Planning Agency, c. 1981. p. 26.

5/ Japan. Office of the Prime Minister. Monthly Statistics of Japan, Sept. 1980. Tokyo. p. 46. Krause, Lawrence, and Sukeo Sekiguchi. Japan and the World Economy. In Patrick, H., and H. Rosovsky, eds. Asia's New Giant. Washington, Brookings, 1976. p. 386.

6/ Akao, Nobutoshi and Maureen White. Japan's Economic Security. Intereconomics, May/June 1981. p. 115-20.

II. BACKGROUND AND HISTORY

Following Japan's defeat in World War II, U.S. occupation forces rigidly controlled Japan's international economic relations. Imports were limited to essential food and raw materials, with a sizable proportion financed by U.S. economic assistance. Over the 1945-52 period, the United States provided Japan with net economic assistance of $1,938 million, of which Japan eventually repaid $490 million. Approximately 59 percent of the aid was in food or agricultural equipment, while 15 percent was in industrial materials, and 12 percent in transportation vehicles and equipment. Aid imports amounted to 19 percent of total Japanese imports over the occupation period. 7/

With extreme shortages of supplies in Japan's domestic economy, exports did not begin to recover until the Korean Conflict when special procurement by United Nations forces induced boom conditions in Japan's industries. By 1960, Japan's exports had grown to account for 3.6 percent of those of non-Communist countries, enough to rank sixth and to be at approximately the same level as the Netherlands and Italy.

Over the 1960s, the dollar value of Japan's exports grew at an average annual rate of 16.9 percent, more than 75 percent faster than the average of all non-Communist countries. By 1970, therefore, Japan's exports had risen to account for 6.8 percent of all free-world exports, up considerably from the 3.6 percent in 1960. 8/

7/ Nanto, Dick K. The United States' Role in the Postwar Economic Recovery of Japan. Doctoral Dissertation. Cambridge, Mass., Harvard University, 1976. p. 66-69, 181.

8/ International Monetary Fund. International Financial Statistics, May 1977. Washington. p. 56-7

During the 1970s, the growth rate in Japan's domestic economy dropped in half from the double-digit rates of previous decades. Japan also faced sharply higher bills for imported energy and raw materials. This caused Japanese industries to look abroad for new markets. As a result, Japan's exports continued to grow at an average annual rate of 21 percent to account for 7.1 percent of all non-Communist country exports in 1980. Japan's trade grew so rapidly that whereas the United States exported five times as much as Japan in 1960, by 1980, it exported less than twice as much. 9/

During the 1970s, in particular, Japan's export growth provided a stimulus to sluggish domestic economic markets. In that sense, Japan's recent economic growth has been "export-led." During the earlier postwar period, however, Japan's rapid growth in international trade appears to have been as much a result of the rapid growth in its domestic economy as a cause of it. 10/

The development of Japan's international economy followed two distinct patterns. The first is a process of import-substituting industrialization. As Japan began to industrialize, it first imported certain products. As imports rose, domestic production was initiated and gradually substituted for imports. Imports, therefore, would peak and then decline, as Japanese production rose. Eventually the Japanese product would gain acceptance on world markets and exports would rise. After a time, however, as domestic wage rates rose, producers in newly industrialized countries became more efficient, or energy costs became too high, Japanese production and exports could peak. Imports also could rise again.

9/ International Monetary Fund. International Financial Statistics, July 1981. Washington. p. 46.

10/ Ohkawa, Kazushi and H. Rosovsky. Japanese Economic Growth. Palo Alto, Stanford University Press, 1973. p. 173-5.

The second pattern is one of growing relative labor costs forcing industries to move up to higher value-added products. As Japan's wage costs have risen relative to those in less developed nations, its traditional products have become less able to compete both at home and in international markets. This has required that Japan move up the technological spectrum from labor-intensive manufactures to more sophisticated and technology-intensive products. 11/ Hence, Japan, which began by exporting such labor-intensive products as textiles, tea, and toys, moved on to cameras, cars, steel, ships, and television receivers, and is now expanding into computers, copy machines, machine tools, and telecommunications equipment.

11/ Lifson, Thomas R. Japanese Business Strategies for the 1980's. Japan Report, v. XXVI, May 1, 1980. p. 2-3.

III. INSTITUTIONS FOR TRADE

A. Ministry of International Trade and Industry (MITI). MITI holds primary responsibility for formulating and implementing international trade policy, although it does so by seeking a consensus among interested parties. The Ministry coordinates trade policy with the Ministry of Foreign Affairs, which holds primary responsibility for international political relations, and the Ministry of Finance, which becomes involved in matters pertaining to government revenues or expenditures. MITI also coordinates trade policy with the Economic Planning Agency, the Bank of Japan, and the Ministries of Agriculture, Transport, Telecommunications, and Health on issues affecting their interests. The Prime Minister, Diet, and Fair Trade Commission also can restrict MITI's operations. 12/

MITI is responsible not only for exports and imports, but also for all domestic industries and businesses not specifically covered by other ministries, investments in plant and equipment, pollution control, energy and power, some aspects of foreign economic assistance, and consumer complaints. Such broad responsibility allows MITI to integrate conflicting policies, such as pollution control and export competitiveness, to prevent excessive damage to industries. 13/

MITI serves as an architect of industrial policy, an arbiter for industrial problems and disputes, and a regulator. MITI's major objective is to strengthen Japan's industrial base and to insure that Japan's foreign trade operates

---

12/ FTC Warns Against MITI's Administrative Guidance. The Japan Economic Journal, v. 19, Sept. 1, 1981. p. 2.

13/ Ojimi, Yoshihisa. A Government Ministry: The Case of the Ministry of International Trade and Industry. In Vogel, E. F. Modern Japanese Organization and Decision-making. Berkeley, University of California Press, 1975. p. 101.

smoothly and efficiently. MITI maintains very close relations with domestic producers and key factions within the Liberal Democratic Party. It does not manage Japanese trade and industry along the lines of a centrally planned economy. It does, however, provide administrative guidance and other direction--either formal or informal--to industries on modernization, technology, plans for investments in new plant and equipment, and on competing both with each other and with foreign firms. 14/

With some industries, MITI has strong statutory authority to intervene. In others, however, its influence is weak (newspapers, for example). 15/ MITI's guidance is backed, however, by its ability to develop a consensus among those industries receiving its advice; its power to grant certain licenses; its influence with the Japan Development Bank, Japan's Export-Import Bank, and the Asian Development Bank; and a basic confidence Japanese business seems to have in the validity of the guidance. 16/ As a last resort, MITI can either "go public" and bring peer pressure on the reluctant firm or exert its influence on the firm's banks or creditors. 17/

The close relationship between MITI and Japanese industries means that foreign trade policy often complements and is coordinated with the ministry's efforts to strengthen domestic manufacturing interests. MITI facilitated the early development of nearly all major Japanese industries by providing protection from import competition, technological intelligence, help in

---

14/ Ibid. Vogel, Ezra F. Japan as No. One. Cambridge, Mass., Harvard University Press, 1979. p. 72-3.

15/ Magaziner, Ira C. and Thomas M. Hout. Japanese Industrial Policy. London, Policy Studies Institute, 1980. p. 32-3.

16/ Vogel. No. One. p. 71-3.

17/ Lepon, Jeffrey M. Administrative Guidance in Japan. Fletcher Forum. v, 2, May 1978. p. 148-50.

licensing foreign technology or affiliates, access to foreign exchange, or assistance in mergers. 18/

By the 1980s, however, with reduced import tariffs, ready access by firms to foreign exchange, and international codes preventing government subsidies, MITI's ability to protect domestic industry from imports has been weakened considerably. In 1981, for example, MITI initially stood by while a surge of lower-cost aluminum imports from the United States threatened Japan's aluminum industry. The assistance program MITI eventually proposed has faced resistance by both the United States and Japan's Ministry of Finance. 19/

MITI also plays the leading role in agreements by Japanese industry to limit exports to various countries. In 1978, for example, MITI requested that the motor vehicle, motorcycle, copy machine, wrist watch, and camera industries limit their exports to 1977 levels. 20/ A later example, in 1981, was Japan's voluntary export restraints on automobiles to the United States and Canada. In the discussions over the issue, MITI, along with the Foreign Ministry, convinced the Japanese auto industry to go along with the restraints despite industry objections. MITI allocated the export quota among the various manufacturers and monitored their compliance. 21/

18/ Magaziner, Industrial Policy, p. 45-90. For a description of MITI's activities in developing the computer, steel, and motor vehicle industries, see Kaplan, Eugene. Japan, the Government-Business Relationship. Washington, U.S. Govt. Print. Off., 1972. p. 77-158.

19/ Japanese Aluminum Producers Blast 'Unfair' U.S. Competition. Journal of Commerce, April 29, 1981. p. 13A. Cullison, A.E. Japanese Impose Tariff Quotas on Imports of Aluminum Ingots. Journal of Commerce, October 26, 1981. p. 12A.

20/ Oriental Economist, Japan Economic Yearbook, 1979/80. Tokyo, Oriental Economist, 1979. p. 35.

21/ Letter, Okawara, Yoshio to William F. Smith. May 7, 1981. Cullinson, A. E. Japanese Automakers to Comply with Quotas. Journal of Commerce, May 4, 1981. p. 1, 5.

B. The Japan External Trade Organization (JETRO). JETRO was established by MITI in 1958 in order to consolidate Japan's export promotion efforts. It operates as a non-profit facility initially capitalized at two billion yen. The Japanese government provides more than half of its annual operating budget. 22/

Initially, JETRO's activities focussed mainly on promoting Japan's products in other countries. As Japan's exporters established themselves in world markets and Japan's balance of trade turned from deficit to surplus, however, JETRO's role has shifted from strictly export promotion to more varied activities. These include the furtherance of mutual understanding with trading partners, import promotion, liaison between small businesses in Japan and their overseas counterparts, and data dissemination. JETRO maintains offices in more than sixty countries.

C. Trading Companies. A major Japanese contribution to international trade has been the development of the integrated (general) trading company. These were first organized during the late 1800s to replace the foreign companies dominating Japanese trade and to provide foreign marketing services to Japanese firms unfamiliar with the outside world. 23/

The trading company's role initially was to act as specialized wholesalers for Japanese manufacturers in domestic and foreign markets and to buy raw materials and other inputs for manufacturing operations. Later, however, Japanese trading companies developed the capacity to serve as financial intermediaries, absorb foreign exchange risk for their customers, provide

---

22/ Japan External Trade Organization. Japan External Trade Organization, 1979. Tokyo, JETRO, 1979. p. 2-4.

23/ Krause and Sekiguchi, Japan and World Economy, p. 389-92.

technical advice to small firms whose products might be exported, and engage in direct investment overseas, often to secure stable sources of supply. A few large trading companies have grown to form the core of zaibatsu groupings of businesses.

Trading companies, moreover, engage in trade not only for Japanese firms, but among third countries. Such transactions might include, for example, arranging for the sale of a U.S. chemical plant to the Soviet Union or importing Rumanian urea into Bangladesh. 24/ Third country trade now accounts for more than 10 percent of the sales of the nine largest trading companies. 25/ Japanese trading companies handle approximately 10 percent of all U.S. exports. 26/

Japan's integrated trading companies enter into a variety of transactions. Each company will handle as many as 20,000 different products with numerous suppliers. This enables them to arrange multi-product deals encompassing many facets of a project. An example would be the export of a turnkey petrochemical plant to Singapore requiring equipment, technology, and consulting services of many different firms. 27/

In 1980 more than 6,000 trading companies existed in Japan. The top nine companies, however, accounted for the bulk of the transactions. The leaders

---

24/ Young, Alexander K. The Sogo Shosha: Japan's Multinational Trading Companies. Boulder, Colo., Westview Press, 1979. p. 9-10.

25/ Kanabayashi, Masayoshi. Japan's Big and Evolving Trading Firms: Can the U.S. Use Something Like Them? Wall Street Journal, Dec. 17, 1980. p. 56.

26/ Lachica, Eduardo. Unlikely American Exporter: Japan. Wall Street Journal, Nov. 11, 1981. p. 31.

27/ Young, Sogo Shosha, p. 4-9.

of the top nine were Mitsubishi with sales over the fiscal year of $63.4 billion, followed by Mitsui with $57.6 billion, C. Itoh with $48.7 billion, and Marubeni with $46.3 billion. Sumitomo and Nissho-Iwai with sales of $43.9 and $29.9 billion, respectively, also were major traders. 28/

Together the top nine trading companies recorded gross sales in fiscal year 1980 of $330 billion or an amount equivalent to 30.2 percent of the nation's GNP. 29/ These companies also handle more than half of Japan's imports and nearly half of Japan's exports. There is greater concentration in certain products. These companies, for example, handle more than 90 percent of Japan's imports of steel, 70 percent of food imports, and more than 50 percent of imports of textiles and fuels. They also are responsible for nearly 90 percent of Japan's exports of steel, 60 percent of the exports of chemicals, and 50 percent of the textiles. In 1980 nearly 6,000 Japanese were employed abroad by the big nine trading companies. 30/

D. International Banks. Japan's extensive foreign trade and international capital flows are financed by a well-developed banking system. The system was orginally patterned after England's but has subsequently evolved into one with its own structure and characteristics. It consists of a mixture of government and private banking institutions with a higher degree of specialization than in most countries. 31/

28/ Aoyama, Norio. The Role of the Japanese Sogoshosha. Paper presented at the U.S.-Japan Business Conference, Lincoln, Nebraska. Oct. 6, 1981.

29/ Ibid.

30/ Keizai Koho, Japan 1981, p. 31.

31/ Bieda, Ken. The Structure and Operation of the Japanese Economy. Sydney, John Wiley and Sons Australasia, 1970. p. 134-35.

The Bank of Japan stands at the head of the banking structure. Although it coordinates policy with the Ministry of Finance, it maintains considerable independence in pursuing monetary policy and regulating activities of Japan's banking community.

The commercial banking system centers on fourteen city banks (including the Bank of Tokyo), which tend to be larger and to have headquarters in more populous cities than Japan's sixty-three regional banks. Most of these city banks are very large. When ranked by assets (in 1979) the Dai-Ichi Kangyo Bank was the tenth largest in the world, the Fuji Bank the fourteenth, the Sumitomo Bank the sixteenth, the Mitsubishi Bank the seventeenth, the Sanwa Bank the nineteenth, and the Norinchukin Bank the twentieth. 32/

The six largest Japanese banks, therefore, rank among the top twenty in the world. All but the Norinchukin Bank also rank among the top twenty in terms of deposits. When ranked by pre-tax earnings, however, only the Industrial Bank of Japan at eighteenth place was counted among the world's top twenty.

The Bank of Tokyo was established as a special foreign exchange bank with the purpose of facilitating foreign exchange transactions and export financing. 33/ All the city banks and some of the regional banks, however, also are authorized to deal in foreign exchange, finance international transactions, and make international loans. Sixty-four foreign banks, including many American, also maintain subsidiaries in Japan and handle international transactions. 34/

32/ The Top 500. The Banker, v. 130. p. 125.

33/ Adams, T.F.M. and Iwao Hoshii. A Financial History of the New Japan. Tokyo, Kodansha International, 1972. p. 104-5.

34/ Ranking Foreign Banks in Japan. Euromoney, March 1981. p. 79.

The Export-Import Bank of Japan plays an important role in financing costly exports such as whole plants or major pieces of equipment. Such export financing often is vital in international bidding on major projects and is a key component in Japan's programs for export promotion. In mid-1981, the Bank reported a total of 5.02 trillion yen in loans and discounts outstanding. 35/

E. International Organizations for Trade. Japan holds membership in the United Nations (U.N.), International Monetary Fund (IMF), Organization for Economic Cooperation and Development (OECD), and the General Agreement on Tariffs and Trade (GATT). It also participates in the international organizations whose focus is economic development.

As a member of the IMF, Japan cooperates with other countries in moderating short-run volatility in the value of the yen and in following guidelines for maintaining a strong and viable international currency system. It is obliged to follow IMF guidelines, for example, which prohibit countries from manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members. This places a constraint on Japan's ability to protect its less efficient export industries by holding the value of the yen at an artificially low level. 36/

Japan's membership in the OECD also constrains its foreign economic policy to some extent. The OECD's "gentlemen's agreement" on guidelines for government-supported export credits, for example, places a floor on interest rates and other terms of loans to less developed countries which often are

---

35/ The Bank of Japan. Economic Statistics Monthly, August 1981. p. 105.

36/ International Monetary Fund. Annual Report 1980. Washington, IMF, 1980. p. 57.

used to finance imports. 37/ Japan occasionally circumvents such guidelines, however, by combining economic assistance and loans.

GATT provides the structure under which Japan hammers out most detailed international agreements on import and export policies. In particular, the Tokyo Round of the Multilateral Trade Negotiations resulted in the reduction of many of its tariff and non-tariff barriers to trade. 38/ Japan also negotiates bilaterally with countries on economic matters of mutual interest.

37/ Eximbank and the War on Export Credit Subsidies: Should We Compete? Trade Policy Review, v. 2, July 1981. p. 3.

38/ Key MTN Agreements Open Markets in European Community, Canada, and Japan. Business America, v. 4, Feb. 23, 1981. p. 3-9.

IV. FOREIGN TRADE POLICIES

A. Export policies. The fundamental proposition that Japan must "export or perish" (if not perish, at least suffer a sizable decrease in standard of living) appears to underlie much of its export policymaking. It tends however, to view exports not as an end but as a means by which it can buy imports. MITI feels that since Japan is lacking in resources and has a high population density, it cannot attain a high income level without importing a variety of primary and finished goods while exporting finished products. 39/

Following World War II, Japan's re-emergence as a major exporter was not accomplished without considerable difficulty. Without raw material exports that tend to sell themselves, Japan had to crack open foreign markets that often were unfamiliar or even hostile. Developing markets abroad for products bearing the label, "Made in Japan," did not come easily. The president of the Sony Corporation, for example, after his first visit to the United States left with the impression that selling Sony products here would be impossible. 40/ Japanese exports also were not always afforded the lowest tariff rates. Although Japan joined GATT in 1955, for example, fourteen nations (including the United Kingdom, France, and Australia) did not extend most-favored-nation treatment to Japanese exports until later. 41/

Until the late 1960s, Japan's ability to export usually fell short of its appetite for foreign products. With no floating exchange rate to elicit

---

39/ Japan. Ministry of International Trade and Industry. White Paper on the International Trade, 1979. Tokyo. Foreign Press Center, 1979. p. 97.

40/ Weymouth, Lally. Meet Mr. Sony, How the Japanese Outsmart Us. The Atlantic Monthly, v. 244, Nov. 1979. p. 37.

41/ Krause and Sekiguchi, Japan and the World Economy, p. 414.

market forces to reduce any trade deficit, Japan turned to either restricting imports or promoting exports. Its methods for promoting exports took two paths. The first was to develop world-class industries whose products would initially substitute for imports and then compete in international markets. The second was to provide incentives for firms to export.

During the two decades following World War II, Japan's export strategy took the form of a combination of taxes and government assistance to build its export industries. After joining the IMF in 1964, however, it had to drop its major export incentive, the total exemption of export income from taxes, in order to comply with IMF procedures. Special tax treatment of costs for market development and export promotion were maintained, however, into the 1970s. 42/

Once Japanese export industries became established, most have been able to compete without abnormal government assistance. Japan's current programs of export promotion and of export finance appear to differ little from those in other major countries. MITI's problem of the 1980s appears to be more one of restraining Japanese exports, in the face of increased protectionist pressures abroad, not promoting them.

B. Import policies. By the late 1950s, Japan's international trade had regained its prewar level and its balance of payments was displaying enough strength that the rigid protection imposed during the immediate postwar recovery period became increasingly difficult to justify. The IMF, GATT, and OECD all placed strong pressure on Japan to free its commerce and inter-

42/ Ishimine, Tomotaka. Fiscal Incentives for Japan's Export and Direct Foreign Investment. Bulletin for International Fiscal Documentation, v. 32, 1978. p. 174-5.

national payments system. In 1960, therefore, Japan adopted a policy of gradual trade liberalization. 43/ This liberalization has continued into the 1980s.

The process of liberalization involved easing import quotas, reducing tariff rates, freeing transactions in foreign exchange, and admitting foreign capital and technology into Japanese industries. By 1964, Japan was able to achieve the level of trade liberalization required for full membership in GATT, the IMF, and the OECD. 44/ Not until December 1968, however, did it make the political decision truly to begin to open its economy to international competition. By then Japan's trade problem had shifted from one of deficits to surpluses. Even with liberalization, however, its economy was still relatively protected. 45/

Under the Kennedy Round of trade negotiations completed under GATT in 1967, moreover, Japan was committed to reduce its tariff rates. Japan's average tariff rates on consumer goods, therefore, dropped from 23.6 percent in 1968 to 11.2 percent in 1972. For capital goods, the corresponding tariff rates were cut from 15.2 to 9.3 percent over the same period. 46/

During the 1970s, with Japan's strong export performance, the remaining barriers to trade in its industrial sector became increasingly difficult to justify. Under the Tokyo Round of the Multilateral Trade Negotiations concluded in 1979, Japan is scheduled to reduce import tariffs by 1987 on about 2,600 industrial products and about 200 agricultural or fishery products. In addition,

---

43/ Ho, Alfred K. Japan's Trade Liberalization in the 1960s. White Plains, N.Y., International Arts and Sciences Press, 1973. p. 6-7.

44/ Ho, Japan's Trade Liberalization, p. 16.

45/ Krause and Sekiguchi, Japan and World Economy, p. 426-7.

46/ Ibid., p. 428.

it has signed codes which call for the simplification of application procedures for import licenses; publication of standards for manufactured goods and systems of approved imports; setting of a customs valuation standard at sales price; and government procurement, including that by the Nippon Telegraph and Telephone Company, based on national treatment and non-discrimination. 47/

When the Tokyo Round tariff cuts are fully implemented, Japan's average tariff rate on total industrial imports (dutiable plus duty-free, excluding petroleum) should decline from 5.0 to 2.5 percent. This compares favorably with the drop from 6.1 to 4.2 percent scheduled for the United States and from 6.3 to 4.6 percent for the European Economic Community. On most industrial products, therefore, tariffs no longer can be considered a serious barrier to imports into Japan. 48/ The tariff on automobiles, for example, is zero.

In terms of import quotas, Japan still maintains residual quantitative restrictions on 5 manufactured goods and 22 agricultural products. This is down considerably from the 490 items in 1962, the 136 items in 1964, the 90 items in 1970, and the 31 items in 1973. The items under quota restrictions, such as oranges, beef, flour, fruit juice, shore fish, and leather, however, have proved to be highly visible and the subject of considerable complaints by exporting countries. 49/

Japan certainly is not the only country which imposes import quotas; the stringency of its quotas, however, opens it to foreign criticism. The United States, for example, also maintains an import quota on beef, although it has

---

47/ Japan, MITI, White Paper 1979, p. 105.

48/ U.S. Department of Commerce. International Trade Administration. Tokyo Round Tariff Reductions. Washington, U.S. Department of Commerce, 1980. p. 1-3.

49/ Krause and Sekiguchi, Japan and World Economy, p. 426. MITI, White Paper 1979, p. 107. U.S. Congress, U.S.-Japan Trade Report, 1980. p. 54-63.

only a minor effect on the U.S. price of beef. In Japan, however, the price of beef is so high that at times cattle have been air-freighted in for slaughter, since the quota does not apply to living animals.

Unlike Japan's policy to eliminate gradually most import barriers in its industrial sector, protection of its agricultural sector remains strong. Agricultural import policy, however, is determined mainly by Japan's agricultural ministry, not MITI. This ministry has little incentive to liberalize agricultural imports, since Japan's farmers export little, are highly dependent on government price supports, and with the shortage of land, have only distant hope of competing fully with imports. As a result of these policies, in 1979, food cost 70 percent more in Tokyo than it did in New York City or Paris. 50/

Although some very tough residual attitudes of protectionism remain, Japan is generally considered to be an open trading nation, except in most agricultural products. 51/ Nontariff barriers to foreign products in Japan, however, still make market penetration difficult. These include an intricate and unwieldy system of distribution, the tendency of firms belonging to *zaibatsu* groupings to buy from affiliated companies, arbitrary product standards, complicated and time-consuming customs procedures, long time lags in regulatory approval, and the fact that most foreign firms had been shut out of the Japanese market during the years when the economy was growing rapidly.

In November 1981 the United States proposed to Japan that it reduce a number of trade barriers to reduce its export surplus. These included removing

---

50/ Gutman, M. and A. Kruck. Prices and Earnings Around the Globe. Zurich, Union Bank of Switzerland, 1979. p. 11.

51/ U.S. Congress. House Committee on Ways and Means. Subcommittee on Trade. United States-Japan Trade Report 1980, Committee Print, Washington, U.S. Govt. Print Off., 1980. p. 1.

import tariffs on 29 commodity items, abolishing nontariff barriers which hamper imports, simplifying highly complicated import procedures, and generally relaxing the remaining import controls. 52/ Japan responded by promising to move up tariff reductions on 1,600 commodities (scheduled to occur in future years) and to reduce nontariff barriers on 67 of 99 items on which complaints had been received.

In 1982, Japan's import barriers, in particular nontariff barriers, became a primary target of U.S. legislation aimed at attaining reciprocity in market access between the United States and major trading partners. 53/ Trade negotiations traditionally have hinged on offers of reciprocal trade concessions usually presented as a package of reductions in tariff and nontariff barriers. Such concessions, however, generally did not require equal market access on an industry by industry basis across countries. Nations with a recent history of protectionism, moreover, could offer much, because they had much to give.

As currently envisaged, reciprocity would tend to de-emphasize past concessions and focus on current market access for competitive U.S. products on an industry by industry basis. It also would expand coverage to include, not only merchandise, but services and investment. Proposed U.S. reciprocity legislation would require the U.S. President to determine which foreign markets are less open than those in the United States, pursue remedies under current dispute settlement procedures, and if necessary, retaliate against the exports of the country in question.

Japan has viewed the reciprocity proposals with some alarm. Many in Japan feel that such reciprocity would only promote protectionism. 54/

52/ Cullison, A.E. U.S. Nudges Japanese on Trade. Journal of Commerce, November 18, 1981. p. 1A, 7A.

53/ See, for example, S. 2071, S.2094, and H.R. 5457, 97th Congress.

54/ Cullison, A. E. Japanese Hit US Plan for Trade. Journal of Commerce. Jan. 12, 1982. p. 1A.

V. LEVEL AND COMMODITY COMPOSITION OF TRADE

A. Export Levels. The growth of Japan's exports during the 1960s and 1970s was phenomenal. Beginning in 1960 at $4.1 billion, Japan's merchandise exports grew at an average annual rate of 18.9 percent to reach $129.8 billion in 1980. During 1974, the growth rate in merchandise exports reached a high of 50.4 percent, although some of this growth appears to have been merely moved forward from 1975. During the 1980s, exports are likely to continue to grow, but rising protectionism in many markets has caused policymakers to reconsider the limits to a strategy requiring such rapid increases in exports. (See Table 1.)

The growth in Japan's exports can be viewed as the result of both pull and push factors. The pull represents increasing demand for Japan's products as trade barriers in major countries were reduced and and incomes grew. In addition, from the mid-1960s, procurement for the Vietnam War created a large market for Japanese goods. The countries involved in the war (or their bases) were located relatively close by. One estimate is that in 1971 the Indochina conflict added more than a billion dollars to Japanese exports. 55/

Another pull factor was the price competitiveness of Japanese products, particularly during the 1960s. From 1960 to 1970, Japan's export price index increased by only 4 percent. By 1975, however, export prices had jumped 38 percent, although they declined by 12 percent by 1978. In 1979 and 1980, export prices rose 19 percent, but even at that, in 1980 they were only 51 percent higher than they were in 1960. (U.S. export prices were 189 percent higher.) This price competitiveness facilitated sales of Japanese products abroad. 56/

55/ Krause and Sekiguchi, Japan and World Economy, p. 419.

56/ Bank of Japan. Economic Statistics Annual, 1980. Tokyo, Bank of Japan, 1981. p. 8.

Table 1. Japan's Merchandise Exports, Imports and Trade Balance, 1960-80
(In millions of U.S. dollars and percentages)

Year	Exports	Imports a/	Balance	Annual Growth Rate of Exports
1960	4,054.5	4,491.1	-436.6	17.3%
1961	4,235.6	5,810.4	-1,574.8	4.5
1962	4,916.2	5,636.5	-720.3	16.1
1963	5,452.1	6,736.3	-1,284.2	10.9
1964	6,673.2	7,937.5	-1,264.3	22.4
1965	8,451.7	8,169.0	282.7	26.7
1966	9,776.4	9,522.7	253.7	15.7
1967	10,441.6	11,663.1	-1,221.5	6.8
1968	12,971.7	12,987.2	-15.5	24.2
1969	15,990.0	15,023.5	966.5	23.3
1970	19,317.7	18,881.2	436.5	20.8
1971	24,018.9	19,711.8	4,307.1	24.3
1972	28,591.1	23,470.7	5,120.4	19.0
1973	36,930.0	38,313.6	-1,383.6	29.2
1974	55,535.8	62,110.5	-6,574.7	50.4
1975	55,752.8	57,863.1	-2,110.3	0.4
1976	67,225.5	64,799.0	2,426.5	20.6
1977	80,494.8	70,808.7	9,686.1	19.7
1978	97,543.1	79,343.0	18,200.1	21.2
1979	103,031.6	110,672.2	-7,640.6	5.6
1980	129,807.0	140,527.7	-10,720.7	26.0
1981	152,100.0	143,210.0	8,890.0	17.2

a/ Customs clearance basis (includes shipping costs).

Source: Export and import data from Bank of Japan. Economic Statistics Annual, 1977, p. 207 and 1980, p. 223. Japan Posted Trade Deficit for December, Asian Wall Street Journal Weekly, Jan 25, 1982. p. 7

During the 1970s the rising quality of Japanese products began to receive wide press. Japanese steel, ships, watches, television receivers, stereo equipment, automobiles, semiconductors, and many other goods gradually developed a reputation for being manufactured to high standards and under strict quality control. This also worked to increase demand for Japanese exports.

The push factor for Japan's exports came as domestic markets became saturated or as the domestic economy moved into a recession. By 1964, for example virtually all households had radios and television sets (monochrome), 80 percent had bicycles, and each household had an average of 2.7 watches. 57/ New markets had to be found elsewhere. During recessions, moreover, manufacturers looked abroad for sales as domestic markets contracted and as accounts receivable from domestic wholesalers became increasingly difficult to collect. As recessions ended, new export markets often were maintained. With the slower economic growth rates of the 1980s, moreover, Japanese firms are likely to be turning to export markets for expansion.

B. Composition of Exports. Japan's exports comprise a variety of products, virtually all of which are processed to some degree. (See Tables 2 and 3.) During the postwar period, the composition of Japan's exports shifted through a technological progression. Primary products, light manufacturers, and crude items, which were predominant during the 1950s, were gradually eclipsed by heavy industrial goods, complex machinery and equipment, and consumer durables which required large capital investment and advanced technology to produce. This is not to say that the earlier products decreased in absolute amounts, but rather that those of advanced technology increased much more rapidly.

57/ Japan. Office of the Prime Minister. Japan Statistical Yearbook, 1968. Tokyo. Japan Statistical Association, 1969. p. 458-59.

Table 2. Japan's Exports by Commodity, Selected Years, 1960-80
(in millions of U.S. dollars)*

Commodity	1960	1970	1975	1979	1980
Foodstuffs	255.9	647.7	760.1	1,206.8	1,588.5
Textiles	1,223.4	2,407.5	3,718.7	4,908.2	6,295.5
Chemicals	181.1	1,234.5	3,888.8	6,100.2	6,766.7
Plastics	(14.4)	(436.2)	(995.4)	(1,674.7)	(1,866.6)
Fertilizers	(59.5)	(143.4)	(664.5)	(328.4)	(376.6)
Other	(107.2)	(654.9)	(2,228.9)	(4,097.1)	(4,523.5)
Nonmetallic mineral manufacturers	169.0	372.4	729.6	1,547.1	1,862.7
Metals	568.4	3,805.3	12,517.5	18,378.9	21,318.6
Iron and steel products	(388.1)	(2,843.7)	(10,176.5)	(14,113.4)	(15,454.2)
Fabricated metal products	(154.7)	(713.7)	(1,801.1)	(3,127.0)	(3,947.0)
Nonferrous metals	(25.6)	(248.0)	(539.9)	(1,138.5)	(1,917.4)
Machinery and equipment	1,035.1	8,941.3	30,003.7	63,182.5	81,481.2
Motor vehicles	(78.1)	(1,337.4)	(6,190.4)	(17,021.2)	(23,273.4)
Vessels	(288.1)	(1,409.6)	(5,998.2)	(3,868.8)	(4,681.9)
Scientific and optical equipment	(92.5)	(498.5)	(1,367.6)	(3,860.7)	(4,526.3)
Tape recorders	(9.7)	(450.8)	(632.6)	(2,102.0)	(3,305.1)
Radio Receivers	(144.6)	(694.9)	(1,324.0)	(2,497.2)	(3,008.9)
Power generating machinery	(24.1)	(238.3)	(873.4)	(2,103.4)	(2,548.1)
Thermionic valves, transistors	(6.4)	(399.8)	(442.5)	(1,679.2)	(2,306.9)
Office machinery	(1.3)	(329.4)	(776.5)	(1,830.5)	(2,279.7)
Metalworking machinery	(7.8)	(115.7)	(451.9)	(1,534.2)	(1,743.2)
Watches and clocks	(3.5)	(129.5)	(458.2)	(1,386.4)	(1,733.5)
Television receivers	(2.9)	(383.8)	(782.8)	(1,282.7)	(1,660.4)
Electric generators & equipment	(21.7)	(156.6)	(435.4)	(1,243.4)	(1,503.4)
Textile machines	(48.4)	(196.4)	(534.4)	(715.6)	(871.3)
Sewing machines	(54.7)	(129.3)	(246.8)	(409.6)	(465.5)
Other	(251.3)	(2,471.3)	(9,489.0)	(21,647.6)	(27,573.6)
Other commodities	621.7	1,909.0	4,134.5	7,708.0	10,493.8
Rubber tires and tubes	(23.3)	(162.2)	(545.4)	(900.6)	(1,382.1)
Toys	(90.0)	(137.5)	(115.1)	(254.1)	(335.3)
Other	(508.4)	(1,609.3)	(3,474.0)	(6,553.3)	(8,776.4)
Total	4,054.5	19,317.7	55,752.8	103,031.6	129,807.0

*Totals may not add because of rounding. Valued on a free-on-board basis.

Sources: Bank of Japan. Economic Statistics Annual, 1980. Tokyo, Bank of Japan. p. 227-30. Japan Tariff Association. The Summary Report, Trade of Japan. December 1980. p. 73-80 and March 1976, p. 67-74. Japan Ministry of Finance. Monthly Return of the Foreign Trade of Japan, January-December 1960. p. 72-371.

Table 3. Composition of Exports, Selected Years, 1960-80
(percentages)*

Commodity	1960	1970	1975	1979	1980
Foodstuffs	6.3	3.4	1.4	1.2	1.2
Textiles	30.2	12.5	6.7	4.8	4.8
Chemicals	4.5	6.4	7.0	5.9	5.2
Plastics	(0.4)	(2.3)	(1.8)	(1.6)	(1.4)
Fertilizers	(1.5)	(0.7)	(1.2)	(0.3)	(0.3)
Other	(2.6)	(3.4)	(4.0)	(4.0)	(3.5)
Nonmetallic Mineral Manufacturers	4.2	1.9	1.3	1.5	1.4
Metals	14.0	19.7	22.5	17.8	16.4
Iron and Steel products	(9.6)	(14.7)	(18.3)	(13.7)	(11.9)
Fabricated Metal products	(3.8)	(3.7)	(3.2)	(3.0)	(3.0)
Nonferrous Metals	(0.7)	(1.3)	(1.0)	(1.1)	(1.5)
Machinery and Equipment	25.5	46.3	53.8	61.3	62.8
Motor Vehicles	(1.9)	(6.9)	(11.1)	(16.5)	(17.9)
Vessels	(7.1)	(7.3)	(10.8	(3.8)	(3.6)
Scientific and Optical Equipment	(2.3)	(2.6)	(2.5)	(3.7)	(3.5)
Tape Recorders	(0.2)	(2.3)	(1.1)	(2.0)	(2.5)
Radio Receivers	(3.6)	(3.6)	(2.4)	(2.4)	(2.3)
Power Generating Machinery	(0.6)	(1.2)	(1.6)	(2.0)	(2.0)
Thermionic Valves, Transistors, etc.	(0.2)	(2.1)	(0.8)	(1.6)	(1.8)
Office Machinery	(0.0)	(1.7)	(1.4)	(1.8)	(1.8)
Metalworking Machinery	(0.2)	(0.6)	(0.8)	(1.5)	(1.3)
Watches and Clocks	(0.1)	(0.7)	(0.8)	(1.3)	(1.3)
Television Receivers	(0.1)	(2.0)	(1.4)	(1.2)	(1.3)
Electric Generators and Equipment	(0.5)	(0.8)	(0.8)	(1.2)	(1.2)
Textile Machines	(1.2)	(1.0)	(1.0)	(0.7)	(0.7)
Sewing Machines	(1.3)	(0.7)	(0.4)	(0.4)	(0.4)
Other	(6.2)	(12.8)	(17.0)	(21.0)	(21.2)
Other Commodities	15.3	9.9	7.4	7.5	8.1
Rubber Tires and Tubes	(0.6)	(0.8)	(1.0)	(0.9)	(1.1)
Toys	(2.2)	(0.7)	(0.2)	(0.2)	(0.3)
Other	(12.5)	(8.3)	(6.2)	(6.4)	(6.8)
Total	100.0	100.0	100.0	100.0	100.0

*Totals may not add because of rounding.

Source: See Table 2.

Between 1960 and 1980, for example, foodstuffs fell from 6 to 1 percent of total exports. Textiles, likewise, fell from 30 to 5 percent, and other manufacturers dropped from 15 to 8 percent. Nonmetallic mineral manufacturers also declined from 4 percent in 1960 to 1 percent in 1980.

Over the same period, exports of higher technology items, such as machinery and equipment, soared from 26 to 63 percent of total exports. Metals and chemicals increased slightly. Major exports in 1980 were motor vehicles, iron and steel products, vessels, and scientific and optical equipment.

C. Import Levels. During the 1960s and 1970s, imports grew in tandem with exports. In a sense, import growth was constrained by exports, because exports generated the foreign exchange to purchase the imports. Beginning from $4.5 billion in 1960 (on a customs clearance basis), imports grew at an average annual rate of 18.8 percent to reach $140.5 billion in 1980.

The growth in imports was facilitated by several major factors. The most important probably has been the overall growth in the Japanese economy and income levels. Another factor has been the price of imports. In 1973, Japan's import prices were at essentially the same level as in 1955. By 1976, however, they had nearly doubled and by 1981 had increased by another 50 percent. 58/ Each increase in import prices, in particular those of essential raw materials and energy, caused Japan's import bill to rise accordingly. In the short-term Japan had little choice but to pay higher prices for imports. Its bill for imported crude oil, for example, rose from $23 billion in 1978 to $53 billion in 1980. 59/

58/ Japan. Office of the Prime Minister. Annual Report on the Consumer Price Index, 1979. Tokyo, 1980. p. 12. Bank of Japan. Economic Statistics Monthly, May 1981. p. 12.

59/ Japan Tariff Association. Summary Report, Trade of Japan, December, 1980. p. 87.

A third major factor explaining the increase in imports has been trade liberalization. Reduced tariff rates and a weakening of other barriers to trade have enabled imports to compete more fully in Japan's markets. The appreciation of the yen after 1971, moreover, caused imports to be less expensive for Japanese buyers.

In the short-term, the level of imports tends to fluctuate with Japan's domestic economy. When the economy expands, imports also grow. During recessions, when growth slackens or turns negative, imports also slow down or decline.

D. Composition of Imports. Japan imports a wide range of products, although energy, raw materials, and food have been the major items. (See Tables 4 and 5.) It experienced the largest growth, however, in imports of mineral fuels, (petroleum, coal, and other fuels, mainly because of price increases), which rose from 17 percent of all imports in 1960 to 50 percent in 1980. The only other major category of imports to gain in terms of the percentage of total imports was the miscellaneous category, which rose from 7 percent in 1960 to 11 percent in 1980.

All other categories of imports declined as a percent of total imports, although in absolute terms, they grew quite rapidly. Over the 1960 to 1980 period, raw materials declined from 17 to 9 percent of total imports. Metal ores and scrap, likewise, declined from 15 to 6 percent.

The most precipitous decline, however, was in textile materials (mainly cotton and wool), which fell from 17 percent to 2 percent of total imports. This one statistic tells much about the diversification of Japan's economy away from textiles and the growing popularity of locally produced synthetic fibers.

Food imports rose from 12 percent of total imports in 1960 to 15 percent in 1975 only to fall to 10 percent by 1980. Foodstuff imports include animal feeds, such as corn and grains, but not soy beans. Similar declines occurred in imports of chemicals and in machinery and equipment.

Table 4. Japan's Imports by Commodity, Selected Years, 1960-80
(in millions of United States dollars)*

Commodity	1960	1970	1975	1979	1980
Foodstuff	547.6	2,574.1	8,814.9	14,415.4	14,666.1
Corn	(78.3)	(294.0)	(870.0)	(1,088.3)	(1,507.0)
Wheat	(176.9)	(318.4)	(1,117.0)	(1,090.0)	(1,229.3)
Sugar	(111.2)	(283.7)	(1,668.6)	(707.6)	(1,224.6)
Other	(181.2)	(1,678.0)	(5,159.3)	(11,529.8)	(10,705.2)
Textile Materials	761.6	962.7	1,524.5	2,448.6	2,393.4
Raw cotton	(431.4)	(470.7)	(846.8)	(1,263.7)	(1,359.2)
Wool	(265.2)	(348.3)	(515.1)	(725.7)	(688.7)
Other	(65.0)	(143.7)	(162.6)	(495.2)	(345.5)
Metal Ores and Scrap	673.2	2,696.3	4,416.6	6,850.1	8,429.6
Iron ore and ferrous scrap	(443.4)	(1,549.3)	(2,568.4)	(3,490.9)	(3,945.9)
Nonferrous metal ores	(155.6)	(1,064.1)	(1,763.2)	(2,879.3)	(3,730.8)
Other	(74.2)	(82.9)	(85.0)	(480.1)	(752.9)
Raw Materials	773.5	3,017.7	5,718.7	12,896.9	12,937.4
Wood	(170.3)	(1,572.1)	(2,620.6)	(7,353.2)	(6,908.9)
Soy beans	(107.4)	(365.8)	(940.3)	(1,271.8)	(1,310.2)
Natural rubber	(125.8)	(115.3)	(155.5)	(440.1)	(603.0)
Other	(370.0)	(964.5)	(2,002.3)	(3,831.8)	(4,115.3)
Mineral Fuels	741.6	3,905.5	25,640.9	45,286.1	69,991.2
Petroleum and products	(600.4)	(2,785.5)	(20,995.2)	(37,970.8)	(57,850.9)
Coal	(141.2)	(1,010.1)	(3,454.4)	(3,548.8)	(4,458.3)
Other	(0.0)	(109.9)	(1,191.3)	(3,766.5)	(7,682.0)
Chemicals	265.2	1,000.5	2,057.3	5,178.2	6,202.4
Machinery and Equipment	434.9	2,297.7	4,286.0	8,342.8	9,843.0
Precision Instruments	(26.8)	(165.5)	(455.2)	(1,012.2)	(1,086.8)
Office machines	(52.9)	(322.4)	(504.9)	(783.3)	(1,032.3)
Aircraft	(29.2)	(294.4)	(368.9)	(742.7)	(991.1)
Other	(326.0)	(1,560.4)	(2,957.0)	(5,804.6)	(6,732.8)
Miscellaneous commodities	293.5	2,426.7	5,404.2	15,254.2	16,064.6
Nonferrous metals	(118.4)	(944.8)	(1,284.5)	(3,416.4)	(4,479.7)
Textiles	(19.0)	(314.5)	(1,310.4)	(3,831.9)	(3,179.9)
Iron and steel products	(87.6)	(276.1)	(188.5)	(898.7)	(893.9)
Other	(68.5)	(891.3)	(2,620.8)	(7,107.2)	(7,511.1)
Total	4,491.1	18,881.2	57,863.1	110,672.2	140,527.7

*Totals may not add because of rounding. Valued on a customs-clearance basis.

Source: Based on information from Bank of Japan, Economic Statistics Annual, 1980, Tokyo, p. 231-34. Japan, Ministry of Finance, Monthly Return of the Foreign Trade of Japan, January-December, 1960, Tokyo, p. 72-371. Japan Tariff Association. The Summary Report, Trade of Japan, December 1980. Tokyo, p. 82-89 and March 1976, p. 76-83.

Table 5. Composition of Imports, Selected Years, 1960-1980 (percentages)*

Commodity	1960	1970	1975	1979	1980
Foodstuffs	12.2	13.6	15.2	13.0	10.4
Wheat	(3.9)	(1.7)	(1.9)	(1.0)	(0.9)
Corn	(1.7)	(1.6)	(1.5)	(1.0)	(1.1)
Sugar	(2.5)	(1.5)	(2.9)	(0.6)	(0.9)
Other	(4.0)	(8.9)	(8.9)	(10.4)	(7.6)
Textile Materials	17.0	5.1	2.6	2.2	1.7
Raw Cotton	(9.6)	(2.5)	(1.5)	(1.1)	(1.0)
Wool	(5.2)	(1.8)	(0.9)	(0.7)	(0.5)
Other	(1.4)	(0.8)	(0.3)	(0.4)	(0.2)
Metal Ores and Scrap	15.0	14.3	7.6	6.2	6.0
Iron Ore and Ferrous Scrap	(9.9)	(8.2)	(4.4)	(3.2)	(2.8)
Nonferrous Metal Ores	(3.5)	(5.6)	(3.0)	(2.6)	(2.7)
Other	(1.7)	(0.4)	(0.1)	(0.4)	(0.5)
Raw Materials	17.2	16.0	9.9	11.7	9.2
Soy Beans	(2.4)	(1.9)	(1.6)	(1.1)	(0.9)
Wood	(3.8)	(8.3)	(4.5)	(6.6)	(4.9)
Natural Rubber	(2.8)	(0.6)	(0.3)	(0.4)	(0.4)
Other	(8.2)	(5.1)	(3.5)	(3.5)	(2.9)
Mineral Fuels	16.5	20.7	44.3	40.9	49.8
Petroleum and Products	(13.4)	(14.8)	(36.3)	(34.3)	(41.2)
Coal	(3.1)	(5.3)	(6.0)	(3.2)	(3.2)
Other	(0.0)	(0.6)	(2.1)	(3.4)	(5.5)
Chemicals	5.9	5.3	3.6	4.7	4.4
Machinery and Equipment	9.7	12.2	7.4	7.5	7.0
Office Machines	(1.2)	(1.7)	(0.9)	(0.7)	(0.7)
Precision Instruments	(0.6)	(0.9)	(0.8)	(0.9)	(0.8)
Aircraft	(0.7)	(1.3)	(0.6)	(0.7)	(0.7)
Other	(7.3)	(8.3)	(5.1)	(5.2)	(4.8)
Miscellaneous Commodities	6.5	12.9	9.3	13.8	11.4
Nonferrous Metals	(2.6)	(5.0)	(2.2)	(3.1)	(3.2)
Iron and Steel Products	(2.0)	(1.5)	(0.3)	(0.8)	(0.6)
Textiles	(0.4)	(1.7)	(2.3)	(3.5)	(2.3)
Others	(1.5)	(4.7)	(4.5)	(6.4)	(5.3)
Total	100.0	100.0	100.0	100.0	100.0

*Totals may not add because of rounding.

Source: See table 4.

In terms of individual commodities, major imports were petroleum and products, wood, coal, iron ore, and other ores. The Japanese government's strategy of importing raw materials and exporting finished products in order to maintain its high standard of living is amply revealed in this list of Japan's major imports.

The predominance of energy and raw materials in Japan's imports implies that its strategy of import-substituting industrialization has proceeded nearly as far as it can go. The products that Japan now imports generally have no domestic substitute. Raw material, energy, and food imports, moreover, are expected to increase as the economy grows. In order to balance its external trade accounts, therefore, Japan is being forced to turn to higher value-added exports and to manufacturing processes that conserve on raw material or energy inputs.

E. Balance of Merchandise Trade. Between 1960 and 1964, Japan incurred annual deficits (on a customs clearance basis for imports) ranging from $0.4 to $1.5 billion. By 1965, however, this pattern began to shift. From 1965 to 1969, the balance alternated between deficit and surplus. By 1969, with a positive balance of $966 million, Japan's trade position was widely regarded as having achieved a position of that of a surplus trading nation. 60/ By 1972, the trade surplus had ballooned to $5.1 billion. (See Table 1)

The rapid rise in the prices of petroleum and raw materials during 1973, however, plunged Japan's balance of trade into deficit. In 1974, the deficit reached $6.6 billion. Japan's determined exporters, however, soon reversed the trend toward deficit, and by 1976 the balance again registered a surplus. This surplus grew to a record $18.2 million in 1978.

60/ Witaker, Donald P., et. al. Area Handbook for Japan. 3rd ed. Washington, U.S. Govt. Print. Off., 1974. p. 500. Note: Customs clearance figures tend to overstate the size of merchandise trade deficits.

The second oil crisis in 1979, however, again pushed the balance of trade into deficit. With consecutive deficits of $7.6 and $10.7 billion, in 1979 and 1980, respectively, the country appeared to be heading for a long struggle with adverse external balances. By 1981, however, a world glut of petroleum softened prices and, concurrently, because of conservation and a slowing economy, consumption demand weakened. Japan's rapid export growth, moreover, helped return its trade balance to surplus. 61/

Japan's experience with its balance of trade over the past two decades illustrates a fundamental weakness and strength that likely will persist. The country is highly vulnerable to increases in the price of petroleum and raw materials. Without close substitutes, when prices rise, it has little choice but to pay them, which causes its import bill to rise dramatically.

Japan's strength, however, is that its export sector is able to respond rapidly to match increases in imports. This is partly attributable to the system of floating exchange rates which automatically works to bring external accounts into balance. Countries with deficits in their balance of trade (if not offset by surpluses elsewhere), experience a depreciating currency which tends to reduce imports and increase exports.

In Japan's case, however, the ability of exporters to expand sales abroad while commanding premium prices for their products seems remarkable. Following the 1973 oil crisis, for example, when Japan's import bill rose by some $39 billion, its export industries increased their sales by $27 billion.

As a note of caution, the customs clearance trade statistics that Japan prefers to cite tend to overstate the amount of the trade deficit. (European

---

61/ Sato, Akihiro. Japan Fears Trade Surplus Will Spark Renewed Friction. Asian Wall Street Journal, August 31, 1981. p. 1, 20.

nations and even the United States at times also use these figures.) These data include shipping costs, even though in balance of payments accounting, such costs are picked up as imports of services. If shipping costs are excluded from imports, Japan has not incurred a merchandise trade deficit since 1963, even during the oil crises of 1973 and 1979. (See Table 6.)

Table 6. Japan's Exports, Imports, Trade Balance, Net Service Exports, Net Transfers, and Current Account Balance, 1961-80
(millions of U.S. dollars)

Year	Exports	Imports a/	Trade Balance	Services	Net Transfers	Current Account Balance
1961	4,149	4,707	-558	-383	-41	-982
1962	4,861	4,707	401	-420	-29	-48
1963	5,391	5,557	-166	-569	-45	-780
1964	6,704	6,327	377	-784	-73	-480
1965	8,332	6,431	1,901	-884	-85	932
1966	9,641	7,366	2,275	-886	-135	1,254
1967	10,231	9,071	1,160	-1,172	-178	-190
1968	12,751	10,222	2,529	-1,306	-175	1,048
1969	15,679	11,980	3,699	-1,399	-181	2,119
1970	18,969	15,006	3,963	-1,785	-208	1,970
1971	23,566	15,779	7,787	-1,738	-252	5,797
1972	28,032	19,061	8,971	-1,883	-464	6,624
1973	36,264	32,576	3,688	-3,510	-314	-136
1974	54,480	53,044	1,436	-5,842	-287	-4,693
1975	54,734	49,706	5,028	-5,354	-356	-682
1976	66,026	56,139	9,887	-5,867	-340	3,680
1977	79,333	62,022	17,311	-6,004	-389	10,918
1978	95,634	71,038	24,596	-7,387	-675	16,534
1979	101,232	99,387	1,845	-9,472	-1,127	-8,754
1980	126,736	124,611	2,215	-11,343	-1,528	-10,746

a/ Imports are valued f.o.b. (free on board).

Source: Bank of Japan. Balance of Payments Monthly, March 1970 (p. 1-2), May 1973 (p. 1-2), March 1974 (p. 1-2), Feb. 1981 (p. 1-2).

VI. BALANCE ON CURRENT ACCOUNT

The balance on current account, which includes invisibles as well as merchandise, is generally accepted as a more comprehensive indicator of the trade performance of a nation than the merchandise trade balance. It should be noted that invisibles, such as services, also generate employment or income.

A. Services. Since 1961, Japan's net service trade has been in deficit. Trade in services includes transportation (freight and passenger fares), insurance, travel expenditures, and income from investments. In 1980, a service trade deficit of $11.3 million was formed from service exports of $31.5 billion and imports of $42.8 billion. This deficit can be broken down into a $4.3 billion deficit in transportation, a $3.9 billion deficit in travel expenditures, a $0.8 billion surplus in investment income, and a $3.9 billion deficit in other services. 62/

In transportation, the largest deficits occur in freight, charter fees, and port fees. In travel expenses, the deficit reflects the larger number of Japanese businessmen and tourists who travel abroad than foreigners who travel in Japan. In investment income, the small surplus relects the greater amount of Japanese investment overseas compared with foreign investment in Japan. In other services, a surplus existed in military transactions, but there were deficits in management fees, patent royalties, and other fees.

Adding net exports of services and net unilateral transfers (mostly remittances) to the merchandise trade balance (free-on-board) gives the balance on current account. In this balance, Japan began to register surpluses from

---

62/ Bank of Japan. Balance of Payments Monthly, Feb. 1981. p. 23-46.

1965 and has generally kept in the black with the exception of 1967 and the years following the two oil crises of 1973 and 1979. In 1979, Japan's current account balance registered a deficit of $8.7 billion, followed by another deficit of $10.7 billion in 1980. In 1981, the balance turned to surplus again.

The current account balance exerts a large influence on the value of the yen in foreign exchange markets. It represents the major demand for and supply of foreign currency to Japan. The current account, however, does not reflect three other types of international transactions: long- and short-term capital flows and official settlements (payments by central governments).

B. Capital Flows. Capital movements consist of the international short- and long-term loans governments or private entities make with or receive from each other. A short-term capital credit for Japan, for example, would occur when an American buys a Japanese bond. A debit would arise when a Japanese opens a British savings account. A long-term capital credit would arise when an American company establishes a subsidiary in Japan, while a debit would occur when a Japanese company builds a plant abroad.

Following World War II, unlike Japan's rapid reentry into the international trading world, its return to world capital markets was slow and deliberate. Even before the war, however, Japan did not participate in world capital markets to the same extent as the United States or European countries. In recent years, however, capital flows have become more important in the balance of payments and their impact on the evolution of Japan's economy. 63/

As might be expected of a country recovering from a major defeat, Japan remained a net debtor nation until the mid-1960s. By 1967, however, total Japanese

---

63/ Krause and Sekiguchi, Japan and World Economy, p. 440.

investments overseas began to exceed foreign investments in Japan, which changed it from a net debtor to a net creditor nation. Japan's major form of borrowing came in loans designed to assist domestic industrial development, but gradually shifted more toward international sales of stocks. 64/

As Japan shifted from a net debtor to net creditor nation, earnings on the foreign investment account also shifted from deficit to surpus. (These earnings are counted as services in the current account.) Net income from investments turned positive at the end of 1971 and reached $854 million in 1980. 65/

From 1945 to around 1965, when Japan perceived that it was being threatened with balance-of-payments deficits, rigorous controls were placed on outflows of capital. Long-term capital inflows also were controlled, partly as a means of limiting foreign involvement in Japan's economy but also to prevent a burdensome repayment problem from developing. In principle, direct investment by foreign firms for the purpose of establishing new businesses was forbidden. The purchase of shares of existing firms also was restricted to about 5 percent or less for one investor. 66/ In order to tap sources of foreign technology, licensing agreements with foreign firms were encouraged (rather than allowing direct investments). The government allowed limited short-term financing arrangements through foreign loans and debentures, but these tended to be subject to considerable government control. 67/

64/ Bank of Japan. Balance of Payments Monthly, February 1981. p. 47ff.

65/ Ibid., p. 23-36.

66/ Japan External Trade Organization. Operating a Business in Japan. Tokyo, JETRO, c. 1974. p. 3-4.

67/ Whitaker, Area Handbook, p. 522. Krause and Sekiguchi, Japan and World Economy, p. 440-41.

By 1967, however, the Japanese government began to lift its restrictions on international capital transactions. By 1973, all industries, except for five, in principle, were opened for foreign firms to establish totally owned subsidiaries. Seventeen additional industries, however, were restricted to either 50 percent ownership or a case-by-case ruling on foreign ownership. The 1973 liberalization also removed limitations on the purchase of a controlling share of existing firms by foreign enterprises, provided the firm whose shares were being purchased gave its consent.

On December 1, 1980, Japan's new Foreign Exchange and Foreign Trade Control Law went into effect. Under this law, all external economic transactions are free, unless specified otherwise. Restrictions can be imposed only as exceptional actions to meet an emergency, such as unusual instability in the foreign exchange markets or an abnormally large movement in funds. This represented a complete reversal from the previous legal system where all economic transactions were controlled unless specified otherwise. 68/

Under the new law, the Japanese government still can specifically invoke any of several criteria to declare a particular transaction illegal. The government, for example, retains the power to limit foreign ownership of companies whose takeover would "cause a grave impact upon the country's economy and security." As of 1981, this clause had been used to justify limiting foreign ownership to between 25 and 50 percent in 11 companies, mostly in energy and high technology. 69/

68/ Matsuda, Osamu. New Exchange Law Goes Into Effect. Japan Economic Journal, v. 18, Nov. 15, 1980. p. II-1.

69/ Kanabayashi, Masayoshi. Japan Relaxes Investment Rules for Foreigners. Wall Street Journal, Dec. 1, 1980. p. 31.)

As international capital and foreign exchange transactions have been gradually liberalized, both imports and exports of capital have increased. From 1964, when the balance of long-term capital flows turned negative, to 1979, the balance has continued to grow in a negative direction. Japanese investments overseas were rising faster than foreign investments in Japan. In 1978 and 1979, the negative balance exceeded $12 billion. In 1980, however, Japanese investments abroad dropped by $4 billon, while foreign investments in Japan soared by $10 billion over their 1979 levels. As a result, in 1980, the long-term capital balance registered a positive $2 billion. (See Table 7.)

Over the 1951-80 period, Japan approved a total of 23,948 cases of direct investment overseas for a value of $36.5 billion. Of this total, manufacturing accounted for 35 percent, mining for 19 percent, and commerce for 15 percent. By region, 27 percent went to both North America and Asia, 17 percent to Latin America, 13 percent to Europe, 11 percent to Oceania and Africa, and 6 percent to the Middle East. 70/

As of the end of 1980, Japanese held assets from foreign direct investments in the United States of $4.2 billion (53% in trade, 20% in manufacturing, and the rest in petroleum, insurance and other activities). Americans held assets in Japan worth $6.3 billion (48% in manufacturing, 25% in petroleum, 18% in trade, and the rest in banking, finance, and other activities). 71/

70/ Keizai Koho Center, Japan 1981, p. 42-43.

71/ Whichard, Obie G. U.S. Direct Investment Abroad in 1980. Survey of Current Business, v. 61, Aug. 1981. p. 32. Chung, William K. and Gregory C. Fouch. Foreign Direct Investment in the United States in 1980. Survey of Current Business, v. 61, Aug. 1981. p. 41.

Table 7. Japan's Balance of Payments, Capital Flows, Official Settlements, and Foreign Exchange Reserves, 1961-1980
(millions of U.S. dollars)

Year	Long-term Capital Flows	Short-term Capital Flows	Errors and Omissions	Balance of Payments a/	Gold and Foreign Exchange Reserves (end of year)	
					Change	Level
1961	-11	21	20	-952	-338	1,486
1962	172	107	6	237	355	1,841
1963	467	107	45	-161	37	1,878
1964	107	234	10	-129	121 b/	1,999
1965	-415	-61	-51	405	108	2,107
1966	-808	-64	-45	337	-33	2,074
1967	-812	506	-75	-571	-69	2,005
1968	-239	209	84	1,102	886	2,891
1969	-155	178	141	2,283	605	3,496
1970	-1,591	724	271	1,374	903 c/	4,399
1971	-1,082	2,435	527	7,677	10,836 d/	15,235
1972	-4,487	1,966	638	4,741	3,130 e/	18,365
1973	9,750	2,407	-2,595	-10,074	-6,119	12,246
1974	-3,881	1,778	-43	-6,839	1,272	13,518
1975	-272	-1,138	-584	-2,676	-703	12,815
1976	-984	111	117	2,924	3,789	16,604
1977	-3,184	-648	657	7,743	6,244	22,848
1978	-12,389	1,538	267	5,950	10,171	33,019
1979	-12,618	2,377	2,333	-16,662	-12,692	20,327
1980	2,394	3,071	-3,115	-8,396	4,905	25,232

a/ Official Settlements = Balance of Payments = Current Account Balance + Capital Flows + Errors and Omissions. Errors can be traced to reporting mistakes, unreported transactions, and leads or lags in payments when exchange rate are fluctuating.

b/ Includes gold transche (transfer of reserves) of $180 million.

c/ Includes $122 million in Special Drawing Rights.

d/ Incluces $128 million in SDR's.

e/ Includes $160 million in SDR's.

Sources: Bank of Japan. Balance of Payments Monthly. Jan. 1968 (p. 1-2), Oct. 1976 (p. 1-2), Feb. 1981,(p. 1-2). Economic Statistics Annual 1980. p. 243.

In terms of direct overseas investments outstanding, Japanese businesses are still far behind those in the United States, the United Kingdom, or West Germany. The trend and momentum, however, are in Japan's favor. The Japanese are on a fast track, and their outward expansion is likely to accelerate. Over the 1978-80 period, Japanese direct overseas investments each year averaged $4.6 billion--more than the cumulative amount in 1970. 72/

The motivation behind the Japanese overseas investment drive stems from several sources. First is the rising cost of land and labor in Japan. This makes investments in countries, particularly in Asia, with lower wage and overhead costs quite attractive. Second is the need for investment in facilities to handle export sales. Third are Japan's tightening pollution control requirements which have encouraged a move overseas by certain kinds of smelting and processing plants. Fourth is the voracious Japanese appetite for raw materials, energy, and food. Many of Japan's investments are in mining, energy facilities, or food production.

The fifth motive arises from barriers to Japanese exports in various markets. Restrictions on automotive exports to the United Kingdom, Australia, and many other countries, for example, have forced Japanese automakers to establish assembly plants there. The same has been true for plants manufacturing television receivers. Firms exporting from developing countries, moreover, even if owned by Japanese companies, usually receive preferential tariff treatment in developed country markets (under the Generalized System of Preferences). And sixth, local governments often provide financial incentives in the form of reduced taxes or

---

72/ Japanese Multinationals, Covering the World with Investment. Business Week, June 16, 1980. p. 92-93.

subsidies for firms locating in their jurisdiction. 73/

Flows into Japan of short-term capital have generally exceeded outflows. During the 1960s, the annual balance averaged $137 million. During the 1970s it averaged $1,155 million and reached $3,071 million in 1980. The bulk of short-term capital is in trade credits. 74/

Japanese bond markets have also been developing as a source of international financing. In 1970, the first such yen-denominated bond issue was floated by the Asian Development Bank. This was followed by similar issues by the World Bank and syndicates of Japanese banks. 75/

The addition of capital flows (plus errors and omissions) to the balance on current account provides what is termed the balance of payments or official settlements. This represents final government action to balance inflow and outflow transactions in the international sector. Since 1961, Japan's balance of payments has generally been in surplus, with the notable exception of the years following the oil crises in 1973 and 1979.

Most of the deficit or surplus in the balance of payments is accommodated by changes in government holdings of gold and foreign exchange. Since Japan has usually enjoyed a surplus in this account, its official reserves of gold and foreign exchange have increased during the past two decades. Starting from $1.49 billion in 1961, its official reserves rose to $15.23 billion by 1971, peaked at $33.02 billion in 1978, and dropped to $25.23 billion in 1980.

73/ Japan, MITI, White Paper on International Trade 1981, p. 127-29.

74/ Bank of Japan. Balance of Payments Monthly, Feb. 1981. p. 59.

75/ Whitaker, Area Handbook, p. 525.

VII. VALUE OF THE YEN

The relative value of the yen is determined in foreign exchange markets by the forces of demand and supply. The demand for yen arises from the demand for what the yen will buy by foreigners in Japan--either goods and services or investments. The supply of yen arises from the desire of yen holders to exchange their yen for dollars, marks, or other foreign exchange in order to purchase something abroad. An excess of Japanese exports (excess demand for yen), therefore, will tend to increase the value of the yen. An import surplus (excess supply of yen), likewise, will tend to decrease the value of the yen.

Capital flows enter foreign exchange markets in the same manner as imports and exports. Markets do not differentiate between someone buying foreign exchange for a capital or merchandise transaction. A surplus in a country's current account, therefore, can be offset by a deficit in capital flows. Likewise, a current account surplus can be exacerabated by a similar surplus in capital flows.

Governments also intervene to influence either the supply of or demand for a currency. If the yen is either depreciating or appreciating more than market conditions seem to warrant, the Japanese government often will intervene by either buying or selling yen on the foreign exchange market.

Prior to the 1970s, Japan also maintained control over foreign exchange transactions in order to reduce the demand for foreign exchange. Its import restrictions also worked in a similar manner to reduce demand for foreign currencies and prop up the value of the yen.

In 1949, the value of the yen was set at 360 per dollar as part of an American plan to stabilize prices in the Japanese economy. Japan maintained that exchange rate until 1971, when former U.S. President Nixon abandoned dollar convertibility to gold, imposed a 10 percent surcharge on imports, and set in motion a series of changes that eventually led to floating exchange rates. 76/ By that time the yen had become undervalued. Japanese exports were costing too little in international markets and imports from abroad were costing Japanese too much to buy. This was reflected in Japan's current account balance which had risen from deficits in the early 1960s to a $5.8 billion surplus in 1971. The time was ripe for the "Nixon dollar shock."

Following the U.S. measures to devalue the dollar, the Japanese government attempted to keep the yen from appreciating too rapidly by buying dollars and selling yen on the foreign exchange market. Over 1971 and 1972, the Bank of Japan bought nearly $14 billion worth of foreign exchange, which was added to its official reserves. While this reduced the exchange losses by Japan's multinational corporations, Japan paid dearly for the resulting increase in its domestic money supply by the virulent inflation it suffered in 1973 and 1974. 77/

By the end of 1971, the yen had appreciated from 360 to 314 yen per dollar. By the end of 1972, it was up further to 302 yen per dollar and peaked temporarily at 265 yen per dollar in 1973 before the impact of the oil crisis began to be felt. Over the ensuing recession, the yen weakened to an average of 297 yen per dollar in 1976, but regained strength over 1978 to register an average of

---

76/ Nanto, U.S. Role, p. 247-58.

77/ Hayden, Eric W. Internationalizing Japan's Financial System. An Occasional Paper of the Northeast Asia-United States Forum on International Policy, Stanford University. Dec. 1980. p. v. Organisation for Economic Co-operation and Development. OECD Economic Surveys, Japan. Paris, OECD, 1972. p. 31-35.

219 yen per dollar in 1979. On occasion, short-term fluctuations took the value to about 180 yen per dollar. 78/

With the large increase in oil prices in 1979 and ensuing deficits in Japan's trade and current account balances, the yen weakened to 227 yen per dollar by 1980. Considerable intervention by the Japanese government, which saw its official reserves of foreign exchange drop from $33 billion in 1978 to $20 billion in 1979, plus large inflows of capital, however, kept the yen surprisingly strong. In 1981, with high U.S. interest rates and a strong dollar, the yen depreciated slightly against its 1980 level.

Table 8. Yen-Dollar Exchange Rate, 1970-81

Year:	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Rate:	360	351	303	271	291	292	297	269	211	219	227	221

Source: International Monetary Fund, International Financial Statistics, Dec. 1975, p. 220-21 and Feb. 1982, p. 225-26.

Annual averages of the yen/dollar exchange rate mask sizable short-term fluctuations. In 1979, for example, although the average exchange rate was 219 yen per dollar, monthly averages ranged from 198 to 249. These large swings in relative exchange rates can negate gains in tariff concessions and change relative costs of production faster than investment in new plant and equipment can occur in response to the changes. An industry can enjoy a comfortable international cost advantage one year and similar cost disadvantage the next--not because of underlying productivity changes but because of fluctuations in

78/ International Monetary Fund, International Financial Statistics, various issues.

the exchange rate. Instability in the exchange rate, rather than the rate's being considered to be too high or too low, appears to invite government intervention into the foreign exchange market.

With Japan's new Foreign Exchange Law, which came into effect December 1, 1980, the government has even less control over the exchange rate than it did in the past. Traders and investors dealing with Japan, therefore, are being subject to considerably more exchange risk than in previous periods.

VIII. DIRECTION OF TRADE

Japan trades with nearly every country in the world. Since the mid-1950s, however, its export markets have been shifting from developing to developed countries. (See Table 9.) In terms of merchandise exports, in 1980, 47.1 percent went to developed countries with high income levels. Another 45.8 percent found markets in the developing countries, and 7.1 percent were sold to Communist countries. The largest customer was the United States (24.2 percent of exports), followed by West Germany, South Korea, Taiwan, the People's Republic of China, Saudia Arabia, and Hong Kong all at the much lower level of between 3.7 and 4.4 percent each. 79/

The distribution of countries from which Japan buys goods reflects its needs to import food, energy, and raw materials. In 1980, developing countries supplied 60.3 percent of Japan's imports with about half coming from the Middle East. (See Table 10.) The developed countries provided 35.0 percent of Japan's imports, and the communist countries the remaining 4.7 percent. In terms of specific countries, the United States with 17.4 percent and Saudia Arabia with 13.9 percent are the leading exporters to Japan. They are followed by Indonesia, the United Arab Emirates, Australia, Canada, Iraq, China, Iran, Malaysia, and Kuwait.

The structure of Japan's international trade naturally gives rise to international trade friction. Japan's problem is that the country's economic well-being rests partly on its ability to import food, energy, and raw materials and export finished products. In most cases, the countries which provide Japan with imports of essential commodities do not have the population,

---

79/ Keizai Koho, Japan 1981, p. 32-33.

Table 9. Japan's Exports by Country Groups and Selected Countries, Selected Years, 1961-80
(in millions of U.S. dollars)

Country Groups and Selected Countries	1961	1965	1970	1975	1979	1980
Developed Countries	1,902	4,298	10,440	23,434	48,759	61,172
of which: United States	1,067	2,479	5,940	11,149	26,403	31,367
Canada	117	214	56	1,151	1,738	2,437
West Germany	83	215	550	1,661	4,266	5,756
United Kingdom	115	205	480	1,473	3,097	3,782
Australia	100	313	589	1,739	2,607	3,389
Developing Areas	1,228	3,672	7,827	27,633	46,899	59,480
Noncommunist Asia	1,384	2,195	4,902	12,543	26,128	30,910
of which: Rep. of Korea	126	180	818	2,248	6,247	5,368
Taiwan	96	218	700	1,822	4,367	5,146
Hong Kong	154	288	700	1,378	3,679	4,761
Thailand	134	219	449	959	1,714	1,917
Philippines	128	240	454	1,026	1,622	1,683
Indonesia	154	205	316	1,850	2,124	3,458
India	116	204	103	471	780	915
Middle East	206	356	634	6,075	10,734	14,358
Latin America	345	488	1,187	4,765	6,555	8,917
Africa (Excluding South Africa)	278	603	1,005	4,087	3,147	4,886
Other	15	30	99	163	325	409
Communist Countries	103	478	1,045	4,683	7,383	9,155
of which: Soviet Union	65	168	341	1,626	2,461	2,778
People's Rep. of China	17	245	569	2,259	3,699	5,078
Total Exports	4,236	8,452	19,318	55,753	103,032	129,807

Source: Bank of Japan. Balance of Payments Monthly, Jan. 1968, p. 15-16, Feb. 1981, p. 15-16.

Table 10. Japan's Imports by Country Group and Selected Countries, Selected Years, 1961-1980. (Customs Clearance Basis) (in millions of U.S. dollars)

Country Group and Selected Countries	1961	1965	1970	1975	1979	1980
Developed Countries	3,502	4,186	10,430	23,894	43,044	49,120
of which: United States	2,096	2,366	5,560	11,608	20,431	24,408
Canada	266	357	929	2,499	4,105	4,724
West Germany	193	223	617	1,139	2,584	2,501
United Kingdom	137	163	395	810	1,681	1,954
Australia	452	552	1,508	4,156	6,298	6,982
Developing Areas	2,091	3,456	7,564	30,962	62,234	84,733
Noncommunist Asia	975	1,406	3,013	10,586	26,195	31,751
of which: Rep. of Korea	22	41	229	1,308	3,359	2,996
Taiwan	68	157	251	812	2,476	2,293
Thailand	78	131	190	724	1,169	1,120
Philippines	156	254	533	1,121	1,583	1,951
Indonesia	85	149	637	3,430	8,794	13,167
India	152	184	390	658	1,053	1,014
Malaysia	223	263	419	691	3,257	3,471
Middle East	526	1,112	2,337	16,477	29,377	44,500
Latin America	481	707	1,373	2,524	4,517	5,700
Africa (Excluding South Africa)	80	192	693	1,111	1,629	2,139
Other	29	39	148	264	516	643
Communist Countries	217	527	887	3,006	5,392	6,669
of which: Soviet Union	145	240	481	1,170	1,911	1,860
People's Rep. of China	31	225	254	1,531	2,955	4,323
Total Imports	5,810	8,169	18,881	57,863	110,672	140,528

Source: Bank of Japan. Balance of Payments Monthly, Jan. 1968, p. 19-20, Feb. 1981, p. 19-20.

income levels, or trading ties with Japan to buy sufficient finished products to bring bilateral trade into balance. (See Table 11.)

The oil exporting countries, for example, continue to run large trade surpluses with Japan. In order to offset its deficits in trade with those countries, Japan must run trade surpluses with other countries. In 1980, for example, Japan's $30 billion bilateral merchandise trade deficit with the Middle East was met partly by surpluses of $7.0 billion with the United States, $5.2 billion with South Korea and Taiwan, and $4.0 billion with the countries of Western Europe.

While the nations experiencing bilateral trade deficits with Japan can sympathize with Japan's dilemma, the deficits often tend to become politically difficult to tolerate. Japan currently is walking an uneasy tightrope in trying to balance its need to run bilateral surpluses with countries like the United States and its desire not to incite protectionist reactions.

Table 11. Japan's Bilateral Trade Balances by Country Group and Selected Countries, Selected Years, 1961-1980
(in millions of U.S. dollars)

Country Group and Selected Countries	1961	1965	1970	1975	1979	1980
Developed Countries	-1,600	112	10	-460	5,715	12,052
of which: United States	-1,029	113	380	-459	5,972	6,959
Canada	-149	-143	-366	-1,348	-2,367	-2,287
West Germany	-110	-8	-67	522	1,682	3,255
United Kingdom	-22	42	85	663	1,416	1,828
Australia	-352	-239	-919	-2,417	-3,691	-3,593
Developing Areas	137	216	263	-3,329	15,345	-25,253
Noncommunist Asia	409	789	1,889	1,957	-67	-841
of which: Rep. of Korea	104	139	589	940	2,888	2,372
Taiwan	28	61	449	1,010	1,891	2,853
Thailand	56	88	259	235	545	797
Philippines	-28	-14	-79	-95	39	-268
Indonesia	69	56	-321	1,580	-6,670	-9,709
India	-36	20	-287	-187	-273	-99
Middle East	-320	-756	-1,703	-10,402	-18,643	-30,142
Latin America	-136	-219	-186	2,241	2,038	3,217
Africa (Excluding South Africa)	198	411	312	2,976	1,518	2,747
Other	-14	-9	-49	-101	-191	-234
Communist Countries	-114	-49	158	1,677	1,991	2,486
of which: Soviet Union	-80	-72	-140	456	550	918
People's Rep. of China	-14	20	315	728	744	755
Total Balance	-1,574	283	437	-2,110	-7,640	-10,721

Source: Based on data in Bank of Japan, Balance of Payments Monthly, Jan. 1968, p. 15-20, and Feb. 1981, p. 15-20.

SELECTED BIBLIOGRAPHY

SOURCES OF DATA ON JAPAN

Bank of Japan. Balance of payments monthly. (Monthly).

______. Economics statistics annual. (Annual).

______. Economic statistics monthly. (Monthly).

International Monetary Fund. International financial statistics. (monthly).

Japan Economic Planning Agency. Economic outlook, Japan. (annual).

Japan. Office of the Prime Minister. Annual report on the consumer price index. (Annual).

Japan Prime Minister's Office. Japan statistical yearbook. (Annual).

______. Monthly statistics of Japan. (monthly).

Japan Tariff Association. Japan exports & imports. [Data are commodity by country and country by commodity] (monthly).

______. The Summary report, trade of Japan. (monthly).

Organisation for Economic Co-operation and Development. Statistics of foreign trade. (Monthly).

OTHER SOURCES

Adams, T.F.M. and Iwao Hoshii. A financial history of the new Japan. Tokyo, Kodansha International [1972] 547 p.

Akao, Nobutoshi. Japan's economic security. Intereconomics, May/June 1981: 115-20.

Bieda, Ken. The structure and operation of the Japanese economy. Sydney, John Wiley and Sons, Australasia [1970] 292 p.

Cullison, A.E. Japanese hit US plan for trade. Journal of commerce, Jan. 12, 1982: 1A.

______. US nudges Japanese on trade. Journal of commerce, Nov. 18, 1981: 1A, 7A.

Eximbank and the war on export credit subsidies: should we compete? Trade policy review, v. 2, July 1981: 3-4.

FTC warns against administrative guidance. The Japan economic journal, v. 19, Sept. 1, 1981: 2.

Gutman, M. and A. Kruck. Prices and earnings around the globe. Zurich, Union Bank of Switzerland [1979] 53 p.

Hayden, Eric W. Internationalizing Japan's financial system. An occasional paper of the Northeast Asia-United States Forum on International Policy, Stanford University [Dec. 1980] 29 p.

Ho, Alfred K. Japan's trade liberalization in the 1960s. White Plains, N.Y., International Arts and Sciences Press [1973] 118 p.

International Monetary Fund. Annual report 1980. Washington, IMF [1980] 209 p.

Ishimine, Tomotaka. Fiscal incentives for Japan's export and direct foreign investment. Bulletin for international fiscal documentation, v. 32 1978: 173-77.

Japan External Trade Organization. Japan External Trade Organization, 1979. Tokyo, JETRO [1979] 16 p.

______. Operating a business in Japan. Tokyo, JETRO [c.1974] 31 p.

Japan. Ministry of International Trade and Industry. White paper on the international trade, 1979. Tokyo, Foreign Press Center [1979] 125 p.

Japanese multinationals covering the world with investment. Business week, June 16, 1980: 92-102.

Kanabayashi, Masayoshi. Japan relaxes investment rules for foreigners. Wall Street journal, Dec. 1, 1980: 31.

Key MTN agreements open markets in European Community, Canada, and Japan. Business America, v. 4, Feb. 23, 1981: 3-4.

Krause, Lawrence, and Sukeo Sekiguchi. Japan and the world economy. In Patrick, H., and H. Rosovsky, eds. Asia's New Giant. Washington, Brookings, 1976. p. 383-458.

Lachica, Eduardo. Unlikely American exporter: Japan. Wall Street journal, Nov. 11, 1981: 31.

Lifson, Thomas R. Japanese business strategies for the 1980's. Japan report, v. XXVI, May 1, 1980: 2-3.

Magaziner, Ira C., and Thomas M. Hout. Japanese industrial policy. London, Policy Studies Institute [1980] 90 p.

Matsuda, Osamu. New exchange law goes into effect. Japan economic journal, v. 18, Nov. 15, 1980: II-1.

Nanto, Dick K. The United States' role in the postwar economic recovery of Japan. Doctoral Dissertation. Cambridge, Mass., Harvard University [1976] 333 p.

Organisation for Economic Co-operation and Development. OECD economic surveys, Japan. Paris, OECD [1972] 78 p.

Ohkawa, Kazushi and H. Rosovsky. Japanese economic growth. Palo Alto, Stanford University Press [1973] 329 p.

Ojimi, Yoshihisa. A government ministry: the case of the Ministry of International Trade and Industry. In Vogel, E.F. Modern Japanese organization and decision-making. Berkeley, University of California Press [1975] p. 101-14.

Oriental Economist. Japan economic yearbook, 1979/80. Tokyo, Oriental Economist [1979] 334 p.

Ranking foreign banks in Japan. Euromoney, March 1981: 79-80.

Sato, Akihiro. Japan fears trade surplus will spark renewed friction. Asian Wall Street journal, Aug. 31, 1981: 1, 20.

U.S. Congress. House. Committee on Ways and Means, Subcommittee on Trade. United States-Japan Trade Report 1980. Washington, U.S. Govt. Print. Off., 1980. 91 p.

U.S. Department of Commerce. International Trade Administration. Tokyo Round tariff reductions. Washington, U.S. Department of Commerce, [1980] 5 p.

______. Japan, the government-business relationship. By Eugene Kaplan. Washington, U.S. Govt. Print. Off. [1972] 158 p.

Vogel, Exra F. Japan as no. one. Cambridge, Mass., Harvard University Press [1979] 272 p.

Weymouth, Lally. Meet Mr. Sony, how the Japanese outsmart us. Atlantic monthly, v. 244, Nov. 1979: 33-44.

Whitaker, Donald P., et. al. Area handbook for Japan, 3rd ed. Washington, U.S. Govt. Print. Off. [1974] 672 p.

Whichard, Obie G. U.S. direct investment abroad in 1980. Survey of current business, v. 61, Aug. 1981: 16-36.

Young, Alexander K. The sogo shosha: Japan's multinational trading companies. Boulder, Colo., Westview Press [1979] 247 p.

mls