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September 25, 1951

THE PROBLEM OF THE BELGIAN  
SURPLUS IN EPU

Albert O. Hirschman

Since the end of the war Belgium has been the most persistent intra-European creditor country. After having remained in approximate balance with the other Western European countries during the first six months of the operation of the European Payments Union, Belgium again earned increasingly large surpluses since January of this year. By the end of August, the Belgian EPU quota of \$360 million had been exceeded by \$13 million.

In accordance with a decision of the OEEC Council, Belgium will continue to receive 50% of its surplus in gold up to an amount of \$40 million over and above the Belgium quota. Negotiations are presently in progress in order to determine a definitive basis for handling the Belgium's surplus in excess of its EPU quota (hereafter called "excess surplus"). Independently of these negotiations the Belgian Government is considering a series of commercial policy, credit, and exchange rate measures designed to reduce its EPU surplus. The financing the Belgian excess surplus and the measures contemplated by the Belgian Government both raise important and complex problems for U. S. international financial policy.

The Settlement of the excess surplus

The EPU agreement itself does not contain any guidance as to the treatment of creditor countries that exceed their quota. While debtor countries that exhaust their quota are required to pay 100% of their excess deficit in gold unless granted special additional credit facilities, the treatment of creditor country was left intentionally vague in the EPU agreement. It was merely provided that any excess surplus would be "settled in accordance with the decisions of the Organization" (Article 13-B). Underlying this vagueness was the thought that the appropriate method for settling the excess surplus would have to be determined from case to case from the points of view of: (1) the internal economic policy of the creditor country, (2) its overall balance of payments position, and (3) the resources of the EPU. It was generally assumed that, if a country had not followed a deflationary policy, if its balance of payments was in overall balance rather than in surplus and if the resources of the EPU permitted it, then the creditor country would receive 100% of its excess surplus in gold.

The evidence in the case of Belgium is unequivocal concerning the first point. Belgium's production has increased by 10% since the beginning of the year and by over 20% since Korea. Over the past year, wholesale and retail prices have risen by some 30 and 15% respectively. Although still high in comparison with other countries, unemployment has dropped from 11% to 9% of all insured workers. It cannot be maintained, therefore, that Belgium should not receive 100% for its excess surplus as a penalty for any deflationary policy or developments.

The evidence is somewhat less clear with respect to Belgium's overall balance of payments. While Belgium's gold and dollar holdings

dropped by over \$100 million in the course of 1950, they have remained stationary during the first seven months of 1951. Up to the present time, therefore, dollar receipts to the extent of 50% of Belgium's EPU surplus have been sufficient to maintain Belgium in dollar balance, but it is of course possible that, because of the cut in ECA aid, this will cease to be the case in the current fiscal year.

The third test of Belgium's eligibility to receive 100% settlement in gold -- the adequacy of the resources of the EPU -- is not as narrow as it might seem. The question really is whether the EPU can look forward, in counterpart to Belgium, to the emergence of a country with converse balance of payments characteristics; i. e. a country having a continuing EPU deficit which it could settle 100% in gold because it had either very large reserves or a continuing dollar surplus. If there is no such country or such countries, then the settlement of Belgium's resources in gold could only lead to the exhaustion of the capital of EPU and could be maintained thereafter only by additional injection of United States funds.

To say, therefore, that the resources of the Union are inadequate for the payment of 100% in gold to Belgium, is only another way of saying that there is a missing link in the structure of international payments which would contain Belgium as a country that settles its dollar deficits through an EPU surplus. Unfortunately this missing link, i. e. a country or a group of countries that can afford to settle their EPU deficit by means of their dollar surpluses, does not appear likely to come into existence in the near future.

The situation, therefore, confronts us with a dilemma; from the point of view of Belgium's performance and needs, a pretty good case can be made for a 100% gold settlement of the excess surplus, but such a settlement is fraught with dangers for the capital of the European Payments Union, it might result in demands for increased U. S. aid to the EPU debtors and is not really warranted by the structure of international payments in immediate prospect. Moreover, it is dangerous for Belgium's position in the multilateral and liberalized area of trade and payments which has been created by EPU in Europe. Belgium is likely to be excluded from the liberalization measures which all EPU countries have undertaken toward one another if European debtors cannot in fact afford a large-scale deficit, payable in dollars, with Belgium.

### A possible solution

This analysis leads to the conclusion that in principle the Belgians have a right to 100% settlement after exhaustion of whatever additional credit they may be persuaded to grant to the EPU beyond their quota. At the same time, however, recognition should be given to the fact that an indefinite and unlimited continuation of such a settlement is not desirable from the point of view of the EPU, the United States, and even Belgium, which would soon find itself discriminated against by the other EPU countries. It, therefore, seems desirable to establish a ceiling on

Belgium's eligibility for 100% settlement beyond which the question of settlement would be reopened. Such a ceiling could be expressed either as an absolute amount in dollars or, preferably, as a monthly rate. If the latter device is adopted, it would be determined that Belgium would receive 100% settlement up to a surplus of, e. g., \$15 million per month, whereas the settlement of any excess above this rate would again be subject to determination by the OEEC Council. The cumulative principle would have to be applied to this scheme. The monthly rate eligible for 100% settlement would be determined on the basis of the resources of the EPU and of Belgium's probable dollar deficit.

The advantage of this solution is that it recognizes that, on the one hand, no blame can be attached to Belgium for its present surplus position in EPU, and that no creditor country should be compelled to assume an open-end commitment to extend credit. On the other hand, the proposed method of handling the Belgian surplus limits the potential drain on the EPU and maintains the pressure on Belgium to correct the structure of its international payments which could not possibly be sustained at present in the absence of additional U. S. aid.

Measures to correct Belgium's payments position

In discussing the measures designed to reduce Belgium's EPU surplus and its dollar deficit, one must first recognize that such measures are necessarily distasteful because, to be successful, they must be discriminatory in substance if not in form. The only way in which one could escape such measures would be the adoption on the part of EPU debtors of policies designed to close their overall balance-of-payments deficit. However, Belgium cannot entirely rely on the actions of other countries particularly since such actions may well take the form of excluding Belgium from the trade liberalization granted by EPU countries to each other. Any action which Belgium itself takes to deal successfully with this problem will necessarily be discriminatory in substance since Belgium must seek to deteriorate its balance-of-payments position vis-a-vis Europe while improving it vis-a-vis the dollar area.

While recognizing the fundamental unpleasantness of this situation, it may still be worthwhile to look for measures that are not formally and overtly discriminatory -- to rank, as it were, the various possible measures according to their unpleasantness. Such a ranking would look approximately as follows:

- (1) Suspension of tariffs on goods which are primarily imported from Europe.
- (2) Further relaxation of quantitative restrictions vis-a-vis EPU countries. This type of discrimination has been accepted by the United

States as a means of promoting a "single market" in Europe. The freeing from restrictions of capital movement toward EPU countries falls in the same category.

- (3) Granting of special credit facilities to imports from EPU countries.
- (4) Broken cross rates or equivalent devices.
- (5) Outright discrimination against dollar goods.

The measures in the course of adoption or discussion by the Belgian Government unfortunately center around the lower end of this scale and an effort should be made to explore possibilities on its upper end.

One word might be said with respect to the possibility of broken cross rates. The proposal to retain 5% of the proceeds of exporters toward EPU countries and to devote these 5% to grant larger credit facilities to importers from the EPU area amounts to a differential appreciation of the Belgian franc vis-a-vis all EPU currencies, but will not fully result in broken cross rates. Moreover, the principal drawback of cross rates, i. e. commodity arbitrage, is not likely to develop as long as the scheme is maintained within the narrow limits so far contemplated. In fact, in the case of Belgium, the problem is not how to prevent such arbitrage operations from arising but how to stop the existing "commodity shunting" that results from the fact that Belgium has less restrictions on dollar imports than other EPU countries as well as from the dollar retention schemes of these countries. The proposed discriminatory exchange rate and credit measures would be entirely legitimate if they were so designed as to prevent the existing types of commodity shunting without resulting in arbitrage operations in the inverse direction.

Postscript on "burden sharing"

The preceding discussion ignores the question whether Belgium's contribution to the common defense effort is an adequate one and, if not, what consequences should result for the EPU settlement. I believe it is important to discuss the problem first without reference to the adequacy or inadequacy of the Belgian defense effort since questions of principle basic to the functioning of EPU are primarily involved. Should there be a NATO finding that the Belgian defense effort undertaken so far is inadequate, and that the additional effort to be furnished by Belgium would best be given in the form of an export surplus to the other NATO countries, then it would be best for Belgium to grant Belgian francs in stated amounts to other NATO countries which will then be available to these countries for the settlement of deficits with EPU, much as sterling balances (the so-called "existing resources") have been used during the first year of the EPU.

September 11, 1951

POST KOREAN INFLATION  
IN JAPAN

Frank H. Golay

Following the outbreak of hostilities in Korea, Japanese prices rose continuously through the first half of 1951. In recent months, Japanese price indices have become stabilized at levels from 25-50 per cent above levels of June 1951. The increases in prices, to the extent that they are in excess of price inflation in other countries, have seriously weakened the competitive position of Japanese exports, and may materially affect the possibility of post treaty Japan becoming independent of U. S. aid.

Indices of Japanese Prices

	<u>Wholesale Prices a/</u>	<u>Cost of Living b/</u>	<u>Black &amp; Free Market Prices c/ (Tokyo)</u>	<u>Retail Price Index (Tokyo) c/</u>
June 30, 1950	100	100	100	110
Sept. 30, 1950	114	105	115	111
Dec. 31, 1950	123	107	121	117
Mar. 31, 1950	145	119	140	140
May 31	158	121	141	144

a/ SCAP, Japanese Economic Statistics, May 1951, No. 57, Section III.

b/ Ibid. This index called the "Consumer Price Index", is constructed upon the basis of data collected in the Family Income and Expenditures Survey. Price data are computed on the basis of expenditures for and quantities of goods and services purchased as reported in the survey. Prices are the average of actual official and black-market prices weighted by the quantities purchased in the respective markets.

c/ Bank of Japan, Financial Statistics Monthly, June 1951.

The principal causes of price increases in Japan have been advances in the prices of Japanese imports, including heavy imports of raw cotton, and the speculative reactions of Japanese traders to the strong export demands including "special procurement" for U. S. and U. N. forces in Korea. Furthermore, Japanese import planning was badly timed and heavy imports were encouraged when world prices were at peak levels. Following the outbreak of hostilities in Korea, Japanese exports (including "special procurement") expanded sharply while imports, limited by modest allocations of foreign exchange and by the reluctance of Japanese importers to buy in rising markets, lagged behind previous levels. The large export surplus was made possible by drawing down Japanese inventories of manufactured goods and raw materials. In order to restore stocks and to expand imports, the Japanese government drastically increased the foreign exchange budgets following June 1950 and in September 1950 they instituted a "usance bill system" which both reduced interest rates and expanded credit available

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to importers. Under those stimuli, Japanese imports and outstanding letters of credit representing import commitments expanded sharply. This expansion in imports coincided with peak prices of materials entering into international trade, and Japanese traders and manufactures faced large losses when price subsequently fell.

Japanese Foreign Exchange Budgets, 1950 - 51 a/  
(Million dollars)

<u>Period</u> (1950)	<u>Official Foreign Exchange Budget</u>	<u>Revised Import Licenses</u>	<u>Approved Import</u> <u>Per Cent</u> <u>of</u> <u>Budget</u>	<u>Import Remittances b/</u> <u>During Period</u>
Jan. - March	123	65	53	155
April - June	175	139	79	133
July - Sept.	415 <u>c/</u>	346 <u>c/</u>	83	161
Oct. - Dec. (1951)	525	438	83	198
Jan. - March	923	790	86	471
April - June	456	n.a.	n.a.	516

a/ Economic Stabilization Board (Japanese Government), Monthly Economic Report, May 1951, p. 43.

b/ Foreign Exchange Control Board (Japanese Government), Foreign Exchange Statistics Monthly.

c/ Excluding a special "long-term" budget for essential raw material imports. The budgeted allocation of foreign exchange was \$113 million of which \$90 million was licensed.

The upward pressures on prices resulting from export demands and higher import costs were enhanced by the sharp increase in the money supply which materialized through a combination of the "usance bill system" introduced to facilitate import financing and the expanded foreign exchange allocations. Moreover, the potentially deflationary effect of sharply expanded foreign exchange allocations in reducing the money supply was delayed by the "usance bill system".

The Japanese money supply increased by 39 per cent in the eleven months following June 30, 1950. This increase was more than matched by the increase in industrial production which expanded by 48 per cent. To some extent the effect of the expanded money supply on prices was neutralized by the expansion in the output of goods and services. However, industrial production represents only slightly more than half of total Japanese product with the remainder accounted for by agricultural, forestry and aquatic production which remained relatively stable in the year following June 1950. Therefore the percentage increase in goods and services was substantially less than the relative increase in the money supply.

Japanese Money Supply and Production Statistics a/

	<u>Currency in circulation outside banks</u>	<u>Deposit currency</u> b/	<u>Money supply</u> (Billion yen)	<u>Relative increase in money supply</u>	<u>Rate of turnover of current deposits</u>	<u>Index of industrial production</u> c/ (1932-36=100)
6-30-50	292	459	751	-	14.4	93.6
12-31-50	405	557	962	.281	15.9	116.7
5-31-51	382	660	1,042	.083	15.8	139.3

- a/ Bank of Japan, Financial Statistics Monthly.  
 b/ Including "ordinary" and "current deposits" of Japanese banks.  
 c/ SCAP, Japanese Economic Statistics.

Origins of the "usance bill system"

Japanese postwar foreign exchange earnings through the third quarter of 1950 were acquired by the Foreign Exchange Control Board (FECB) of the Japanese Government (or by SCAP, prior to turning external trade over to the Japanese Government) against yen payments by the Japanese Government through special budgetary accounts. 1/ The yen funds necessary to acquire the foreign exchange earnings were provided by budgetary appropriations of governmental revenues and by transfers between special budgetary accounts of the proceeds realized from the liquidation of the various foreign trade kodan (trading corporations) of the Japanese Government when foreign trade was restored to a private enterprise basis. As a result, the surplus in the balance of payments was not permitted to increase the supply of money, as is customarily the case when foreign exchange earnings are acquired by the banking system. As of September 10, 1950, when the "usance bill system" was introduced, the Japanese foreign exchange reserves totalled approximately \$420 million.

The heavy surplus of foreign exchange receipts following June 1950 exhausted the yen appropriated by the general fund budget to the FECB and, in addition, the Japanese Government had reached the statutory limit to borrowings by the government from the Bank of Japan. Under these circumstances, the FECB had reached the limit of the yen payments it could make to acquire the surplus in current account receipts. To escape from this impasse and also to provide easy credit to stimulate imports, a "usance bill" system was introduced in mid-September, 1950.

1/ The Foreign Exchange Control Board was created in November 1949 to operate the foreign exchange funds. While SCAP retained title to all foreign exchange funds arising out of external transactions, operations were vested by SCAP in the FECB by power of attorney.



Japanese Postwar Balance of Payments on Commercial Account  
(Million dollars)

	January - <u>June 1951 a/</u>	July - <u>Dec. 1951 b/</u>	September 1945 <u>June 1950 b/</u>
Current Transactions			
Commercial imports (c.i.f.)	987	304	1,088
Invisible payments	64	20	8
Total payments	<u>1,051</u>	<u>324</u>	<u>1,096</u>
Commercial exports	654	497	1,352
Invisible receipts	387	150	128
Total receipts	<u>1,041</u>	<u>647</u>	<u>1,480</u>
Current Commercial Account Balance	-10	323	384
Special adjustment			<u>-63 c/</u>
			<u>321</u>

a/ Economic and Scientific Section, SCAP.

b/ FECB, Foreign Exchange Statistics Monthly.

c/ Including: (a) Restitution settlements, \$21.7 million, (b) uncollectable trade accounts with Korea and China written off, \$20.2 million, and loss on sterling devaluation \$20.5 million.

Description of the "usance bill system"

The central feature of the "usance bill system" provided that the Bank of Japan loan foreign exchange to foreign exchange banks, in amounts corresponding to import letters of credit opened by these banks. This had two consequences: (1) since all foreign exchange was held by the Foreign Exchange Control Board, the Bank of Japan had to purchase foreign exchange from the FECB, which provided the yen funds needed by FECB to acquire the surplus in external payments; 1/ (2) foreign exchange banks in turn were to open yen credits for Japanese importers when issuing letters of credit. These yen credits would appear as bank loans at the time of the receipt of the shipping documents when the remittance in foreign currency for the imports would be made, and would have a duration corresponding (in theory) to the period required for processing and sale of the imported goods in Japan. The maximum duration of "usance bills" was originally fixed at 90 days and was subsequently extended to 120 days.

i/ To the extent that purchases of foreign exchange by the Bank of Japan were in addition to normal sales of exchange to make import remittances, the FECB will acquire additional yen funds. This amount would be equal to the outstanding import letters of credit plus the foreign exchange acquired by the banking system in anticipation of their requirements.

The Bank of Japan loans of foreign exchange to the banks and the yen credits extended by banks to Japanese importers were both for this period.

A "usance bill" transaction would be completed approximately 120 days after the remittance of foreign exchange when (a) the Japanese importer repaid the yen loan from the Japanese foreign exchange bank, (b) the Japanese foreign exchange bank acquired the foreign exchange from the FECB to repay the foreign exchange loan from the Bank of Japan, and (c) the Bank of Japan in turn sells back the foreign exchange to the FECB. Maximum rates of interest, 4 per cent on Bank of Japan foreign exchange loans and 5 per cent on yen loans to importers, were fixed under the "usance bill" system. In the Japanese interest rate structure these are very low rates.

Comparison of the "usance bill system" and earlier procedures for financing the FECB

Prior to the inauguration of the "usance bill system", the yen required by the FECB to purchase foreign exchange receipts, was provided only from budgetary appropriation and sales of exchange to make remittances. The Japanese foreign exchange bank, having opened a letter of credit for a Japanese importer following the issuance of the import license, would not acquire the foreign exchange necessary to make the import remittance until arrival of the shipping documents when it would purchase exchange from the FECB. When the banks gave credit to importers beyond the time of arrival of shipping documents, <sup>1/</sup> an expansion in an asset (import bills) of the foreign exchange banks resulted. To the extent that the Bank of Japan discounted import bills for the banks, to provide them with yen reserves, there resulted an expansion in the assets of the Bank of Japan and therefore in the currency issue and/or bank deposits at the Bank of Japan.

Under the "usance bill system", the Bank of Japan provides yen to the FECB. This makes the yen payments for foreign exchange remittances available to the FECB at the time of the issuance of the import letter of credit, rather than later at the time of arrival of the shipping documents. Therefore, the minimum advance payment of yen to the FECB under the "usance system", as contrasted to the "import bill" system was equal to the outstanding import letters of credit. Introducing the "usance system" providing concessional interest rates and extended credit terms at a time when import licenses were being issued in unprecedented volume resulted in a volume of import letters of credit far in excess of the volume of import remittances at the time of arrival of shipping documents. The huge volume of outstanding import letters of credit, resulted in the transfer of a large portion of the postwar Japanese accumulation of

<sup>1/</sup> The duration of import bills was limited by the Policy Board of the Bank of Japan to 60 days.

of foreign exchange from the FECB to the banking system. Moreover, Japanese banks acquired foreign exchange in excess of their requirements to cover import letters of credit, thus providing the FECB with additional yen funds. In effect, a large part of the postwar surplus on current account, which through September 15, 1950, was not allowed to affect the money supply but which was "sterilized" by providing the FECB with yen funds largely from tax receipts, was injected into the Japanese banking system in a few months following the introduction of the "usance system."

Transfer of Foreign Exchange Reserves to the Banking System  
(Million dollars)

<u>Period</u>	<u>Foreign exchange a/ purchased by Bank of Japan from FECB (cumulative)</u> (1)	<u>Foreign exchange b/ remittance by foreign exchange banks</u> (2)	<u>Estimated outstanding import letters of credit plus additional borrowings of foreign exchange by Japanese foreign exchange banks c/ (1) less (2)</u>
1950			
Sept.	28	25	3
Oct.	149	130	19
Nov.	307	253	54
Dec.	447	339	108
1951			
Jan.	618	394	224
Feb.	808	451	357

a/ Bank of Japan, Financial Statistics Monthly, April 1951, table 69. Receipts and Payments of Foreign Exchange Special Account.

b/ Ibid., table 21, Foreign Exchange Settlement, Assets of All Banks except the Bank of Japan.

c/ Under the "usance system" foreign exchange banks have been permitted to borrow foreign exchange from the Bank of Japan in anticipation of future requirements to cover import letters of credit. Therefore, the outstanding letters of credit will be less than the amount indicated which is actually a measure of the foreign exchange held by the Japanese banking system.

Inflationary impact of the "usance bill system"

The inflationary impact on the money supply arising out of the introduction of the "usance system" can most conveniently be considered in two parts. First the surplus in Japanese external payments which heretofore had not been permitted to affect the currency issue of the Central Bank, was now acquired by the FECB with yen advanced by the Central Bank. 1/

1/ The current account surplus under the "usance system" might logically be considered as accruing to the Central Bank, which had advanced the yen to the FECB. Under normal trading and banking procedures, the surplus in external payments would be held by the banking system, either by the commercial banks or by the Central Bank.

During the period September 20, 1950, to January 31, 1951, the excess of foreign exchange receipts over payments amounted to approximately ¥79.2 billion (\$220 million). This amount represents the direct disbursement of yen by the FECB and compares closely to the increase in the currency issue over this period of ¥81.7 billion (\$227 million). <sup>1/</sup> There are no reserve requirements in Japan and commercial bank holdings of cash are negligible <sup>2/</sup> (\$40-55 million, or approximately 1-2 per cent of deposit liabilities). In such a system, the effective limit on bank credit expansion is the leakage of currency as the supply of money (deposits and currency) expands and/or prices rise and individuals choose to hold larger amounts of currency. The ¥79.2 billion (25 per cent) increase in the currency issue made possible an expansion in the earning assets of Japanese commercial banks at a rate of approximately ¥31 billion (\$90 million) or 3.2 per cent per month over total earning assets as of September 30, 1950.

The second inflationary impact of the "usance bill system" arises from the extension of the period of import credit. Under the "import bill" system, the maximum period of credit was limited to 60 days following the issuance of the import letter of credit. Under the "usance system" this period of credit is extended to 120 days. As contrasted to the earlier procedures, this means that Japanese importers are permitted an additional period of 60 days before surrendering their yen to the banks for subsequent transfer via the Bank of Japan to the FECB. In effect, yen credits equivalent approximately to Japanese commercial imports over a two month period are extended, which would not have existed under the previous procedures. Because of the drastic expansion in foreign exchange allocations during this period, the volume of yen credits attributable to the "usance bill system" grew sharply. If we assume that all commercial imports were made with usance bill credit following October 1, 1950, this volume of additional yen credit increased by approximately \$391 million up to the end of April 1951.

The mechanics of the "usance bill system" indicate that the volume of foreign exchange loans by the Bank of Japan will continue to increase only until it is approximately equal to the volume of Japanese commercial imports during a period of the length (120 days) for which usance credit is extended. After this amount is reached, usance credit will circulate as a revolving fund and the volume (subject to fluctuations in Japanese imports) will tend to be stabilized.

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- <sup>1/</sup> During the period September 20-January 31, the outstanding foreign exchange loans of the **Bank of Japan** increased by \$582 million. This increase was offset to some extent by the decline in other earning assets (including import bills discounted) of \$218 million, such that there was a **net increase** in earning assets of \$364 million. This increase was more than matched by the increase in the currency in circulation of \$227 million and by the increase in the Government's Deposits (including the FECB) of \$148 million.
- <sup>2/</sup> The Japanese commercial banks have negligible deposits (\$10-15 million) in the Bank of Japan, while their borrowings from the Bank of Japan are substantial, amounting on January 31, 1951, to \$266 million.

Effect of "Usance Bill System" on Japanese Credit Structure  
(Million dollars)

	<u>Commercial imports</u>	<u>Expansion in yen credits due to lengthening of credit terms for import financing (sum of two months imports)</u>	<u>Actual volume c/ of usance credit (Bank of Japan foreign exchange loans)</u>	<u>Theoretical volume of usance credit (Sum of commercial imports during previous four months)</u>
<u>1950</u>				
Sept. <u>b/</u>	30	30	25	30
Oct.	54	84	130	84
Nov.	68	122	253	152
Dec.	75	143	339	227
<u>1951</u>				
Jan.	102	177	394	299
Feb.	160	162	451	405
Mar.	209	369		546
Apr.	182	391		653
May	176	358		727
June	158	334		725

a/ FECEB, Foreign Exchange Statistics Monthly.

b/ Estimated for period Sept. 15-Sept. 30, from reported amounts for entire month of September.

c/ Bank of Japan, Financial Statistics Monthly, April 1951, table 21, assets and liabilities of all banks except the Bank of Japan. Information is not available regarding the distribution between actual holdings of foreign exchange and "Foreign Exchange Settlements" (volume of usance credit) following February 1951. The excess of the Bank of Japan foreign exchange loans over the theoretical volume of usance credit (sum of four months imports) represents the transfer of foreign exchange to the banking system in anticipation of future requirements.

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These calculations indicate that the introduction of the "usance bill system", when contrasted with procedures previously employed in Japan, resulted in a rapid expansion in both the currency issue and the supply of yen credit. Primarily as a result of the operations of this system the supply of money expanded rapidly from ¥751 billion on June 30, 1950, to ¥1039 billion on March 31, 1951, an expansion of 38 per cent. 1/

### Current problems

The timing of the introduction of the liberal "usance system" with the relaxation of import controls and expanded foreign exchange allocations for imports has had an inflationary effect on the Japanese money supply. Furthermore, this inflationary pressure has been superimposed on the price increases which tended to result from strong export demands and higher costs of imported materials. 2/

The increase in prices since the outbreak of hostilities in Korea, is in sharp contrast to the moderate price declines in the fifteen months of the Stabilization Program following March 1949. The inflation in Japan relative to those countries which traditionally compete with Japan in international trade, e.g., the U.K. and India, is rapidly reducing the Japanese ability to compete in international trade in the future when demand conditions for Japanese exports become more normal.

It should be emphasized that the behavior of the volume of "usance" credit and the distribution of holdings of foreign exchange between the FECB and the banking system, as analyzed above, is reversible. That is, in a period when foreign exchange budgets are being reduced, the foreign exchange actually held by FECB should increase (subject to an obvious lag) relative to that held by banks, and the volume of outstanding letters of credit as well as the volume of "usance" credit should decline. However, the apparent unwillingness of the Bank of Japan and the Japanese banking system to reduce credit outstanding may merely result in some other form of credit being extended to replace the "usance" credit.

1/ IMF, International Financial Statistics, July 1951.

2/ A continuation of the stabilization (Dodge) program policy of removing various production and consumption subsidies provided by budgetary appropriations also contributed to the upward pressure on Japanese prices.

September 25, 1951

UNITED STATES FOREIGN TRADE: A YEAR AFTER KOREA

Edward Marcus

One of the most striking effects of the world situation after June 1950 was the marked diminution of the U. S. export surplus due primarily to sharply rising import values. This reduction lasted for about nine months and, outside the military program, we actually imported more than we exported in August and November 1950 and January 1951. Imports continued high, and, until the second quarter of 1951, were a higher percentage of exports than at any time since the end of the Second World War.

If we look farther, however, the picture is not quite so hopeful for balance-of-payments equilibrium. The large visible surplus that re-emerged in the second quarter of this year may be a portent of difficulties that could arise in the future should the rearmament program level off. Significant current factors that may be indicative of such a possibility are: (i) lagging import volumes, particularly of raw materials; (ii) the great influence of temporary price increases on import values, price increases which in many cases have now become decreases; and (iii) the reversal of the previous upward trend in imports from the ERP countries.

Total trade<sup>1/</sup>

It may be helpful to review foreign trade developments over the past two or three years. U. S. imports dropped off in the first half of 1949, while our export surplus rose. This led to increased restrictions on purchases from this country in mid-1949, particularly in the Sterling Area, and then, in September-October 1949, to a series of currency devaluations. Aided by our own internal upswing, U. S. imports began to rise, while the increased trade restrictions, devaluations, and continued recovery abroad reduced our exports. As a percentage of U. S. exports,<sup>2/</sup> our imports for consumption, which

<sup>1/</sup> The various Department of Commerce statistical series on which this article is based are not uniform in composition. Because of their military use special category exports are excluded from most country and some commodity breakdowns. Most shipments under the Mutual Defense Assistance Program (MDAP) have been in these special categories. Re-exports are included in the country data but not in the commodity data. "General imports", broken down by country, include entries into bonded Customs warehouses, whereas import data for commodities are "imports for consumption" which includes withdrawals from these warehouses. This difference is of significance only in March, April, and May of this year, when the excess of entries averaged more than \$65 million monthly, compared with a monthly average excess in the preceding 12 months of but \$9 million.

<sup>2/</sup> Excluding re-exports and MDAP shipments.

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had fallen to 48 per cent of exports by the second quarter of 1949, rose gradually to 80 per cent in the first quarter of 1950, dipped to 77 per cent in the second quarter, and then jumped to 101 per cent in the third quarter, indicating an excess of imports. By this time exports were rising, and in the following two quarters the ratio remained between 95 per cent and 100 per cent. Then, in April of this year, imports slackened while exports continued to rise for one more month; for the second quarter of 1951 the ratio dropped to 77 per cent or about the same as in the corresponding quarter of 1950.

Even this somewhat lower figure would not be too alarming -- it is half again higher than for the corresponding quarter of 1949 -- were it not for the price influence. If we were to re-price the volume at pre-Korean price levels -- say, on the basis of the second quarter of 1950 -- imports would be but 69 per cent of exports. That is, the visible surplus would be increased from 23 per cent of exports to 31 per cent. This change, of course, is the arithmetic reflection of the greater rise in import unit values during the past year. The export unit value index rose 21 per cent from the second quarter of 1950 to that of 1951, whereas the import unit value index rose 36 per cent, a deterioration in our terms of trade<sup>1/</sup> of 11 per cent.

#### Recent export rise

As already indicated, part of the explanation for the increased trade surplus in recent months has been the relatively high level of exports. Much of the rise since last autumn was simply the result of a greater quantity of goods going abroad; although unit values in the second quarter were about 10 per cent above the last quarter of 1950, the volume was up 23 per cent, with wheat and automobiles accounting for a third of the rise. The second quarter surplus for total trade, excluding MDAP shipments, was at an annual rate of \$2.9 billion, the largest since before the 1949 devaluations.<sup>2/</sup> It might be noted that the geographical distribution of the export increase has been widespread, with all important areas showing marked gains, and some observers have tended to regard it as analogous to our own buying upsurge following the active intervention in Korea of the Chinese Communists.<sup>3/</sup> In the second quarter U. S. trade with every important area but one showed a larger export surplus -- or smaller trade deficit -- than at any time since the last quarter of 1949. The one exception was the Sterling Area, a sharp rise in our imports from Australia about offsetting the export increase to the area as a whole.

<sup>1/</sup> Export unit value index divided by import unit value index.

<sup>2/</sup> Based on exports including re-exports and general imports. The surplus of exports of non-military domestic merchandise over imports for consumption was \$3.3 billion, annual rate.

<sup>3/</sup> See for example The Journal of Commerce, July 25, 1951, p. 1.



On a monthly basis, the peak of total exports was reached in April of this year. In July total exports (excluding MDAP shipments) were 11 per cent below the second quarter monthly average.

TABLE I

CHANGE IN VALUE OF U. S. FOREIGN TRADE BY AREAS

Per cent Increase or Decrease (-) from Second Quarter 1950 to Second Quarter 1951

	<u>Total Exports</u>	<u>General Imports</u>
Total	60	54
Total Excluding MDAP	47	54
<hr/>		
Excluding special categories:		
Total	48	54
ERP	40	111
United Kingdom	97	83
Belgium and Luxembourg	27	89
France	53	275
Germany	- 4	270
Italy	57	81
Netherlands	33	86
Switzerland	79	53
All other	25	86
Canada	46	22
Latin American Republics	49	41
Sterling Area	68	84
Self-governing countries <sup>1/</sup>	67	108
Other <sup>1/</sup>	12	50
Soviet Bloc	- 84	- 14
China Mainland	-100	- 76
Other Non-Sterling Far East <sup>2/</sup>	65	60

<sup>1/</sup> Excludes the United Kingdom, Eire, and Iceland.

<sup>2/</sup> Indonesia, Japan, Philippine Republic, Taiwan, and Thailand.

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TABLE II

U. S. VISIBLE TRADE BALANCESSurplus or Deficit (-)  
(In millions of dollars)

	<u>1951</u> <u>Second</u> <u>Quarter</u>	<u>1950</u> <u>Second</u> <u>Quarter</u>
Total		
Total excluding MDAP	1038 713	580 580
<hr/>		
Excluding Special Categories:		
Total	597	491
ERP		
United Kingdom	515	491
Belgium and Luxembourg	66	28
France	27	36
Germany	41	57
Italy	63	115
Netherlands	136	90
Switzerland	61	52
All other	16 104	6 107
Canada	170	40
Latin American Republics	74	15
Sterling Area		
Self-governing countries <sup>1/</sup>	- 164	- 63
Other <sup>1/</sup>	- 109 - 133	- 24 - 77
Soviet Bloc	- 15	- 12
China Mainland	- 8	- 26
Other non-sterling Far East <sup>2/</sup>	82	44

<sup>1/</sup> Excludes the United Kingdom, Eire, and Iceland.<sup>2/</sup> Indonesia, Japan, Philippine Republic, Taiwan, and Thailand.RESTRICTED

Lagging import volumes

In view of the strong demand that has emerged during the past year, the behaviour of import volumes is surprising.<sup>1/</sup> For the second quarter as a whole, the volume of imports in 1951 was only 7 per cent larger than in 1950, with important decreases in tin bars, crude rubber, sawed boards, copper, and burlap. Throughout the second quarter of 1951 there was a declining tendency in imports, and in June we actually imported less, on a volume basis, than in June 1950, at a rate but 3 per cent above the pre-Korean half-year. As compared with the previous June, only manufactured foodstuffs (especially meat products) and finished manufactures (notably chemicals and metal products) were up.

To some extent this lag in imports may be attributable to temporary obstacles. One factor is the slowness with which agricultural and mining supplies can respond to an expansion in demand; the legacy of the depressed thirties has made these industries reluctant to increase output even though the current shortage has pushed prices to extremely profitable levels. A second depressing influence has been the recent drawing down of inventories accompanying the decline in domestic spending, a reversal of the forces at work in the months immediately after the Korean outbreak; once this movement ends, our purchases abroad should recover.<sup>2/</sup> Finally, price ceilings for certain of our imports, such as the non-ferrous metals, have been low relative to world prices, so that some of the supply that ordinarily would have come here has gone to other areas.

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<sup>1/</sup> See this Review, July 17, 1951, Recent Developments in United States Foreign Trade, pp. 1-2.

<sup>2/</sup> See the Journal of Commerce Import Bulletin, September 13, 1951, p. 1.

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TABLE III

## U. S. IMPORTS FOR CONSUMPTION

	Per Cent Increase from 2nd Quarter 1950 to 2nd Quarter 1951			Value 2nd Quarter 1951 (In millions of dollars)
	Quantity	Unit Value	Value	
Crude Materials	<u>2</u>	<u>75</u>	<u>79</u>	<u>925</u>
Unmanufactured wool (clean content)	2	184	189	260
Crude rubber	- 28	197	113	188
Crude petroleum	13	1	12	101
Others	--	--	52	377
Crude Foodstuffs	<u>15</u>	<u>20</u>	<u>38</u>	<u>478</u>
Coffee	34	19	60	286
Cocoa	- 8	50	38	62
Others	--	--	6	130
Manufactured Foodstuffs	<u>13</u>	<u>13</u>	<u>28</u>	<u>274</u>
Cane sugar	4	4	8	106
Others	--	--	46	167
Semi-manufactures	- <u>1</u>	<u>35</u>	<u>34</u>	<u>644</u>
Wood pulp	10	59	76	98
Gas and fuel oil	3	5	9	51
Copper	- 27	39	1	58
Sawed boards, planks, deals, etc.	- 27	35	- 2	61
Tin bars	- 76	55	- 62	14
Others	--	--	63	362
Finished Manufactures	<u>21</u>	<u>16</u>	<u>41</u>	<u>496</u>
Burlap	- 17	54	28	29
Newsprint	- 2	7	5	125
Others	--	--	63	343
TOTAL	7	36	48	2817

Figures may not add to totals because of rounding.

Prices

Immediately following Korea, world prices of strategic materials climbed rapidly, although there is evidence that a price upswing had begun in the preceding quarter. From June 1950 to June 1951, the unit value

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index for our imports rose 37 per cent, whereas export unit values went up only 20 per cent. The largest increases were in crude materials, notably raw wool, raw cotton and crude rubber; if we exclude that category from both calculations, then the June-to-June rise in our export prices of 19 per cent was not much less than that of imports-- 26 per cent. Comparing the second quarter of 1951 with that of 1950, the comparable price rises were:

All Exports	21 per cent
All Imports	36 per cent
Excluding Crude Materials:	
Exports	19 per cent
Imports	22 per cent

Both total unit value indices rose every month after June 1950 until this June, when the export unit value index dropped slightly, 1/2 per cent. However, the recent sharp declines in many wholesale prices should soon show up in our trade statistics, particularly the import indices, and, indeed, individual commodity unit values in June did register declines, notably crude rubber and tin bars.

The effect of this price rise in reducing the U. S. export surplus can be best seen if we revalue current volumes at pre-Korean unit values, as shown in the following table.

TABLE IV

U. S. FOREIGN TRADE AT CURRENT AND PRE-KOREAN PRICES  
(In millions of dollars)

	Exports <sup>1/</sup>	Imports <sup>2/</sup>	Trade Balance	Imports: Exports %
June 1951:				
At Current Prices	1165.9	914.4	+251.5	78.4
At June 1950 Prices	972.4	664.8	+307.6	68.4
1951 Second Quarter				
At Current Prices	3645.5	2817.3	+828.2 <sup>3/</sup>	77.3
At 1950 Second Quarter Prices	3022.1	2073.5	+948.6	68.6

<sup>1/</sup> Excludes re-exports and MDAP shipments.

<sup>2/</sup> Imports for consumption.

<sup>3/</sup> See footnote 2, page 2.

Thus, at pre-Korean prices, not only would imports be a lower percentage of exports, but, in addition, the absolute size of our export surplus would be increased.

Area trade patterns

ERP countries. - Since the end of the Second World War, the most serious imbalance in our foreign trade has been the large surplus with Western Europe, particularly the Continental members. It is primarily this segment of our visible trade surplus that has given rise to the phrase "dollar shortage." And Western Europe is probably the one area with which our trade has still shown a continuing large surplus in every quarter since Korea.

This is not to imply that there has been little gain in the direction of a viable Europe without U. S. aid. Thus, from the second quarter of 1950 to the second quarter of 1951, our imports from the United Kingdom rose 83 per cent, while from the other ERP countries the rise was 122 per cent, and France and Germany each recorded gains of more than 200 per cent. As a result, the Western European share in our imports rose from 12.6 per cent to 17.3 per cent.

On the other hand, our exports to the ERP countries rose too and, even if we exclude the "special categories" <sup>1/</sup>, our trade surplus with the ERP countries rose slightly, from \$491 million to \$515 million from the second quarter of 1950 to the second quarter of 1951. Only with Western Germany did our surplus decline significantly, as that country's continued recovery aided a larger rise in shipments to the United States. Other countries with which we had a smaller surplus in the second quarter of this year as compared with the second quarter of 1950 were France and Belgium-Luxembourg.

At present, two possibilities threaten to increase our trade surplus even more. Much of the increase in imports occurred in industrial chemicals and steel products, which increased 448 per cent and 482 per cent, respectively, from the second quarter of 1950 to the second quarter of 1951. These increases were directly attributable to our own shortages, and whether we will continue to import these items in as large a volume is uncertain. Both dropped off significantly after March, with France sending less chemicals, the Netherlands less steel-mill products, and Belgium-Luxembourg less of both. The other, more general potential difficulty is the effect of European rearming on exportable supplies. Shortages may result in lower exports to the United States, even if our demand continues high. On the other hand, our exports to the ERP countries also dropped off after April, which may be indicative of the ending of the recent buying surge. <sup>2/</sup>

<sup>1/</sup> "Special category" exports are those for which complete statistical data are not furnished because of their military uses. Most such exports are financed under MDAP, and do not, therefore, represent a financial drain on the receiving country. Cf. below, p. 10.

<sup>2/</sup> Cf. the UN ECE Economic Bulletin for Europe, First Quarter, 1951, pp. 2-3. The area breakdown of the lower export total for July is not yet available at the time of writing.

Other areas. - Among the other areas, the most striking change during the past year has been the doubling in our imports from the self-governing members of the Sterling Area, in large part due to the sharp price increases following Korea. Australian shipments rose from \$32 million in the second quarter of 1950 to \$170 million in the second quarter of 1951, raw wool being the main factor. Since our exports rose much less both proportionately and absolutely--those to Australia, for example, went up only \$8 million, or 31 per cent--our visible trade deficit with the group as a whole rose from \$24 million to \$109 million. With the entire Sterling Area, we had a deficit of \$164 million in the second quarter of 1951, compared with \$63 million in the second quarter of last year. On a monthly basis, the deficit continued high through June.

Significant increases in our trade surplus occurred with Canada; the Latin American Republics, mainly Mexico; and the non-sterling Far East <sup>1/</sup>, mainly Japan. While our imports from Canada rose less than 25 per cent, our exports rose almost 50 per cent, thus increasing our surplus from \$40 million to \$170 million. There were marked increases in our exports to Mexico, Cuba, and Venezuela which were not accompanied by equally sharp rises in imports. On the other hand, because of a rise in coffee imports from Colombia from an exceptionally low level in the second quarter of 1950, our trade balance with that country shifted from an export surplus in the second quarter of 1950 to a deficit this year.

Although our imports from Japan increased almost 50 per cent from the second quarter of 1950 to the second quarter of this year, our exports almost doubled, so that our trade surplus rose from \$54 million

TABLE V

U. S. TRADE WITH THE LATIN AMERICAN REPUBLICS

(In millions of dollars)

	E X P O R T S		I M P O R T S		T R A D E B A L A N C E	
	1951-2 q.	1950-2 q.	1951-2 q.	1950-2 q.	1951-2 q.	1950-2 q.
Argentina	64	35	80	47	-16	-12
Brazil	159	67	198	127	-39	-59
Colombia	67	73	73	45	-7	+29
Cuba	132	99	108	96	+24	+4
Mexico	183	111	79	73	+103	+38
Venezuela	124	95	84	77	+40	+18
Central American Republics	57	68	61	41	-5	+27
All others	136	67	162	96	-26	-28

Discrepancies between trade balances and exports and imports are due to rounding.

<sup>1/</sup> Indonesia, Japan, the Philippine Republic, Taiwan, and Thailand.

to \$109 million. The most marked rise came in the second quarter of this year, when the surplus almost doubled. Much of this movement may be attributed to speculative buying of U. S. cotton <sup>1/</sup>, and has since ended with the subsidence of inflationary fears and accompanying shortages of materials. Trade with Indonesia rose both ways, exports rising from \$20 million to \$46 million, and imports from \$31 million to \$58 million, our import surplus rising very slightly, from \$10.5 million to \$11.8 million. A \$20 million rise in exports to the Philippines was exceeded by a \$26 million rise in our imports, thus changing an export surplus of \$4.6 million to an import surplus of \$1.5 million.

With the Soviet Bloc and the China mainland <sup>2/</sup>, the increased international tension and accompanying restrictions on trade reduced our exports 70 per cent and imports 49 per cent. China plus the ten East European countries took less than 0.1 per cent of our exports in the second quarter of 1951 while supplying 0.9 per cent of our imports. In the second quarter of last year, the export and import shares were 0.5 per cent and 2.7 per cent respectively, plus an additional amount via Hong Kong.

#### Commodity composition of exports

The bulk of the increase in import values over the past year can be attributed to rising prices, but the export value increases have been due more to quantity increases. Comparing the second quarters, unit values of exports were up 21 per cent, whereas the quantity rose 33 per cent, or 22 per cent excluding MDAP shipments. <sup>3/</sup> Mainly because of lower raw cotton and tobacco exports, the volume of crude materials shipped out was down 12 per cent, but the other categories rose, crude foodstuffs as much as 115 per cent, wheat to India being among the major increases. Other significant quantity increases were in corn, coal, new automobiles, trucks, cotton cloth, lard, and, in fact, fats and oils as a group. Cotton and its products and manufactured foodstuffs, such as lard, were those showing the major price rises.

Of increasing importance among our exports over the past year is the Mutual Defense Assistance Program. The export total for the second quarter of 1950 included less than 4 per cent in the "special categories," all sold for cash. During the second quarter of this year, the percentage for all special category exports had risen to almost 11 per cent, three-fourths of which were under the military assistance program, and were thus automatically matched by grants to the receiving country. Half the estimated quantity increase in our finished manufactures exports can be attributed to this source.

- <sup>1/</sup> See The Oriental Economist, August 25, 1951, pp. 663-665.
- <sup>2/</sup> The data used here include also Hong Kong, as the main Chinese entrepot.
- <sup>3/</sup> The assumption made for this calculation is that the unit value of MDAP shipments moved in the same way as that for the finished manufactures index. Actually, MDAP shipments made in the second quarter of 1950, but reported with July exports, amounted to less than 2 per cent of the second quarter total exports.



TABLE VI

U. S. EXPORTS

	(excludes re-exports)			Value 2nd Quarter 1951 (In millions of dollars)
	Per cent increase from 2nd Quarter 1950 to 2nd Quarter 1951			
	<u>Quantity</u>	<u>Unit value</u>	<u>Value</u>	
Crude Materials	-12	30	15	583
Coal	89	1/n.c.	91	151
Unmanufactured cotton	-41	50	-12	263
Unmanufactured tobacco	-18	34	11	49
Others	--	--	40	120
Crude Foodstuffs	115	15	148	436
Wheat	146	9	167	287
Corn	49	23	84	56
Others	--	--	144	92
Manufactured Foodstuffs	12	43	59	239
Lard	93	69	227	42
Wheat flour	23	19	46	31
Others	--	--	44	166
Semi-manufactures <u>2/</u>	25	28	59	431
Finished Manufactures	44	15	66	2,281
Passenger cars, new	157	8	177	111
Cotton cloth, duck and tire fabric	42	38	96	75
Motor trucks and busses, commercial, new	55	9	69	94
Tractors <u>2/</u>	17	5	23	56
Others	--	--	63	1,946
Total	33	21	60	3,970
Excluding MDAP <u>3/</u>	22	21	47	3,646

1/ Not calculable.

2/ Excludes certain special categories.

3/ See footnote 3, page 10.

Conclusion

The United States once again has a large export surplus and it appears that there is considerable possibility that it will again become embarrassingly large some time in the future, particularly should the rearmament program level off.

Before that contingency arises, however, we may see a reversal of recent trends. We may look for shortages of exportable supplies, particularly among metal products; increased demands for imported raw materials and consumers' goods once the present downward trend of prices comes to a halt; import unit values rising again; and rising foreign balances. Forecasts of a very large rise in foreign gold and dollar balances made during the past year have proved utterly false for the present. Whether or not a more moderate forecast of a smaller increase in foreign balances in the next several months will prove correct may depend on the course of imports of finished manufactures, and these may be limited by supply availabilities in Europe. The main uncertainty for the immediate future is U. S. demand. Later on, supply shortages loom as possibilities. Whatever the shape of our balance of payments in the near future, the emergence in the post-rearmament period of tendencies for the visible surplus to be far in excess of net dollar availabilities from sources other than government aid is at least a strong possibility.