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DIRECTORATE OF
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Intelligence Report

*Japan's Economic Role
in the Development of Free Asia*

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JAPAN'S ECONOMIC ROLE IN THE DEVELOPMENT
OF FREE ASIA*

Summary

The Japanese government is groping for a foreign aid policy that is consistent with the nation's new status as one of the world's industrial leaders and an important member of the community of advanced nations. Until quite recently, official Japanese aid to Free Asia centered on reparations, which were treated by Japan as obligations to be discharged as expeditiously as possible. Particularly since 1965, the Japanese government has developed a more positive approach to foreign aid, which has increasingly reflected an awareness of the long-run benefits to Japan of economic development in Free Asia.

Between 1950 and 1965 the flow of long-term capital** from Japan to the less developed countries amounted to some \$2.6 billion, and activity during 1966 will probably raise this total to \$3.1 billion. About \$1.8 billion of the flow through 1965 as well as probably another \$300 million in 1966 were accounted for by official disbursements, the most important element of which consisted of the programs of reparations to a number of countries

* This report was produced solely by CIA. It was prepared by the Office of Research and Reports and coordinated with the Office of Current Intelligence; the estimates and conclusions represent the best judgment of the Directorate of Intelligence as of April 1967.

The term Free Asia is used throughout this report to denote the non-Communist Asian countries extending from Afghanistan eastward through South and Southeast Asia and north from there to South Korea. Australia and New Zealand are not considered parts of the region for the purposes of this report.

** The expression long-term capital is used throughout this report to denote official and private capital flows involving repayment over periods of five years and more, although in some recent years data on private capital reflect only flows involving repayment terms of more than five years. Because of frequent changes in classification of data by both the Japanese government and the principal international organizations reporting economic assistance, the reader may encounter a variety of related data differing from that shown in this report. Insofar as possible conflicting series of data have been adjusted for this report to adhere to the standard described above, and differences with other reports represent the selection of other criteria for long-term capital.

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of Free Asia. As these programs draw to a close, considerable attention is being focused on whether Japan will be able so to increase its flow of official grants and loans,* contributions to multilateral agencies, and private investment and export credits as to provide the 1 percent of national income that the Sato administration regards as its goal in these forms of development assistance. In addition to the usual impediments to foreign aid, Japan faces some peculiar obstacles, including low per capita income, particularly strong competing demand for domestic investment, and pronounced rivalries among the ministries that are concerned with aid planning.

Free Asia has been the principal beneficiary of Japanese development assistance, with annual flows of long-term capital to the region increasing from an estimated \$125 million in 1960 to an estimated \$265 million in 1965. The Free Asian share in the various forms of long-term assistance has varied from almost the complete amount of grant aid to about a third of the private capital flow. All of the countries of the region have received at least some long-term capital from Japan, and in a number of cases this assistance has been noteworthy. In Burma, Indonesia, and the Philippines, reparations have been principal sources of grant aid. Official bilateral credits extended by Japan through consortia have been significant sources of development capital for India and Pakistan. A large program of official and private assistance to South Korea and bilateral credits to Nationalist China and Malaysia will give Japan a prominent role in the present development plans in those countries.

Japan has made important official contributions in project and non-project aid to the rehabilitation and development of Free Asia. Particularly noteworthy among the project assistance is infrastructure such as the Balu Chaung hydroelectric dam in Burma and the Da Nhim hydroelectric dam in South Vietnam and assistance to heavy industry such as the construction of fertilizer plants in India and steel plants in India and Pakistan. Among other official assistance that has been especially significant to development efforts is the supply of capital equipment for manufacturing facilities and agriculture and transportation equipment in the form of ships, railroad rolling stock, automobiles, and trucks. These programs of material aid have been complemented by extensive

* Following common usage, the terms loan and credit are used interchangeably in this report. It should be noted that virtually all Japanese "loans" have been suppliers' credits in the sense that they have been tied to procurement in Japan.

Japanese participation in technical assistance and by academic training through official Japanese channels, multilateral programs, or activities of the private sector.

In addition to providing increasing amounts of official bilateral aid to Free Asia, Japan has been an important source of numerous small private investment activities for the region. Thailand is clearly the principal beneficiary of this form of long-term capital, and a conservative estimate would put the total stock of Japanese capital in that country at \$35 million. Other major areas of private investment for Japan are Indonesia, Singapore, and Malaysia, the last of which is the recipient of assistance in the construction of a steel mill that represents one of the major Japanese private investments in heavy industry in Free Asia. Especially in the case of the numerous investments in minerals and forestry in Indonesia, production-sharing has been an important means by which the Japanese have overcome obstacles to the entry of private capital into the less developed countries, and this form of investment will probably continue to play an important role in overseas Japanese economic activities.

The importance to Free Asia of trade with Japan is steadily increasing as the Japanese market share expands in most of the less developed countries of the region, and rapid growth of the Japanese economy will continue to provide an important source of demand for many of Free Asia's primary products. Nevertheless, because Japan's growth rates in output and trade are greater than those of the region as a whole, the share of Free Asia in Japanese imports and exports is shrinking. Thus, between 1955 and 1965, the share of Japanese imports coming from Free Asia fell from 27 percent to 17 percent, and a similar relative decline occurred in exports. Although there is every reason to believe that Japan will remain competitive in the heavy industrial exports to the region that have spurred its advance in the Free Asian market, the prospects for a complementary growth in the Free Asian share of Japanese imports of raw materials are not as promising. Production difficulties in Free Asia and Japanese emphasis on a wide distribution of sources of low-priced raw materials militate against a substantial rise in the Free Asian share of the Japanese market for such raw materials as sawlogs, iron ore, bauxite, and crude oil. Rapid expansion in Japanese imports of certain tropical foodstuffs suggests that there may be more growth potential in these commodities as the Japanese diet continues to diversify.

Although Japan is a major industrial power and the most economically advanced of the Asian countries, efforts of the more progressive elements

of the Japanese government to assume active leadership in the development of Free Asia have been inhibited by at least two major factors, the future impact of which is still uncertain. The first of these, which is most prevalent in government circles, is anxiety over animosities throughout Free Asia lingering from World War II. The second impediment to a more active role in Asian economic leadership is the fact that the Japanese people, whose standard of living is still relatively low on the European scale, have only recently become aware of Japan's advanced economic status. Moreover, strong domestic demand for public investment will continue to compete with foreign aid, and a coherent Japanese aid policy remains to be developed. Nevertheless, the declared goal of 1 percent of national income for the annual flow of long-term capital from Japan to the less developed countries probably will be achieved by 1970. At a rate of growth of 8 percent for national income, this would mean a flow in that year of \$1 billion in 1965 prices, and of this amount \$600 million or more might be expected to go to Free Asia. Grant aid is not likely to be expanded much beyond its present scale, but a growing share of the official bilateral assistance to Free Asia will probably take the form of credits on terms softer than the interest rate of slightly less than 6 percent characteristic of the past. Japan's growing awareness of the increasing competitiveness of its heavy industrial products will probably lead to more enthusiasm for disbursement of aid through such multilateral channels as special funds of the Asian Development Bank and the Mekong Commission. The geographic distribution of official economic aid to Free Asia in 1970 is likely to show a relative concentration in East and Southeast Asia as opposed to South Asia, but Japan will probably continue to play a constructive role in the consortia for India and Pakistan. Private investment will probably focus on Thailand, Indonesia, Singapore, and Malaysia, but improvements in the climate for Japanese investment in the Philippines and South Korea could mean significant growth in private capital flows to those countries.

The outlook for Japanese trade with Free Asia is strongly conditional on foreign aid to the region. Although Japan will probably continue to expand to some extent its market shares in the trade of the less developed countries of Free Asia, sustained growth in Japanese exports to the region will require the increased purchasing power that can only come from economic development. The Japanese are becoming distinctly more aware that their traditional conception of foreign aid as primarily a means of direct export promotion is too narrow and that Japan stands to benefit greatly from the growth-stimulating effects of both its own and other aid programs in the area.

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Viewed from the perspective of the less developed countries of Free Asia, the crucial trade issue is how to increase Japanese imports from the region to help overcome large bilateral trade deficits. Among the factors liable to influence the expansion of these imports, the most significant appears to be the stimulation of production in Free Asia of raw materials for heavy industry. The most direct means to achieve this end is a so-called "development and import formula" employed by the Japanese. Because this approach has involved a considerable measure of Japanese government support for the foreign investment activities of the private sector, its continued application will probably elicit increased anxiety on the part of the press and investors in the other advanced countries for what some of them see as Japanese exploitation of Free Asia and an attempt to reestablish the Greater East Asia Co-Prosperity Sphere. This anxiety appears unwarranted, however, for it is clearly not in the national interest of Japan to establish any significant proprietary role in the region's economies at a time when it is seeking to broaden its sources of supply of raw materials and its exports are benefiting from regional growth stimulated by capital assistance from other advanced countries.

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I. POSTWAR JAPANESE ECONOMIC AID

A. The Flow of Japanese Capital

From 1950 through 1965 the flow of long-term capital from Japan to the less developed countries totaled some \$2.6 billion. As can be seen in Table 1, this flow averaged about \$300 million annually from 1960 through 1965 and, for the most part, has been significantly less than the Sato administration's goal of 1 percent of national income per annum. In 1966 the total was probably between \$500 million and \$520 million, while 1 percent of the national income would have amounted to almost \$800 million in current prices.

Despite the common practice of calling total flows of long-term capital "economic aid," these data reflect a wide array of capital transactions, such as reparations payments and official grants, official development loans, various private direct investments, and private and official export credits on relatively hard commercial terms. Of the total capital flow of \$2.6 billion from 1950 through 1965, about \$1.8 billion was made up of net official disbursements, distributed among the various major kinds of aid as follows:

	<u>Million US \$</u>
Official grant aid (including reparations)	835
Official loans*	865
Net contributions to multilateral agencies	135

As much as \$300 million more in official aid may have been disbursed in 1966, of which about \$100 million is accounted for by grants.

* For the purpose of long-term comparisons, data on official and private credits in this report reflect a series of definitions in use by the Japanese government through 1965. Because changes in these definitions have led to partial revision of the allocation of credit disbursements between the public and private sectors, the reader may encounter reports on official or private credit disbursements since 1962 in other sources that do not agree with the data in this report. Since the problem is simply one of allocating capital flow between sectors, these differences have no effect on the total annual flows of aid in any report using the criteria described in the second footnote on p. 1, above.

Table 1

Flow of Japanese Long-Term Capital
to the Less Developed Countries and Multilateral Agencies a/
1950-65

	<u>Total Net Capital Flow</u>		
	<u>Million US \$</u>	<u>As a Percent of National Income</u>	<u>Net Official Flow (Million US \$)</u>
1950-55 (annual average)	15		10
1956	109	0.53	94
1957	109	0.47	92
1958	310	1.34	285
1959	171	0.64	152
1960	229	0.71	126
1961	371	0.97	214
1962	281	0.66	165
1963	265	0.54	171
1964	245	0.44	179
1965	414	0.61	302

a. Data exclude private export credits for periods of less than five years through 1959 and private export and official bilateral credits of less than five years since the beginning of 1960. Because of the initial inclusion of some capital transactions not generally regarded as aid, this series of data has been revised and reclassified a number of times since Japan joined the Development Assistance Committee of the Organization for Economic Cooperation and Development in 1961. Although further revisions occurred in 1966, the data shown above are based primarily on the system of classification in use in 1965 in order to preserve comparability within the timespan being discussed.

B. The Pattern of Aid and Investment Activities

1. Official Aid

The reparations programs were the first and most important phase of the official Japanese effort in the postwar period to provide

long-term capital to less developed countries.* This phase of Japanese development assistance began with the San Francisco Treaty, which provided for bilateral negotiations on the reparations issue. As can be seen in the chronology (see Figure 1), negotiations on reparations between Japan and the affected nations** began in 1951 and continued intermittently through the settlement of outstanding issues with Singapore in October 1966.

Grant commitments under various programs of reparations and indemnifications, including those in the "normalization" agreement with South Korea, have totaled over \$1.5 billion. Actual disbursements were some \$785 million through 1965. Grants extended "in lieu of reparations" or in place of further reparations have amounted to an additional \$147 million. Finally, official loan commitments associated with the broad category of indemnification have added more than another \$1.0 billion, but this type of aid has seen only limited use so far. Although more than half of the regular reparations grants have been disbursed so far, remaining obligations for this or related grant aid are still large in the cases of the Philippines, Burma, and South Korea; and the influence of indemnifications on Japanese aid programs and policies, although diminishing rapidly, will be present well past 1970.

Thus far, official economic aid not related to reparations and indemnification has, for the most part, centered on government-to-government agreements for yen credits and on suppliers' credits for more than five years extended by the Export-Import Bank of Japan. Although pertinent data are notably misleading prior to 1960 and inconsistent since then, the disbursement of some \$200 million for 1965 probably represents a tripling of net annual disbursements under such credits since the late fifties. Japanese policy on credit assistance to less developed countries has undergone a number of basic changes since 1957. In that year the scope of activities of the Export-Import Bank of

* An alternative position would be that reparations do not constitute conventional economic aid. Nevertheless, because Japanese reparations have been an important source of foreign capital for development and have been included within "official grant and grant-like contributions" in aid reviews by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), they are treated as economic aid in this report.

** Among the Asian nations entitled to reparations, Nationalist China, India, Cambodia, and Laos waived their rights to such settlement.

- 1951: SAN FRANCISCO PEACE TREATY (SEPTEMBER)
REPARATIONS TALKS BEGIN WITH INDONESIA
- 1952: ASSOCIATE MEMBERSHIP IN ECONOMIC COMMISSION FOR ASIA AND THE FAR EAST (ECAFE)
(JANUARY)
REPARATIONS TALKS BEGIN WITH THE PHILIPPINES (JANUARY)
- 1953: FULL MEMBERSHIP IN ECAFE (APRIL)
CABINET ANNOUNCES THREE-POINT PROGRAM OF ECONOMIC COOPERATION WITH SOUTHEAST
ASIA (DECEMBER)
- 1954: REPARATIONS TALKS BEGIN WITH BURMA (AUGUST)
FULL MEMBERSHIP IN THE COLOMBO PLAN (OCTOBER) AND FIRST POSTWAR TECHNICAL
ASSISTANCE TO SOUTHEAST ASIA THROUGH THAT ORGANIZATION
REPARATIONS AGREEMENT SIGNED WITH BURMA (NOVEMBER)
- 1955: BURMA REPARATIONS AGREEMENT BECOMES EFFECTIVE (APRIL)
SETTLEMENT AGREEMENT ON SPECIAL YEN PROBLEM SIGNED WITH THAILAND FOR \$15 MIL-
LION IN CASH AND \$26.7 MILLION IN LOANS (JULY)
- 1956: PHILIPPINES REPARATIONS AGREEMENT SIGNED (MAY)
PHILIPPINES REPARATIONS AGREEMENT BECOMES EFFECTIVE (JULY)
- 1957: JAPAN DECLARES INTENTION TO ASSIST MEKONG DEVELOPMENT SCHEME (MARCH)
OVERSEAS INVESTMENT INSURANCE SYSTEM REVISED TO COVER LOSSES THROUGH NAT-
IONALIZATION AND TO INCLUDE COVERAGE FOR CAPITAL REPATRIATION PROBLEMS (MAY)
EXPORT-IMPORT BANK LAW REVISED TO ALLOW BROADER RANGE OF OVERSEAS
ACTIVITIES (MAY)
- 1958: INDONESIA REPARATIONS AGREEMENT SIGNED (JANUARY)
FIRST GOVERNMENT-TO-GOVERNMENT CREDIT AGREEMENT (\$50 MILLION) CONCLUDED WITH
INDIA (FEBRUARY)
INDONESIA REPARATIONS AGREEMENT BECOMES EFFECTIVE (APRIL)
LAOS GRANT AID ("IN LIEU OF REPARATIONS") AGREED TO (OCTOBER)
- 1959: LAOS GRANT AID ("IN LIEU OF REPARATIONS") BEGINS (JANUARY)
CAMBODIA GRANT AID ("IN LIEU OF REPARATIONS") AGREED TO (MARCH)
VIETNAM REPARATIONS AGREEMENT SIGNED (MAY)
CAMBODIA GRANT AID ("IN LIEU OF REPARATIONS") BEGINS (JULY)

FIGURE 1

AID TO LESS DEVELOPED COUNTRIES

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- 1960: SOUTH VIETNAM REPARATIONS AGREEMENT BECOMES EFFECTIVE (JANUARY)
ASIAN ECONOMIC RESEARCH INSTITUTE, ORGANIZED IN 1958 (NOVEMBER), BECOMES SEMIGOVERNMENTAL ORGANIZATION WITH \$ 1 MILLION TO \$ 2 MILLION ANNUAL BUDGET
- 1961: OVERSEAS ECONOMIC COOPERATION FUND (OECF) ESTABLISHED TO PROVIDE CREDITS ON MORE LIBERAL TERMS TO DEVELOPING COUNTRIES (MARCH)
JAPAN ADMITTED TO THE DEVELOPMENT ASSISTANCE COMMITTEE OF THE ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD) (SEPTEMBER)
FIRST GOVERNMENT-TO-GOVERNMENT CREDIT EXTENDED TO PAKISTAN (NOVEMBER)
- 1962: SPECIAL YEN AGREEMENT WITH THAILAND MODIFIED TO CONVERT LOAN PORTION OF SETTLEMENT TO GRANT AID (JANUARY)
OVERSEAS TECHNICAL COOPERATION AGENCY (OTCA) SET UP TO COORDINATE ALL OFFICIAL AND PRIVATE TECHNICAL ASSISTANCE EFFORTS (JUNE)
- 1963: AGREEMENT ON ECONOMIC AND TECHNICAL COOPERATION INVOLVING \$140 MILLION IN GRANTS SIGNED WITH BURMA (MARCH)
- 1964: EXPORT-IMPORT BANK LAW REVISED TO PROVIDE FOR REFINANCING LOANS TO DEVELOPING COUNTRIES WITH BALANCE-OF-PAYMENTS PROBLEMS (MARCH)
- 1965: JAPAN MAKES FIRST CONTRIBUTION TO FOREIGN EXCHANGE OPERATIONS FUND FOR LAOS (APRIL)
JAPAN AGREES TO \$150 MILLION CREDIT FOR NATIONALIST CHINA (APRIL)
JAPAN SIGNS NORMALIZATION AGREEMENT WITH SOUTH KOREA PROVIDING FOR \$800 MILLION IN GRANTS, CREDITS, AND INVESTMENTS (JUNE)
FIRST GROUP OF JAPAN OVERSEAS COOPERATION VOLUNTEERS ("PEACE CORPS") SENT TO LAOS (DECEMBER)
- 1966: JAPAN PLEDGES CONTRIBUTION TO NAM NGUM DEVELOPMENT FUND UNDER MEKONG SCHEME (MARCH)
JAPAN CONVENES SOUTHEAST ASIAN MINISTERIAL CONFERENCE TO DISCUSS ECONOMIC DEVELOPMENT IN REGION (APRIL)
EMERGENCY CREDIT OF \$30 MILLION EXTENDED TO INDONESIA (MAY)
JAPAN SUBSCRIBES \$200 MILLION TO CAPITAL OF ASIAN DEVELOPMENT BANK (JULY)
JAPAN CONVENES MEETING OF INDONESIAN CREDITORS IN TOKYO (SEPTEMBER)
REPARATIONS AGREEMENT CONCLUDED WITH SINGAPORE (OCTOBER)
OFFICIAL BILATERAL CREDIT FOR \$50 MILLION EXTENDED TO MALAYSIA (NOVEMBER)
JAPAN CONVENES CONFERENCE ON AGRICULTURAL DEVELOPMENT IN SOUTHEAST ASIA (DECEMBER)

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Japan was enlarged to permit a wider range of credit activities involving foreign governments and foreign corporations. Following this liberalization of credit policy, the Export-Import Bank entered into its first major government-to-government credit, a so-called "special yen agreement" for a long-term credit of \$50 million to India in February 1958; and this sort of loan activity has expanded rapidly since then.

The necessarily high interest rates charged by the Export-Import Bank impede credit assistance to less developed countries. To help overcome this obstacle, the Japanese government created the Overseas Economic Cooperation Fund (OECF) in March 1961. This organization, initially authorized a capital fund of \$47 million, was set up under the Economic Planning Agency to provide credits with provisions for repayment over 20 years (including five-year grace periods) and interest rates of 3.5 percent or less. Although the OECF is authorized to loan directly to foreign governments or foreign firms, no such loans were extended until mid-1966, and its funds had instead been disbursed primarily to Japanese firms engaged in development projects.

Among important developments in the OECF in 1965 were a significant increase in disbursements, increases in capitalization, changes in the OECF law permitting domestic borrowing and the issuance of bonds, and provisions for a total of roughly \$250 million in official credits for South Korea and Nationalist China to be disbursed through the OECF at relatively liberal terms.* By the end of 1965, loans outstanding (that is, disbursements less repayments) under the OECF amounted to \$37.7 million, and total commitments were \$57.4 million at the end of January 1966. A sum of \$20.8 million was appropriated in the Japanese budget for Fiscal Year (FY) 1966** as a capital subscription to the OECF. A like sum was authorized for lending to the OECF by the Trust Fund Bureau during FY 1966 to help meet the OECF's growing requirements, but there was general recognition among the ministries and agencies concerned with foreign aid that continued borrowing of this sort could prejudice the low interest rates of OECF loans. The Director of the OECF Loan Department has estimated that only about \$2.8 million would be borrowed by the OECF in FY 1966.

* The credits to South Korea and Nationalist China are the first cases in which the OECF actually has authorized terms as liberal as 3.5 percent interest with repayment over 20 years, the most liberal terms through March 1965 having been 5.5 percent and 12 years.

** The Japanese fiscal year begins on 1 April of the year specified.

Net contributions to multilateral agencies have been the principal remaining category of official Japanese capital flows classified by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) as economic aid. From 1950 through 1965 this category accounted for some \$135 million, or about 7 percent of the total flow of official Japanese capital to the less developed countries. Included in it were grants to various international agencies and subscriptions to the International Bank for Reconstruction and Development (IBRD) and its affiliated organizations. In 1965 these net contributions totaled \$17.5 million, but a special increase in the capital of the IBRD and an initial payment of \$20 million on a capital subscription of \$200 million to the Asian Development Bank probably raised the figure to almost \$50 million for 1966.

Special note should be taken of the small but increasing role played by technical and academic assistance in Japan's official and private aid programs. Disbursements of official bilateral grants for technical cooperation (other than the limited amounts under reparations) totaled only \$24.5 million from 1960 through 1965, but over the period the annual disbursements grew from \$2.2 million to \$6.0 million. The Japanese government has frequently argued that Japan has a distinct contribution to make in the area of technical assistance, and this attitude will probably be reflected in the continued growth of technical cooperation grants.

The creation of the Overseas Technical Cooperation Agency (OTCA) under the Ministry of Foreign Affairs in June 1962 was an important step forward in the coordination of public and private technical assistance programs.* Programs of the public and private sectors supervised or coordinated by this agency include training in Japan, the dispatch of Japanese experts to less developed countries, the establishment and operation of overseas technical training centers, and the preparation of feasibility studies. In 1965 the OTCA broadened its activities through the creation of a Japanese Peace Corps, known officially as the Japan Overseas Cooperation Volunteers (JOCV). Budgetary appropriations for technical cooperation in FY 1965 and 1966 covering the activities of the OTCA and various subsidies for private technical aid amounted to \$7.5 million and \$9.4 million, respectively.

* Even before this, however, the Japanese government subsidized much of the nominally private activity in this field.

2. Private Capital Flows

Disbursements of private loans and investments have accounted for a considerable share of the flow of Japanese long-term capital to the less developed countries. Totalling over \$750 million from 1950 through 1965, these disbursements have accounted for about 30 percent of the total net flow. These figures for private assistance include direct investment in developing countries, net private trade credits of over five years, and portfolio investments in multilateral agencies. Of these categories, direct investment, which amounted to two-thirds of the net private capital flow from 1961 through 1965, is the most significant; but the relatively volatile category of trade credits has also been an important component in the private capital flow.*

The cumulative value of Japanese private direct investment in productive activities** in the less developed countries since 1951 was in excess of \$580 million at the end of March 1966. The flow of this amount was in no small measure facilitated by Export-Import Bank credits that in some instances provided up to 50 percent of the value of project costs directly to Japanese firms and through them to foreign partners. Various institutional measures such as the Export Proceeds Insurance Scheme, the Overseas Investment Principal Insurance System, and the Overseas Investment Profit Insurance Program also have contributed to an improved climate for private credit and investment activities abroad, but Japanese businessmen are still quite apprehensive about political and economic uncertainties in the developing countries.

Such Japanese private direct investment abroad as has taken place so far has followed three basic patterns. The two most prevalent are those in which the Japanese party to an agreement acquires stock in a foreign firm by supplying capital, technology, or cash and those in which the Japanese investor extends credits for basic funds for equipment or working capital in exchange for claims for subsequent repayment in cash or through production-sharing. The second arrangement usually produces a long-term relationship tantamount to equity investment. Though it may provide less

* Using the new definitions adopted by the Japanese government in 1966, direct investment accounted for 47 percent and private trade credits for 53 percent of the private long-term capital flow from Japan to the less developed countries from 1962 through 1965.

** That is, enterprises other than commercial facilities for Japanese exports and overseas branches of Japanese firms.

Japanese control over a firm's operations, this arrangement is often used to get around the various restrictions imposed on foreign investments in the underdeveloped countries and to reduce the risk of losses through nationalization. A third and less frequent method of investment abroad, the most notable example of which is the Japanese-owned Arabian Oil Company in the Middle East, is that wherein the Japanese firm directly undertakes a project through the acquisition of real estate or mining rights.

C. Factors Inhibiting Increases in Aid

As Japan passes from the period of reparations and indemnifications into one of more conventional economic aid, there is much interest in its prospects for assuming a larger aid burden commensurate with its position as a major industrial power. On the one hand, Japan may ultimately be able to assume a more active role in economic assistance than any of the European nations, because its national product probably is destined to exceed all but those of the United States and the USSR; and the small share expended on defense is unique among the major powers. On the other hand, Japan has a larger population than any of the European powers except the USSR, and its per capita national output is relatively small. Moreover, in the short run at least, the degree of perseverance that characterized Japan's efforts to normalize its economic relations with former enemies is not likely to be matched in its responses to the pressing capital requirements of the developing countries.

The problems that inhibit increases in the flow of Japanese capital to developing countries are those common to all donors plus a few that are peculiar, at least in some degree, to Japan. Like all the major donor nations, Japan is concerned about the effect of foreign aid on its balance of payments. The balance on current account, in deficit since 1961, swung into surplus in 1965 and 1966 with strong improvement in merchandise trade. Despite a continued large deficit in the capital account, another overall surplus, this time amounting to \$335 million, occurred in the balance of payments for 1966. Nevertheless, Japanese officials and businessmen are wary of long-term capital commitments that might produce or aggravate balance-of-payments difficulties.

The Japanese, in common with others, are also inhibited by conditions in the recipient countries. Japan has been particularly vocal in pointing out the limited absorptive capacity of the developing countries for foreign capital. Thus far, this attitude has led the Japanese to avoid meeting the long-term development requirements of less

developed countries and to focus on aid to specific projects. Over time, however, Japanese participation in aid consortia may foster a greater sense of responsibility for comprehensive development efforts. Recognition of the limitations of less developed countries in planning and staffing economic programs ultimately could be channeled into a greatly expanded Japanese technical and academic assistance effort, but in 1966 Japan was still under attack in the DAC annual meetings for its small contribution in this field.

Another factor inhibiting the flow of Japanese capital to the less developed countries is the unfavorable climate for private investment in these areas. Despite the national fixations of the Japanese on the necessity for export growth and the desirability of diversification of sources of raw materials, the private sector is still essentially cautious about extending its holdings in politically unstable nations. Of probably greater importance has been the high return available on investment at home. Some of the obstacles to overseas investment have been offset by the various government insurance programs,* and Japanese investors have appeared ready to accept greater risks in certain countries, such as Indonesia and Thailand, in which they hope to secure a preeminent position in particular industries.

Although the problems discussed above have been significant impediments to increased capital flows to the developing countries, they do not particularly explain why Japan's contribution to economic development abroad has been proportionately smaller than that of many other industrial nations. The explanation lies in problems that affect Japan more strongly than other nations. Some of the most important of these relate to Japan's comparative stage of economic development.

Among the DAC nations, which include all of the major Western aid donors, Japan has the next to the smallest national income per capita, as can be seen in the following tabulation for 1964:

* See B, 2, above.

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<u>Country</u>	<u>US \$</u>
United States	2,700
Sweden	2,020
Canada	1,680
Denmark	1,490
West Germany	1,410
United Kingdom	1,370
France	1,360
Norway	1,310
Belgium	1,300
Netherlands	1,130
Austria	890
Italy	760
Japan	570
Portugal	310

Although Japan's per capita national income stood at \$695 in 1965 and grew rapidly in 1966, the order of rank shown above did not change. Viewed within the context of per capita incomes, the United Nations Conference on Trade and Development (UNCTAD) and DAC aid goal of 1 percent of national income can be described as a sort of regressive tax, and Japanese arguments in the past of inability to meet this standard because of income levels are more convincing than those of most other donors. Indeed, Japanese performance by this criterion alone has been quite respectable. For 1964, computation of the net flow of official and private long-term capital to less developed countries as a share of national income shows Japan ranking with Italy, Canada, and Norway (which cluster around 0.5 percent), significantly ahead of Austria and Denmark, and behind such nations as Belgium, West Germany, the Netherlands, the United Kingdom, and the United States (which approach or slightly exceed 1 percent).

Aid is inhibited also by economic problems arising from the unusually rapid pace of growth in Japan. The flow of long-term capital from the country is affected by rapid growth in at least three unfavorable ways. First, the strong demand for domestic investment in manufacturing that has sustained Japanese growth rates yields high domestic interest rates that tend to make overseas investment less attractive. Second, these high interest charges affect the rates at which funds may be borrowed by government agencies such as the Export-Import Bank and the OECF, and (until a few instances in the last two years) credits extended to the less developed countries by these agencies have had to be offered at terms no more attractive than those of the IBRD.* Finally, the remarkably

* Although the OECF now loans at lower rates, all bilateral Japanese loans to less developed countries are tied to procurement in Japan. Thus Japan is not strictly competitive with the IBRD in loan assistance.

strong demand for investment in the private sector, of which the tight domestic capital market is symptomatic, has meant inadequate investment in the public sector. This last consideration suggests that budget appropriations for Japanese aid will have to compete against increasingly strong demands for Japanese government spending on housing and public works at home.

For a number of reasons, the Japanese find it hard to secure public and parliamentary approval of significant enlargement of their official aid effort. Although the public is aware of the importance of foreign trade to Japan's industrial growth, it has only the most tentative impression of the recent emergence of the national economy into the front rank of major economic powers and generally has no conception of how Japan might contribute to the needs of developing countries. Public confusion on Japan's role as a donor country is compounded by the lack of cooperation or constructive suggestions from the Japan Socialist Party. Areas of bipartisan agreement on foreign aid policy are notably absent in Japanese politics, and the fact that the Socialists have had no experience in administering Japanese aid only aggravates this problem. In late June 1966 the Socialists embarrassed the Sato government internationally by blocking the passage in regular Diet session of an appropriation for the Asian Development Bank. At the same time the Socialists advanced a rather naive "long-range policy" on Japanese aid that called for, among other things, the creation of a "Peace and Prosperity Force" from personnel of the Japan Self-Defense Forces to improve relations with other countries. Besides the fact that the Japan Overseas Cooperation Volunteers are already performing the function of such an organization, this proposal raises the question of how Southeast Asians might react to the presence of an organization with a Japanese military background.

The most pressing problem is the need for better administrative organization and coordination between official agencies. The principal agencies concerned with foreign aid and investment and their responsibilities are as follows:

Ministry of Foreign Affairs

Assumes leading role in generating aid proposals; supervises Overseas Technical Cooperation Agency;

Ministry of Finance

Occupies pivotal budgetary position; wields important discretionary power in extensions of credits and allocation of some grants; supervises Export-Import Bank and exercises strong influence on operation of the Overseas Economic Cooperation Fund;

Ministry of International Trade and Industry (MITI)

Presses commercial interests in formulation of official aid policies; supervises Asian Economic Research Bureau;

Economic Planning Agency

Participates in formulation of long-term aid goals; officially responsible for supervision of OECF.

There are rivalries among these organizations that reflect both the particular perspectives of the various organizations and the fact that ministers are often chosen so as to balance the Liberal Democratic factions in the Cabinet. Thus the attributes cumulatively described as "commercialism" in Japanese aid activities are readily associable with MITI's primary mission of promoting exports or the caution of the Finance Ministry in assessing credit risks. The Foreign Ministry, which characteristically takes the most positive stance toward increased and more liberal aid, has found itself embarrassingly ahead of the rest of the Japanese government on many occasions. This gap has been partially closed by the growing emphasis of Prime Minister Sato on a greater Japanese role in regional economic affairs in Asia, by the repeated incantations of former Finance Minister Fukuda that Japan would meet the UNCTAD aid goal of 1 percent of national income,* and by the relatively

* It is worth noting that the achievement of this much-discussed goal was not tied to any particular time until the Ministry of Foreign Affairs picked FY 1968 as target year in a draft three-year economic cooperation program completed in March 1966. The program apparently has not yet received the blessing of the Ministry of Finance. At the annual DAC review of Japan's aid program in June 1966, Foreign Ministry officials were still unwilling to specify a target year.

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imaginative suggestions for assistance in agriculture and marketing of primary products to less developed countries that emanated from MITI under the leadership of the politically ambitious Takeo Miki. One of the most encouraging features of the Southeast Asian Ministerial Conference on Development held in Tokyo in early April 1966 was the direct involvement of the whole Japanese Cabinet in discussions of regional economic cooperation. Participation in such an international conference created pressure for more creative thinking on economic development, and, exposed to public view, the various Cabinet members discussed assistance in joint development activities more daring than they would otherwise have been inclined to support.

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II. JAPANESE AID TO FREE ASIA

A. The Region's Share of Japanese Aid and Investment Activities

Asia has been the principal beneficiary of Japanese aid activities. * Although basic data are often inconsistent, the following crude estimates may be made of annual Japanese official and private financial assistance to the Free Asian countries:

<u>Year</u>	<u>Million US \$</u>
1960	125
1961	165
1962	145
1963	175
1964	200
1965	265

A comparison of these figures with the data in Table 1 shows that Free Asia received about 60 percent of all Japanese assistance to the less developed nations from 1960 through 1965. Although data for earlier periods are inadequate to make specific, reliable comparisons, the Free Asian share of Japanese official and private assistance was probably significantly higher than two-thirds in most years prior to 1960.

Reparations and indemnifications have been the most important element in official grant aid, accounting for about 95 percent of the total to date. All of the disbursements under these reparations programs were made to Asian countries, as well as \$40.1 million in official bilateral grants (see Table 2). Official grant aid has gone almost exclusively to Asia, and this trend is likely to continue for the foreseeable future. Although the regular reparations programs in Burma and South Vietnam have been completed, such current commitments as reparations to the Philippines, continued grant aid to Burma and Indonesia, and grants under the normalization treaty with South Korea will probably account for well over half of the disbursements of bilateral grant aid over the next few years.

* For major details of commitments of official grant and credit aid to Asian countries, see Table 3.

Table 2

Japan: Grant Aid to Free Asian Countries
1950-65

Thousand US \$

	Total Bilateral Grant Aid to all Countries	To Free Asian Countries		Total Grant Aid ^{a/}
		Reparations and Indemnifications	Other Grants	
1950-59 ^{b/}	395,800	395,800		395,800
1960	66,900	64,300	2,100	66,500
1961	67,800	65,100	1,700	66,800
1962	74,600	69,500 ^{c/}	4,100	73,600
1963	76,700	64,900 ^{c/}	10,800	75,700
1964	68,700	60,500 ^{c/}	6,400	67,000
1965	82,200	65,600 ^{c/}	15,000	80,600
Total	<u>832,700</u>	<u>785,700</u>	<u>40,100</u>	<u>826,000</u>

a. Because of rounding, components may not add to the total shown.

b. Including settlement of an Indonesian trade deficit of \$176.9 million and payments for the Thai Special Yen Account.

c. Including disbursements under the Thai Special Yen Account for 1962-65.

Bilateral grants other than those related to reparations, Korean normalization, and the special grant program for Burma have been disbursed primarily for technical assistance. In this category, Asia has again been the principal beneficiary. Thus, of a total of some \$20 million in grants for technical assistance from 1962 through 1965, almost three-fourths went to Free Asia. In addition to financing the overseas activities of Japanese technicians, these grants have funded the Japanese share of establishing technical training centers in a number of Asian countries.

The share of Southeast Asia in Japanese official loans is more difficult to gauge because of recurring changes in classification of data. In annual presentations to DAC, the Japanese government has cited figures indicating that since 1963 well over three-fourths of the

annual net disbursements of all official loans to less developed countries have gone to Free Asia.* By far the largest part of these disbursements has been channeled through the Export-Import Bank of Japan. After adjusting available regional data of the Export-Import Bank for FY 1963 and 1964 to exclude credits to developed countries, the Free Asian share of credit commitments to the less developed countries in those years amounts to over 50 percent. This figure may misstate the region's share of long-term assistance, for it includes credits for less than five years. Despite the inadequacy of such an indicator, it is clear that credit commitments by the Export-Import Bank to Asian countries are both numerous and of major importance. Indeed, by the end of FY 1964, "special yen" agreements** with India and Pakistan had accounted for 10 percent of all credit commitments since the founding of the Export-Import Bank in 1950.*** Finally, using all Export-Import Bank loans outstanding to the less developed areas of the world at the end of FY 1964 as another crude index of this organization's participation in Japan's long-term credit assistance, loans to Free Asia account for about half the total.

Since 1961 the OECF has also participated in Japan's credit assistance, and the activities of this institution again indicate the primary position of Free Asia in official Japanese aid. Although only about half of the \$57.4 million in total commitments of the OECF as of the end of January 1966 was accounted for by Free Asian countries, the OECF was responsible for disbursing funds over 10 years to South Korea under a line of credit for \$200 million related to the normalization treaty and to Nationalist China over five years under a portion of a \$150 million line of credit also agreed to in 1965. The Director of the OECF Loan Department indicated in early 1966 that, despite a capital subscription of \$20.8 million in the national budget for FY 1966, he expected half of the total funds of \$64 million available to the OECF to be required to meet 1966 disbursements under the Korean and Nationalist Chinese commitments. Increasing pressure from other donors and from the less developed countries themselves for more liberal Japanese credit terms

* In 1961 and 1962 the Asian share of net official credit disbursements stood at an unusually low 40 percent. This was the result of heavy disbursements on a steel mill in Brazil and lags in implementation of "special yen" credits to India and Pakistan.

** See I, B, above.

*** Between the end of FY 1964 and February 1967, another \$300 million of major credits were extended to India, Pakistan, Nationalist China, and Malaysia alone by the Export-Import Bank.

may lead to further expansion of OECF activities; but, partially because of a sense of familiarity with the region, Japanese business interests probably will tend to focus these activities on Southeast Asia in general and Indonesia in particular.*

Although regional data on long-term private capital flows** from Japan to the less developed countries are both scarce and inconsistent, available information indicates that Free Asia received about a third of such capital from 1962 through 1965. Over this period the annual flows to the region ranged from less than one-third to an exceptional one-half of total Japanese investment and long-term private credits to the less developed countries. Of the two major categories, Free Asia received a greater net share of guaranteed private export credits than of net direct investment. Indeed, despite a considerable number of individual investments in a wide variety of enterprises throughout Asia, the stock of Japanese investment in the region at the end of 1965 amounted to only about 28 percent of total Japanese investment in less developed countries. In no small measure, this pattern is a reflection of the unreceptive attitude toward foreign private investment on the part of several governments of the region.

B. The Japanese Role in National Development Activities

All of the countries of Free Asia have been recipients of Japanese long-term capital. In some of these countries the relative importance of this assistance to economic development has been especially noteworthy. Thus \$200 million in reparations have been by far the most important postwar source of official foreign grants for Burma, and the successor program of \$140 million in grants occupies the same position among Burma's present resources for financing development. In Indonesia and the Philippines, Japanese reparations have been second only to US aid as a source of grant disbursements, and unpaid balances under the reparations program in the Philippines are

* In Indonesia, OECF credits have helped provide capital for production-sharing investments in petroleum, nickel ore, and forestry development projects.

** Data that follow are for private direct (equity) investment and government-guaranteed credits for more than five years.

currently the principal grant commitments to that nation.* The grants and loans to be provided to South Korea under the normalization treaty will make Japan the second-ranking donor of aid to that nation. Through its "special yen" credits, Japan, as a member of aid consortia, has also been a significant participant in the economic development of India and Pakistan. A credit for \$150 million to be disbursed over five years to Nationalist China will bring the annual amount of Japanese assistance to that country almost to the level of the remaining US economic assistance. Japan has also become a major contributor of official foreign aid for the current Malaysian five-year development program through the extension of a \$50 million credit in late November 1966. Conclusion of an agreement on a similar \$60 million credit to Thailand, which is still under discussion, would greatly enhance the Japanese role in that nation's development activities.

1. Official Aid Activities

The quality or yield of official Japanese assistance in the countries of Free Asia is difficult to describe in other than general terms. Japan, like other donor countries, has encountered difficulties in administering project aid. A recurrent theme in criticisms of Japanese aid has been the failure to consider the requirements of the recipient. There are reasons to suspect that this criticism, although valid, may lose some of its applicability as the reparations payments draw to a close. The Japanese have felt that reparations payments should be completed as expeditiously as possible, and the nature and mechanics of these transactions are not conducive to strong Japanese suggestions on end use. Officials of the Philippine government have done some soul-searching in recent times, and a representative judgment is that only about 60 percent of the reparations disbursed in that country were effectively used for national economic development. Both ex-President Macapagal and President Marcos have expressed concern over waste by Philippine recipients

* The remaining reparations commitments to Indonesia are not as large or accessible as the \$300 million or more as yet undisbursed to the Philippines. Of \$42.9 million still due Indonesia as of December 1966, \$39.7 million secures loans upon which Indonesia will probably be unable to make further payments.

of this aid and have urged that more productive use should be made of this important source of foreign capital.*

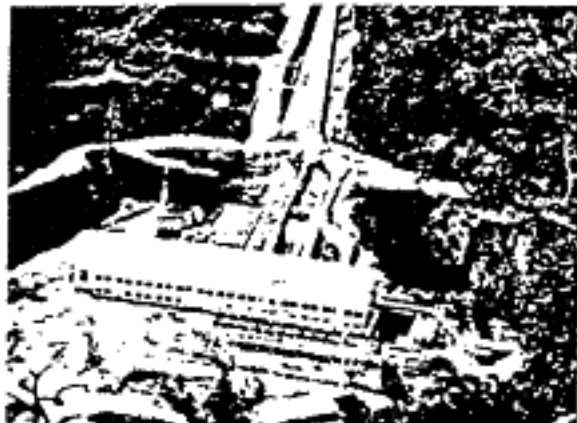
More effective coordination of Japanese aid activities with national development programs of the recipients might be achieved through increased involvement in aid consortia. The Japanese have been regarded as cooperative participants in the consortia for India and Pakistan. To avert the disorder that might attend a loosely administered normalization program in Korea, the United States sought to have Japan participate in a Consultative Group for that country, and the Japanese joined the group for its first formal meeting in December 1966. The activities of consortia provide the Japanese Ministry of Foreign Affairs with justification in arguing to the Ministry of Finance that Japan is being asked to give its "fair share" in assistance to the recipients. Thus far, however, this has done little to overcome the necessity that the Foreign Ministry justify aid programs on the basis of potential trade gains.

Official Japanese reparations and aid have been disbursed for a wide variety of end purposes, as can be seen in Table 3 (which shows some of the forms of official Japanese aid to Free Asia). Principal projects have included major public works (such as power plants, an irrigation scheme, bridges, and water supply systems -- see Figure 2) and contributions to industrial development through the construction of numerous plants in both light and heavy industries throughout the region. Within the recipient countries, these projects frequently have been notable for either scale or type. Thus the Balu Chaung hydroelectric plant in Burma and the Da Nhim hydroelectric plant in South Vietnam**are the largest such installations and the principal elements of installed capacity in these countries. The Brantus River development project in Indonesia has been racked with difficulties and, at best, can only be completed well past the target date of 1969. This project, which was to include the nation's second or third largest hydroelectric installation, was intended to supply the power necessary to regional industrial development in eastern Java and major irrigation and flood control facilities for the nation's leading agricultural area.

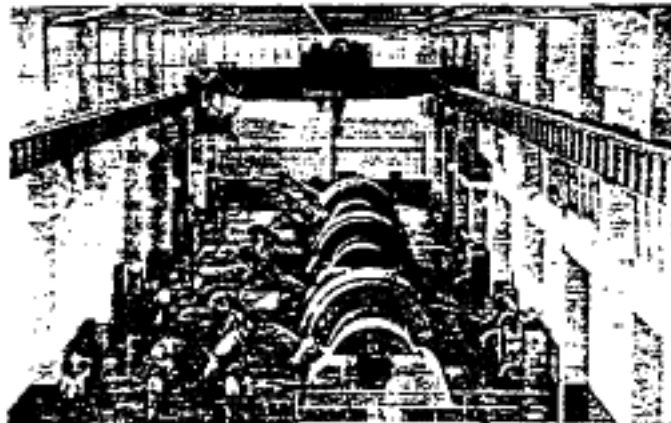
* To secure more effective use of these funds, Marcos has urged legislation to channel all remaining reparations to the public sector.

** This installation has not been in full use since May 1965 as a result of Viet Cong sabotage to the power lines.

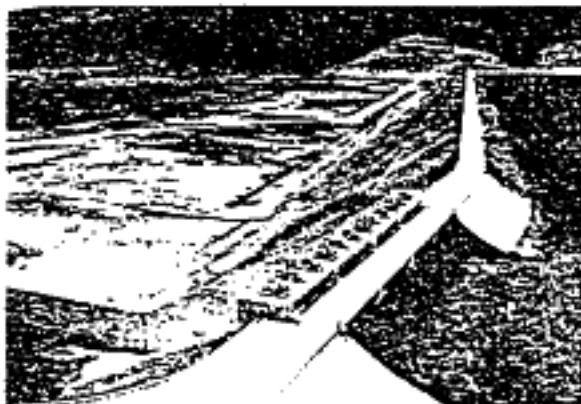
JAPAN: SELECTED AID PROJECTS IN FREE ASIA



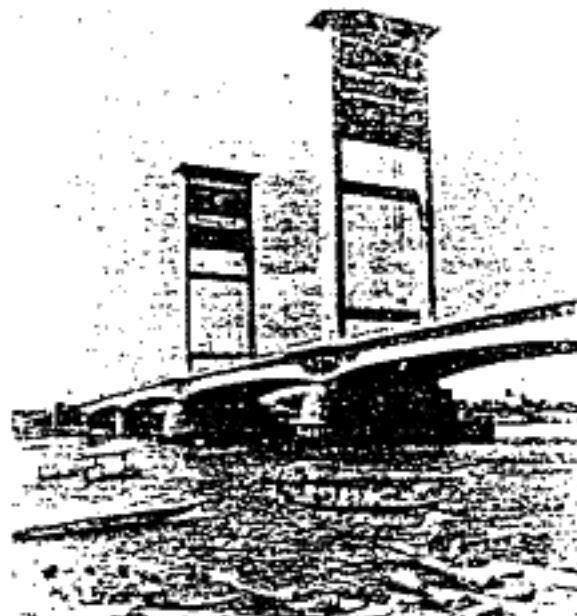
BURMA: EXTERIOR VIEW OF THE
BALU CHAUNG POWER STATION



BURMA: INTERIOR VIEW OF THE BALU CHAUNG
POWERHOUSE



SOUTH VIETNAM: DA NHIM FALLS HYDRO-
ELECTRIC DAM



INDONESIA: MUSTI RIVER BRIDGE

Table 3
 Japan: Some Uses of Reparations and Official Aid to Free Asia
 as of 31 March 1966

Recipient	Principal Assistance		Uses of Assistance Disbursed		Principal Nonproject Assistance
	Committed	Disbursed	Principal Projects		
Burma	(1) 200 (R) $\frac{a}{b}$	200	Hydroelectric plant; motor vehicles assembly plants; electric appliances assembly plants; other plants	Machinery; transport equipment; steel products; ceramic ware; textiles; fertilizer	
	(2) 140 (G)	8.3	Various assembly plants	Transport equipment	
Indonesia	223 (R) $\frac{a}{b}$	155.6	Major river development project (power and irrigation); paper plants; cotton-spinning plant; other plants	Cargo ships; motor vehicles; railroad equipment; machinery; chemical products; pulp and textiles	
Philippines	550 (R)	204.7	3 cement plants; various assembly and manufacturing plants	18 cargo ships; construction materials and heavy equipment; railroad equipment; industrial machinery; consumer goods	
South Vietnam	39 (R)	39.0	Hydroelectric plant; small wood-products plants	Diesel engines	
Laos	2.8 (G)	2.8	Water supply and sewer systems in Vientiane; power plants	Construction materials for water supply and sewer systems in Phnom Penh	
Cambodia	4.2 (G)	4.2	Establishment of three training centers; Ton Le Sap bridge	Cargo vessels; railroad equipment; machinery; spare parts	
India	330 (Sp Y) $\frac{a}{b}$	210 (estimated)	Power projects; alloy steel plant; fertilizer plants; other plants		

Pakistan	105 (Sp Y) <u>d/</u>	hO (estimated)	Steel mill; textile mills; paper plant; alloy steel plant; other plants	(Planned use: fertilizer, textiles, trucks, and spare parts)
Ceylon	5 (C)			
Nationalist China	150 (C)	N.A.	(Planned use: multipurpose dam; harbor development; bridge; power development; industrial plants)	
South Korea	(1) 300 (G) <u>e/</u>	4.5		(First-year payment on \$45 million trade deficit)
	(2) 200 (C) <u>e/</u>			

a. (R) = reparations
(Sp Y) = "special yen" credit
(G) = other grants
(C) = other credits

b. In addition, Indonesia received \$177 million in grant aid under reparations in the form of a trade deficit cancellation.

c. An additional \$42.5 million credit and a deferral of \$2.5 million in existing credits were agreed to on 16 December 1966.

d. Two additional \$30 million credits were extended on 6 May 1966 and 24 February 1967, bringing the total commitment to \$165 million.

e. The first-year program under the normalization agreement called for disbursements of \$48 million in grants and \$45 million in credits, and a second-year program negotiated in February 1967 provides for \$50 million and \$36 million, respectively, for these forms of aid. In addition to official assistance, Japan has set a relatively ambiguous guideline of \$300 million in private credits to be extended under the normalization agreement.

In India the projects in which Japan has participated under the "special yen" credits have included the construction of two particularly large fertilizer plants and the nation's leading plant for making alloy and special steels. A 150,000-ton steel ingot plant that is, in essence, Pakistan's modern steel industry is also a Japanese-aided project. * Two of the eight operating cement plants in the Philippines, accounting for over 20 percent of annual production, were equipped under the reparations program, and a third plant had not yet received all of its reparations-financed equipment in late July 1966.

Nonproject assistance by the Japanese government to the less developed countries has also been extensive and has taken the forms of both capital equipment and consumer goods. The reparations agreements covered such aid, and subsequent grants have also provided for various types of nonproject uses. Those suppliers' credits and government-to-government credits of the Export-Import Bank that until recently comprised Japan's only loan assistance program to the less developed countries were frequently nonproject aid. Although future "special yen" credits to India and Pakistan and loans under the normalization agreement with South Korea probably will be oriented primarily to specific development projects, nonproject assistance will continue to be an important element of the capital flow from Japan to the other Free Asian countries. Attempts to draw a sharp line between project and nonproject aid or to assign aggregate values to either category may cause unnecessary confusion. In the case of Japan, the major role played by transportation equipment and industrial machinery in nonproject aid increases this risk. Thus it is somewhat arbitrary to describe the supply of 15 large oceangoing freighters and 3 smaller interisland ships to the Philippines as "nonproject" aid when it might as easily be regarded as a major component of an infrastructure "project" for the Philippine fleet. (see Figure 3). A similar problem would arise in connection with the first normalization loan by the OECF to Korea, which provided \$11 million for purchases of rolling stock. As the Japanese aid program moves out of the era of reparations, Japan (both as a bilateral donor and a member of consortia) will become increasingly concerned with coordinating its nonproject aid with national development goals abroad. Foreign pressures on the Japanese government to restrict supplies of

* Opened on 1 February 1967, this plant will be increased to a capacity of 250,000 metric tons over the next few years. (Ton-nages are given in metric tons.)

FIGURE 3

JAPAN: "NONPROJECT" AID TO THE PHILIPPINES



THE VESSEL MARIA ROSELLO

consumer goods in favor of nonproject aid in the forms of industrial and transportation machinery and agricultural equipment will tend to increase. At the same time, the numerous difficulties encountered by the Japanese textile industry in the United States and other markets will mean a continuing effort on the part of that industry to sustain sales through participation in official aid programs, and it is likely that the Japanese government will continue to offer textiles in such emergency credit assistance as that extended to Ceylon and Indonesia in 1965 and 1966.

Extensive technical assistance has also been provided by Japan to the developing countries of Free Asia. The most important element of the Japanese technical assistance "program"* is the training of students and technicians in Japan (see Figure 4). Country totals for this activity, shown in Table 4, reflect trainees both under programs for which Japan bore full expenses and under those for which it bore only part of the costs.**

* For a description of the forms that Japan's technical assistance takes, see p. 14, above.

** The latter category includes the US-Japan Joint Third Country Training Program, under which some 2,200 personnel were trained before it phased out beginning in 1964, and the various United Nations programs.

FIGURE 4

TRAINING IN JAPAN OF STUDENTS AND TECHNICIANS FROM FREE ASIAN COUNTRIES



INSTRUCTION IN TEXTILE PRINTING TO AN INDO-
NESIAN TECHNICIAN IN JAPAN



INSTRUCTION TO A BURMESE TECHNICIAN AT
THE JAPANESE ATOMIC ENERGY RESEARCH
INSTITUTE

Table 4

Japan: Academic and Technical Training of Free Asians
Total for 1954-66 a/

<u>Country</u>	<u>Number of Trainees</u>	<u>Country</u>	<u>Number of Trainees</u>
Nationalist China	1,055	Pakistan	332
Thailand	965	Cambodia	228
Indonesia	926	Ceylon	220
India	641	Vietnam	207
Philippines	542	Other Free Asian	520 b/
South Korea	398	All other	1,466 b/
		Total World	7,500 b/

a. Data as of October 1966.

b. Estimated.

Although it may be useful to distinguish between the categories of "academic students" and "technical trainees" for some purposes, the thrust of the Japanese training effort can best be visualized as an effort to provide advanced or specialized training to both experienced nondegree and degree students or trainees. On the basis of fragmentary data, it appears that about 25 to 30 percent of the technical and academic trainees from Free Asia probably have received instruction in agriculture and fishing, with distinctly smaller shares being trained for a variety of other fields. As can be seen from Table 5, which shows the number of Free Asian students and trainees in Japan in 1965, agriculture currently places second to engineering among academic disciplines and second to the field of public utilities in technical training.

Table 5

Fields of Instruction of Free Asian Academic Students
and Technical Trainees in Japan
1965

<u>Field</u>	<u>Number of Students</u>	<u>Field</u>	<u>Number of Technical Trainees</u>
Engineering	198	Power, transport, and communications	171
Agriculture	55	Agriculture	163
Medicine	49	Industry, mining, and handicrafts	159
Social sciences	46	Public administration	48
Natural sciences	36	Health services	45
Other	47	Other	112

In addition to training programs at home, Japan sponsors considerable technical assistance abroad (see Figure 5). Since

FIGURE 5

JAPAN: OVERSEAS TECHNICAL ASSISTANCE TO FREE ASIAN COUNTRIES



INSTRUCTION ON THE OPERATION OF A FISH DETECTOR IN THE PHILIPPINES



INSTRUCTION ON THE OPERATION OF A THRESHING MACHINE AT THE AGRICULTURAL TRAINING CENTER IN PAKISTAN

1954 the Japanese government has dispatched over 800 experts to Free Asian countries. * In 1965 the 425 experts and technicians in Free Asia being financed by the Japanese government were distributed by fields as follows:

<u>Field</u>	<u>Experts and Technicians</u>	<u>Field</u>	<u>Experts and Technicians</u>
Agriculture	116	Education	33
Industry, mining, and handicrafts	105	Health services	30
Economic planning and surveys	85	Other services	1
Power, transport, and communications	55		

Japan also has helped a number of Free Asian countries establish training centers. These have included eight agricultural demonstration farms in India, agricultural training centers in Cambodia and Pakistan, a fisheries center in Ceylon, a marine-products center in India, small-scale industry centers in Afghanistan and India, telecommunications centers in Pakistan and Thailand, medical centers in Cambodia and Thailand, and a road construction center in Thailand. Related to this form of assistance are current plans of the Ministry of International Trade and Industry to assist in the construction and operation of model industrial plants abroad. Proposals for FY 1967 include a rice-bran oil plant for Cambodia and an agricultural implements plant for Laos. Finally, Japanese technical assistance has included many preinvestment and feasibility studies on mineral resources, infrastructure projects, and industrial development.

2. Private Investment Activities

Consideration of the role of Japan's private sector in the national development activities of Free Asian countries is hampered by inadequate data and the fragmentary nature of reports on specific transactions. Data

* Although pertinent figures are extremely sparse and outdated, it is possible that the private sector has sent five times as many technicians to Free Asia in connection with exports of machinery and equipment and private investment in the region.

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recently published by the Ministry of Finance show the following percentage distribution by productive activities of a total Japanese investment flow of \$177.8 million to Free Asia from FY 1951 through FY 1965:

<u>Productive Activities</u>	<u>Percent</u>	<u>Productive Activities</u>	<u>Percent</u>
Agriculture, forestry, and fisheries	5	Steel and other metals	6
Mining	44	General machinery	4
Food processing	11	Electrical machinery	3
Textiles	11	Other	16
		Total	<u>100</u>

The Japanese apparently have been unable or reluctant to publish compilations showing the related information on the stock of their investment by projects or countries. Some sense of the kinds of projects in which the Japanese have participated can be derived from the list (which is less than exhaustive) of lines of postwar investment in Figure 6. Data on the stock of investment by countries for 1960 have been extracted for Table 6 from one of the relatively rare Japanese releases of information on this topic. Read in conjunction with Table 7, * which shows the net flow of Japanese direct investment to Free Asia for 1963-65, these data provide a number of reliable general impressions.

* Note that the data are in no way additive because of the gap from 1960 through 1962. Some flow data are available for this period but, because of various inadequacies, are not shown here.

FIGURE 6
 JAPAN: SOME LINES OF PRIVATE INVESTMENT IN FREE ASIA
 1945-66

<u>COUNTRY*</u>	<u>PRINCIPAL POSTWAR LINES OF JAPANESE PRIVATE INVESTMENT</u>
THAILAND	TIN AND TUNGSTEN MINES; AUTOMOBILE, TRUCK, AND MOTORCYCLE ASSEMBLY PLANTS; GALVANIZED IRON SHEETS; RADIO EQUIPMENT; MANUFACTURE OF APPAREL; FISHING NETS; SUGAR REFINING
INDONESIA	PETROLEUM; NICKEL ORE MINES; TIMBER EXTRACTION
SINGAPORE	SHIPYARD; STEEL MILL; CEMENT MILL; STEEL TUBES; ELECTRIC WIRES AND CABLE; ELECTRIC APPLIANCES; POLYVINYLCHLORIDE PIPES; PLYWOOD; PAPER BAGS; MATCHES; APPAREL
MALAYSIA	IRON ORE MINES; IRON AND STEEL MILLING; TIN SMELTER; CEMENT MILLS; TIMBER AND WOOD PRODUCTS; TEXTILES AND WEARING APPAREL; FOOD PROCESSING; FISHERIES
PHILIPPINES	IRON ORE MINES; COPPER MINES; TIMBER EXTRACTION
INDIA	IRON ORE MINES; SPECIAL STEEL WIRES AND WIRE ROPE; ELECTRIC WIRES AND CABLE; POLYVINYLCHLORIDE PRODUCTS; BICYCLE TIRES
HONG KONG	TEXTILES AND APPAREL; SHIP SALVAGE; STEEL PRODUCTS
NATIONALIST CHINA	AGRICULTURAL MACHINERY; WIRE ROPE; FLUORESCENT LAMPS; CHEMICAL AND SYNTHETIC TEXTILE PROCESSING

* LISTED IN PROBABLE ORDER OF RANK OF THE VALUE OF STOCK OF JAPANESE INVESTMENT.

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Table 6

Stock of Japanese Private Direct Investment in Free Asia
as of March 1960

	Thousand US \$
Philippines	8,282
India (including Goa) ^{a/}	6,314
Malaysia (including Singapore)	5,937
Thailand	3,021
Indonesia	1,712
Nationalist China ^{b/}	1,412
Pakistan	635
Hong Kong	209
Other	3,080
 Total Free Asia	 <u>30,602</u>
 Total overseas investment	 185,801

a. Goa accounted for \$4.1 million of this total.

b. In early 1967 the Nationalist Chinese Minister of Economic Affairs stated that Japanese investment in Nationalist China over the last 12 years (1955-66) had totaled \$11 million.

Table 7

Net Flow of Japanese Private Direct Investment to Free Asia ^{a/}
Total for 1963-65

	Sector			Total Value of Investment Flow
	Manufacturing	Minerals	Other	
	Thousand US \$			
Thailand	27,995	504	2,662	31,161
Indonesia	0	16,973	0	16,973 ^{b/}
Malaysia (including Singapore)	8,928	-127	973	9,774
Hong Kong	4,805	20	1,302	6,127
Nationalist China	3,940	-19	102	4,023 ^{c/}
India	1,382	-122	241	1,501
Pakistan	187	0	1,179	1,366
Philippines	0	1,148	75	1,223
Other	348	197	24	569
 Total	 <u>47,585</u>	 <u>18,574</u>	 <u>6,558</u>	 <u>72,717</u>

a. Including reinvested earnings for 1965 only.

b. Of which 39.3 million was invested in petroleum development.

c. See the second footnote in Table 6.

Thailand (and especially its manufacturing sector) is clearly the major beneficiary of Japanese private investment, with the surge in Japanese activities in this country beginning after 1960. Both before and since 1960, there has been significant Japanese investment in Malaysia and Singapore.* The data also reflect considerable Japanese investment in Indonesia, which indicates that the production-sharing approach to investment is sufficiently attractive in that case to counterbalance myriad problems of political and economic instability. India, where private initiatives have been stymied by extensive government controls and participation in industry, has received little Japanese private investment; and this point becomes even more apparent when some \$4.1 million of investment in Goa, then a Portuguese colony, is deducted from the 1960 data.** Finally, the two tables point up a decline in the share of the Philippines in Japanese private investment that results from two unrelated factors. First, Japanese investment in the minerals sector and in forestry took the form of production sharing, and initial outflows of capital from Japan were later offset by inflows of resources from the Philippines that thereby represented Japanese disinvestment. Second, Japanese investment in any joint ventures has been held up by the reluctance of the Philippine Congress to ratify the Treaty of Amity, Commerce and Navigation signed in December 1960 and ratified shortly thereafter by the Japanese Diet.

C. The Japanese Role in Regional Development Activities

During the 1950's, Japan slowly reestablished its presence as a significant participant in the economic affairs of Free Asia. Increasing bilateral aid, trade, and private investment were important factors in this recovery. Somewhat greater difficulty was experienced by the Japanese in trying to find their place in regional efforts to develop the nations of Free Asia. This difficulty resulted from the lack of a sense of community or common purpose among the other Free Asian nations,

* Over five years ending in mid-1966, Japanese investment in joint industrial ventures in Singapore reportedly amounted to \$23.5 million (which was distributed among 19 companies), and \$18.3 million more was expected to be invested by 1968. Japanese investment in Malaysia, including a few overseas branches of Japanese firms, was more reliably assessed by October 1966 at \$10.1 million spread among 27 enterprises.

** In January 1966 a Japanese newspaper reported the stock of Japanese investment in India to be \$8.4 million, spread over some 200 different industrial ventures. All but some 25 of these ventures took the form of technical collaboration (or licensing).

the necessary Japanese preoccupation with reconstruction and growth, and the reluctance of the Japanese to be accused of seeking a new version of the Greater East Asia Co-Prosperity Sphere.

The postwar involvement of Japan in regional development activities can be traced back to its acceptance as a full member of the Economic Commission for Asia and the Far East (ECAFE) in April 1953 or of the Colombo Plan in October 1954, (see Figure 1), but the real thrust of Japanese efforts to play a positive role in regional development activities came in 1957 with the "Asian-centered diplomacy" of Prime Minister Kishi. Kishi toured the countries of Free Asia in 1957 and carried the messages of Japan's peaceful interest in Asian economic development and the necessity for closer regional cooperation. The Kishi government concluded reparations agreements with Indonesia and Vietnam, liberalized the credit functions of the Export-Import Bank, initiated the "special yen" credits to India, and took measures to stimulate private investment in less developed countries. It also offered a few cogent proposals for regional development. One of the most interesting of these was the suggestion that the advanced nations, particularly the United States and Japan, should contribute capital for a Southeast Asia Development Fund from which Free Asian nations might borrow. Among a variety of other Japanese assistance efforts in Free Asia under the Kishi government, the dispatch in 1959 of three Japanese missions to survey the Mekong River stands out as one of the earlier activities of the Mekong Commission* and one of the first tangible Japanese contributions to what can legitimately be called a regional project.

There was no real diminution in Japanese economic activities in Free Asia under the Ikeda government, which came to power in mid-1960. This new administration, however, was not as convinced of the ultimate primacy of Free Asia in Japanese trade opportunities and was more concerned with problems of domestic economic growth. Nevertheless, Japan took an increasingly active part in meetings of the ECAFE under the Ikeda government.

An important element in Japan's confident emergence in recent times as the economic leader of Free Asia is the growing national cognizance of advanced industrial status. With Japanese income

* The Mekong Commission came into being in 1957.

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per capita less than that of Italy or Venezuela and frequent uncertainty among Western economists as to whether Japan should be called a developed nation, many Japanese only began to appreciate the nation's new economic status with its attainment of regular membership in the OECD and its elevation to Article VIII status* in the IMF in April 1964. Reinforcing the sense of coming of age in 1964 were repeated foreign comments on the remarkable progress of reconstruction and industrial growth in Japan and the country's successful job in hosting the Olympics. Stimulated by the plea of the UNCTAD for donors to increase aid as a share of national income to 1 percent, the Japanese were reviewing their own aid programs when President Johnson made his 7 April 1965 speech calling for Asian initiatives to effectively employ \$1 billion in regional economic development in Southeast Asia. For many Japanese (especially those in the Foreign Ministry), the President's speech was the long-awaited opening for positive Japanese leadership in regional affairs and an opportunity to cooperate more directly with the United States in the development of Free Asia.

Since early 1965 the Sato administration has shown considerable interest in increasing Japan's role in regional economic projects as part of the effort to expand its development assistance. One of the most impressive aspects of this new interest is the fact that Japan's subscription of \$200 million to the capital of the Asian Development Bank (ADB),** an organization conceived by the ECAFE, was as large as that of the United States. Indeed, the Japanese have even informally suggested to the United States the multilateral creation of a special fund for regional agricultural development to be administered by the ADB. As originally proposed in July 1965 by Takeo Miki, Minister of International Trade and Industry, this agricultural fund was to amount to some \$200 million outside of the \$1 billion of basic ADB capital and was to be used to advance low-interest loans for individual agricultural projects and community development. At variou

* Article VIII of the Fund Agreement of the International Monetary Fund (IMF) requires the country concerned to refrain from imposing restrictions on current payments and transfers of foreign exchange without prior approval. Attainment of this status by Japan signified a greater responsibility for the operation of the international monetary system.

** The Asian Development Bank, which opened formally on 19 December 1966 in Manila, has a total capital of \$1 billion subscribed by the nations of Free Asia and the advanced countries. Half of this amount is to be paid into the bank over a period of five years. In late September 1966, Japan made its first annual payment of \$20 million.

points in the discussion of the Miki plan, the Japanese Foreign Ministry has spoken in terms of Japan subscribing \$100 million to such a fund. This concept is now under intensive study by the Japanese government, and there is a good chance that a modified version of the Miki plan will be made public in 1967.

Japan's initiatives in the Mekong Committee also represent increased participation in ECAFE-sponsored programs for regional development. In March 1966, Japan agreed to provide a grant of \$4 million to help meet a total cost of \$22.8 million for the Nam Ngum hydroelectric project on a Mekong tributary in Laos. More recently, the Japanese Foreign Ministry, with unofficial encouragement from the United States, has taken the lead in trying to organize financial support for construction of a multipurpose dam under the Mekong Committee on the Prek Thnot River in Cambodia. In January 1967 the Japanese government notified the Mekong Committee that it was prepared to provide up to \$11 million, of which \$5 million would be in grants, toward the cost of the dam if the other donor countries could come up with the remaining \$11 million.

Of potentially greater importance to Free Asian development than Japan's participation in the projects of multilateral agencies is its newfound confidence in openly assuming the leader's role in attacking regional economic problems. The clearest (and, indeed, the first) manifestation of this new confidence was the Southeast Asian Ministerial Conference on regional economic development convened by Japan in Tokyo in early April 1966. (see Figure 7). This two-day conference was attended by

FIGURE 7



JAPAN: PRIME MINISTER SATO ADDRESSING THE SOUTH-EAST ASIAN MINISTERIAL CONFERENCE IN TOKYO IN APRIL 1966

economic ministers from Japan, the Philippines, Malaysia, Singapore, Laos, South Vietnam, and Thailand and observers from Indonesia and Cambodia, and covered such basic issues as capital formation, technological development, access to export markets, agricultural development, industrialization, and improvement of public works and services. Although such a brief gathering could only scratch the surface of problems in these areas, the Tokyo Ministerial Conference had a number of merits beyond its contribution to Japan's growing international confidence. First, it did provide a purely Asian setting in which representatives of Southeast Asian countries with divergent political attitudes could discuss their problems. More importantly, it dramatized to the Japanese people and to elements of the Japanese bureaucracy not usually concerned with foreign relations the new responsibility for regional economic leadership incumbent upon Japan as an advanced industrial nation. The conference also thrust upon the more conservative and parochial Japanese ministries the new role of seeking areas in which they could assist in regional development, and this challenge was enthusiastically met by proposals for a variety of regional cooperation schemes. Finally, the Tokyo Conference initiated a new round of Japanese offers of credit assistance, with \$60 million proposed for Thailand, \$50 million for Malaysia, and \$7 million for Cambodia.

In addition to giving rise to plans for a similar meeting in Manila in 1967, the Tokyo Ministerial Conference in April provided for another conference in Tokyo in November 1966. Rescheduled for 6-7 December 1966, this second Tokyo conference was to be concerned exclusively with Southeast Asian agricultural development. The December meeting was attended by approximately the same group of countries that went to the April ministerial conference* and by observers from various international organizations. This meeting strongly endorsed the idea of a regional agricultural development fund, thereby clearing the way for more active Japanese involvement in this field. It also called for feasibility studies for fishery training and research centers in Southeast Asia. By early 1967 the Japanese government was well under way with plans to establish four such centers, beginning with one in Bangkok to be in operation in 1967.

* The April meeting represented no small diplomatic triumph in securing Indonesian and Cambodian attendance in observer status. In December, Indonesia and Cambodia sent regular delegations. Heroic Japanese efforts to secure Burmese participation in December were unsuccessful.

III. JAPANESE TRADE WITH FREE ASIA

A. Magnitude and Growth

Japan's exports to Free Asia in 1965 were valued at about \$2.2 billion and imports at \$1.4 billion (see Table 8). Comparable US trade with the region was \$2.7 billion in exports and \$1.7 billion in imports. The region's growing trade deficit with Japan in recent years has in part reflected and been facilitated by the increased flow of long-term capital from Japan. On the average, about a third of the trade deficits between 1960 and 1965 were covered by the flow of Japanese long-term capital, and most of the rest was financed by the less developed countries out of credits received from multilateral agencies and hard currency earnings on other markets.

Japanese trade with Free Asia grew rapidly between 1960 and 1965, when exports to this area increased almost 11 percent and imports 9 percent annually. Nevertheless, because the overall expansion of Japanese trade was even more rapid,* the Free Asian shares in total Japanese trade declined. Thus exports to Free Asia in 1965 represented 26 percent of Japan's total exports, a significant relative decline from the 32 percent of Japanese exports that had gone to the region in 1960. Similarly, the Free Asian share of Japanese imports declined from over 20 percent in 1960 to about 17 percent in 1965. Both of these trends were continuations of secular declines from corresponding shares of 36 percent for exports and 27 percent for imports in 1955. Although some significant changes occurred in 1966 in the patterns of trade with some Free Asian countries -- primarily because of the cessation of insurance of exports to Indonesia, the war in Vietnam, and the beginning of normalization payments to South Korea -- the relative shares of Free Asia in Japanese exports and imports (27 percent and 17 percent, respectively) showed little change from 1965.

The overall expansion of Japanese trade was spurred on by remarkable growth in the already large exports to the United States and other advanced countries and by increased imports from countries outside Free Asia. Both of these overall growth patterns are likely to persist. A sustained increase of exports to advanced countries is likely because Japan is continuing to develop its productive capacity and international competitiveness in those sophisticated lines of manufactured consumer goods that are

* Japan's exports grew at an average annual rate of 15.8 percent from 1960 through 1965. Over the same period the import growth rate was 12.7 percent.

Table 8

Japanese Trade with Free Asian Countries
1948-65

Country	Japanese Exports										Japanese Imports					
	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1960	1961	1962	1963	1964	1965
South Korea	100.0	115.9	138.1	159.7	164.8	180.3	18.6	22.4	28.5	27.0	41.7	41.7	27.0	27.0	41.7	41.3
Indonesia	96.6	114.8	134.8	135.5	140.7	170.9	26.1	32.7	41.1	64.5	62.8	62.8	64.5	64.5	62.8	61.8
Netherlands East Indies	102.2	96.3	118.6	107.1	137.9	217.9	63.5	67.7	61.4	122.6	140.9	140.9	122.6	122.6	140.9	157.3
Hong Kong	156.0	153.5	192.4	246.4	292.0	287.9	23.0	24.1	18.9	28.8	28.9	28.9	28.8	28.8	28.9	35.3
Philippines	154.5	138.0	170.0	170.3	190.8	240.3	158.9	156.0	183.9	230.2	224.3	224.3	230.2	230.2	224.3	253.7
Indonesia	110.2	154.2	115.3	99.1	121.1	204.7	70.3	85.2	91.2	104.8	128.3	128.3	104.8	104.8	128.3	148.8
Malaysia a/	34.3	33.9	62.7	56.0	59.2	74.6	269.4	273.7	262.1	270.0	256.1	256.1	270.0	270.0	256.1	263.4
Singapore	27.0	101.8	105.0	112.0	114.2	124.0	13.5	24.6	22.7	22.4	26.7	26.7	22.4	22.4	26.7	32.7
South Vietnam	61.5	65.7	60.0	33.3	34.1	36.7	4.8	2.8	3.9	6.0	6.7	6.7	6.0	6.0	6.7	6.5
Cambodia	13.9	16.5	16.0	14.5	11.3	13.3	8.4	3.6	3.1	3.9	5.4	5.4	3.9	3.9	5.4	7.9
Thailand	117.5	133.9	148.5	181.0	213.3	219.1	72.3	78.3	71.7	90.7	130.6	130.6	90.7	90.7	130.6	130.8
Burma	64.5	52.3	53.4	76.3	55.3	76.3	13.4	11.4	16.3	20.1	17.2	17.2	20.1	20.1	17.2	25.8
Ceylon	32.2	33.0	32.4	22.1	23.3	22.0	12.4	10.2	7.3	9.6	9.6	9.6	9.6	9.6	9.6	10.1
India b/	111.4	116.2	120.5	153.7	149.4	203.5	159.8	151.6	124.1	161.9	179.6	179.6	161.9	161.9	179.6	183.8
Pakistan	59.0	51.7	57.3	47.8	80.5	103.9	31.7	28.9	28.5	47.7	31.1	31.1	47.7	47.7	31.1	26.5
Other (residual)	7.8	9.5	10.7	12.9	12.4	19.5	2.8	1.8	2.4	0.7	3.3	3.3	0.7	0.7	3.3	0.5
Total Free Asia	1,306.6	1,386.4	1,464.7	1,607.9	1,782.3	2,194.9	214.9	275.0	267.1	1,210.9	1,293.2	1,406.2	1,210.9	1,210.9	1,406.2	1,406.2
	Percent															
Share of Japan's World Trade	32.2	32.7	29.8	29.5	26.7	26.0	20.4	16.8	17.2	18.0	16.3	17.2	18.0	18.0	16.3	17.2

a. Malaysian data include the States of Malaya, Sabah, and Sarawak for all years.
 b. Indian data include Portuguese India for 1960 through 1962.

most easily marketed in high-income countries.* A continuation of the decline in the share of Japanese imports originating in Free Asia is equally probable because, first, the rapid pace of expansion of Japanese requirements for industrial raw materials significantly exceeds the rate of growth of production of most of these commodities in Asia, and second, the Japanese government and importers are making every effort, within the bounds of sound cost relations, to diversify their sources of raw materials.

As long as the growth of Japan's trade continues to outpace that of the less developed countries of Free Asia, it will be possible for the share of these countries in the Japanese market to fall while Japan's share in the region's market grows. Thus, despite the relative changes described above, the share of Free Asian exports going to Japan increased from 10 percent in 1960 to about 13 percent in 1965, and the Japanese market share of Free Asian imports increased correspondingly from 13 percent to almost 18 percent. These increases are continuations of a longer trend, for in the period since 1950, Japan has been the country showing the largest gain in market shares in the region's trade.

The growing role of Japan in the trade relations of the other Free Asian countries has tended to increase the attention paid by their governments to adverse bilateral trade balances with Japan. In recent times, Pakistan and Cambodia, among other countries, have expressed considerable anxiety over the size and persistence of their bilateral trade deficits with Japan, and, in the latter case, this anxiety has resulted in a requirement that an existing trade agreement be renegotiated every six months. Concern for bilateral trade deficits can be expected to lead to greater pressure on Japan to apply corrective measures such as forms of regional preference and assistance in diversification of export commodities of the region.

The patterns of change in Japan's shares of the imports and exports of Free Asian countries, which are shown in Table 9, vary significantly by country. Notable increases in shares of the market have occurred

* Some 70 percent of the value of US imports from Japan are goods related to personal consumption expenditures. These include such items as metal manufactures, cameras, radios, television sets, motorcycles, and sporting goods.

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with respect to such relatively important regional trading partners as the Philippines, * Indonesia, and Thailand. Despite much greater rates of growth of global trade for Japan than for India, the Japanese shares of the Indian market have declined slightly. Tables 8 and 9 also show that, among the major Asian trading partners, trade with Malaysia has suffered the greatest relative stagnation, and Japan's shares of that country's trade have declined markedly. A recently concluded development credit for \$50 million to be disbursed by Japan over five years, growing Japanese private investment, and the reopening of reparations discussions may provide the necessary stimulants to the Malaysian trade.

Table 9

The Japanese Share of the Market in Free Asian Countries
1960 and 1965

Country a/	Percent of Country's Exports to Japan		Percent of Country's Imports from Japan	
	1960	1965	1960	1965
Philippines	25 ^{b/}	28	18 ^{b/}	24
India	6 ^{c/}	7	5 ^{c/}	6
Nationalist China	38	31	35	40
Indonesia	15 ^{b/}	20	21 ^{b/}	38
Thailand	18	19	26	32
Malaysia	16	16	7	10
Hong Kong	6	6	16	17
South Korea	51 ^{b/}	26	23 ^{b/}	37
Singapore	1	3	7	11
Pakistan	7	4	9	10
Burma	5	10	23	29
South Vietnam	3	10	22	9
Ceylon	3	2	8	8
Cambodia	7	5	17	17

a. Countries are shown in the order of their rank in 1965 trade turnover with Japan.

b. Because of statistical inadequacies or unusual trade patterns, data shown are for 1961.

c. Data are adjusted to include Portuguese India in 1960.

* The Philippines provides the one instance in which the data are adequate to separate reparations deliveries from normal commerce. Thus subtracting reparations from Philippine imports from Japan in 1960 and 1965 yields an increase in the Japanese share of the Philippine import market from 16 to 20 percent.

B. Commodity Composition

Japan's trade with Free Asia can still be categorized broadly as an exchange of manufactures for raw materials, but important modifications have occurred within this pattern in the postwar era (see Table 10). Major factors in these changes have been the steady growth of heavy industry in Japan and that of light industry in the less developed countries of Free Asia. Growth of Japanese heavy industry has both facilitated and been supported by a continuing shift from light to heavy industrial manufactures in Japan's exports to the region, although in recent years the rate of growth of heavy industrial exports from Japan to the advanced countries has exceeded that for such exports to Free Asia. At the same time, the growth of light industries and increased protection for their products in the less developed countries has led to a decline in the share of such traditional Japanese exports as textiles in total trade. Japanese imports from Free Asia have also been affected by the steady growth of heavy industry at home. To sustain rates of expansion of industrial output in Japan that exceed the annual increases in supply of raw materials in Free Asia, additional sources of primary commodities have been sought throughout the world. The dimensions of this problem of divergent growth can be partially perceived in Figure 8.

The data on shares of various commodity categories in Japanese trade with Free Asia highlight the rapid growth of exports of capital goods to the region. Such growth derives directly from the increased demand for these goods in the development programs of Free Asian countries, for from 1960 through 1964 the Japanese share of the market in the region's imports of machinery and transportation equipment held steady at 17 to 18 percent. Some significant changes have occurred in the mix of these Japanese machinery exports since 1960. Taken together, electrical and general machinery have moved from a position in which they accounted for about half as large a share of exports as textiles in 1960 to one in which their combined share was greater than that of textiles in 1965. The fact that the share of general machinery in trade with Free Asia has been greater than its share in Japan's total trade is indicative of the important role the region plays in providing a market for Japan's heavy industrial exports. This is particularly true for such items as metalworking machinery, textile machinery, internal combustion engines, and cargo-handling equipment. The share of exports of electrical machinery in Japan's trade with the region has lagged somewhat behind the corresponding share in Japan's total trade, but Free Asia has accounted for well over half of Japan's exports of heavy electrical equipment, such as generators, motors, and transformers.

Table 10
Commodity Composition of Japanese Trade with Free Asia
1960-65

	1960		1961		1962		1963		1964		1965	
	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent
Japanese imports												
Foodstuffs	130.8	15.0	130.0	15.4	152.5	16.1	278.2	23.0	330.4	25.5	360.3	25.6
Raw materials ^{a/}	609.3	71.0	672.9	69.0	660.1	68.3	758.6	62.6	765.8	59.2	837.2	59.5
Mineral fuels	87.3	10.2	108.6	10.7	100.0	10.2	108.9	9.0	109.0	8.4	111.1	7.9
Manufactures ^{b/}	37.7	4.4	46.7	4.6	46.3	4.6	63.1	5.2	84.9	6.6	93.3	6.6
Other (residual)	4.3	0.4	2.8	0.3	5.2	0.5	2.1	0.2	3.1	0.3	4.3	0.4
Total imports	918.9	100.0	975.0	100.0	967.1	100.0	1,210.9	100.0	1,293.2	100.0	1,406.2	100.0
Japanese exports												
Chemical and pharmaceutical products	109.3	8.4	123.8	8.9	158.1	10.8	168.2	10.5	178.1	10.0	230.9	10.5
Textiles	360.3	27.6	355.5	25.7	339.8	23.2	343.8	21.4	378.3	21.2	429.9	19.6
Metals and metal products	277.7	17.4	233.1	16.8	247.1	16.9	289.4	18.0	343.6	19.3	428.7	19.5
General machinery	152.0	9.3	136.7	9.8	172.3	11.8	159.9	9.9	214.8	12.1	280.6	12.8
Electrical machinery ^{c/}	72.8	5.6	87.0	6.3	123.9	8.5	147.7	9.2	176.7	9.9	207.7	9.5
Transportation equipment	175.9	13.5	171.3	13.0	156.7	10.7	206.5	12.8	177.9	10.0	259.1	11.8
Other (residual)	238.6	18.7	262.5	19.5	266.8	18.1	292.4	18.2	312.9	17.5	358.0	16.3
Total exports	1,306.6	100.0	1,388.4	100.0	1,464.7	100.0	1,607.9	100.0	1,782.3	100.0	2,194.9	100.0

a. Including animal and vegetable fats and oils.

b. Excluding some miscellaneous manufactures such as instruments for 1960 through 1962 but including them for 1963 through 1965.

c. Data for 1963 through 1965 incorporate slight changes in the range of commodities included in this category.

in recent years. Although the relative share of transportation equipment in Japan's trade with Free Asia declined slightly between 1960 and 1965 and was significantly less than the share of this category in Japan's total trade, the region is still the principal market for exports of railroad rolling stock (see Figure 9) and an important recipient of automobile exports. Rapid growth in exports of rolling stock and motorcycles to Free Asia in 1966 suggests some recovery of the share of transportation equipment in trade with the region.

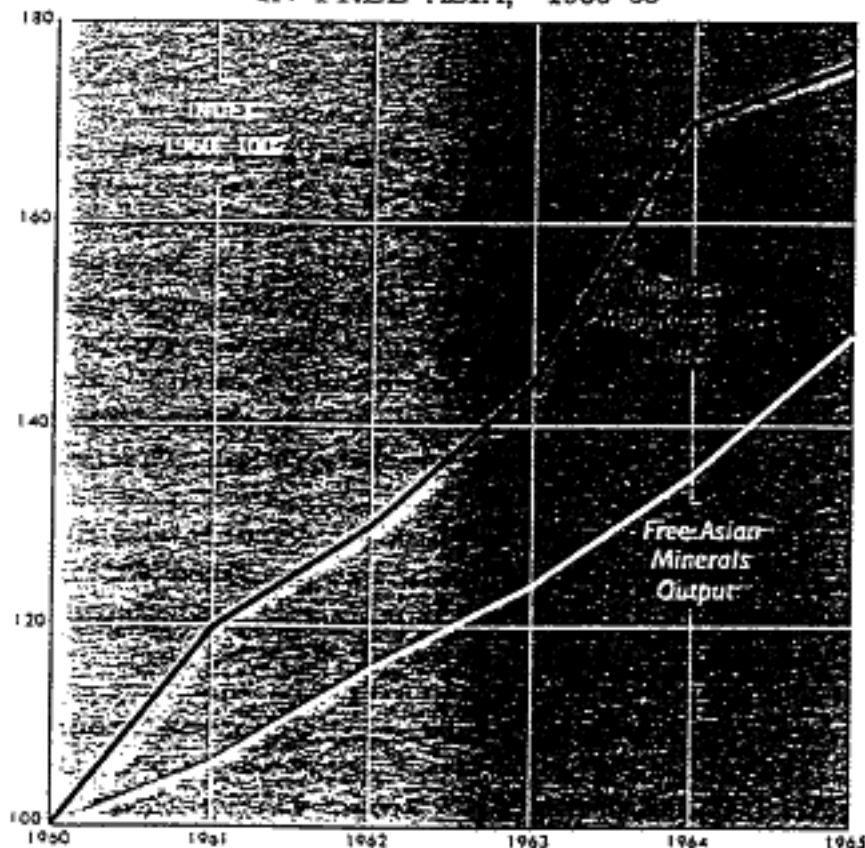
The increased share of metals and metal products in Japan's trade with Free Asia also reflects the growth of industry and construction activities in the region. By far the largest share of this category is made up of basic iron and steel products such as sheets, shapes, bars, pipes, and tubes. Rapidly expanding capacity in Japan's steel industry, distinctly competitive prices, and a solid international reputation for its products suggest that, despite any impact of recent US measures* to enforce a stronger "Buy American" policy in procurement of steel products for overseas aid activities, Japan's exports of steel products to Free Asia will continue to grow at a fast pace.

Conspicuous growth has also occurred in Japanese exports of chemicals to Free Asia. Japan's market share in the region's imports in this category moved from about 15 percent in 1960 to about 20 percent in 1964. A small but rapidly growing element of the trade with Free Asia has been Japanese exports of plastics, which increased from about \$12.7 million in 1960 to \$37.9 million in 1964 and \$49.8 million in 1965.** The greatest part of the trade in chemicals, however, has been accounted for by fertilizers. A relatively slow and faltering growth in exports of chemical fertilizers to Free Asia from 1960 through 1964 gave way to a sudden spurt in 1965, and exports to the region for that year were \$84.6 million, or 52 percent of total Japanese fertilizer exports. Further growth in fertilizer exports to Free Asia is likely, as the Japanese government is persuaded by other aid donors to increase commodity assistance in its bilateral aid programs. Another factor favoring such growth would be the creation of a revolving fund of \$25 million for long-term, low-interest

* The impact of these measures on Japan is indirect. Japanese sheet steel galvanized in South Korea and Taiwan for shipment to South Vietnam is most directly affected, but a declining market for the galvanized sheet in South Vietnam reduces import demand for Japanese iron sheet in South Korea and Taiwan.

** The growth of shipments of synthetic plastics, among which polyvinylchloride resin is a particularly important component, is another reflection of the development of light industry in the region.

**MANUFACTURING OUTPUT IN JAPAN
COMPARED WITH MINERALS OUTPUT
IN FREE ASIA,* 1960-65**



59911 4-67

*Mineral index is for ECAFE countries, which include Free Asia and Iran. Inclusion of Iran tends to bias data upward.

FIGURE 9

JAPAN: ROLLING STOCK EXPORTED TO FREE ASIA



INDIA: JAPANESE-BUILT ELECTRIC LOCOMOTIVE



THAILAND: JAPANESE-BUILT DIESEL-ELECTRIC LOCOMOTIVE

fertilizer loans to Southeast Asian countries that was under consideration in the Ministry of International Trade and Industry in mid-1966.

The most prominent feature of Japan's imports from Free Asia is the steady decline of the share of raw materials in total trade from 71.0 percent in 1960 to 59.5 percent in 1965. This relative decline has been accompanied by a proportional drop in the share of mineral fuels over the period. A corresponding increase in the share of foodstuffs reflects more transitory demand factors, the nature of which is discussed below. Japanese imports of raw materials and mineral fuels from Free Asia grew at annual rates of 5.2 and 4.9 percent, respectively, while the rates for total Japanese imports of these goods were 7.8 and 17.0 percent. The growth of Japanese imports from Free Asia will depend mainly on the regional supply of raw materials for some time to come. Further growth in Japanese food imports from the region is not likely to be great, and even a rapid rise in demand for imported manufactures, which accounted for less than 7 percent of Japanese imports from Free Asia in 1965, will have little overall effect over the next few years.

Changes in the Free Asian share of the Japanese market for certain important raw materials are shown in Table 11. This table particularly highlights the falling shares of Free Asia in Japan's imports of iron ore, sawlogs, and crude oil, which together account for about 40 percent of the value of Japan's imports from the region. In the cases of sawlogs in the Philippines and iron ore in the Philippines and Malaysia, increased domestic consumption is or may soon become a significant factor in restricting the amounts of the commodities available for export. Generally, however, the problem has been the slow growth of production in the region. Increased foreign investment and managerial participation in the exporting countries' extractive industries probably will be necessary if production of quantities and qualities satisfactory to Japanese importers is to be achieved. The alternative may be a greater Japanese emphasis on participation in the development of sources of raw materials in countries with more liberal investment policies such as Australia, Canada, and the United States. These three countries have recently assumed more important roles in current and prospective Japanese imports of hard minerals, petroleum, and natural gas. A more remote, but still plausible, alternative is Japanese investment in Siberia on a production-sharing basis.

That Japan has been able to evolve satisfactory production-sharing arrangements with Indonesia in petroleum and timber extraction indicates that obstacles imposed by tight government control of the minerals industries in less developed countries are not insurmountable for Japanese

Table 11
Share of Free Asia in the Japanese Market for Selected Commodity Imports
1960-65

Commodity and Principal Free Asian Sources ^{a/}	Commodity's Share in Total Japanese Imports		Commodity's Share in Japanese Imports from Free Asia		Free Asian Share of the Japanese Market		Percent
	1965		1965		1960	1965	
Cereals and cereal preparations ^{b/} (Taiwan, Thailand, Burma)	6.0	5.1	9.7	7.7	10.6	10.3	14.6
Sugar (Sri Lanka, Taiwan)	1.9	6.0	48.4	40.7	50.2	50.0	46.3
Raw cotton (India, Pakistan)	5.4	2.6	8.7	8.5	11.1	13.2	8.4
Hard and soft fibers (Thailand, Philippines, Pakistan)	0.4	2.1	76.9	75.2	75.4	78.7	81.6
Rubber, all kinds (Indonesia, Thailand, Malaysia)	1.6	7.2	80.5	77.4	76.8	74.4	78.6
Iron ore (Malaysia, India, Philippines, Thailand)	6.4	15.8	73.8	60.4	55.6	53.1	42.5
Nonferrous metal ores (Philippines, India, Malaysia, Indonesia)	3.5	5.8	30.8	30.7	29.6	30.3	28.4
Of which:							
Bauxite (Malaysia, Indonesia)	0.2	0.8	87.8	83.4	84.8	83.4	68.2
Copper ore (Philippines)	1.3	2.9	30.5	31.2	30.3	33.1	38.4
Crude oil (Indonesia)	12.8	5.7	15.2	13.9	11.7	10.9	9.4
Sawlogs (Philippines, Malaysia, Taiwan, Indonesia)	6.0	18.3	72.2	54.2	56.4	56.5	50.1

a. Principal sources are identified for background only. The first column of data is concerned with Japanese global trade; data in all other columns apply to Free Asia.

b. Excluding maize and sorghum as feed grains.

investors. Unfortunately, however, the domestic political and economic turmoil in Indonesia has made this a poor test of performance in output. Recent production-sharing agreements between Japanese investors and the Indonesian government call for extensive exploration to begin in 1967 both south and east of Borneo to complement existing Japanese oil development activities in northern Sumatra. With the exception of Sumatran onshore fields which are currently producing, however, these development activities probably will contribute little or nothing to Japanese petroleum imports until after 1970 and are not likely to offset the decline in the Free Asian share of the Japanese petroleum market significantly until much later than that.

A clear example of some of the difficulties encountered in expanding production of raw materials in Free Asia in response to Japanese import requirements is iron ore extraction in India. In this instance, despite the challenge raised by large Japanese contracts with Australia for supply of pelletized ores, an Indian delegation took the occasion of an ECAFE meeting in mid-1966 to propound an official view that, were lump ore from India not purchased by Japan at the same premium prices as Australian pelletized ore, it would be a definite sign of Japanese indifference to Indian economic development. This argument completely begged the crucial issues of improvement of India's ore extraction and processing facilities, changes which might be effected by more liberal attitudes toward foreign private investment.

As impressive as the declining share of raw materials is the growing share of foodstuffs in Japan's imports from Free Asia. Comparison of Tables 10 and 11 suggests that, particularly since 1961, cereals (which accounted for about 20 percent of foodstuffs imported from Free Asia in 1965) have had a prominent role in this growth. In fact, rice imports from Free Asia, the United States, and Communist China have increased greatly since 1961, but leveling demand for rice and greater government emphasis on research to increase yields will probably reduce import demand in the long run. Indeed, a 10-year forecast of Japanese agriculture done in late 1966 projected a 10-percent growth in rice production accompanied by a decline in per capita consumption that would leave Japan virtually self-sufficient in rice.

Free Asian exports to Japan of foodstuffs other than rice have better prospects. One commodity that has made considerable headway in the Japanese market has been maize, primarily for use as a feed grain. Thailand has been a major beneficiary of this expansion, as Japan's maize imports from this source have increased from less than 50,000 tons per year prior to 1958 to over 500,000 tons per year since 1964. Prospects

for further expansion are generally good as Japanese meat consumption steadily increases, but Thailand and other Free Asian exporters will have to remain competitive with the United States.

Particularly strong growth has also been sustained in recent years by such tropical products as bananas and canned pineapple, which together accounted for 19 percent of the value of foodstuff imports from Free Asia in 1965 compared with 10 percent in 1960. Tropical fruits will probably continue to encounter an expanding market in Japan for years to come. Sugar, primarily a tropical product, has performed less impressively in Japanese imports from Free Asia. In 1965 this commodity accounted for 23 percent of the value of foodstuff imports from the region compared with 39 percent for 1960. Nevertheless, the annual growth of sugar imports came to about 9 percent over the period. Large amounts of sugar probably will continue to be imported because domestic production meets only about 25 percent of Japan's requirements at present and domestic consumption is growing at about 6 percent annually. With this expansion of domestic demand, Japan could be an important purchaser of Philippine sugar if that country were forced to make its way on the relatively depressed international market rather than enjoying premium prices in the United States.

IV. PROSPECTS FOR JAPANESE ECONOMIC LEADERSHIP
IN FREE ASIA

The explosive growth of industry and the steady rise of the standard of living toward European levels have given Japan a legitimate claim to the economic leadership of Asia. Only in the last few years, however, has Japan begun to assume a significant share of the responsibility for active leadership in helping to meet the development problems of Free Asia. In no small measure, the hesitation of the past was a result of the time required to overcome antipathy toward Japanese imperialism in the region during the 1930's and 1940's. An equally important deterrent to more active Japanese concern for Free Asian economic problems was the national preoccupation with rehabilitation and closing of the gap between Japanese and European stages of economic development. As a steadily increasing stream of indicators has attested since about 1964, however, Japan has arrived as an advanced industrial nation, and this fact is understood by the Sato administration if not by the Japanese people as a whole. Although continued Japanese economic growth is itself vital to the security and general prosperity of Free Asia, it is also fair to question the extent to which the Japanese government is prepared to go in providing long-term capital and skills required in the development programs of Free Asia. It is only in this last sense that Japanese economic leadership in the region can legitimately be judged, for Japan has the less constructive option of simply withdrawing into its new role as a member of the community of advanced nations.

A. The Outlook for Increased Japanese Aid

Two aspects of the current stage of development of Japanese aid programs and policies complicate the task of estimating the prospects for increased Japanese aid to Free Asia. The first of these is the lack of coordination in the administration of aid. The Japanese government not only has no real equivalent of the US Agency for International Development (AID), but it is also burdened with radically different aid philosophies within its executive branch. Although the ultimate power in making decisions on the amounts and terms of aid generally rests with the Ministry of Finance, this office rarely articulates its general views on aid and, for the most part, restricts itself to conservative statements on the wide range of Japanese international obligations and the tightness of the Japanese capital market. Given the ministerial conflicts in the field of economic assistance, ambitious and visionary statements by the Foreign Ministry on how much aid Japan is willing to provide in any particular context generally must be discounted. On the other hand, it

is equally apparent that some of the reactionary attitudes of the Ministry of Finance have not been in tune with the more aggressive policies of Prime Minister Sato and the rest of his administration.

The second complication in estimating Japanese aid is the fact that Japan has only recently begun to seek a role in guiding development activities in the region. The implications of this fact are that Japan is moving out of an era in which obligations for capital assistance were both fairly well defined and assumed under pressure from other countries into one in which the initiative for development aid in as yet unspecified amounts must come more frequently from the Japanese government itself. Symbolically, this is the difference between a reparations program negotiated with Burma and more recent Japanese efforts to drum up support among lukewarm capital donors for a dam project of the Mekong Committee in Cambodia. Although creative Japanese response to the development of Free Asia suggests an ultimate requirement for better internal coordination of aid policies and programs within the Japanese government, the current status of Japan's initiative is that of a considerable array of specific suggestions by private and public agencies for particular projects. Thus we may know that elements of one ministry support a revolving Japanese fund for fertilizer loans and technical assistance in agriculture while other elements in the same ministry back an internationally subscribed agricultural development fund for Free Asia without knowing what, if any, relation the two approaches bear to each other. The enthusiasm that Japanese official and private agencies have recently shown for conjuring up grandiose Free Asian development schemes* in some respects has been an overzealous response both to President Johnson's \$1 billion aid proposal and to the spirit of their own ministerial conferences. This positive initiative, however, is bound to be tempered by a traditional Japanese realism concerning the absorptive capacities of the less developed countries of Free Asia.

Within the limits imposed by these problems, some crude estimates still seem warranted. First, the Japanese government has publicly repeated the goal of 1 percent of national income as an annual target for

* In addition to some of the less ambitious schemes such as the agricultural development fund and the fertilizer fund, the Japanese press in 1966 reflected discussion of an Asian Seaway (that is, extensive maritime rehabilitation) project, a Southeast Asian submarine cable, a substitute television satellite network, and a long-range purchasing program for imported rice.

long-term capital flow to the less developed countries with sufficient frequency that it is hard to believe that it will not be approximated at least by 1970. Allowing for growth of national income between 1965 and 1970 at an annual rate of 8 percent, this would mean that Japan's official and private development assistance would amount to \$1.0 billion in 1965 prices for 1970. Although the shares of Japanese official aid going to Africa and Latin America have grown in recent years and private capital flows are likely to continue to be distributed widely, Free Asia would probably receive at least as large a share of the long-term capital flow as it did for the period from 1960 through 1965.* This would mean a combined official and private assistance flow of \$600 million or more in 1965 prices to the region in 1970.

Second, most of such assistance to Free Asia probably will be in the form of long-term credits, although, within the private sector, export credits will probably be matched by direct investment. The most prominent exceptions to this rule would be the official reparations and grants already projected or now under discussion for Burma, the Philippines, South Korea, Indonesia, the ADB, and other multilateral funds. The terms of official bilateral credits would probably be softer than the rate of nearly 6 percent that prevailed for almost all such credits until quite recently. Within this context, it appears likely that the activities of the OECF would expand to facilitate softer loans without complicating or jeopardizing the normal commercial loan activities of the Export-Import Bank. The predominant credit activities would probably be made more flexible with respect to use for commodity (as opposed to project) assistance, but use of credit funds would still be tied to procurement in Japan.

Third, Japan probably will concentrate most of its bilateral aid activities in Southeast and East Asia. This does not rule out a significant continued role within the consortia for India and Pakistan, but it does suggest that Japanese official aid and private investment activities in the other countries of Free Asia will grow at a faster pace. In addition to the principal recipients of major grant assistance identified above, official Japanese aid in the form of credits will probably be an important source of developmental capital in Thailand, Malaysia, and Taiwan in 1970. Private investment will continue to focus on Thailand, Indonesia, and Malaysia, and, with modest improvements in the climate for Japanese investment, will pick up significantly in the Philippines

* See II, above.

and South Korea. A last point to be considered is that increasing Japanese enthusiasm for multilateral aid activities may mean more suggestions and programs for special development funds for Southeast Asia.

B. The Future of Japanese Trade with Free Asia

Over the last 10 years the Japanese have shown increasing awareness of the relation of expanded economic aid to the long-run growth of Japanese exports to Free Asia. The prevailing view among the Japanese has been that the stimulative effects of foreign aid to trade consist merely of financing exports and helping to introduce Japanese products. Accordingly, budget proposals for economic assistance have long been presented to the Diet as "trade promotion" expenditures. This view is changing, however. Japan has now established its competitive strength in heavy industrial exports; and overseas investments in manufacturing, such as those shown in the list above,* have secured a favored position for Japan in future Free Asian imports of a variety of semimanufactures and producers' goods. Under these circumstances, it has become more apparent that the principal limitation on the growth of Japanese exports to Free Asia is the prevailing level of income in the region. Although Japan will probably continue to enlarge somewhat its market shares in the trade of the region's less developed countries, the primary means for further stimulation of Japanese exports to Free Asia will have to be an expanding market based on sustained economic development. The Japanese are beginning to recognize that they are likely to benefit from any aid which stimulates the area's economic development. Thus participation in multilateral aid to Free Asia is seen increasingly to be in Japan's commercial interests.

Viewed from the perspective of the less developed countries of Free Asia, the crucial trade issue is how to increase Japanese imports from the region. As in the past decade, when the Japanese economy grew about 10 percent annually, the Japanese market will expand rapidly. Nor are Japanese trade restrictions a problem, except for a few agricultural products and manufactures. The most important factor limiting Japanese imports from Free Asia will continue to be the slow growth of production of industrial raw materials in the region.

* See Figure 6, p. 39, above.

The most direct means of increasing Free Asian minerals production is what the Japanese frequently refer to as the "development and import formula." This method is based on such facets as Japanese government credits, private investment, and technical assistance for the development of a primary product required by Japan. Instances of application of one or more of the facets of this approach are maize in Thailand, iron ore in India, copper ore in the Philippines, crude oil in Indonesia, and timber in Malaysia and Indonesia. Through the Ministry of International Trade and Industry, the Japanese government covers up to three-fourths of the expenses of surveys and technical assistance related to the development of sources of primary products in the less developed countries.

Perhaps more than anything else, the combination of government assistance in initial surveys, government facilities for long-term loans to Japanese private investors, and long-range contracts for purchases of Free Asian minerals under production-sharing has elicited cries from a variety of Western sources that the Japanese are seeking to reconstruct the Greater East Asia Co-Prosperity Sphere. This concern appears unwarranted, for the Japanese have shown a strong preference for a wide distribution of sources of raw materials, and the external features of what is characterized as a new form of purposive Japanese imperialism can be too readily explained on purely economic grounds. Thus Japanese credit assistance to private investors in Free Asian minerals production is most plausibly seen as an attempt to overcome problems of high domestic interest rates stemming from strong competing demand for domestic investment. Similarly, Japanese participation in minerals surveys is primarily a reflection of the fact that governments in the region have inadequate knowledge of natural resources and, for the most part, have done little to overcome this obstacle to foreign investment.

Two considerations that tend to favor mineral development through Japanese overseas investment over similar agricultural development are the prospects for continued expansion of the large Japanese demand for raw materials for heavy industry and the advantage to the less developed countries of dependence on exports, the supply of which is not subject to such random shocks as bad weather. On the other hand, the extensive application of the "development and import" method to agricultural diversification could have greater direct impact on the standards of living of rural population in many areas of Free Asia. If this diversification were directed toward tropical agricultural products having relatively high income elasticities of demand in Japan, the prospects for an expanding market in Japan would be enhanced.

A less satisfactory approach to the problem of expanding Japanese imports from Free Asia is that of providing preferences to the less developed countries in this region. Given the Japanese adherence to the General Agreement on Tariffs and Trade and other commitments to international bodies, this method would depend on subsidies for Japanese importers rather than any direct preference scheme. The issue of preferences to less developed countries is presently under heated discussion among advanced countries, but there are at least two reasons why this sort of solution to the problem of large trade imbalances with Free Asian countries is not likely to be satisfactory. First, unless preferences were extended across the board to all less developed countries, the political conflicts that such a system would engender would be monumental. In the absence of regional preferences, however, there is only limited reason to believe that Free Asian primary exports would benefit much. Second, although preferential treatment might divert Free Asian exports of raw materials to the Japanese market, this diversion would probably have only limited impact on the production of such commodities.