

products, including sewing machines, air conditioners, washing machines, transistor radios, and television receivers were up an average of 42 per cent (measured in unit output). Production and transportation equipment, mainly bicycles and motorcycles, also rose sharply.

The recovery of exports and consequent trade surplus

led to a significant growth in Taiwan's foreign exchange reserves. As of September the reserves stood at \$2.55 billion, up from the September 1975 total of \$1.99 billion. With an estimated total debt of only \$3.2 billion and a debt service ratio for 1976 of only 6.5 per cent, Taiwan was easily able to meet its international payments.

People's Republic of China: Oil Will Lead the Way

1976 was likely a bad year for the economy of the People's Republic of China in light of political developments and natural catastrophes. Quantitative figures for 1976 are much scarcer than for any recent year and highly unreliable, which is explained by the revelations that have been published since the anti-Maoist coup in October. Those have told of massive disruptions of industrial production in many sectors, stoppages in some factories that continued for most of the year, and substantial violence among groups of workers.

But despite the often cautious post-October Western evaluations of China's future economic course, it is now clear that China will be seeking to return to the program championed by Teng Hsiao-ping over a year ago — for crash foreign development of China's oil by the West in order to make possible billions of dollars of capital imports in the next several years. There are indications that in 1975, just before Teng's purge, a deal was under consideration involving U.S. technology and assistance for oil development, in the multi-billion dollar range, including an arrangement for China to receive much of it as long-term credit. Nothing has been heard since, but Teng's

imminent return to power may revive this plan.

Teng had also been negotiating with the Japanese for a long-term contract for the export of Chinese oil to Japan in return for steel and other capital goods during the fall of 1975. Reports circulating at the time speculated that China might export up to 50 million tons by 1980. The deal fell through in early 1976 when Maoist factional pressure forced Teng out.

The news that Nippon Steel's Inayama, and a representative from the Idemitsu oil company, will lead a major delegation to China in February makes it quite likely that some major deals will be concluded along the lines delineated over a year ago. The major question mark is the state of China's economy itself. Not only did economic growth in 1976 stall, but oil production, which had increased at 20 per cent per year from 1963-1975, fell to only 13 per cent in 1976. Any long-term agreement to provide Japan sizeable quantities of oil would probably require that China receive Western aid to develop its offshore fields rapidly. China's new leadership has made clear where its desires lie; the only question is its ability to rapidly fulfill them which has been placed in jeopardy by the damage done to the economy in recent years.

Fukuda's 'Reflationary' Budget: Neither Fish Nor Fowl

The Carter Administration and its backers have been pressuring Japan to run a highly reflationary budget. They insist that Japan reduce its high 1976 trade surplus and use domestic public works as a substitute demand. As a result, according to the mythos, Japan should be able to increase its imports from the developing sector and thus help the U.S. and West Germany bring about a wondrous worldwide recovery.

In fact, officials at Treasury and Chase Manhattan Bank told NSIPS that, on a long term basis they want Japan to restructure itself fundamentally away from its postwar export orientation and to a domestic public works buildup and *longterm trade deficit financed by overseas borrowing*. Under such a policy, they believe the New York banks can shift loans from Third World and weak OECD countries to strong U.S., Japan and the BRD. The officials neglected to say how long Japan would remain "strong" under such a policy.

Fukuda's budget

The new Prime Minister Takeo Fukuda personally supports the Carter Administration policy and has tried to the extent possible to implement it in his new budget. In fact, the real issue in Fukuda's year-long campaign to

oust predecessor Takeo Miki was Fukuda's support for the Rockefeller-Carter economic policy vs. Miki's support for the alternative approach of the pro-development wing of Japanese industrialists discussed below. However, simple reality — amplified by the business community's recognition of it — has severely crimped Fukuda's ability to carry out Rockefeller's intentions.

In terms of overall size Fukuda's budget is not really reflationary.

At \$95 billion, the proposed budget is 17.3 per cent above 1975 budget (which was 14 per cent above 1974). Public works projects are 20 per cent above 1975 at \$14 billion. At \$28 billion — with local bonds the total in 1977 will be \$44 billion — Fukuda has kept national bond issues to 30 per cent of budget, a little higher than 1975 ratio. Running such a huge deficit at this point is no longer additional stimulus but simply preservation of what has become the built-in norm necessary to sustain at least minimal levels of consumer spending. Only an increase in the ratio to 35-40 per cent would represent new stimulus. This Fukuda cannot do.

Within the new budget, according to Jan. 4 *Nikkei*, Fukuda has ordered the Finance Ministry to effect a shift away from social spending toward public works. Within

BREAKDOWN OF FUKUDA BUDGET FOR 1977 (In Billion Dollars)

ITEM	1977	INITIAL 1976 BUDGET	INCREASE	% INCREASE
A. REVENUE	\$95	\$81	\$14	17.2
Bonds	29	24	5	21
B. SPENDING	95	81	14	17.2
Social Welfare	19	16	3	18
Education and Science	11	10	1	10
<u>Debt Service</u>	8	5.5	2.5	45
Pensions	3.6	3.3	.3	10
Subsidies to Local Governments	16	13	3	25
Defense	5.5	5	.5	10
<u>Public Works</u>	14	11.7	2.3	20
Others	18	16	2	12

NOTE: Numbers rounded off, but percentages calculated from more precise figures. Total Revenue includes the amount raised from bonds. Notice the most significant increases are not for defense or public works, but for the government's own debt service and subsidies to localities which are necessary to cover their deficits.

the latter category, he has ordered a shift from housing toward highways and water conservation projects, etc. No magnitude of shift was available at press time.

In line with the International Monetary Fund cutoff of technology to the developing sector and the Soviet bloc, Fukuda's new Minister of International Trade and Industry, Tatsuo Tanaka, has ordered a review of MITI's traditional policy of stimulating plant export. Miki's MITI minister has proposed doubling Japan's exports of plant to \$20 billion in 1977, but Tanaka told newsmen that shipping technology to the developing sector and the Soviet bloc was "dangerous" and "too generous." Thus, the Export-Import Bank, which asked for a 40 per cent increase in funding to \$2.8 billion (against an 80 per cent increase in 1976) will probably only get a 10-20 per cent increase and funds for plant export will likely be restricted.

Defense spending increased only 10 per cent and actually will decrease as a portion of GNP slightly to 0.8 per cent from 0.9. This is, of course, the opposite of Carter Administration policy and Takeo Fukuda's desires.

Finally, Fukuda has at last word decided not to lower the discount rate beyond the 6.5 per cent level hit last autumn, a major industrial demand. Big opposition had been raised to the reduction in interest rates on deposits that would have resulted, since the rate is already so far below that of inflation. At one point, according to the

Japanese press, Fukuda had favored accompanying the discount rate with a cut in rates on deposits for private banks, but not in the postal savings system which funds public works. This would have still further shifted the economy from private capital formation to public works, along the lines of Hitler's finance minister Hjalmar Schacht. Latest word is that Fukuda will not cut the discount rate but will increase public works still further.

The Pro-Development Alternative

While some business leaders, notably Employers Association head Takeshi Sakkurada, (a political supporter of Fukuda) support the Carter-Fukuda line, most other top industrialists have counterposed a program based on high capital formation in Japan and development projects in the Third World. Many of these leaders, such as Business Federation (Keidanren) head Toshio Doko, Chamber of Commerce and Industry head Shigeo Nagano, and Industrial Bank of Japan Chairman Sohei Nakayama, were (with greater or lesser ardence) supporters of Miki in the recent power struggle. Specifically, they have called for tax cuts to stimulate consumer spending immediately, a cut in the discount rate, and for the long-term investment tax credits and promotion of *plant and machinery exports* to the developing sector, the East bloc and China, and to the Mideast.

These industrialists do not control Fukuda. But they

are acting to prevent Fukuda from implementing Carter's policy, while striving to get as much of their program into effect as possible. Besides direct internal political pressure, the pro-development faction of the industrialists — often termed the "resource faction" within Japan — have launched an economic diplomacy drive to secure the trade deals and raw materials and energy supplies their program requires.

The keystone of the current business diplomatic efforts involves overtures to the Soviet-China-Vietnam sector and to the Mideast. Nagano, Nakayama and others will visit the Mideast in February to arrange major oil-for-technology deals, which may include opening a new oil site in Saudi Arabia with a 5 million barrel a day capacity. Nippon Steel President Inayama will visit China in February to discuss major trade upgrading; Mitsui Bank adviser Tatsuo Mizukami will lead a mission to Vietnam that same month; and Japan and the USSR have just signed an agreement on oil exploration in Sakhalin in which Japan will get half of oil discovered at 8 per cent below world prices.

As Japan prepares to arrange the oil-for-technology deals with the Mideast which the Europeans began a few months ago, and which began to free Europeans from grip of the dollar system, reports come in that the Arabs have greatly stepped up their inflow of money into the Tokyo markets. Arab investments rose to the \$2 billion level in 1976 from \$1.2 billion in 1975 and 1974 each. Moreover, the Arabs have begun to invest directly rather than through British or Swiss-managed investment trusts. Most important, there are indications that the investments may be long-term and stable, rather than mere speculative hot money flows. The evidence is that in November there was a \$100 million net outflow of foreign investments in Japanese stocks (all countries, not just Arabs) but a \$200 net inflow in bonds, which are longer terms. If the Japanese are able to secure Arab assurance that the money won't flow out at the next fluctuation of interest rates or yen parity, then we can expect to see a stream of triangular trade deals involving Japan-Arab cooperation in third countries in the developing sector.