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Significant Economic Developments in Selected
Far Eastern Countries: 1963 and Early 1964

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In examining the more significant economic developments in the Far East in the past year, one is struck by the important role that balance-of-payments developments have played in these countries. One finds that in areas with realistic exchange systems, such as Taiwan and Hong Kong, there has been substantial growth and economic prosperity. In other countries, such as Japan, Korea, and the Philippines, one of the main problems has been to correct deficiencies in the balance-of-payments position through stabilization of domestic monetary conditions or revision of the exchange system. Other countries that have taken very little, or no, significant steps to establish realistic exchange systems have shown very little, or no, economic growth. In Indonesia, where the rupiah continues to remain grossly overvalued, both exports and economic growth have been stagnant. Burma, preoccupied with nationalizing the economy, has also shown little evidence of export expansion or substantial economic growth.

Although a dynamic export performance may not be a guarantee of substantial economic growth, it is interesting to note that most of the countries with good growth rates are also those with a good export performance. This suggests the importance of establishing a realistic exchange system to support export growth and the necessity of keeping the system viable.

Strong export growth in Taiwan

One of the most significant developments in Taiwan last year was the growth in both the value and diversity of the country's exports. According to preliminary reports, exports are estimated to have risen 52 per cent, or from $218 million in 1962 to $332 million in 1963. This was nearly double the 1960 level.

Although part of the expansion in 1963 was due to higher prices for sugar, one of Taiwan's main exports, there was also a substantial expansion of other exports. On the basis of the volume and value of sugar exports in 1963, only about $57 million, or half of the $114 million increase in exports in 1963, was due to the rise in sugar prices. Thus, the expansion of other exports provided $57 million in additional export earnings in 1963.

Because imports have risen less rapidly than exports in recent years, the trade deficit has narrowed substantially. Last year imports rose 19 per cent to a level of $362 million. The trade deficit was reduced to only $30 million, compared to $86 million in 1962.

Largely as a result of the sharp rise in exports last year, Taiwan's international reserves almost doubled. From a level of $124 million at the end of 1962, central bank and official gross reserves increased to $237 million at the end of 1963. Reserves did not change too much in earlier years in spite of Taiwan's export growth largely because of a steady rise in imports.

Taiwan's ability to develop new exports is no less impressive than the growth in total sales abroad. In 1957, sugar and rice accounted for 74 per cent of Taiwan's total exports, but this was reduced to only 37 per cent in 1963 because of the spectacular increase in sales of commodities which were of minor importance a few years ago. Other exports have thus increased their share from 26 per cent to 63 per cent of total exports in only 6 years. Some of the more important products that have contributed to this growth are: lumber, cement, chemicals, textiles, light manufacturers, and vegetables, including mushrooms.

Two of the key factors helping Taiwan to expand her exports in recent years have been the realistic, unitary exchange rate established around 1958 and the relative price stability since 1960. During much of the 1950's, Taiwan had a complex multiple exchange rate system that, at times, was changed almost daily. Unification at a single realistic rate of NT$40.00 to the U.S. dollar has aided Taiwan exporters and importers by providing incentives and stable conditions conducive to business planning. Both wholesale and consumer prices have increased only moderately in the past three years, except for some rise in wholesale prices in 1963. In terms of the annual averages, the cost of living index rose 2 and 3 per cent in 1962 and 1963, respectively. The comparable change for wholesale prices was 2 per cent and 7 per cent, respectively.

Hong Kong blessed with "Midas Touch"

In spite of the serious water shortage problem, Hong Kong turned in a good economic performance last year--surprising even some of the local officials. Exports were up 16 per cent and re-exports increased 8 per cent. Imports rose 11 per cent. Hong Kong's exports and re-exports for 1963 totaled $666 million and $202 million, respectively, and imports were $1,289 million.

The various restraints on textiles, interestingly enough, did not hamper substantial growth in this area. During 1963, exports of clothing, textile yarn, fabrics, and other cotton make-up articles increased 21 per cent.

Other data indicate substantial economic growth last year. Electric power consumption rose 19 per cent and there was a 25 per cent increase in the number of tourists (316,000) who visited the Colony. About $48 million in residential and industrial construction took place during this period, an increase of 15 per cent over a year earlier.

There were apparently no serious contractions of employment or production due to the water shortage last year. Although various steps are being taken to solve the problem, they will take at least one or two years. Consequently, the water shortage will continue to remain a serious problem in 1964. If the summer monsoons should fail to materialize, the problem would become very serious for Hong Kong. But the good performance during 1963 in the face of the water shortage seems to suggest that Hong Kong has indeed inherited King Midas' magic touch.

Japanese reserve loss threatens slowing of economic boom

There were several significant economic developments in Japan last year. These included economic recovery, the turning to Europe for foreign capital needs, and the deterioration in the balance of payments.

After experiencing balance-of-payments difficulties in 1961 and a period of monetary restraint in 1962, January of 1963 marked the beginning of a strong, economic recovery. By March of 1964, the seasonally adjusted index of industrial activity was up 20 per cent over the level a year earlier. As a result of the U.S. proposed interest equalization tax, Japan has turned increasingly to European capital markets. In the five months ending April 30, 1964, Japan floated $103 million in security issues in Europe.

The third development, and the one likely to remain a problem during 1964, is the weakening in the balance-of-payments position. The first indication of a deterioration was a widening in the seasonally adjusted trade deficit early in 1963. During the first quarter, the deficit was $816 million at a seasonally adjusted annual rate (imports c.i.f. and exports f.o.b. on a customs basis), and it increased to $1,240 million in the second quarter. By the fourth quarter of last year, the trade deficit, at a seasonally adjusted annual rate had risen to $1,844 million, and in the first quarter of this year it was $2,100 million.

In recent years, Japan has usually had about $600 million per year in net earnings from service items that could be used to offset a trade account deficit of a similar amount. Capital inflows served for a time to maintain international reserves in the face of this rising deficit, but an impact was eventually felt after mid-year as reserves tended to level off. After October, they began to decline and did so through May.

The Bank of Japan has been concerned about the worsening trend in the balance of payments, and began to tighten credit mildly last fall. Stronger measures were taken in December when the reserve requirements against demand deposits for the larger banks were doubled from 1.5 to 3.0 per cent. In January of this year, the Bank of Japan resumed "window guidance" operations, following discontinuance last May, whereby limits are placed on the amount of credit accommodation that the large city banks can obtain from the central bank, and maximum limits on loan expansion are suggested for these banks. On March 18, 1964, Japan took action to reduce the pressure on its international reserves by raising the Bank of Japan's basic discount rate from 5.84 to 6.57 per cent. At the same time advance import deposit requirements for raw materials and industrial machinery were raised from 1 to 5 per cent, and for foodstuffs and specified non-essential imports they were increased from 5 to 35 per cent.

Japan has been confronted with another balance-of-payments problem unusually soon after solving the previous one. In the previous two cycles in the 1950's, it was not necessary to invoke tight monetary and fiscal restraints until about three years after the upturn in economic output. A major factor contributing to the earlier occurence of balance-of-payments difficulties this time is the substantial rate of monetary expansion since early 1963. Money supply at the end of January 1964 was up 30 per cent over the level a year earlier. This has been reflected in strong import demand and a lag in the growth of exports behind imports as domestic demand siphoned off potential exports. It is also possible that the recent deficits might have been smaller if there had been more of a downward price adjustment in 1962 and 1963. This, presumably, would have aided export growth and encouraged consumption of domestic goods in lieu of imports. Although wholesale prices did decline 3 per cent during the last cycle, this compares with declines of 6 and 9 per cent in the 1954 and 1957 contractionary periods, respectively.

Besides the widening deficit on trade account, which has been basically due to imports rising faster than exports, Japan has been faced with rising net service payments on current account (as indicated below) and a declining trend in net capital receipts.

	1962	1963
Payments for Services	$1,441 million	$1,722 million
Receipts for Services	700	785
Deficit	$ 741	$ 937

Note: Current transactions for services; Japanese balance of payments, IMF basis.

Net long-term capital receipts, as measured on an exchange transactions basis, fell from $176 million in the second quarter of 1963 to $124 million in the third and $103 million in the fourth. In the first quarter of 1964, they were $68 million. Net short-term capital receipts have held up fairly well. But the Economic Planning Agency recently estimated that net capital receipts in fiscal 1964 (the year ending March 31, 1965) would be only $400 million. This would be $471 million below the $871 million level in fiscal 1963.

Japan is likely to face the problem of restoring balance of payments equilibrium during much of 1964, but on the basis of past experience, she should be able to do so successfully. The main question is 'how long will this process take,' and 'will additional tightening measures be necessary?'

Korea combats foreign exchange problem

The most serious economic problem that arose for Korea last year was a foreign exchange shortage. The problem became serious early in 1963 when international reserves began an accelerated decline. After reaching a peak of $214 million in March of 1962, reserves declined $46 million in the following nine months. In the first six months of 1963, however, the pace accelerated and reserves dropped $56 million. In September, reserves reached a low for the year at $107 million, and have since been held above that level by means of tight import controls and some special financing. The latter includes a $10 million loan from the First National City Bank of New York, a $6 million loan from Gulf Oil to the Korean Oil Corporation and a $5 million equity investment by Gulf in the KOC. At the end of April 1964, reserves totaled approximately $130 million.

The foreign exchange problem has, of course, been only the symptom of other unstabilizing forces operating in the economy. The basic cause of the problem relates to the excessive monetary expansion that has occurred in recent years. In 1962, credit claims on the Government and the private sectors each rose about 11 billion won compared to a money supply of 35 billion won at the end of 1962. During 1963, most of the credit expansion was in the private sector as domestic credit claims on this sector rose 7 billion won. As a result of this excessive expansion in recent years, wholesale prices rose 71 per cent from the end of January 1961 (just prior to a major reform of the exchange system on February 2, 1961) through the end of February 1964. This resulted in an overvalued exchange rate, which had the usual effect of stimulating a high volume of imports, not matched by an equivalent rise in exports, with a resultant decline in reserves.

Normally, export performance is poor when the exchange rate overvalues the domestic currency. But in the case of Korea, exports rose by substantial proportions--although more modestly in absolute terms--because of an export-import link system introduced by the Government in the fall of 1962 and because of a system of export subsidies. The link system served as a strong inducement to export, since many importers--who either needed scarce foreign materials to carry out their operations, or were able to make handsome profits from certain imported goods--were able to obtain import rights to the degree that they exported. Korea's exports in 1961, 1962 and 1963 were $41, $55 and $87 million, respectively. While the proportional increases are impressive here, they have to be set against total commodity imports for the same years of $316, $422 and $560 million, respectively. U.S. foreign aid has largely bridged the gap between imports and exports.

The foreign exchange problem began to affect some industries as they found themselves running short of raw materials. Some factories had to reduce their rate of output and in certain cases close down temporarily. After rising since August of 1961, industrial production, seasonally adjusted, showed signs of leveling off in the fourth quarter of last year.

The Korean Government finally took action on May 3, 1964, to improve the foreign exchange system. A unitary, fluctuating rate was established. Trading was light during the first two weeks after the reform and was carried out at a rate of 255 won to the dollar. Although the previous official rate was 130 won to the dollar, most trade was actually carried out under a complex multiple-rate system at rates of 180 to 210 won to the dollar. The black market rate at the time of the reform was about 250 won to the dollar. Foreign exchange certificates have been issued by the authorities against foreign exchange surrendered and part of the available reserves, with the price of the certificate reportedly being left free to find its own level in the market.

This move marks a major step forward in establishing a realistic exchange rate for Korea. There is good reason to believe that the step will be successful if the authorities can maintain domestic monetary stability and if they actually leave the rate free to find its own level on the basis of market forces.

Philippines confronted with a balance-of-payments problem

There have been increasing signs recently that the balance-of-payments situation in the Philippines has deteriorated. This follows a period of substantial improvement since early 1962. At that time, exchange controls were abolished, a more realistic exchange system was instituted, and an effective stabilization program was pursued. The result was a rise in exports, a marked reduction in the deficit on current account, and a general rise in the Central Bank's net international reserves. This program, on the whole, was successful.

But since about September of 1962, there has been an increased rate of monetary expansion and this finally began to affect the balance-of-payments situation last September. After rising generally since early 1962, international reserves (as measured by gross central bank and net commercial bank holdings of gold and foreign exchange) began to level off after August of 1963. Since November, they have trended down. From a peak of $162 million at the end of August, reserves declined to $105 million on April 29, 1964. It is disturbing that the decline should be occurring when: (1) Philippine exports are in their period of seasonal strength; (2) U.S. bank claims on the Philippines have been rising (up $96 million from $56 million at the end of September to $142 million at the end of February); and (3) Central Bank reserves (at $100 million at the end of March 1963) are still only equivalent to about two months of imports.

Despite a substantial improvement in the trade account last year due mainly to a rise in export earnings, the current account surplus according to preliminary exchange transactions data narrowed from $40 million in 1962 to $8 million in 1963 because of heavy payments for services. International reserves (gross central bank and net commercial bank holdings) rose $5 million during 1963. Exports were up 31 per cent in 1963, or from $556 to $727 million, and imports (f.o.b.) were up 5 per cent, or from $587 to $618 million. Payments for services, however, were $147 million higher in 1963 than in 1962, while service receipts were up only $24 million. Changes in other current account items, such as gold, U.S. Government expenditures, and Philippine Government expenditures, were relatively minor.

Part of the increase in payments for services (i.e., disbursements for "invisibles") was accounted for by higher payments for remittances, trade, and transportation. There are signs, however, that because of high Philippine tariffs and other factors, a substantial part of the disbursements represented payments in connection with undervaluation of imports or smuggling activities. One indication that the international reserve situation is actually worse than the data on current account indicate is the substantial rise in the errors and omissions item. Balance of payments data are not yet available for all of 1963, but during the first half of 1963, the net errors and omissions item was reported to be a minus $116 million (i.e., a debit item). This compares with a net credit item of $47 million during the same period in 1962. In calendar years 1960 and 1961, net errors and omissions were reported to be a minus $35 million and a minus $28 million, respectively.

The increase in export earnings last year was due about evenly to increases in export prices and volume. In terms of dollar earnings, exports of coconut products and wood increased the most, or by $77 and $40 million, respectively. Despite a substantial rise in sugar prices, earnings from sugar exports were only $25 million higher in 1963.

There are several other factors creating pressure on the balance of payments. The main one is the excessive monetary expansion that has occurred since September of 1962. Between October 1962 and December 1963, money supply rose 31 per cent. Last year, money supply rose ₱ 449 million, reflecting primarily a ₱ 938 million expansion in commercial bank credit, and a ₱ 193 million increase in credit to the public sector. Time and savings deposits, an offsetting factor, rose ₱ 478 million.

In addition, exporters are still confronted with the equivalent of a 10 per cent export tax. With a free market rate of 3.90 pesos to the dollar, and a 20 per cent surrender requirement at the official rate of 2.00 pesos to the dollar, the effective exchange rate for exporters is 3.50 pesos to the dollar. This has been the effective rate for exporters since May of 1962, and all goods since then have been imported at 3.90 pesos to the dollar.

The Central Bank has taken a few mild steps to restrain the rate of credit expansion. On August 5, commercial bank reserve requirements for time and savings deposits were raised from 5 to 6 per cent, and on September 11, the rediscount quotas of the commercial banks were reduced. Also, on February 7, the Central Bank ruled that beginning May 15, 1964, commercial banks would have to hold a special 30 per cent reserve against government deposits in the form of government securities. In addition, the authorities reduced substantially as of March 31, 1964, the amount of government deposits that banks can legally hold.

But it would appear that further steps may be necessary if equilibrium is to be restored to the balance of payments. It remains to be seen whether the central bank will be able to meet this challenge.

Indonesian stabilization stillborn

One of the significant developments in Indonesia last year was the complete failure of the long-awaited stabilization program. This was begun in May and was scrapped after the break in political and economic relations with Malaysia on September 21, but the program was a failure even before the break with Malaysia. This fact has been obscured by the paucity of recent unclassified economic data and the clash with Malaysia.

The program gave the appearance of being somewhat successful during June and July, largely because of a decline in prices and a rise in exports. But the price stability was largely due to the unloading of goods purchased earlier as sellers saw this as a good time to take profits, and to a drop in spending as people adopted a wait-and-see attitude in view of the announced stabilization program. The rise in exports in June and July stemmed primarily from the release of exports previously held back in anticipation of devaluation.

The announced stabilization measures included a devaluation of the rupiah, an increase in transportation, communications and electricity rates, and an increase in government salaries. Other specific stabilization goals relating to credit and monetary expansion were not announced publicly.

Because the Indonesians make public very little current, economic data, it is difficult to trace precisely the developments following stabilization. But from the data that is available, it is known that retail prices declined through mid-July and then began to rise again. Between mid-July and September 17 -- four days before the break with Malaysia -- retail prices rose 24 per cent. Rice prices moved up very rapidly and from mid-August through September 19 they increased 75 per cent.

Total exports excluding petroleum jumped to Rp. 2,201 million in July compared to a monthly average of Rp. 1,510 million in March-May 1963. But in August, exports were down to Rp. 1,955 million, and in September they fell further to Rp. 1,518 million.

In addition, the strengthening of the black market rate for the rupiah proved to be temporary. The rate appreciated from Rp. 1,050 to the dollar on May 22 to Rp. 900 on July 11, but by September 19 the rate had depreciated again to Rp. 1,050. The rate has since continued to depreciate and on April 30 was Rp. 1,750 to the dollar. On April 17, 1964, Indonesia made some adjustments in its exceedingly complex foreign exchange system. Somewhat more depreciated rates now prevail for exporters, tourists, payments for services, and certain other transactions. Despite these changes, the exchange rate system continues to overvalue the rupiah.

Burma moves toward full nationalization of the economy

During the past year in Burma, there was a sharp increase in the rate of nationalization of the economy. This development overshadowed all others in importance. Since Burma achieved its independence in 1948, its various Governments have committed themselves to promoting a socialist economy, but they had done relatively little to implement this commitment. Although General Ne Win assumed the reins of Government in March of 1962, relatively few steps were taken that year to nationalize the economy. It is believed that this was due in part to the restraining hand of Brigadier General Aung Gyi who looked with some favor on preserving the benefits of the private market economy. General Aung Gyi was forced out of the Government on February 8, 1963, and the socialization process was greatly accelerated.

The first step was to nationalize on February 23, 1963, all of Burma's 14 foreign-owned and 10 Burmese-owned banks. This was followed by a nationalization of the timber industry, the channeling of all products of local industries through government stores, the nationalization of the country's export and import trade, nationalization of the cigarette industry, government purchase of all private shares in joint venture corporations, and the monopolization by the Government during 1963 and 1964 of eleven major agricultural commodities including rice. Since October 1963, control of all imported and domestic consumer goods has been placed with the Government-owned People's Stores Corporation. Peasants are now required to sell their paddy and other major crops to government purchasers. In March and April of this year the Government nationalized all commodity distribution except for certain small businesses. Over 3,000 shops in 48 towns were affected by this action. As a result of these moves, many cooperative organizations have discontinued operations.

In addition to the above moves, which have hit the private sector hard, a new tax law was implemented in October. Under this law, a single, highly progressive tax schedule is now applied to all taxpayers -- whether individuals, partnerships, or corporations. Income ranging from $10,000 to $12,000 is taxed at a rate of 85 per cent and over $12,000 at a rate of 91 per cent. The law will undoubtedly hasten the demise of what is left of the private sector.

Currently some private industrial firms are hoping that they will be nationalized since they are operating at a loss. However, the Government refuses to let most of them close down for fear of worsening the already high rate of unemployment. Dissatisfaction with the latest developments is reportedly not limited to private businessmen. Some peasants have complained of the low prices paid by the Government for their products and the delays in obtaining cash.

It will probably be difficult to judge in the future how well the economy is doing under these various policies. Not only are current, comprehensive data lacking on industrial and agricultural output, but there are indications that government data since the fall of 1963 are not always reliable. For example, in the recent data released on the country's sown acreage, an increase of 8.6 per cent for crop year 1962/63 over the previous year is shown. Such a rate of increase appears highly unlikely, in spite of the official explanation that Burma has large, unused land resources and the government's agricultural development schemes have borne fruit. The largest annual increase in the past decade was 3.7 per cent in 1958/59 and the average annual increase between 1954/55 and 1961/62 was only 0.8 per cent.

In addition to the nationalization binge, there have also been some interesting monetary developments recently in Burma, stemming to a large extent from the nationalization activities. After remaining relatively stable during 1960/61, money supply increased 10 per cent in 1962 and 43 per cent in 1963. The latter increase is very unusual for Burma and reflects mainly a sharp increase in government borrowing from the central bank. The expansion of money supply was retarded by the growing public preference for currency over deposits. During 1963, currency rose from 70 per cent to over 80 per cent of total money supply. With the nationalization of all commercial banks, people have evidently preferred to hold an increasing share of their funds in the form of banknotes. Demand and time deposits, and all loans of commercial banks, declined in 1963.

The public may have preferred to hold currency because of fears that bank deposits might be frozen, as has happened in a number of countries which have experimented with currency reform. The Burmese Government was no doubt faced with a buildup of inflationary pressure through the sharp expansion of deficit financing, even though this was not reflected in official price indexes. These are suspect, however, since many basic commodities are subject to price controls and much of the distribution system is now in the hands of the Government. In this situation, inflation is manifested in the form of shortages, not price increases. There have been reports of various shortages in Burma, including even rice shortages in some parts of the country.

The holders of currency did not find the security they were probably seeking--at least if they held notes of a denomination of 50 kyat or larger ($10.50 at the official rate, and only about $6.80 at the Hong Kong rate.) On May 17, 1964, the government demonetized the 50 and 100 kyat notes. At first, they permitted conversion to smaller notes of an amount up to 500 kyats ($125), but this was soon reduced to only 200 kyats ($42), and on May 20th, the conversion privilege was completely suspended. Holders of the demonetized notes have been asked to submit lists of their notes, and the Government will apparently decide on any refunds in legal tender on a case-by-case basis. Rough estimates indicate that this move will demonetize about one-third of the money supply.

The Burmese action apparently reflects an awareness of the Government of the mounting inflationary pressure which has been generated over the past year. The remedy amounts to a drastic capital levy which falls on those individuals who had chosen to hold their wealth in the form of paper money rather than in gold, commodities, real estates or bank accounts. It is somewhat reminiscent of a move taken by Indonesia in August 1959. The Indonesian Government decreed a 90 per cent reduction in the value of all large-denomination notes as part of an anti-inflationary program. At the same time, it blocked 90 per cent of all bank deposits in excess of 25,000 rupiah. The main result of the Indonesian action was to virtually immobilize economic activity in the monetized sector of the economy. The deflationary effects were shortlived. Although the reform cut money supply by 38 per cent in one fell swoop, by the end of the year, money supply had again risen to the pre-reform level. It continued to rise at a rapid rate in 1960, as did consumer prices.

The Burmese action, like the Indonesian, cannot be expected to produce anything more than a temporary deflationary impact. The inflationary pressures will no doubt reappear very quickly if the creation of new money proceeds at the same pace that it has in past years.