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Economic Intelligence Report

PROSPECTS FOR SOVIET-JAPANESE TRADE



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FOREWORD

This report is based to a large extent on information contained in official government announcements and press releases emanating from Tokyo and Moscow. The statistical data were derived from the UN Commodity Trade Statistics and the US Department of Commerce Country-by-Commodity Series.

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PROSPECTS FOR SOVIET-JAPANESE TRADE*Summary and Conclusions

Negotiations have been concluded recently in Moscow for a new long-term Soviet-Japanese trade agreement to replace the 3-year agreement which expired in December 1962. The new agreement does not provide for any substantial increase in Soviet-Japanese trade and should not lead to any significant increase in Japanese dependence on the USSR either as a market or as a source of supply.

Both economic and political factors will limit the expansion of Soviet-Japanese trade. Japan has been faced with a growing unfavorable balance in its total trade as well as in trade with the USSR. The Japanese government's recent liberalization of quantitative restrictions on commodities could lead to a further deterioration in its balance-of-payments position. To counteract this trend, Japan is currently employing foreign exchange controls and exerting pressure on private business to forestall undue expansion of imports. The expected limitation of imports from the USSR, especially imports of crude oil and timber, will also reduce the possibility of any Japanese dependence on Soviet supplies. Moreover, even if trade is expanded as much as Soviet announcements envisage, this exchange will continue to represent only 2 to 3 percent of total Japanese trade.

On the other hand, increased competition in Free World markets, especially from the European Economic Community (EEC) countries, greater difficulties in marketing in the EEC area itself, and US restrictions on imports from Japan all provide support for the various commercial and leftist groups in Japan that desire closer ties with the Soviet Bloc. In view of these current difficulties, Soviet offers to permit Japanese participation in the development of Siberia appear inordinately appealing. It is probable, however, that many of the problems currently being encountered in Free World areas can be mitigated through negotiations with the countries involved and that, in any event, their impact would not be sufficiently great to warrant the risks involved in shifting a greater share of Japanese trade to Bloc markets. The Japanese government's fear that economic dependence will lead to greater susceptibility to Soviet political pressures, coupled with continuing efforts by the US government to discourage any substantial increase in Japanese-Bloc

* The estimates and conclusions in this report represent the best judgment of this Office as of 1 May 1963.

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economic relations, should effectively limit the expansion of Japanese trade with the USSR.

In addition to the factors limiting total trade between Japan and the USSR, there are factors that are peculiar to specific commodity trade. Fear of economic dependence on the USSR has restricted the expansion of crude oil imports from the USSR. As a result, exports of steel pipe, which the USSR tried to link to Japanese oil purchases, have also been restricted. Rising domestic production coupled with diminished requirements has reduced Japanese requirements for imported pig iron. Finally, competition from third countries has reduced Japanese requirements for imports of Soviet timber.

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I. Background and Current Structure of Trade

The Japan-USSR Joint Declaration of December 1956, which terminated the state of war and reestablished diplomatic relations, created a basis for the expansion of economic relations between the two countries. The Declaration provided that the countries should place their trading and commercial relations on a "stable and friendly basis" as soon as possible. Subsequent negotiations led in 1957 to the signing of a 1-year trade agreement -- Japan's first trade agreement with a Communist country. This agreement called for trade of \$30 million each way with the settlement of any imbalance to be made in pounds sterling. Japan and the USSR also signed in 1957 a 5-year Treaty of Commerce and Navigation, which guaranteed most-favored-nation treatment and allowed exceptions only if they were necessary to protect the national security (a concession to Japan's COCOM commitments) or the international financial reserve of either country.

A protocol signed in 1958 extended the original trade agreement for another year and set the total trade turnover for 1959 at \$70 million. During the negotiations for this protocol the USSR encouraged the Japanese to import products from the Soviet Far East, mainly raw materials, rather than goods from the European USSR, which it could sell more profitably in the markets of Western Europe.

In March 1960 a 3-year trade agreement, covering 1960-62, was signed. It called for trade valued at \$210 million each way during this period with the total turnover for 1960 to be \$125 million. The agreement further stipulated that all necessary payments between the two countries would be effected in convertible currencies. During the negotiations, Japan agreed in principle to extend credits of an undetermined amount on terms similar to those granted to the USSR by Western European countries. The trade quotas for 1961 and 1962, determined in later protocols to the original agreement, differed from previous arrangements in that they provided for an unbalanced trade. Total trade for 1961 was to be \$160 million, with Japanese imports valued at \$75 million and Japanese exports at \$85 million, and for 1962 these goals were set at \$105 million and \$120 million, respectively. The planned export surplus included in these recent agreements represents a Japanese attempt to offset partially the large import balances accumulated in its trade with the USSR since 1958. Japan's imports exceeded the plan during every year after 1959, whereas its exports reached the planned level only in 1962. As a result, imports from the USSR increased by 268 percent, from \$39 million in 1959 to \$145 million in 1961, and exports grew only from \$23 million to \$65 million (an increase of 184 percent).

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The imbalance in Soviet-Japanese trade is viewed with some concern by the Japanese government as a factor contributing to the deterioration of its over-all balance-of-payments position. The rapid expansion of the Japanese economy, which began in 1958 and was further accelerated by Prime Minister Ikeda's program to double the national income by 1970, contributed to a rapid rise in over-all imports at a time when unfavorable foreign market conditions (particularly in the US and Southeast Asia) and a strong domestic demand led to a slackening in exports.

A substantial portion of the increase in Japanese imports from the USSR can be attributed to the expansion in purchases of Soviet fuels from \$7.7 million in 1959 to \$60 million in 1961 (representing 19 percent and 41 percent, respectively, of total Japanese imports from the USSR). Crude petroleum accounted for most of this increase, rising from 4 percent of total imports in 1959 to 23 percent in 1961. Imports of Soviet petroleum were encouraged in part by a foreign exchange allocation system* which favored low-priced supplies without regard to the transportation cost involved. Imports of pig iron also increased substantially from \$0.7 million in 1959 to \$27.6 million in 1961. Manufactured goods in general increased from \$5 million in 1959 to \$36 million in 1961.

In spite of the rapid expansion of Japanese trade with the USSR from \$22 million in 1957 to \$211 million in 1961, it is still only a small portion -- 2 percent -- of total Japanese trade. By comparison, the US, Japan's most important trading partner, accounts for about 30 percent of Japan's total trade, while other Asian countries (excluding Communist Asia) account for about 25 percent of Japan's trade (see Tables 1 through 3**).

Japan exports mainly manufactured goods and machinery (85 percent of total exports in 1961), while its imports consist primarily of raw materials and fuels (63 percent of total imports). Its commodity trade with the USSR has followed this basic pattern, with exports consisting mainly of iron and steel (26 percent), ships (6 percent), other machinery and transportation equipment (33 percent), staple and artificial fibers (6 percent), and yarns and thread of synthetic fibers (8 percent), while its imports have been mainly oil (crude, 23 percent; petroleum products, 9 percent), pig iron (19 percent), coal (9 percent), and lumber (16 percent) (see Tables 4 and 5***).

* See IV, B, p. 12, below.

** Pp. 19 through 21, below.

*** Pp. 22 and 23, respectively, below.

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II. Pressures for Increased Soviet-Japanese Trade

Anticipating the negotiations for a new trade agreement for 1963, the USSR, with the support of Japanese leftist groups, for many months has been pointing out the advantages for Japan of an expansion of its trade with the USSR. Soviet offers to expand trade, especially in the new market to be developed in Siberia, are even more appealing when contrasted with the increasing restrictions that Japanese exports are facing in other countries, particularly the US and the European Economic Community (EEC) countries.

A. Japanese Participation in the Development of Siberia

In 1957 the USSR recommended to Japan that it try to expand its trade with countries that still had underdeveloped areas to be built up rather than with countries that were, in fact, its trading rivals. In line with this recommendation the USSR suggested the possibility of Japanese participation in the development of Siberia. Soviet negotiators reasoned that the development of Siberia would mean not only a new market for Japan but also a nearby one where Japanese goods could compete more effectively with those from Western Europe.

Soviet promotional efforts continued to increase and finally led, in August 1962, to the visit of a Japanese industrial mission to the USSR to investigate the actual possibilities for Japanese contribution to the development of Siberia. Although several contracts important to over-all Japanese-Soviet trade were signed during this trip, little progress was made in the plans for Siberian development.

A key stipulation in Soviet proposals for the development of Siberia has been that Japan supply equipment on credit with payment to be made later with the goods that are produced in the newly established Siberian industries. The most important project of this type and the one most frequently discussed is the Siberian oil pipeline that allegedly is to be built from Irkutsk to Nakhodka. The USSR wants Japan to supply the pipe for this line on credit to be repaid with Soviet crude oil that is shipped through the finished line. Soviet insistence upon credit terms and Japan's reluctance to accept increased supplies of Soviet oil thus far have been the major obstacles to any agreement on Japanese participation in Siberian development.

B. Restrictions on Japanese Trade with the US

Japan, faced with a growing trade imbalance, is concerned about the serious consequences for its exports of any dislocation in its trade with the US, which now takes about 25 percent of total Japanese exports. The Japanese government is particularly apprehensive that the current consolidation of the US tariff list will result in higher tariffs for

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some Asian goods; the US, however, has tried to reassure the Japanese government by promising to lower tariff rates on other goods in compensation for those that are raised in the list. In addition to the tariff restrictions placed on Japanese exports by the US, there are also voluntary Japanese restrictions which control the level of exports of some goods. For example, since 1956 Japanese industry has observed a gentleman's agreement to limit its exports of cotton textiles to the US. Voluntary controls on exports cover about 40 percent of Japan's exports to the US and have caused additional discontent among Japanese businessmen.

Moreover, faced with a balance-of-payments problem of its own, the US recently has been trying to reduce its imports through its "Buy American" campaigns, and this policy has already affected Japan's foreign earnings. Although the US government has assured Japan that this is only a temporary policy, at recent US-Japanese trade talks there was no indication that the campaign would be abandoned soon, but instead Japan was urged to liberalize its quantitative controls on imports even further.

C. Impact of the EEC on Japan

The successful development of the EEC poses a double threat to the future expansion of Japanese exports in that the Japanese fear not only a reduction in their exports to the countries of the EEC but also increased competition from these countries in other markets, particularly in underdeveloped areas. The USSR has played frequently on these fears by stressing actions of the EEC countries that are detrimental to Japan. Soviet spokesmen have drawn attention to the rejection of most-favored-nation treatment for Japan by the EEC's employment of the General Agreement on Tariffs and Trade (GATT) exception clause, Article 35 (see below); to the imposition by the EEC of dual duties and other restrictive measures against imports of those Japanese goods that are competitive with indigenous European products; and to alleged EEC dumping activities in Japan's traditional markets in Southeast Asia.

Although the value of Japanese exports to the EEC has been growing steadily and the EEC has been taking an increasing share of Japanese exports, the Japanese have been worried because the rate of growth of their trade with the EEC has been falling. Japanese exports to the EEC countries grew from \$139 million in 1957 to \$213 million in 1961 and were expected to reach \$230 million by 1962. The EEC's share of total Japanese exports rose to 5.0 percent in 1961 and was expected to reach 5.2 percent in 1962. At the same time, however, the rate of growth fell from 30 percent in 1960 to 20 percent in 1961 and may have dropped as low as 8 percent in 1962.

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The main restriction on Japanese trade with the EEC has been Article 35 of GATT, which allows members to approve the membership of a new country without granting that country full GATT concessions. When Japan became a member of GATT, 14 countries, including all of the EEC countries and the UK, invoked Article 35 and under it refused to extend most-favored-nation treatment to Japan. Since then, Germany has in effect given Japan most-favored-nation treatment and the UK, as a result of recent negotiations, soon will grant the same privilege. Italy maintains normal GATT relations with Japan but enforces other discriminatory measures against it, while the Benelux countries* invoke Article 35 but limit their discrimination to a small number of items. Only France continues to enforce large-scale discrimination against Japan; it still has 270 items on its negative list.

Japan hopes to find a temporary solution to these problems through negotiations with the individual countries rather than with the EEC Commission because the present discriminatory policies are national in character rather than part of a common EEC policy and also because Japan believes that the powers of the Commission are still rather limited. Individual negotiations are to be initiated soon with Belgium-Luxembourg and with France, and several of the EEC countries have already indicated their willingness to replace Article 35 with "sensitive lists" of Japanese goods, the import of which they feel would be disruptive to their economies.

When the EEC's common tariff is fully applied, however, Japan will face additional barriers that cannot be offset through negotiations with individual countries. Although the common agricultural policy will not have much impact on the type of agricultural products that Japan exports, the common external tariff on manufactured goods will apply to a large part of Japan's exports to the EEC -- in 1961, manufactured goods and machinery made up almost 60 percent of Japanese exports to the EEC countries. Although the total result of the common external tariff will be a lower effective tariff, Japan, because of its pattern of trade with the EEC, will face higher over-all tariffs. Almost 40 percent of Japan's exports of manufactured goods and machinery to the EEC are purchased by the Benelux countries, whose tariff rate will increase substantially when the common external tariff is applied, while another 45 percent of these exports go to Germany, whose tariffs also will increase somewhat. Unfortunately for Japan, the effect of these increased tariffs will not be offset by lower rates in Italy and France: these countries currently absorb only 15 percent of Japanese exports in these categories.

At least in the short run, however, perhaps the most serious problem confronting the growth of Japanese exports to the EEC will arise

* Belgium, the Netherlands, and Luxembourg.

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as a result of the simultaneous elimination of tariff barriers within the EEC. Further increases in intra-EEC trade expected at this time undoubtedly will occur partly at the expense of trade with third countries such as Japan.

III. Factors Limiting Soviet-Japanese Trade

The issues that prolonged the recent Soviet-Japanese negotiations for a new trade agreement include the following: renewal of the most-favored-nation clause; the period of time to be covered by the agreement; Japan's unfavorable balance of trade; Soviet requests for credits; and the desire of the USSR to increase exports of raw materials, especially oil and timber. The disadvantages associated with these issues apparently outweigh the advantages to Japan of increased trade with the USSR and will limit any immediate expansion of Soviet-Japanese trade. Political pressures, especially from the US, also will serve to limit expansion of this trade.

A. Most-Favored-Nation Treatment

The Treaty of Commerce and Navigation which established most-favored-nation treatment between Japan and the USSR was due to expire in May 1963, and a preliminary discussion of its provisions was undertaken during the recent negotiations for its renewal. Although many Japanese feel that the benefits of the most-favored-nation clause accrue mainly to the USSR, it is unlikely that this clause will be eliminated. The USSR, apprehensive that Japan might try to cancel the clause, pressed for the elimination of the cancellation provisions in the Treaty, but the Japanese delegation apparently rejected this proposal.

B. Duration of the New Agreement

In keeping with its long-term planning procedures, the USSR suggested that the new agreement cover a minimum of 5 years or even a 7-to-10-year period. The Japanese government, on the other hand, prefers that its commitments not exceed a period of 3 years. The USSR offered to purchase nine chemical plants if the Japanese would extend the agreement from 3 years to 5. The Japanese, however, have continued to oppose any extension, and the USSR has given in on this point.

C. Japan's Unfavorable Balance of Trade

Faced with an increasingly unfavorable balance of trade, both in its over-all trade and in its trade with the USSR, Japan has been forced to give primary consideration to the achievement of a balance in its trade accounts. It is likely that fulfillment of this basic goal will rule out any significant increases in Soviet-Japanese trade in the immediate future.

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The difficulties encountered by Japan in its attempt to solve its balance-of-trade problem -- and indeed the development of the problem itself -- derived in large part from the pursuance of two other important policy objectives: Prime Minister Ikeda's plan to double Japanese national income by 1970 and the trade liberalization program. Whereas capital investment was the most significant factor determining the rapid rate of expansion in the Japanese economy during 1960-61, the program placed serious strains on the Japanese balance of payments (see Table 6*). Investments in plant and equipment increased in 1960 and 1961 by 45 and 38 percent, respectively, contributing to increases in imports of machinery of about 15 and 50 percent during the same years. Moreover, imports as a whole increased 25 percent in 1960 and 29 percent in 1961 compared with a growth in exports of only 18 percent in 1960 and a sharp drop to 4 percent in 1961.

Simultaneously, the Japanese government, under heavy pressure from the other industrialized nations of the Free World to liberalize its controls on imports, agreed to eliminate quantitative restrictions on commodities comprising 90 percent of the value of its imports in 1959.** This commitment, which was made to the International Monetary Fund, was only partially honored, 88 percent liberalization having been achieved by the October 1962 deadline, with action on the more "sensitive" items still pending. Fears of the Ministry of International Trade and Industry and other vocal Japanese groups that liberalization would lead to harmful increases in imports of the goods freed, although often excessive, have been further nurtured by the continuation of Western import restrictions on the products in which Japan is most competitive.

As a means of slowing down new investment in plant and equipment and improving its international payments position, the Japanese government in late 1961 adopted a tight money policy which has succeeded in recent months in curbing the implementation of investment plans and in bringing about a decline in imports. Simultaneously, the export picture has improved as a result of increased efforts by Japanese businessmen to supplement falling domestic demand through increased foreign sales. The government also has taken steps to offset the expected results of the recent liberalization. In June 1962 an extensive increase in tariff rates went into effect, and the government is considering another increase on

* P. 24, below.

** The liberalization program does not apply to goods that were not imported in 1959, a year when imports of many goods were severely restricted. The 10 percent not freed probably represents a greater share of Japanese trade today than it did in 1959. In addition, the liberalization did not benefit all of Japan's trading partners equally: there are still 262 items that have not been liberalized, including goods such as automobiles and television sets, which the US would like to sell in Japan.

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the commodities recently liberalized. In order further to limit imports, a "Buy Japanese" campaign has been launched and reductions have been made in the foreign exchange budget for imports.

To supplement the general measures taken to correct its payments problems, the Japanese government also has attempted to regulate trade with specific countries with which it has an unfavorable balance. Japan has incurred an import surplus in its trade with the USSR during every year since normal trade relations were established. Although the Japanese government has tried to correct this situation by insisting that the trade agreements provide for balanced trade, this procedure has proven ineffective inasmuch as Japanese imports generally have exceeded those planned while exports have fallen below the planned level (see Table 7*). In an attempt to offset deficits incurred earlier, the trade agreements covering 1961 and 1962 called for a surplus of Japanese exports to the USSR. The record for 1961 indicates an increase, however, in the unfavorable balance of trade with the USSR, and, although a great improvement was effected in 1962, it is not known as yet if the export surplus materialized as planned. Moreover, it is possible that the USSR will attempt to maintain its export surplus in trade with Japan as a means of earning convertible currencies to cover payment deficits in trade with other Free World countries, particularly in the underdeveloped areas.

Japan also has tried to influence the balance of trade through revisions in the commodity lists accompanying the trade protocols. Inasmuch as the USSR usually pays cash for raw materials and semiprocessed goods (while insisting on deferred payment terms for machinery and equipment), the 1961-62 lists increased the proportion of these goods in the total of Japanese exports to the USSR. In 1962, Japan also placed further limitations on imports of several key commodities from the USSR: planned oil imports were set at 3.4 million tons** which, although double the figure planned for 1961, represented an increase of only 17 percent above the actual imports during that year; planned imports of timber were reduced to half of their 1961 level; and planned purchases of pig iron were cut from 500,000 tons in 1961 to 200,000 tons in 1962.

D. Soviet Demands for Credits

In negotiating sales to the USSR, particularly of capital equipment, the Japanese have been confronted with Soviet demands for credit terms "equal to those offered by the countries of Western Europe." Japanese businessmen have been especially sensitive to the implication that their European competitors have been permitted to arrange more liberal credit terms.

* P. 25, below.

** Tonnages are given in metric tons throughout this report.

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As a result of pressures from these groups -- and against the background of the Japanese government's claim that it has been unable to determine the actual terms provided by Western European countries -- Japanese contracts on occasion have carried easier credit terms than those permitted by most Western countries. In fact, the NATO countries have agreed to ban the extension of government-to-government credits to Communist countries (with the exception of credits provided for in PL 480 agreements) and to guarantee only medium-term loans (2 to 5 years). The only exceptions to the NATO agreement involve deliveries of ships and aircraft, but there is no known instance of utilization of this clause. Only two Italian credits, which were slightly in excess of 5 years, are known to have been granted over the prescribed limitations.

Japan's limited foreign exchange reserves, coupled with pressures from the US, have been instrumental in the Japanese government's decision to tighten its credit policies toward Bloc countries. Recently the Ikeda government imposed a ceiling on outstanding medium-term credits to the USSR. Although this ceiling, which is to increase from \$230 million in 1962 to \$368 million by 1965, seems unduly high relative to the level of trade between the two countries, it is possible that the full amount available will not be drawn. The government also has taken other steps to tighten the easy credit terms previously granted to Bloc countries. An export application involving a relatively small delivery of ships, for example, recently was rejected because the company requesting it had granted terms to a Communist country that were too liberal. The government announced that it will permit delivery on the earlier contract for ships valued at \$96 million carrying terms of 30 percent down with 6 years to pay but would from now on insist on 30 percent down with the remainder to be paid over 5 years.

IV. Limitations on Trade in Selected Commodities

Since the unilateral renunciation by Communist China of its trade agreement in 1958, the Japanese government has been particularly sensitive to the argument -- propounded especially by the US -- that it is unwise to permit a growth in dependence on trade with a Bloc country, either in general or in specific commodities. This principle, coupled with a myriad of domestic economic forces, has served to place limitations on the growth of Japanese trade with the USSR in several of those commodities that traditionally have provided the major basis for the exchange.

A. Steel Pipe

The Soviet proposal that Japan supply the pipe for a pipeline in the Soviet Far East has offered Japanese steel producers an opportunity to increase substantially their exports to the USSR. In 1961 an

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agreement involving Japanese exports of 28-inch steel pipe and associated pipeline equipment valued at \$250 million, to be repaid with 17 million to 18 million tons of Soviet crude oil over a 3-to-5-year period, appeared to be imminent. The agreement, however, was not concluded, because of the unwillingness of the Japanese to commit themselves to substantially increased imports of Soviet crude oil. The completed pipeline, with all pumping stations in place, would have an annual capacity of 18 million to 20 million tons, of which the USSR insisted Japan must take at least 10 million in order to make the pipeline profitable. The USSR does not consider this pipeline as a part of its Seven Year Plan (1959-65) and has left the initiative for any new developments on this project solely to the Japanese.*

Recent Soviet difficulties in obtaining sufficient quantities of large-diameter pipe for oil and gas pipelines, caused by inadequate domestic supplies and NATO restrictions on exports of large-diameter (above 19-inch) pipe to the USSR, resulted in renewed Soviet efforts to purchase such pipe in Japan. Thus far, Japanese industry has offered to sell the USSR 43,400 tons, of which the Japanese government reportedly has approved the sale of 25,000 tons, valued at \$3.8 million.

Reports of the Japanese government's approval of these sales to the USSR met with immediate opposition from the NATO countries, which had just adopted a resolution that "to the extent possible" they would stop deliveries of large-diameter pipe to the Soviet Bloc under existing contracts and would prevent new contracts. It was feared that pressures from steel manufacturers and other commercial interests in Western Europe would make it impossible for their governments to adhere to the resolution should the USSR be able to obtain an alternate source of supply in Japan. Although not a member of NATO, as a result of pressures from the US and Western Europe the Japanese government apparently has agreed at least for the time being to limit exports of pipe to the USSR to the 25,000 tons already committed.

B. Purchases of Soviet Crude Oil

Since the first Japanese purchase of Soviet crude oil in late 1958 (11,000 tons from Sakhalin), these imports have grown until they are now Japan's most important import from the USSR. In 1961, purchases of Soviet crude oil constituted 23 percent of total Japanese imports from the USSR and accounted for 6.4 percent of total Japanese crude oil imports.

* For the limitations on the expansion of Japanese imports of Soviet crude oil, a factor on which the Far East pipeline apparently depends, see B, below.

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The fear that economic dependence on Soviet oil could lead to political pressures from the USSR and the desire to expand the share of the domestic market for the Japanese-owned Arabian Oil Company have been important factors, however, in the formulation of the policy of the Japanese government to limit imports of Soviet crude oil to a maximum of 10 percent of the Japanese market. During the recent trade negotiations with the USSR the Japanese delegation actually tried to lower the oil import quota for 1963. Under Soviet pressure, however, Japan agreed to increase the planned imports of oil to 3.5 million tons rather than expand its imports of other raw materials. Although the new figure is about 13 percent above estimated actual imports in 1962 (about 3.1 million tons), it represents a declining percentage of Japan's growing oil imports and little more than the quota originally planned for 1962 (3.4 million tons).

The Japanese government feared that the lifting of controls on crude oil, which was to be part of the general liberalization in October 1962 (the benefits of which would have to be extended to the USSR because of the most-favored-nation agreement between the two countries), would lead to an influx of low-priced Soviet crude oil. Although postponement was considered, the government finally approved the liberalization of crude oil, hoping that other factors would limit the feared expansion.

The liberalization program itself eliminated use of the foreign exchange allocation system which had contained features advantageous to Soviet suppliers of crude oil. This system had been designed in part to encourage oil companies to find low-cost supplies by rewarding those companies that imported oil at low f.o.b. prices with a larger share of foreign exchange at the next allocation. Although Soviet crude oil on a c.i.f. basis was only slightly cheaper than that of other suppliers, the longer haul for Soviet oil resulted in a lower imputed f.o.b. price, making it doubly attractive under the exchange allocation system.

A more serious factor limiting further increases in imports of Soviet crude oil is the continued preeminence of Western suppliers in the Japanese market. Inasmuch as long-term contracts between these suppliers and Japanese firms account for about 85 percent of the Japanese crude oil market, Western companies are able to exert considerable pressure on their Japanese affiliates to limit purchases of competitive crude oils. In addition, Western companies have refused to refine Soviet crude oil in their facilities, thus limiting the ability of Japanese firms to handle these imports. Even the Japanese company Idemitsu Kosan, the largest importer of Soviet crude oil and not an affiliate of a Western firm, must be responsive to some degree to Western pressures inasmuch as it buys a major portion of its oil from Western sources.

Another potential means of limiting the expansion of imports of soviet crude oil by independent companies is through implementation of a

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new law which gives the Ministry of International Trade and Industry broad regulatory powers over that industry. It has already been suggested that one of the clauses in this law, which requires permission from the Ministry of International Trade and Industry before refiners can expand or alter their facilities, be used to limit the expansion of the refining capabilities of Idemitsu Kosan. US pressures have also been brought to bear on Japanese importers of Soviet crude oil. For example, in 1961 the US government canceled a jet fuel supply contract with Idemitsu Kosan, in order to "avoid giving any encouragement whatsoever to the expansion of Soviet oil exports in Free World markets."

C. Coal and Pig Iron

The magnitude of Japan's imports of coal and pig iron from the USSR in the past has been dictated by its desire to increase sales of steel to the USSR. Although the USSR continued to insist during the recent trade talks that its steel purchases be tied to continued Japanese acceptance of Soviet raw materials, high inventories and the generally depressed conditions in the Japanese steel industry have forced the government to pursue a more restrictive policy in regard to future imports of both coal and pig iron.

Japan, which has already taken measures to protect its depressed domestic coal industry, is now supplementing these measures by efforts to reduce purchases of coal from foreign sources. Supplies of coal from Sakhalin are readily expendable, inasmuch as they are of a relatively poor quality and can be replaced easily by coal from low-grade domestic deposits. The Japanese desire to decrease imports of Soviet coal is reflected in the quotas contained in the new trade agreement, which call for imports averaging a little less than 1 million tons annually for the next 3 years compared with the 1962 quota of 1.4 million tons.

The recent expansion of domestic production of pig iron coupled with surpluses resulting from the fall in demand for steel have led to lower requirements for imports of pig iron as well. The need to reduce imports of pig iron and to trim existing commitments wherever possible resulted in the establishment of a quota for 1963 calling for Japanese imports of 500,000 tons of Soviet pig iron (reflecting little if any increase over actual imports in 1962) and in the Japanese refusal to take more than 100,000 tons after 1963. Soviet opposition to these low figures resulted in the omission from the final agreement of any quotas for 1964 and 1965.

D. Timber

Imports of timber represent a significant but declining share of total Japanese imports from the USSR. Although imports of timber increased

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in value terms from \$12.3 million in 1959 to \$23.6 million in 1961, their share of total trade fell from 31 to 16 percent during this period.

Japanese importers of timber, expecting an increase in domestic demand and higher prices in 1962, signed several long-term contracts with suppliers in the Soviet Far East. Because of an influx of lower priced US timber, a decline in domestic prices, and the government's tight money policy, these importers found themselves overcommitted and had to appeal to the Soviet government for reductions in the price and volume of their import commitments and for a delay in payment. The Soviet government at first refused to grant any concessions and threatened to suspend its imports of Japanese goods if contracts were not honored. Later it offered to reduce the price of ordinary and pulp lumber on condition that the Japanese take delivery of the entire amount contracted for in 1962. Some Japanese businessmen accepted this offer, but others insisted on greater concessions if they were to meet their commitments at all. The USSR finally agreed to defer deliveries of timber under the 1962 quota until the first quarter of 1963.

In the recent trade talks the USSR renewed its demands that Japan increase its timber imports. Japan has refused and instead has offered to buy 1.8 million tons in 1963, which is only a slight increase over actual purchases in 1962 (1.6 million) and a decrease from the amount planned for that year (2.0 million).

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APPENDIX

STATISTICAL TABLES

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Table 1
Geographic Distribution of Japanese Trade ^{a/}
1956-61

Country	1956		1957		1958		1959		1960		1961	
	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total
Free World	5,549.8	97.1	6,955.7	97.5	5,742.9	97.4	6,944.4	98.7	8,348.0	97.7	9,726.6	96.8
Of which:												
US	1,613.4	28.2	2,228.4	31.3	1,745.5	29.6	2,162.6	30.7	2,661.6	31.1	3,169.3	31.5
Canada	213.1	3.7	231.3	3.2	197.3	3.3	267.6	3.8	323.0	3.8	382.4	3.8
EEC ^{b/}	217.5	3.8	364.2	5.1	270.9	4.6	313.4	4.4	383.7	4.5	524.6	5.2
UK	129.5	2.3	171.6	2.4	164.0	2.8	206.2	2.9	219.7	2.6	251.8	2.5
Other EFTA ^{c/}	69.4	1.2	131.4	1.9	104.9	1.8	122.2	1.8	166.4	1.9	214.7	2.1
Free World Asia	1,606.4	28.1	1,882.9	26.4	1,595.2	27.1	1,902.6	27.0	2,221.7	26.0	2,359.6	23.5
Sino-Soviet Bloc	167.7	2.9	173.4	2.5	152.6	2.6	95.7	1.3	198.4	2.3	320.2	3.2
Of which:												
USSR	3.6	0.1	21.6	0.3	40.3	0.7	62.5	0.9	147.0	1.7	210.8	2.1
Total	<u>5,717.6</u>	<u>100.0</u>	<u>7,129.0</u>	<u>100.0</u>	<u>5,895.5</u>	<u>100.0</u>	<u>7,040.2</u>	<u>100.0</u>	<u>8,546.4</u>	<u>100.0</u>	<u>10,046.8</u>	<u>100.0</u>

a. Because of rounding, figures may not add to the totals shown.

b. European Economic Community (the Benelux countries -- Belgium, the Netherlands, and Luxembourg -- France, Italy, and West Germany).

c. European Free Trade Association (Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and the UK).

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Table 2

Geographic Distribution of Japanese Exports a/
1956-61

Country	1956		1957		1958		1959		1960		1961	
	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total
Free World	2,419.4	97.1	2,773.6	97.4	2,792.3	97.4	3,412.7	99.0	3,981.5	98.2	4,132.8	97.6
Of which:												
US	549.4	22.0	603.7	21.2	688.9	24.0	1,047.7	30.4	1,107.4	27.3	1,072.7	25.3
Canada	69.1	2.8	63.7	2.2	76.1	2.7	114.1	3.3	119.2	2.9	116.6	2.8
EEC <u>b/</u>	106.4	4.3	139.0	4.9	122.4	4.3	133.0	3.9	174.6	4.3	212.7	5.0
UK	63.0	2.5	73.1	2.6	104.6	3.6	102.8	3.0	120.6	3.0	114.7	2.7
Other EFTA <u>c/</u>	42.4	1.7	79.9	2.8	64.9	2.3	77.3	2.2	108.0	2.6	128.9	3.1
Free World Asia	966.5	38.8	1,088.0	38.2	983.9	34.3	1,109.3	32.2	1,306.8	32.2	1,384.6	32.7
Sino-Soviet Bloc	73.3	2.9	75.7	2.6	73.4	2.6	32.9	1.0	73.4	1.8	103.1	2.4
Of which:												
USSR	0.8	0	9.3	0.3	18.1	0.6	23.0	0.7	60.0	1.5	65.4	1.5
Total	<u>2,492.6</u>	<u>100.0</u>	<u>2,849.3</u>	<u>100.0</u>	<u>2,865.8</u>	<u>100.0</u>	<u>3,445.6</u>	<u>100.0</u>	<u>4,054.9</u>	<u>100.0</u>	<u>4,235.9</u>	<u>100.0</u>

a. Because of rounding, figures may not add to the totals shown.

b. European Economic Community (the Benelux countries -- Belgium, the Netherlands, and Luxembourg -- France, Italy, and West Germany)

c. European Free Trade Association (Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and the UK).

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Table 3
Geographic Distribution of Japanese Imports a/
1956-61

Country	1956		1957		1958		1959		1960		1961	
	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total	Million US \$	Percent of Total
Free World	3,130.5	97.1	4,182.1	97.7	2,950.6	97.4	3,531.8	98.3	4,366.5	97.2	5,593.8	96.3
Of which:												
US	1,064.1	33.0	1,624.7	38.0	1,056.6	34.9	1,114.9	31.0	1,554.3	34.6	2,096.6	36.1
Canada	144.0	4.5	167.6	3.9	121.3	4.0	153.5	4.3	203.7	4.5	265.8	4.6
EEC b/	111.1	3.4	225.2	5.3	148.5	4.9	180.3	5.0	209.1	4.7	311.9	5.4
UK	66.5	2.1	98.5	2.3	59.4	2.0	103.4	2.9	99.1	2.2	137.1	2.4
Other EFTA c/	26.9	0.8	51.5	1.2	40.0	1.3	44.9	1.2	58.4	1.3	85.7	1.4
Free World Asia	639.9	19.8	794.8	18.6	611.4	20.2	793.3	22.1	914.9	20.4	975.0	16.8
Sino-Soviet Bloc	94.5	2.9	97.6	2.3	79.2	2.6	62.8	1.7	125.0	2.8	217.1	3.7
Of which:												
USSR	2.9	0.1	12.3	0.3	22.2	0.7	39.5	1.1	87.0	1.9	145.4	2.5
Total	<u>3,224.9</u>	<u>100.0</u>	<u>4,279.8</u>	<u>100.0</u>	<u>3,029.7</u>	<u>100.0</u>	<u>3,594.6</u>	<u>100.0</u>	<u>4,491.5</u>	<u>100.0</u>	<u>5,810.9</u>	<u>100.0</u>

a. Because of rounding, figures may not add to the totals shown.

b. European Economic Community (the Benelux countries -- Belgium, the Netherlands, and Luxembourg -- France, Italy, and West Germany).

c. European Free Trade Association (Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and the UK).

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Table 4

Commodity Composition of Japanese Exports to the USSR a/
1959-61

Commodities	1959		1960		1961	
	Thousand US \$	Percent of Total	Thousand US \$	Percent of Total	Thousand US \$	Percent of Total
Crude materials (inedible), except fuels	<u>3,482</u>	<u>15.1</u>	<u>5,643</u>	<u>9.4</u>	<u>6,333</u>	<u>9.7</u>
Chemicals	<u>678</u>	<u>2.9</u>	<u>1,333</u>	<u>2.2</u>	<u>718</u>	<u>1.1</u>
Machinery and transportation equipment	<u>9,966</u>	<u>44.3</u>	<u>17,403</u>	<u>29.0</u>	<u>25,544</u>	<u>39.1</u>
Steel ships	8,087	35.1	11,202	18.7	3,895	6.0
Manufactured goods	<u>8,879</u>	<u>38.6</u>	<u>35,550</u>	<u>59.3</u>	<u>32,557</u>	<u>49.8</u>
Iron and steel	5,450	23.7	26,714	44.5	16,914	25.9
Stainless steel pipe	800	3.5	11,307	18.8	8,237	12.6
Yarn and thread of synthetic fiber	1,174	5.1	3,272	5.5	5,411	8.3
Rubber belting for machinery	0	0	1,406	2.3	3,726	5.7
Miscellaneous, not elsewhere specified	<u>23</u>	<u>0.1</u>	<u>52</u>	<u>0</u>	<u>233</u>	<u>0.4</u>
Total	<u>23,028</u>	<u>100.0</u>	<u>59,981</u>	<u>100.0</u>	<u>65,385</u>	<u>100.0</u>

a. Because of rounding, figures may not add to the totals shown. Data in Tables 4 and 5 differ slightly from those in tables based on UN statistics.

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Table 5

Commodity Composition of Japanese Imports from the USSR a/
1959-61

Commodities	1959		1960		1961	
	Thousand US \$	Percent of Total	Thousand US \$	Percent of Total	Thousand US \$	Percent of Total
Food and live animals	<u>2,791</u>	<u>7.1</u>	<u>6,484</u>	<u>7.5</u>	<u>4,540</u>	<u>3.1</u>
Crude materials (inedible), except fuels	<u>18,331</u>	<u>46.4</u>	<u>26,188</u>	<u>30.1</u>	<u>32,543</u>	<u>22.4</u>
Wood and lumber	12,281	31.1	15,606	17.9	23,635	16.3
Raw cotton	2,667	6.8	6,598	7.6	4,604	3.2
Mineral fuels, lubricants, and related materials	<u>7,652</u>	<u>19.4</u>	<u>27,291</u>	<u>31.4</u>	<u>60,057</u>	<u>41.3</u>
Crude petroleum	1,396	3.5	15,217	17.5	33,028	22.7
Heavy fuel oil	879	2.2	3,632	4.2	13,431	9.2
Coal	5,047	12.8	7,661	8.8	13,255	9.1
Chemicals	<u>5,330</u>	<u>13.5</u>	<u>7,569</u>	<u>8.7</u>	<u>11,361</u>	<u>7.8</u>
Potassium chloride	4,248	10.8	5,940	6.8	8,713	6.0
Manufactured goods	<u>5,353</u>	<u>13.6</u>	<u>19,241</u>	<u>22.1</u>	<u>35,755</u>	<u>24.6</u>
Pig iron	678	1.7	13,322	15.3	27,614	19.0
Miscellaneous, not elsewhere specified	<u>37</u>	<u>0.1</u>	<u>259</u>	<u>0.3</u>	<u>1,165</u>	<u>0.8</u>
Total	<u>39,494</u>	<u>100.0</u>	<u>87,032</u>	<u>100.0</u>	<u>145,421</u>	<u>100.0</u>

a. Because of rounding, figures may not add to the totals shown. Data in Tables 4 and 5 differ slightly from those in tables based on UN statistics.

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Table 6

Japanese Commodity Trade Balance: Total Trade and Trade with the USSR
1956-61

	Million US \$					
	<u>1956</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>
Exports	2,492.6	2,849.3	2,865.8	3,445.6	4,054.9	4,235.9
Of which:						
Exports to the USSR	0.8	9.3	18.1	23.0	60.0	65.4
Imports	3,224.9	4,279.8	3,029.7	3,594.6	4,491.5	5,810.9
Of which:						
Imports from the USSR	2.9	12.3	22.2	39.5	87.0	145.4
Net Japanese imports <u>a/</u>	732.3	1,430.5	163.9	148.9	436.6	1,575.0
Of which:						
Net imports from the USSR <u>a/</u>	2.1	3.0	4.1	16.5	27.1	80.0

a. Because of rounding, net figures may not check with the balance of imports and exports shown.

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Table 7
 Japanese Trade with the USSR: Planned and Actual
 1958-62

Year	Million US \$					
	Imports		Exports		Total ^{a/}	
	Planned	Actual	Planned	Actual	Planned	Actual
1958	28 to 30	22	28 to 30	18	56 to 60	40
1959	35 ^{b/}	39	35 ^{b/}	23	70	62
1960	62 ^{b/}	87	62 ^{b/}	60	125	147
1961	75	145	85	65	160	211
1962	105	122 ^{c/}	120	130 ^{c/}	225	253 ^{c/}

- a. Because of rounding, figures may not add to the totals shown.
 b. Available data for total turnover divided equally between imports and exports.
 c. For 10 months only.

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