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<th>Balance of Trade and Economic Growth in Japan</th>
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<tr>
<td>Author(s)</td>
<td>Baba, Keinosuke</td>
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BALANCE OF TRADE AND ECONOMIC GROWTH IN JAPAN

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Professor of Economic Philosophy

I. Balance of Trade and Steady Growth of Economy

In the open system of national economy, the balance between investment and savings is formed as follows:

\[ S = V_d + (X - M) \]

Where \( S \), \( V_d \), \( X \) and \( M \) show the values of savings, domestic investment, exports, and imports respectively. Restated, it becomes as follows:

\[ S + M = V_d + X \]

If there is such a relation as \( X = \beta M \) between the value of imports and that of exports, the following equation holds:

\[ S + (1 - \beta)M = V_d \]

In the open system of national economy, even if savings and domestic investment, or imports and exports are not balanced, a balance in the national economy can be made. If there is the trend \( S > V_d \), the balance may be formed, provided that it has a tendency toward excess of exports, and is \( \beta > 1 \), such as follows:

\[ S - (\beta - 1)M = V_d \]

For a national economy which has a trend of excess savings, excess of exports is essential to form the balance. In the opposite case, that is, in case it has a tendency \( S < V_d \), excess of imports is essential. Because, under the condition of \( \beta < 1 \), it is balanced in the shape of the following form:

\[ S + (1 - \beta)M = V_d \]

A balance in national economy is formally explained in above form. However, it is hard to establish the condition that \( \beta \) has a numerical value other than 1 and that numerical value to be stable. Because \( \beta \) is to be determined under the complex structure of international economy, its numerical value easily undergoes a change. National economy which has to keep excess of exports at a fixed rate owing to excess savings is unable to attain this desirable favorable balance because of bad turns of international economic conditions. And it is easily touched by alien influences. On the other hand, national economy which has always to keep excess of imports at a fixed rate owing to insufficient savings, is placed in an unstable situation by foreign conditions. To stabilize the economy, it is

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1 This is a English translation of the Chapter II of my book, Economic Analysis of Japanese Foreign Trade, Tokyo 1959, in Japanese.
desirable to realize a growth of national economy conditioned upon the balance of trade. As the Japanese economy has a tendency $S<V_d$, excess of imports is desirable to realize the balance. However, trade policy has never been framed for the aim of unfavorable balance, but has been adopted to adjust the growth rate of economy to get rid of the unfavorable balance. For it must have been considered that the balance conditional upon excess of imports at the fixed rate was unstable.

It is the essential condition for the steady growth of national economy to maintain the balance of trade. The necessary condition to maintain the balance of trade in the dynamic process of economy is established, if the trade was balanced at the initial condition, by uniformity of the increase rate of subsequent imports and exports. This is expressed in the following equation:

Assuming $X_0 = M_0$

It is expressed as $G_x = G_m$ (1. 1)

$G_x$ and $G_m$ show the increase rate of exports and imports respectively. In this case, however, both increase rates should be expressed by the same unit of value, such as the standard export price. If $G_x$ and $G_m$ are expressed by the increase rate of each quantity, the equation should be as follows:

$G_x = G_m(G_d)$ (1. 2)

$G_t$ means the rate of variation in the terms of trade $t$. But, as the first approximation, $G_t$ is from now on disregarded in this section. This, however, will be corrected later. If the import function is given with a equation such as

$log M = \gamma_m log Y_d + \alpha'$

using the domestic national income, $Y_d$, as the explanatory variable, the increase rate of the total import is explained by the rate of growth of domestic income, $G_d$:

$G_m = G_m(G_d)$ (1. 4)

Accordingly, the equation (1. 1) becomes

$G_x = G_m(G_d)$ (1. 5)

This corresponds to

$log Y = k log X + \alpha$

Increase of national income is determined by expansion of exports. If exports can be politically adjusted, growth of national income must be also settled to cope with it. Exports, however, cannot always politically be adjusted with ease. In the international economic structure, exports are woven unto the net work of inter-dependence. The strategic variable explaining export behavior must be selected from that interwoven net. The formula which most easily suggests itself to our mind as the export behavior equation is, for example,

$log X = \gamma_f log Y_f + \alpha''$ (1. 6)

using income of foreign economy, $Y_f$, as the explanatory variable. Therefore, the increase rate of exports is formulated as the function of the rate of growth in foreign economy:

$G_x = G_d(G_f)$ (1. 7)

Under this condition the equation (1. 5) is rewritten as
This becomes the conditional formula which settles the equilibrium rate of growth, \( \hat{G}_d \), in domestic economy. From the import and export behavior equation, they become \( G_m = \eta_m G_d \) and \( G_x = \eta_f G_f \) respectively; and the equilibrium rate of growth corresponding to the balance of trade becomes \( \hat{G}_d = \left[ \frac{\eta_f}{\eta_m} \right] G_f \). By being rewritten, it is formed as

\[
\hat{G}_d = \mu G_f \tag{1.9}
\]

\( \mu \) is tentatively called hereafter the coefficient of comparative growth. It is nothing but the ratio of elasticity coefficients of export and import. This expresses the thesis that the equilibrium rate of growth of domestic national economy is determined by the rate of growth of foreign economy. This means that if the actual rate of growth of national economy is higher than that equilibrium rate, it causes excess of imports, and if contrarily lower, it leads to excess of exports.

In the following, this conditional formula is applied to Japanese economy.

In applying this, we encounter the question of what the rate of growth of foreign economy is expressed by. So long as reliable data of national income of all the nations of the world cannot be obtained, the equation (1.6) cannot be applied just as it is. Two short cut methods are used in this paper: One is to use the trend of production in the mining and manufacturing industries of the world instead of the growth rate of the world income. The other is to use the growth rate of the total international trade as the explanatory variable. Both are only approximation. At first, the analysis is made of the post-war period.

Table (1.1) shows production index of the world mining and manufacturing industry, \( Z_f \), and the index of Japanese total export, \( X_d \), for the period from 1950 to 1956, formulated by taking 1952 to be 100.0. Analyzing the correlation between indicated figures, we obtain the result as follows:

Table (1.1) Analysis of Export Behavior 1950–1956
index numbers base year: 1952

<table>
<thead>
<tr>
<th></th>
<th>exports ( \log X_d )</th>
<th>world production ( \log Z_f )</th>
<th>world trade ( \log M_f )</th>
<th>domestic production ( \log Z_d )</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>1.9267</td>
<td>1.9558</td>
<td>1.9563</td>
<td>1.8059</td>
</tr>
<tr>
<td>1951</td>
<td>1.9741</td>
<td>1.9903</td>
<td>2.0046</td>
<td>1.9532</td>
</tr>
<tr>
<td>1952</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1953</td>
<td>2.0352</td>
<td>2.0315</td>
<td>2.0268</td>
<td>2.0945</td>
</tr>
<tr>
<td>1954</td>
<td>2.1598</td>
<td>2.0315</td>
<td>2.0480</td>
<td>2.1321</td>
</tr>
<tr>
<td>1955</td>
<td>2.2751</td>
<td>2.0729</td>
<td>2.0837</td>
<td>2.1695</td>
</tr>
<tr>
<td>1956</td>
<td>2.3527</td>
<td>2.0922</td>
<td>2.1203</td>
<td>2.2591</td>
</tr>
</tbody>
</table>

\( X_d \) is estimated by Japanese Ministry of Finance, \( Z_f \) and \( M_f \) by United Nations, \( Z_d \) by Japanese Economic Planning Board.

\[
\log X_d = 3.25 \log Z_f - 4.4776 \tag{1.6, 1}
\]

\( r^2 = 0.9265, \quad r = 0.9626 \)

Export elasticity coefficient is 3.25. Table (1.2) shows the index of Japanese
national income, \( Y_d \), and index of the total import, \( M_d \), for the same period. By analyzing it, it becomes as follows:

\[
\log M_d = 2.3095 \log Y_d - 2.6057
\]

\[
I = 0.9739 \quad r = 0.9869
\]

Import elasticity coefficient is 2.31. The conditional formula maintaining the balance of trade is obtained by combining these two equations. It becomes as follows:

\[ \text{From } 2.31G_d = 3.25 G_f \]

\[ \text{it is formed as } G_d = 1.406 G_f \]

Production of the world mining and manufacturing industry, however, was increasing with the average annual rate of 5.4% during the period. By inserting this numerical value into the above formula, the equilibrium rate of growth of the Japanese economy becomes 7.56%. If national income in Japan will expand at the rate greater than 7.56%, the rate of growth in imports becomes larger than of exports. Consequently, the balance of trade becomes adverse. As the rate of growth of Japanese national income during that period was 8.2% in average, it can be said that Japan had a tendency to increase the unfavorable balance.

If the index of the world trade, \( M_f \), during that period is taken as the explanatory variable of the exports behavior equation, the result of correlation analysis

\[
\log X_d = 2.814 \log M_f - 3.6209
\]

\[
r^2 = 0.9285 \quad r = 0.9686
\]

Export elasticity coefficient is 2.8. The condition necessary to maintain the balance of trade is obtained by combining this export elasticity coefficient with that of import already mentioned. That is

\[ 2.309 \dot{G}_d = 2.814 \dot{G}_f \]

\[ \text{therefore, } \dot{G}_d = 1.218 \dot{G}_f \]

As the average annual rate of growth of the world trade in the same period was 6.5%, the equilibrium rate of growth of Japanese national income is 7.971%. This a little higher than the preceding estimated value. Although both correlation

<table>
<thead>
<tr>
<th>Year</th>
<th>( \log M_d )</th>
<th>( \log Y_d )</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>1.7862</td>
<td>1.9189</td>
</tr>
<tr>
<td>1951</td>
<td>1.9566</td>
<td>1.9605</td>
</tr>
<tr>
<td>1952</td>
<td>2.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1953</td>
<td>2.1314</td>
<td>2.0327</td>
</tr>
<tr>
<td>1954</td>
<td>2.1468</td>
<td>2.0420</td>
</tr>
<tr>
<td>1955</td>
<td>2.1686</td>
<td>2.0819</td>
</tr>
<tr>
<td>1956</td>
<td>2.2723</td>
<td>2.1236</td>
</tr>
</tbody>
</table>
coefficients are considerably high, difference of this degree are inevitable, for it is a matter of course that there are errors in estimation. It is, anyway, certain that a rate of growth more than 8% of national income is apt to cause an excess of imports. As a matter of fact, exports during the period increased at an average annual rate of 17.8%, while imports increased at a rate of 20.6%.

Business recessions experienced twice in post-war years in Japan occurred as reactions of the excessive growth of Japanese economy, which bumped into "the wall of international payment", and caused heavy deficits in that balance. Moreover, both occurred in a period during which a government tight money policy was carried out. The fact that the relation which excessive growth of economy bears to intensifying an excess imports was emphasized as the basis of the policy is still fresh in our memory. It seems that what is analyzed here supports this political idea. The coefficient of comparative growth $\mu$, mentioned above, gives an effective key to judge the propriety of rate of growth of national economy.

Rates of growth of economy in Britain in the 19th Century and in the United States of America in the 20th Century were higher than those of other countries. For all that they showed a remarkable excess of exports, it must not be concluded that this analysis is not appropriate. It merely shows that the coefficient of comparative growth $\mu$, was large in both countries. This coefficient consisted of the ratio of elasticity coefficients of import and export. In case the elasticity coefficient of export is larger than that of import, the coefficient becomes higher. Thus, even though the rate of growth of national economy is high, an excess of exports can be made.

It is well-known that, reflecting on Britain's experience in the 19th Century, R.F. Harrod stated that a high rate of growth does not always develop a tendency to unfavorable balance. He tried to elucidate the relation between rate of growth and the balance of trade by the doctrine of comparative costs. His claim was that: In case the high rate of growth is chiefly supported by a industry which has a comparative advantage in the cost of production—it may be briefly called an export industry—it causes, at the same time, a marked expansion of exports. It must, therefore, be able to bring about an excess of exports. It may be said that when this theory is compared with the above analysis of ours, it is critical of the latter. However, it is yet insufficient to negate the validity of the analysis completely. Because even in such examples that seem not to be applicable to this analysis at first sight, with the interpretation that it formed a high coefficient of comparative growth by making the export elasticity coefficient large, the analysis is able to escape from criticism by this theory. Yet, the analysis (this will be hereafter called the "A" formula for short) and the theory are not constructed from a similar approach, for they hold a completely different opinion from each other about the export function.

In the "A" formula, the behavior of export is interpreted by the trend of

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foreign economy. On the other hand, it is understood that in the Harrod theory it is settled by the trend of the export industry. The former is passive, while the latter is active. It may be an issue to be discussed which is right. For my opinion, it is more important to coordinate the two. For preparation of the coordination, it is necessary to formulate the Harrod theory or its basic doctrine of comparative costs into a formula which is easily compared with the analysis now mentioned. In the following, the formulation will be made: the following formula is derived from the Harrod theory as the export function:

$$\log X = \eta_d \log Z_d + \alpha'$$ (1.3)

$Z_d$ shows production quantities of the domestic export industry. By uniting this formula with the import function, the condition maintaining the balance of trade becomes $G_x(G_d) = G_m(G_d)$, where $G_x$ is the rate of growth in the export industry. By expanding this formula,

$$\eta_d G_x = \eta_m G_d$$ (1.11)

is derived. From it, the equilibrium rate of growth in the export industry is formed as

$$\bar{G}_x = \left[ \frac{\eta_m}{\eta_d} \right] G_d.$$

Abbreviated, it is rewritten as

$$\bar{G}_x = \lambda G_d.$$

$\lambda$ shows the tilting coefficient. If the growth of national economy puts a greater emphasis than this coefficient into the export industry, an excess of exports occurs. In the converse case, it is apt to cause an excess of imports. The Harrod theory can probably be generalized by being formulated like this. Hereinafter, the theory is called the “B” formula.

In the following, the “B” formula will be applied to the Japanese economy: Analyzing the Japanese economy for the period 1950–1956, the export behavior is measured as follows:

$$\log X = 0.975 \log Z_d + 0.0938$$ (1.10, 1)

$$r^2 = 0.8337 \quad r = 0.9131$$

However, the manufacturing industry is considered here as the export industry. (cf. Table (1.1)) By uniting this with the above-mentioned formula of import function (1.1, 1), the condition maintaining the balance of trade becomes as follows:

$$0.975 \bar{G}_x = 2.3095 G_d$$

Accordingly, $\bar{G}_x = 2.366 G_d$

The tilting coefficient is 2.366. If the rate of production increase in the export industry is smaller than 2.366 times the rate of growth of national income, it must have a tendency to an unfavorable balance. As the average annual rate of growth in national income in this period was 8.2%, the rate of production increase in the export industry which is essential to maintain the balance of trade was 19.4% where, as a matter of fact, its average actual rate was 19.0%.

According to this analysis, it can be said that, contrary to the previous one, an excess of imports was made due to the fact that the growth of national income
was not made to the export industry with sufficient emphasis of weights. The necessary policy to maintain the balance of trade is not to control import by restraining the growth rate of national income, but to expand export by promoting the development of the export industry. The positive policy is much more desirable than the passive. Thus opinions which are contrary to each other are derived as political proposals. On the other hand, the theoretical analysis is as if both of them were looking only on one side of the shield.

An analysis of Japanese economy in pre-war days will now be described. For the "A" formula, data of production index numbers of the world mining and manufacturing industry and index numbers of the world trade, which had been collected over a long time, have not yet put in order. So, the analysis is made with data in two limited periods—from 1920 to 1929 and from 1928 to 1937. The following is the analysis between 1920 and 1929:

Instead of index numbers of the world income, those of manufacturing production were applied. The behavior of Japanese export was analyzed according to the index of the world manufacturing production as the explanatory variable:

$$\log X = 1.1873 \log Z_f - 0.3774$$

$$r^2 = 0.8688$$

The export elasticity coefficient is 1.1873. The behavior of the Japanese import is explained by the index of national income as the explanatory variable:

$$\log M = 0.8956 \log Y_d + 0.8741$$

$$r^2 = 0.7308$$

As the import elasticity coefficient is 0.8956, the appropriate rate of growth corresponding to the balance of trade is shown by \( G_d = 1.9934 G_f \) (cf. the Table 1.3).

The period between 1928 and 1937 was a time of upheaval involving a state of the Great Depression and the recovery from it. Amidst the worldwide depression, Japanese trade expanded with a low exchange rate of yen as its lever, and

**Table (1.3) Analysis of Export and Import Behaviors 1920–1929**

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports log X</th>
<th>World Production log Z_f</th>
<th>Imports log M</th>
<th>Real Natl. Income log Y_d</th>
</tr>
</thead>
<tbody>
<tr>
<td>1920</td>
<td>1.7681</td>
<td>1.8179</td>
<td>1.8140</td>
<td>1.6870</td>
</tr>
<tr>
<td>1921</td>
<td>1.7411</td>
<td>1.7575</td>
<td>1.8378</td>
<td>1.7610</td>
</tr>
<tr>
<td>1922</td>
<td>1.8667</td>
<td>1.8464</td>
<td>1.9308</td>
<td>1.7751</td>
</tr>
<tr>
<td>1923</td>
<td>1.7423</td>
<td>1.8675</td>
<td>1.9246</td>
<td>1.7952</td>
</tr>
<tr>
<td>1924</td>
<td>1.8520</td>
<td>1.8936</td>
<td>1.9662</td>
<td>1.8174</td>
</tr>
<tr>
<td>1925</td>
<td>1.9356</td>
<td>1.9302</td>
<td>1.9620</td>
<td>1.8387</td>
</tr>
<tr>
<td>1926</td>
<td>1.9423</td>
<td>1.9505</td>
<td>1.9994</td>
<td>1.8833</td>
</tr>
<tr>
<td>1927</td>
<td>1.9769</td>
<td>1.9770</td>
<td>2.0231</td>
<td>1.9004</td>
</tr>
<tr>
<td>1928</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1929</td>
<td>2.0472</td>
<td>2.0340</td>
<td>2.0134</td>
<td>2.0107</td>
</tr>
</tbody>
</table>

\( X \) and \( M \) are estimated by Toyo Keizai Shimpo Sha (Oriental Economist Co.), \( Z_f \) by League of Nations, \( Y_d \) by Hitotsubashi Keizai Kenkyujo (Hitotsubashi Economic Research Institute).
helped the national economy to recover from the depression. The reason why the expansion of exports was made cannot be sufficiently explained merely by the behavior of world economy. It seems that Japanese trade policy was a powerful factor in its expansion. Therefore, this period is not suitable for the "A" formula to be applied. Between Japanese total export and the world manufacturing production, only the following weak correlation can be seen:

\[
\log X = 0.9539 \log Z_f + 0.02014 \\
\left(1. 6, 4\right) \\
\begin{array}{c}
\end{array}
\]

\[
r^2 = 0.4794
\]

Again, between the Japanese exports and the world trade, there is an abnormal relation like a negative correlation. This shows that the world trade is not the proper factor to interpret the behavior of demand for Japanese exports. In addition, between import demand and national income in Japan, there was only a weak correlation, which is not significant from the statistical point of view (cf. Table 1.4):

\[
\log M = 0.6562 \log Y_d + 0.6571 \\
\left(1. 3, 3\right) \\
\begin{array}{c}
\end{array}
\]

\[
r^2 = 0.5104
\]

The following is the application of the "B" formula: As only domestic data are necessary, the formula is easily applied. The analysis over a long period is made with this description.

The period from 1878 to 1932 is divided into ten parts. The index number of exports and that of production in the manufacturing industry, and also that of imports and that of real national income are shown in the Table (1.5). Now the figures will be analyzed in the following. As the export equation, the following is obtained:

\[
\log X = 0.9637 \log Z_d - 0.0525 \\
\left(1. 12, 2\right) \\
\begin{array}{c}
\end{array}
\]

\[
r^2 = 0.9898 \quad r = 0.9944
\]

Table (1.4) Analysis of Export and Import Behaviors 1928–1937

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports log X</th>
<th>World Production log Zf</th>
<th>Imports log M</th>
<th>Real Natl. Income log Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>1928</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1929</td>
<td>2.0472</td>
<td>2.0340</td>
<td>2.0134</td>
<td>2.0107</td>
</tr>
<tr>
<td>1930</td>
<td>1.9956</td>
<td>1.9867</td>
<td>1.9534</td>
<td>2.0704</td>
</tr>
<tr>
<td>1931</td>
<td>2.0093</td>
<td>1.9366</td>
<td>2.0057</td>
<td>2.1099</td>
</tr>
<tr>
<td>1932</td>
<td>2.0701</td>
<td>1.8832</td>
<td>1.9968</td>
<td>2.1082</td>
</tr>
<tr>
<td>1933</td>
<td>2.0939</td>
<td>1.9336</td>
<td>2.0231</td>
<td>2.1068</td>
</tr>
<tr>
<td>1934</td>
<td>2.1623</td>
<td>1.9832</td>
<td>2.0576</td>
<td>2.1202</td>
</tr>
<tr>
<td>1935</td>
<td>2.2176</td>
<td>2.0375</td>
<td>2.0677</td>
<td>2.1519</td>
</tr>
<tr>
<td>1936</td>
<td>2.2555</td>
<td>2.0986</td>
<td>2.1082</td>
<td>2.1769</td>
</tr>
<tr>
<td>1937</td>
<td>2.2730</td>
<td>2.1402</td>
<td>2.1350</td>
<td>2.1601</td>
</tr>
</tbody>
</table>

X and M are estimated by Toyo Keizai Shimpo Sha and Yokohama Specie Bank, Zf by League of Nations, Yd by Hitotsubashi Keizai Kenkyujo.

As the import equation, the following is derived:
\[ \log M = 1.5371 \log Y_d - 1.1158 \]  \hspace{1cm} (1.3, 5) \\
\[ r^2 = 0.9755 \quad r = 0.9877 \]

Table (1.5) Analysis of Export and Import Behaviors 1978–1932

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports log X</th>
<th>Domestic Production log Zd</th>
<th>Imports log M</th>
<th>Real Natl. Income log Yd</th>
</tr>
</thead>
<tbody>
<tr>
<td>1878–1887</td>
<td>1.0319</td>
<td>1.1476</td>
<td>1.0216</td>
<td>1.4464</td>
</tr>
<tr>
<td>1883–1892</td>
<td>1.2130</td>
<td>1.3189</td>
<td>1.1979</td>
<td>1.5364</td>
</tr>
<tr>
<td>1888–1897</td>
<td>1.3615</td>
<td>1.4935</td>
<td>1.4239</td>
<td>1.6402</td>
</tr>
<tr>
<td>1893–1902</td>
<td>1.5023</td>
<td>1.6500</td>
<td>1.6105</td>
<td>1.7530</td>
</tr>
<tr>
<td>1898–1907</td>
<td>1.6544</td>
<td>1.7346</td>
<td>1.7676</td>
<td>1.8179</td>
</tr>
<tr>
<td>1903–1912</td>
<td>1.7881</td>
<td>1.8506</td>
<td>1.8504</td>
<td>1.8820</td>
</tr>
<tr>
<td>1908–1917</td>
<td>1.9742</td>
<td>2.0252</td>
<td>1.9102</td>
<td>1.9583</td>
</tr>
<tr>
<td>1913–1922</td>
<td>2.0785</td>
<td>2.2004</td>
<td>2.0386</td>
<td>2.0444</td>
</tr>
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<td>1918–1927</td>
<td>2.1253</td>
<td>2.3013</td>
<td>2.1897</td>
<td>2.1513</td>
</tr>
<tr>
<td>1923–1932</td>
<td>2.2314</td>
<td>2.4211</td>
<td>2.2645</td>
<td>2.2683</td>
</tr>
</tbody>
</table>

\( X \) and \( M \) are estimated by Toyo Keizai Shimpo Sha, \( Z_d \) by former Nagoya Commercial College, \( Y \) by Hitotsubashi Keizai Kenkyujo.

The condition maintaining the balance of trade is as follows:

\[ 0.9637 \tilde{G}_x = 1.5371 G_d \]

Then, the following is derived:

\[ \tilde{G}_x = 1.54 G_d \]  \hspace{1cm} (1.12, 2)

The tilting coefficient is 1.54. The average annual rate of growth in national income during period was 4.30%. Therefore, the required rate of production increase in the export industry is to be 6.93%, where it was actually 6.73%. That is, it was a little lower than the required one. While the average rate of increase of import during the period was 6.57%, that of export was practically 5.89%, which is considerably lower than the former. There was an obvious tendency to an unfavorable balance of trade.

The fact that the rate of growth of Japanese economy was remarkably higher over a long period than that of any other country is now a matter of common knowledge. Nonetheless, what differs from Britain in the 19th Century and the United States of America in the 20th Century is that Japan had a tendency to an unfavorable balance of trade. This cannot be interpreted by the Harrod theory of comparative costs. The high rate of growth in the Japanese economy was mainly supported by the export industry, so that the condition of the favorable balance described in the Harrod theory was fully exemplified. However, an excess of imports occurred. By generalizing the theory of comparative costs in our revised form, this Japanese instance can be explained. But, we do not claim that the "B" formula is a theory having already sufficient generality. In order to generalize it further, it is necessary to coordinate the relation between this "B" formula and the abovementioned "A" formula.
II. Balance of Trade and Terms of Trade

The problem in this section is to coordinate the relation between two formulas — "A" and "B" formulas. Both formulas follow the same method to obtain import equation. However, they differ in obtaining the export one. In the "A" formula, export equation makes the movement of income in foreign economy the important explanatory variable. Accordingly, it has the interpretation that the balance of trade is determined by reciprocal demands between one country and others. It may be safely said that it is connected to the reciprocal demands theory in its fundamental view, while the "B" formula take the movement of export industry as the explanatory variable of export behavior, and relates to the theory of comparative costs as mentioned before.

In this way, it is easily understood that coordination of these two formulas can be done by re-examining the relation between these two theories. Far back in the mid-19 Century it was already made clear by John S. Mill (1806–73) that both theories have the relation of complementing each other. The theory of international equilibrium propounded afterwards is accomplished by making itself more elaborately along the lines of Mill's proposal. Therefore, the problem is not a new one. However, the two formulas mentioned above are considerably different from that of reciprocal demands and that of comparative costs in their analytical contents, so that the difference of contents must be examined.

The theory of reciprocal demands is as follows:

Export in Japan, X_d, is in other word import in foreign countries, M_f. Thus, the balance of trade is as follows:

\[ M_f = M_d \] (2.1)

It was interpreted that import demands in a country and the other were functions which made the terms of trade the principal explanatory variable respectively:

\[ M_f = M_f(t) \]
\[ M_d = M_d(t) \] (2.2)

In this way, the equilibrium of reciprocal demands was thought to be established by making the terms of trade the adjusting variable:

\[ M_f(t) = M_d(t) \] (2.3)

The equilibrium terms of trade were assumed to be more profitable than the price ratio which would have been settled by domestic costs of production in each nation. The foreign trade stimulated by the difference in comparative costs between the countries reaches the balance of trade under these equilibrium terms of trade. Then the gains from trade are divided between each country under the same terms. This is the core of Mill's doctrine. The theory of international equilibrium held fundamentally the same view which the former held until comparatively recent years.
The biggest defect in this theory seems it was formed on the method of economic statics. The equilibrium shown in the formula (2.3) is only formed on the assumption that the reciprocal demand curve in each country does not shift. The theory of comparative costs is the dynamic theory in its foundation: each country puts emphasis on the export industry from the standpoint of comparative advantage and reorganizes its industrial structure, then places it in the system of international specialization and fosters its economic development. This is the consistent conviction in the latter. This dynamic idea cannot directly be united with the static theory of the former. In this way, the gap develops between the vision and the analytical framework. In order to fill up the gap, the variable settling the shift of the demand curve must be adapted to the formula of the balance of trade in a clear statement. The revision of the analytical framework must be accomplished.

The above-mentioned “A” formula made the formulation of the function of reciprocal demands by making shift variable only an explanatory variable. Assuming that:

\[ M_f = M_f(Y_f) \]  
\[ M_d = M_d(Y_d) \]

The balance of trade was expressed in the following form:

\[ M_f(Y_f) = M_d(Y_d) \]  

By uniting this with the theory of reciprocal demands, the function of reciprocal demands is as follows:

\[ M_f = M_f(t, Y_f) \]  
\[ M_d = M_d(t, Y_d) \]

The balance of trade is formed as follows:

\[ M_f(t, Y_f) = M_d(t, Y_d) \]  

As shown above, by applying the shift variable of the reciprocal demand curve into the formula specifically, the gap between the static equilibrium analysis and dynamic theory of comparative costs can be reduced. From the standpoint of adjustment of the “A” formula, by adding the terms of trade as the explanatory variable, the “A” formula approaches a step toward the theory of comparative costs, accordingly toward the “B” formula.

With the same reason, the latter can approach the former in the following way. The necessary adjustment is as follows: The export function becomes:

\[ X_d = X_d(t, Z_d) \]  

As the above mentioned import function can be used without any change, the balance of trade becomes as follows:

\[ X_d(t, Z_d) = M_d(t, Y_d) \]  

In this way, the “B” formula approaches the “A” formula. Of course, by this adjustment, the difference of basic idea existing between the two formulas is not always wiped away perfectly. Yet the “A” formula propounds the passive view about exports while the “B” propounds the active. However, so long as the statistical survey is continued with observable data, it might not be very
difficult to reconcile the difference of opinions between the two. If the difference
of opinions is taken up as they are without considering this survey, there is no
room to reconcile it. Following the previous section, the statistical analysis
for Japanese trade will be carried out in the following. It is a matter of course
that both revised formulas are statistically applied closely, and the results of
measurements are compared and examined. Now both formulas must be expanded
into applicable forms. For the sake of convenience, the "B" formula will be
explained first. The import equation is mainly formed as follows:
\[
\log M = \varepsilon_m \log t + \eta_m \log Y_d + \alpha 
\] (2. 10)
Also the export equation in the "B" formula is supposed as follows:
\[
\log X = -\varepsilon_x \log t + \eta_x \log Z_d + \alpha' 
\] (2. 11)
Under this supposition, if the rate of variation in the terms of trade is \( G_t \), the
rate of growth of the import value at the export price base is as follows:
\[
G_m = (\varepsilon_m - 1)G_t + \eta_m G_d 
\] (2. 12)
The rate of growth of the export value at the same base is as follows:
\[
G_x = -\varepsilon_x G_t + \eta_x G_d 
\] (2. 13)
The condition required to maintain the balance of trade in the dynamic process
is, if it was balanced at the initial stage, as follows:
\[
\eta_x G_x = (\varepsilon_m + \varepsilon_x - 1)G_t + \eta_m G_d 
\] (2. 14)
If the left side of the above equation is larger than the right, it means an excess
of exports. Oppositely, it means an excess of imports. Comparing this equation
with the balance equation which was expanded in the previous section (1. 11),
\( \eta_x G_x = \eta_m G_d \), two pieces of information are obtained: One is that: In
cases where the rate of production increase in the export industry is relatively
higher than that of growth in national income, if it does not accompany any
improvement of productivity of the export industry and causes the relative rise
of export price, it might bring an unfavorable balance of trade through the action
of the terms of trade, even if it becomes \( \eta_x G_x \geq \eta_m G_d \). On the contrary, if
the improvement of productivity of that industry is sufficient, it has the possibility
of preserving the favorable balance by making comparatively cheap the export
price, even though it becomes \( \eta_x G_x \leq \eta_m G_d \). The other is that: The sum
of price elasticity coefficients of imports and exports has to be larger than 1 to
realize the above-mentioned possibility. If it is \( \varepsilon_m + \varepsilon_x < 1 \), the balance of
trade enters into unfavorable condition by deterioration of the terms of trade.
Therefore, \( \varepsilon_m + \varepsilon_x = 1 \) is, as it were, the critical point. This was explained
by J. Robinson.8

These two pieces of information probably play an important part in the study
of the problem of the balance of trade. However, in case of statistical measure-
ment, attention must be previously paid to the fact that price elasticity of import
and export, \( \varepsilon_m \) and \( \varepsilon_x \), is apt to contain considerable errors of estimation, and
there are not a few occasions when useful judgments can hardly be made at all.

It means that, at the time of application of import and export functions, the scheme obtaining as significant results of statistical analysis as possible must be made by modifying functional forms.

The export equation in the "A" formula is shown below:
\[
\log X = -e_x \log t + \eta_x \log Y \log Y_f + \alpha''
\]  
(2. 15)

The condition required to maintain the balance of trade are:
\[
\eta_x G_f = (e_m + e_x - 1)G_t + \eta_m G_d
\]  
(2. 16)

The equation similar to this was already expanded by G. H. Johnson. The meaning of his equation is the same as the equation (2. 16) of ours. With these preparations, I hope the measurement can easily be accomplished.

Analysis for the post-war days will be made in the following: in a period from 1950 to 1956, the import equation is:
\[
\log M = 0.4942 t + 2.0859 \log Y_d - 2.8045
\]  
(2. 10, 1)

\[R^2 = 0.9892\]  
(cf. the Table 2, 1)

The income elasticity coefficient of import in the equation mentioned before (1. 3, 1) is 2.3095. In this equation containing the terms of trade as an additional explanatory variable, the value is 2.0859, a little lower than the former. The price elasticity coefficient of import is easily measured from parameter 0.4942 which is affected by the terms of trade. Its average elasticity coefficient is 1.1208. In import, the income elasticity is 2.0895, and the price elasticity is 1.1208. It is understood that import demand is considerably elastic. These parameters contain estimated errors, which must be examined. Errors in the price elasticity are greater than that of income. However, both values are, anyhow, statistically significant. That is:

- the income elasticity 2.0859 ± 0.1626
- the price elasticity 1.1208 ± 0.5299

In export, according to the "A" formula, two methods of measurement are made; one is the method using the index number of production of the world mining and

<table>
<thead>
<tr>
<th>Year</th>
<th>imports log M</th>
<th>terms of trade log t</th>
<th>real natl. income log Yd</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>1.7862</td>
<td>0.9701</td>
<td>1.9189</td>
</tr>
<tr>
<td>1951</td>
<td>1.9566</td>
<td>1.0986</td>
<td>1.9605</td>
</tr>
<tr>
<td>1952</td>
<td>2.0000</td>
<td>1.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1953</td>
<td>2.1314</td>
<td>1.0515</td>
<td>2.0327</td>
</tr>
<tr>
<td>1954</td>
<td>2.1468</td>
<td>1.0533</td>
<td>2.0420</td>
</tr>
<tr>
<td>1955</td>
<td>2.1686</td>
<td>1.0497</td>
<td>2.0819</td>
</tr>
<tr>
<td>1956</td>
<td>2.2723</td>
<td>1.1158</td>
<td>2.1236</td>
</tr>
</tbody>
</table>

\[M\] and \[t\] are estimated by Japanese Ministry of Finance, \[Y\] by Japanese Economic Planning Board.

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manufacturing industry instead of the world income, and the other is to use the index number of the world trade. In the former method, the statistical equation explaining the export behavior is as follows:

$$\log X = -0.1893 t + 3.3825 \log Z_f - 4.5474$$  \hspace{2cm} (2. 15, 1)

$$R^2 = 0.9245$$

In the latter, the result is:

$$\log X = -0.5643 t + 3.1156 \log M_f - 3.6428$$  \hspace{2cm} (2. 15, 2)

$$R^2 = 0.9416$$  \hspace{1cm} (cf. the Table 2. 2)

Parameters affected by the terms of trade must theoretically be equivalent to each other. However, they are unequal in the above measurements. Estimated errors between the two are markedly great. Each elasticity coefficient taking estimated errors into consideration is as follows:

- The elasticity coefficient related to production in the world mining and manufacturing industry: $3.3825 \pm 0.6661$
- The elasticity coefficient related to the world total trade: $3.1156 \pm 0.5187$
- The price elasticity coefficient (1): $-0.4569 \pm 1.4449$
- The price elasticity coefficient (2): $-1.3621 \pm 1.3780$

As indicated above, errors in price elasticity coefficients are great. Therefore, these values are not significant.

According to the “B” formula, the export behavior equation is as follows:

$$\log X = -0.1864 t + 1.0280 \log Z_d + 0.1817$$  \hspace{2cm} (2. 11, 1)

$$R^2 = 0.8358$$

The price elasticity coefficient in the above equation has also a large error. Two elasticity coefficients and their errors are as follows:

- The elasticity coefficient related to the export industry: $1.0280 \pm 0.3201$
- The price elasticity coefficient: $-0.4499 \pm 2.2625$

Though the former is anyhow, the latter is not significant (cf. the Table 2. 2).

As described above, even the revision of “A” and “B” formulas is tried by adding the terms of trade to them as additional explanatory variables, and the comparative study of both formulas is also attempted, it is impossible to obtain the meaningful results from data in post-war days. Each export behavior equa-

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports log X</th>
<th>Terms of Trade log t</th>
<th>World Production log Zf</th>
<th>World Trade log Mf</th>
<th>Domestic Production log Zd</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>1.9267</td>
<td>0.9701</td>
<td>1.9538</td>
<td>1.9563</td>
<td>1.8059</td>
</tr>
<tr>
<td>1951</td>
<td>1.9741</td>
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<td>1.9905</td>
<td>2.0046</td>
<td>1.9332</td>
</tr>
<tr>
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<td>2.0000</td>
<td>1.0000</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
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<tr>
<td>1953</td>
<td>2.0352</td>
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<td>2.0268</td>
<td>2.0954</td>
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<tr>
<td>1954</td>
<td>2.1598</td>
<td>1.0533</td>
<td>2.0315</td>
<td>2.0480</td>
<td>2.1321</td>
</tr>
<tr>
<td>1955</td>
<td>2.2751</td>
<td>1.0497</td>
<td>2.0729</td>
<td>2.0837</td>
<td>2.1695</td>
</tr>
<tr>
<td>1956</td>
<td>2.3527</td>
<td>1.1158</td>
<td>2.0922</td>
<td>2.1203</td>
<td>2.2591</td>
</tr>
</tbody>
</table>

$X$ and $t$ are estimated by Japanese Ministry of Finance, $Z_f$ and $M_f$ by United Nations, $Z_d$ by Japanese Economic Planning Board.
tion itself has anyhow a considerably high coefficient of determination. However, it is dangerous to derive some economic judgement from it concerning the action of terms of trade. Useful results to supplement the analysis in the previous section could not be obtained.

Now an analysis of pre-war years will be made in the following. Firstly, the "B" formula is applied. Analysis over a long period from 1878 to 1932 is made. The import behavior equation in this period is:

$$\log M = 0.5038 t + 1.6955 \log Y_d - 1.9513$$  \hspace{1cm} (2. 10, 2)

$$R^2 = 0.9824$$  \hspace{1cm} (cf. the Table 2. 3)

Two elasticity coefficients obtained from this are:

- The income elasticity coefficient: $$1.6955 \pm 0.1286$$
- The price elasticity coefficient: $$1.7024 \pm 0.8633$$

In this case, the price elasticity coefficient also has a considerably large error, but is significant at any rate.

The export behavior equation in the same period is:

$$X = -1.5195 t + 0.9517 \log Z_d + 0.7650$$  \hspace{1cm} (2. 11, 2)

$$R^2 = 0.9570$$

The average elasticity coefficients are:

- The elasticity coefficient related to the export industry: $$0.5851 \pm 0.1118$$
- The price elasticity coefficient: $$-2.5317 \pm 1.1990$$

The error of price elasticity coefficient is also large, but it is anyhow statistically significant. The condition required to maintain the balance of trade is:

$$0.5851G_e = 3.2341G_t + 1.6955G_d$$

The average annual growth rate of national income during that period was 4.30%, and that of the terms of trade was minus 0.38%. Applying these value into the above equation, it is understood that the annual growth rate of the export industry required to maintain the balance of trade must be 10.60%. However, the actual average growth rate was 6.73%. There exists the reason why it brought

| Table (2. 3) Analysis of Import Behavior 1878–1932 |
|---------------------------------|-----------------|-----------------|
| index numbers base year: 1913  |
| imports log M                  | terms of trade t | real natl. income log Y_d |
| 1878–1887                      | 1.0216          | 1.2441           | 1.4464 |
| 1883–1892                      | 1.1979          | 1.2558           | 1.5364 |
| 1888–1897                      | 1.4239          | 1.2424           | 1.6402 |
| 1893–1902                      | 1.6105          | 1.2550           | 1.7530 |
| 1898–1907                      | 1.7676          | 1.2980           | 1.8179 |
| 1903–1912                      | 1.8504          | 1.2537           | 1.8820 |
| 1908–1917                      | 1.9102          | 1.0736           | 1.9583 |
| 1913–1922                      | 2.0386          | 1.0138           | 2.0444 |
| 1918–1927                      | 2.1897          | 1.0847           | 2.1513 |
| 1923–1932                      | 2.2645          | 1.0478           | 2.2683 |

* M and t are estimated by Toyo Keizai Shimpo Sha, Y by Hitotsubashi Keizai Kenkyujo.
Table (2.4) **Analysis of Export Behavior 1878–1932**

*Index numbers base year: 1913*

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports $X$</th>
<th>Terms of Trade $t$</th>
<th>Domestic Production $Z_d$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1878–1887</td>
<td>0.1076</td>
<td>1.2441</td>
<td>1.1476</td>
</tr>
<tr>
<td>1883–1892</td>
<td>0.1636</td>
<td>1.2538</td>
<td>1.3189</td>
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<td>1888–1897</td>
<td>0.2299</td>
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<td>1.4955</td>
</tr>
<tr>
<td>1893–1902</td>
<td>0.3179</td>
<td>1.2550</td>
<td>1.6500</td>
</tr>
<tr>
<td>1898–1907</td>
<td>0.4512</td>
<td>1.2980</td>
<td>1.7346</td>
</tr>
<tr>
<td>1903–1912</td>
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</tr>
<tr>
<td>1913–1922</td>
<td>1.1979</td>
<td>1.0138</td>
<td>2.2004</td>
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<td>1918–1927</td>
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<td>2.3013</td>
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<td>1923–1932</td>
<td>1.7042</td>
<td>1.0478</td>
<td>2.4211</td>
</tr>
</tbody>
</table>

$X$ and $t$ are estimated by Toyo Keizai Shimpo Sha, $Z_d$ by former Nagoya Commercial College.

The necessary lowering rate of terms of trade had to be 1.03%, which is far larger than the actual lowering rate, 0.38%.

Secondly, an analysis of the period from 1894 to 1915 will be made in the following:

The import behavior equation is obtained analyzing figures indicated in the Table (2.5):

$$\log M = 0.4477t + 1.8112 \log Y_d - 2.117$$  \hspace{1cm} (2.10, 3)

$R^2 = 0.9863$

The export behavior equation is obtained by analyzing that of Table (2.6):

$$\log X = -0.3049t + 0.7302 \log Z_d + 0.8150$$  \hspace{1cm} (2.11, 3)

$R^2 = 0.7054$

Elasticity coefficients concerned are:

- Income elasticity coefficient of import: $1.8112 \pm 0.0558$
- Elasticity coefficient of export related to the export industry: $0.7302 \pm 0.1669$
- Price elasticity of import: $1.2589 \pm 0.1133$
- Price elasticity of export: $-0.8573 \pm 0.6598$

The price elasticity coefficient of export has a large error. The condition required to maintain the balance of trade are:

$$0.7302 \dot{G}_e = 0.5875 \dot{G}_d + 1.8112 \dot{G}_d$$

During this period, national income increased by the average annual rate of 3.50%, and the terms of trade decreased by that of 1.23%. Therefore, the growth rate of production in the export industry which is asked to maintain the balance of trade should be 7.84%. This required rate of 7.84% higher than the actual rate of 7.02%. If the adjustment is made in the terms of trade, supposing that this actual rate of 7.02% was maintained, the terms of trade must decrease by the
Table (2.5)  Analysis of Import Behavior 1894–1915

<table>
<thead>
<tr>
<th>Year</th>
<th>log M</th>
<th>Terms of trade</th>
<th>log Yd</th>
</tr>
</thead>
<tbody>
<tr>
<td>1894–1896</td>
<td>1.4893</td>
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<td>1.7043</td>
</tr>
<tr>
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<tr>
<td>1896–1898</td>
<td>1.6662</td>
<td>1.2601</td>
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<td>1897–1899</td>
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<td>1.7670</td>
</tr>
<tr>
<td>1898–1900</td>
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<td>1901–1903</td>
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<tr>
<td>1902–1904</td>
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<td>1.8191</td>
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<tr>
<td>1903–1905</td>
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<td>1908–1910</td>
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<td>1.8924</td>
</tr>
<tr>
<td>1909–1911</td>
<td>1.8533</td>
<td>1.1527</td>
<td>1.9114</td>
</tr>
<tr>
<td>1910–1912</td>
<td>1.8919</td>
<td>1.0590</td>
<td>1.9417</td>
</tr>
<tr>
<td>1911–1913</td>
<td>1.9362</td>
<td>1.0300</td>
<td>1.9810</td>
</tr>
<tr>
<td>1912–1914</td>
<td>1.9552</td>
<td>0.9842</td>
<td>1.9934</td>
</tr>
<tr>
<td>1913–1915</td>
<td>1.9451</td>
<td>0.9804</td>
<td>1.9882</td>
</tr>
</tbody>
</table>

\( M \) and \( t \) are estimated by Toyo Keizai Shinpo Sha, \( Y \) by Hitotsubashi Keizai Kenkyujo.

average annual rate of 2.19%.

Thirdly, in the period from 1919 to 1928 the import behavior equation is as follows (cf. Table 2.7):

\[
\log M = 0.2037t + 0.7725 \log Y_d + 0.3010
\]

\( R^2 = 0.7609 \)  

The export behavior equation is (cf. Table 2.8):

\[
\log X = -0.2751t + 0.9178 \log Z_d + 0.2884
\]

\( R^2 = 0.8630 \)

Elasticity coefficients are:
- of import related to income \( 0.7725 \pm 0.1906 \)
- of export related to the export industry \( 0.9178 \pm 0.1612 \)
- of import related to price \( 0.5174 \pm 0.3513 \)
- of export related to price \( -0.6987 \pm 0.3235 \)

The condition required to maintain the balance of trade is:

\[ 0.9178G + 0.2161G_d + 0.7725G_d \]

The sum of elasticity coefficients of import and export has not a significant difference from unity, taking estimated errors into consideration. It can be said that it is almost close to a critical point. However, according to the above-mentioned equation, the condition required to maintain the balance will be examined in the following.
Table (2.6) Analysis of Export Behavior 1894–1915
index numbers base year: 1913

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports $\log X$</th>
<th>Terms of Trade $t$</th>
<th>Domestic Production $\log Z_d$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1894–96</td>
<td>1.4066</td>
<td>1.2365</td>
<td>1.4363</td>
</tr>
<tr>
<td>1895–97</td>
<td>1.4407</td>
<td>1.2537</td>
<td>1.4932</td>
</tr>
<tr>
<td>1896–98</td>
<td>1.4559</td>
<td>1.2601</td>
<td>1.5382</td>
</tr>
<tr>
<td>1897–99</td>
<td>1.5189</td>
<td>1.2906</td>
<td>1.5507</td>
</tr>
<tr>
<td>1898–99</td>
<td>1.5189</td>
<td>1.3032</td>
<td>1.5658</td>
</tr>
<tr>
<td>1899–99</td>
<td>1.5744</td>
<td>1.2323</td>
<td>1.5729</td>
</tr>
<tr>
<td>1900–02</td>
<td>1.6011</td>
<td>1.1935</td>
<td>1.6012</td>
</tr>
<tr>
<td>1901–03</td>
<td>1.6644</td>
<td>1.2150</td>
<td>1.6187</td>
</tr>
<tr>
<td>1902–04</td>
<td>1.6909</td>
<td>1.2511</td>
<td>1.6609</td>
</tr>
<tr>
<td>1903–05</td>
<td>1.7023</td>
<td>1.2832</td>
<td>1.7127</td>
</tr>
<tr>
<td>1904–06</td>
<td>1.7241</td>
<td>1.3167</td>
<td>1.7515</td>
</tr>
<tr>
<td>1905–07</td>
<td>1.7254</td>
<td>1.3960</td>
<td>1.7843</td>
</tr>
<tr>
<td>1906–08</td>
<td>1.7393</td>
<td>1.3941</td>
<td>1.7863</td>
</tr>
<tr>
<td>1907–09</td>
<td>1.7564</td>
<td>1.3592</td>
<td>1.8056</td>
</tr>
<tr>
<td>1908–10</td>
<td>1.8082</td>
<td>1.2345</td>
<td>1.8222</td>
</tr>
<tr>
<td>1909–11</td>
<td>1.8491</td>
<td>1.1527</td>
<td>1.8659</td>
</tr>
<tr>
<td>1910–12</td>
<td>1.8894</td>
<td>1.0590</td>
<td>1.9220</td>
</tr>
<tr>
<td>1911–13</td>
<td>1.9276</td>
<td>1.0300</td>
<td>1.9660</td>
</tr>
<tr>
<td>1912–14</td>
<td>1.9776</td>
<td>0.9842</td>
<td>1.9898</td>
</tr>
<tr>
<td>1913–15</td>
<td>2.0189</td>
<td>0.9804</td>
<td>1.9965</td>
</tr>
</tbody>
</table>

Base year for index numbers is 1913. $X$ and $t$ are estimated by Toyo Keizai Shinpo Sha. $Z_d$ by former Nagoya Commercial College.

Table (2.7) Analysis of Import Behavior 1919–1928
index numbers base year: 1913

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports $\log M$</th>
<th>Terms of Trade $t$</th>
<th>Real Natl. Income $\log Y_d$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1919</td>
<td>2.1014</td>
<td>1.000</td>
<td>2.1304</td>
</tr>
<tr>
<td>1920</td>
<td>2.0930</td>
<td>0.974</td>
<td>2.0398</td>
</tr>
<tr>
<td>1921</td>
<td>2.1168</td>
<td>1.132</td>
<td>2.1138</td>
</tr>
<tr>
<td>1922</td>
<td>2.2098</td>
<td>1.287</td>
<td>2.1279</td>
</tr>
<tr>
<td>1923</td>
<td>2.2036</td>
<td>1.293</td>
<td>2.1490</td>
</tr>
<tr>
<td>1924</td>
<td>2.2452</td>
<td>1.125</td>
<td>2.1702</td>
</tr>
<tr>
<td>1925</td>
<td>2.2410</td>
<td>1.044</td>
<td>2.1915</td>
</tr>
<tr>
<td>1926</td>
<td>2.2784</td>
<td>1.083</td>
<td>2.2361</td>
</tr>
<tr>
<td>1927</td>
<td>2.3021</td>
<td>1.090</td>
<td>2.2532</td>
</tr>
<tr>
<td>1928</td>
<td>2.2790</td>
<td>1.004</td>
<td>2.3528</td>
</tr>
</tbody>
</table>

$M$ and $t$ are estimated by Toyo Keizai Shinpo Sha. $Y$ by Hitotsubashi Keizai Kenkyujo.

This period involves the years from the Armistic of World War I to the Great Depression (The so-called Showa Kyoko, in Japanese). The wave of business fluctuation was rather strong. According to the logarithmic linear trend
equations derived from the fluctuating annual national income data shows at
the annual rate an increase of 6.22\%, and the terms of trade shows the decrease
of 0.10\%. By substituting these into the above equation, the annual rate of increase
in the export industry which is required to maintain the balance of trade is
5.24\%. The actual increasing rate was, however, a little higher: 6.62\%.
Thus, it can be seen that there was a trend toward improvement of the balance of
trade through the period. As a matter of fact, the trend of foreign trade was
that export increased by the annual rate of 6.25\%, and import increased only
by that of 5.86\%, even if it was converted into the export price base including
the decrease of terms of trade. Therefore a 0.39\% improvement of the balance
of trade was made annually. Nonetheless an excess of imports was noted during
the period. The unfavorable balance was made at the initial stage of the period
and it was not erased in spite of the favorable trend.

Fourthly, in the period from 1928 to 1937—the period involving the Great
Depression mentioned before and its recovery—it was difficult to analyze the
behavior of import and export, as was explained in a previous section. Can
improvement be made in this respect by adding the terms of trade as the
explanatory variable? As mentioned below, a considerable improvement was
made. Yet a really satisfactory result of statistical analysis cannot be obtained.
The import behavior equation is obtained by analyzing the data indicated in
the Table (2.9)

\[
\log M = -0.4903 \log t + 0.1352 \log Y_d + 2.6922
\]

\[
R^2 = 0.7401
\]

Price and income elasticity coefficients are shown with their estimated errors:

price elasticity $-0.4903 \pm 0.1783$
income elasticity $0.1352 \pm 0.2484$

Contrary to examples indicated heretofore, the income elasticity is lacking in
significance. By analyzing the Table (2.10), the following export equation is
obtained:
log $X = -1.0624 \log t + 0.1962 \log Z_d + 3.9731 \quad (2.11,5)$

$R^2 = 0.9282$

Each elasticity coefficient is shown with each error:

price elasticity $\quad -1.0624 \pm 0.5415$

elasticity coefficient related to the export industry $\quad 0.1962 \pm 0.4768$

Each coefficient has not enough significances. The condition required to settle the proper rate of growth in the export industry is:

$$\hat{G}_2 = -2.1809G_t + 0.6890G_d$$

Now the "A" formula will be applied:

The adequate data are available only for the period from 1920 to 1937. In the following, analysis will be made in two separated periods 1920 through 1929 and 1928 through 1937—as was done in previous section

Table (2.9) Analysis of Import Behavior 1928—1937

<table>
<thead>
<tr>
<th>Year</th>
<th>M</th>
<th>$t$</th>
<th>$Y_d$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1928</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1929</td>
<td>2.0134</td>
<td>2.0081</td>
<td>2.0107</td>
</tr>
<tr>
<td>1930</td>
<td>1.9534</td>
<td>1.9778</td>
<td>2.0704</td>
</tr>
<tr>
<td>1931</td>
<td>2.0057</td>
<td>1.9991</td>
<td>2.1099</td>
</tr>
<tr>
<td>1932</td>
<td>1.9968</td>
<td>1.9476</td>
<td>2.1082</td>
</tr>
<tr>
<td>1933</td>
<td>2.0231</td>
<td>1.9131</td>
<td>2.1068</td>
</tr>
<tr>
<td>1934</td>
<td>2.0576</td>
<td>1.8598</td>
<td>2.1202</td>
</tr>
<tr>
<td>1935</td>
<td>2.0677</td>
<td>1.8519</td>
<td>2.1519</td>
</tr>
<tr>
<td>1936</td>
<td>2.1082</td>
<td>1.8383</td>
<td>2.1769</td>
</tr>
<tr>
<td>1937</td>
<td>2.1350</td>
<td>1.7821</td>
<td>2.1601</td>
</tr>
</tbody>
</table>

$M$ and $t$ are estimated by Toyo Keizai Shimpo sha and Yokohama Specie Bank, $y$ by Hitotsubashi Keizai Kenkyujo.

Table (2.10) Analysis of Export Behavior 1928—1937

<table>
<thead>
<tr>
<th>Year</th>
<th>$X$</th>
<th>$t$</th>
<th>$Z_d$</th>
<th>$Z_f$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1928</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1929</td>
<td>2.0472</td>
<td>2.0081</td>
<td>2.0447</td>
<td>2.0340</td>
</tr>
<tr>
<td>1930</td>
<td>1.9956</td>
<td>1.9778</td>
<td>2.0765</td>
<td>1.9867</td>
</tr>
<tr>
<td>1931</td>
<td>2.0093</td>
<td>1.9991</td>
<td>2.0848</td>
<td>1.9366</td>
</tr>
<tr>
<td>1932</td>
<td>2.0701</td>
<td>1.9476</td>
<td>2.1028</td>
<td>1.8832</td>
</tr>
<tr>
<td>1933</td>
<td>2.0939</td>
<td>1.9131</td>
<td>2.1499</td>
<td>1.9336</td>
</tr>
<tr>
<td>1934</td>
<td>2.1623</td>
<td>1.8598</td>
<td>2.2302</td>
<td>1.9832</td>
</tr>
<tr>
<td>1935</td>
<td>2.2176</td>
<td>1.8519</td>
<td>2.2939</td>
<td>2.0375</td>
</tr>
<tr>
<td>1936</td>
<td>2.2555</td>
<td>1.8383</td>
<td>2.3297</td>
<td>2.0986</td>
</tr>
<tr>
<td>1937</td>
<td>2.2730</td>
<td>1.7821</td>
<td>2.3519</td>
<td>2.1406</td>
</tr>
</tbody>
</table>

$X$ and $t$ are estimated by Toyo Keizai Shimpo Sha and Yokohama Specie Bank, $Z_d$ by former Nagoya Commercial College, $Z_f$ by League of Nations.
The period from 1920 to 1929: Analyzing the Table (2.11) the import equation is:
\[
\log M = 0.3989 \log t + 0.6495 \log Y_d - 0.0660 \quad (2.10, 6)
\]
\[R^2 = 0.7789\]

Analyzing the Table (2.12), the export equation:
\[
\log X = -0.2584 \log t + 1.1377 \log Z_f + 0.2442 \quad (2.15, 2)
\]
\[R^2 = 0.8769\]

Elasticity coefficients concerned are:
- of the price for import: 0.3989 ± 0.3018
- of income for import: 0.6495 ± 0.1225
- of the price for export: -0.2584 ± 0.3551
- of income for export: 1.1377 ± 0.1717

Errors of price elasticity coefficients are as great as those of previous analysis. The condition to settle the proper rate of growth in the national economy is:
\[
\hat{G}_d = 0.5276G_t + 1.7516G_f
\]

The period from 1928 to 1937: The import equation is the same as in the "B" formula:
\[
\log M = -0.4903 \log t + 0.1352 \log Y_d + 2.6922 \quad (2.15, 4)
\]
\[R^2 = 0.7401\]

Analyzing the Table (2.10), the export equation is:
\[
\log X = -1.1441 \log t + 0.2291 \log Z_f + 3.8474 \quad (2.15, 4)
\]
\[R^2 = 0.9440\]

In this equation, errors are relatively large in the income elasticity coefficient as shown below:
- of the price: -1.1441 ± 0.1400
- of income: 0.2291 ± 0.1452

Table (2.11) Analysis of Import Behavior 1920–1929

<table>
<thead>
<tr>
<th></th>
<th>imports</th>
<th>terms of trade</th>
<th>real natl. income</th>
</tr>
</thead>
<tbody>
<tr>
<td>log M</td>
<td>log t</td>
<td>log Y_d</td>
<td>log Y_d</td>
</tr>
<tr>
<td>1920</td>
<td>1.8140</td>
<td>1.9869</td>
<td>1.6870</td>
</tr>
<tr>
<td>1921</td>
<td>1.8378</td>
<td>2.0522</td>
<td>1.7610</td>
</tr>
<tr>
<td>1922</td>
<td>1.9308</td>
<td>2.1079</td>
<td>1.7751</td>
</tr>
<tr>
<td>1923</td>
<td>1.9246</td>
<td>2.1099</td>
<td>1.7952</td>
</tr>
<tr>
<td>1924</td>
<td>1.9662</td>
<td>2.0494</td>
<td>1.8174</td>
</tr>
<tr>
<td>1925</td>
<td>1.9620</td>
<td>2.0153</td>
<td>1.8387</td>
</tr>
<tr>
<td>1926</td>
<td>1.9994</td>
<td>2.0329</td>
<td>1.8833</td>
</tr>
<tr>
<td>1927</td>
<td>2.0231</td>
<td>2.0357</td>
<td>1.9004</td>
</tr>
<tr>
<td>1928</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1929</td>
<td>2.0134</td>
<td>2.0081</td>
<td>2.0107</td>
</tr>
</tbody>
</table>

*M and t are estimated by Toyo Keizai Shimpo Sha, Y by Hitotsubashi Keizai Kenkyujo.*

The condition to settle the proper rate of growth in the national economy is:
\[
\hat{G}_d = 2.5606 G_t + 1.6945 G_f
\]
Table (2.12) *Analysis of Export Behavior 1920—1929*

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Terms of Trade</th>
<th>World Production</th>
</tr>
</thead>
<tbody>
<tr>
<td>1920</td>
<td>1.7681</td>
<td>1.9869</td>
<td>1.8179</td>
</tr>
<tr>
<td>1921</td>
<td>1.7411</td>
<td>2.0522</td>
<td>1.7575</td>
</tr>
<tr>
<td>1922</td>
<td>1.8667</td>
<td>2.1079</td>
<td>1.8464</td>
</tr>
<tr>
<td>1923</td>
<td>1.7423</td>
<td>2.1099</td>
<td>1.8675</td>
</tr>
<tr>
<td>1924</td>
<td>1.8520</td>
<td>2.0494</td>
<td>1.8936</td>
</tr>
<tr>
<td>1925</td>
<td>1.9356</td>
<td>2.0153</td>
<td>1.9302</td>
</tr>
<tr>
<td>1926</td>
<td>1.9423</td>
<td>2.0329</td>
<td>1.9505</td>
</tr>
<tr>
<td>1927</td>
<td>1.9769</td>
<td>2.0357</td>
<td>1.9770</td>
</tr>
<tr>
<td>1928</td>
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<td>2.0000</td>
<td>2.0000</td>
</tr>
<tr>
<td>1929</td>
<td>2.0472</td>
<td>2.0081</td>
<td>2.0340</td>
</tr>
</tbody>
</table>

*X* and *t* are estimated by Toyo Keizai Shimpo Sha, *Zf* by League of Nations.

In this period, the “A” formula obtained slightly better results than the “B” formula. However, results are not so reliable as that the proper economic judgment can be formed on the basis of it.

For the first approach to the coordination of “A” and “B” formulas, the terms of trade as the explanatory variables were added to functions of import and export behavior. There is no question about the import functions, for both formulas accept the same equation. However, there is a question about the export function. As the export function has different way of using the variables which explain the shift of export curve, the coordination of the two equations of different types is to be made mainly by parameters concerning the terms of trade which are held in common by both equations. If both formulas contain structural equations to determine statistically significant export behaviors, parameters concerning the terms of trade must be the same. Both formulas, as a matter of fact, have not statistically significant results as to the said parameters. Under these circumstances, it is almost impossible to examine which formula is superior as the working hypothesis for the statistical analysis. Another method has to be studied for the coordination.

III. *Model Analysis*

By coordinating “A” and “B” formulas, models are hypothetically formed. In the following, model will be verified in comparison with economic data. At first, by taking the “B” formula into the “A” formula the model “A” will be formed. As to the export function, the equation of the “A” formula is used without change:

\[
\log X = -a \log t + b \log Z_f + h, \quad (3.1)
\]
Then, the relation in which the export demand brings about production of the
domestic export industry will be explained by reversing the variables of export
equation in the "B" formula:

\[ \log Z_d = c \log t + d \log X + h_2 \]  \hspace{1cm} (3. 2)

As to the import function, the previous equation is used:

\[ \log M = e \log t + f \log Y_d + h_4 \]  \hspace{1cm} (3. 3)

The equation shown the behavior of balance of trade is added:

\[ \log M = l \log t + g \log X + h_3 \]  \hspace{1cm} (3. 4)

If the trade is always balanced, it must be:

\[ \log M = \log t + \log X \]

However, it is not always, in reality, balanced, and it is presumed to be like the
equation (3.4). It seems that this is the necessary step to make the application
of the model possible.

The model is formed with above-mentioned four equations. As their variables
are six—Z_f, t, X, M, Y_d and Z_d, it is regarded that two variables out of the six
are given to national economy as exogenous variables. Doubtlessly, Z_f is pre-
determined. As the terms of trade have the marked tendency to be easily in-
fluenced by the behavior of the the world economy, it is assumed as the prede-
determined factor in this model. There is no way except verifying empirically whether
it is proper to regard it as a predetermined one.

In this way, if Z_f and t are regarded as predetermined factors, which are
determined exogenously by the tendency of the world economy, the system of
simultaneous equations consisting of above-mentioned four equations contains
the sufficient information which settles endogeneous variables, X, M, Y_d and Z_d.
In order to solve this equations, it is required to derive the equations which explain
the dispersion of each endogeneous variable by only exogeneous variables as
the exlanatory variables. The following reduced froms are derived by simple
algebra:

\[ \log X = -a \log t + b \log Z_f + h_1 \]  \hspace{1cm} (3. 1)

\[ \log Z_d = (c - ad) \log t + bd \log Z_f + (h_1d + h_2) \]  \hspace{1cm} (3. 5)

\[ \log X = \frac{l - ag - e}{f} \log t + \frac{bg}{f} \log Z_f + \frac{gh_1 + h_4 - h_3}{f} \]  \hspace{1cm} (3. 6)

\[ \log M = (l - ag) \log t + bg \log Z_f + (gh_1 + h_4) \]  \hspace{1cm} (3. 7)

After applying these equation to observable data, each parameter is determined.
Then the parameter of the origninal model is derived from them.

As it will be explained later, the model "A" is probably useful to make con-
siderably clear the relation between the foreign trade and national economy,
as far as Japan continues to develope her trade in line with the behaivior of the
international economy without forming strong export drive policy. In short,
this model is a useful working hypothesis under normal conditions.

(Post-war days) The model will be applied to the period between 1950 and 1956. The necessary data are described in the Tables (2.1) and (2.2) of the previous section. By analyzing them, the following equation are obtained:

\[
\log X = -0.1893t + 3.3825Z_f - 4.5474 \\
R^2 = 0.9245
\]

\[
\log Z_d = 0.2500t + 2.8750 \log Z_f - 4.0243 \\
R^2 = 0.9486
\]

\[
\log Y_d = -0.0984t + 1.5189 \log Z_f - 0.9499 \\
R^2 = 0.9922
\]

\[
\log M = 0.3636t + 3.0454 \log Z_f - 4.4819 \\
R^2 = 0.9545
\]

From these equations, the model "A" is derived

\[
\log X = -0.1893t + 3.3825 \log Z_f - 4.5474 \\
R^2 = 0.9245
\]

\[
\log Z_d = 0.4108t + 0.8499 \log X - 0.1595 \\
R^2 = 0.9486
\]

\[
\log M = 0.5609t + 2.0050 \log Y_d - 2.5780 \\
R^2 = 0.9922
\]

\[
\log M = 0.5340t + 0.9003 \log X - 0.3879 \\
R^2 = 0.9545
\]

The results which were solved by a simple least square method are as follows:

\[
\log Z_d = 0.6413t + 0.7267 \log X - 0.1415 \\
R^2 = 0.8653
\]

\[
\log M = 0.4942t + 2.0859 \log Y_d - 2.8045 \\
R^2 = 0.9892
\]

\[
\log M = 0.7759t + 0.7175 \log X - 0.2656 \\
R^2 = 0.8082
\]

Except for equation (3.1, 1), those solves by the former simultaneous equations have errors smaller than those by the latter. Nonetheless, parameters concerning the terms of trade are as yet unreliable.

(Pre-war days) Model analysis will be conducted for the period between 1920 and 1929, using the data of (2.11) and (2.12) Table of the previous section:

\[
\log X = -0.2584 \log t + 1.1377 \log Z_f + 0.2442 \\
R^2 = 0.8769
\]

\[
\log Z_d = 0.0797 \log t + 1.1052 \log Z_f - 0.3862 \\
R^2 = 0.9621
\]

\[
\log Y_d = 0.0886 \log t + 1.1084 \log Z_f - 0.4480 \\
R^2 = 0.8406
\]

\[
\log M = 0.5740 \log t + 0.8637 \log Z_f - 0.8711 \\
R^2 = 0.9192
\]

From the above equations the model is:

\[
\log X = -0.2584 \log t + 1.1377 \log Z_f - 0.2442 \\
R^2 = 0.8769
\]

\[
\log Z_d = 0.3307 \log t + 0.9714 \log X - 0.6234 \\
R^2 = 0.9621
\]

\[
\log M = 0.5050 \log t + 0.7792 \log Y_d - 0.5302 \\
R^2 = 0.9701 \log t + 0.7591 \log X - 1.0564 \\
R^2 = 0.9192
\]

Comparing these with the equations, derived by the simple least square method,
import functions of the former and the latter are as follows:

[The former] \[ \log M = 0.5050 \log t + 0.7792 \log Y_d - 0.5302 \]
\[ (0.1694) \quad (0.0686) \]

[The latter] \[ \log M = 0.3989 \log t + 0.6495 \log Y_d - 0.0660 \]
\[ (0.3018) \quad (0.1225) \]

The equation of the former, on the whole, has small estimated error, and each parameter has considerably the more minor errors (as shown in parentheses). The condition settling the required rate of growth of national income which corresponds to the equilibrium between incoming and outgoing of trade becomes:

\[ \hat{G}_d = 0.3036G_t + 1.4600G_f \]

In fact, as indicated in the equation (3. 6, 2,) the actual rate of growth was:

\[ G_d = 0.0886G_t + 1.1084G_f \]

Therefore it may be safely said that, \( G_d \) being smaller than \( \hat{G}_d \), the balance of trade tended toward improvement.

Japanese economy at that time was remarkably influenced by the world economy. The expansion of production of the world manufacturing industry was increasing the total export, manufacturing production and national income in Japan at almost the same rate as that of its own expansion. The total import was increasing at a little slower rate than that. It can be said that, for Japanese economy, it was proceeding along the normal road of economic development.

The application of the model "A" is difficult in the case of the following period—from 1928 to 1937. The results of analysis of the Table (2.9) and 2.10) are shown:

\[ \log X = -1.1441 \log t + 0.2291 \log Z_f + 3.8474 \]  
\[ R^2 = 0.9440 \]  
(3. 1, 3)

\[ \log Z_d = -1.0160 \log t + 0.1500 \log Z_f + 3.7534 \]  
\[ R^2 = 0.9561 \]  
(3. 5, 3)

\[ \log Y_d = -0.7573 \log t - 0.2422 \log Z_f + 4.0389 \]  
\[ R^2 = 0.7590 \]  
(3. 6, 3)

\[ \log M = -0.4756 \log t + 0.2419 \log Z_f + 2.4635 \]  
\[ R^2 = 0.8774 \]  
(3. 7, 3)

From them, the model is:

\[ \log X = -1.1441 \log t + 0.2291 \log Z_f + 3.8474 \]  
(3. 1, 3)

\[ \log Z_d = -0.3656 \log t + 0.6547 \log X + 1.2345 \]  
(3. 2, 3)

\[ \log M = -1.2319 \log t - 0.9987 \log Y_d + 6.4971 \]  
(3. 3, 3)

\[ \log M = 0.7321 \log t + 1.0556 \log X - 1.5978 \]  
(3. 4, 3)

Where production of the export industry ought to have a positive correlation to the terms of trade, the parameter of the terms of trade in the equation (3. 2, 3) is negative. The response of import demand to the terms of trade also ought to be positive, but it is negative (cf. the equation (3. 3, 3)). Owing to the sudden fall in exchange rate after the Depression, the terms of trade were rapidly getting worse. Responding to the expansion of export despite the decline of terms of trade, the export industry continued to increase productions. Import also in-
creased. By analyzing this very fact, such relations as the production of the export industry and the total import increase by the decline of terms of trade are obtained, but these results are lacking in economic meaning. This shows that the hypothesis taken up in analyzing was clearly a wrong one. That is the model "A" is not proper working hypothesis to explain the movement at that time.

The hypothesis which formed the basis of the model was taken up to interpret the trend of domestic economy by production of the world manufacturing industry and the terms of trade as predetermined factors. However, under the economic situation in Japan at that time, the world manufacturing industry was unable to explain the movement of Japan's domestic economy adequately, and the terms of trade are not regarded as the predetermined factor. In the middle of the world-wide depression, Japan attempted to overcome her own domestic slump by driving export strongly, and at the same time, enduring the rapid decline of terms of trade. Defying the world-wide depression, she tried to recover her economic situation from its depression. The weapon on the occasion was the export drive. To express these circumstances, export is regarded as the exogeneous variable in the sense of the political factor. As the production of the world manufacturing industry is no longer the powerful variable to explain Japan's economic movement, but is certainly the exogeneous variable from Japan's economic point of view, it is also regarded as the predetermined factor.

In the model "B", the Japan's export and the production of the world manufacturing industry are regarded exogeneous variables, while the terms of trade, the import, national income and production of the export industry in Japan are regarded as endogenous variables. The structure of the model "B" is as follows:

\[
\begin{align*}
\text{(the terms of trade)} & \quad \log t = -a \log X + b \log Z_f + h_1 \\
\text{(the export industry)} & \quad \log Z_d = c \log t + d \log X + h_2 \\
\text{(the balance of payments)} & \quad \log M = e \log t + f \log X + h_3 \\
\text{(the trade multiplier)} & \quad \log Y_d = g \log X + h_4
\end{align*}
\]

Their reduced form are as follows:

\[
\begin{align*}
\log t &= -a \log X + b \log Z_f + h_1 \\
\log Z_d &= (d - ac) \log X + bc \log Z_f + (ch_1 + h_2) \\
\log M &= (f - ae) \log X + be \log Z_f + (eh_1 + h_3) \\
\log Y_d &= g \log X + h_4
\end{align*}
\]

By applying these to data in the period between 1928 and 1937:

\[
\begin{align*}
\log t &= -0.7801 \log X + 0.1107 \log Z_f + 3.3438 \\
R^2 &= 0.9326 \\
\log Z_d &= 0.7857 \log X + 0.0441 \log Z_f + 0.3575 \\
R^2 &= 0.8944 \\
\log M &= 0.4239 \log X + 0.1388 \log Z_f + 0.8626 \\
R^2 &= 0.9261 \\
\log Y_d &= 0.4481 \log X + 1.1549 \\
r^2 &= 0.6530
\end{align*}
\]
From these, the model is derived as follows:
\[
\begin{align*}
\log t &= -0.7801 \log X + 0.1107 \log Z + 3.3438 \\
\log Z_d &= 0.3983 \log t + 1.0964 \log X - 0.9743 \\
\log M &= 1.2538 \log t + 1.4119 \log X - 4.3079 \\
\log Y_d &= 0.4481 \log X + 1.1549
\end{align*}
\]
(3.8, 1)
(3.9, 1)
(3.10, 1)
(3.11, 1)

The model gives sufficient information as to the circumstances mentioned below:

1. Japanese economy is less influenced by the world economic trend.
2. Export drives caused the heavy decline of terms of trade.
3. Expansion of export increased the production of the export industry at almost the same pace, and expanded national income at the rate of growth nearly half that of manufacturing production.
4. As a result, an unequal development inside the national economy took place.

By applying this model to the period from 1920 to 1929, the equation (3.8) which is supposed to be the most important support of this model becomes as follows:
\[
\begin{align*}
\log t &= -0.2402 \log X + 0.0935 Z_f + 2.3147 \\
R^2 &= 0.2090
\end{align*}
\]
The correlation in the equation is weak, and it makes the application of the model difficult.

Applied to the period between 1950 and 1956 in post-war years:
\[
\begin{align*}
t &= -0.5070 \log X + 2.4478 \log Z_f - 2.8417 \\
R^2 &= 0.7549 \\
\log Z_d &= -0.3043 \log X + 4.0567 \log Z_f - 5.5150 \\
R^2 &= 0.9562 \\
\log M &= -0.7042 \log X + 5.5887 \log Z_f - 8.7495 \\
R^2 &= 0.9852 \\
\log Y_d &= 0.4079 \log X + 1.1648 \\
R^2 &= 0.9261
\end{align*}
\]
The model becomes:
\[
\begin{align*}
t &= -0.5070 \log X + 2.4478 \log Z_f - 2.8417 \\
\log Z_d &= 1.6572t + 0.5359 \log X - 0.8058 \\
\log M &= 2.2831t + 0.4533 \log X - 2.2617 \\
\log Y_d &= 0.4079 \log X + 1.1648
\end{align*}
\]
(3.8, 2)
(3.9, 2)
(3.10, 2)
(3.11, 2)

Compared with the analysis done with model "A", (1) the correlation of the basic equation (3.8) of the model "B" is weak, and (2) in the two equations (3.9) and (3.10) which have the same functional forms, estimated errors are great. Therefore, it seems that model "B" is inferior to the former. Except for such periods with special policy as the one from 1928 and 1937, model "B" is not always the proper hypothesis analyze the relation between foreign trade and national economy in Japan.