The Japanese System of
Foreign Exchange and Trade Control,
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Working Paper No. 123

A version of this paper was presented at the conference *Micro-economic Reform and Deregulation in Japan* held at Columbia University on March 22-23, 1996.

Working Paper Series
Center on Japanese Economy and Business
Columbia Business School
June 1996

May 1996

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Introduction

Whether by choice or by necessity, liberalization is the key principle by which the Japanese authorities have guided the structural transformation of the Japanese economy over the past several decades. To be sure, the economy inherited from the World War II era was highly regimented, and it could only be changed in one direction, if it were to change at all. However, the pace, as well as the timing, of liberalization or deregulation have differed from sector to sector. Of the many regulated sectors of the economy, the trade and payments system was certainly among the most restrictive in the early 1950s. It was also among the first to be liberalized albeit in a piecemeal fashion, with full liberalization virtually completed in 1964 for current transactions.[1]

This paper will present a summary of how Japan's system of foreign exchange and trade control operated in the early 1950s as well as how it was liberalized from the late 1950s into the early 1960s. As it stands, the paper is largely descriptive and is intended to provide background information for conducting more analytical studies of some of the economic policies of the early post-war period. For example, in order to assess the nature and effectiveness of the stabilization programs of 1953-54 and 1957-58 (both supported by the International Monetary Fund), it is crucial to understand the institutional apparatus of the restrictive system, including the tools of trade control. Although the restrictive system of the type considered in the paper existed from 1950 (when the first foreign exchange budget was formulated) to 1964 (when the foreign exchange budget system was

[1] For capital transactions, the process of liberalization was not completed until the 1980s. See Takagi (1994). For the liberalization of domestic financial markets, see Takagi (1988).

abolished), greater emphasis will be placed on the earlier period (through the latter part of the 1950s) because, with the more favorable performance of Japanese exports and the restoration of convertibility for most European currencies in the late 1950s, Japan's system of foreign exchange and trade control became increasingly flexible in its operation.

The rest of the paper is organized as follows. Section I will summarize the principal features of the restrictive system as it existed in the early 1950s, including the legal framework, the foreign exchange budget, the concentration requirement for foreign exchange, the regulations governing foreign exchange transactions and foreign exchange rates, and the prescribed methods of external payment. Section II will take a more detailed look at the system of trade control in the early 1950s, including export control procedures, the import licensing system, the tools of import control, the Special Exchange Fund Allocation System (or the system of retention quotas or credits), and the control of invisible receipts and payments. Section III will review the operation of the restrictive system as a policy tool, by discussing how the system was used to cope with the balance of payments crises of 1952-53 and 1956-57. Section IV will review major deregulatory changes from the middle of the 1950s through the early 1960s, including those related to the currency area classification, the system of export control, the foreign exchange market, the import licensing system, other aspects of import control, and capital transactions, and ends with a discussion of the program of import liberalization which began in June 1960. Finally, section V will present concluding remarks.

I. An Outline of the Restrictive System in the Early 1950s

(1) The Legal and Administrative Framework

On December 1, 1949, when Japan was still under Allied occupation, the Foreign Exchange and Foreign Trade Control Law (FEFTCL) was promulgated, setting forth the principle that all external transactions were prohibited unless expressly authorized. On the same day, a Cabinet order was issued requiring the formulation of a foreign exchange budget for the purpose of allocating foreign exchange for external payments, beginning in January 1950. The foreign exchange budget (FEB) formed the basis of Japan's restrictive system until it was abolished on April 1, 1964, when Japan accepted the obligations of Article 8 of the Articles of Agreement of the International Monetary Fund (IMF) by removing all remaining exchange restrictions on current transactions. For the period under consideration (1950-1964), the FEFTCL was the legal framework, and the FEB was the central tool, of the restrictive trade and payments system.

In this system, the Ministry of Finance (MOF), through its Foreign Exchange Bureau, was responsible for general foreign exchange control. With the abolishment of the Foreign Exchange Control Board and the Foreign Investment Commission on July 31, 1952, the MOF also assumed responsibility for the concentration of foreign exchange reserves, the management of the Foreign Exchange Fund Special Account, and the administration of foreign investment control. The Ministry of International Trade and Industry (MITI) performed foreign trade control and the licensing of imports and exports. The Bank of Japan (BOJ) was given charge of the routine day-to-day operation of the system as the agent of the national government.

(2) The Foreign Exchange Budget

The fundamental tool of foreign exchange and trade control was the Foreign Exchange Budget system (Gaikoku Kawase Yosan Seido), under which the allocation of foreign exchange was made. The FEB, which was first formulated for the January-March quarter of 1950, was initially determined quarterly. Beginning in fiscal 1952, however, the formulation of FEBs became semiannual (Table 1).[2] The FEB, which must be approved by the Ministerial Council, prescribed foreign exchange payments on the basis of anticipated foreign exchange receipts for the period concerned. Exchange receipts and payments for different types of commodities were initially classified into the dollar area, the sterling area and the open account area (see below for details).

(3) The Concentration Requirement

Under the system of foreign exchange concentration (Gaika Shuchu Seido), all residents were required to sell foreign means of payment acquired to authorized foreign exchange banks, money changers (e.g., travel agencies and hotels) or post offices within 10 days of the date of acquisition. Authorized foreign exchange banks would buy foreign exchange from their customers for the account of the Foreign Exchange Fund Special Account of the national budget.

Until the end of June 1950, foreign exchange banks had been required to surrender foreign exchange obtained to the Foreign Exchange Control Board. They also needed to buy

[2] The Japanese fiscal year begins on April 1 and ends on March 31 of the following year. Thus, fiscal 1952 covers the 12-month period from April 1952 to March 1953.

foreign exchange requested by their customers on a case-by-case basis. From July 1950, however, foreign exchange banks were permitted to hold dollar funds as working balances, subject to BOJ approval, and this provision was extended to foreign exchange balances expressed in sterling in March 1953.

As a further liberalization measure, in April 1952, authorized foreign exchange banks became subject to the more relaxed requirement that they surrender only that portion of foreign exchange in excess of a designated amount within 10 days (within one month from June 1971) of acquisition.[3] In June 1952, foreign exchange banks were authorized to maintain US dollar balances for settlement purposes at foreign correspondence banks, and this provision was extended to sterling balances in March 1953.

(4) Foreign Exchange Transactions

In principle, all transactions between residents and non-residents were prohibited unless expressly authorized, even when the yen was involved. Likewise, all transactions between residents involving foreign currency and all transactions between non-residents involving yen were subject to control. License by the MITI was required when transactions were effected by exporters or importers in direct connection with exports or imports. License by the MOF was required in all others.

Although both inward and outward movements of capital were subject to control, outward movements were particularly severely restricted. Investments abroad were approved on a case-by-case basis. Issuance of securities abroad by a resident and issuance of

[3] The system of foreign exchange concentration was not abolished in its entirety until May 1972.

securities in Japan by a non-resident were subject to license by the MOF. Subscription to foreign securities by a resident and subscription to domestic securities by a non-resident were similarly subject to license by the MOF.

(5) Exchange Rates

On December 1, 1949, the US dollar and the pound sterling were designated as eligible currencies for use in external transactions and were called designated foreign currencies (shitei tsuka). In special cases, however, authorization could be obtained to use means of payment denominated in other currencies. In subsequent years, additional currencies were added to the list of designated currencies, as Japan concluded new bilateral trade and payments treaties with the respective governments or as the currencies became convertible (Table 2). The MOF determined the rates at which the BOJ would buy or sell foreign exchange as well as the commissions to be charged by money changers. The MOF also determined the interbank rates at which the foreign exchange banks must trade foreign exchange with each other.

The unified exchange rate of ¥360 per US dollar was established on April 25, 1949, with the official selling rate of ¥360.35 and the official buying rate of ¥359.65.[4] When the US dollar and the pound sterling became the designated foreign currencies in December1949, it was announced that the basic exchange rate (kijun gaikoku kawase soba) was ¥360 per US dollar and that the arbitrage exchange rate (saitei gaikoku kawase soba) was ¥1008 per pound. Subsequently, the MOF changed the official selling and buying rates to ¥360.80 and

[4] The rate of ¥360 per US dollar became the yen's parity at the IMF on May 11, 1953, some nine months after Japan had joined the organization (i.e., on August 13, 1952).

¥359.20, respectively, on January 12, 1953. In January 1954, it was determined that the arbitrage exchange rate for the pound sterling would be adjusted in line with the market conditions in London.

The MOF also determined the forward rates as well as the length of forward contracts. Forward exchange contracts could be concluded by a foreign exchange bank with its customers, another foreign exchange bank or the BOJ. In the case of sterling, the forward contracts could not exceed 6 months for sales and 4 months for purchases, although the term of buying contracts could be extended to 6 months or a year. For the US dollar, the official selling rate was 0.10 yen higher than the spot rate, and the buying rate was 0.10 yen lower than the spot rate for each ten days forward. In the case of sterling, the selling rate was the same as the spot rate and the buying rate was 0.28 yen lower than the spot rate for each ten days forward.

(6) Methods of External Payment

Both the currency and the terms of payment were prescribed for different types of external transactions. There were three standard methods of payment (hyojun kessai), corresponding to the three designated currency areas: (1) settlement in sterling on a cash basis for countries with sterling payment agreements; (2) settlement through bilateral clearing accounts (called open accounts) expressed in US dollars for countries with special payment agreements (Table 3); and (3) settlement in US dollars on a cash basis for all others.

II. The System of Trade Control in the Early 1950s

(1) Export Control

Until the enactment of the FEFTCL, all exports had been subject to licensing. With the enactment of the FEFTCL, however, exports became freely permitted, except for certain designated commodities, such as those of strategic nature, those in short domestic supply, etc. Export control was also used from time to time to adjust Japan's trade relations with the sterling area and open account countries in order to reduce the balance of inconvertible currencies. The export of some commodities to the dollar area was also placed under annual quota for political and other reasons, an example being the export of canned tuna to the US. Except for these and other designated commodities, no license was required for export trade, except that the certification of a foreign exchange bank was required to prevent capital flight through under-declaration and to assure prompt settlement by a standard method.

To appreciate the way in which trade control procedures were used for exports, it is important to understand that Japan was securing a substantial portion of raw materials from the dollar area, while its principal exports went to the soft currency countries. As a result, Japan's merchandise trade balance could be in surplus with the sterling or open account areas, even when the balance was in substantial deficit with the dollar area (see, for example, the figures for fiscal 1951 and 1954 in Table 4). While the initial agreement with the UK (concluded in May 1948) had allowed Japan to convert sterling balances in excess of a certain designated amount into dollars every six months, this so-called "dollar clause" was abolished in April 1951. Thus, sterling balances did increase steadily from early 1951 through 1952 (Table 5).

For this reason, the authorities used control procedures to discourage exports of goods to the sterling area by placing certain goods under the licensing procedure, or shortening the period of execution of export contracts. For a time, the discount rate for sterling area export bills was set higher than that for the dollar area, margins were increased for the buying rate of spot and forward sterling, and the length of forward contracts in sterling was reduced from a year to three months.

On the other hand, retention credits (or quotas) were granted in different percentages for three categories of goods (to be explained below) in order to encourage exports to the dollar area. The retention credits could be used to import goods on a specified list or for travel and other invisible expenses associated with the promotion of trade. The procedure for obtaining the license to import with retained exchange was simpler than the usual procedure.

The system of linking exports with preferred imports was another way of promoting certain exports. For example, the export of raw silk, whale oil and plant equipment was linked with the import of Cuban sugar, which was cheaper than sugar from Taiwan or Indonesia. Because the domestic price of sugar was set much higher than the import cost of Cuban sugar, the profit from its sales provided an incentive to expand the export of those designated commodities. In May 1954, however, the linking of raw silk with Cuban sugar was suspended, because the export of silk had exceeded the target for the April-June period.

The Japanese authorities also adopted the system of granting preferential treatment in the allocation of foreign exchange for the import of raw materials to those manufacturers who could fulfill their export quotas. Ratios were fixed between the raw materials allocated and the exports of finished products. As of November 1954, imports of six raw materials were linked to exports of their final products: raw cotton to cotton textile products, wood to wood products, rayon pulp to artificial fiber products, iron and steel scrap to iron and steel products, lumber to plywood, and beef tallow to glycerin.

(2) The Import Licensing System

Import licenses were granted within the framework of the FEB, which specified the maximum amounts for overall as well as individual imports. With minor exceptions (e.g., government imports), all goods to be imported must be licensed. Licenses were fairly freely granted for foodstuffs, basic raw materials and specified machinery and equipment. More severe restrictions were imposed on consumer goods, especially luxuries. All licensed imports were planned in the exchange budget and made public through the MITI's "import announcements" (yunyu kohyo, or Tsusho Sangyosho Kokuji) from time to time. The announcements included information regarding: (1) the commodities for which application for license to import would be accepted; (2) the currency of settlement; (3) the import limit for one applicant; (4) the opening and closing dates for license application; (5) the percentage of required guaranty money (to be explained below); (6) the foreign exchange allocation requirements; (7) the shipment area; (8) the settlement period; and (9) others.

Initially, the regular imports covered by these announcements were licensed under two principal systems. [5] First, the most important instrument of import control was direct allocation of exchange under the Fund Allocation (FA) system (Gaika Shikin Wariate Sei), consisting of establishing quotas for the importation of particular goods from particular currency areas. In 1953, for example, the FA System was applied to about 65 percent of all imports, covering foodstuffs, raw materials and other essentials, primarily from the dollar area. The MITI allocated import allocation certificates to importers entitling them to obtain the necessary exchange from authorized foreign exchange banks. A lump sum of exchange was allotted to each importer for a certain commodity with a view to insuring proper supply of raw materials to selected industries.

Second, another system of import licensing was the Automatic Approval (AA) system (Jido Shonin Sei), which was first introduced in August 1950 (Table 6). The AA system was applied to about 34 percent of all imports in 1953. Licenses were issued as long as the budgetary quota for a particular currency area was not fully committed. No quantitative limit was set for each commodity, but only the limit for overall imports from a particular currency area was set. This system was applied to goods which could not be easily allocated to specific industries.

(3) Tools of Import Control

As a means of relaxing or tightening restrictions, goods were constantly shifted from one licensing system to another. To encourage imports from certain areas, for example, the

[5] In addition, there was a minor system called "the First-Come, First-Served System", applied to those commodities which Japan was obliged to import in order to comply with the provisions of certain trade and payments agreements. This licensing system, which covered only about one percent of total imports in 1953, would be formally abolished in November 1956.

goods subject to direct allocation of exchange under the FA system might be moved to the AA list. To discourage imports from some areas, on the other hand, some goods might be withdrawn from the AA list and be placed on the FA list.

Non-quantitative measures for import control included financial incentives and the imposition of more strict terms of settlement. To encourage imports, for example, better import financing facilities, such as yen usance bills or foreign exchange loans with a much lower rate of interest, were extended. To discourage imports, the application period or the terms of license might be shortened.

The system of guarantee money was another tool of import control. Applicants for import licenses under the AA system were required to make a deposit of import guarantee money (yunyu hoshokin), the amount of which was calculated by multiplying the value of the intended import by the percentage specified for the particular category of goods and the currency area from which they were being imported. In cases of cancellation, the deposit was in principle confiscated. To encourage or discourage imports, the deposit requirements for particular items might be lowered or raised, either collectively or discriminately.

(4) The Special Exchange Fund Allocation System

The Special Exchange Fund Allocation System (Gaika Shikin Tokubetsu Wariate Seido), called the Export Promotion Foreign Exchange System (Yushutsu Shinko Gaika Shikin Seido) prior to August 1953, was originally introduced in July 1949 on a non-discriminatory basis for all currency areas, with three different percentages of 3, 6 and 10 applied on the basis of the type of commodities exported. Retention credits could be used to make payments for certain commodities and services under a much simpler licensing procedure. All payments abroad to be effected with retention credits required the prior approval of the BOJ in the case of non-trade payments, and the approval of the MITI in the case of imports.

The system, however, was suspended in the middle of 1951, and was reinstated in December 1951 on a discriminatory basis. The old set of retained percentages (3, 6, 10) was applied only to exports to the dollar area, while the percentages for exports to the other currency areas were set at 1, 3 and 6 percent. In July 1952, the allocation of retention credits for exports to the sterling area and open account countries was suspended because of the excessive accumulation of sterling and open account dollar balances. At the same time, the retention percentages for exports to the dollar area were raised to 5, 10 and 15 percent. The scope of eligible imports under the system was also expanded from "raw materials, machinery, instruments and related commodities which are recognized to contribute to export promotion" to "commodities which are recognized to contribute to export promotion or the reconstruction and stabilization of the economy".

In particular, retention credits could be used for the following purposes: (1) expenses for traveling or staying abroad connected with the promotion of trade; (2) advertising, research and similar expenses associated with the promotion of trade; (3) freight, insurance premium and similar expenses associated with goods imported by the use of retention credits; (4) expenses associated with the establishment of branches in foreign countries; (5) goods deemed to contribute to the promotion of exports and the rehabilitation of the economy; and (6) samples, catalogs and other similar materials. In August 1953, the uniform rate of 10 percent was applied to all exports regardless of the currency area, with the name of the system changed from the Export Promotion Foreign Exchange System to the Special Exchange Fund Allocation System.

(5) Control of Invisible Receipts and Payments

In general, transactions which would result in a receipt of funds from abroad could be conducted relatively freely and no license was required if settlements were to be effected by a standard method. Payments for invisible services rendered by non-residents, however, were subject to stricter control. The conclusion of a transportation contract in connection with imports required a license. Licenses to purchase foreign exchange could be obtained from the MITI in case of travel directly connected with imports or exports, and from the MOF in all others. The purchase and sale of patent rights, other industrial property rights and mining rights were subject to prior approval by the MITI.

III. The Operation of the Restrictive System as a Policy Tool

(1) The Balance of Payments Crisis of 1952-53

Japan's balance of payments deteriorated sharply in 1952 and 1953. The deterioration was due in part to the stagnation of the world economy and the imposition of import restrictions against Japanese exports by members of the British Commonwealth and some open account countries, but it could more directly be attributable to the sizable expansion of Japan's domestic demand. While the overall merchandise trade deficit deteriorated from $249 million in fiscal 1951 to $997 million in fiscal 1953, the deterioration was even more pronounced for the sterling balance: the surplus of $231 million in fiscal 1951 turned to a deficit of $233 million in fiscal 1953 (Table 4). Because the sterling balance reached a critically low level by the middle of 1953, Japan purchased the sterling equivalent of $124 million in four installments from the IMF between September and December of that year.[6] Even with this drawing, the official holding of sterling declined by $130 million from the end of fiscal 1952 to the end of fiscal 1953 (Table 5).

Measures were taken to reduce aggregate spending, stimulate exports and achieve balance in trade with the sterling area countries. In February 1953, the authorities temporarily suspended the processing of applications for imports under the AA system from the sterling area countries. As previously stated, in August 1953, the system of retention credits was modified to remove disincentive against exporting to the sterling area, and the rate was set at 10 percent for all areas. Imports of less essential and luxury goods were excluded as eligible under retention credits. Credits arising from exports to the open account area were not permitted to be used for imports from the dollar and the sterling areas.

In October 1953, the MITI removed 60 items from the exchange allocation system for the second half of fiscal 1953, including cocoa, coffee, alcoholic drinks, cosmetics and some drugs. For fiscal 1954, moreover, the authorities scaled down the FEB substantially from $1446 million in the second half of fiscal 1953 to $932 and $1040 million, respectively,

[6] Because Japan repurchased ¥22.2 billion with a payment of $61.6 million before making the fourth purchase, amounting to $61.6 million, its net purchase did not exceed $62.4 million.

for the first and second halves of fiscal 1954 on a confirmation basis (Table 1),[7] thus reducing the amount of foreign exchange available for imports. Moreover, in the FEBs of the second half of fiscal 1953 and the first half of fiscal 1954, items were transferred from the AA list to the more restrictive FA system. As a result, the proportion of imports covered under the AA system declined from 33 percent of total imports in the second half of fiscal 1952 to 13 percent in the first half of fiscal 1954. Imports covered under the FA system rose from 65 percent to 82 percent over the same period.

At the same time, the Japanese authorities adopted measures to tighten special facilities for import financing, including the shortening of loan terms. In April 1954, they raised the deposit requirements from 5 percent to 25 percent for imports under the AA system and from one percent to 5 percent for some imports under the FA system (to which the requirement had been applied during the previous year). From January 1954, moreover, they had required that foreign exchange banks receive guarantee money in cash and deposit it with the BOJ for a prescribed number of months (initially 20 days; subsequently increased to 3 months), whereas the previous requirement was simply that a letter of guarantee be sent by a foreign exchange bank to the BOJ.

In April 1954, the scope of barter transactions was expanded. Previously, the Japanese authorities had approved barter trade only when (1) it was necessary to cultivate new markets or (2) it was difficult to expand exports to certain countries because of trade

[7] The initial figures could differ from the confirmation figures because (1) there were lags in execution of import contracts; (2) additional funds were made available during the course of a given budget period; or (3) the budgeted funds were not fully utilized for various reasons.

restrictions. Now, barter could be approved if deemed necessary to improve Japan's balance of payments. In July, the authorities expanded the export insurance system and the system of preferential export finance, under which the BOJ applied lower interest rates to export advance bills and extended yen funds to Japanese commercial banks upon collateral of export usance bills at rates prevailing in major financial markets abroad. To promote exports, a part of the income received from exports was exempted from taxation, and items were added to the list of imports eligible under the retention credit system.

It should be noted that these restrictive measures were taken in conjunction with more broad deflationary macroeconomic policies consisting of monetary tightening (began in October 1953) and fiscal austerity (adopted with the fiscal 1954 budget). Commercial bank lending was curtailed through the application of higher central bank penal rates as well as through the BOJ's window guidance. The scale of the general account budget was also cut in the fiscal 1954 budget mainly through a reduction in the investment program, although the overall cash position of the government remained in deficit.

The Japanese balance of payments began to improve from the spring of 1954, and the overall balance turned to a surplus in the July-September quarter, followed by a surplus in the trade balance in the October-December quarter. In April 1955, therefore, there began to be a relaxation of the restrictive measures. The deposit requirements, for example, were reduced to 5 percent for most imports under the AA system and to 3 percent for imports from the dollar area and one percent for imports from the sterling area under the FA system. The authorities also began to expand the scope of the AA system as well as the global quotas of the FA system. At the same time, however, they remained somewhat cautious in relaxing the restrictions on imports too much, so that they reduced the maximum term of import usance bills from 6 months to 4 months.[8]

(2) The Balance of Payments Crisis of 1956-57

After improving further in 1955, Japan's external position began to deteriorate again in 1956, when the current account surplus of $205 million in 1955 turned to a deficit of $59 million. As in the previous crisis, Japan's problem showed up most seriously as a shortage of sterling balances because of the Japanese policies of encouraging imports from the sterling and open account area countries and of encouraging exports to the dollar area. Because of the increased transferability of sterling, moreover, Japan had used sterling to make payments to the non-dollar area (Narvekar 1961). The balance of payments difficulties in 1956-57 occurred despite the large increase in exports, suggesting that the primary cause was the expanding domestic demand associated with economic growth.

In fact, during this period, the Japanese economy was experiencing an investment boom, with private investment, national income and industrial production all rising sharply in 1956 and early 1957. Wholesale prices also rose. In addition to the rise in domestic demand and prices, the progress of import liberalization subsequent to the improvement in Japan's external position in 1954-55 contributed to a surge in imports as well. The balance of payments surplus of 1954-55 began to shrink in 1956, and a deficit emerged in the first half of 1957.

[8] It was not until November 1960 that the restrictions on import usance bills were relaxed.

During this balance of payments crisis, the authorities stated that an attempt to intensify the restrictions on trade and payments would be resisted in order to maintain the degree of liberalization which had been achieved. In order to cope with the balance of payments problem, therefore, the initial response of the authorities was to use the macroeconomic tools of demand management. The BOJ raised the discount rate twice, first in March and then in May of 1957. Beginning with the fiscal 1957 budget (formulated in April), the authorities pursued a tight fiscal policy by curtailing the scale of the government investment program. Although an income tax cut was implemented in the budget, the central government ran a surplus in its cash position for that fiscal year. In June, Japan concluded an agreement to purchase $125 million from the IMF in order to finance part of the external deficit.[9]

In terms of trade control, the Japanese authorities implemented only a few measures to restrict imports, most of which were financial (as opposed to quantitative) in nature. In May 1957, they tightened the conditions on the granting of sterling usance bills so as to put them on an equal basis with dollar usance bills, and raised the interest rates on usance facilities. In June, the MITI raised the required percentage of import guarantee money from 3-5 to 25 percent for imports under the AA system and from 1-3 to 5 percent for imports under the FA system, and required that the deposit be made in cash for redeposit with the BOJ. There was some scaling down in the foreign exchange budget for the second half of 1957, with a substantially reduced allocation for raw cotton and wool.

[9] Japan made a drawing of $75 million in July and a drawing of $50 million in August.

Owing to the macroeconomic adjustment program which began in May 1957, there emerged a marked slowdown in economic activity. The total value of imports for the second half of 1957 declined to a level comparable to the second half of 1956, so that even the smaller foreign exchange budget was not fully utilized. While there was a deficit of \$689 million in the balance of payments in the first half of 1957, there was a surplus of \$187 million in the second half. As the balance of payments began to improve in the latter part of 1957, the authorities began once again to ease the restrictions. In December 1957, the interest rates on usance bills were lowered. In May 1958, the percentages of import guarantee money were lowered back to the levels prevailing before June 1957. Japan's trade and payments position further improved in 1958, and the adjustment program was terminated, at least symbolically with the lowering of the discount rate on June 18, 1958.

IV. Towards the Liberalization of the System

(1) Changes in the Currency Area Classification

With the conclusion of less restrictive bilateral trade and payments agreements, new currencies were added to the list of designated currencies (Tables 2 and 3) and adjustments were made in the classification of currency areas. In fiscal 1955, the Japanese authorities began to abolish bilateral clearing account agreements in favor of settlement in US dollars, sterling or selected major currencies. As a result, the number of such agreements steadily decreased from the peak of 14 at the end of fiscal 1954. In addition to the Canadian dollar and Swiss franc, which were added to the list of designated currencies in 1954, the Deutsche mark and the Swedish krona became designated currencies when the new payment agreements took effect with West Germany (October 1955) and Sweden (April 1956), respectively.

By this time, the old three-currency area classification had been changed to the six-currency area classification: (1) the sterling area; (2) "specified area" countries (created in January 1956), such as Argentina, Austria, China (Mainland), Denmark, Italy, the Portuguese Monetary Area, Norway, Sudan and Thailand; (3) the Federal Republic of Germany and Sweden; (4) Canada and Switzerland; (5) countries with bilateral clearing account agreements; and (6) all other countries on settlement in US dollars on a cash basis.

In December 1958, the six currency areas were again reclassified into three groups, namely: (1) the dollar settlement area, (2) the special settlement account area, and (3) all others (with which transactions were made principally in convertible currencies). In January 1959, the countries were further reclassified into two groups, namely: (1) the special settlement account countries and (2) all others, with the result that the distinction between different designated currencies had been eliminated. Except with countries under bilateral clearing agreements, settlements with all other countries could be made in any of the designated currencies. This measure was taken in view of the restoration of external convertibility of 13 major European currencies, which took effect on December 27, 1958.

At this time, there were only four bilateral clearing treaties in existence, namely, those with Turkey, Greece, Taiwan and Korea. By then, not only those with European countries but also those with such countries as Thailand, the Philippines and Indonesia had been abolished. The new payment agreements with the Philippines (stipulating settlement in

US dollars on a cash basis from August 1957) and with Indonesia (stipulating settlement in transferable pounds on a cash basis from July 1957) had been negotiated in the context of reparations or economic cooperation treaties concluded with the respective governments in May 1956 and January 1958 (Takagi 1995). By the end of fiscal 1961, all bilateral clearing treaties would be abolished, except with Korea.

(2) Changes in the System of Export Control

In October 1954, the MITI abolished barter trade with certain areas and reduced the list of barter items. In November, the linking of exports to raw sugar and other preferred imports was abolished. The linking of exports to certain raw material imports remained in place, however, although the number of categories was reduced from six to four. In April 1955, the linking of scrap iron imports with exports of iron and steep products and the linking of imports of timber with the export of plywood were discontinued.

Effective from March 1955, there was a reduction in the percentage of retention credits from 10 percent to 5 percent, in the light of the abuse of the system as well as the need to further normalize the system. Effective in January 1957, the percentage was further reduced from 5 to 3 percent. Beginning in July, retention credits could no longer be applied to invisibles, such as foreign travels, advertisements and expenses associated with the maintenance of foreign resident offices. In October 1960, the Special Exchange Fund Allocation System (with retention credits) was abolished, and the eligible imports under the system was transferred to the regular import licensing procedure.

(3) Changes in the Foreign Exchange Market

In January 1956, twenty leading trading companies were allowed to hold a small amount of foreign currencies as operating funds. In September 1957, the Foreign Exchange Fund Special Account ceased to buy or sell forward sterling, effectively liberalizing transactions in forward sterling contracts. In December 1957, the arbitrage exchange rate for sterling was abolished, allowing the rate to be determined in the market with a 0.75 percent margin on either side of parity. In January 1959, the MOF removed all restrictions on spot and forward dealings in designated foreign currencies by authorized foreign exchange banks in Japan.

On September 12, 1959, the official selling and buying rates of the US dollar were changed to ¥361.80 and ¥358.20 (i.e., 0.5 percent on either side of parity), respectively. At this time, the determination of spot exchange rates in the retail market was liberalized, subject to the requirement that the rate be within 0.5 percent on either side of the basic exchange rate. Spot rates for telegraphic transfers in US dollars were made freely quotable within 0.5 percent on either side of parity. In the retail market, forward exchange rates for the US dollar were made freely quotable. Official transactions in forward US dollars with foreign exchange banks were discontinued. The buying and selling rates for other designated foreign currencies were allowed to fluctuate within 1.5 percent on either side of parity.

In April 1960, trading companies resident in Japan were permitted to hold foreign currency deposit accounts in US dollars or sterling with authorized foreign exchange banks, to which no surrender requirements applied. In August 1960, the authorization to hold limited amounts of working balances in foreign currencies (first given in 1956) was extended to all trading companies. On April 22, 1963, the fluctuation margin for the dollar exchange rate was widened from 0.5 percent to 0.75 percent on either side of parity, consistent with the practice of most industrial countries. At the same time, the quotation of exchange rates by foreign exchange banks in the retail market was completely liberalized for all currencies.

(4) Changes in the Import Licensing System

In the first half of fiscal 1954, the authorities expanded the global quotas of the FA system (first introduced in the first half of fiscal 1953 for pulp and few other commodities), under which import allocation certificates were issued up to certain quotas for specified commodities without regard to the country of origin or the currency of settlement. Thus, if the global quota system was treated as a separate licensing system, there were three principal types of import licensing: (1) the AA system; (2) the global quota system within the FA system; and (3) the individual licensing system within the FA system.

In the latter part of fiscal 1955, Japan's balance of payments improved, prompting the authorities to begin to liberalize imports by enlarging the overall FEB, widening the scope of the AA system, enlarging the global quota system, and introducing the non-dollar global quota system (in April 1956). Whereas, for example, the global quota system accounted for less than 2 percent of total imports in the April-October 1954 budget, it covered about 50 percent in the April-October 1956 budget, with another 8 percent accounted for by the non-dollar global quota system. The most restrictive and discriminatory system of individual licensing covered only 23 percent. In the second half of fiscal 1956, additional 31 items were transferred from the FA system to the AA system.

With a deterioration in the balance of payments, however, there was some setback to the progress of import liberalization in fiscal 1957 (see the previous section). As previously stated, however, during the adjustment program of 1957-58, the authorities tried to maintain the degree of progress made in import liberalization by principally resorting to demand management policies. Although they did take some restrictive measures mostly of financial nature, they continued to expand the AA system and to increase the proportion of foreign exchange set aside as the global quota system albeit within the context of overall tightening. In the first half of fiscal 1957, 35 more items were added to the AA list. Within the FA system, the global quota system was expanded to cover almost 70 percent of total imports in the first half of fiscal 1957.

In response to the improved balance of payments situation and the resumption of external convertibility of major European currencies, the authorities began to liberalize imports still further. In November 1959, the Automatic Fund Allocation (AFA) System (Gaika Shikin Jido Wariate Sei) was introduced as a way of providing an easy and flexible means of protecting certain domestic industries as imports were liberalized (Table 6). Under the AFA system, the allocation of foreign exchange for the import of certain designated items, such as various types of machinery and equipment, could be made automatically on application to the MITI without restrictions, unless it was thought that the importation of a particular item would be harmful to domestic producers or that it might have an adverse effect on the balance of payments. In practice, the authorities used the AFA system as a buffer to transfer items from the FA system to the AA system. Typically, if the transfer of a commodity from the FA system to the AFA system did not raise any problem in one semiannual FEB period, the commodity was transferred to the AA system in the next period.

By the end of the 1950s, exchange allocation certificates under the FA system were issued on a global basis for most commodities without regard to the country of origin or the currency of settlement. Under the AA system, the allocation of foreign exchange to import specified commodities was effectively free from restrictions as to total value, because additional amounts were routinely replenished when the original appropriation in the FEB was exhausted. In fact, licenses for the specified commodities on the AA list were issued automatically by foreign exchange banks simply upon application. Except for certain commodities, discrimination on the basis of currency areas had also been eliminated from the AA list. The remaining discrimination against the dollar area ceased to exist in July 1961, with the liberalization of the imports of soybeans and refined lard.

(5) Changes in the Other Aspects of Import Control

Changes in the system of guarantee money were frequently made, depending on the need to either encourage or discourage imports. In June 1959, for example, the deposit requirements were eliminated for imports under the FA system, and the deposit requirement for imports under the AA system was reduced from 5 to one percent. In January 1960, the deposit requirement of one percent was applied to imports under the newly introduced AFA system, in view of the fact that the AFA system was similar in its operation to the AA system.

As Japan's balance of payments had worsened, the deposit requirements were again increased or newly established for some commodities in September 1961: 5 percent for imports of most materials and machinery; 10 percent for imports of office machines; and 35 percent for other categories.[10] Guarantee money must be in cash and deposited with an authorized bank for redeposit with the BOJ.

With an improvement in the balance of payments, the deposit requirements were again reduced in October 1962 from 5 percent to one percent for certain raw materials. In December 1962, the requirements were further reduced from 5 percent to one percent for most raw materials and machinery, from 10 percent to one percent for office machines, and from 35 percent to 5 percent for most other goods. Deposits did not have to be made in cash, except for those goods to which the 5 percent rate was applied. The redeposit with the BOJ was no longer required.

In August 1960, usance bill facilities were extended to all import items. In November, moreover, the maximum term of import usance bills was extended from 3 months to 4 months. For the first time since 1951, the customs tariff system was revised in June 1961, changing not only the tariff rates but also the tariff classification. With the adoption of the Brussels Nomenclature, tariffs were raised, kept unchanged or lowered, depending on the type of commodities.[11] These changes were made not only to bring the tariff structure

[10] The deposit requirements were uniformly reduced to zero for all commodities in May 1970, signaling the effective end of the system. The system was formally abolished in November 1972 and was replaced by the system of import notification (to be abolished altogether in December 1980, with the promulgation of the revised FEFTCL).

[11] Where the rates were unchanged or lowered, the government was said to have no intention of permitting foreign goods to displace Japanese goods to any significant degree (Hunsberger 1964; Hollerman 1967). There were additional rate adjustments in subsequent years.

more in line with the prevailing composition of trade but also to protect domestic industries against the impact of import liberalization in progress (see below).

(6) The Liberalization of Capital Transactions[12]

Generally, cross-border capital transactions remained highly regulated well into the 1970s. When the program of import liberalization (to be explained below) was announced in June 1960, however, it was stated that exchange controls connected with current transactions would all be abolished within two years and that exchange controls connected with capital transactions would be gradually relaxed as the circumstances would permit. In the event, the selected capital transactions which were closely linked with current transactions, including direct investments, did begin to be relaxed in subsequent years.

In April 1960, even before the announcement of the liberalization program, resident trading companies were authorized to open foreign currency deposits up to 20 days (this holding period would be extended to 6 months in June 1971). In June, foreign investors were allowed to purchase up to 15 percent of the stock of general corporations and up to 10 percent of restricted businesses, subject to the approval of the BOJ (previously, the limits had been set at 8 percent and 5 percent, respectively, since October 1956).

On July 1, 1960, the partial external convertibility of the yen was established by the creation of non-resident free yen accounts. Free yen accounts could be opened by non-residents with any authorized foreign exchange bank in Japan and be credited with yen proceeds from current transactions, and be converted into any of the designated currencies.

[12] For a more comprehensive chronology of capital liberalization measures, particularly for the period of the 1970s and 1980s, see Takagi (1994).

In view of this, the yen became the 15th currency to be added to the list of designated currencies for international transactions (Table 2).

(7) The Program of Import Liberalization

On June 24, 1960, the government approved a program of foreign exchange and trade liberalization, called the "Plan for Trade and Exchange Liberalization", over the next three years. In this program, imports were divided into four broad groups: (1) those to be liberalized within one year; (2) those to be liberalized within two to three years; (3) those to be liberalized within three years, if possible; and (4) those for which no schedule could be determined. It was announced that the import liberalization ratio (the proportion of imports under the AA and AFA systems in terms of the composition of imports in 1959, chosen as the base period) would increase from about 40 percent in April 1960 to about 80 percent within three years. All restrictions on payments for current invisibles would be removed within two years, and the Special Exchange Fund Allocation System (with retention credits) would be abolished during 1960.

In October 1960, 236 items were added to the list of goods under the AA system. In April 1961, 410 items were transferred from the FA to the AA system, and 120 items were transferred from the AFA to the AA system. In June and July, more than 100 items were further added to the AA system, bringing the number of items on the AA list to 1997, or 65 percent of total imports (Table 6).

In September 1961, the government formally began to accelerate by six months the implementation of the trade liberalization program, by announcing that the import liberalization ratio would be raised from 65 percent in July 1961 to 90 percent by October 1962. In October 1961, 240 items were transferred from the FA system to the AA system, and 330 items were moved from the FA system to the AFA system. In addition, 120 items were transferred from the AFA system to the AA system, raising the import liberalization ratio from 65 percent to 68 percent. In December 1961, additional 40 items were added to the AA system, and 130 items were moved to the AFA system, bringing the ratio to 70 percent.

In April 1962, 150 items were added to the AA system and 170 items to the AFA system, raising the ratio to 73 percent. At the same time, the remaining restricted items (numbering 492) were placed on a negative list in terms of the Brussels Tariff Nomenclature. Previously, items freely importable had been on a so-called positive list, with imports of all items not included in the list subject to restrictions. In October 1962, the government liberalized 230 items, including crude oil, automobile tires and tubes, paper pulp and ballpoint pens, thereby raising the liberalization ratio to 88 percent, or 2 percent short of the target announced in September 1961. In November 1962, imports of 8 items were liberalized, leaving 254 items on the negative list.

V. Concluding Remarks

This paper has briefly summarized the operation and liberalization of Japan's restrictive trade and payments system for the period 1950-64. Under the restrictive system of the early 1950s, the government authorities were directly involved in the allocation of scarce foreign exchange, according to commodity categories and currency areas, through the allocation system based on the Foreign Exchange Budget. Although there is little doubt that the system was conceived or used by the authorities as a tool of government intervention in the economic activities of the reconstruction period, it is also important to recognize that the system existed in the context of the world economy in which there were only a handful of convertible currencies. With improved export performance and the resumption of convertibility for major European currencies, this system of foreign exchange and trade control became operationally much more flexible in the late 1950s.

The restrictive system was also used as a tool of economic policy. During the balance of payments crises of 1952-53 and (to a much lesser extent)1956-57, the authorities used the system to restrict the aggregate amount of imports by raising the required percentage of import guarantee money, transferring certain commodities from the Automatic Approval list to the more restrictive Fund Allocation system, or scaling down the overall size of the Foreign Exchange Budget. On the export side, the authorities sometimes raised the percentage of retention credits for exports to the dollar area in order presumably to increase the official holding of convertible currencies. The effectiveness of the restrictive system as a policy tool, however, should not be overstated, especially as the system was increasingly liberalized over time. Its effectiveness must have been particularly limited on the export side. Narvekar (1957, 1961), for example, argues that it was Japan's increased competitiveness and macroeconomic management which enabled the country to overcome the balance of payments crises of 1952-53 and 1956-57.

To the extent that the balance of payments is a macroeconomic variable, it must be true that the overall balance or the current account balance of an economy is largely determined by international developments in real and monetary conditions which affect the adjustment in financial assets or the saving and investment decisions of economic agents located in different countries. On the other hand, it was clearly the case that the restrictive system allowed the government to be directly involved in the sectoral allocation of resources in the economy. As a result, the system no doubt helped establish the status of the Ministry of Finance, the Ministry of International Trade and Industry and the Bank of Japan in the economic arena of Japan. It will be of interest in the future to investigate the extent to which the government was deliberate and successful in using the system to accomplish its industrial policy objectives.

When the Japanese government accepted the obligations of Article 8 of the IMF's Articles of Agreement in April 1964, it abolished the foreign exchange budget and the associated foreign exchange allocation procedures. However, the structure of the trade and exchange control system itself remained virtually intact. In terms of import control, for example, the foreign exchange budget was replaced by the Import Quota System under which the prior classification of AA, AFA and FA licensing procedures was only nominally changed to that of AA, Automatic Import Quota (AIQ) and Import Quota (IQ) procedures. With more than 90 percent of imports in the AA and AIQ categories and the country's greatly improved balance of payments position, the trade and foreign exchange control system was certainly not as restrictive as it had been before. Even so, the legacy of the old system would survive for another 16 years until the promulgation of the revised Foreign Trade and Foreign Exchange Control Law on December 1, 1980.

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Table 1. Foreign Exchange Budgets, Fiscal 1950-60
(in millions of US dollars)

		merchandise			invisible		
		initial	final	confirmed	initial	final	authorized
1950:	Q1	141	172	139			
	Q2	257	526	435			
	Q3	386	526	437			
	Q4	525	926	858			
1951:	Q1	456	465	310			
	Q2	533	576	414			
	Q3	653	660	465			
	Q4	727	750	461			
1952:	H1	1211	1241	968	126	208	149
	H2	1415	1500	1253	246	344	230
1953:	H1	1225	1245	1095	315	395	282
	H2	1335	1545	1446	299	444	342
1954:	H1	1100	1100	932	310	372	294
	H2	1090	1090	1040	154	173	154
1955:	H1	1107	1160	1136	190	213	193
	H2	1314	1454	1416	244	244	292
1956:	H1	1543	1765	1687	314	346	302
	H2	1915	2483	2374	376	396	332
1957:	H1	2236	2236	1729	378	378	342
	H2	1652	1652	1307	327	334	294
1958:	H1	1628	1628	1243	366	431	367
	H2	1752	1757	1450	406	427	370
1959:	H1	1941	1941	1653	408	475	418
	H2	2328	2328	2158	485	519	410
1960:	H1	2624	2624	2150	594	618	529
	H2	2800	2800	2490	680	697	557

Source: Ministry of Finance, Fiscal and Financial Statistics Monthly, various issues.

Table 2. Designated Currencies for International Transactions

date of designation	currencies or comments
December 1, 1949	US dollar; pound sterling
July 1, 1954	Canadian dollar
August 2, 1954	Swiss franc
October 1, 1955	Deutsche mark
April 15, 1956	Swedish krona
January 1, 1957	French franc
June 1, 1957	Dutch guilder
May 10, 1958	Belgium franc
April 1, 1959	Austrian schilling; Danish krone, Italian lira, Norwegian krone, Portuguese escudo
July 1, 1960	Japanese yen
January 16, 1962	all currencyrestrictions abolished for external payments
March 15, 1964	Australian dollar (for external receipts)
June 10, 1971	all currencyrestrictions abolished for external receipts

Table 3. Bilateral Clearing Agreements, 1953-61

at the end of March 1953: Argentina, Brazil, Finland, French Union (including French Indochina), West Germany, Indonesia, Italy, Korea, the Netherlands, the Philippines, Sweden, Thailand, and Taiwan. (13 treaties in existence)

during fiscal 1953: Egypt (November 1953) added. (14 treaties)

during fiscal 1954: Turkey (February 1955), and Greece (March 1955) added. (16 treaties)

during fiscal 1955: West Germany (October 1955) and Italy (January 1956) abolished. (14 bilateral treaties)

during fiscal 1956: Sweden (April 1956), Thailand (April 1956), Argentine (June 1956) and French Union (January 1957) abolished. (10 treaties)

during fiscal 1957: Finland (April 1957), the Netherlands (June 1957), Indonesia (July 1957), the Philippines (August 1957) abolished. (6 treaties)

during fiscal 1958: Brazil (October 1958) and Egypt (November 1958) abolished. (4 treaties)

during fiscal 1959: Turkey (August 1959) abolished. (3 treaties)

during fiscal 1960: Greece (April 1960) abolished. (2 treaties)

during fiscal 1961: Taiwan (October 1961) abolished (1 treaty with Korea)

Source: MITI, Annual Reports, annual issues.

Table 4. Exports and Imports by Currency Area, Fiscal 1951-57
(in millions of US dollars)

		Exports		Imports		Balance	
1951		1410		1659		-249	
	dollars		(309)		(933)		(-624)
	sterling		(674)		(443)		(231)
	open		(427)		(283)		(144)
1952		1168		1790		-622	
	dollars		(440)		(957)		(-517)
	sterling		(469)		(557)		(-88)
	open		(259)		(276)		(-17)
1953		1245		2242		-997	
	dollars		(453)		(1160)		(-707)
	sterling		(335)		(568)		(-233)
	open		(457)		(514)		(-57)
1954		1602		1768		-166	
	dollars		(530)		(1006)		(-476)
	sterling		(580)		(324)		(256)
	open		(492)		(438)		(54)
1955		2095		1956		139	
	dollars		(846)		(896)		(-50)
	sterling		(781)		(613)		(168)
	open		(468)		(447)		(21)
1956		2494		2782		-288	
	dollars		(1149)		(1404)		(-255)
	sterling		(1013)		(998)		(15)
	open		(332)		(380)		(-48)
1957		2818		3347		-529	
	dollars		(1300)		(1793)		(-493)
	sterling		(1286)		(1341)		(-55)
	open		(232)		(213)		(19)

Source: Ministry of Finance, Fiscal and Financial Statistics Monthly, various issues.

Table 5. Foreign Exchange Reserves, Fiscal 1949-57 1/
(in millions of US dollars)

end of fiscal year	US dollars	sterling	open	total
1949	156	44	18	219
1950	464	55	42	561
1951	583	211	120	915
1952	768	249	122	1138
1953	789	119	69	977
1954	648	214	192	1054
1955	811	261	244	1316
1956	1063	91	267	1421
1957	594	59	304	957

Note 1/ The method of measuring foreign exchange reserves was substantially revised in April 1958, by subtracting from the previous concept (1) the balances in the open account, (2) the balance held by foreign exchange banks, and (3) Treasury deposits at foreign exchange banks and by adding (4) official gold holdings.

Source: Ministry of Finance, Fiscal and Financial Statistics Monthly, various issues.

Table 6. Selected Import Liberalization Measures in Japan

August 1950	The Automatic Approval (AA) System introduced.
January 1951	154 items announced on the AA list.
November 1959	The Automatic Fund Allocation (AFA) System introduced, with 48 items on the list.
January 1960	42 percent of imports liberalized.
October 1960	44 percent of imports liberalized.
April 1961	62 percent of imports liberalized.
June 1961	63 percent of imports liberalized.
July 1961	65 percent of imports liberalized.
October 1961	68 percent of imports liberalized.
December 1961	70 percent of imports liberalized.
April 1962	The classification of items was changed from the Standard International Trade Classification (SITC) Nomenclature to the Brussels Tariff Nomenclature. The positive list of items on the AA system was replaced by a negative list of items subject to restrictions, with 492 items. 73 percent of imports liberalized.
October 1962	88 percent of imports liberalized, with 262 items on the negative list.
November 1962	88 percent, with 254 items.
April 1963	89 percent, with 229 items.
January 1964	92 percent, with 189 items.
April 1964	Less than 93 percent, with 174 items.
October 1965	More than 93 percent, with 162 items.
April 1966	More than 93 percent, with 159 items.
May 1966	168 items placed on the negative list, as a result of the revision of the Brussels Tariff Nomenclature.
April 1968	More than 93 percent, with 165 items.
April 1969	More than 93 percent, with 163 items.
April 1970	Less than 94 percent, with 141 items.
October 1971	Less than 95 percent, with 133 items.
April 1972	Less than 97 percent, with 79 items.