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Japan's Restrictive System of Trade and Payments: Operation, Effectiveness, and Liberalization, 1950-1964

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Abstract

The paper summarizes how Japan's foreign exchange and trade control system operated in the early 1950s, how and how effectively it was used as a tool of external adjustment, and how it was liberalized from the late 1950s into the early 1960s. Although the Japanese government was extensively involved in allocating scarce foreign exchange in the early 1950s, the control system became increasingly flexible over this period. A preliminary analysis based on the behavior of wholesale prices seems to indicate that, along with its liberalization, the restrictive system became less effective as a tool of external adjustment, while the impact of deflationary macroeconomic measures became more dominant.

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SUMMARY

This paper summarizes how Japan's foreign exchange and trade control system operated in the early 1950s, how and how effectively it was used as a tool of external adjustment, and how it was liberalized from the late 1950s into the early 1960s. Under the restrictive system of the 1950s, the Japanese government was directly involved in allocating scarce foreign exchange through the allocation mechanism based on the Foreign Exchange Budget, in part responding to the economic reality of the period in which there were only a few convertible currencies. With the more favorable performance of Japanese exports and the restoration of convertibility of most European currencies in the late 1950s, however, the restrictive system became increasingly flexible in its operation. In terms of import control, an increasing number of commodities were placed on the Automatic Approval system, so that foreign exchange control lost more of its effectiveness as a means of trade control.

The restrictive system was also used as a tool of external adjustment. During the balance of payments crises of 1952-53, 1956-57 and 1961-62, the authorities used the system in their attempt to restrict the aggregate amount of imports. They did so, for example, by raising the deposit rates of import guarantee money, tightening the terms of import usance facilities, 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. A preliminary quantitative analysis, however, suggests that the effectiveness of the restrictive system as a tool of external adjustment was limited at best, especially as the system was increasingly liberalized over time. Instead, it appears that the impact of deflationary measures became more dominant as an instrument of external adjustment.

I. INTRODUCTION

This paper reviews the experience of Japan with a restrictive trade and payments system during the early part of the post-World War II period, as a case study of how the fixed exchange rate system was managed in practice under the Bretton Woods system. Specifically, it presents a summary of how Japan's system of foreign exchange and trade control operated in the early 1950s, how effectively it was used as a tool of macroeconomic policy, and how it was liberalized from the late 1950s into the early 1960s.

It is well known that the choice between fixed and flexible exchange rates often involves the question of exchange restrictions because countries are limited in their ability to maintain free international transactions, fixed exchange rates and monetary independence at the same time. In recent history, the fixed exchange rate system has often been accompanied by exchange rate restrictions of one type or another, indicating the desire of many countries to maintain monetary independence or possibly to maintain inappropriate levels of exchange rates, given some policy objectives. Until recently, for example, some countries participating in the European Monetary System maintained controls on capital transactions (for a survey of the literature on capital controls, see Dooley 1996). In addition to restrictions on capital transactions. moreover, many countries under fixed exchange rates have used, and some continue to use, exchange restrictions on current transactions.

This means that the study of a fixed exchange rate system cannot generally be separated from the study of a restrictive system associated with it. This applies to the experience of Japan as well. During the fixed exchange rate period of 1950-1973, Japan experienced two regulatory regimes. First, with the resumption of private imports at the beginning of 1950, exchange restrictions were imposed on all international transactions, both current and capital. Second, in 1964, this restrictive system of trade and payments was replaced by a system in which, while the payments for current transactions were in principle liberalized, exchange restrictions remained on capital transactions. Although this paper reviews the specific experience of Japan under the first of these two regimes, it should give some insight into the operation of similar restrictive systems that are still in place in many countries.

During the immediate post-World War II period, Japan's trade and payments were placed under the strict control of the Supreme Commander for the Allied Powers (SCAP). Both export and import trade were conducted by the Board of Trade under the supervision of the occupation authorities; settlements in foreign currencies were made on the SCAP's account. Under the directives of the Far Eastern Commission, however, successive steps were taken to place international trade on a private basis and to transfer control authority over trade and payments to the Japanese government. In August 1947, some private firms were allowed to enter export trade. In March 1949, a Foreign Exchange Control Board was set up to make preparation for the eventual transfer of authority over trade and payments from the SCAP. As a culmination of these and other measures, a new Foreign Exchange and Foreign Trade Control Law was promulgated, along with the associated laws and orders, on December 1, 1949. The Japanese government assumed control over export trade on December 1, 1949 and over import trade on January 1, 1950. Foreign exchange, amounting to an equivalent of $67 million, was transferred to the Japanese government on December 29, 1949.[2]

In this way, Japan's resrictive system was defined by the Foreign Trade Control Law in the context of the resumption of private trade, which took place as part of the normailzation of the occupation regime. Although the restrictive system of the type considered in the paper existed from January 1, 1950 (when the first foreign exchange budget took effect) to March 31, 1964 (the last day covered by the final foreign exchange budget), somewhat 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 of 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 II 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 III 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, and the Special Exchange Fund Allocation System (or the system of retention quotas or credits).

Section IV will review the restrictive system as a tool of external adjustment, by discussing how the system was used to cope with the balance of payments crises of 1952-53 and 1956-57. It will also present a quantitative, albeit indirect, indication of the effectiveness of the restrictive system in reducing external deficits. Section V will review major deregulatory changes in the latter half of the 1950s, including those related to the currency area classification, the system of export control, the foreign exchange market, and the import licensing system. Section VI will discuss the program of trade and exchange liberalization which began in June 1960, the balance of payments crisis of 1961-62, and the developments leading to the termination of the restrictive system in April 1964. Finally, section VII will present concluding remarks.

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

A. The Legal and Administrative Framework

The Foreign Exchange and Foreign Trade Control Law (FEFTCL) of December 1949 set forth the principle that all external transactions were prohibited unless expressly authorized, and prescribed that a foreign exchange budget be formulated for the purpose of allocating foreign exchange for external payments. From January 1, 1950 to March 31, 1964, the

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[2]The Foreign Exchange Control Board assumed the responsibility of book keeping for the SCAP's commercial account on November 1, 1949.

FEFTCL was the legal framework, and the FEB was the central tool, of Japan's restrictive trade and payments system. The key feature of the restrictive system was that exchange restrictions were made to serve also as a means of import control. When Japan accepted the obligations of Article 8 of the Fund agreement on April 1, 1964 by removing virtually all exchange restrictions on current transactions, it replaced the system of import control based on exchange restrictions with an alternative system based directly on import quotas.

During the period under review (1950-64), the Ministry of Finance (MOF) 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,[3] the MOF also assumed responsibility for the concentration of foreign exchange reserves, the management of the Foreign Exchange 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 much of the routine day-to-day operation of the system as the agent of the national government. As the system of foreign exchange and trade control was liberalized over time, an increasing amount of approval authority was delegated to the BOJ and, in automatic cases, to authorized foreign exchange banks.

B. The Foreign Exchange Budget

As stated above, the fundamental tool of foreign exchange and trade control was the Foreign Exchange Budget system (*Gaikoku Kawase Yosan Seido*). The FEB, which was first formulated for the January-March quarter of 1950 (or the fourth quarter of fiscal 1949), was initially determined quarterly. Beginning in fiscal 1952, however, the formulation of FEBs became semiannual (Table 1).[4] The FEB, which must be approved by the Cabinet Ministerial Council (*Kakuryo Shingikai*) under the chairmanship of the Prime Minister, 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). In order to provide flexibility in management, the FEB also included a reserve account.

C. The Concentration Requirement

Under the system of foreign exchange concentration (*Gaika Shuchu Seido*), all residents were required, except under license, to surrender foreign means of payment and claimable assets acquired to authorized foreign exchange banks within 10 days of acquisition.[5] Authorized

[3]On this day, the Foreign Exchange Bureau was established within the MOF.

[4]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.

[5]In addition, money changers (e.g., travel agencies and hotels) and post offices were

(continued...)

foreign exchange banks would buy foreign exchange from their customers for the account of the Foreign Exchange 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 had also needed to buy 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.[6] In June 1952, foreign exchange banks were authorized to maintain U.S. dollar balances for settlement purposes at foreign correspondence banks, and this provision was extended to sterling balances in March 1953.

D. Foreign Exchange Receipts and Payments

In principle, all non-trade transactions between residents and non-residents were prohibited unless expressly authorized, even when the yen was involved. Likewise, all non-trade transactions between residents involving foreign currency and all transactions between non-residents involving yen were subject to control. Unlike imports and exports, no authority was delegated to foreign exchange banks to approve payments except for transactions explicitly designated by the Ministerial Council.

As to invisibles, 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 method of payment prescribed for them (see below). Payments for 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 must be obtained from the MITI in the case of payments directly connected with imports or exports, or in the case of transactions involving patent rights, other industrial property rights and mining rights. In all others, license must be obtained from the MOF.

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

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[5](...continued)
authorized to accept foreign currency notes, travelers' checks and postal money orders.

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

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

E. Exchange Rates

On December 1, 1949, the U.S. 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 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.

When the U.S. dollar and the pound sterling became designated currencies, it was announced that the basic exchange rate (*kijun gaikoku kawase soba*) was 360 yen per U.S. dollar (established on April 25, 1949)[7] and that the arbitrage exchange rate (*saitei gaikoku kawase soba*) was 1008 yen per pound. For the dollar, the official selling rate was 360.35 yen and the official buying rate was 359.65 yen; for the pound, the official selling rate was 1,008.98 yen and the official buying rate was 1,007.02 yen. On January 12, 1953, the MOF changed the official selling and buying rates of the U.S. dollar to 360.80 yen and 359.20 yen, respectively. 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 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 generally could not exceed 6 months for sales and 4 months for purchases. For the U.S. dollar, the official selling rate was higher than the spot rate by a designated amount, and the buying rate was lower by the same amount, depending on the length of the forward contract. In the case of sterling, the selling rate was the same as the spot rate, and the buying rate was lower than the spot rate by a designated amount, depending on the length of the forward contract.

F. Methods of External Payment

Both the currency and the terms of payment were prescribed for different types of external transactions. In terms of prescription of currency, 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 U.S. dollars for

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

countries with special payments agreements (Table 3); and (3) settlement in U.S. dollars on a cash basis for all others. As long as the standard method prescribed for a particular transaction was used, no additional approval was necessary to effect the payment. Otherwise, approval must be obtained from the control authorities.

III. THE SYSTEM OF TRADE CONTROL IN THE EARLY 1950S

A. 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, those under barter contracts, etc. Export control was also used from time to time to adjust Japan's trade relations with the sterling 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 United States. Except for these and other designated commodities, no license was required for export trade, provided that the certification of a foreign exchange bank was obtained 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 United Kingdom (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 the end of fiscal 1950 (i.e., early 1951) through 1952 (Table 5).

For this reason, the authorities sometimes 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. At times, 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. On the other hand, to encourage exports to the dollar area, export proceeds from that area were sometimes accorded higher retention credits, which could preferentially be used to import goods on a specified list or for travel and other invisible expenses associated with the promotion of trade (see below for details).

The system of linking exports with preferred imports was another way of promoting certain exports. For example, during 1953-54, the export of ships, 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 a subsidy 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, and this type of export-import link was altogether abolished in 1955, in response to foreign criticism (Okazaki 1996).

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 oil and fats (glycerin).

B. 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, and for most commodities, portions were made public through the MITI's "import announcements" (*yunyu kohyo* or *yunyu happyo*) from time to time. The budget for most invisibles was announced by the MOF.

The type of announcement known as *yunyu kohyo* was made at the beginning of each budget period for some commodities. For others, however, disclosure was made in several installments during the period in order for the authorities to make a better assessment of the flow of imports as well as the prevailing domestic market conditions and to minimize the possibility of disturbing the suppliers' markets abroad. This latter type of import announcement was called *yunyu happyo*. The announcements would include information regarding: (1) the commodities for which application for license to import would be accepted; (2) the prescribed currency of settlement; (3) the import limit per applicant; (4) the opening and closing dates for license application; (5) the percentage of required guarantee 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.[8] First, the most important instrument of import control was direct

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[8]In addition, there was a minor system called "the First-Come, First-Served System" (*Senchakujun Sei*), applied to minor miscellaneous imports as well as those commodities which Japan was obliged to import in order to comply with the provisions of certain trade and (continued...)

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. For most FA goods, *yunyu happyo* was used as the type of import announcement. 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. In allocating the certificates, however, the control authorities could take into consideration the applicants' production capacity, inventories and shipment records.[9]

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. For AA goods, *yunyu kohyo* was the method of import announcement. 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.

C. 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 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 (time) 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

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[8](...continued)
payments agreements. This licensing system, which covered only about one percent of total imports in 1953, would be formally abolished in November 1956.

[9]Okazaki (1996) shows, on the basis of detailed data for the wool spinning industry, that the authorities devised and then fairly strictly followed a foreign exchange allocation rule based on export performance and production capacity, thus minimizing the potential for corruption associated with rent-seeking activities.

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.

D. 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*) from December 1951 to August 1953, was originally introduced in July 1949 as the Foreign Exchange Credit System on a non-discriminatory basis for all currency areas. It was the Japanese version of the so-called retention quota system, which was widely used in many countries as a scheme of export promotion in the 1950s (IMF 1950). In the original system, exporters were given three different retention credits of 3, 6, 10 percent on their proceeds, depending on 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 at the end of June 1951 and was reinstated in December 1951 (retroactive to July 1, 1951) as the Export Promotion Foreign Exchange System 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 deemed to contribute to the promotion of exports" to "commodities deemed to contribute to the promotion of exports or the rehabilitation and stabilization of the economy".

In particular, retention credits could be used for the following purposes: (1) expenses for travelling 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 or the rehabilitation and stabilization 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.

IV. THE RESTRICTIVE SYSTEM AS A TOOL OF EXTERNAL ADJUSTMENT

A. The Restrictive System in the Absence of Exchange Rate Adjustment

During the period under consideration, Japan experienced balance of payment crises three times, namely, during 1952-53, 1956-57, and 1961-62. This recurrence of balance of payments crises has led some observers to conclude that the Japanese yen, which was set at the unified rate of 360 yen to one U.S. dollar in April 1949, was overvalued during the 1950s. As an evidence of overvaluation, Okazaki (1996), for example, cites the black market rate of the yen in Hong Kong which ranged between 400 and 450 yen per U.S. dollar in 1955. Although it is well known that the black market rate likely underestimates the "true" equilibrium rate which would prevail in the absence of exchange restrictions (see, for example, Nowak 1984), the yen may well have been overvalued, given the more rapid rise of domestic prices relative to the U.S. prices from 1949 to 1951.

To have some indication of the appropriateness of the level of the exchange rate, it may be useful to estimate the purchasing power parity (PPP) rate for the yen, given some benchmark rate. Japanese government documents suggest that, when the unified exchange rate of 360 yen per U.S. dollar was determined in April 1949, the appropriate official rate (as judged by the U.S. authorities) was believed to be about 330 yen to a dollar, but that the actual rate was set at a lower level in order to encourage exports and to discourage imports (BOJ 1985, pp. 254-259). Table 7 summarizes, for the period 1949-64, the estimated PPP rates of the yen based on the relative wholesale price indices (WPIs) and consumer price indices (CPIs) between Japan and the United States, assuming that the rate of 330 yen per U.S. dollar was the PPP rate in 1949.

According to Table 7, the Japanese yen became overvalued quickly relative to the WPI-based PPP rate from 1949-1951, owing to the rapid rise of domestic wholesale prices. However, from 1952 to 1964, the real exchange rate of the yen remained fairly stable relative to U.S. dollar, possibly indicating that the Japanese wholesale prices closely reflected the international prices of traded goods. In terms of consumer prices, on the other hand, the Japanese yen did not show signs of overvaluation relative to the PPP rate until the early 1960s. Moreover, the real appreciation of the yen in the early 1960s most likely reflected the well-known Balassa-Samuelson effect, whereby the consumer price index (with a greater share of non-traded goods) of a more rapidly growing economy rises faster than that of a less rapidly growing economy. In other words, the real appreciation in terms of consumer prices probably was an equilibrium rise of the yen, and did not represent an overvaluation.

Of course, judgement of overvaluation or undervaluation cannot be based solely on a comparison of the actual exchange rate with the WPI-based or CPI-based PPP rate. With active investments in plants and equipment since the middle of the 1950s, the productivity of Japanese manufacturing industries rose rapidly, and Japan's competitiveness in terms of unit labor cost must have risen (Kosai 1986). In this respect, the WPI-based PPP rate, as reported in Table 7, most likely underestimates the correct equilibrium value of the yen in the late 1950s and the early 1960s. Given the subsequent course of Japan's balance of payments developments in the late 1960s, the Japanese yen could have even become undervalued as early as in the early 1960s.

Subject to these qualifications, it is still possible that the Japanese yen was overvalued in the early 1950s and that this overvaluation was the background against which the restrictive system was maintained. In fact, serious consideration is said to have been given to the possibility of devaluing the yen when the pound sterling was devalued in September 1949 as well as when Japan joined the International Monetary Fund in August 1952. However, the exchange rate reason for maintaining the restrictive system weakened over time, with the increasing competitiveness of Japanese industries (Narvekar 1957, 1961). Coupled with the restoration of the external convertibility of most major European currencies in the late 1950s, this was the background against which Japan's restrictive system was liberalized from the late 1950s into the early 1960s. The convergence of Hong Kong's black market rate to the official rate, as observed from the beginning of 1960s, gives credence to the view that the Japanese yen was becoming less overvalued and the restrictive system less binding from the early 1960s (Okazaki 1996).

B. 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).[10] Because the balance of sterling reserves reached a critically low level by the middle of 1953, Japan purchased the sterling equivalent of $124 million in four installments from the Fund between September and December of that year.[11] Even with this drawing, the official holding of sterling declined by an equivalent of $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 disincentives against exports to the sterling area, and the rate was set uniformly at 10 percent for all areas. Imports of less essential and luxury goods were

[10]During this period, there was a sizable inflow of U.S. dollar funds associated with U.S. special procurements arising from the Korean War. A part of the increase in imports was supported by these invisible receipts.

[11]Because Japan repurchased 22.2 billion yen 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.

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: the foreign exchange allocation of $1446 million for imports in the second half of fiscal 1953 was reduced to $932 and $1040, respectively, for the first and second halves of fiscal 1954 on a confirmation basis (Table 1).[12] With the removal of additional items from the AA list in the first half of fiscal 1954, 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. On the other hand, 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 January 1954, they required that foreign exchange banks receive import guarantee money in cash and redeposit it with the BOJ for a prescribed period of time (initially 20 days; subsequently increased to 3 months), whereas the previous requirement had been simply that a letter of guarantee be sent by a foreign exchange bank to the BOJ. 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 for the first time).

In April 1954, also, the scope of barter transactions was expanded. Previously, the Japanese authorities had approved barter deals only when (1) it was necessary to cultivate new markets or (2) it was difficult to expand exports to certain countries because of trade 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 broad deflationary macroeconomic measures 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 number of instruments eligible for discount by the central bank was also reduced. The scale of the general account budget was also cut in the fiscal 1954

[12]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.

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 (first introduced in April 1953 for pulp, barley, wheat 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. At the same time, however, they remained somewhat cautious in relaxing the restrictions on imports too much too fast, so that they reduced the maximum term of import usance bills from 6 months to 4 months.[13]

C. 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.

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 (which took effect in April), the authorities pursued a tight fiscal policy by curtailing the scale of the government investment

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

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 Fund in order to finance part of the external deficit. [14]

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 deposit rates of imports 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 of the foreign exchange budgets for 1957, with a substantially reduced allocation for raw cotton and wool.[15]

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 thus 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 deposit rates 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, symbolically with the lowering of the discount rate on June 18, 1958.

D. Assessing the Effectiveness of Restrictive Measures

It would be useful to obtain some indication of how effective the restrictive system was as a tool of external adjustment during the balance of payments crises of the 1950s. It should be noted that this is not the same as the question of how binding the exchange restrictions were as a tool of import control. To the extent that the yen was being traded at a discount in the black market in Hong Kong during most of the 1950s, it is clear that some demand for imports was not being satisfied. In this sense, the exchange restrictions must have been

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

[15]Okazaki (1996) discusses the confrontation which existed between the MITI and the MOF regarding the scaling down of the foreign exchange budgets for 1957. For the first half of fiscal 1957, the MITI argued for a large budget coupled with tight fiscal policy, while the MOF argued for the need to reduce the budget as well. For the second half, given the improved balance of payments situation, the MOF argued for a significantly expanded budget, while the MITI asked for a smaller budget in order to adjust demand and supply conditions in industries. For each period, the result of this inter-Ministry confrontation was to reduce the size of the foreign exchange budget slightly from the previous period.

binding at least through the 1950s. The question of interest, on the other hand, concerns whether or not a relaxing or tightening of exchange restrictions had the desired effect on the balance of trade or payments. To consider the effectiveness of the restrictive system as a tool of external adjustment, we begin by noting that the external balance (trade balance, current account balance or, under limited capital flows, overall balance) of a country is determined by the difference between income and absorption. Then, adjustment measures must either increase income or reduce absorption if they are to improve the external balance.

The two types of adjustment measures taken during the balance of payments crises of the 1950s, namely, trade restrictions and deflationary macroeconomic measures, have different implications for import prices. If trade restrictions are effective in reducing the external deficit, it must be that they curtail imports sufficiently to raise the domestic price of imports, thereby shifting consumption from imports to domestic goods. With a resulting increase in the level of overall domestic prices, domestic production may be stimulated and, through the wealth effect, absorption may also be reduced. On the other hand, if deflationary macroeconomic measures are effective, it must be that they directly reduce absorption so as to lower the domestic price of imports as well as that of domestic goods. In reality, however, both of these effects could have been operative. We may then infer that: (1) if an increase in the domestic price of imports was observed, the restrictive measures were more effective; and (2) if a decrease in the domestic price of imports was observed, the deflationary macroeconomic measures were more effective.

In specifying the manner in which the domestic price of imports was determined, we note that Japan in the 1950s and the early 1960s was a much smaller player in world trade than it is today, and assume that it was essentially a price taker in the international market. Thus, we assume that the wholesale price of the ith good was determined by the import price of the same good in the following partial adjustment fashion,

$$p_{i,t} - p_{i,t-1} = \lambda(p^*_{i,t} - p_{i,t-1}) + x_t \qquad (1)$$

where p_i is the wholesale price index of the ith commodity group, p^* is the import price index of the same commodity group, x is a variable which indicates the implementation of adjustment measures designed to reduce external deficits, t and t-1 are discrete time subscripts, and λ is the speed of adjustment parameter.

Equation (1) can be rearranged to yield,

$$p_{i,t} = (1-\lambda)p_{i,t-1} + \lambda p^*_{i,t} + x_t \qquad (2)$$

If the restrictive import measures were more effective in reducing the external deficits, we would expect x_t to have a positive effect on the wholesale price index; if the deflationary macroeconomic measures were more effective, we would expect x_t to have a negative effect.

The regression equation to be estimated is as follows,

$$p_{i,t} = a_0 + a_1 p_{i,t-1} + a_2 p^*_{i,t} + a_3 D53_t + a_4 D57_t + a_5 D61_t + \epsilon_t \qquad (3)$$

where D53, D57 and D61 are the dummy variables for the adjustment policies of 1953-54, 1957-58 and 1961-62, and ϵ is a random error term. To compare the more restrictive regime of the 1950s with the more liberalized regime of the 1960s, it was decided to include the adjustment policy of 1961-62 as well (see Section VI (2) for details). In particular, D53 takes the value of unity for the 12-month period from February 1953 (when the authorities suspended the processing of applications for imports under the AA system for the sterling area countries) and zero otherwise; D57 takes the value of unity for the 12-month period from May 1957 (when the authorities tightened the granting of sterling usance bills) and zero otherwise; and D61 takes the value of unity for the 12-month period from September 1961 (when the authorities tightened import application procedures) and zero otherwise. The length of 12 months was chosen because, in all of these adjustment policies, Japan's balance of payments began to improve within about a year after the implementation of the first adjustment measure(s).

Table 7 reports the results of estimating equation (3) for the period of January 1951 to December 1963, using monthly data. The commodity groups chosen are metal products, textiles and chemicals, for which we could obtain both the wholesale price indices and the import price indices, as compiled by the Bank of Japan. It should be noted, however, that the correspondence in commodity composition between the two sets of price indices is less than perfect. Because the initial ordinary least squares (OLS) regressions indicated the presence of first-order serial correlation in residuals, equation (3) was reestimated by the Cochrane-Orcutt iteration method. For each commodity group, both sets of results are reported.

To concentrate our attention on the estimated coefficients of the policy dummies, we first find that the estimated coefficient of D53 is generally positive, suggesting that the restrictive measures raised the wholesale price of imports during the adjustment policy of 1953-54. Second, the estimated coefficient of D57 is generally negative, suggesting that the deflationary macroeconomic measures lowered the wholesale price of imports during the adjustment policy of 1957-58. Third, the estimated coefficient of D61 is negative, though insignificant, suggesting the possibility that the wholesale price of imports may have been reduced during the adjustment policy of 1961-62. Thus, we may conclude that, the restrictive system, which may have been somewhat effective in the early 1950s, lost much of its effectiveness as a tool of external adjustment in the subsequently years.

V. Towards the Liberalization of the System

A. 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, in part to comply with the Fund's Executive Board decision on bilateralism,[16] the Japanese authorities began to abolish bilateral

[16]In June 1955, the Fund issued an appeal to member countries to reduce and to eliminate
(continued...)

clearing account agreements in favor of settlement in U.S. 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 payments 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, 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 U.S. dollars on a cash basis. With the increased transferability of sterling, category (2) above, the "specified area", was created in January 1956 to include those countries with which sterling could be used as one of the possible means of payment (between late 1956 and early 1957, Finland, Uruguay, Cambodia, the USSR, Yugoslavia and other East European countries were added to this group). With category (3) countries, settlements could be made either in the currency of the country or in sterling (the Belgian, French and the Netherlands Monetary Areas were later added to this group). With category (4) countries, settlements could be made either in the currency of the country or in U.S. dollars.

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 29, 1958.[17]

At this time, there were only four bilateral clearing treaties in existence, namely, those with Turkey, Greece, Taiwan and Korea. By then, Japan had abolished bilateral treaties not only with European countries but also with such countries as Thailand, the Philippines and Indonesia. The new payments agreements with the Philippines (stipulating settlement in U.S. dollars on a cash basis from August 1957) and with Indonesia (stipulating settlement in

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[16](...continued)
reliance on bilateralism as rapidly as practicable.

[17]Under external (or non-resident) convertibility, the exchange authorities permit only non-residents' current earnings to be exchanged into any foreign currency. Otherwise, most of the countries continued to maintain restrictions on current transactions. With the addition of other countries in the monetary areas of Western European countries, as many as 30 countries had established external convertibility by the beginning of January 1959 (IMF 1959).

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 were abolished, except with Korea.

B. Changes in the System of Export Control

Whereas the worsened balance of payments situation had led the authorities to expand the scope of barter trade in April 1954, they revised the regulations again in October of that year, tightening the scope of barter trade (in which exports and imports were balanced transaction by transaction) in terms of geographical areas and the number of eligible items.[18] 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, with the termination of links between scrap iron imports with exports of iron and steel products as well as between imports of timber with the export of plywood. The linking of beef tallow imports with exports of glycerin was abolished in April 1957.

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 were transferred to the regular import licensing procedure.

C. 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 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 within one percent on either side of parity. In January 1959, the MOF removed all restrictions on spot and forward dealings in designated currencies by authorized foreign exchange banks in Japan.

On September 12, 1959, the official selling and buying rates of the U.S. dollar were changed to 361.80 yen and 358.20 yen (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

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[18]In principle, barter trade could be approved only if the country in question had no diplomatic relation or trade agreement with Japan or it had insufficient foreign exchange to purchase Japanese goods; barter contracts would not be approved if Japan had an open account settlement agreement with that country.

the requirement that the rate be within 0.5 percent on either side of the basic exchange rate. Spot rates for telegraphic transfers in U.S. dollars were made freely quotable within 0.5 percent on either side of parity. In the retail market, forward exchange rates for the U.S. dollar were made freely quotable. Official transactions in forward U.S. 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 (previously, the margin had been one percent on either side).

In April 1960, trading companies resident in Japan were permitted to hold foreign currency deposit accounts in U.S. 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, for the stated objective of allowing the exchange rate to play a greater role in trade adjustment as imports were increasingly liberalized. At the same time, the quotation of exchange rates by foreign exchange banks in the retail market was completely liberalized for all currencies.

D. Changes in the Import Licensing 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 had 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 a setback to the liberalization of the restrictive system 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.[19] 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 a few commodities, discrimination on the basis of currency areas had also been eliminated from the AA list.

VI. Trade and Exchange Liberalization in the Early 1960s

A. The Program of Trade and Exchange Liberalization

The possibility of terminating the transitional arrangements under Article 14 of the Fund agreement to assume the obligations of Article 8 was discussed between the Fund staff and the Japanese authorities as early as the summer of 1955. However, the Japanese authorities were initially reluctant. In addition to Japan's still weak economic conditions, the lack of diplomatic relations or commercial treaties with many countries, invocation of Article 35 of the GATT by some countries to discriminate against Japanese goods,[20] the heavy orientation of Japanese exports towards soft-currency areas were among the reasons cited by the authorities.

[19]In view of the fact that the AFA system was similar in its operation to the AA system, it was decided, in January 1960, to apply the same import deposit requirement to the AFA system as that applicable to the AA system.

[20]When Japan was admitted as a full member of the Contracting Parties of the GATT on September 9, 1955, Article 35 was invoked against Japan by 14 countries, namely, Australia, Austria, Belgium, Brazil, Cuba, France, Haiti, India, Luxembourg, the Netherlands, New Zealand, Rhodesia & Nyasaland, Union of South Africa and the United Kingdom. It was not until the early 1960s that Article 35 against Japan was disinvoked by most countries, including Australia (1964), Belgium (1964), Cuba (1961), France (1963), Luxembourg (1964), the Netherlands (1964), New Zealand (1962), Rhodesia & Nyasaland (1963), and the United Kingdom (1963).

Following the restoration of external convertibility for major European currencies in December 1958, however, there began to be an increased awareness within Japan of the benefit of a more open trade and payments system (Sumitomo Bank 1960). At the same time, with a deterioration of the U.S. balance of payments during 1958-59, Japan faced increasing external pressure to ease trade restrictions, particularly discriminatory practices against U.S. products. At the Annual Meetings of the Fund and the GATT in 1959, for example, specific criticisms were directed at aspects of Japan's restrictive trade and payments system, such as the export-import linking devices, barter deals and the apparent lack of transparency in foreign exchange allocation rules.

It was against this background that a Ministerial Council on the Promotion of Trade and Exchange Liberalization (*Boeki Kawase Jiyuka Sokushin Kakuryo Kaigi*) was set up within the Cabinet, with the Prime Minister as Chairman, in order to discuss the objectives and timing of liberalization. In its inaugural meeting on January 12, 1960, it was decided that a program of liberalization would be formulated by the end of May. On June 24, 1960, the government approved a program of foreign exchange and trade liberalization, called the "Plan for Trade and Exchange Liberalization" (*Boeki Kawase Jiyuka Keikaku*), to be implemented over the following 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 calendar year 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 exchange controls connected with capital transactions would be gradually relaxed as the circumstances would permit.

The restrictive trade practices were soon terminated. In September 1960, the Special Exchange Fund Allocation System (with retention credits) was abolished. In April 1961, the system of linking raw material imports to exports was eliminated. On July 1, 1961, discrimination against the dollar area ceased to exist, with the removal of restrictions on dollar imports of soybeans and refined lard.

As to import liberalization, over 700 items were added to the list of goods under the AA system from October 1960 to July 1961, 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. Thus, from October 1961 to April 1962, over 400 items were transferred from the FA system to the AA system, and over 600 items were moved from the FA system to the AFA system, bringing the liberalization ratio to 73 percent.

In April 1962, 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.[21] With subsequent measures, the liberalization ratio was raised to 92 percent, with 192 items on the negative list, by August 1963.

B. The Balance of Payments Crisis of 1961-62

There emerged a marked deterioration in the balance of payments in early 1961, owing to a sharp increase in imports associated with the steady expansion of the economy. The overall balance turned to a deficit of $399 million in 1961, compared with a surplus of $504 million in 1960. The trade balance also worsened, turning from the surplus of $268 million in 1960 to a deficit of $559 million in 1961. As precautionary measures, monetary conditions were tightened in the second half of 1961. On July 5, commercial banks were requested to curtail lending; on July 22, the Bank of Japan raised the discount rate by 0.365 percent, although the interest rates for export financing were lowered by 0.365 percent.

With little improvement in the balance of payments in sight, the Bank of Japan raised the discount rate by an additional 0.365 percent on September 29. Except for the rates for export financing, which were kept unchanged, all the principal lending rates were raised accordingly. The Bank of Japan also increased penal rates for lending to commercial banks. On October 1, the minimum cash reserve requirements for banks were raised for the first time since the introduction of the reserve requirement system in September 1959. In January 1962, Japan concluded a stand-by arrangement with the Fund for a period of one year for an amount equivalent to $305 million.[22]

In terms of import control, on September 18, 1961, the authorities expanded the list of import items subject to the deposit of import guarantee money, increased the rates of deposit, and required that the money placed with banks be redeposited with the Bank of Japan. Now, the rates were 5 percent for most raw materials, 10 percent for office machines, and 35 percent for other categories. The foreign exchange budget for the first half of fiscal 1962 was reduced by 10 percent from the previous period.

The balance of payments situation began to show signs of improvement in the first half of 1962. Judging that the objectives of the adjustment program had been achieved, the authorities began to relax monetary conditions in late 1962. The Bank of Japan lowered the discount rate at the end of October, and then again at the end of November. These measures were followed by further reductions of the discount rate in March and April of 1963. On November 1, 1962, reserve requirements were lowered to their previous levels. From

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[21]The shortfall of 2 percent was mainly accounted for by the exclusion of heavy oil (in consideration of the domestic coal industry).

[22]In the event, no drawing was made.

December 1962 through the summer of 1963, the BOJ purchased securities in the market on a substantial scale in order to ease monetary conditions.

On October 8, 1962, the authorities reduced the deposit rate of import guarantee money for most raw materials from 5 to 1 percent and, on December 13, further reduced the rates from 5 to 1 percent for most raw materials and most machines, from 10 percent to 1 percent for office machines, and from 35 to 5 percent for most other goods, and eliminated the requirement that the money be redeposited with the Bank of Japan. The foreign exchange budget for the second half of fiscal 1962 was marginally increased from the previous period.

C. Towards the Termination of the Restrictive System

The adjustment policy of 1961-62 had little effect on the progress of import liberalization, although it tightened import control somewhat through financial measures. In fact, despite the adjustment policy, successive measures were being taken throughout this period towards the termination of the restrictive system, including the relaxation of the surrender requirement for foreign exchange, resumption of external convertibility of the yen, tariff reforms, and the liberalization of payments for invisibles.

In April 1960, 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). The waiting period for the repatriation of proceeds from the sale of stocks by nonresidents was shortened over time, and was abolished in April 1963.

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 credited with yen proceeds from most current transactions, and the accounts could be converted into any of the designated currencies. In view of this, the yen became the 15th currency to be added to the list of designated currencies for international transactions (Table 2).

In June 1961, the customs tariff was revised for the first time since 1951, 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.[23] These changes were made not only to bring the tariff structure more in line with the prevailing composition of trade but also to protect domestic industries against the impact of import liberalization in progress. There was another round of tariff rate changes in April 1962, in which some were raised and others were lowered, and the "positive" list of

[23] 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).

items on the AA list was replaced by a "negative" list of 492 items subject to restrictions in terms of the Brussels Nomenclature.

The effort at liberalization became even more determined as 11 European countries assumed the obligations of Article 8 of the Fund agreement in February 1961, and as Japan was invited to membership by the Council of the Organization for Economic Cooperation and Development (OECD) in July 1963.[24] In addition to import liberalization, restrictions on invisible transactions also began to be relaxed on a substantial scale. In November 1962, for example, contracts for chartering foreign aircraft and vessels for a period of less than one year were liberalized; payments for literary copyrights and advertising were liberalized up to a certain limit. In April 1963, restrictions on expenditures for business travel, TV screening rights of foreign pictures, services in Japan by nonresident artists and athletes were eased. In November 1963, restrictions were either eased or abolished for about 40 of the 82 restricted items under the OECD codes for invisibles and capital, including the payment for publishing and translation rights of books, maintenance expenses of personal property abroad, subscription to periodicals, musical records, and many other miscellaneous expenses.

As the number of restricted items decreased, the foreign exchange budget system lost more and more of its effectiveness as a tool of foreign exchange control. Moreover, because the remaining import restrictions were kept not for balance of payments purposes[25] but mostly for political or industrial policy reasons, the Japanese authorities began to question the exchange restrictions entailed by the foreign exchange budget system as a logical means of import restrictions. After accepting the obligations of Article 8 of the Fund agreement, moreover, such exchange restrictions would become subject to Fund approval. Thus, the Japanese authorities made a decision in November 1963 to abolish the foreign exchange budget system and to replace the associated foreign exchange allocation system with an import permission system on a quantity basis, which would not involve restraint on payments.

With effect from April 1, 1964, Japan accepted the obligations of Article 8, and abolished the foreign exchange budget system.[26] As a cautionary measure against a run on the yen, on March 11, 1964, the Fund had agreed to a stand-by arrangement for Japan for a period of one year in an amount equivalent to $305 million under the first credit tranche.[27] Under the new import control apparatus, there were three import approval systems, corresponding to the FA, AFA and AA systems under the old trade control regime. Under the new Import Quota (IQ)

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[24]Following approval by the Diet, Japan's membership in OECD became effective on April 28, 1964.

[25]In February 1963, Japan informed the GATT that it no longer claimed balance of payments justification under GATT Article 12 for maintaining import restrictions.

[26]At this time, Japan obtained approval of the Fund to maintain two restrictions: the bilateral payments agreement with Korea and the limit of $500 per person per trip per year for tourism. Previously, expenditures for personal travels abroad for pleasure had not been permitted.

[27]No drawing was made.

system, covering goods on the negative list, importers received import quota certificates for approved imports from the MITI, which entitle them to receive import licenses from authorized foreign exchange banks upon application. Under the Automatic Import Quota (AIQ) system, import quotas for specified categories of goods were granted automatically by the MITI, and individual licenses could be automatically obtained from authorized foreign exchange banks.[28] Finally, under the Automatic Approval System, import licenses were issued freely by authorized foreign exchange banks without limit.

VII. Concluding Remarks

This paper has briefly summarized the operation and liberalization of Japan's restrictive trade and payments system for the period 1950-64, and presented a preliminary assessment of the effectiveness of the system as a tool of external adjustment. 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, the system was a response to the existing reality of the world economy in which there were only a few convertible currencies. In fact, throughout much of the 1950s, almost all the countries of the world maintained restrictive trade and payments systems of one type or another (IMF 1950). With improved export performance and the increased convertibility of major currencies, however, Japan's 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 external adjustment. During the balance of payments crises of 1952-53, (to a much lesser extent) 1956-57, and (to a still lesser extent) 1961-62, the authorities used the system in their attempt to restrict the aggregate amount of imports by raising the deposit rates of import guarantee money, tightening the terms of import usance facilities, 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 tool of external adjustment, however, seems to have been limited, especially as the system was increasingly liberalized over time. Although our quantitative analysis does suggest the possibility that the system was somewhat effective in reducing the external deficit during the adjustment policy of 1953-54 by rasing the wholesale price of imports, the impact of deflationary macroeconomic measures became more dominant in the determination of the wholesale price of imports during the adjustment policies

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[28]The AIQ system was used as an administrative device for monitoring the developments in the import of newly liberalized goods, in a manner similar to the AFA system under the old regime.

of 1957-58 and 1961-62. As a tool of export promotion, the effectiveness of the restrictive system must have been even more limited. In this context, Narvekar (1957, 1961) 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.

When the Japanese government accepted the obligations of Article 8 of the Fund 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, though on a different legal basis. In terms of import control, 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 operationally 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.

Table 1. Foreign Exchange Budgets, Fiscal 1950-1960
(in millions of U.S. dollars)

	Merchandise 1/			Invisibles 2/		
	Initial	Final	Confirmed	Initial	Final	Confirmed
1950 Q1	141	172	139			
Q2	257	526	435			
Q3	386	526	437			
Q4	525	926	858	--	40	26
1951 Q1	456	465	310	--	41	31
Q2	533	576	414	--	73	39
Q3	653	660	465	--	61	29
Q4	727	750	461	--	77	38
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	1757	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 MOF, *Fiscal and Monetary Statistics Monthly,* various issues.

1/ Including the reserve fund.

2/ Excluding the reserve fund.

Table 2. Designated Currencies for International Transactions, 1949-64 1/

Date of Designation	Currencies or Comments
December 1, 1949	U.S. 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	Belgian franc
April 1, 1959	Austrian schilling; Danish krone; Italian lira; Norwegian krone; Portuguese escudo
July 1, 1960	Japanese yen
January 16, 1962	All currency restrictions abolished for external payments
March 15, 1964	Australian dollar (for external receipts)

1/ All currency restrictions were abolished for external receipts on June 10, 1971.

Table 3. Bilateral Open Account Clearing Agreements, Fiscal 1949-61

At the End of Fiscal Year	Number of Treaties	Countries Added or Terminated During the Year 1/
1949	9	French Union (July 1948); Thailand (December 1948); Egypt (January 1949); the Netherlands (January 1949); Argentina (June 1949); Brazil (June 1949); Finland (July 1949); West Germany (August 1949);Hong Kong. 2/
1950	14	Korea (April 1950); Sweden (April 1950); the Philippines (May 1950); Indonesia (July 1950); Taiwan (July 1950) added.
1951	14	Hong Kong (September 1951) terminated; 3/ Italy (January 1952) added.
1952	14	
1953	14	
1954	16	Turkey (February 1955) and Greece (March 1955) added.
1955	14	West Germany (October 1955) and Italy (January 1956) terminated.
1956	10	Sweden (April 1956); Thailand (April 1956); Argentina (June 1956); and French Union (January 1957) terminated.
1957	6	Finland (April 1957); the Netherlands (June 1957); Indonesia (July 1957); and the Philippines (August 1957) terminated.
1958	4	Brazil (October 1958) and Egypt (November 1958) terminated.
1959	3	Turkey (August 1959) terminated.
1960	2	Greece (April 1960) terminated.
1961	1 4/	Taiwan (October 1961) terminated.

Source: MITI, *Annual Report*, annual issues.

1/ Each parenthesis indicates the month in which the payment treaty in question was either signed or took effect.

2/ The treaty was never formally signed.

3/ Hong Kong was fully included in the sterling area.

4/ The bilateral agreement with Korea was terminated in March 1966.

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

		Exports		Imports		Balance	
1951		1410		1659		-249	
	dollars		309		933		-624
	sterling		674		443		231
	open		427		283		144
1952		1168		1790		-622 1/	
	dollars		440		987		-517
	sterling		469		557		-88
	open		259		276		-17
1953		1245		2242		-997 1/	
	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: MOF, *Fiscal and Monetary Statistics Monthly*, various issues.

1/ Much of the trade deficits in fiscal 1952 and 1953 was financed by large invisible receipts associated with U.S. special procurements arising from the Korean War. In fact, the balance of U.S. dollar reserves rose slightly during this period (see Table 5).

Table 5. Foreign Exchange Reserves, Fiscal 1949-63 1/
(in millions of U.S. dollars)

At the End of the Fiscal Year	U.S. Dollars	Sterling	Open	Total (old method)	Total (new method)
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	839
1956	1063	91	267	1421	738
1957	594	59	304	957	629
1958	--	--	--	--	974
1959	--	--	--	--	1361
1960	--	--	--	--	1997
1961	--	--	--	--	1561
1962	--	--	--	--	1863
1963	--	--	--	--	1996

Sources: MOF, *Fiscal and Monetary Statistics Monthly*, various issues;
BOJ, *Economic Statistics of Japan*, annual issues.

1/ The method of measuring foreign exchange reserves was substantially revised at the end of Fiscal Year 1957 (i.e., from 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; "--" indicates the figure is not available.

Table 6. Selected Import Liberalization Measures in Japan, 1950-64

Date	Actions or Comments
August 1950	The Automatic Approval (AA) System introduced.
January 1951	154 items announced on the AA list.
April 1953	The global quota system was introduced within the Fund Allocation (FA) System.
January/April 1959	Of the 231 AA items remaining on the FA list for the dollar area, 221 items were moved to the unrestricted 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; in terms of the AA list, the discrimination against the dollar area was abolished.
April 1961	62 percent of imports liberalized.
June 1961	The classification of items was changed from the Standard International Trade Calssification (SITC) Nomenclature to the Brussels Tariff Nomenclature; 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 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	Almost 93 percent, with 174 items.

Table 7. The Estimated Purchasing Power Parity Rates for the Japanese Yen
(yen per U.S. dollar) 1/

	Based on Wholesale Prices	Based on Consumer Prices
1949	330	330
1950	376	305
1951	468	324
1952	487	329
1953	498	352
1954	488	371
1955	478	364
1956	486	364
1957	485	363
1958	449	356
1959	454	356
1960	458	367
1961	462	384
1962	454	400
1963	362	427
1964	462	439

1/ Calculated from data obtained from IMF, *International Financial Statistics;* it is assumed that the rate of 330 yen per U.S. dollar was the PPP rate in 1949.

Table 8. The Determination of Disaggregated Wholesale Prices in Japan, January 1951 to December 1963

Dependent Variable	Metal Products		Textiles		Chemicals	
Estimation Method 1/	OLS	CO	OLS	CO	OLS	CO
Coefficients: 2/						
Lagged Dependent Variable (a_1)	0.924** (0.019)	0.768** (0.045)	0.849** (0.037)	0.679** (0.054)	0.939** (0.014)	0.940** (0.018)
Import Price Index (a_2)	0.086** (0.013)	0.089** (0.031)	0.087** (0.028)	0.185** (0.044)	0.067** (0.010)	0.062** (0.012)
D53 (a_3) 3/	-0.003 (0.005)	0.004 (0.008)	0.018** (0.007)	0.026** (0.011)	0.005 (0.004)	0.003 (0.005)
D57 (a_4) 3/	-0.004 (0.006)	0.006 (0.008)	-0.017** (0.008)	-0.021** (0.011)	-0.006** (0.003)	-0.005 (0.004)
D61 (a_5) 3/	-0.005 (0.005)	-0.004 (0.008)	-0.006 (0.007)	-0.008 (0.011)	-0.005 (0.003)	-0.004 (0.004)
Summary Statistics:						
DF	149	147	149	147	149	147
Adjusted-R^2	0.95	0.98	0.97	0.98	0.99	0.99
DW	0.55	2.06	1.15	1.84	1.45	2.07
LM 4/	80.01**	--	27.29**	--	10.63**	--

1/ OLS: Ordinary Least Squares; CO: the Cochrane-Orcutt method.

2/ The figures in parentheses are standard errors; ** (*) indicates that the statistic is significant at the 5 (10) percent level.

3/ The dummy variables are for the respective initial 12-month periods during which external adjustment measures were being implemented to cope with the balance of payment difficulties.

4/ The chi-square statistic for the Lagrangean multiplier test for serial correlation; ** indicates that the null hypothesis of no serial correlation is rejected at the 5 percent level.

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