

FOREIGN EXCHANGE RESERVES AS A BUFFER IN JAPANESE COUNTERCYCLICAL POLICY

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I. *Prerequisite for countercyclical policy in Japan*

In recent times, countercyclical policy through various monetary and fiscal measures has been developed, especially in the United States. However, in Japan, the amount of foreign exchange reserves is the strategic factor which determines the limit of proper countercyclical policy.

The Economic Planning Board of the Japanese Government describes the requirements for balanced economic development, as follows:

“An optimum expansion is a long-range proposition. The actual economic trends will fluctuate above or below the optimum expansion rate according to the prevailing circumstances. Japanese economic conditions are subject to change largely with world market fluctuations. It is desirable that the shocks of change be absorbed and changes in economic conditions in Japan be kept in minimum degree with a view to a stable, permanent expansion on a basis of an optimum expansion rate. For this purpose the national treasury and the money market had better be equipped with a device to adjust the rate of economic expansion. In a country like Japan where economic situations are liable to effect the nation's international balance of revenue and payment, there should be a reserve holding of foreign exchange as a prerequisite for the policy of insuring business prosperity.”¹

This seems to suggest a foreign exchange reserves buffer policy. Yonosuke Goto, head of the Economic Planning Board Research Department at that time, gave the following personal explanation of this policy.² In case exports are expanding as the result of a boom in world markets, foreign exchange reserves should be accumulated; and in case exports are diminishing as a result of depression in world markets, foreign exchange reserves should be used to maintain imports. To accumulate foreign exchange reserves during prosperity, it is necessary to restrict domestic demand and imports, in spite of the increase in exports. In the other hand, in the case of depression, domestic demand should be expanded through proper fiscal and monetary policy to counterbalance the decrease in

¹ Economic Planning Board, *Economic Survey of Japan (1955-1956)*, Tokyo, 1956, (English edition.) p. 23.

² Yonosuke Goto and Hisao Kanamori, “Buffer Policy of Foreign Exchange Reserves,” *Studies in International Trade and Industry*, May, 1956, Tokyo (in Japanese).

exports. If this policy induces an increase in imports accumulated foreign exchange reserves should be used.

The purpose of this policy is to make the sum of domestic and foreign demand grow at a constant rate notwithstanding fluctuations in the world market. The accumulation of foreign exchange reserves is to be used to realize a steady growth of the national income of Japan. However, there are three requirements for executing this policy: (1) accumulation of foreign exchange reserves, (2) monetary policy which can neutralize the effect of fluctuations in foreign exchange reserves upon the domestic money market and (3) fiscal policy which can diminish or expand effective domestic demand, as required. Although the buffer policy of foreign exchange reserves appears theoretically reasonable, there are many obstacles to be overcome. It is especially doubtful whether "the optimum expansion rate" mentioned above can be precisely determined, and whether foreign exchange reserves sufficient to tide over a depression can be accumulated. Study of the secular growth rate of the Japanese economy in the past has shown remarkable development recently,³ but it is a different matter to determine the optimum expansion rate for the future. Countercyclical policy requires a careful diagnosis of the cyclical position of the economy at various points in time. The record of economic forecasting is rather poor. Simple criteria to determine the turning points of the business cycle have not been found. To the difficulty, or impossibility, of exact forecasting must be added the unavoidable delay in enforcing countercyclical measures.

Because of the great difficulties of forecasting and timing, cyclical fluctuations can not be eliminated, but they can be dampened. Thus, theoretical consideration of the buffer policy seems in order. Now, four cases of cyclical disequilibrium can be distinguished. In the first case, there is domestic deflation and an external surplus. The remedy for such a case is expansion, or reflation, and it is not necessary to accumulate foreign exchange reserves. In the second situation, however, there is internal inflation and an external surplus. Here, foreign exchange reserves should be accumulated, and it is necessary to reduce domestic demand, that is, follow a policy of disinflation. The third condition is one of inflationary pressure at home and an external deficit. The only remedy required is disinflation. In the fourth case, there is domestic deflation and an external deficit. Then, a domestic policy of reflation is required, and accumulated foreign exchange reserves should be used.

The above classification is suggested by Prof. Harrod's analysis⁴ of fundamental disequilibria in a nation's international balance of payments and their remedies. However, because the buffer policy under consideration here concerns only cyclical disequilibrium, changes in the foreign exchange rate, and factor rewards are excluded as remedies. Also, the buffer policy assumes that cyclical disequilibrium

³ Kazushi, Ohkawa, etc., *The Growth Rate of the Japanese Economy since 1878*, Tokyo, 1958 (English edition).

⁴ R. F. Harrod, *International Economics*, London, Revised and Reset, 1957, pp. 140.

would balance out over a complete cycle. Actually, the foreign exchange reserves accumulated might be insufficient to make this possible. However, the assistance of the International Monetary Fund could be expected in such an event.

Experiences with a buffer policy in Japan are examined in this paper, retrospectively. Strictly speaking, 1914 to 1920 is not an appropriate period to examine the applicability of the buffer policy, especially because the rate of foreign exchange was fluctuating freely. After the collapse of the gold standard with the outbreak of World War I, the main monetary problem in Japan was how and when to return to the pre-war gold standard. However the policy was applied unintentionally, so it is discussed in section two. Japan returned to the gold standard at the pre-war exchange level in January 1930, but another departure from the gold standard was forced in December, 1931. Since then, some form of exchange control has always been in effect. A basic foreign exchange control law was enacted in 1933, and exchange control adjusted to a semi-war and war economy was practiced till 1945. During the occupation, the Foreign Exchange and Trade Control Law was enacted in December, 1949. Although it has been amended several times, the present system of control is based on this law. The Japanese Government makes foreign exchange allocations for all transactions on the basis of special exchange budgets prepared semiannually. The foreign exchange budget is an estimate by the Government of receipts and payments of foreign currency from visible and invisible transactions. On the basis of this budget an import program is determined and exchange set aside for various commitments during the period, including remittances of profits and dividends on investments, interest on loans, and repatriation of foreign capital.

Accordingly, a system of licensing is in effect for all transactions, both domestic and foreign, which involve foreign exchange payments or receipts. All foreign exchange must be surrendered to the government and maintained in special accounts under government control. This is the Foreign Exchange Fund Account. The Minister of Finance administers this Account, but actual management and operation are delegated to the Bank of Japan, which acts as the agent of the Minister of Finance. In the case of an external surplus, yen payments from this Account to the domestic private sector exceed receipts and currency increases. This is similar to the effects of a gold inflow under the gold standard. In the case of an external deficit, yen receipts to this Account from the domestic private sector exceed payments and currency decreases, as with a gold outflow under the gold standard.

The official exchange rate for the yen has been ¥360 to one United States dollar since 1949. Sections three and four of this paper examine the applicability of a buffer policy to the Japanese economy during the period 1950-1958 under these institutional conditions.

II. *Experiences from 1914 to 1920*

It seems that the buffer policy of foreign exchange was executed unintentionally during World War I. The unfavourable balance of payments which had prevailed in Japan's international trade to that time, changed to a favourable balance as a result of the outbreak of W.W.I. During the five years from 1914 to 1918, exports exceeded imports by 1,375 million yen, while the surplus from items other than visible trade amounted to 1,339 million yen. The total balance of payments surplus was, therefore, 2,714 million yen for the period. The payments surplus on items other than visible trade continued after the armistice into 1920. Thus, the payments surplus in the balance of payments totalled as much as 2,962 million yen from 1914 to 1920.

In 1914, the debts Japan owed to other countries were, in total, 1,900 million yen including national loans and loans raised by prefectural governments and private companies. On the other hand, the gold reserve held by the Bank of Japan was valued at 129 million yen, while the gold reserve kept abroad and overseas investments respectively amounted to 213 million and 460 million yen. Therefore, debts exceeded credits by 1,098 million yen. In 1920, Japan's total foreign debts were 1,600 million yen, while the gold reserve of the Bank of Japan, the gold reserve kept abroad and overseas investments were respectively 1,116, 1,062 and 2,200 million yen and credits exceeded debts by 2,778 million yen. Japan was, therefore, faced with grave difficulties in the field of international finance because of a large payments surplus accumulated over the relatively short period of 7 years.

This situation was further aggravated by the ban on exports of gold from Europe and America. Meanwhile, the Yokohama Specie Bank and other foreign exchange banks ran short of funds for trading and were given credits by the Bank of Japan, amounting to respectively 20, 120, 200 and 440 million yen in June of 1915, 1916, 1917 and 1918. On the other hand, they raised funds in the market, the amounts of which fluctuated from 100 to 250 million yen. The foreign exchange banks also had to bear the difference between the rate of interest at home and abroad. The decline in the value of the reserve foreign currency was also a heavy blow to them, the exchange rate per 100 yen rising from \$10.59 in July, 1914., to \$52.125 in December, 1918.

The great surplus of exports over imports brought inflation and the rise of commodity prices. Taking July, 1914, as the base, the index of wholesale prices was 99, 117, 164, 200 and 254, respectively, in July, 1915, 1916, 1917, 1918 and 1919. The note issues of the Bank of Japan were respectively 430, 601, 831, 1,144, and 1,555 million yen at the end of 1915, 1916, 1917, 1918, 1919.

With a view to checking the rise in commodity prices, control or ban of exports was proposed. However, the proposal was not approved by the authorities,

who found in the export boom a golden opportunity for acquiring foreign exchange. From a foreign exchange reserves buffer policy standpoint, measures should have been adopted to check domestic demand in order to solve the difficulty which resulted from the accumulation of a large amount of foreign exchange at the exchange banks. This foreign exchange was purchased by the government from the Deposits Account partly as preparation for repayment of foreign loans, but it should also be interpreted as a policy for sterilization of gold. By 1918, foreign exchange amounting to some 14,000 million yen had been purchased by the government, and it became the governmental reserve kept abroad.

Table 1 *Specie Holding*

(million yen)

end of year	Possessor		Location		
	Government	The Bank of Japan	Total	At home	Abroad
1912	82	269	351	136	215
1913	91	285	376	130	246
1914	49	292	341	129	213
1915	153	363	516	137	379
1916	262	453	714	228	487
1917	386	719	1,105	461	643
1918	855	733	1,588	453	1,135
1919	1,051	994	2,045	702	1,343
1920	888	1,292	2,179	1,116	1,062
1921	791	1,289	2,080	1,225	855
1922	667	1,163	1,830	1,215	615
1923	526	1,127	1,653	1,208	445
1924	421	1,077	1,501	1,175	326

Source: The Bank of Japan, *Economic Statistics of Japan* (1925), Tokyo, 1925, pp. 1-2.

According to Mr. Eigo Fukai, then a staff member and later president of the Bank of Japan, "A gold inflow is welcomed by most countries, because the acquisition of gold is, in most cases, very difficult. The bank of issue keeps the gold thus acquired and use it to strengthen the basis of the currency. Even if the inflow of gold is not desired, it cannot be stopped, unless import or free minting of gold is prohibited. Currency inflation is also an unavoidable consequence of a gold inflow. If gold is bought by the bank of issue, the currency in circulation increases by the amount of the bank notes issued in exchange for the gold. If it is not purchased by the central bank, the gold will be minted and put in circulation, again bringing about currency inflation. When an inflow of gold causes inflation of the currency, measures are available which have the effect of contracting the circulation of currency. This is, however, beyond the control of the bank of issue. In fact, if inflation is to be avoided, the gold should not be kept at the bank of issue, but by the government. When a large amount of gold poured into Japan immediately after World War I, the government purchased

the gold from the Bank of Japan and kept it under government control with the above-mentioned idea in mind. The Bank of Japan received bank notes or the equivalent amount from the Deposits Account. Both of these transactions naturally had the effect of checking currency issue and, thereby, its increase. On the other hand, the gold, which thus came into possession of the government, was deposited at the Bank of Japan as a separate deposit, the balance of which was made independent as special cash in the Government account. In this form, the gold lost the effect it previously had on the money supply. However, all the procedures concerned were now essentially the business of the Government, not of the Bank of Japan."⁵

Another measure adopted was the conversion of foreign loans into domestic obligations, which meant the redemption of foreign loans by means of raising loans in domestic markets, where interest rates were lower. This had the effect of contraction currency, but, in reality, loans of only 90 million yen were floated, because the Government at that time adhered to the so-called non-issuance policy and did not want to increase domestic obligations for any purpose. Measures other than the above were adopted but with slight effect, the problem being automatically solved by the armistice.

Recalling the situation at that time, Mr. Junnosuke Inoue, then president of the Bank of Japan and later Minister of Finance, made the following statement:

"For the past several decades, imports have exceeded exports. We have therefore cudged our brains with a view to encouraging exports and discouraging imports. Now, however, exports are exceeding imports and we are in a position to make money very easily. However, no thoroughgoing study is available concerning the measures to be taken at such a time. It is just like the perplexing situation in which a non-drinker is placed when he suddenly makes up his mind to go wet and tries to warm *sake*, but does not know how to go about it. The various difficulties ensuing from an excess of export are, therefore, mainly due to unfamiliarity with the related problems on the part of us, who are the very parties concerned."⁶

The foreign currency reserves obtained during these years were exhausted during the following depression period. The result, though unplanned, was therefore just the same as that under a buffer policy of foreign exchange reserves.

III. *Experiences from 1950 to 1953*

As a result of the outbreak of the Korean War in June, 1950, the economy of Japan suddenly jumped into a boom, after the depression due to the Dodge

⁵ Eigo Fukai, *Regulation of Currency*, Tokyo, 1928 (in Japanese), p. 294-398.

⁶ Junnosuke Inoue, *The Present International Finance Situation and Policy for its Improvement*, Tokyo, 1925 (in Japanese), p. 15.

line. Owing to the increase of exports and procurement by the U.S. army, the foreign exchange reserves grew from 225 million dollars at the end of 1949 to 564 million dollars at the end of 1950. In spite of the large amount of excess receipts of the General and Special Accounts, which amounted to 232,200 million yen, payments of the Treasury Account, including the Foreign Exchange Fund Account, exceeded receipts by 41,900 million yen in fiscal 1950. Because the net payment over receipt from the Foreign Exchange Fund Account to the private sector amountad to 278,200 million yen. Increased demand and rising profits induced new investment in plant, and the Bank of Japan was forced to expand credit by 51,400 million yen and its note issue by 84,900 million yen during the period. Using June, 1950, as 100, the wholesale price index for December, 1950, and June, 1951, became respectively 123 and 152. In the supplementary budget for 1950 and the ordinary budget for 1951, respectively, 10,000 and 50,000 million yen were transfered to the Foreign Exchange Fund Account from the General Account. This was the so-called policy of inventory finance.

Inventory finance was first introduced to Japan by Mr. Dodge in 1949. Ascribing the post war inflation to deficit budgets and the cheap money policy adopted for rehabilitation, Mr. Dodge attempted to stabilize the economy by having the Government firmly maintain a balanced budget and tight money policy. Funds necessary for covering increased prices of inventories by various public corporations and the Food Control Special Account, as well as funds required to increase the amount of foreign currency held in the Foreign Exchange Fund Account, were to be obtained neither by sale of government bonds nor by borrowing from the Bank of Japan, but by transfer from the General Account of the Treasury.

A favorable trade balance, such as that caused by the world-wide boom accompanying the Korean War, results in an increase of foreign currency held in the Foreign Exchange Fund Account, while a shortage of yen funds results from the excess of yen payments over yen receipts. In the latter case, if yen funds are supplied by sale of short-term government bonds or loans by the Bank of Japan, the situation is essentially the same as that which results from an increase in gold reserves under a gold standard system. If yen funds are supplied from the General Account by the inventory finance method, the ultimate source of such funds is none other than taxes and other governmental revenues. In other words, there is absorption of yen funds in the private sector, and the causal connection between increase in foreign currency reserves and domestic inflation no longer exists.

From 1949 to 1953, the sum of 1,540,000 million yen was transferred from the General Account to the Foreign Exchange Fund Account. However, the effect of this inventory finance was offset by other anti-inflation measures aimed at promoting imports and production. During the world-wide armament boom ensuing from the Korean War, no attempt was made to accumulate foreign currencies as suggested by the buffer policy. On the contrary, emergency procurement of essential imports was the major concern in view of difficulties of

acquiring raw materials in competition with other countries and fears concerning the spread of hostilities. In September, 1950, a foreign exchange loan system was instituted by the Bank of Japan. Under this system, a large amount of money was advanced to traders by the Bank of Japan and other banks to facilitate imports. However, because of various occupation controls, arrangements for imports were delayed. In particular, strategic materials such as leather, fat and rubber could be imported only after a rise in their prices.

The world-wide armament boom came to an end when the procurement of war materials by the United States was discontinued in March, 1951, and the so-called Malik proposal for the peaceful settlement of the Korean War was made in June of the same year. As a result, the situation which would have justified the emergency import program did not materialize. Following the establishment of peace in Korea, there was a need for loans to many enterprises suffering from increase in inventories and falling prices, and finding it difficult to export. In 1951, there was a balance of payments surplus of 340 million dollars, but commodity imports exceeded exports by 290 million dollars.

Table 2 *Gold and Foreign Exchange Holding*

U. S. \$ million

End of Year	The Bank of Japan			Government						Authorized Foreign Exchange Banks
	Total	Gold	Foreign Exchange	Total	Gold	Foreign Exchange				Foreign Exchange
						Sub Total	U. S. Dollars	Pound Sterling	Open Account	
1949	—	—	—	225	4	222	166	44	11	—
1950	—	—	—	564	7	557	462	54	41	5
1951	—	—	—	924	10	914	583	211	120	2
1952	50	—	50	1051	16	1035	664	249	122	64
1953	51	—	51	844	18	826	679	78	69	122
1954	51	—	51	971	21	950	564	194	192	108
1955	514	—	514	824	23	801	334	223	245	132
1956	497	—	497	1010	23	987	629	91	267	139
1957	211	—	211	808	23	785	431	50	304	189

Source: The Bank of Japan, Statistics Department, *Economic Statistics of Japan (1957)*, Tokyo, 1958, p. 261.

The world-wide recession began to influence the Japanese economy in 1952. The policy which was adopted at the time was, in a certain sense, along lines suggested by the buffer policy. More specifically, attempts were made to stimulate domestic demand in order to provide markets for production, which continued to increase even after the end of the boom. Among other objectives of the policy were neutralization of the deflationary effects of decreased foreign demand; use of available foreign currency to modernize plant and equipment and thus reduce production costs in preparation for future international competition; strengthening the basis of production by such means as the development

of electric power and increased food production in order to save foreign currency in the future.

By November, 1951, when the foreign exchange loan system was partially revised, exports to the sterling area had begun to exceed imports from that area. In fact, the sterling funds in the Foreign Exchange Fund Account grew from 54 million dollars at the end of 1950 to 211 million dollars at the end of 1951. At that time, England was experiencing heavy losses of gold, and as a result devaluation of the pound was rumored. To encourage imports from the sterling area, the Japanese Government instituted foreign exchange extra loan system in February, 1952. But the balance of payment surplus 94 million dollars was recorded in fiscal 1952.

As a result of the Korean armistice in July, 1953, deflation was taking the place of inflation in many countries in the world. In Japan, however, production continued to increase. National income increased from 4,525,200 million in 1951 to 5,084,900 million yen in 1952, while it was as much as 5,747,700 million in 1953. This seems to have been due to the policy adopted to counterbalance the decline of exports by an increase of domestic demand through enlarged public investment. The purpose of this policy was, in a sense, well in accord with the buffer policy, but it was limited by the insufficiency of accumulated reserves. Meanwhile, the index of wholesale prices decreased during 1952, being 151.0 and 148.7, respectively, in June and December, but increased during 1953, to 152.9 and 158.8, respectively. A poor rice harvest due to typhoons and floods increased the food imports. Thus, receipts and payments in international balance in fiscal 1953 were, respectively, 2,161 and 2,474 million dollars, payments exceeding receipts by 313 million dollars. Also the foreign currency reserves held by the government decreased to 844 million dollars at the end of 1953, from 1051 million dollars at the end 1952.

As is clear from the above, the policy of maintaining internal economic stability was affected by the decrease of foreign currency reserves. Government receipt from the private sector exceeded payments by 21,500 million yen in 1952, but on the contrary excess payments were 63,600 million yen in 1953. This was due to the fact that excess yen receipts by the Foreign Exchange Fund Account in 1953 totalled 129,800 million yen, reflecting the external deficit; while excess yen payments were 13,100 million yen in 1952.

Had a balanced budget policy been adopted at that time, the large amount of yen receipts by the Foreign Exchange Fund Account would have caused a lowering of prices and an increase of unemployment. Actually such a policy was not adopted. Loans by the Bank of Japan increased by 63,500 million yen in fiscal 1952, and by 126,400 million yen in fiscal 1953. Also, Bank of Japan notes in circulation increased by 58,400 million yen in fiscal 1952 and by 18,600 million yen in fiscal 1953.

From around October, 1953, the Bank of Japan began to enforce a tight money policy. At first, there was a speculative rise in the prices of some com-

modities whose imports were reduced, but during the course of 1954, the economy was gradually penetrated by the effects of this deflationary measure.

Reflecting upon economic development in these years from the standpoint of the buffer policy, there is nothing in the policy itself which can be criticized. Nevertheless, if measures are to be taken to offset a decrease in foreign demand the problem of the timing of these measures is important.

IV. *Experiences from 1954 to 1958*

The tight money policy in effect since October, 1953, gradually reduced the liquidity of the corporate business sector and made investment inactive. In 1954, the greater part of the 139,000 million yen Treasury bills issue, which was purchased by the Bank of Japan, was directed, together with funds of the postal savings system, to loans to the private sector totalling 235,000 million yen. This helped relax money market conditions, while the increase in loans of financial institutions to the private sector was a comparatively low 370,700 million yen under the tight money policy. The ratio of the increase in government loans to the increase in financial institutions' loans during the year was considerably higher than that of the average year.

In 1955, backed by the upward trends of overseas business and the effects of tight money measures at home, exports began to increase and business activity showed a remarkable growth.

Corporate business investment continued at about the same level as the previous year and net borrowing was a comparatively low 468,000 million yen. It should be noted, however, that the increase in money held by business amounted to seven times that of the previous year. This shows that funds flowing into the private sector, owing mainly to a 73,500 million yen increase in exports, were not directed to investment in equipment or inventories. Thus, the 352,700 million yen increase in money supply and the 121,700 million yen increase in foreign exchange holdings raised liquidity, both internally and externally.

The Government deficit amounted to 55,200 million yen during 1955, reflecting an increase in the inventory of rice due to a good harvest. This deficit, and the yen deficit of the Foreign Exchange Fund Account were covered by the Bank of Japan's accommodation, the latter by sale of foreign exchange (166,500 million yen) and the former by sale of Treasury bills (68,200 million yen). Funds flowed from the Government to the private sector through purchases of foreign exchange during almost the entire year, and purchases of rice during the last quarter.

These Government payments increased liquidity in the private sector and eased the money market. Under these conditions, the Bank of Japan adopted a policy of absorbing excess liquidity of commercial banks by reducing its advances and discounts. However, the Bank found it impossible to continue this policy

because the liquid funds of commercial banks became so ample that borrowing from the Bank was unnecessary. Thus, the tender of treasury bills and open market operations were next regarded as requisite to absorb excess liquidity. Towards the end of the year the Bank sold a large amount of Treasury bills to banks and other financial institutions. The Ministry of Finance, however, adhered to a low interest rate policy, so the Bank's selling operations were not effective enough. It can be said that the Bank of Japan acted in accordance with the principle of the above-mentioned buffer policy, but it did not have adequate weapons.

Together with the easing of money market conditions after the second half of 1955, commercial banks began to take a more positive attitude toward loans. As these banks could not find suitable securities for investment, they began to compete with one another in granting credit, which brought about a remarkable increase of 1,131,500 million yen in loans to corporate business. Corporate business had already rebuilt from its weakened liquidity position as a result of the inflow of funds due to the external surplus and deficit payments from the Treasury accounts. It now increased its investments in both equipment and inventories, supported by the changed attitude of banks toward loans and the prosperity of the world market. Net borrowing by corporate business recorded a remarkably large total of 1,017,500 million yen 2.3 times that of the previous year.

This brisk activity in the corporate business field increased personal income and brought, in turn, increased personal savings. In the Government sector, it led to a revenue surplus of 110,000 million yen through increased tax revenues. Meanwhile, the increase in money supply was greater than that for 1955, the increase in cash currency being especially remarkable, owing mainly to the expansion of personal income and expenditure for consumption.

In view of these upward trends in the economy the Government could have been expected to play a stabilizing role through increasing tax revenues from the private sector. However, it was unable to put sufficient pressure on the liquidity of the private sector and the money market for the following reasons. Firstly, in spite of the unfavorable balance of trade, yen payments by the Foreign Exchange Fund Account recorded an excess over receipts owing to the increase in foreign debt of corporate business. Secondly, the increase in Government loans was larger than that in postal savings and receipts of postal life insurance premium. Finally, the funds for these payments by the Government were covered by credit from the Bank of Japan.

Over-expansion of economic activities continued through 1956, and gave rise to deterioration of the balance of payments in the first half of 1957. The excess of imports over exports amounted to 210,200 million yen, and the reduction of foreign exchange holdings to 157,600 million yen. In the first half of the year the former was 239,500 million yen and latter 174,900 million yen, respectively. Finally, in order to meet the rapidly worsening balance of payments situation, a tight money policy was adopted in May. It was eventually effective

in curbing the unduly large investment lying behind the balance of payments deficit. On the other hand, 125 million dollars were bought from the International Monetary Fund. For a short period after the adoption of stringent measures, however, investment in corporate business continued to increase as both equipment programs and purchases of raw materials previously contracted for were effected. Net corporate borrowing totalled 1,226,300 million yen for 1957, 20 per cent larger than that in 1956.

In the Government sector, the increase in tax revenues resulted in the remarkably large revenue surplus of 224,400 million yen. The greater part of this surplus flowed into the Bank of Japan through redemption of Treasury bills held by the Bank. Also, the Foreign Exchange Fund Account absorbed 216,200 million yen due to the external deficit. These measures made the liquidity position of corporate business stringent, leading to increased demands for credit on the part of business and making commercial banks more dependent upon the Bank of Japan for loans.

Meanwhile, the commercial bank attitude toward loans became very restrictive. This weakened the cash position of corporate business, where the increase in cash holdings was only a fifth of that in 1956. Also, in the household sector, the increase in cash holdings was only a third of that in 1956.⁷

The buffer policy was not successful in either the period 1950–1953 or the period 1954–1958. However, lack of success was due partly to insufficient recognition by the monetary authorities that a buffer policy was necessary. Also, its failure might be partly the result of the fact that it is difficult to distinguish cyclical disequilibrium from fundamental disequilibrium. Nonetheless, the necessity of a buffer policy seems to have been clearly revealed.

⁷ The Bank of Japan, *Monetary Development, 1954–1957, and Essential Features of Financial Structure of Japan (A Study on Money Flow in Japan)*, Tokyo, Dec. 1958 (English edition), pp. 3–6.