Chapter 2 Fiscal and Monetary Policies as the Economy Stabilized

1. Political and Economic Conditions

Although the reconstruction was advancing, inflation had not been staunched, which made it difficult for Japan to revive trade and foreign exchange under the fixed-rate market system. Anxious to stabilize the Japanese economy quickly, the U.S. government directed SCAP to implement a "Nine-Point Economic Stabilization Program" in December 1948. Joseph Dodge was brought in from the United States as an economic advisor to help make the transition to the Nine-Point Program, and Japan enacted the "Dodge Plan" in fiscal 1949. The fiscal and monetary policies of the Dodge Plan consisted of a sharp tightening of the money supply, which produced a sufficient deflationary effect to overcome inflation quickly and stabilize the economy. Meanwhile, the peace treaty was signed in San Francisco on September 8, 1951. It was scheduled to take effect on April 28, 1952, but political conditions elsewhere in the Far East were turbulent. In July 1950, armed conflict broke out on the Korean Peninsula. Though it was brought to an end with armistice talks the following July, the Korean War produced special procurement demand from the U.S. armed forces, giving Japan extraordinary dollar income amounting to 25 percent of its exports in 1951, and 35 percent in 1952. Special procurement demand from the war created large numbers of new jobs and proved a major stimulus for domestic production.

The period of reconstruction and postwar inflation featured extensive hidden unemployment. It was in many respects an exercise in creating a nominal expansion in economic activity, in the face of an absolute shortage of goods. The boom produced by the Korean War created stability, as income increased under the single exchange rate. What is more, the Dodge Plan brought significant relief to the postwar economic system by spurring economic growth, as the focus shifted to market mechanism-based transactions. Finally, the extraordinary dollar income from the Korean War raised the ceiling on the foreign reserves Japan could import, rapidly enough to keep pace with booming demand for imported goods. Demand from the war more than made up for the cessation of GARIOA in 1951, and growth during the war helped the Japanese GNE (gross national expenditure) to continue to rise during the postwar reconstruction period. In terms of prewar prices (1934-1936), real GNE climbed from ¥ 14,211 million in 1948, the year before the Dodge Plan went into effect, to ¥ 18,207 million in 1951, exceeding the levels recorded during the base years of 1934-1936.

Table 2-1 Expenditure on Special Procurement Demand

(In thousands of yen)

Year	Total	Dollar-based Transaction	Yen-based transaction
1950	90,633	90,633	—
1951	341,599	341,599	—
1952	457,296	413,875	43,421
1953	594,575	434,717	159,858
1954	453,674	268,679	184,995
1955	345,443	223,654	121,789
1956	344,783	256,562	88,221
1957	320,443	237,384	83,059
1958	283,143	221,110	62,033
1959	225,211	186,556	38,655
1960	234,062	226,353	7,709
1961	242,801	242,801	—
1962	217,029	217,029	—

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made* ", Vol.19, pp.117

2. Dodge Plan Fiscal Policies

1) Budgetary Policies

The fiscal 1949 budget, the first to be prepared under the Dodge Plan guidelines, had three main targets to fulfill. First, it had to achieve an overall balance in the

General Account, special accounts and government-affiliated agencies budgets. Second, it had to impose austerity and frugality measures on the public in order to establish a long-term base for efficient production and capital accumulation. This included distinguishing clearly between the budget proper and U.S. aid, and using aid effectively in the cause of reconstruction. Finally, the budget had to prepare for Japan’s return to the international economy, by such means as eliminating export subsidies.

The characteristic that set the Dodge Plan budgets apart more than anything else was the requirement for a real, comprehensive balance of the aggregate budgets for the General Account, special accounts and government-affiliated agencies (the budgets which became subject to Diet approval in fiscal 1949). Known at the time as "over balanced" budgets, the goal was to eradicate deficits.

The fiscal 1949 budget also attempted to reduce government debt. In an effort to enable the economy to break out of inflation, it held down increases in spending across the board. The initial budget went from ¥ 414.4 billion in fiscal 1948 to ¥ 704.9 billion in fiscal 1949 - a hefty 70.1 percent annual growth rate. But the reasons for the increase were, first, projected rises in nominal expenses due to the 1948 inflation and, second, increases in price adjustment subsidies. The latter, in particular, were the result of the transfer of a hidden subsidy for exports and imports that had been paid from trade funds to the General Account. As the 360 yen / dollar fixed exchange rate came into being, import subsidies soared during fiscal 1949. The result was to raise commodity and price adjustment expenditures for the final budget from ¥ 62,500 million the previous year (13.2 percent of total spending) to ¥ 179,200 million (24.1 percent), making the subsidy the fastest growing spending item in the General Account. The budget restrained growth in termination-of-the-war expenses and began to eliminate distribution controls, allowing the abolishment of the public corporations which had been set up for rationing purposes. During fiscal 1949 the Liquor Rationing Public Corporation and the Petroleum Rationing

Public Corporation closed their doors.

The fiscal 1950 budget maintained the austerity. Its guidelines were 1) to achieve a true balance in the aggregate budget; 2) to cut spending; 3) to make significant reforms in the tax system to coincide with the spending cuts; and 4) to provide a large increase in funding for construction and other public works. The initial budget came in at ¥ 661.4 billion, down a sharp 6.2 percent from the previous year. The cuts in commodities and price adjustment expenditures were particularly large because of the relaxation of rationing. The final budget, after all the supplemental budgets were added, recorded a drop of ¥ 64 billion (9.6 percent) in commodity and price adjustment expenditures. Fiscal 1950 saw the creation of such public corporations as the Feed Ration Public Corporation, Foodstuffs Distribution Public Corporation, Coal Distribution Public Corporation and Ship Administration Public Corporation go out of business. The remaining seven public corporations would be liquidated during fiscal 1951. The only item in the fiscal 1950 General Account expenditure final budget that recorded significant growth was spending on local governments, which surged from ¥ 66.7 billion (9.0 percent) in fiscal 1949 to ¥ 108.5 billion (16.3 percent). The reason for this growth was the elimination of the Special Account for Local Allocations of Taxes and Revenues in 1949 and its replacement with Local Fiscal Resource Equalization System in 1950, under which General Account tax revenues would be transferred to local governments.

The 1949 and 1950 budgets had stabilized prices, while special procurement demand from the Korean War had triggered a boom among Japanese manufacturers, setting the stage for the budget of fiscal 1951. The guidelines that year called for 1) paying particular attention to the achievement of an aggregate balance encompassing the General Account, special accounts and government-affiliated agencies budgets; 2) reducing the size of the central government and bringing it into harmony with the national economy; 3) making another large tax cut; and 4) actively creating programs to promote stability, education and culture, and science among the general public. The initial budget was set at ¥ 657.4 billion, a 0.2 percent decline from the previous year, but price increases triggered by the Korean War boom pushed the final budget up to ¥ 793.7 billion. There were again major cuts in price adjustment subsidies, bringing spending from this area down to 2.8 percent of the final budget, a relatively tiny portion. Spending on government projects - economic rebuilding investments - rose rapidly, reaching ¥ 157,841 million (19.8 percent) in the final budget. Another large spending item, the police reserves, was organized and granted ¥ 31,000 million (3.9 percent) in the final budget.

Dodge Plan budgeting enabled Japan to balance its fiscal spending, restrain government outlays, cut price subsidies and eliminate the rationing system. Postwar inflation died down, and the postwar controls were thrown off.

2) U.S. Counterpart Fund Special Account

As part of the Dodge Plan, SCAP issued a memorandum on counterpart funds on April 1, 1949, which resulted in the establishment of a “counterpart fund” system. This triggered a reform in the Trade Fund Special Account, which until fiscal 1948 had received aid supplies and sold them domestically at below their import price. In place of the Trade Fund Special Account, which treated the receipt and payment of aid goods as non-income/expenditure funds in order to control aid imports, a new Trade Special Account was established in April 1949, and an Aid Goods Sub-account set up under this. The Aid Goods Sub-account recorded aid imports at the newly fixed exchange rate of ¥ 360 to the dollar set up in April 1949, with the proceeds from their domestic sale posted to a newly established U.S. Counterpart Fund Special Account. Under the U.S. Counterpart Fund Special Account Law of April 30, 1949, funds collected in the account could be used to redeem debt or to fund investment, loans or spending, with surpluses carried over to the next year. With the decline of state-managed trade in 1950, the Aid Goods Sub-account was switched from the trade account, in which the proceeds were recorded, to a new U.S. Aid Goods Disposition Special Account.

Table 2-2 Revenue and Expenditure of Counterpart Fund (Actual)

(In millions of yen)

Fiscal Year	1949	1950	1951	1952	1953	Total
Revenue	129,329	162,971	54,267	42,970	11,277	400,815
Funds from the Special Account	127,867	130,851	45,527	2,261	-	306,506
Interest and Dividends	1,461	4,705	6,404	6,476	570	19,616
Collection of Invested Funds	-	27,415	2,335	4,661	1,887	36,298
Redemption and Sell-off of Bonds	-	-	-	29,557	8,820	38,378
Miscellaneous Receipts	-	-	1	14	-	15
Expenditure	114,070	79,956	122,508	59,053	17,808	393,395
Public Businesses	27,000	38,185	23,286	25,018	17,800	131,288
Telecommunication	12,000	12,000	-	-	-	24,000
National Railways	15,000	4,000	-	-	-	19,000
National Forestry	-	3,000	-	-	-	3,000
Housing Loan Corporation	-	8,640	1,360	-	-	10,000
Export-Import Bank of Japan	-	2,500	5,000	-	-	7,500
Agriculture, Forestry and Fisheries	-	-	4,000	3,000	-	7,000
Japan Development Bank	-	-	10,000	22,000	13,800	45,800
Electric Power Development Company	-	-	-	-	4,000	4,000
Public Works	-	8,045	2,926	17	-	10,987
Private/public Businesses	24,604	33,800	48,322	33,281	-	140,007
Electric Power	10,093	10,000	23,200	19,800	-	63,093
Maritime Traffic	8,343	12,872	21,469	11,953	-	54,637
Coal	3,858	2,362	205	-	-	6,425
Steel	1,417	791	-	-	-	2,208
Others	593	1,378	1,486	40	-	3,496
Small and Medium-sized Enterprises	300	1,197	1,962	737	-	4,196
Preferred Stock	-	5,200	-	750	-	5,950
Redemption of Debt	62,467	-	-	-	-	62,467
Others	-	7,972	50,901	754	8	59,635
Housing for the Allied Military	-	6,949	459	-	-	7,408
Specific Education Projects	-	149	401	147	8	705
Balance	15,258	83,015	△ 68,242	△ 16,083	△ 6,531	7,418

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp. 363

Between 1949 and 1952, receipt of the counterpart funds from the sale of aid goods brought in a total of ¥ 400,815 million. To meet the formal requirement for disbursing funds under a general consensus by the government of Japan, expenditures of the counterpart fund required a Cabinet decision, with detailed information on the particulars of each loan proposal, which then had to be submitted to SCAP for permission for disbursement. A comprehensive plan drafted by Dodge went into effect at the beginning of the fiscal year. Expenditures for purposes that had been approved for disbursement were allowed to continue in subsequent fiscal years. The approved expenditures in fiscal 1949 included purchases of grant bonds from the Reconstruction Finance Bank. The bank then used the money to redeem the Reconstruction Finance Bank bonds on the open market. This produced counterpart fund expenditures of ¥ 62,467 million for the year, one of the largest outlays in fiscal 1949. Other uses of counterpart funds included capital formation for state enterprises, primarily purchases of bonds floated by the Telecommunications Special Account and loans to the Japan National Railways. Counterpart funds were also invested in the government-operated Housing Loan Corporation and lent in the private sector to the fertilizer and coal industries beginning in December 1949. Lending by the Reconstruction Finance Bank was suspended in principle in fiscal 1949, and corporate borrowings for capital investment concentrated on the counterpart funds as a result. The receipt of the counterpart funds from the Aid Sub-account of the Trade Special Account was far larger than the amount spent during the year on investments, loans and debt redemption, and it took a fairly long time after the counterpart funds were received until permission .was granted for their disbursement. This would have led to a strong deflationary impact from the revenue and expenditure of the counterpart funds, but the idle funds were invested instead in foodstuffs bills, in order to relieve some of the excessive surplus in the Treasury.

During fiscal 1950 counterpart funds were used for capital formation with allocations to the Telecommunications Special Account and National Forests Special Account, as well as grants to the national railways. The telecommunications bonds and national railway loans of fiscal 1949 were, however, taken over by the Deposits Bureau. Some spending on public works was also seen, as were investments in the Export-Import Bank of Japan, which was established in February 1951. The increase in lending to the private sector that began in 1950 made electric power and marine transportation the largest recipients of funds, which they used to pay for capital investment. Other sectors receiving loans from counterpart funds included steel, fertilizer, agriculture, forestry, fishing, small businesses and transportation and tourism. In the financial sector, counterpart funds underwrote preferred shares issued by the Industrial Bank of Japan, Central Cooperative Bank for Agriculture and Forestry (Norinchukin Bank), and three other financial institutions approved for issues of financial securities, enabling them to issue bank debentures with a value 20 times that of the new capital. (Preferred shares were equities that had no voting rights but that could receive dividends. They could be retired by the institution as it saw fit.)

The bank debentures issued on the basis of investments of counterpart funds enabled the institutions in question to take in long-term funding from the market. Some of the bank debentures were also underwritten by the Deposit Bureau fund, providing a pipeline through which its money could be supplied to the private sector. Since it was inappropriate for the MOF, which had jurisdiction over counterpart funds, to be involved in reviewing loans to the private sector or managing credits, these responsibilities were entrusted to the Bank of Japan. Counterpart fund loans to private-sector companies took the form of co-lending with commercial banks. The rates on counterpart fund loans were set low in order to move market rates down.

In fiscal 1951, the Japan Development Bank was established with counterpart funds and assigned responsibility for lending to small businesses and new industries other than electric power and marine transportation. This resulted in a cessation of new counterpart fund lending, though counterpart funds continued to be invested in the Japan Development Bank as necessary. Counterpart funds were also lent to the Special Account for Loans to Agriculture, Forestry and Fisheries, which was established in fiscal 1951 and placed in charge of prior agriculture, forestry and fisheries lending, as well as new investment. In fiscal 1951, the counterpart fund balance turned to an excess of disbursement as the government tried to meet the demand for funding stemming from the Korean War. During fiscal 1952, counterpart funds were used for new Japan Development Bank investments and in loans to the electric power and marine transportation industries, and a revision of the Japan Development Bank Law in March gave the bank control over all private-sector assets in the counterpart funds account (except those allotted to the agricultural, forestry and fishing sectors) by lending it the entire amount. Counterpart funds also underwrote preferred shares issued by the Long-term Credit Bank of Japan during the year, paving the way for issues of bank debentures. The U.S. Counterpart Fund Special Account was scheduled to be reorganized into the Industrial Investment Special Account beginning in fiscal 1953, but political difficulties forced the government to operate on provisional budgets for four months of the fiscal year. During this time, the account invested in the Electric Power Development Company. At the end of July 1958, the U.S. Counterpart Fund Special Account was superseded by the Industrial Investment Special Account.

3) The Deposit Bureau and Trust Fund Bureau

The history of the Deposit Bureau Fund dates back to the Deposit Bureau Fund Law and Ministry of Finance Deposit Bureau Special Account Law of March 8, 1925, which established it as a special account for the management of non-income/expenditure funds. When Japan lost the war, the Deposit Bureau Fund took large losses on loans to wartime institutions and overseas companies, and the cancellation of war indemnity threatened it with further losses. The law to treat the losses handled them in much the same way as the reconstruction and reorganization of financial institutions: part of the losses were covered with compensation funds from the General Account, and some of the Class Two frozen postal savings assets were written off. During the period of postwar inflation, there was a sharp rise in allocations to the Postal Service Special Account among the administrative expenses for postal savings, causing the Deposit Bureau Special Account to post deficits from fiscal 1947 to 1949. The decline in postal savings in fiscal 1947 and 1948 was the major reason for the deficit. Accumulated reserve funds were to be used to cover the special losses of the Deposit Bureau Special Account, not to offset deficits. To cover the mounting red ink, laws were passed that provided for funding from the General Account for fiscal years 1947 to 1949, with the General Account to be repaid at a later date. Deposit Bureau Fund investments after September 1945 were mainly for government bonds, industrial bonds, bank debentures and loans to special banking companies. With postal savings funds declining, investments concentrated in fiscal 1946 on municipal bonds and loans to special accounts. Postal savings funds continued to drop in fiscal 1947, and investments again went to municipal bonds, loans to public corporations and purchases of government bonds. In fiscal 1948, the Bureau Fund purchased municipal bonds and Reconstruction Finance Bank bonds, repurchased government bonds, underwrote government bonds, and made loans to special accounts.

During the period of the Dodge Plan, Dodge established the investment types and ceilings for Deposit Bureau funds at the time the general budget was being drafted. Dodge took General Account investments and allocations and counterpart fund allocations into account in determining Deposit Bureau Fund investments. The Bureau Fund was first permitted to buy municipal bonds in fiscal 1949, and it purchased them consistently thereafter. In fiscal 1949 the Reconstruction Finance Bank ceased to issue new loans. The public corporations that had been dependent on it for their funding turned to the Deposit Bureau Fund instead. This was approved, and the bureau's records do, indeed, show some outstanding loans to five such public corporations at the end of fiscal 1949, but the liquidation of some public corporations reduced its lending to three public corporations as of the end of 1950. By the end of fiscal 1951 Deposit Bureau Fund lending to public corporations had ceased.

Table 2-3 Outstanding of Investment by Deposit Bureau and Trust Fund Bueau

（In millions of yen）

	FY 1945-end	FY 1946	FY 1947	FY 1948	FY 1949	FY 1950	FY 1951	FY 1952	FY 1953	FY 1954	FY 1955
Government bonds	45,481	44,827	48,358	70,741	77,439	87,386	178,877	204,082	244,910	42,176	44,566
General account loans	94	2,381	2,567	2,969	2,891	17,890	7,326	20,739	2,500	2,500	2,352
Special accounts	1,229	2,288	2,475	2,888	1,669	1,669	7,249	17,744	5,185	11,090	17,298
Government agencies	—	—	—	—	1,142	15,000	38,000	83,166	148,057	221,222	301,346
Local government bonds	1,404	1,337	1,171	923	522	405	610	533	451	294	295
Local government loans	1,815	3,507	6,691	40,010	79,285	103,340	156,851	226,832	287,479	334,590	364,583
Special bank debt	2,826	2,772	3,019	4,706	526	509	152	131	83	78	74
Special bank loans	1,424	1,482	1,464	811	411	305	233	143	111	93	87
Special company debt	2,439	2,373	2,189	909	907	712	598	515	363	288	93
Special company loans	960	678	668	384	289	123	120	112	111	110	110
Foreign bonds	1,606	1,606	1,606	—	—	—	—	—	—	—	—
Foreign loans	329	329	329	—	—	—	—	—	—	—	—
Public corporation loans	—	—	—	—	20,502	11,199	—	—	—	—	—
Special corporation debt	—	—	—	—	—	—	394	884	1,154	2,041	2,479
Special corporation loans	—	—	—	—	—	—	400	1,700	7,900	22,450	39,850
Bank dibentures	—	—	—	—	—	17,960	47,994	83,722	137,739	132,727	135,425
Financial institution deposits	—	—	—	—	13,976	—	—	—	—	—	—
Total	59,607	63,580	70,537	124,341	199,559	256,498	438,804	640,303	836,043	769,659	908,558

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp. 360-61. Ministry of Finance, Budget Settlement

To cushion the deflationary impact of the Dodge Plan, “designated deposits” were held with private-sector financial institutions beginning in fiscal 1949, thus providing the private sector with short-term funds. By the end of the fiscal year, the Deposit Bureau Fund had ¥ 13,976 million in deposits with private institutions. In 1950, it had drawn down all of its designated deposits, but it was permitted to lend against bank debentures in order to supply the private sector with long-term funding, thus reintroducing its private-sector investment activities. The Central Cooperative Bank for Agriculture and Forestry (Norinchukin Bank) and four other institutions were entitled to issue bank debentures up to 20 times the value of-their preferred shares. During fiscal 1950 the Deposit Bureau Fund underwrote ¥ 180 million in such issues. The Deposit Bureau Fund took over a ¥ 15 billion loan to the national railways and a ¥ 12 billion bond issued by the Telecommunications Special Account that had originally been underwritten by counterpart funds in fiscal 1949.

The Trust Fund Bureau Fund Law and Trust Fund Bureau Funds Special Account Law of March 31, 1951, reorganized the Deposit Bureau. The new Trust Fund Bureau was an active investor of the funds entrusted to it. Thanks to the price stabilization achieved by the Dodge Plan, the postal savings funds that served as the bureau's main source of funding began to increase. During fiscal 1951 and 1952 the Trust Fund Bureau underwrote bank debentures. The fiscal 1952 underwriting was for bank debentures issued by the Long-term Credit Bank of Japan, which was entitled to issue them up to 20 times the value of preferred shares underwritten with counterpart funds. Bank debentures continued to be one of the Bureau's core investments. Government institutions made loans during fiscal 1951 to the People's Finance Corporation, the Special Account for Loans to the Agriculture, Forestry and Fisheries, and the Housing Loan Corporation as well as to the Teito Rapid Transit Authority. In fiscal 1952, Dodge merely provided a ceiling for Trust Fund Bureau investments, leaving it to the government to decide the specifics of investment after the peace treaty took effect. During fiscal 1952 the Trust Bureau Fund made loans to the Electric Power Development Company and the Special Account for Designated Road Construction.

4) Foreign exchange and the fixed ¥ 360 rate

The Trade Fund Special Account Law of December 13, 1947 established the Trade Fund Special Account. This account handled trade funds as non-income/expenditure funds, providing a system for managing state trade. The revenues from the domestic sale of aid imports were counted among the trade fund, and a system of foreign exchange allocations closely resembling a multiple-rate system, with provisions for export promotion, import prevention and selective importing, went into operation. The legal rationale for foreign exchange control was based on the Foreign Exchange Control Law of 1941, which was held over without modification. At the time, the price of export items was set in dollars based on foreign market prices, while imports were sold at controlled Japanese prices. The foreign exchange market was thus for all intents and purposes a multiple rate market, with rates determined after the fact on a product-by-product basis depending on whether exports or imports were involved. In October 1948, the government adopted a price calculation system that fixed exchange rates for specific export products. In January 1949, the export foreign exchange market ranged from ¥ 160 to ¥ 600 to the dollar. The ceiling rate was reduced to ¥ 450 in February of that year and lowered to ¥ 425 in April. There were three rates in place for textiles, which accounted for 60 percent of exports: ¥ 420, ¥ 350 and ¥ 330 to the dollar. In April the import rate was changed from an after-the-fact multiple rate to a set rate of ¥ 330 to the dollar, paving the way for the transition to a fixed-rate market.

The publication of the Nine-Point Economic Stabilization Program made it necessary to use a single-rate market to adjust domestic prices to international levels. A single rate was also necessary if Japan wanted to join the International Bank for Reconstruction and Development after the peace treaty took effect. Part of the Dodge Plan price stabilization policy was an immediate move to a fixed-rate market.

Before settling on the rate of ¥ 360 to the dollar, SCAP floated several ideas, ¥ 300 or ¥ 400, among others. It decided on ¥ 360 with a fluctuation range of 10 percent on either side in March 1949. Japan agreed, and the rate was formalized with a SCAP memorandum dated April 23, 1949. It took effect on April 25.

In April 1949, the Trade Special Account was established to replace the Trade Fund Special Account. The Trade Special Account handled the foreign exchange fund which was established under the special account, in addition to managing aid imports and other state trade. The foreign exchange fund, provided a financial basis for government purchases of export exchange and sales of import exchange under the uniform rate. Foreign funds were used for centralized buying and selling of foreign exchange. When private-sector trade began again in fiscal 1949, the expected increases in foreign exchange trading led to the passage of the Foreign Exchange and Foreign Trade Control Law and the Foreign Exchange Special Account Law on December 1, 1949, establishing a framework for new foreign exchange controls through the special account. SCAP transferred foreign exchange controls to the Japanese government. The government implemented central control over foreign exchange positions only for dollar funds, to replace the original system of central control over all foreign exchange. The U.S. dollar funds (August 1951), British pounds (October 1951) and open accounts of other currencies (according to exchange-clearing agreement) were moved to the jurisdiction of the government of Japan.

The second main means of foreign exchange control was known as the “foreign exchange allocation system.” Beginning in January 1950, Japan created a foreign exchange budget each quarter that defined the foreign exchange payments to cover import and invisible payments and the transactions upon which these payments would be based for the period. These budgets permitted control of foreign payments in terms of the product and item imported, and the currency of payment. The underlying law imposed no obligation to publish the foreign exchange budget, but

Table 2-4 Foreign Exchange Budget

(In millions of yen)

Period	Budget for Import				Budget for Non-trade Payment
	US Dollar	Sterling Pound	Open Account	Total	
Jan.-Mar. 1950	37	46	40	123	14
Apr.-Jun.	78	48	48	174	22
Jul.-Sep.	237	158	133	528	29
Oct.-Dec.	233	127	165	525	29
Jan.-Mar. 1951	480	253	194	927	40
Apr.-Jun.	225	110	131	466	40
Jul.-Sep.	357	127	92	576	75
Oct.-Dec.	269	230	162	661	62
Jan.-Mar. 1952	244	307	199	751	89
1st Half of 1953	583	299	362	1,245	N.A.
2nd Half of 1953	872	299	373	1,545	N.A.
1st Half of 1954	595	219	268	1,100	163
2nd Half of 1954	540	250	204	1,090	N.A.

Notes : 1. The figure for the non-trade payment in the first half of 1954 is the amount of the whole FY1954. The figures for the second half of 1954 are the amounts of the budgets from July 1954 to January 1955.

2. The figures in the first and second half of 1954 do not add up to the resepective totals. The budgets for the whole year of 1952 are not available.

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made* ", Vol. 15, pp. 350-51, 354-55

Ministry of Finance, Reference Chart of Foreign Currency Funds, January and February in 1955

all the budgets were announced from April 1950 onward. Although the amount of foreign exchange allocated to each import product was defined in the budget, no budget ceilings were imposed on products qualified for automatic approval, under the automatic approval system initiated in August 1950. Rather, the foreign exchange control policies changed according to the country's reserve position. When it was appropriate to promote imports, the automatic approval system's ceiling was raised and more items and countries were added; when it was appropriate to restrain imports, the opposite policies were introduced. Import exchange makes up a large portion of the foreign exchange budget, and following the surge in special procurement demand from the Korean War in late 1950, the ceiling on import exchange rose to keep pace with the increase in incoming foreign currency. This, in turn, prompted an increase in the foreign exchange allotted to the automatic approval system, although the ceilings were later lowered in order to restrain imports. There was also a foreign exchange budget for non-trade payments. After the July-September 1951 quarter, repayment of investment in Japan increased, a result, as will be discussed later, of looser regulations on capital imports.

A lack of adequate foreign exchange funds in the Trade Special Account made it impossible to allocate ¥ 5 billion from the Trade Special Account to the Foreign Exchange Special Account, as provided for in the budget. This resulted in a shortage of bought funds on the 1949 commercial foreign exchange market. Bought foreign exchange funds were raised with temporary borrowing, resulting in a borrowing balance of ¥ 19.7 billion at the end of the fiscal year. The initial fiscal 1950 budget provided for an allocation of ¥ 50 billion from trade funds. Dodge suggested that the Trade Special Account and General Account transfer capital to the Foreign Exchange Special Account, and such transfer be used to pay down the borrowings of the previous year. The issue of foreign exchange bills in August 1950 removed the issue of foreign exchange bought funds as a headache for the policy-makers. The surge in domestic and foreign prices and the increase in exports and imports resulting from the Korean War led to sharp growth of receipts and payments of foreign exchange by the Foreign Exchange Special Account. This account reported all buying and selling of foreign exchange by the private sector as revenues and expenditures. The budgeted figures and those in the settlement of accounts consequently vary considerably, depending on trade and economic conditions. The Foreign Exchange Fund Special Account Law passed on March 30, 1951, reorganized the Foreign Exchange Special Account into the Foreign Exchange Fund Special Account, which would treat foreign exchange funds as non-income/expenditure funds. On May l0, 1950, the Law Concerning Foreign Capital was passed and the Foreign Capital Committee set up to administer it. This law regulated foreign investment in Japan by, for example, guaranteeing remittance of dividends but not of principal. Amendments to the Special Taxation Measures Law, enacted on May 2, 1950, created tax breaks for capital imports, and U.S. companies stepped up their investment in occupied Japan. Foreign equity investment in Japan rose from 76 deals valued at $3,150 thousand in fiscal 1950, to 502 deals valued at $10,123 thousand in fiscal 1951. Similarly, technology imports increased from 27 deals in fiscal 1950 to 101 in fiscal 1951.

3. The Shoup Mission

1) The Recommendations

Japan was in the process of rebuilding its tax system, but fundamental reforms were needed before the system could be stabilized. The considerations had to be both broad-based and long-term, and advice was sought from outside. In July 1948, the decision was made to invite a mission headed by Professor Carl Shoup of Columbia University to Japan to examine the tax system. With inflation rampant, the greatest problem at the time was finding ways to cut taxes without exacerbating the price increases. Later, in December 1948, the publication of the Nine-Point Economic Stabilization Program made economic stabilization a priority for the Occupation policies as well. Arriving in May 1949, the Shoup mission looked closely at Japan's tax revenues, taxes and collection system. A summation of its findings was released in August, and the first set of Shoup recommendations, the “Report of the Shoup Mission on the Japanese Tax System,” followed in September. Having examined the way tax revenues were divided between central and local governments and having considered the details of the Japanese taxation structure, the mission recommended changes in each type of tax and enhancement of the administrative system. The most significant accomplishment of the Shoup Mission, however, was introducing the principle of “fairness” to Japanese taxation. The first set of recommendations retained a relationship with the Dodge Plan austerity budgets and took care to fight inflation while providing revenues large enough to ensure that the budget would not slip into deficit.

The first set of recommendations tried to make the burdens on salaried workers and independent businessmen fairer, by lowering the maximum rate for the national income tax from 85 percent to 55 percent, a level at which rational administration would also be possible. It also reworked some of the deductions, deducting the allowance for dependents from income, for example, rather than from tax value. In the area of capital gains, the report advocated a 100-percent capital gains tax with a deduction for capital losses. It also noted the need to put some limits on the ability of investors to hold assets such as stocks anonymously, in order to maintain the principle of a comprehensive, progressive income tax. The idea of comprehensive taxation was deeply rooted in the idea of fairness. For the corporate tax, Shoup maintained the 85-percent flat rate then current, allowing a 25-percent dividend deduction for shareholders and adding a 1-percent interest surtax on retained earnings (higher for family-owned companies). In exchange for this, it did away with the existing excess income tax and liquidation income taxes, and advised eliminating the 20-percent withholding tax on dividends.

The inheritance and gift taxes were similar to those in the United States at the time and were subject to widespread evasion. The report advised integrating the two into a progressive “succession tax” or “acquisition tax” on the recipients of gifts and legacies. Another new direct tax it proposed was the revaluation tax. Asset prices had risen significantly during the postwar inflation, resulting in a large gap between prices as recorded on balance sheets and market prices. The new tax would revalue assets at prevailing prices and take 6 percent of tax to the revaluation profit. There was also a wealth tax on individuals. This tax on personal asset growth resulting from inflation was recommended because the reduction in the maximum income tax rate had lowered the burden on people in the high-income brackets, and the inheritance tax was not considered sufficient taxation on the concentration of assets. The asset tax was apparently imbued with the idea of vertical fairness. Shoup recommended rates of 0.5 percent to 3.0 percent on all assets valued in excess of ¥ 5 million.

In the area of indirect taxation, the mission proposed a large hike in the liquor tax, since alcoholic beverages were considered luxury items. Shoup also recommended scrapping the transactions tax that had been introduced in September 1948. This tax was paid by purchasing revenue stamps, which irritated the taxpayers. Nor did it provide for any deductions of transactions taxes paid at previous stages of the production and marketing process, which led to complaints that it did not divide the burden fairly among companies that both produced and marketed their goods and those that specialized in manufacturing, wholesaling or retailing. The textiles consumption tax was another slated for elimination, since the mission did not think it proper to tax basic necessities. The Shoup Mission liked the commodities tax on luxury items, on the other hand, because it would be able to generate revenues. Its recommendation for the sugar consumption tax was to eliminate taxation of domestically produced sugar. The Shoup Mission placed particular emphasis on ensuring adequate funding for local authorities and recommended sweeping changes in local taxation. To replace the real estate acquisition tax, which it recommended scrapping, the report proposed an added-value business tax to be collected at the prefectural level. It suggested that taxation at the municipal level should consist primarily of a resident's tax, land tax and house tax. One of its objectives in this was to make a clear distinction between prefectural and municipal tax items. It is notable that the prefectural added-value tax marked the introduction of a very broadly based tax immediately after the elimination of the transactions tax.

The Shoup Mission had much to say about tax administration as well. Its primary recommendations were as follows: l) to eliminate the traditional “collection target system” in favor of a self-assessment of expected tax liabilities based on the results of the previous year; 2) to simplify the income tax reporting system; 3) to publish the incomes of high-income earners; 4) to create a new “blue form” income tax assessment (for the self-employed and taxpayers with multiple sources of income); 5) to introduce a withholding tax for agricultural income; 6) to ban anonymous and assumed-name deposits; 7) to make registration and changes of title mandatory for stock and bonds; 8) to establish a tribunal system to hear complaints about taxation and conduct tax-related claim proceedings; and 9) to use certified public accountants in the tax assessment system and to improve the quality of tax attorneys.

Diet deliberations on the proposed changes coincided with the debate on the fiscal 1949 supplementary budget. As discussed below, the Income Tax Law was amended during fiscal 1949, and reforms began in other areas in fiscal 1950. As the “Shoup Tax System” was being put in place, measures were taken to strengthen the administrative systems as well. After his return home, Shoup worried about the kind of reception his advice would receive in Japan. He organized a second mission in July 1950 to follow up on its implementation and to finish off unresolved matters. The MOF asked Shoup to suggest tax cuts, particularly in the income tax. There were worries that the second report would insist on implementation of the local added-value tax, a ban on separate deposit and savings accounts and tax on interest income, and mandatory registration of stocks - all elements of the first report that had been delayed. The second report, the “Shoup Mission Report for Newspaper Publication” of September 21, did not include these points, however.

The second report's tax system advice was as follows: l) to agree to a 10-percent labor deduction from the income tax for farmers and fishermen to be administered according to the level of surplus funding resources; 2) to agree to hikes in the dependent allowance and basic deduction and to reductions in the rate for low-income taxpayers; 3) to recommend that local fiscal resources be secured with municipal bond issues and higher Local Fiscal Resource Equalization payments from the General Account (which replaced the Special Account for Local Allocations of Taxes at the end of fiscal 1949) rather than through higher tax rates; 4) to instruct the municipalities to base their residents' taxes on annual income and to collect it as a withholding tax; 5) to unify rates for the added-value tax to be introduced at the prefectural level and to allow companies the option of including the total of net profits, labor costs, interest and rent in the amount of added value; and 6) to place the highest priority on the fixed assets tax as a taxed asset. In addition, the recommendations underscored the need for taxation administrative reforms, asking for enhancement of the blue-form system, allowing simplification of the bookkeeping procedures for farmers and small businessmen, pointing out the need to deal with taxpayers in cumulative arrears, and recommending a tax-payment savings system. The focus of the second set of recommendations was thus on local finances and income tax administration.

How much binding force the second recommendation had on tax law was a matter of debate in Japan. SCAP informed the government that the recommendation should be considered as guidelines. The second set of recommendations promised to explain the technical details in an appendix to be provided later. On October 30, SCAP delivered the appendix to the government, but it contained only a detailed technical discussion of tax administration.

2) The Shoup Reforms

The Shoup recommendations led to fundamental reform of the Japanese tax system. The beginning of deliberations coincided with the Diet debate on the fiscal 1949 supplementary budget, and many amendments to various tax laws were proposed. The reason for the amendments, according to the bill, was to reduce the withholding income tax for wage earners for an interim period in order to lighten and optimize the national tax burden as part of an upcoming full-scale reform of the tax system. In the area of indirect taxation, the bill proposed repealing the textile consumption tax and transactions tax, implemented January 1950, amending the commodities tax as appropriate and integrating the soft drinks tax into the commodities tax. This led to the enactment of the Law on Temporary Exceptions to the Income Tax Law of December 15, 1949, the Law to Repeal the Textile Consumption Tax, Soft Drinks Tax and Transactions Tax of December 27, and an amendment to the Commodities Tax Law, all of which were implemented during fiscal 1949.

The reforms were extended into the fiscal 1950 budget process, where further amendments were proposed to the Diet. Again, the bill explains, the purpose was to reform the entire existing tax system in line with the general principles of the Shoup recommendations, with some modifications recognized as appropriate in light of current fiscal and economic conditions. On March 31, 1950, the Income Tax Law, Corporate Tax Law, Inheritance Tax Law, Liquor Tax Law were all amended, and the Securities Transfer Tax Law was invalidated. The National Tax Collection Law was also amended. These amendments were followed by implementation of the Asset Revaluation Law (April 25), Special Tax Measures Law (May 2) and Wealth Tax Law (May 11) and an amendment to the Inheritance Tax Law (May 20).

This series of modifications of Japanese tax law did not contain many of the recommendations of the first advisory, notably the measures aimed at reforming the securities tax system, the creation of a new social security tax, the revision of the tax attorney system or the modification of official “useful lives” for depreciable assets. All were to be subject to further consideration. On July 31, 1950, the Local Tax Law was amended to provide a new added-value tax to be collected by prefectures from businesses. Its enforcement was put on hold, however.

Let us now consider some of the differences between the recommendations and the actual laws. The amended Income Tax Law included a higher basic deduction than that recommended in the first advisory, in order to reduce the burden on low-income taxpayers. In addition, the maximum rate of 55 percent was applied to income in excess of ¥ 500,000 rather than ¥ 300,000. Finally, the law was narrower in its application of profit-and-loss netting and carry-overs and back-charges for losses. Still, it was generally in line with the advisory. The securities capital gains tax was legalized, as was the wealth tax, as a supplement to the income tax which was set at the rates advised by Shoup. Taking effect in May 1950, the wealth tax brought in ¥ 516 million in revenues in fiscal 1950, and ¥ 962 million in fiscal 1951. Although not large amounts, the value of taxable assets was growing thanks to the Korean War boom. In fiscal 1950 taxable assets were worth ¥ 170.2 billion; in 1951, ¥ 227.0 billion; in 1952, ¥ 408.0 billion.

Table 2-5 Wealth Tax

(In millions of yen)

		Taxable property value	Debt	Net taxable property value	Wealth tax amount
FY 1950	Payers	26,081	14,225	26,081	26,081
	Value	170,264	32,772	137,491	653
FY 1951	Payers	31,225	18,910	31,224	31,050
	Value	227,095	41,088	186,005	957
Retrospective	Payers	14,599	7,282	14,559	14,526
	Value	41,773	5,661	36,111	172
FY 1952	Payers	48,025	31,416	48,019	47,929
	Value	408,031	61,367	346,661	2,272
Retrospective	Payers	22,343	9,717	22,383	22,401
	Value	53,124	8,740	44,392	328
FY 1953	Payers	38,272	18,956	38,258	38,276
	Value	98,710	14,159	84,548	732
FY 1954	Payers	1,731	739	1,737	1,771
	Value	11,188	1,274	9,913	156
FY 1955	Payers	571	252	574	588
	Value	5,206	643	4,563	71
FY 1956	Payers	270	90	270	281
	Value	4,292	499	3,793	78

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa nade* ", Vol. 19, pp. 294

The Corporate Tax Law amendment raised the rate on reserves to 2 percent for ordinary companies and to 7 percent for family-owned companies. Like the income tax, it was narrower in its application of profit-and-loss netting and carry-overs and back-charges for losses than Shoup's recommendations. There was much concern over the asset revaluation tax, because of the potentially large impact it would have on corporate finances. The tax, as implemented, differed from the recommendations on several points, generally softening it. The revaluation base date was extended from July 1, 1949, to January 1, 1950; revaluation was made voluntary (the recommendations suggested that it be mandatory); the methods of payment were relaxed in an effort to encourage companies to revalue; and the ban on dipping into the revaluation reserve was relaxed for the first five years. Revaluation brought in ¥ 6,403 million in tax revenues during fiscal 1950 and ¥ 11,532 million in 1951. The administrators set ceilings on the revaluation amounts, and the difference between the revalued price and the book value was considered as revaluation profit and subjected to a 6-percent tax. Inflation resulted in large revaluation profits, bringing in ¥ 359.6 billion for companies in fiscal 1950 and ¥ 388.5 billion in fiscal 1951, mostly in terms of depreciable assets. The progress in revaluation, together with the economic stabilization of the Dodge Plan, led to a decline in revaluation profits, beginning in fiscal 1952. The modification of the inheritance tax followed the Shoup recommendations almost to the letter.

In the area of indirect taxation, the government followed the advisory's recommendations on the commodities tax faithfully. The soft drinks tax was repealed as part of the fiscal 1949 supplementary budget, and taxation on soft drinks was integrated in to the commodities tax. Japan hiked the liquor tax rate as recommended, but it did not follow the advice to put alcoholic beverages back under government control. Shoup recommended scrapping the 5-percent travel tax, but the government merely did away with the tax on ordinary fares and boosted rates on first- and second-class seats to 20 percent on the assumption that those buying the seats could afford to pay more. The advisory's recommendations for elimination of the stamp tax, registration tax and sugar consumption tax were ignored.

Table 2-6 Asset Revaluation Tax

(In millions of yen)

	FY 1950		FY 1951		FY 1952		FY 1956	
	Total	Depreciated assets	Total	Depreciated assets	Total	Depreciated assets	Total	Depreciated assets
Corporate tax asset revaluation								
Number of corporations	30,901	30,077	7,597	7,298	502	479	3,186	2,838
Revaluation amount limit	647,057	611,581	544,200	540,634	208,459	208,064	290,255	263,886
Revaluation amount	432,626	414,993	465,806	457,079	178,194	177,905	262,594	242,095
Book value, others	72,987	70,431	77,270	75,627	100,667	100,647	146,113	141,136
Revaluation difference	359,640	344,562	388,536	381,452	77,526	77,258	116,481	100,959
Revaluation tax amount	21,578	20,674	23,312	22,887	4,652	4,635	6,989	6,058
Special declaration								
Number of corporations	142	140	256	250	221	206	63	42
Revaluation amount limit	15,443	14,909	332,198	339,555	103,871	103,550	12,309	11,978
Revaluation amount	11,613	11,401	296,818	294,968	81,895	81,633	6,995	6,717
Book value, others	1,909	1,887	18,138	18,058	28,566	28,547	279	256
Revaluation difference	9,704	9,514	278,680	276,910	53,329	53,086	6,716	6,461
Revaluation tax amount	582	571	16,721	16,615	3,200	3,185	403	388
Statutory personal revaluation								
Personnel	294,986		428,513		182,059			
Revaluation amount	32,112		56,744		39,883		47,738	
Revaluation difference	21,415		42,467		30,218		35,445	
Revaluation tax amount	1,284		2,546		1,377		1,464	
Voluntary personal revaluation								
Personnel	68,216		23,028		7		10,231	
Revaluation amount limit	41,368		15,051		48		13,428	
Revaluation amount	33,399		13,163		38		12,463	
Fiscal tax valuation amount or acquisition value	7,953		3,603		6		5,825	
Revaluation difference	25,446		9,560		32		6,897	
Revaluation tax amount	1,526		573		2		414	

Note: Special declarations were made by companies subjected to special accounting procedures.
Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp. 297-298

The second advisory was published in newspapers in September 1950. It was officially deemed “guidelines,” but opinions differed even within SCAP on how to position it. Nevertheless, the amendments to tax laws that coincided with the fiscal

1950 supplementary budget generally conformed to the second advisory's recommendations. The government reduced the income tax by hiking deductions and lowered the rates for the liquor tax, commodities tax, gasoline tax and sugar consumption tax. The reduction in the gasoline tax was counter to the recommendations, which did not think reductions appropriate as long as gasoline was being rationed. The recommendations made no mention of the sugar consumption tax, but the government cut it anyway.

The amendments based on the Shoup recommendations put in place the main features of the postwar tax system, with its heavy dependence on income taxes, corporate taxes and other direct taxation. Gaps between the ideal and the reality meant that some aspects of the Shoup system were not necessarily suited to Japan, but the principle of fair taxation it articulated would underlie Japanese taxation for decades to come. Elements which would have a particular impact in later years included the progressive, comprehensive income tax, the reorganization of indirect taxes, the use of local taxes to allocate revenues to local governments and the administrative enhancements.

4. The Monetary Policies of the Dodge Plan

1) Money Supply

The announcement of the Nine-Point Economic Stabilization Program preceded a severe monetary tightening in 1949. The Dodge Plan put an end to the priority finance that had been the chief characteristic of monetary policy up to that time. Since the Bank of Japan was the supplier of funds, the Bank of Japan Law was amended on June 3, 1949, to create a Bank of Japan Policy Board empowered to make decisions on important monetary issues, including basic business guidelines for the BOJ and changes in the official discount rate. The amendments also made the BOJ independent of the government as far as monetary policy was concerned. They did not, however, change the various regulations in the BOJ Law that had been imposed during the war. In the financial sector, the Dodge Plan did away with the "special bank system" that had allowed certain banks to issue bank debentures since the Meiji Era, replacing it with a law that provided for bank debenture issues up to 20 times the preferred shares underwritten with the counterpart funds, as described earlier in this chapter. It also made provisions for credit cooperatives. The Savings and Loan Law of June 15, 1951, converted the "business district credit cooperatives" to "savings and loans" (*shinyo kinko*). Mutual finance associations (*mujin*) were reorganized as mutual (*sogo*) banks by the Mutual Bank Law of June 5, 1951.

The system of higher applied rates for BOJ loans that had run parallel to priority financing continued. Under the applied rate system, the BOJ set lending levels for the financial institutions it dealt with. Any lending in excess of those levels was made at higher interest rates. The BOJ used high applied interest rates for lending to commercial banks, trust banks, the Central Cooperative Bank for Agriculture and Forestry (Norinchukin Bank) and the Central Bank for Commercial and Industrial Cooperatives (Shoko Chukin Bank). In April 1949, the applied rate system was strengthened as part of a general monetary tightening. The purpose of the higher rates was to wean the commercial banks from their dependence on BOJ funding, in conformance with Dodge Plan principles. The excess treasury fund combined with the cessation of new lending by the Reconstruction Finance Bank to put a strain on commercial funding, however, leading to a reduction in Class 2 higher applied rates on applicable bills on July 13, 1949; trade bills had already been exempted in a June 24 measure. When the deflationary effects of the Dodge Plan continued to accelerate, the BOJ moved to provide some relief by exempting bill discounts from higher applied rates on January 17, 1950. As a result, higher applied rates were maintained only for general loans among loans on bills, and the Class 2 rate was cut by 0.365-0.720 percent at the same time. This easing of higher applied rates enabled the BOJ to encourage lower market rates, bringing down the maximum lending rate of commercial institutions and setting ceilings on interbank deposit rates so that overcompetition of deposits would not ensue.

Table 2-7 Higher Applied Rates Loans by the Bank of Japan

(In hundred millions of yen)

Perid	Loans Outstanding	Higher Applied Rates Loans	Secondary Higher Applied Rates Loans	Higher Rates Applied Banks
Mar. 1951	1,279	n.a.	238	n.a.
Jun.	1,913	n.a.	601	n.a.
Sep.	2,463	n.a.	1,158	n.a.
Dec.	2,230	n.a.	995	n.a.
Mar. 1952	2,278	n.a.	534	n.a.
Jun.	2,518	n.a.	419	n.a.
Sep.	2,959	n.a.	550	n.a.
Dec.	2,232	n.a.	45	n.a.
Mar. 1953	2,912	n.a.	380	n.a.
Jun.	3,262	n.a.	483	n.a.
Sep.	3,500	1,932	581	61
Dec.	2,987	1,433	883	49
Mar. 1954	4,173	2,545	2,034	59
Jun.	3,996	2,648	2,145	57
Sep.	3,898	2,824	2,253	57
Dec.	2,434	1,954	1,562	43
Mar. 1955	2,521	2,098	1,693	43
Jun.	2,118	1,521	1,159	45
Sep.	1,435	14	-	11
Dec.	319	-	-	-

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa* ", Vol. 19, pp. 84

Another method used to supply funds to the private sector was the government designated deposit. The Treasury ran a fund excess in 1949, causing government deposits with the BOJ to grow. Designated deposits were a way to return that money to the market by entrusting banks with Deposit Bureau funds. The government deposited ¥ 6 billion with the Central Cooperative Bank for Agriculture and Forestry (Norinchukin Bank), which had cash-flow problems, in March 1949, enabling it to repay loans from the BOJ. Another ¥ 15 billion was added later, with the money to be used to purchase short-term government securities. Deposits with commercial banks began shortly thereafter. The government entrusted a total of ¥ 16 billion to 14 institutions, including city banks, the Industrial Bank of Japan, Nippon Kangyo Bank and Hokkaido Takushoku Bank. Deposits in regional banks enabled them to repay BOJ loans. The government continued to increase designated deposits until about October. In July, it entrusted ¥ 10 billion in surplus funds to the BOJ. These deposits were made initially to avoid an expansion in credit, but as the deflationary effects became more widely felt, supplying credit emerged as the main policy objective. The government-designated deposits were of great significance for monetary policy. At the end of fiscal 1949, the government had ¥ 10,878 million in designated bank deposits and a total of ¥ 13,976 million, when other miscellaneous deposits were added in. During fiscal 1950, it withdrew the entire amount. Meanwhile, the Reconstruction Finance Bank quit lending to public corporations in fiscal 1949, causing agricultural public corporations to turn to the Deposit Bureau for funding instead. Year-end monetary policies for 1949 resulted in ¥ 9.9 billion in Deposit Bureau funds being placed in short-term deposits with private-sector financial institutions. A relaxation of the rules led to a surge in Deposit Bureau lending to local governments during the year, as well.

The BOJ began to purchase Reconstruction Finance Bank bonds during the June-August period of 1949, and buying operations of government bonds continued thereafter, developing into a powerful tool for supplying money to the markets. By the end of 1949, BOJ purchases of government bonds to counteract Dodge Plan funding shortages reached a cumulative total of ¥ 32.1 billion. SCAP approved of the BOJ credit supplies as a means of providing relief from the deflationary effects of the Dodge Plan. BOJ lending to commercial banks rose steadily through the end of 1950, climbing from ¥ 49,306 million at the end of 1948, to ¥ 84,213 million at the end of 1949, and to ¥ 255,573 million at the end of 1950. These funds prompted a corresponding rise in commercial lending. Outstanding loans on commercial bank books were valued at ¥ 381,347 million at the end of 1948, rising to ¥ 679,051 million at the end of 1949, and ¥ 994,746 million at the end of 1950. This increase in lending by commercial institutions dependent on the BOJ money supply was the major factor in establishing the postwar excessive lending structure.

Even easier money policies came into being in 1950. Between February and April, excess funds of the Reconstruction Finance Bank were deposited with commercial banks, and the BOJ's higher applied rates were cut sharply in February. Bill discounts were exempted from higher applied rates as part of this easing, triggering an upsurge in industrial bill discounting. Beginning around March 1950, however, Dodge became critical of monetary policy, claiming that the effects of suspending public bond issues were being negated by excessive increases in bank credit. Japan had no choice but to implement policies to restrain the growth of bank credit, beginning in April. As part of these restraints, the rediscounting of industrial bills was suspended in May 1950. Instead, they were handled as stamp bills and subjected to higher applied rates. The attitude toward government bond purchases also became less enthusiastic in May, reducing BOJ credit facilitation. It should be noted, however, that there was no substantial real decline in bond buying operations. Lending by the BOJ continued to expand. The reason the BOJ's government bond holdings did not grow was that they were shifted to the special accounts and government mutual aid associations. The Korean War broke out in July, while these money supply policies were in force. The boom it triggered began causing the economy to heat up as early as December, bringing an end to the need for easy money policies to counteract Dodge Plan deflation.

The Dodge Plan exerted a strongly deflationary impact that stabilized prices. The deflation policies were pursued during fiscal 1950 as well, but the situation changed after the Korean War broke out. Prices for textiles, metals and internationally traded commodities skyrocketed in July and August, and import prices rose sharply in 1951. The rising prices brought profits to companies and

Table 2-8 Lending and Securities Holding of the Bank of Japan

(In millions of yen)

At year's end	1946	1947	1948	1949	1950	1951	1952	1953	1954
Lendings	58,030	85,502	135,410	188,649	332,039	400,918	356,150	402,619	266,531
Banks	47,908	30,686	49,306	84,213	225,573	343,229	301,229	371,550	251,986
Small Business Finance	2,522	1,615	2,595	4,432	13,452	18,065	16,532	19,556	13,262
Special Accounts of the government	7,600	53,201	83,509	100,004	63,014	39,624	38,389	11,513	1,283
Securities	34,741	145,866	247,718	188,900	136,787	126,044	286,140	314,379	483,573
National Bonds	34,741	113,496	211,484	188,900	136,787	126,044	286,140	314,379	483,573
Reconstruction Finance bank Bonds	-	32,370	36,234	-	-	-	-	-	-

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp. 424-41 carried the economy out of the Dodge deflation into a boom. During the latter half of 1950, $240 million in foreign currency flooded into Japan, and as the hard currency supply mounted, a Foreign Currency Loan Program was established on September 25, 1950, to promote import finance. Under the program, the BOJ bought foreign currency from the Foreign Exchange Control Committee to lend to the foreign exchange banks, which in turn lent it to importers. The balance of lending reached ¥ 280,175 million in March 1951, after which it declined.

Fearing that the Korean War boom would cause the economy to overheat, the BOJ tightened its higher applied rate lending. It had exempted commercial bills from the higher applied rates in February 1950 as part of its easy money policy, but it reapplied the higher rates now, revising its lending ceilings to reflect the change. Some of the Class 2 rates were hiked to close the spread between commercial and general rates. These policies were expected to restrain demand for funds not based on real economic demand, and to normalize the commercial banks' dependence on the BOJ. Demand for funds remained high, however, leading to a further tightening of the higher applied rate system in March 1951. The requirements for higher applied rate lending were made stricter, the ceiling for Class 1 lending was lowered and the rates were hiked. Government bond buying operations during the summer of 1950 served as a powerful tool for supplying funds to the market, but money had been eased sufficiently, thanks to the Foreign Currency Loan Program. It was possible to reduce the purchasing operations for the supply of funds to 60 percent of the industrial bond issue value in September, 50 percent in October, and 30 percent in December. The bond purchasing operations continued to decline, and ceased entirely in October 1951. In January 1951, bank debentures were excluded from the list of bonds eligible for purchase, narrowing the focus to industrial bonds.

The armistice ending the Korean War came in July 1951. The price rises during the war had been high by international standards, prompting SCAP to implement anti-inflationary price-reduction policies. When prices continued to rise after the

Table 2-9　Lending Outstanding in Foreign Currency by the Bank of Japan

(In millions of yen)

Period	Old System		New System	Others	Total
	Type A	Type B			
Sep. 1950	10,175		-	-	10,175
Dec.	102,215	52,295	-	-	154,510
Mar. 1951	132,949	147,225	-	-	280,175
Jun.	57,910	158,735	-	-	216,645
Sep.	32,430	104,955	-	-	137,385
Dec.	25,803	93,609	18,845	-	138,257
Mar. 1952	7,570	59,112	30,352	-	97,034
Jun.	3,850	9,871	34,751	12,570	61,043
Sep.	2,807	1,608	28,334	39,497	72,247
Dec.	2,093	601	29,214	62,578	94,486
Mar. 1953	1,351	348	13,187	81,579	96,466
Jun.	1,039	290	1,467	90,966	93,762
Sep.	661	118	202	95,094	96,075
Dec.	313	35	50	91,923	92,321
Mar. 1954	0	17	12	68,442	68,471
Jun.	-	0.3		45,011	45,011
Sep.	-	-	-	26,068	26,068
Dec.	-	-	-	21,864	21,864
Mar. 1955	-	-	-	20,319	20,319
Jun.	-	-	-	18,843	18,843
Sep.	-	-	-	16,436	16,436
Dec.	-	-	-	12,738	12,738
Mar. 1956	-	-	-	9,790	9,790
Jun.	-	-	-	8,173	8,173
Sep.	-	-	-	5,762	5,762
Dec.	-	-	-	3,091	3,091
Mar. 1957	-	-	-	1,538	1,538
Jun.	-	-	-	763	763

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made* ", Vol.12, pp. 499

armistice, the authorities had little choice but to adopt a tight money stance. The ODR was hiked 0.73 percent on October 1, 1951. The higher applied rate lending ceiling was reduced on October 15, and new rules for capital investment lending were announced on October 20. On November 15, the Foreign Currency Loan Program ceased to lend funds to settle import bills.

Other significant measures of the day included a decision to scrap the system of centralized settlement of domestic exchanges by the BOJ, effective April 1952. The system was introduced during World War II, as a means of conserving funds for commercial interbank settlements, but it required the BOJ to lend the difference for banks with payment surpluses, offsetting the effects of lending restraints in other areas. These measures reduced BOJ lending to commercial banks from ¥ 343,229 million at the end of 1951 to ¥ 301,229 million at the end of 1952. The growth in bank lending finally began to slow in 1952 as well. This tightening policy was effective in quelling the inflation triggered by the Korean War.

2) The Securities Markets

Speculative short sale trading dominated the Japanese stock market, while the bond market developed around government bond trading. With most of the shares in major corporations in the hands of the zaibatsu, the securities market was still in its infancy as a tool for corporate fund-raising. During the war, the stock market was controlled by the government under the Japan Stock Exchange Law of March 1943. The Japan Stock Exchange had been followed by some government investments and the integration of all the stock exchanges into a single stock exchange in August 1943. That stock exchange had closed its doors on August 10, 1945, and it had not yet reopened. The MOF and the securities brokers wanted the stock exchange reopened as quickly as possible, but SCAP refused, believing it still too early. Until the stock exchange reopened, stock trading had to be carried out elsewhere.

Large increases in government securities holdings were expected. The asset tax brought more securities into the Treasury, along with securities from the dissolution of the zaibatsu and special liquidation of closed institutions, and the securities in the old accounts of special accounting corporations. The Coordinating Liquidation Committee was established in June 1947, to decide how to deal with them. A part of the program for the democratization of securities, this council functioned, for all intents and purposes, under instructions from SCAP. Shares that had belonged to the *zaibatsu* or liquidated institutions, or that had been paid in kind as asset taxes to the Treasury were disposed of by promoting employee stock-holding programs, public tenders and general sales. One result of these activities was to raise the share held by individual investors from 53 percent at the end of fiscal 1945, to 69 percent at the end of fiscal 1949.

The Securities and Exchange Law of March 27, 1947, established a new legal framework for securities trading and repealed the Japan Securities Exchange Law. The drafters of the Securities and Exchange Law had envisioned a U.S.-style Securities and Exchange Commission that would oversee the brokers, but the commission stipulated in the law was not an administrative council. SCAP wanted amendments that would define the nature of the commission. Among the revisions it called for was also a ban on participation in the securities business by ordinary and trust banks.

The revised Securities and Exchange Law was enacted on April 13, 1948, creating a Securities Exchange Commission as an administrative council and greater authority, switching from a licensing to an approval system for brokers and stock exchanges, and limiting securities underwriting to brokerages. Article 65 of the law also banned banks and securities companies from competing in each others' industries, as was the U.S. practice. The banks having been excluded, would-be brokers merely needed to seek government approval for their establishment, with the Securities Exchange Commission providing oversight and supervision.

In short, the U.S. systems for regulating the securities markets were imported wholesale into Japan. During this time, trading took the irregular form of group trading, in which groups of designated brokers bought and sold shares over the counter. The reopening of the stock exchange was awaited impatiently. The postwar inflation had brought activity to the stock market, but the trading was speculative, and the trading groups were instructed to exercise “self-restraint” in January 1948. After the revised Securities and Exchange Law took effect and the Securities Exchange Commission was established in May of that year, the trading groups were subject to strict supervision.

The revised law and establishment of the commission brought new demands for the reopening of the stock exchanges, but they were again denied and the reopening delayed, while the economy was stabilized under the Nine-Point Economic Stabilization Plan published in December 1948, and the shares held by the Securities Coordinating Liquidation Committee were sold off. Approval for reopening of the stock exchanges finally came in January 1949, and stock exchanges were registered in Tokyo, Osaka and Nagoya that April. Before trading restarted, SCAP provided the Securities and Exchange Commission with a list of Three Principles of Trading: 1) All trading conducted on the stock exchanges would be recorded in chronological order; 2) the stock exchange members would be required to effect all trades in listed issues on the exchanges; and 3) no futures trading would be allowed. The result was to concentrate all trading of listed shares in the stock exchanges, with accurate records kept to prevent unfairness, and speculative short sales trading banned (only real demand trading in underlying shares was allowed). These instructions came as a shock to the Japanese brokers, who had grown accustomed over the years to speculative short sale trading, but they had to be accepted for the purpose of investor protection. The Tokyo, Osaka and Nagoya stock exchanges reopened on May 16, as members-only organizations. They were followed by stock exchanges in Kyoto, Kobe, Hiroshima, Fukuoka, Niigata and Sapporo.

Share prices, which had risen consistently during the group trading years, peaked about the time the stock exchanges reopened and declined under the Dodge

Plan policies. When they hit bottom in 1950, the prices were half what they had been when the stock exchanges reopened. Since the exchanges only allowed trading in actual shares, speculative trading off the exchange flourished, though the Securities Exchange Commission did try to clamp down on it. To prop up the market, the Securities Coordinating Liquidation Committee quit releasing shares, more securities financing was made available to brokers and general investors, short sales were banned and capital increases were regulated. As a result, in 1950, the amount of paid-up equity shares fell to 50 percent of year-before levels. The market bottomed out in December 1949, but it did not turn upwards. Most of the shares sold to individual investors and employee stock-holding programs under the securities democratization policy lost money during the Dodge Plan deflation, and those losses drove many individual investors out of the market. The percentage of stocks in institutional portfolios continued to rise, however. By the end of fiscal 1951, individual investor holdings were down to 56 percent, and they continued to decline. The MOF considered establishing securities holding institutions to bolster share prices, but the idea was never acted upon. Japan Securities Finance Co. was established in December 1949, to provide larger securities financing, and by May 1950 every exchange had its own securities finance company. The job of the securities finance companies was to facilitate trading by lending money and shares. Japan Securities Finance Co. could borrow directly from the BOJ, and it was active in supplying funds. Amendments to the Securities and Exchange Law, designed to protect investors while share prices slumped, imposed stricter capital requirements on the securities companies to strengthen their base of operations. The Korean War boom of 1951 turned the market upward, permitting the regulations on capital increases to be relaxed and the money raised through the sale of shares to be used for long-term capital investment.

One idea put forward to encourage more stock purchases during the slump involved the establishment of securities investment trust companies. The Securities

Investment Trust Law of June 4, 1951 was enacted, and the investment trust system revived. Within a month, the top four brokers had registered as trust companies, and by August, there were a total of seven registered companies soliciting subscriptions in investment trusts. Coming in the midst of the Korean War boom, the trusts won immediate popularity, and began raising and investing large amounts of money.

On the bond market, meanwhile, the Dodge Plan policies brought an end to the issue of Reconstruction Finance Bank bonds, making it necessary for companies to issue their own bonds to raise industrial funding. In fiscal 1949, the BOJ bought Reconstruction Finance Bank bonds from financial institutions and instructed them to use the money to buy industrial bonds and Industrial Bank of Japan bonds. To counteract the Dodge Plan deflation, BOJ credits were used to promote corporate bond issues as well. In June 1949, the BOJ began lending at favorable terms against corporate bond collateral, and since only bonds qualifying for BOJ lending were issued, the system strengthened the control and selection process on the new issues market. Corporate bond issues fell off between 1950 and 1951 as a result. Beginning in 1950, the Industrial Bank of Japan and four other institutions were allowed to issue bank debentures, which were bought by the markets. Since most of the purchases were by financial institutions, however, the bank debentures competed for funds directly with private-sector capital increases and bond issues. After the peace treaty took effect on August 1, 1952, the Securities and Exchange Commission was disbanded and its functions moved to the Financial Bureau of the MOF. Japan did not, however, revive the brokerage licensing system at that time.