大蔵省財政史室 編

昭和財政史

終戦から講和まで

第20巻

英文資料

東洋経済新報社

Financial History Section
Ministry of Finance

THE FINANCIAL HISTORY OF JAPAN
The Allied Occupation Period, 1945-1952

20 English Documents

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監修のことば

『昭和財政史——終戦から講和まで——』（全20巻）は，『明治財政史』(全15巻)，『明治大正財政史』（全20巻）および『昭和財政史』（全18巻）につづく大蔵省とその担当する財政・金融行政の歴史であり，副題に示されているように，昭和20(1945)年8月15日の「終戦」から「サンフランシスコ平和条約」が発効した昭和27(1952)年4月28日までの，日本が連合国の占領の下におかれた期間を対象とするものである．

ところで，わたくしたち両名は，昭和46(1971)年4月，本財政史の編集事業が正式に発足するに当たり大蔵省から監修を委嘱され，ひきつづいて，別欄にかかげられているメンバーが共同研究者として決定された．以後監修者と共同研究者は研究会を組織するとともに，「一般」「財政」「金融」の各部会に分属し，かつて大蔵省の要職にあって占領期の行政を担当された方々のほか占領期財政に関係の深かった各界学識経験者（元占領政策担当官等アメリカ側関係者をふくむ）からのヒヤリングを中心とした共同研究会と部会を度重ねて開催し，資料調査と研究を進めた．

この間，資料の収集，整理も精力的に行なわれたが，とくに後述するような在米資料をふくめて未発掘，未公表資料の収集整理も積極的に行なわれたのである．資料調査と研究が一段落した段階で執筆段階に入り，共同研究者とわたくしたち両名が全員執筆を分担することとなり，また，特定の項目については大蔵省内から若干の関係者が執筆に加わることとなった．

わたくしたちは，大蔵省の省議によって今回の財政史の編さん，刊行の具体的計画が決定した際，そのなかにおいて決められた「大蔵省の担当した財政・金融行政の実績を実証的に記述分析することを主とするが，時期の特殊性にかんがみ，社会経済的背景の把握ならびに米国の対日経済政策の解明に留意する」という主旨の基本方針を尊重するとともに，新しくかつ豊富な資料をでき得る限り発掘活用し，客観的で詳密な財政史をつくり上げることに意を用いてきた．

今回の財政史が対象とする期間は，『明治財政史』の35年間，『明治大正財政史』の24年間，『昭和財政史』の20年間に比べて，わずか7年弱にすぎないが，日本がいま

だかつて経験したことのない外国の占領下におかれた時期であり，古い日本が新しい日本に生まれかわる激動の時期であったことをおもえば，けっして短い期間とはいえず，記録されなければならない事柄はむしろ戦前の20年ないし30年の歴史を述べる場合以上に多いといえよう．しかもそれらの多くは，財政・金融面のみならずその後の日本経済全体の復興と成長に大きな影響を与え，あるいは，その原型となったものである．

したがって本財政史の内容が財政・金融の領域にとどまることなく，その経済的背景，さらに連合国，とくにアメリカ合衆国の対日占領政策にも及ぶのは当然であり，そうでなくてはこの占領期を対象とする財政史は財政史そのものとしてもきわめて不十分なものとならざるをえないのである．この意味において今回の財政史は，従来大蔵省が編さん刊行した財政史に比べて対象期間は短期間であるが，その内容は量的に膨大であるとともに，きわめて多角的なものとならざるをえなかったのである．しかも外国の占領下という時期であるため，従来のように国内の資料のみでは十分とはいえず，占領当事者である連合軍総司令部および連合国，具体的にはアメリカ側の資料を参照しなければならなかった．

これらの資料の大部分は従来非公開のものであったが，その多くは，年次の経過に従ってアメリカ政府の公文書取扱に関する規定に基づいて公開されるにいたったため，その利用が可能となった．これは，われわれにとって幸いなことであり，このため，共同研究者および財政史室スタッフによる在米資料の収集も行なわれたが，これらの資料を活用できたことは，この財政史を特徴づけるものとなったと思われる．

この財政史の執筆，監修に当たっては，もとより各巻とも執筆者がそれぞれ専門家としての立場から自主的に叙述したものではあるが，個人の著書を集めた全集といったようなものでなく，全巻が有機的なつながりをもったものとし，出来うる限り客観的で，正確な史実を後世に残すものであることに意が用いられた．そのためにも，執筆者の第一稿は未定稿として省内関係部局に回覧されるとともに，研究会における相互討論にも付されたのである．

なお，本財政史は，各執筆担当者の責任において書かれたものであるが，また全体の統一，調整についての責任は，わたくしたち監修者両名が負うものである．

終りにわたくしたち監修に当たった両名は，執筆者一同とともに，本財政史の編さん・刊行について示された大蔵省の非常な熱意と理解，ならびに種々行き届いたご配

慮をいただいた舟山正吉顧問に対し深く感謝するとともに，快くヒヤリングに応じて貴重な談話をいただいた方々，省内省外の協力委員をはじめ編さん・執筆に積極的な協力ないし助言をいただいた方々，ならびに何くれとなくお世話をいただいた財政史室，大蔵省文庫の方々にも衷心より感謝申し上げたい．また，あわせて本財政史刊行の業務を担当された東洋経済新報社の各位にも謝意を表するものである．

昭和50年10月1日

監修者

鈴木武雄

安藤良雄

監修者の一人鈴木武雄博士は，本財政史の刊行をまたず昭和50年12月6日，病気のため逝去されたが，同博士は本財政史編集事業の発足以来，編集・執筆を指導され，全執筆者の原稿または執筆構想についても草稿の校閲，共同研究会における指導助言等を行なわれたので，実質的には全巻にわたっての監修の任を果たされた．この「監修のことば」も鈴木・安藤両博士が協議し執筆されたものである．

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Introductory Note

This collection of English documents on the Occupation of Japan is part of a 20 volume series prepared under the auspices of the Financial History Section (Zaisei-shi shitsu) in the Japanese Ministry of Finance. Work began on this project in April 1971, and when finished the series will comprise sixteen volumes of historical analysis (all in Japanese), three volumes of documentary materials (two of which are in Japanese and one in English), one volume of statistics.

The official title of the series is *Shōwa zaisei-shi: shūsen kara kōwa made* (*The Financial History of Japan: The Allied Occupation Period, 1945–52*). In addition to the years covered in the official title, this English document volume and some of the volumes of analysis include material on pre-Occupation planning and on economic conditions following Japan's recovery of independence in 1952. The series itself is part of a much longer tradition and, in fact, is the fourth project of its kind undertaken by the Ministry of Finance. Its three predecessors and their publication dates are the *Meiji zaisei-shi* (1904–05), the *Meiji-Taishō zaisei-shi* (1936–40), and the *Shōwa zaisei-shi: 1927–1945* (1954–65).

This present series differs from its predecessors in at least two ways. First, the special nature of the Occupation period has made it necessary to take a broader approach than the exclusive financial and economic focus of the first three projects. Secondly, this series is the first to have separate documentary volumes, both Japanese and English.

The Character of the English Documents

Most of the documents printed here represent the United States side of the Allied Occupation of Japan. These American documents reflect the process of policy formation in Washington, the internal administration of the Supreme

Commander for the Allied Powers (SCAP), and the relation of private groups to the Occupation. In addition we have included a few documents from the British Public Record Office and a few which were translated from Japanese at the time. Most material representing the Japanese side will appear in the Japanese document volumes. The documents of the United States side will also correspond to the subject matter of Ikuhiko Hata's *Amerika no tai-Nichi senryō seisaku* (*U. S. Occupation Policy toward Japan*), vol. III (1976) in this series.

Organizaion of Documents

The documents are organized into thirteen categories and appear chronologically within each category. One or two minor exceptions to this order are explained in the text. The thirteen categories are as follows:

1. Pre-Occupation—General
2. Pre-Occupation—Economic
3. General Policy
4. National Security and External Relations
5. Political and Social Reform
6. Economic Reform
7. Economic Disarmament and Reparations
8. Economic Controls and Planning
9. Aid and Trade
10. Finance
11. The "Dodge Line"
12. Money and Banking
13. U. S. Occupation of Germany

Criteria for Selection and Editing

Because of limitations of space and a desire to include as many previously unpublished documents as possible, as a general rule we have not presented here already published documents which are readily accessible. For these, the reader may consult especially the *Foreign Relations of the United States* series. We have made one exception to this general rule in the case of extremely fundamental documents, some of which we have included.

A second problem is that many documents, especially the reports of the various special missions, are extremely long. To have printed even a few of these in their entirety would have meant the exclusion of many other vitally important shorter documents. As much as possible, therefore, we have included only the most essential passages of these long documents, either in the form of excerpts or by printing a summary in cases where the document itself has one. Whenever it has been reasonable to do so, we have indicated where portions have been omitted by utilizing a broken line of seven dots (.....).

The Pattern of Printing Documents

(a) Titles

The documents included here consist of many types: reports, letters, directives, memoranda and so forth. The types of documents themselves have no consistent standard for attaching titles, and in the case of letters there are no titles at all. For the benefit of Japanese readers especially, we have felt it necessary to give every document a title. However, to have indicated for every document which was a real or chosen title would have involved an intolerable amount of editorial matter. Where reasonable we have retained the original, but if the original was excessively long or not truly indicative of the contents of the document itself, we have substituted a more appropriate title. All titles have been translated into Japanese. Also, in the table of contents we have abbreviated most titles and in some cases added identifying numbers.

(b) Footnotes

We have tried to keep footnotes to a minimum, but exceptions have been made in several cases. For example, some documents are in a numbered series. We have printed SWNCC–150/3, "United States Initial Post-Defeat Policy Relating to Japan," and in a footnote referred to SWNCC–150/2, an earlier version in the same series. Sometimes documents on similar problems were considered by various committees and came to bear different series numbers. We have noted, for example, that document PWC–290a on Japanese Workers' Organizations was based on CAC–254 and was later revised to SFE 140 and SWNCC–92. Other cases requiring footnotes are subjects like deconcentration in category 6, Economic Reform, which relate closely to decision-making. Here footnotes are sometimes necessary for the reader to be able to follow the train of events.

In addition, any footnote with an asterisk (*) preceding it denotes that it

can be found in the original.

(c) Other Information

We have tried to provide a common editorial format for each document: a title, a number (if the document has one), the date, the sender and the recipient, and an indication of the type of document, such as "letter," "report," or "draft memorandum." Where possible we have also noted the classification category: top secret, secret, and confidential. This does not mean, of course, that documents appearing without a classification label were originally unclassified. Many of the documents in our possession are copies and it is impossible to determine their classification, if any.

Finally, unless otherwise indicated, most of the documents printed here can be found in either the National Archives, Washington, D. C. or in the Federal Records Center, Suitland, Maryland.

These documents were prepared and edited by Ikuhiko Hata and William D. Wray with assistance from Chizuko Saeki and Louise Schumacher.

Ikuhiko Hata
William D. Wray

Tokyo, Japan
September, 1982

Abbreviations

A	Agriculture Division (NR)
AC	Antitrust and Cartels Division (ESS)
ADM	Administrative Division (ESS)
CAC	Country and Area Committees (State Department)
CAD	Civil Affairs Division (War Department)
CIE	Civil Information and Education Section
CINCAFPAC	Commander-in-Chief, Army Forces, Pacific
CINCFE	Commander-in-Chief, Far East
EROA	Economic Rehabilitation of Occupied Areas
ESS	Economic and Scientific Section (SCAP)
FEC	Far Eastern Commission
FI	Finance Division (ESS)
FRUS	State Department, *Foreign Relations of the United States*
GARIOA	Government and Relief in Occupied Areas
HCLC	Holding Company Liquidation Commission
IDAC-FE	Inter-Divisional Area Committee on the Far East (State Department)
IE	Import-Export Division (ESS)
JCAC	Joint Civil Affairs Committee (JCS)
JCS	Joint Chiefs of Staff
JMD MSS	Joseph M. Dodge Papers, Detroit Public Library
JWPC	Joint War Plans Committee (JCS)
LOF	Liaison Office (Ministry of Finance)
NAC	National Advisory Council on International Monetary and Financial Problems
NMA	Supreme Commander for the Allied Powers, *History of the Nonmilitary Activities of the Occupation of Japan, 1945 through 1951.* (SCAP Official History, originally in typescript and now available on microfilm.)
NR	Natural Resources Section (SCAP)
NSC	National Security Council
OSS	Office of Strategic Services
PRJ	Supreme Commander for the Allied Powers, Government Section, *Political Reorientation of Japan, September 1945 to September 1948.* Washington, D. C., U. S. Government Printing Office, 1949.
PWC	Postwar Programs Committee (State Department)

R & A	Research & Analysis (OSS)
REP	Reparations Section (SCAP)
SANACC	State-Army-Navy-Air Force Coordinating Committee
SC	Secretary of State's Staff Committee
SCAP	Supreme Commander for the Allied Powers
SCAPIN	Supreme Commander for the Allied Powers, Instructions to the Japanese Government
SFE	State-War-Navy Coordinating Subcommittee for the Far East
SR	Division of Special Research (State Department)
SWNCC	State-War-Navy Coordinating Committee

CONTENTS

Doc. No.	Title	Date	表題	
	1 PRE-OCCUPATION–GENERAL		占領開始前（一般）	
1- 1	Proposed Work Schedule, Far East Section of SR	*Dec. 1, 1942*	国務省特別調査課東アジア班業務計画案	1
1- 2	Planning for the Handling of Civil Affairs in Enemy Occupied Areas Which May Become Theaters of Operations	*Apr. 10, 1943*	占領予定地域における民事処理計画	2
1- 3	Status of the Japanese Emperor (T-315)	*May. 25, 1943*	天皇の地位に関する領土分科会報告	3
1- 4	Organizational Chart of Civil Affairs Division in War Department	*Jun. 12, 1943*	陸軍省民事部の機構図	5
1- 5	Sir George Sansom's Views of Postwar Japan	*Jul. 28, 1943*	戦後日本に関するジョージ・サンソム卿の見解	6
1- 6	General Principles Applicable to the Postwar Settlement with Japan (T-357a)	*Sep. 29, 1943*	日本の戦後処理に適用する一般原則	7
1- 7	Draft Directive for Military Government of Japan	*Oct. 8, 1943*	日本の軍政に関する指令案	8
1- 8	Planning for Relief and Rehabilitation of Liberated Areas	*Nov. 10, 1943*	解放地域の救済・復興計画に関するルーズベルト書簡	10
1- 9	Summary Outline of Work of the Inter-Divisional Area Committee on the Far East	*Feb. 1944*	国務省極東地域委員会の業務報告	11
1-10	Postwar Objectives of the United States in Regard to Japan (CAC-116b)	*Mar. 14, 1944*	日本に関する合衆国の戦後目的	13
1-11	Decentralization of Japanese Administration (PWC-153)	*May 1, 1944*	日本の行政の地方分権化	14
1-12	Functions of Country and Area Committees in the Department of State	*May 2, 1944*	国務省地域委員会の機能	16
1-13	Post-War Objectives of the United States in Regard to Japan	*May 4, 1944*	日本に関する合衆国の戦後目的	17
1-14	Propaganda Treatment of the Institution of the Emperor	*Jul. 3, 1944*	天皇制の処理の宣伝に関する討議	18

1-15 Consideration of Bombing the Imperial Palace — *Jul. 28, 1944* 宮城の爆撃についての検討 19

1-16 Abdication of Hirohito (CAC-265 prelim-a) — *Aug. 2, 1944* 天皇ヒロヒトの退位 20

1-17 Japan's Education System under Military Government (PWC-287a) — *Nov. 6, 1944* 軍政下における日本の教育制度 23

1-18 Revisions in PWC Documents — *Nov. 17, 1944* PWC 諸文書の修正について 27

1-19 Japanese Surrender and Post-Surrender Resistance — *Nov. 21, 1944* 日本の降伏と抵抗についての検討 29

1-20 A Summary of the Recommendations for Japan (CAC-342) — *Jan. 5, 1945* 日本に対する諸勧告の概要 30

1-21 Comments on State Department Recommendations for Military Government — *Jan. 19, 1945* 軍政に関する国務省勧告に対する陸軍省のコメント 33

1-22 Important Points at Institute of Pacific Relations Conference on Military Government Activities — *Jan. 21, 1945* 太平洋問題調査会会議の概要 35

1-23 Postwar Treatment of Japan — *Feb. 8, 1945* 日本の戦後処理に関する討議 36

1-24 Treatment of the Emperor — *Mar. 8, 1945* 天皇の処遇に関する討議 38

1-25 Comment on State Department Draft on Post-Surrender Policy Toward Japan — *Apr. 14, 1945* 降伏後における対日方針—国務省案への SFE のコメント 39

1-26 Consideration of State Department Draft on Post-Surrender Policy Toward Japan — *Apr. 16, 1945* 降伏後における対日方針—国務省案への SFE のコメント 40

1-27 Responsibilities for Military Government — *May 9, 1945* 対日軍政の責任についてのマッカーサー宛JCS電 41

1-28 British Report on American Policy Toward Japan — *May 30, 1945* 米国の対日政策に関する英国外務省の見解 41

1-29 British Report on United States Policy Toward Japan — *Jun. 20, 1945* 米国の対日政策に関する英国外務省の見解 42

1-30 Selection of Experts for MacArthur's Staff — *Jul. 16, 1945* マッカーサーに付す専門家スタッフの人選 45

1-31 British Government Response to Telegram on U. S. Post-Surrender Control of Japan — *Jul. 17, 1945* 米国の日本管理案に対する英国政府の反応 45

1-32 State Department's Role in Occupation Policy Formulation — *Jul. 17, 1945* 占領政策形成における国務省の役割 46

1-33 British Suggestions for Amendments to American Draft Plan — *Jul. 22, 1945* 対日管理米国草案に対する英国修正提案 47

1-34 Consultations with China — *Jul. 23, 1945* 対日方針についての中国との協議について 47

1-35 Comments on British Views of Occupation Machinery — *Jul. 24, 1945* 占領機構に関する英国の見解へのコメント 48

1-36 Draft Proclamation to Japan — *Jul. 25, 1945* ポツダム宣言案 48

1-37 Analysis of Potsdam Proclamation — *Jul. 27, 1945* ポツダム宣言の分析 49

1-38 Comparison of the Potsdam Declaration with State Department Policy — *Jul. 30, 1945* ポツダム宣言と国務省方針との比較 50

1-39 British Government's Policy Toward Post-Surrender Japan — *Aug. 7, 1945* 降伏後における英国の対日政策 51

1-40 Basic Outline Plan for "Black List" Operations to Occupy Japan Proper and Korea after Surrender or Collapse — *Aug. 8, 1945* 日本・朝鮮占領のためのブラックリスト作戦計画 52

1-41 Discussion at SWNCC on U. S. Policy Toward Japan — *Aug. 11, 1945* SWNCC 第20回会議議事録 55

1-42 Discussion at SWNCC on U. S. Policies Toward Japan — *Aug. 12, 1945* SWNCC 第21回会議議事録 56

1-43 Draft Study on British Participation in the Machinery for the Control of Japan — *Aug. 13, 1945* 対日管理機構への英国の参加に関する考察 58

1-44 Ultimate Occupation of Japan and Japanese Territory (JWPC-385/1) — *Aug. 16, 1945* 日本占領の兵力拠出計画 60

1-45 Politico-Military Problems in the Far East: Memo on United States Initial Post-Defeat Policy Relating to Japan — *Aug. 22, 1945* 降伏後における米国の初期の対日方針に関するメモ 62

1-46 United States Initial Post Defeat Policy Relating to Japan (SWNCC-150/3) — *Aug. 22, 1945* 降伏後における米国の初期の対日方針 63

1-47 Discussion on U. S. Initial Post-Surrender Policy Toward Japan — *Aug. 24, 1945* 降伏後における米国の初期の対日方針に関する討議 67

1-48 Bureaucratic Decision-Making in Washington — *Aug. 24, 1945* ワシントンにおける政策決定機構に関する所見 69

1-49 United States Initial Post-Defeat Policy Relating to Japan — *Aug. 27, 1945* 降伏後における米国の初期の対日方針（メモ） 69

1-50 Annex 8 (Military Government) to Operations Instructions No. 4 — *Aug. 28, 1945* 作戦命令第4号付属文書—軍政 70

1-51 SFE Minutes, 37th Meeting — *Aug. 29, 1945* SFE第37回会議議事録 72

1-52 Memo on Initial Post-Surrender Policy for Japan — *Aug. 31, 1945* 初期の対日方針に関するJCSメモ 74

1-53 SWNCC Minutes, 22nd Meeting — *Aug. 31, 1945* SWNCC第22回会議議事録 74

1-54 Background of SWNCC/SFE Origins — *Jan. 21, 1948* SWNCCの起源と歴史 76

2 PRE-OCCUPATION-ECONOMIC 占領開始前—経済

2- 1 Japanese Post-War Economic Considerations (E-155) — *Jul. 21, 1943* 戦後日本の経済問題 79

2- 2 Post-War Economic and Political Problems of Japan — *Jul. 30, 1943* 戦後日本の経済・政治問題 89

2- 3 Japan: United States Economic Policies (CAC-165 Prelim) — *Apr. 15, 1944* 米国の対日経済政策 92

2- 4 Security Policy vis-à-vis Japan: Economic Aspects (CAC-194 Prelim) — *Apr. 30, 1944* 対日安全保障政策—経済的側面 95

2- 5 Japan: Economic Policies during Military Occupation (CAC-222) — *Jul. 4, 1944* 占領下における対日経済政策 98

2- 6 Japan: Economic Policy (CAC-160) — *Jul. 24, 1944* 対日経済政策 103

2- 7 Cartels from the Point of View of Japan — *Aug. 3, 1944* 日本のカルテルに関するリーマーのメモ 105

2- 8 Japan: Worker's Organizations During the Period of Military Occupation (PWC-290a) — *Nov. 15, 1944* 占領下における日本の労働者組織 105

2- 9 Japan: Military Government: Initial Economic Policies (CAC-222a) — *Nov. 22, 1944* 軍政下における初期の対日経済政策 110

2-10 Economic Foreign Policy of the United States with Respect to Japan (FEA) — *Jan. 1, 1945* 米国の対日経済外交政策 113

2-11 Japan: Economic Policies during Military Occupation (CAC-222a Revision) — *Mar. 16, 1945* *May 19, 1945* 軍政下における対日経済政策 119

2-12 Politico-Military Problems in the Far East: the Post-Surrender Military Government of the Japanese Empire: Policy with Respect to Problems of Rural Land Tenure (SWNCC-100) — *Apr. 7, 1945* 農地の地代問題 121

2-13 Economic Policy Toward Japan: Summary Statement — *Apr. 17, 1945* 対日経済政策の要約 122

2-14 Economic Policy Toward Japan (Document SC-101) — *Apr. 23, 1945* SC-101についての討議 129

2-15 Politico-Military Problems in the Far East: Post-Surrender Military Government of the Japanese Empire: Financial Problems (SWNCC-114) — *Apr. 23, 1945* 日本帝国降伏後の軍政—財政問題 130

2-16 Post-War Economic Planning and Representation of Government Departments — *May 15, 1945* 戦後経済計画における政府各省の参画に関するグルーのメモ 132

2-17 United States Initial Post-Defeat Policy Toward Japan — *Jun. 23, 1945* 降伏後における米国の初期対日方針 132

2-18 Discussion of Agrarian Reform — *Jun. 23, 1945* 農地改革に関する討議 133

2-19 Role of Treasury Department in Directive on Japan — *Jun. 25, 1945* 対日指令と財務省の役割に関する討議 134

2-20 Comments on June 23, 1945 Minutes of Committee on Economic Policy Toward Japan — *Jul. 7, 1945* 対日経済政策に関するハドレーのコメント 134

2-21 Agriculture and Food in Japan (Civil Affairs Guide) — *Jul. 15, 1945* 日本の農業と食糧 135

2-22 Control and Use of the Bank of Japan (Civil Affairs Guide) — *Aug. 1945* 日本銀行の管理と利用 138

2-23 Draft Financial Directive for Japan — *Aug. 28, 1945* 対日財政金融指令草案に関する財務省メモ 143

2-24 Japan's Acceptance of the Potsdam Declaration and Labor Policy — *Aug. 28, 1945* 日本のポツダム宣言受諾と労働政策に関するメモ 147

3 GENERAL POLICY 一般

3- 1 Atlantic Charter — *Aug. 12, 1941* 大西洋憲章 149

3- 2 The Cairo Declaration — *Dec. 1, 1943* カイロ宣言 149

3- 3 Soviet Entry in Pacific War — *May 12, 1945* ソ連の太平洋戦争への参戦 150

3- 4 Potsdam Declaration — *Jul. 26, 1945* ポツダム宣言 151

3- 5 Directive to the Supreme Commander for the Allied Powers — *Aug. 13, 1945* 米大統領の連合国最高司令官への指令 152

3- 6 General Order No. 1, Military and Naval — *Sep. 2, 1945* 一般命令第1号 152

3- 7 SCAP's Proclamations to the Japanese People — *Sep. 2, 1945* マ元帥より日本国民への布告1～3号 155

3- 8 Directives and the Authority of the Supreme Commander — *Sep. 3, 1945* 最高司令官の指令と権限に関するマッカーサー電 159

3- 9 Authority of the Supreme Commander — *Sep. 4, 1945* 最高司令官の権限に関するマッカーサー宛陸軍参謀総長電 159

3-10 Authority of General MacArthur as Supreme Commander for the Allied Powers — *Sep. 6, 1945* 連合国最高司令官としてのマ元帥の権限に関する声明 160

3-11 British Analysis of White House Statement of the 22nd September, on United States General Initial Post-Surrender Policy in Japan — *Oct. 3, 1945* 合衆国の降伏後初期の対日政策についてのホワイトハウス声明に関する英国の分析 160

3-12 Basic Directive for Post-Surrender Military Government in Japan Proper — *Nov. 3, 1945* 日本占領及び管理のための連合国最高司令官に対する降伏後における初期の基本的指令 162

3-13 Establishment of Far Eastern Commission and Allied Council for Japan — *Dec. 27, 1945* 極東委員会・対日理事会の設置に関する合意 175

3-14 United States Policy with Respect to Occupied Areas — *Apr. 8, 1946* 占領地域に関する米国の政策に関するSWNCC指令 177

3-15 Press Interview with MacArthur — *Mar. 19, 1947* マッカーサーの記者会見概要 178

3-16 Hussey's Report on Washington's Attitude Regarding Aspects of the Occupation — *Dec. 6, 1947* ハッセーの帰任報告 181

3-17 Royall's Speech on American Policy Towards Japan — *Jan. 6, 1948* 対日政策に関するロイヤル陸軍長官演説 183

3-18 United States Policy for Japan (McCoy Statement) — *Jan. 21, 1948* 日本の経済自立に関するマッコイ声明 186

3-19 Manual of Military Government in Japan — *Sep. 1, 1948* 第8軍の日本軍政に関するマニュアル 187

3-20 NSC Recommendations with Respect to U. S. Policy Toward Japan (NSC-13/2) — *Oct. 7, 1948* 米国の対日政策に関する国家安全保障会議(NSC)の勧告 192

3-21 SCAP's Scope of Authority — *Dec. 18, 1948* SCAPの権限に関するマッカーサー電 195

3-22 Authority of SCAP — *Dec. 25, 1948* SCAPの権限に関するドレーパー電 196

3-23 NSC Recommendations with Respect to U. S. Policy Toward Japan (NSC-13/3) — *May 6, 1949* 米国の対日政策に関するNSCの勧告 197

3-24 United States Policy Toward Asia — *Jun. 10, 1949* 米国のアジア政策に関する国防長官覚書 201

3-25 Position of the United States with Respect to Asia (NSC-48/2) — *Dec. 30, 1949* 米国のアジア政策に関するNSCの勧告 201

3-26 United States Objectives, Policies and Courses of Action in Asia (NSC-48/4) — *May 17, 1951* 米国のアジア政策に関するNSCの勧告 205

3-27 Desired Repeal of Revision of Occupation Laws and Ordinances — *Apr. 9, 1951* 占領法規の改正と廃止に関する吉田書簡 209

3-28 United States Objectives and Courses of Action with Respect to Japan (NSC-125/1) — *Jul. 18, 1952* 日本に関する米国の目標と行動の基準に関するNSCの勧告 212

4 National Security and External Relations 安全保障および外交

4- 1 Occupation Force in Japan — *Jan. 30, 1946* 日本占領に参加する連合国軍に関する合意 216

4- 2 Reappraisal of United States Security Interests and Policies in Regard to Japan — *Apr. 17, 1946* 米国の対日安全保障政策に関するフィアリーのメモ 218

4- 3 Comments on "Reappraisal of United States Security Interests" — *May 15, 1946* 米国の対日安全保障政策に関するエマソン所見 220

4- 4 Draft Treaty of Disarmament and Demilitarization — *Jun. 21, 1946* 日本の非武装化及び非軍事化条約案 221

4- 5 Soviet Intention with Regard to Japan — *Aug. 10, 1946* ソ連の対日意図に関するデービスのメモ 223

4- 6 Japanese Peace Treaty — *Oct. 25, 1946* 対日平和条約に関する国務省部内メモ 224

4- 7 Limits of Allied Council Authority — *Sep. 3, 1947* 第40回対日理事会議事録 224

4- 8 Interests and Attitudes of F. E. C. Powers on Questions Relating to the Peace Settlement with Japan — *Feb. 19, 1948* 対日講和に関する極東委員会諸国の利害と態度に関する検討 225

4- 9 Police Reform — *Nov. 23, 1948* 警察制度の改革に関する陸軍省電 231

4-10 Staff Study "Gunpowder", 2nd., Edition *Apr. 12, 1949* 「ガンパウダー」作戦計画に関する極東軍幕僚研究 231

4-11 United States Objectives and Programs for National Security (NSC-68) *Apr. 14, 1950* 国家安全保障に関する米国の目標と計画 236

4-12 MacArthur's Memo on Formosa *Jun. 14, 1950* 台湾についてのマッカーサーのメモ 246

4-13 MacArthur's Memo on the Peace Treaty Problem *Jun. 14, 1950* 対日平和条約に関するマッカーサーのメモ 248

4-14 MacArthur's Memo on Security in Post-War Japan *Jun. 23, 1950* 戦後日本の安全保障に関するマッカーサーのメモ 253

4-15 Authorization of National Police Reserve *Jul. 8, 1950* 警察予備隊の創設に関するマッカーサー書簡 254

4-16 Staff Study "Increase in Japanese Security Agencies" *Jul. 14, 1950* 警察予備隊増強構想に関する極東軍司令部覚書 255

4-17 Personnel for National Police Reserve Forces *Aug. 9, 1950* 警察予備隊の人員に関するウイロビー宛メモ 261

4-18 Memorandum of Seven Points *Sep. 22, 1950* 講和条約についてのダレスの7項目覚書 263

4-19 Yoshida Letter on China *Dec. 24, 1951* 中国に関するダレス宛吉田書簡 263

4-20 Assistance for Self-Defense Forces and Trade *Oct. 19, 1953* 自衛隊及び貿易に関する池田=ロバートソン会談 264

4-21 Assistance for Self-Defense Forces *Oct. 21, 1953* 再軍備に関する池田=ロバートソン会談 267

4-22 Japan's Self-Defense *Oct. 27, 1953* 日本の防衛に関する池田=ロバートソン会談 269

5 Political and Social Reform 政治および社会改革

5-1 Apprehension and Punishment of War Criminals (SFE-106/10) *Sep. 12, 1945* 戦争犯罪人の逮捕と処罰 272

5-2 The Japanese Police System Under Allied Occupation *Sep. 28, 1945* 連合国占領下の日本警察制度に関する検討 275

5-3 Function of Government Section, SCAP (General Orders: No. 8) *Oct. 2, 1945* 民政局の任務 277

5-4 Emperor's Possible Abdication *Oct. 11, 1945* 天皇退位の可能性に関する陸軍省宛在東京アメリカ陸軍司令部電 278

5-5 Treatment of Emperor *Oct. 11, 1945* SWNCC 第27回会議議事録 278

5-6 Administration of the Educational System (SCAPIN-178) *Oct. 22, 1945* 教育制度の運営に関する司令部覚書 280

5-7 SFE Minutes on Political Reform *Oct. 23, 1945* SFE 第48回会議議事録 281

5-8 Governmental Reform in Japan *Nov. 20, 1945* 日本の統治体制の改革に関するボートンのメモ 283

5-9 Discussion on the Treatment of the Emperor *Dec. 18, 1945* 天皇の処遇に関する討議 284

5-10 Removal and Exclusion of Undesirable Personnel from Public Office (SCAPIN-550) *Jan. 4, 1946* 公職追放に関する司令部覚書 285

5-11 Reform of Japanese Government (SWNCC-228) *Jan. 7, 1946* 日本の統治体制の改革に関する司令部覚書 290

5-12 Constitutional Reform *Feb. 1, 1946* 憲法改正に関するホイットニーのメモ 293

5-13 Personal Assignments: Government Section *Feb. 4, 1946* 民政局の人員配置に関するホイットニー声明 294

5-14 SCAP Authority on Constitutional Authority *Mar. 9, 1946* 憲法改正と SCAP の権限に関する陸軍省電 295

5-15 U. S. Education Mission to Japan *Apr. 6, 1946* 米国教育使節団報告書の要旨 295

5-16 Reform of the Japanese Writing System and Language Problem *Apr. 30, 1946* 日本の国語改革に関する検討 298

5-17 Reform of Local Government *Apr. 30, 1946* 地方自治改革に関するティルトンのメモ 300

5-18 Summary of Achievements During the First Year of Occupation *Aug. 28, 1946* 日本占領1カ年の業績に関するマッカーサー声明 306

5-19 FEC Discussion on Draft Constitution *Sep. 21, 1946* 憲法草案をめぐる極東委員会の討議 307

5-20 Roster of Personnel in Government Section *Dec. 4, 1947* 民政局の人事配置一覧 311

5-21 Hussey's Memo on Local Autonomy *Dec. 12, 1947* 地方自治に関するハッセーのメモ 313

5-22 Modification of Purge *Dec. 2, 1948* パージの修正 315

5-23 The Inadequacy of Public Security *Aug. 6, 1949* 公共秩序に関するマッカーサー宛吉田書簡 316

5-24 Police Problem and Public Security *Aug. 8, 1949* 警察と公安に関するマッカーサー返書 316

5-25 Political and Economic Stabilization *Aug. 9, 1949* 政治・経済の安定に関するマッカーサー宛吉田書簡 318

6 ECONOMIC REFORM 経済改革

6- 1 The Occupation and Japanese Agriculture (October 1945-April 1952) *undated* 占領下の日本農業に関するラデジンスキー報告 320

6- 2 Establishment of Economic and Scientific Section *Oct. 1, 1945* 経済科学局の設置に関する太平洋陸軍司令官電 320

6- 3 Dissolution or Liquidation of Major Financial or Industrial Enterprises (SCAPIN-162) *Oct. 20, 1945* 金融機関および企業の解体または清算に関する司令部覚書 321

6- 4 Voluntary Dissolution of the Zaibatsu *Oct. 26, 1945* 財閥の自発的解体に関する太平洋陸軍司令官電 322

6- 5 Agrarian Reform in Japan *Oct. 26, 1945* 農地改革に関するフィアリーのメモ 322

6- 6 Sale or Transfer of Securities of Certain Business Firms (SCAPIN-215) *Oct. 31, 1945* 特定会社の証券の処分に関する司令部覚書 331

6- 7 Liquidation of Zaibatsu *Nov. 1, 1945* 財閥解体に関する太平洋陸軍司令官電 331

6- 8 Dissolution of Holding Companies *Nov. 4, 1945* 持株会社の解散に関する司令部宛大蔵大臣覚書 335

6- 9 Dissolution of Holding Companies (SCAPIN-244) *Nov. 6, 1945* 持株会社の解体に関する司令部覚書 336

6-10 Removal of Zaibatsu Property *Dec. 5, 1945* 財閥資産の移転に関するマッカーサー宛ポーレー書簡 337

6-11 Rural Land Reform (SCAPIN-411) *Dec. 9, 1945* 農地改革に関する司令部覚書 338

6-12 Policy Toward the Zaibatsu *Mar. 1946* 財閥解体に関するエドワーズ報告書 339

6-13 Zaibatsu Policy Recommended by the United States Reparations Mission to Japan *Apr. 1, 1946* ポーレー賠償使節団勧告の財閥政策 344

6-14 ESS Study on Corporate Stockholding *May 6, 1946* 企業の株式保有に関するESSの批判 346

6-15 Transmittal of Report of Edwards Mission on the Zaibatsu *May 17, 1946* エドワーズ報告書に関する司令部の見解 348

6-16 On the Report of the Edwards Mission *undated* エドワーズ報告書に対する司令部のコメント 349

6-17 Functions of Anti-Trust and Cartels Division, Economic and Scientific Section *Mar. 7, 1947* 経済科学局反トラスト・カルテル課の任務 349

6-18 Policy on Excessive Concentrations of Economic Power in Japan (FEC-230) *May 12, 1947* 過度経済力集中排除政策 350

6-19 Dissolution of Trading Companies (SCAPIN-1741) *Jul. 3, 1947* 三井物産，三菱商事の解体に関する司令部覚書 361

6-20 Economic Reconstruction and Reorganization Standard Law *Jul. 18, 1947* 経済再建と再編成の基準に関する法案 362

6-21 Holding Company Liquidation Commission Bill *Aug. 6, 1947* 持株会社整理委員会法案に関するメモ 365

6-22 ESB's Report on Elimination of Excessive Concentration of Economic Power *Aug. 22, 1947* 過度経済力集中排除に関する経済安定本部報告 367

6-23 Report on Conditions in Japan as of September 6, 1947 *Sep. 6, 1947* カウフマン報告書 368

6-24 Criticism of Kauffman *undated (1947)* カウフマン報告に対するケーディスの批判 378

6-25 Continued Implementation of Deconcentration Program (Excerpts) *Oct. 24, 1947* 集中排除計画の実施に関するマッカーサー電 380

6-26 Gray's Memo on Japanese Economic Situation *Nov. 14, 1947* 日本経済に関するグレイ陸軍次官補メモ 382

6-27 Stimson's Comment on Deconcentration of Industry *Nov. 21, 1947* 集中排除に関するスチムソンのコメント 383

6-28 Request for Deconcentration Review Board *Nov. 25, 1947* 集中排除審査委員会に関するESSの要請 384

6-29 Elimination of Excessive Concentrations of Economic Power in Japan (Zaibatsu Program) *Dec. 1, 1947* 集中排除に関するウィスナーのメモ 385

6-30 Elimination of Excessive Concentration of Economic Power Law *Dec. 18, 1947* 過度経済力集中排除法 386

6-31 MacArthur's Support for the Law for the Termination of Zaibatsu Family Control *Jan. 9, 1948* 財閥同族支配力排除法に関するマッカーサー電 392

6-32 MacArthur's Views on FEC-230 — *Jan. 21, 1948* — FEC 230号文書に対するマッカーサーの見解 395

6-33 Determining Deconcentration of Excessive Economic Power and the Deconcentration Review Board — *Jan. 26, 1948* — 集中排除と集中排除審査委員会に関するマッカーサー電 397

6-34 Rural Land Reform (SCAPIN-1885) — *Feb. 4, 1948* — 農地改革に関する司令部覚書 400

6-35 Removal of Companies from the "Designation List" — *Apr. 17, 1948* — 「指定会社」の解除に関するフレイルのメモ 400

6-36 Operating Procedure Regarding Law No. 207 — *Jun. 10, 1948* — 集排法運用手続に関する審査委員会宛マーカット書簡 401

6-37 Concerning Yasuda, Teikoku, Mitsubishi, Sanwa and Sumitomo Banks — *Jul. 2, 1948* — 安田・帝国・三菱・三和・住友銀行に関する審査委員会メモ 403

6-38 Request by Westinghouse Electric International Company on Behalf of Mitsubishi Electric Manufacturing Co., Ltd. — *Aug. 27, 1948* — 三菱電機に関するウエスティングハウス社の要望 404

6-39 Four Points of Guidance Regarding Deconcentration — *Sep. 11, 1948* — 集中排除に関する4項目のガイドライン 405

6-40 Initial Report of the Deconcentration Review Board — *Nov. 3, 1948* — 集中排除審査委員会の第1回報告 408

6-41 Excessive Concentration of Economic Power in Japan (FEC-230/3) — *Dec. 9, 1948* — 日本における過度経済力集中排除 410

6-42 Revaluation of Corporate Assets, as Stabilization Measure — *Jan. 6, 1949* — 安定化手段としての法人資産再評価に関するウエルシュ・メモ 412

6-43 Economic and Scientific Section Telephone Directory — *Jun. 1, 1949* — 経済科学局電話帳 414

6-44 Partition of Mitsui and Mitsubishi Coal Mining Companies — *Jun. 20, 1949* — 三井鉱山, 三菱鉱業の分割に関する安本メモ 418

6-45 Final Report of the Deconcentration Review Board — *Jul. 15, 1949* — 集中排除審査委員会の最終報告 419

6-46 Japanese Land Reform Program — *Mar. 15, 1950* — 日本の土地改革に関するヒューズ報告 423

7 ECONOMIC DISARMAMENT AND REPARATIONS 経済の非軍事化及び賠償

7- 1 Principles of Reparation Policy — *Sep. 4, 1944* — 賠償政策の原則について 430

7- 2 Japanese External Assets — *Aug. 1945* — 日本の在外資産に関する司令部民間財産管理局の調査 431

7- 3 U. S. Reparation Policy for Japan — *Oct. 31, 1945* — 米国の対日賠償政策に関するポーレー使節団作成資料 435

7- 4 Report on the Industrial Disarmament of Japan — *Nov. 1945* — 日本工業力の解体に関する報告書 435

7- 5 Request for Data from SCAP by the Reparations Mission — *Nov. 16, 1945* — ポーレー使節団のSCAPに対する資料請求 438

7- 6 Interim Reparations Policy-Pauley Report — *Dec. 6, 1945* — 中間賠償に関するポーレー報告 440

7- 7 Reparations from Japan-Immediate Program (Pauley Interim Report) — *Dec. 18, 1945* — 日本からの賠償即時実施計画（ポーレー報告） 443

7- 8 Policy Toward Japanese Assets in China and Korea — *May 11, 1946* — 中国・朝鮮内日本資産の処理に関するマッカーサー宛ポーレー書簡 449

7- 9 Japanese Assets in Manchuria — *Jul. 1946* — 日本の在満資産に関する大統領宛ポーレー報告 449

7-10 Delays in Comprehensive Reparations Program — *Sep. 18, 1946* — 総合的賠償計画の遅延に関するポーレー書簡 455

7-11 Action on Reparations — *undated* — 賠償処理についてのポーレー宛書簡 456

7-12 Ambassador Pauley's Response to SCAP Comments on Reparations Report — *Dec. 28, 1946* — SCAPのコメントに対するポーレーの所見 457

7-13 Col. Cheseldine's Report on Reparations Policy — *Feb. 17, 1947* — 賠償に関するチェシェルダイン大佐報告 460

7-14 Report on Japanese Reparations (1st. Strike Report) — *Feb. 18, 1947* — 第一次ストライク報告書 464

7-15 Report on Japanese Reparations and War Department View — *Feb. 24, 1947* — 第一次ストライク報告書に関する陸軍省の所見 471

7-16 Interim Directive Regarding Advance Transfers of Japanese Reparations — *Apr. 4, 1947* — 中間賠償取立に関する中間指令 472

7-17 Policy Regarding Availability of Japanese Plants and Equipment for Reparations Removal — *Jul. 25, 1947* — 日本の工場・設備の賠償撤去方針に関する司令部参謀長メモ 472

7-18 Report on Industrial Reparations Survey of Japan to the United States of America (2nd. Strike Report) — *Feb. 26, 1948* — ストライク日本産業賠償調査報告（第2次） 473

7-19 Comments Pertaining to Overseas Consultants Recommendations Relative to Industrial Reparations from Japan — *Mar. 18, 1948* ストライク報告に関するESS工業課の見解 480

7-20 Report on the Economic Position and Prospects of Japan and Korea: Measures Required to Improve Them (Johnston Report) — *Apr. 26, 1948* ジョンストン（ドレーパー）報告書 483

7-21 Concerning the "Report on Industrial Reparations Survey of Japan to the United States of America", by the Overseas Consultants, Inc. — *May 10, 1948* ストライク報告に関する賠償庁の所見 485

7-22 Concerning Letter from Reparations Board, Japanese Government, Commenting on OCI Report — *May 26, 1948* ストライク報告に関する賠償庁の書簡に関する工業課メモ 486

7-23 Concerning the "Report on Industrial Reparations Survey of Japan to the United States of America", by the Overseas Consultants, Inc. — *May 31, 1948* ストライク報告に関する賠償庁メモ 487

7-24 Proposed Action by State Department on Interim Reparations Program — *Dec. 18, 1948* 中間賠償計画に関するポーレー書簡 488

8 Economic Control and Planning 経済統制及び経済計画

8-1 Directive No. 3—Basic Industrial Controls (SCAPIN-47) — *Sep. 22, 1945* 産業統制に関する指令 489

8-2 Control of Inflation in Japan — *Oct. 1, 1945* インフレーションの統制に関する検討 490

8-3 Control of Food and Agriculture in Japan (SWNCC-98/1) — *Oct. 11, 1945* 日本における食糧と農業の統制 493

8-4 Bogdan's Inspection Trip on Financial Problems — *Jan. 6, 1946* ボグダンの国内視察報告 494

8-5 Disposition of Equipment and Supplies of the Japanese Armed Forces (SCAPIN-582) — *Jan. 11, 1946* 日本軍の施設及び需品の処分に関する司令部覚書 495

8-6 Food Situation in Japan — *Feb. 1946* 日本の食糧事情に関する米農務省の見解 495

8-7 Economic Stabilization Board — *Mar. 26, 1946* 経済安定本部の設置に関する民政局の検討 496

8-8 Food Crisis in Japan — *Mar. 28, 1946* 日本の食糧危機に関する司令部政治顧問部報告 496

8-9 The Japanese Textile Industry (Mission Report) — *Mar. 31, 1946* 繊維産業調査団報告書 497

8-10 An Economic Program for Japan (Bogdan Report) — *May 3, 1946* 日本経済のプログラム（ボグダン報告） 499

8-11 Inflation and Its Threat to Occupation Objectives — *Oct. 23, 1946* インフレ対策に関するビッソンのメモ 505

8-12 Living Standard and the Future Economy of Japan — *Dec. 25, 1946* 生活水準と日本経済の将来に関する外務省の研究 507

8-13 Industrial Disarmament and Economic Control of Japan — *Jan. 22, 1947* 日本産業の非軍事化と経済統制に関するESS報告 510

8-14 Program for Economic Stabilization (B) (Summary) — *Feb. 16, 1947* 経済安定計画に関するESSの報告 514

8-15 A Positive Economic Program for Japan — *Mar. 12, 1947* 対日経済計画に関する国務省日本朝鮮課メモ 515

8-16 General MacArthur's Letter on the Food Situation and Economic Stabilization — *Mar. 22, 1947* 経済安定に関する吉田宛マッカーサー書簡 518

8-17 A Possible Program for a Balanced Japanese Economy — *Mar. 27, 1947* 日本経済均衡のためのESS計画 519

8-18 ACJ's View on Stabilization of Wage-Price Relationships — *Apr. 14, 1947* 賃金と物価の安定に関する対日理事会の報告 521

8-19 Essentials of the ESS Economic Stabilization Program — *May 20, 1947* 経済科学局の経済安定計画の要旨 522

8-20 Economic Conditions in Japan — *Aug. 1, 1947* 日本の経済情勢に関するESS報告 525

8-21 Regarding the Establishment of Kodans — *Sep. 3, 1947* 公団の設立に関するマーカット覚書 526

8-22 The Possibility of a Balanced Japanese Economy (Green Book) — *Oct. 1947* 日本の均衡経済の可能性（グリーン・ブック） 527

8-23 SANACC Minutes on the Revival of the Japanese Economy — *Oct. 23, 1947* SANACC第61回会議議事録 530

8-24 Economic Recovery of Japan (SANACC-384/1) — *Dec. 22, 1947* 日本の経済復興に関するSANACCメモ 531

8-25 Maintenance of Present Price Levels — *Jan. 21, 1948* 価格水準の維持に関するアルバーのメモ 533

8-26 Economic Conditions in Japan — *Feb. 4, 1948* 日本の経済情勢に関するESS報告 535

8-27 Self-Support of the Japanese Economy (SANACC-381/2) — *Feb. 12, 1948* 日本経済の自立に関するSANACCメモ 537

8-28 Unwarranted Extension of Occupation Operations — *Mar. 9, 1948* 占領に関するハッセーの所見 539

8-29 Marquat's Memo on Wage Stabilization Program — *May 6, 1948* 賃金安定に関するマーカットのメモ 541

8-30 Essentials of Economic Stabilization Program — *Jul. 15, 1948* 経済安定計画の骨子に関するマーカットのメモ 542

8-31 Joint Recommendations as to Stabilization Policy — *Oct. 26, 1948* 経済安定政策に関するESS 3課の共同勧告 542

8-32 Program for a Self-Supporting Japanese Economy — *Nov. 1948* ESSの日本経済自立5カ年計画 544

8-33 ESS Memo on Economic Stabilization — *Nov. 8, 1948* 経済安定に関するESSメモ 546

8-34 ESB's Basic Ideas Underlying Economic Self-Support Program — *Oct. 4, 1950* 経済自立計画の基本的原則に関する安本の研究 549

8-35 ESB's Economic Self-Supporting Program of Japan — *Jan. 20, 1951* 日本経済自立計画に関する安本の研究 551

8-36 Japan's Industrial Potential — *Feb. 20, 1951* 日本の工業力に関するESSの研究 552

8-37 Notes Regarding Utilization of the Japanese Economic Potential — *Apr. 17, 1951* 日本経済力の活用に関するタッパーのメモ 565

8-38 United States-Japan Economic Cooperation — *May 10, 1951* 日米経済協力に関するマーカット声明 569

8-39 Marquat's Statement on U. S.-Japan Economic Cooperation — *May 16, 1951* 日米経済協力に関するマーカット声明 569

8-40 Japan's Industrial Potential — *Feb. 20, 1952* 日本の工業力に関するESSの研究 572

9 Aid and Trade 援助及び貿易

9- 1 Policy with Respect to Relief in Japan (SWNCC-107/1) — *Oct. 1, 1945* 対日救済政策 582

9- 2 Request for Essential Imports — *Oct. 7, 1945* 必要物資の輸入要請に関するJCS宛司令部電 583

9- 3 Japanese Customs Organization (SCAPIN-941-A) — *Apr. 8, 1946* 日本の関税組織に関する司令部覚書 583

9- 4 A Foreign Exchange Rate for Japan — *Jun. 25, 1947* 外国為替レートに関するESS見解 584

9- 5 Restoration of Private Trade with Japan (SFE-194/2) — *Jul. 16, 1947* 民間貿易の再開について 587

9- 6 Establishment of Occupied Japan Export-Import Revolving Fund — *Aug. 15, 1947* 輸出入回転基金の設立に関する回状第9号 588

9- 7 ESS's Report on Yen Exchange Rate — *Jan. 10, 1948* 円為替レートに関するESSの報告 590

9- 8 Appointment of Exchange Rate Mission — *May 14, 1948* ヤング使節団の任務に関するドレーパー書簡 595

9- 9 Yen-Dollar Price Relations and the Problem of an Exchange Rate — *Jun. 6, 1948* 円ドル価格関係と為替レート問題に関するメモ 596

9-10 Report of the Special Mission on Yen Foreign Exchange Policy (Young Report) — *Jun. 12, 1948* 円レート政策に関する特別使節団報告（ヤング・レポート） 597

9-11 Japanese Exchange Rate — *Jun. 25, 1948* ヤング使節団に関するNACメモ 601

9-12 NAC Minutes on International Monetary and Financial Problems — *Jun. 28, 1948* 国際金融に関する国家諮問委議事録 604

9-13 The Economic Rehabilitation of Japan — *Oct. 15, 1948* 日本の経済復興に関する陸軍省メモ 607

9-14 Yen Exchange Rate and Economic Rehabilitation Program — *Jan. 5, 1949* 円為替レートと経済復興計画に関する貿易業界の見解 612

9-15 Comments on the Exchange Rate Paper of January 11, 1949 — *Jan. (?), 1949* 為替レートに関するジェイノーのコメント 613

9-16 Application of Exchange Rate Proposals — *Feb. 19, 1949* 為替レートに関するマーカットのメモ 617

9-17 Principles of Counterpart Administration — *Mar. 21, 1949* 見返資金運用の原則に関するマクダイアミッドのメモ 621

9-18 Marquat's Recommendation on Foreign Exchange Rate — *Mar. 22, 1949* 為替レートに関するマーカット勧告 622

9-19 Proposed Single Rate for Japanese Yen and Related Measures — *Mar. 25, 1949* 円ドル単一レートに関する国家諮問委の勧告 622

9-20 Proposed Single Rate of Exchange for Japanese Yen and Related Measures — *Mar. 29, 1949* 円ドル単一レートに関する国家諮問委の勧告 624

9-21 Dodge's Telegram on Foreign Exchange Rate — *Mar. 30, 1949* 為替レートに関するドッジ電 625

9-22 Yen Counterpart of GARIOA and EROA Imports (SCAPIN-1988) — *Apr. 1, 1949* ガリオア及びエロア輸入と円見返資金に関する司令部覚書 627

9-23 ECA's Report on Local Currency Counterpart Funds — *May 31, 1949* — 見返資金に関する ECA の報告 627

9-24 Program for the Use of Counterpart Funds — *Jul. 13, 1949* — 見返資金運用計画に関するマーカット宛ルカウントのメモ 641

9-25 Government and Relief in Occupied Areas Economic Rehabilitation in Occupied Areas Fiscal Year 1950 — *undated* — 1950年度のガリオア・エロア援助報告書 642

9-26 ESS Memo on Use of Counterpart Fund — *Sep. 2, 1949* — 見返資金の運用に関する ESS メモ 649

9-27 BOJ's Views Concerning Foreign Exchange Rate — *Oct. 8, 1949* — 為替レートに関する日銀の見解 650

9-28 Recommendations and Findings of the Advisory Mission for International Trade (Freile Report) — *Oct. 24, 1949* — フリール貿易使節団報告書 652

9-29 Report on Exchange and Trade Controls in Japan — *Nov. 18, 1949* — 日本の為替・貿易管理に関する報告（ムラデック・ウィチン報告） 659

9-30 Fiscal Year 1951 Appropriation for Economic Aid to Japan — *Jan. 19, 1950* — 1951年度米政府対日経済援助支出に関するドッジ見解 662

9-31 Proposals to Change U. S. Aid Program Approach — *Jun. 21, 1950* — 米国の対日援助計画に関するモローのメモ 664

9-32 An Export Finance Bank — *Nov. 9, 1950* — 輸出銀行に関するドッジのメモ 666

9-33 Foreign Economic Policies (Gray Report) — *Nov. 10, 1950* — 対外経済政策に関するグレイ報告 667

9-34 For Our Closer Economic Cooperation — *Feb. 6, 1951* — 日米経済協力に関する安本の提案 670

9-35 Items of Solicitation in Connection with Japan's Economic Self-Support — *Feb. 9, 1951* — 日本の経済自立に関する安本の提案 671

9-36 Gross Amount of United States Postwar Economic Assistance to Japan — *Apr. 13, 1960* — 米国の戦後対日経済援助総額 672

10 Finance 財 政

10- 1 Imperial Household Property (SCAPIN-300) — *Nov. 18, 1945* — 皇室財産凍結に関する司令部覚書 674

10- 2 Assets of the Imperial Household (as of September 1, 1945) — *Jan. 1946* — 皇室財産に関する ESS 財政課調査 674

10- 3 On Emergency Financial Measures — *undated* — 金融緊急措置についてのメモ 675

10- 4 Japanese Government's Measures to Combat Inflation — *Feb. 3, 1946* — 日本政府のインフレ対策（民政局覚書） 678

10- 5 U. S. Occupation Costs in Japan — *Feb. 7, 1946* — アメリカの占領経費に関する国務省の検討 679

10- 6 The Extraordinary Japanese Post-War Taxes — *May 14, 1946* — 戦後の臨時特別税（チャーン報告） 680

10- 7 Meeting to Consider Measures Relating to War Indemnities and Taxation — *May 20, 1946* — 戦時補償と課税に関する措置に関する民政局の検討 683

10- 8 Additional Notes on the Proposed Tax Program — *May 22, 1946* — 課税計画に関する追加的所見 684

10- 9 A Memo on Local Government Finances — *May 22, 1946* — 地方財政に関するグラジンジェフのメモ 685

10-10 Recommendations Regarding the Ministry of Finance — *Jul. 18, 1946* — 大蔵省改革に関する勧告 688

10-11 Japanese Cancellation of War Indemnities — *Oct. 14, 1946* — 戦時補償打切に関するボートン宛フィアリーのメモ 689

10-12 Japanese Finance Law — *Feb. 12, 1947* — 財政法に関するリゾーのメモ 690

10-13 New Finance Law — *Feb. 17, 1947* — 財政法に関するリゾーのメモ 692

10-14 New Finance Law — *Feb. 17, 1947* — 財政法に関するローブのメモ 693

10-15 Setting of Revenue Targets in the Japanese Budget — *Jan. 22, 1948* — 歳入目標額の設定に関する ESS の検討 695

10-16 Administrative Management Function — *Mar. 3, 1948* — 行政管理機能に関する ESS の検討 696

10-17 Place of the Budget Bureau in the Japanese Government — *Mar. 6, 1948* — 日本政府内における主計局の位置についてのユージン・リードのメモ 697

10-18 Estimated Japanese Budget Expenditures for Support of Occupation Forces — *Mar. 30, 1948* — 日本政府の対占領軍支出予算に関する検討 697

10-19 Japanese Government 1948-49 Budget — *May 22, 1948* — 1948年度予算に関するコーエンのメモ 699

10-20 Taxation Program — *Jan. 6, 1949* 課税計画に関する ESS メモ 700

10-21 Tax Data for Economic Mission — *Jan. 27, 1949* ドッジ使節団に対する租税関係資料 702

10-22 Reorganization of National Tax Administration of the Japanese Government (SCAPIN-2001) — *May 4, 1949* 国税庁設置に関する司令部覚書 706

10-23 Probes into Scandals in Tax Offices — *May 18, 1949* 税務署の醜聞に関する民政局調査 706

10-24 National Advisory Council Views on Shoup Telegram — *Jul. 21, 1949* シャウプ博士の勧告に対する国家諮問委員会の見解 707

10-25 Reform of Japan's Taxation System — *Aug. 26, 1949* 日本税制の改革に関するシャウプ勧告 709

10-26 Tax Personnel Levels — *Sep. 30, 1949* 税務官吏の水準に関するモスのメモ 716

10-27 Local Tax Law — *Mar. 18, 1950* 地方税法に関する吉田書簡 717

10-28 Revised Local Tax Laws — *Mar. 21, 1950* 改正地方税法に関するマッカーサー書簡 718

10-29 Japanese Government Budget for Fiscal Year 1951-52 — *Apr. 24, 1950* 1951年度日本政府予算に関する司令部参謀長メモ 719

10-30 Dr. Shoup's Modifications of the Value-Added Tax — *Jun. 3, 1950* シャウプ博士の付加価値税修正案 720

10-31 Dr. Shoup's Press Statement — *Sep. 17, 1950* シャウプ博士の記者会見声明 721

10-32 Confidential Supplementary Taxation Report — *Sep. 21, 1950* シャウプ博士の税制に関する追加報告 722

10-33 Tax Survey Conclusions and Recommendations (The Second Shoup Mission) — *Sep. 21, 1950* シャウプ税制使節団第2次報告書 724

10-34 Dr. Shoup's Confidential Memorandum — *Sep. 26, 1950* シャウプ博士の覚書 730

11 The "Dodge Line" ドッジ・ライン

11- 1 The General Economic and Political Problem and Its Relationship to Banking — *undated* 一般経済政治問題と金融との関係に関するドッジの見解 732

11- 2 Statement of the Yen Exchange Committee on Establishing the Exchange Rate for Japan — *Jun. 2, 1948* 為替レートに関するESS円為替委員会の報告 732

11- 3 The Japanese Recovery Program — *Oct. 18, 1948* 日本復興に関するラルフ・リードのメモ 736

11- 4 Conversation with Mr. Dodge Regarding Stabilization Message to General MacArthur — *Nov. 11, 1948* 日本経済安定に関するドッジ=リンカーン大佐会談 737

11- 5 Message Concerning Stabilization Program — *Dec. 11, 1948* 9原則に関する陸軍省のSCAP宛電文 739

11- 6 Nine-Part Interim Directive on Stabilization — *Dec. 11, 1948* 経済安定9原則に関する中間指令 740

11- 7 SCAP Comment on Stabilization Directive — *Dec. 12, 1948* 9原則に関するSCAPのコメント 741

11- 8 Concerning Dodge's Appointment as Financial Advisor — *Dec. 13, 1948* SCAP財政顧問就任事情に関するドッジの報告 741

11- 9 Background and Implementation of Stabilization Program — *Dec. 14, 1948* 安定計画の背景と実施に関するドレーパー書簡 743

11-10 Report on Actions by Industry Division on Stabilization Program Stated in Radio W81059 — *Dec. 17, 1948* 経済安定9原則実施に関する工業課メモ 744

11-11 Information for Reply to Stabilization Directive — *Dec. 17, 1948* 9原則に関する価格配給課の所見 744

11-12 Wage Stabilization — *Dec. 17, 1948* 賃金安定に関するヘプラーのメモ 746

11-13 SCAP's Explanation of Stabilization Program to Japanese Government — *Dec. 19, 1948* 9原則指令に関する吉田宛マッカーサー書簡 747

11-14 Japanese Government's Receipt of Stabilization Program — *Dec. 19, 1948* 9原則受領に関するマッカーサー宛吉田書簡 748

11-15 Stabilization of Japanese Economy — *Dec. 20, 1948* 日本経済の安定に関する反トラスト課メモ 748

11-16 Hepler's Memo on Wage Stabilization — *Jan. 8, 1949* 賃金安定に関するヘプラーのメモ 749

11-17 Plans of the Price and Distribution Division for Implementation of Nine-Point Program — *Jan. 8, 1949* 9原則実施計画に関する価格配給課メモ 750

11-18 Progress Report on Accomplishment of Nine-Point Stabilization Plan — *Feb. 9, 1949* 9原則実施の経過に関する財政課メモ 754

11-19 Japanese Budget 1945-49 — *Feb. 9, 1949* — 日本の予算 (1945-49年) に関するドッジのメモ 754

11-20 Japanese Government Budget, 1949-50 Fiscal Year — *Feb. 17, 1949* — 24年度予算に関する ESS メモ 756

11-21 Japanese Government Budget — *Mar. 4, 1949* — 予算に関するドッジ=池田会談 757

11-22 Inflation vs. Stabilization — *Mar. 6, 1949* — インフレか安定かに関するファインのメモ 760

11-23 Draft Supplementary Budget Recommendations of Dodge Mission — *Mar. 7, 1949* — 24年度補正予算勧告案に関する労働課メモ 761

11-24 Japanese Government Budget (Dodge-Ikeda talk) — *Mar. 10, 1949* — 予算に関するドッジ=池田会談 762

11-25 Japanese Budget 1945-49 — *Mar. 24, 1949* — 予算に関するドッジ=池田会談 764

11-26 Japanese Budget — *Mar. 25, 1949* — 予算に関するドッジ=池田会談 766

11-27 Japanese Budget — *Mar. 28, 1949* — 予算に関するドッジ=池田会談 767

11-28 Japanese Budget — *Mar. 31, 1949* — 予算に関するドッジ=池田会談 768

11-29 Dodge's Statement on the Japanese Budget — *Apr. 15, 1949* — 予算に関するドッジのステートメント 769

11-30 Japanese Budget — *Apr. 15, 1949* — 予算に関するドッジ=池田会談 773

11-31 Japanese Budget — *Apr. 22, 1949* — 予算に関するドッジ=池田会談 775

11-32 The Stabilization Program: Problems and Results (Dodge to Ikeda) — *Aug. 9, 1949* — 安定計画をめぐる池田宛ドッジ書簡 777

11-33 Bank of Japan's Opinion on Financial Issues — *Nov. 14, 1949* — 財政金融問題に関する日銀見解 781

11-34 Dodge-Ikeda Talks — *May 3, 1950* — 予算等に関するドッジ=池田会談 783

11-35 Dodge Comments on Meeting with Finance Minister Ikeda and on General Economic State — *May 8, 1950* — 池田=ドッジ会談に関するマッカーサー宛ドッジ書簡 786

11-36 Economic and Political Situation in Japan and United States Domestic Policies — *May 22, 1950* — 日本の政治・経済情勢及び米国内政策に関するドッジ宛マッカーサー書簡 788

11-37 Government Financing and Tax Policy — *May 22, 1950* — 政府融資と租税政策に関するマッカーサー宛吉田書簡 788

11-38 Finance Minister Ikeda's Proposals and Principles of Economic Stabilization Program — *May 25, 1950* — 安定計画と池田蔵相の提案に関するマッカーサー書簡 790

11-39 Letter from Ikeda to Dodge Concerning the Results of the Visit to the United States — *May 31, 1950* — 渡米の成果に関するドッジ宛池田書簡 791

11-40 Completion of Mission by Mr. Joseph M. Dodge — *Dec. 2, 1950* — ドッジ使節団任務完了報告 792

11-41 Possible Reorganization of Reconstruction Finance Bank — *Dec. 3, 1950* — 復興金融金庫再編成に関するマーカット宛ドッジ書簡 793

11-42 Japanese Financial Obligations and Peace Treaty — *Oct. 28, 1951* — 講和条約調印に伴う日本の財政責任に関するマーカット電 794

11-43 The Principles of Japanese Trade and the Conditions of a Self-Supporting Economy — *Nov. 29, 1951* — 貿易の原則と自立経済の諸条件に関するドッジ声明 794

11-44 Japan: Post-Treaty Relationship — *Jan. 17, 1952* — 講和条約後の日米関係に関するドッジのメモ 797

12 Money and Banking 通貨及び金融

12- 1 Closing of Colonial and Foreign Banks and Special Wartime Institutions (SCAPIN-74) — *Sep. 30, 1945* — 外地銀行，外国銀行及び戦時機関の閉鎖に関する司令部覚書 798

12- 2 Opposition to Opening of National City Bank Branch — *Dec. 2, 1945* — ナショナル・シチー銀行東京支店開設への反対意見 798

12- 3 Abolition of System of Designated Financial Institutions and Compulsory Loans — *Mar. 25, 1946* — 金融機関指定制度及び強制貸付制度の撤廃に関するリゾーのメモ 799

12- 4 Reopening of the Japan Securities Exchange — *Mar. 31, 1946* — 証券取引所の再開に関するホイットニーのメモ 800

12- 5 Abolition of System of Designated Financial Institutions and Compulsory Loans — *undated* — 金融機関指定制度及び強制貸付制度の撤廃に関するメモ 800

12- 6 Reopening of the Japan Securities Exchange — *Apr. 15, 1946* — 証券取引所の再開に関するメモ 801

12- 7 Regulation of Over-the-Counter Dealings in and Transfer of Securities *Jul. 26, 1946* 証券の店頭取引と譲渡規制に関するホイットニーのメモ 802

12- 8 Summary of Securities and Exchanges Bill *Jan. 9, 1947* 証券取引法案の概要に関するアダムスのメモ 802

12- 9 Bill for Revising a Part of the Bank of Japan Law *Jan. 17, 1947* 日本銀行法の一部改正法案に関する財政課の討議 803

12-10 Establishment of Commercial and Foreign Trade Banking Facilities in Japan (SWNCC-226/6) *Jun. 20, 1947* 日本における商業及び外国貿易銀行の設置 804

12-11 Reorganization of Bank of Japan *May 22, 1948* 日本銀行の改組に関するESSメモ 806

12-12 Proposed Banking Law *May 28, 1948* 金融業法の提案に関するルカウントのメモ 808

12-13 Cagle's Memo on Banking Legislation *Dec. 28, 1948* 金融業法に関するケーグルのメモ 817

12-14 LeCount's Memo on Proposed Banking Law *Dec. 31, 1948* 金融業法に関するルカウントのメモ 819

12-15 LeCount's Memo on Controls on Credit Expansion *Jan. 7, 1949* 信用膨脹の統制に関するルカウントのメモ 820

12-16 LeCount's Memo on Controls on Credit Expansion *Jan. 20, 1949* 信用膨脹の統制に関するルカウントのメモ 821

12-17 On the Operation of Japan Development Bank *Aug. 6, 1951* 日本開発銀行の運用についてのメモ 822

13 U. S. Occupation of Germany 対独占領政策

13- 1 Program to Prevent Germany from Starting a World War III *Sep. 1944* ドイツによる第3次大戦開始阻止のための計画 825

13- 2 The Military Government of Germany (JCS-1067) *Apr. 1945* 在ドイツ軍政部に関する指令 827

13- 3 The Liquidation of War Finance and the Financial Rehabilitation of Germany *Apr. 8, 1946* ドイツの戦時金融の終結及び金融の再建 839

13- 4 The Colm-Dodge-Goldsmith Plan and the Objectives of German Occupation *undated* コルム=ドッジ=ゴールドスミス・プラン及びドイツ占領の目的 841

13- 5 United States Objectives in Germany (JCS-1779) *Jul. 11, 1947* ドイツにおける合衆国の目的に関する指令 844

Financial History Section
Ministry of Finance

THE FINANCIAL HISTORY OF JAPAN

The Allied Occupation Period, 1945—1952

20 English Documents

The Official History of the Ministry of Finance

1 PRE-OCCUPATION-GENERAL

1-1 PROPOSED WORK SCHEDULE, FAR EAST SECTION OF SR[1]

Drafted by: H. Borton December, 1, 1942
Secret

Provisional Scheme for a Handbook on:

THE FAR FAST

I. Introduction
II. The Position of Japan
  (1) The Japanese Political System
  (2) Japanese Nationalist Ideology
  (3) Japanese Political Parties and Groups
  (4) Social Classes and Conflicts in Japan
  (5) Japanese Foreign Policy since 1868
  (6) Japanese outlying and Colonial Territories (Korea excepted)
    (a) Ryukyu
    (b) The Bonins
    (c) Formosa
    (d) Karafuto and Chishima
    (e) The Pacific Mandated Islands
  (7) Japan's Population Problem
  (8) Japanese Agriculture and Food Supply
  (9) The Industrialization of Japan
  (10) Japan's Foreign Trade and Access to Raw Materials
  (11) Emigration and Investment in the Co-Prosperity Sphere outside Japanese Territory
III. Chinese National Aims
  (1) Government and Administration in China
  (2) Political Parties and Groups in China
  (3) The Former Chinese Empire and Tributary States
  (4) Chinese Nationalist Ideology
  (5) Chinese Foreign Policy since 1911
  (6) Manchuria
  (7) Mongolia
  (8) Sinkiang
  (9) Tibet
  (10) Chinese Emigrant Communities
  (11) Land Utilization in China
  (12) Industrial Development and Policy in China
  (13) China's Foreign Trade
  (14) Chinese Finance and Currencies
  (15) Extraterritoriality in China
  (16) Foreign Settlements and Concessions
  (17) The Maritime Customs Administration
  (18) Foreign Investments in China
IV. Korea
  (1) Japanese Administration in Korea
  (2) Korean Political Groups
  (3) Resources and Economic Development of Korea

[1] Special Research Division, State Dept.

To be completed by January 1, 1943

Japan
Post-War Position of the Japanese Emperor (December 15)—Coville.
Territorial Limitations of the Empire (December 7)—Masland.
Overseas Japanese, Their Present Status and Post-War Solutions—Masland.
Economic Consequences on Japan of Alternative Peace Settlements—Coville.
Korea
General Descriptive Reference Study with Concise Summaries—Borton.
Implications of Peace Commitments and Proposals, Points of View of Other Countries; Alternate Solutions and their Consequences—Borton.
Mandated Islands
General Descriptive Reference Study Including Character of Japanese Administration, Legal Issues Involved, Security Questions and Alternative Suggestions for Disposition (February 1)—Blakeslee.
Thailand
Descriptive Study and Alternative Disposition (December 15)—Masland.
China
Political Forces and Parties—Spiker.

Work schedule for January, February and March will include:

Japan
Country Study—Borton
Terms of Surrender, Including Government of Territory Following Hostilities and Provisional Government—
Post-War Position of Japan, Alternatives and Consequences—
Indo-China
Country Study and Alternative Post-War Solution for Settlement—Masland.
Formosa
General Descriptive Reference Study with Concise Summaries—Coville.
Implications of Peace Commitments and Proposals, Points of View of Other Countries, Alternative Solutions and their Consequences—Coville.
Manchuria
(Same as Formosa)—Blakeslee.
Southeastern Asia
Netherlands East Indies—Vandenbosch.
Disposition of Colonial Territories—
Economic Position and Controls—
Forms of International Supervision and Organization—
China—
Lui Chui Islands, Southern Saghalin and Others
(Same as Formosa)—
Concrete Projects and Proposals, Alternatives and their Consequences for Regional Groupings and / or International Organizations in the Far East—

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-2 PLANNING FOR THE HANDLING OF CIVIL AFFAIRS IN ENEMY OCCUPIED AREAS WHICH MAY BECOME THEATERS OF OPERATIONS

J. C. S. 250/2 Enclosure "A" April 10, 1943
To: H. L. Stimson, Secretary of War
From: W. D. Leahy[2]
Secret

The Honorable
Henry L. Stimson,
Secretary of War,
Washington, D. C.

Dear Mr. Secretary:

The Joint Chiefs of Staff have given careful consideration to the machinery which should be set up to accomplish advanced planning regarding the handling of civil affairs in an occupied territory and to coordinate the activities of civilian agencies in Washington regarding civil matters in an occupied territory during the period when such territory is under military control.

As long as military occupation exists, civil affairs are a responsibility of the commander concerned. In meeting local problems within his theater the commander is assisted by the Civil Affairs Division of his staff. However, there is much planning to be done in advance of the operation and considerable operating to be done in the United States regarding civil affairs in occupied territories. This must be accomplished or at least coordinated by some agency in Washington.

While many of the matters pertaining to civil affairs can be handled by civilian agencies, the requirements of secrecy and security prevent giving civilian agencies the information in advance of the operation which would be necessary for them to have in order to make advanced plans. It is therefore necessary to charge some military agency with this duty.

The War Department has recently established a Civil Affairs Division which is closely related to the Operations Division of the War Department General Staff. This appears to be the logical agency to plan and coordinate the handling of Civil Affairs in nearly all of the occupied territories. Inasmuch, however, as the military occupation is by joint forces and certain aspects of civil administration are of interest to the Navy, the Navy should be represented on the War Department's Civil Affairs Division and be fully consulted.

This Civil Affairs Division in the War Department can well be given jurisdiction in certain theaters in which the Commander is a Naval Officer, but in which the actual occupying troops are Army.

There will be cases, of course, of occupation by Naval or Marine personnel of areas of small extent in which Civil Affairs matters would be of minor importance. In such cases the Civil Affairs can be handled by existing agencies in the Navy Department.

In instances where the invasion of enemy territory is a combined operation with one or more of our allies, the Civil Affairs Division will, of course, have to be coordinated closely with the appropriate authorities of the allies concerned.

The Joint Chiefs of Staff desire to have civil affairs handled by civil authorities just as soon as the military situation permits subject, of course, to the control of the Theater Commander. As far as the United States is concerned the Office of Foreign Relief and Rehabilitation Operations, State Department, and the Committee of the Combined Boards are now set up to take over civil matters at the opportune time.

In view of the foregoing the Joint Chiefs of Staff recommend that the War Department be designated as the agency to plan the handling of civil affairs in territory about to be occupied and to coordinate the activities of civilian agencies in the United States in administering civil affairs in hostile or liberated territory during the period of military occupation. They request the approval of the Secretary of War and the Secretary of the Navy to this recommendation.

Sincerely yours,
For the Joint Chiefs of Staff:
/s/ WILLIAM D. LEAHY,
Admiral, U. S. Navy,
Chief of Staff to the
Commander in Chief of the Army and Navy.

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

[2] Chief of Staff to the C-I-C of the US Armed Forces (Roosevelt).

1-3 STATUS OF THE JAPANESE EMPEROR

Report T-315 May 25, 1943
Division of Political Studies, State Dept.
Secret

The problem of the overthrow of the militarists in Japan and the problem of changing the military-mindedness of the country raise questions with regard to the Japanese emperorship and its future.

The emperorship has been a dominant and essential part of Japan in a period of rapid rise and aggression, ending in a climax of very wide aggression. The United Nations cannot hereafter tolerate a government of Japan which continues to constitute the same menace.

The question arises whether, in postwar Japan, the survival of the emperorship is something which the United Nations should make impossible.

VI. Postwar Alternatives

1. *Termination of the Emperorship*

A postwar system of government for Japan might conceivably be based on elimination of the emperor and the termination of the emperorship as an institution. Such action would perhaps act as a check on nationalistic fanaticism and on the power which derives from it. It might well weaken Japan as an organized state. It might possibly remove one obstacle to the inculcation of more rational ideas among the Japanese regarding their national uniqueness and world mission. The subservience of the emperorship to the military led to war, directly through control of governmental decision, indirectly through power over forming the mind of the people; discontinuance of the emperorship would eliminate the possibility of a repetition of this in the future.

Various disadvantages would in all probability arise as a result of the abolition of the emperorship. One of these would be the difficulty of finding competent Japanese willing to participate in an emperorless administration. Such action would likewise arouse popular resentment, opposition and non-cooperation. There might develop a general disintegration of the basic incentive of order, law and the acceptance of authority. Finally it would create a permanent incentive for insurgency and revenge.

2. *Continuation of the Emperorship*

In any discussion of postwar policy with regard to the emperorship it should be borne in mind that one principle set forth in the Atlantic Charter and confirmed by the declaration of the United Nations on January 1, 1942, is respect for the right of all peoples to choose the form of government under which they will live, and that there is a present indication that the Japanese, when given the chance, will choose any form other than the emperorship. In event of necessity this principle of choice might be overruled in favor of the point, also stated in the Atlantic Charter and confirmed by the United Nations Decalaration, that the disarmament of nations which threaten or may threaten agression outside their frontiers is required. However, unless the disarmament of Japan makes such a step necessary, it is to be presumed that the United Nations will not interfere with a choice by the Japanese of the form of government under which they will live.

On the other hand it is to be assumed that, if the emperorship should survive, safeguards would be necessary against reassertion of dominance by the military, and modifications in the status of the emperor to that end would be axiomatic requirements. Certain disadvantages would result from its continuation which would leave serious problems for the United Nations to solve. There would be the continuance of superstitious belief deriving from the dogma of divine descent and a strong nationalistic belief consequent upon the dogma of uniqueness of race and world mission. It would also enhance Japanese national strength because of its unifying force. Thus it would be shortsighted to expect that by returning actual governing power from the military to a civilian group about the emperor an automatic solution to problems would be obtained. No ready-made group of liberals in Japan exists, competent to take over the governing of the country.

If the emperorship is allowed to survive, subsequent policy would be under the necessity of seeking methods of reducing the risk which inhere in the institution. Superstitution connected with it might be removed through more liberalized educational practice, and the influence of the exaggerated nationalism can be counteracted by an extensive program of cultural reconstruction. In any case, an adequate governing group will not automatically emerge.

Certain advantages may be obtained through the continuation of the emperorship. The Japanese are peculiarly and sentimentally responsive to generosity and indications of respect (as illustrated by their reaction to American relief at the time of the 1923 earthquake, to the return of Saito's ashes by the U. S. S. Astoria, and to the American acceptance of the Panay settlement); this is especially true in matters having to do with the emperor. There is no approach so completely calculated to carry Japanese approval as good treatment of the emperor.

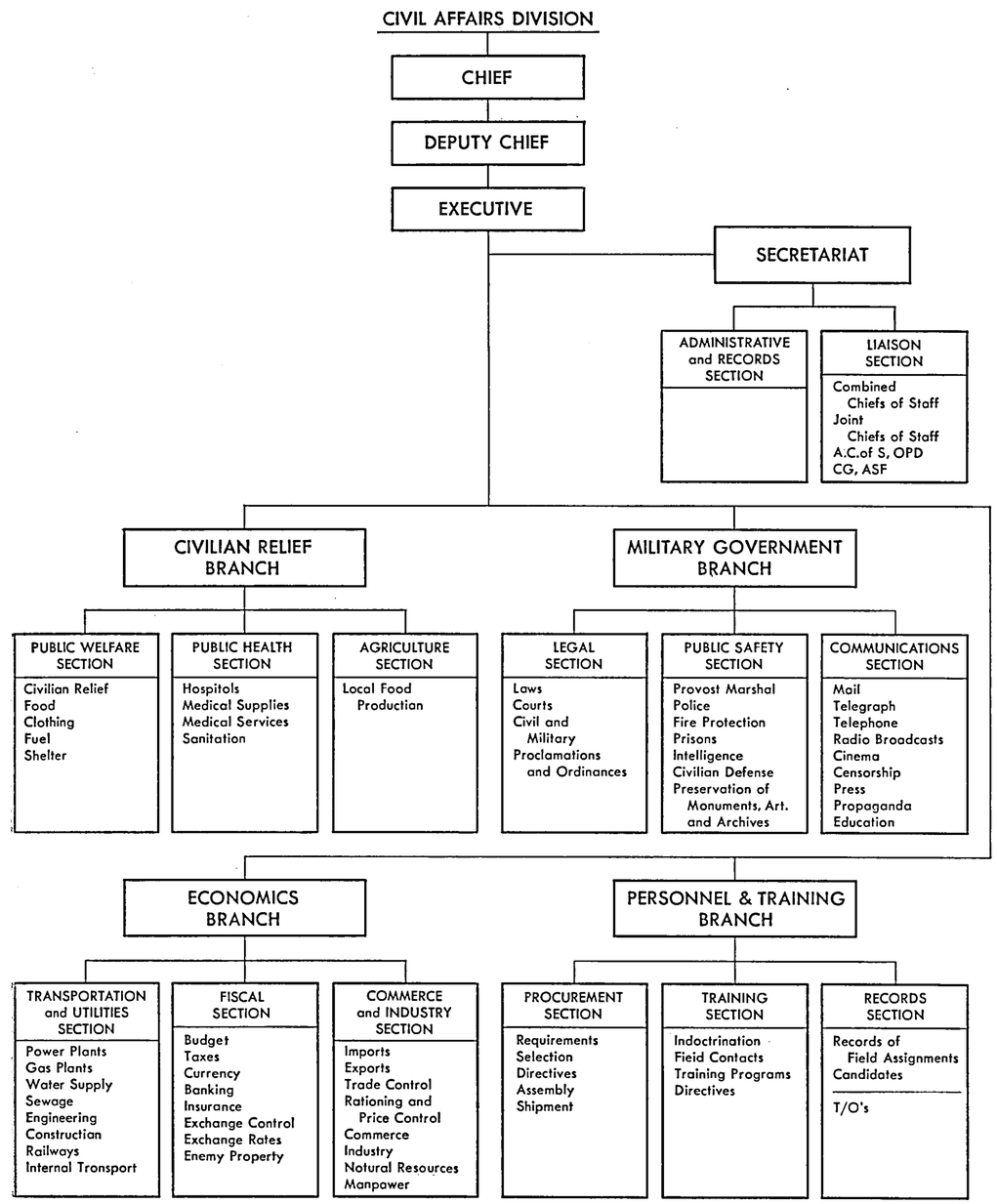
The survival of the emperorship would be a potential asset of great utility, as an instrument not only for promoting domestic stability, but also for bringing about changes desired by the United Nations in Japanese policy. The very fact that the power to initiate amendments to the Japanese constitution is reserved to the emperor makes orderly constitutional change more readily feasible if the approach is through the emperor. A non-militaristic

governing group would be in a better position to make reforms effective if it could speak in the name and with the authority of the emperor.

[Source: Dipl. Br., National Archives]

1-4 ORGANIZATIONAL CHART OF CIVIL AFFAIRS DIVISION IN WAR DEPARTMENT

June 12, 1943



[Source: National Archives]

1-5 SIR GEORGE SANSOM'S[3] VIEWS OF POSTWAR JAPAN

Memorandum of Conversation July 28, 1943
Participants: G. Sansom, G. H. Blakeslee, H. Borton
Drafted by: H. Borton

During an informal luncheon conversation Sir George expressed his personal opinion on post-war Japan as follows:

FUNDAMENTAL CONDITIONS FOR A PEACEFUL JAPAN

Before it will be possible to have permanent peace in the Pacific, Sir George pointed out that two basic factors should underlie all our considerations of the settlement in the Pacific. These are 1) that Japan be given international equality at as early a date as possible and, 2) that Japan be given an opportunity to develop a stable economy and a progressively higher standard of living.

Moderate Elements in Japan

Sir George was convinced of the existence within Japan, even today, of moderate elements but pointed out that whenever their strength had been challenged in the past by the militarists they have always capitulated. In answer to a question he agreed that the elections of 1931, 36 and 37 were evidence of the numerical strength of these elements. He agreed with the statement that many former moderates had swung over between 1937 and 41 to the side of the militarists. He cited, however, such individuals as Mr. Ashida of the Foreign Office and Professor Takaki of Tokyo Imperial University as examples of individuals who still opposed the militarists as late as 1940. When the question concerning the mentality of the Japanese was raised, Sir George emphasized the fact that the Japanese as a people are not naturally militaristic, but are extremely prone to follow any plan or slogan if it is successful. He believes therefore that it is likely that after the defeat of Japanese militarism and the victory of the democracies that the Japanese may well see increased advantages in a democratic form of government and may be anxious to adopt some of its features. Thus if conditions are such as to allow a more democratic government in Japan to be successful, it will be that much more likely to win whole hearted support.

Possible Changes in Japan's Governmental Structure

In general Sir George was opposed to the enforcement by the United Nations of changes in the Japanese Constitution and Government as such enforcement would be practically impossible if the Japanese themselves were not convinced of the need for these changes. Specifically, he felt it extremely inadvisable to depose the Emperor. The supervision from the outside of the Japanese educational system would be quite impossible. The enforced adoption by Japan of a bill of rights would have little meaning as the ordinary Japanese is little aware of the real significance of personal liberties. He believed, however, there might be some advantage in including in the terms of the treaty a provision that foreign information should be disseminated without prejudice throughout Japan.

Sir George emphasized, however, that there were certain definite changes in the operation and structure of Japanese Government which were absolutely necessary. These included the abolition of the special privileges of the military such as their power of "direct access" to the throne. The decree limiting those who are eligible to become Minister of War and Minister of Navy should be rescinded. Parliament should be given full power over budgetary matters and all cabinet members should be responsible to it. However, he believed that these reforms could best be brought about by intimating to the Japanese that unless their military were controlled through changes such as these so that any government that was set up would be a responsible government, there would be no possibility of their attaining a status of international equality or of obtaining economic assistance. Such an unofficial understanding he believed would be much more effective than an attempt to enforce these changes by formal treaty.

Military Occupation

Sir George believed that the military occupation of Japan, unless it came about as a result of hostilities, was both unnecessary and unwise. He believed that the future air strength of the United Nations would be sufficient to protect any disarmament commissions that might be sent to Japan to supervise the enforcement of the terms of surrender and of

[3] British Minister to Washington D.C. and well-known Japanologist.

peace. Furthermore, if there was to be a period during which Japan should be held under either military or economic supervision, this should be as short as possible. Sir George indicated no fear of the sudden resurgence of a powerful Japan especially if sufficient checks were developed against the rise of the military.

Economic Problems

In the brief discussion of economic matters, Sir George pointed out the extreme importance of tariffs in any economic settlement in the Far East. He realized this was an extremely complicated question but emphasized that unless some tariff concessions were made by the victorious United Nations it would be difficult for Japan to achieve sufficient economic prosperity to assure permanent social stability. He feared that the United States and Great Britain would be extremely reluctant to reduce their tariffs but was sure that if they did so Australia and New Zealand would follow suit.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-6 GENERAL PRINCIPLES APPLICABLE TO THE POSTWAR SETTLEMENT WITH JAPAN (REVISION)

Report T-357a September 29, 1943
Division of Political Studies, State Dept.
Drafted by: G. H. Blakeslee
Secret

I. The territorial terms of settlement should force Japan to withdraw from all areas under military occupation, including Manchuria, and to relinquish all territories which by the principles of nationality and self-determination should be independent or assigned to other states.

The application of this principle will take from Japan, Korea and Formosa.

II. The military terms should aim to prevent Japan from again becoming a menace to international peace.

The application of this principle will deprive Japan of its mandated islands and possibly of other strategic islands; and will require such measures of disarmament, of military inspection, and of temporary restriction of Japan's economic activity as the United Nations shall deem indispensable for security purposes.

III. Economic and financial conditions in the post-war period, so far as they may be controlled by the United Nations, should ultimately permit Japan, within the framework of the restrictions necessary for international security, to share in the development of a world economy on a non-discriminatory basis, looking toward a progressively higher standard of living.

This principle will ensure that Japan, after permanent conditions of peace have been established, shall in principle have access, on non-discriminatory terms, to the trade and to the raw materials of the world. It raises questions as to the amount and kind of Japanese reparations, and as to the desirability of permanent restrictions on specific categories of Japanese industry.

IV. The political objective in the post-war settlement should be a government in Japan which will fulfill Japan's international obligations and respect the rights of other states.

This principle implies a government free from military domination and under the control of civilian elements which aim to keep the peace. The means which appear most likely to facilitate the establishment of such a government are constitutional and administrative changes which will deprive the military of its special political privileges, freedom of intellectual communication with democratic countries through press and radio, and other measures which will strengthen the moderate elements in Japan.

The application of this principle raises problems as to the retention of the Emperorship and as to whether it will be more effective to force the desired constitutional, governmental and social changes on Japan or to rely on the influence of the victory of democratic states and the persuasion of the representatives of the United Nations.

V. The ultimate objective of the United Nations is to restore Japan to full and equal membership in the family of nations.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-7 DRAFT DIRECTIVE FOR MILITARY GOVERNMENT OF JAPAN

Draft Directive October 8, 1943
To: Chief, Civil Affairs Division
War Department
From: Brig. Gen. C. W. Wickersham[4]
Top Secret

1. Attached hereto is a draft of a proposed directive for the military government of Japan, less certain areas, prepared in conformity with your letter of 9 August 1943 to the Commandant, subject, "Proposed Area Studies for Conduct of Military Government".

2. Attention is invited to the following paragraphs:

a. Par. 20. In order to make this paragraph effective, the Secretary of War (or the Secretary of Navy) must delegate authority to the theater commander to appoint claims commissions.

b. Par. 23. The rates of exchange should be inserted.

c. Par. 24. This paragraph is desirable if authority for it can be found in appropriation acts. The legal question involved should be studied before this paragraph is finally approved.

3. Certain paragraphs contained in drafts of directives for control of civil affairs in certain other countries will not be found in this draft which deals with military government in an enemy country. In view of FM 27-10, it was deemed unnecessary to deal with a number of subjects clearly within the authority of the occupant.

4. The instructions given to the theater commander are designed to be sufficiently elastic so as to prevent embarrassment if one of the allies other than Great Britain and the United States should occupy some portion of the enemy country.

A. *GENERAL*

1. The forces under your command will establish military government in Japan progressively as such forces occupy the country. Such military government will be a combined undertaking by United States and British forces. In the planning and the conduct of the military government, personnel of United States and British forces will be used in a ratio of approximately 2 to 1; but personnel of any other allied forces under your command may also be utilized.

2. *Responsibility.* Responsibility for such military government will be a joint undertaking, as between the United States and British governments, involving the sharing of political, legal and financial responsibility. The joint character of the military government will be signalized by the display of the United States and British flags at headquarters and posts of the military government.

3. *Objectives.* The objectives of the military government of Japan will be to assist the allied war effort toward the complete occupation of Japan and the destruction of enemy forces therein. To this end the military government should (a) relieve combat troops of the necessity of providing for civil administration; (b) restore law and order and normal conditions among the civil population as soon as possible, import necessary food supplies for them, and where necessary, provide relief and maintenance for needy and destitute persons within available resources; (c) assist in making available to the occupying forces the economic resources of the occupied territory; (d) promote political and military objectives of the allied forces through the application of the policies toward the civil population laid down by you.

4. *Authority of Theater Commander.* By virtue of your position as Theater Commander, you are clothed with supreme legislative, executive, and judicial authority and power in the areas occupied by forces under your command. In your direction of civil affairs, you will be guided by the Rules of War found in United States Basic Field Manual, Rules of Land Warfare (FM 27-10), or in the British Manual of Military Law, 1929, Amendment 12, and by this and such other directives as you may receive from the Combined Chiefs of Staff. This authority will be broadly construed and includes authority to take all measures deemed by you necessary, desirable or appropriate in relation to the exigencies of the military operations and the objectives of the military government.

[4] Commandant, School of Military Government.

5. *Unity of Authority.* Representatives of the civilian branches and agencies and departments of the Allied governments will not be allowed to enter occupied areas except with your consent and, while there, they will be subject in all respects, and in all their activities, to your authority and control. They will not communicate with their home governments except through your headquarters and subject to your approval, except where you may see fit to relax such requirements in individual cases. They will be subject to the jurisdiction of the appropriate courts-martial or military courts.

6. *Delegation of Authority.* You are authorized, at your discretion, to delegate the authority herein granted you, in whole or in part, to task force and other tactical commanders, or Civil Affairs Officers immediately responsible to you, and further to authorize them, at their discretion to make appropriate sub-delegations, in whole or in part, of the authority so delegated to them to subordinate tactical commanders, or Civil Affairs Officers, within the chain of command. This authority will be delegated only to officers in the military, naval, or air service of the United States of America, Great Britain, or other Allied governments, who are members of your command.

7. *Territorial Restriction.* This directive does not apply to territory on the mainland of Asia controlled or occupied by Japan, to Formosa, to the Japanese mandated islands, nor to territory occupied by Japan since 7 December 1941. It applies to all other Japanese territory which may be occupied by forces under your command.

B. *CONTROL POLICIES*

8. *Government Officials.* The Emperor, members of the imperial family, the Premier, High Court Officials, Elder Statesmen, Privy Councillors, Imperial Conference Members, Cabinet Ministers, Governors of Prefectures, and other high political functionaries of Japan, found within the occupied territory will be arrested and held as prisoners of war pending further instructions. The responsibility of determining what other Japanese officials and government employees will be retained in their posts, removed or made prisoners of war rests with you, subject to the provisions of paragraph 10.

9. *Political Activities.* You will forbid all political party activities and political agitation pending further instructions. The Imperial Rule Assistance Association will be dissolved, and its records seized and carefully preserved.

10. *War Criminals.* The Combined Chiefs of Staff will furnish you a list of war criminals who will be arrested, if found within the occupied areas, and held in custody for further instructions from the Combined Chiefs of Staff.

11. *Axis Officials.* Civilian officials of any of the governments allied with Japan, including officials of the Nazi and Fascist Parties, found within the occupied areas may be placed under arrest.

12. *Reports.* Prompt reports will be submitted to the Combined Chiefs of Staff regarding all persons held under the foregoing paragraphs.

13. *Discretionary Power.* While the foregoing instructions will be your basic policies as regards the classes of persons named, you are authorized and will be expected to exercise broad discretion as to their application in individual cases in order to prevent undue dislocation to the administrative machinery or the economy of the occupied areas.

14. *Public Officials.* Except so far as the application of the foregoing policies may require, existing public officials on all levels may be required to continue in office during your pleasure. Where replacements are necessary or become desirable, you may appoint them from the population of the occupied areas, as your discretion may dictate.

15. *Japanese Courts and Police.* The ordinary civil and criminal courts and police may be allowed to function, subject however, to the supervision and control of the military government.

16. *Military Courts.* You are authorized to establish such military courts for the control of the population of the occupied areas as may seem to you desirable, and to establish appropriate regulations regarding their jurisdiction and powers.

17. *Private Property.* Private property will be subject to requisition in the manner indicated in the Rules of Land Warfare, pars. 335-340.

18. *Labor.* Labor may be requisitioned in accordance with the Rules of Land Warfare, pars. 302-305.

19. *Billeting.* The inhabitants will be subject to billeting and to quartering of troops. You will determine suitable compensation to be paid therefore.

20. *Claims.* You are authorized to establish claims commissions for claims arising against the forces under your command and individual members thereof within the limits of applicable legislation (e.g. as to United States Armed Forces, the Act of 2 January 1942 as

amended by Act of 22 April 1943). All approved claims in excess of five thousand dollars resulting from acts of United States forces will be referred to the Combined Chiefs of Staff for transmission to the Secretary of War or the Secretary of the Navy, as the case may be.

21. *Religious Institutions.* Religious edifices and institutions may be closed and officials of religious institutions and members of religious orders may be restricted in their activities, or placed under arrest and held as prisoners of war, to the extent required by considerations of military necessity or internal security.

22. *Cultural Property.* Consistent with the success and security of our military operations and the objectives of the military government, it will be the policy of the military government to extend all appropriate protection to public and private records and archives, art and other cultural treasures, historic buildings and monuments, and the property of institutions dedicated to religion, charity, and education, the arts and sciences.

23. *Currency.* During the initial phases of the occupation you are authorized to use as legal tender "spearhead" currency, provided for the occupying forces as well as Japanese Yen available to you for payments by the armed forces. The rate of exchange will be _____ Yen to the United States dollar and _____ to the British pound sterling. It is desirable that "spearhead" currency be withdrawn from circulation as soon as practicable and replaced by Japanese Yen, requiring, if necessary, new issues of standard Yen to be made by the Bank of Japan or such other bank of issue as it may be necessary to establish.

24. *Advances of Funds.* If cash available to any unit of the civil government is insufficient to meet necessary expenditures for administration, and if necessary funds cannot be raised immediately by taxation, contributions, borrowing or other means, you are authorized to permit necessary advances to be made by Finance Officers, bearing in mind that such advances should be made primarily for payment of current wages and salaries. The amount involved must be shown in accounts of the governmental unit as an advance from the military government.

25. *Trade and Financial Control.* Under your general authority, you may control and regulate the internal and external trade and financial transactions of the occupied areas to the extent and in the manner deemed by you desirable in the interests of the forces under your command and the military government. This includes restrictions of purchases by the armies under your command if such a measure is deemed necessary. Measures tending to interfere with allied or neutral trade or trade agreements will be referred to the Combined Chiefs of Staff for approval.

26. *Army Stocks.* You are authorized to use army stocks to the minimum extent necessary, to meet such public welfare, public health and economic needs among the civilian population as, in your judgment, demand immediate attention. Proper accounting will be maintained for such supplies and payments obtained therefore to such extent as may be possible or appropriate. You will submit requisitions for the necessary supplies for civilian use.

27. *War Prisoners.* Arrangements will be made, as circumstances permit, for the release of citizens of Allied countries found in internment, labor, and prisoner of war camps, or otherwise held within the occupied areas. This will be accomplished as speedily as possible and recommendations for their repatriation, and for the disposition of citizens of other Axis countries found within occupied areas, will be submitted to the Combined Chiefs of Staff.

28. *General.* In matters not specifically covered above, you will act according to your own judgment and discretion, under your general authority as Theater Commander as defined in paragraph 4 herein.

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

1-8 PLANNING FOR RELIEF AND REHABILITATION OF LIBERATED AREAS

Letter — November 10, 1943
To: Secretary of War
From: President F. D. Roosevelt

Dear Mr. Secretary:

Although other agencies of the Government are preparing themselves for the work which must be done in connection with the relief and rehabilitation of liberated areas, it is quite

apparent if prompt results are to be obtained the Army will have to assume the initial period of shipping and distributing relief supplies. This will not only be the case in the event that active military operations are under way but also in the event of a German collapse. I envisage that in the event of a German collapse the need for the Army to undertake this work will be all the more apparent.

Therefore I direct that you have the Army undertake the planning necessary to enable it to carry out this task to the end that it shall be prepared to perform this function pending such time as the civilian agencies must be prepared to carry out the longer range program of relief.

You may take this letter as my authority to call upon all other agencies of the Government for such plans and assistance as you may need. For all matters of policy that have to be determined in connection with this work you will consult with the State Department for any political advice and with the Treasury for such economic and fiscal direction as you may need.

[SOURCE: PASVOLSKY PAPERS]

1-9 SUMMARY OUTLINE OF WORK OF THE INTER-DIVISIONAL AREA COMMITTEE ON THE FAR EAST, OCTOBER 1, 1943—FEBRUARY 1, 1944

Drafted by: G. H. Blakeslee[5] — February, 1944

I. *NUMBER OF MEETINGS:*

Twenty-seven.

II. *PREFERRED SOLUTIONS RECOMMENDED*

The Committee unanimously agreed on preferred solutions for thirty postwar problems. Two problems have been postponed for further study: the future status of Portuguese Timor, and the confiscation of Japanese investments in Japan's mandated islands.

III. *SUBJECTS CONSIDERED*

The subjects considered may be grouped under the following headings, with topics sometimes listed under two or more heads:

1. *Territorial*
   Future status of
   (1) Enemy territory: the Kurile Islands, the Liuchius, the Bonin and Volcano Islands, Marcus Island, the Spratly Islands, Japan's Mandated Islands.
   (2) Liberated Areas: Netherlands Indies, British Malaya, Thailand, Indochina, Hong Kong, British North Borneo and Sarawak, Portuguese Timor.
2. *Boundary Issues*
   Korea: Korea-China-Siberia
   Indochina: Indochina-Thailand
   Thailand: Thailand-Indochina: Thailand-British Malaya.
3. *Military Government in the Far East*
   General Problems: Military government in Thailand, Formosa, Indochina. The need of a new Inter-Departmental committee to consider problems in military government and postwar military settlement.
4. *Japan's Mandated Islands*
   Postwar status of the Islands
   The legal problems
   The repatriation of Japanese
   The confiscation of Japanese investments
   The use of commercial airfields
5. *Korea*
   The problem of Korean independence
   Boundary issues
   Composition of an international council to supervise Korea in the postwar period.
6. *Japan*
   Objectives in the postwar settlement with Japan. The policy which should be adopted by the United States in regard to the institution of the Japanese Emperor.

[5] Division of Territorial Studies (TS), Office of Special Political Affairs, State Dept.

7. *International Organization and Supervision*
Southeast Asia: Regional integration.
International supervision of Korea.
The postwar status of:
(1) Japan's Mandated Islands
(2) The Spratly Islands
(3) The Kurile Islands
(4) Marcus Island
8. *Policies of Leading States in the Far East*
Russian policy in the Far East
Sino-Russian issues

IV. *GENERAL PRINCIPLES AND CONCLUSIONS*

1. *Future status of Territories*

a. *Japanese Territory*

The Committee appeared to base its solutions on the general consideration that Japan should be deprived of territory (1) which by the principles of nationality and self-determination should be independent or assigned to other states, and (2) territory which should be taken from Japan for definite security reasons. Other territory should remain with Japan. These principles will give Korea independence, restore Formosa to China, and deprive Japan of its Mandated Islands, Marcus Island, the Spratly Islands and the Nothern Kuriles.

b. *Liberated Areas*

In general, dependencies in the Far East should be returned to their former sovereign powers, with the recommendation that each colonial state should agree (1) to participate in a Consultative Regional Council, (2) to sign a Colonial Charter, and (3) to make an annual report on its administration to an international organization. This principle was incorporated in the preferred solutions in regard to the future status of British Malaya, British North Borneo and Sarawak, the Netherlands Indies, and Indochina. As to Indochina it was concluded that additional conditions might well be required. Hong Kong should be returned to China. The problem of Portuguese Timor proved so perplexing that the Committee postponed its final consideration. Thailand should be independent with temporary United Nations assistance or supervision.

2. *Military Government*

The Committee concluded (1) that military government in enemy and liberated areas should as a rule be inter-allied, (2) that agreements should be made between the Governments of the interested states to determine the composition and the powers of military government, and (3) that a new inter-departmental committee is needed to enable the State, War and Navy Departments to consider together the problems involved. To the last topic (3) the Committee devoted three meetings.

3. *Boundary Issues*

The Committee applied to boundary issues the principle that all transfers of territory effected by Japan since the beginning of its recent aggressions should be regarded as invalid.

4. *Postwar Japan*

The Committee concluded that a stable, progressive government is desirable within Japan as soon as possible after hostilities.

The Committee, however, for some time was perplexed as to the policy which should be adopted by the United States in regard to the institution of the Japanese Emperor. It finally agreed unanimously on the following preferred solution:

On the assumption the Japanese desire its retention—the adoption, for the present, of a policy of contributing to the reformation of the institution of the Emperor.

5. *Japan's Mandated Islands*

The Committee concluded (1) that the future status of the Islands should be determined neither by the League of Nations nor the Chief Allied and Associated Powers but by a new general multilateral treaty; (2) that the islands should be placed under international control with the United States as administrator; (3) that the Japanese residents in general should be permitted, under designated conditions, to continue to live on the islands; and (4) that the airfields should be open to the commercial use of friendly states. The Committee has not as yet reached an agreement as to the advisability of confiscating all Japanese investments in the Mandate.

6. *Korea*

Korea should in due course be independent, but for a time should be under the helpful supervision of certain leading states, including, probably, at least China, the Soviet Union and the United States.

7. *International Organization and Supervision*

The Committee favored the principle of increased international cooperation in the Pacific and Far East. It unanimously agreed that an international organization should be given control over (1) Japan's Mandated Islands, (2) Marcus Island, (3) the Spratly Islands, and (4) the Northern Kuriles. It supported the principle that colonial powers in the Far East should accept for their dependencies a measure of international cooperation or accountability.

V. *MEMBERS OF THE COMMITTEE*

The membership of the Committee has varied somewhat depending on the subject under consideration. The number present at any one meeting has varied from about 7 to 13. In all, the following have participated in two or more meetings.

TS: P. E. Hosely
G. H. Blakeslee
H. Borton
A. Vandenbosch
F. S. Williams
J. F. Green
R. A. Fearey

FE: J. W. Ballantine
A. Hiss
J. C. Vincent
E. P. Lockhart
E. R. Dickover
H. M. Benninghoff
B. R. Johansen
M. W. Bishop
A. Chase
K. P. Landon

Eu: J. C. H. Bonbright
H. S. Cumming, Jr.
R. B. Stewart
W. P. George

Ge: S. W. Boggs

LA: A. Moffat

TA: W. Willoughby

ISO: D. C. Blaisdell

MEA: M. B. Hall

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-10 POSTWAR OBJECTIVES OF THE UNITED STATES IN REGARD TO JAPAN

Report CAC-116[6] March 14, 1944
IDAC-FE[7]
Secret

I. *TERRITORIAL OBJECTIVES*

Japan is to withdraw from Manchuria, the Mandated Islands, and all areas under Japanese military occupation, and is to be deprived of Korea, Formosa, and all islands obtained since the beginning of the first World War.

II. *MILITARY OBJECTIVES*

Japan is to be prevented from being a menace to the United States and the other countries of the Pacific area. The attainment of this objective will require such measures of disarmament, of military inspection, of control of Japan's economic activity, and possibly of long-term restrictions on specific categories of Japanese industry as the United Nations may deem indispensable for security purposes.

III. *ECONOMIC AND FINANCIAL OBJECTIVES*

Japan is to be permitted, within the framework of the restrictions necessary for international security, and having due regard to the matter of reparations, to share in the development of a world economy on a non-discriminatory basis, looking toward a progressively higher standard of living.

[6] This report was later revised and expanded on May 4, 1944 into CAC-116b (PWC-108b), which is also included in this volume.

[7] Inter-Divisional Area Committee on the Far East.

IV. *POLITICAL OBJECTIVES*

American interests require that there be in Japan a government which will respect the rights of other states and Japan's international obligations. Such a government should be free from military domination and be under the control of civilian elements which aim to keep the peace. This will require (1) depriving the Army and Navy of their special political privileges, (2) establishing freedom of intellectual communication with democratic countries through press and radio, and (3) adopting other measures which will strengthen the moderate political elements in Japan.

V. *THE ULTIMATE OBJECTIVE*

The ultimate aim of the United States is a friendly Japan restored to full and equal membership in the family of nations, in order to assure peace and security in the Pacific area.

The United States desires the peoples of the world, including Japan, to look forward to a peaceful, cooperative, and prosperous national and international life.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-11 DECENTRALIZATION OF JAPANESE ADMINISTRATION

Report PWC-153[8] May 1, 1944
IDAC-FE
Secret

There are presented for consideration some observations on the suggestion that a program of administrative decentralization should be included in our objectives toward Japan, as follows:

During much of Japanese history Japan was in a state of civil war and turmoil in which rival warlords struggled for supremacy. Japanese centralization during the modern period is attributable primarily to the realization by the Japanese that this was essential in order to enable Japan to survive economically and politically in the modern world.

In considering the question of whether and to what extent we should make efforts to bring about political decentralization in Japan we are faced with a dilemma. It is true that whatever is done in this direction will tend to reduce Japan's effective military capacity, but on the other hand decentralization would militate against the maintenance of organization, which is essential if the Japanese people are to live under the conditions with which they will be faced. At best, they will have a hard row to hoe, deprived of their empire and of their merchant shipping and with many of their factories presumably demolished as a result of military operations or of the execution of terms of surrender. Without such organization and discipline as only a centralized administration can give them their position might well nigh be hopeless.

The objectives sought in the suggestion offered for administrative decentralization are, of course, admirable, but it seems to us that the decentralization of the *functions* of the Japanese Government has been confused with the decentralization of *political power in* the Japanese Government, which all of us agree is an essential. The functions of the Japanese Government are essentially those which are to be found in any well organized state, and there is nothing undesirable per se in their remaining under a centralized authority and not being dispersed in some manner as to make the carrying out of those functions virtually impossible. On the other hand, the fact is that power in Japan has been seized by a relatively small element of the population, a seizure made possible by obvious anachronisms and defects in the Constitution and other organic laws as they now exist.

It is believed that our objectives can be attained most effectively by directing our efforts to laying the foundations for a diffusion of *political power* among the Japanese people. It is believed that the most important steps that could be taken would lie in the direction of the strengthening of prefectural and municipal assemblies and other organs of local government, in the building up of the authority and dignity of the legislative branch of the national government, and, above all, in the awakening of the electorate to a consciousness of their rights and responsibilities so as to make elections expressive of the will of the people rather than exercises in manipulation by bureaucratic or militaristic elements of the population. Our efforts to ensure that the Japanese people shall have a real voice in government should be paralleled with efforts to ensure for them the enjoyment of a fuller share in the

[8] Post-War Programs Committee.

rewards of the economic life of Japan. With the advent of our forces in Japan there will immediately terminate the governmentally derived special privilege of favored Japanese groups and classes—the military group in government and the family trusts in the economic world. These measures in themselves should hold much promise for ridding Japan of the danger of the revival of a concentration of a power in a predatory and self-seeking oligarchy and for a complete emancipation of the Japanese people from their thralldom to a vicious social, economic and political system.

Fundamental reforms in Japan's political structure would have to be accomplished through changes in the Japanese constitution and laws duly adopted by the Japanese. In other words they would be brought about in connection with the establishment, recognition, and subsequent support of a provisional Japanese Government. They would not be carried out by the military government. In fact, an attempt to impose such drastic changes through obvious outside means would defeat its own purpose.

We are concerned here primarily with problems to be dealt with by military government. It is believed that there would be no disagreement with the proposition that a highly centralized system of administration will facilitate the operations of that military government. It seems indisputable that the military government would find it practically impossible to provide a sufficient number of qualified non-Japanese personnel to replace the present personnel of the existing Japanese administrative system. Should there be reconstruction of the administrative system, with setting up of various local jurisdictions, it is not certain that military government would be prepared to delegate to those several jurisdictions the authority to collect taxes and disperse funds for the maintenance of services of various kinds (those services being national, not local, in respect to the needs which they satisfy). In addition to the task of reconstruction of the administrative system, there would have to be dealt with the problems of supplying the requisite personnel for the performance of new functions for which that personnel would have to be trained, perhaps in circumstances where the present Japanese personnel might have been pushed further into opposition by virtue of the very reorganization itself. It would therefore seem very probable that the military government in the end would find that the attendant difficulties and confusion had militated strongly against the obtaining of those benefits which had seemed in theory to be promised by virtue of that definitive and conclusive change in the Japanese administrative system. The results of that reorganization, in short, would probably not justify, in terms of benefits received, the military government's undertaking such a project.

A great potential danger in seeking to decentralize the administrative system in Japan would spring from certain characteristic factors inherent in Japanese bureaucracy—such factors as petty jealousies and intrigue, face-saving and personal prestige and wide-spread tendencies toward venality. Administrative officials tend as a rule to resent whatever they are pleased to interpret as interference with their own functions and thus effective cooperation with other officials is often lacking. These tendencies, can, it is true, not fully be held in check under the directives of a central authority, but it is thought that lacking such central authority the whole administrative system in Japan would function ineffectively and might to a large extent disintegrate. One of our fundamental objectives in post-war Japan will be to establish orderly processes at the earliest possible moment. It would seem to be very short-sighted to deprive ourselves of any assets contributory to the attainment of that objective.

Metropolitan Japan itself is not self-sufficient in the matter of foodstuffs and a large number of primary materials; only 15 percent of the entire area is arable, the remainder being mountainous or unproductive for other reasons. Having regard to the wide differences in the productiveness of various parts of the country and to the fact that some parts of the country are industrially undeveloped, arid, and subject to severe droughts and famines, while others are not only industrially developed but agriculturally highly productive, a centralized administrative system is the most effective, and possibly the only way by which the primary resources of the country can be pooled and distributed. The dividing of the country into local jurisdictions could be expected to persist only so long as outside force could be applied to prevent return to a workable system, and no longer.

Those who have been working for some months on this subject are keenly aware that there are aspects to the present system which must be eliminated before authority is returned to the Japanese to govern themselves. They believe that there would be good likelihood of the reforms which could be devised being accepted and acquiesced in by the Japanese. For example, one of the most important of these reforms is involved in the building up of the authority and dignity of the national legislature—namely, the transfer to

the legislature of the power over national funds. Such control as the legislature now has over the budget is more nominal than real, being limited to new appropriations only. During the period of military government, the fields in which this and other changes would be effective would be wholly within the jurisdiction of the military commander, so that they would have no practical application until government reverted to the Japanese. Nevertheless, it would be practicable to formulate without too great delay changes in the machinery of government, calculated to be permanently acceptable to the Japanese, which would decentralize political power, assure the broadest possible basis for power, provide safeguards against the vicious and predatory oligarchies which have made their own people a pawn for the attainment of their megalomaniac dreams of world conquest, and bring to an end the distribution of economic and other privileges to the few.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-12 FUNCTIONS OF COUNTRY AND AREA COMMITTEES IN THE DEPARTMENT OF STATE

Memorandum May 2, 1944
To: L. Pasvolsky (PWC)
From: P. E. Mosley (TS)

1. Origin:

By direction of the Secretary of State transmitted by Mr. Pasvolsky in June 1943, Country and Area Committees were established within the Department in order to pool the knowledge and integrate the judgment of the officers of the various divisions concerned, at the expert level, with analyzing policy with respect to a given country or area. Some fifteen of these Committees are currently at work, with about five others which meet on call.

2. Membership:

a. The regular membership of each Committee consists of full-time members appointed by the respective geographic office, a member appointed to represent the Office of Economic Affairs, a member appointed to represent the Office of Wartime Economic Affairs, and officers appointed from the Division of Territorial Studies.

b. As special subjects relating to their fields are considered, *ad hoc* members are added from other divisions including the Division of Science, Education and Art, the Division of International Security and Organization, and the various divisions of the Office of Economic Affairs not already represented.

c. The chairman of the Country and Area Committee should be the ranking officer of the geographic office or division participating. The executive secretary of the Country and Area Committee should be a member of TS except in certain cases in which other arrangements are in operation or may be approved.

3. Use of Country and Area Committee memoranda:

Memoranda approved by the Country and Area Committees are distributed to offices and divisions represented on that Committee, for further use by officers of the Department in their operating functions. Certain CAC papers are referred to Inter-Departmental Committees, such as the Working Security Committee, to present the point of view of the Department. Other papers are transmitted by the operating officers to the higher officers of the Department as background for policy decisions. Memoranda prepared in the Country and Area Committees are transmitted to the Committee on Post-war Programs after consultation between the Director of the geographic office concerned and the Executive Secretary of the Committee on Post-war Programs. CAC memoranda are transmitted to the Policy Committee by decision of the Director of the Office concerned.

4. Security:

Since the Country and Area Committees are Inter-Divisional Committees of the Department, formulating policy recommendations at the expert level, knowledge of their existence and operation should be confined as far as possible to the members of the Committees and to the higher officers to whom they are responsible and should not be discussed with persons outside the Department. Similarly the authorized distribution of CAC documents within the Department is effected through the TS or ISO executive secretary of the Committee, in agreement with the chairman. A document prepared or reviewed by a Country and Area Committee may be transmitted outside the Department of State only upon recommendation of the chairman of the respective Country and Area Committee with concurrence of the Director of the Office in which the memorandum was prepared.

5. Regrouping of Country and Area Committees:

In order to bring the organization of the Country and Area Committees closer to the divisional arrangements of the political offices it might be desirable to carry through a regrouping of these Committees. The Committee set-up would then appear as follows:

Office	*Division*	*Area Committees*
Office of European Affairs	Western European	Western Europe (France, Belgium, Iberia)
	British Commonwealth	British Commonwealth
	Northern European	Northern Europe (Netherlands, Scandinavia, Finland)
	Central European	Germany Czechoslovakia
	Eastern European	Eastern Europe (Poland-Russia)
	Southern European	Balkan-Danubian Italy
Office of Near Eastern Affairs	Near Eastern	Near East (Arab Countries, Turkey) Greece
	Middle Eastern	Middle East Burma
	African Affairs	Africa
Office of Far Eastern Affairs		Far East
Office of American Republic Affairs		Latin American Area Committee
		Latin American Subcommittee on Inter-American Security and Organization
		Latin American Subcommittee on Country Problems

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-13 POST-WAR OBJECTIVES OF THE UNITED STATES IN REGARD TO JAPAN

Memorandum (PWC-108b) CAC-116b[9] May 4, 1944
IDAC-FE
Secret

I. FUNDAMENTAL OBJECTIVES

(a) Japan must be prevented from being a menace to the United States and the other countries of the Pacific area.

(b) American interests require that there be in Japan a government which will respect the rights of other states and Japan's international obligations.

In order to achieve these fundamental purposes the policies of the United States should be considered separately for three distinct periods of Japan's post-war development.

The first of these periods will be that during which the immediate terms of surrender for Japan will be enforced, and Japan will undergo the stern discipline of occupation as the inevitable retribution for military aggression.

The second period will be one of close surveillance; restrictions will be progressively relaxed as Japan demonstrates its willingness and ability to live at peace with other nations.

The third period will be one which will look toward the ultimate aim of the United States, namely, *a Japan properly discharging its responsibilities in the family of peaceful nations.*

II. THE FIRST PERIOD

In accordance with the Cairo Declaration Japan is to withdraw from Manchuria, the

[9] CF: CAC-116, an earlier draft contained in this volume.

Mandated Islands and all areas under Japanese military occupation and is to be deprived of Korea, Formosa and all islands obtained since the beginning of the first world war.

Japan's military and naval forces are to be disarmed and disbanded, its military and naval installations destroyed and the country placed under military occupation and government.

III. The Second Period

(a) There will be developed such national or international bases as may be necessary to prevent Japanese aggression and to facilitate military policing.

(b) Measures designed to eradicate militarism would include:

(1) Military inspection to prevent rearmament;

(2) Economic controls to prevent the development of a war potential;

(3) *Encouragement* of *democratic* thought through the press, radio, cinema, and schools;

(4) Impressing upon the moderate elements in Japan their responsibility for convincing the Japanese people that militarism is disastrous to their real interests;

(5) Adoption of such other measures as will most effectively strengthen liberal political elements and liberal thought in Japan and assist the development of a civil government actually responsible to the people;

(6) Rooting out of ultra-nationalistic societies.

(c) Japan is to be permitted, within the framework of the restrictions necessary for international security, and having due regard for the matter of reparations, to begin to share in the world economy on a reasonable basis.

IV. The Third Period

The precise measures, whether political or economic, to be taken during the third period cannot be determined at this time. There is, however, to be borne in mind the fact that the break-up of the Japanese Empire, through the loss of dependencies, will call for permanent adjustments of fundamental importance.

[Source: Dipl. Br., National Archives]

1-14 PROPAGANDA TREATMENT OF THE INSTITUTION OF THE EMPEROR[10]

Minutes of 67th Meeting — July 3, 1944
Dept. of State Policy Committee
Secret

Present:	Mr. Berle (Presiding)	Murray
	Messrs. Long	Savage
	Shaw	Taft
	Rackworth	Yost
	Duggan	Ballantine
	Dunn	Hiss
	Green	Landis
	Grew	
	Hornbeck	
Absent:	The Secretary	Erhardt
	Messrs. Stettinius	Rawkins
	Acheson	McDermott
	Pasvolsky	Ross
	Dickey	Wilson

Mr. Grew summarized document FE-7,[11] pointing out that the Post-War Programs Committee has considered the same problem in connection with our post-war policy but that the OWI has asked for an immediate statement for use in determining its propaganda line. Mr. Hornbeck suggested that, since it is altogether possible that there may be a diminution in the devotion of the Japanese to their Emperor, the phrase, "or that there is likely to be" in the second sentence of the paragraph headed "Basic Factors" should be eliminated. Mr. Grew agreed. Mr. Hornbeck also recommended that the word "unnecessary" be substituted for the word "excessive" in recommendation (c), since he believed that OWI has already overplayed this subject and would do well to restrict its comment in the future. This change was also approved. Finally Mr. Long, while voicing full agreement with the recommendations, expressed dissatisfaction with the second sentence of the first paragraph of the document on the ground that it implied that a propaganda line adopted in war time amounted to a policy commitment. In order to meet this point, Mr. Grew suggested that the phrase "should not be inconsistent with" be replaced by the phrase "should not prejudice". This amendment was adopted and the paper as a whole was approved.

[Source: Dipl. Br., National Archives]

[10] Cf: CAC-217

[11] FE-7, dated June 27, 1944, was prepared by the IDAC-FE and was also designated CAC-217.

1-15 CONSIDERATION OF BOMBING THE IMPERIAL PALACE

Report R & A 2395 — July 28, 1944
Office of Strategic Services
Secret

Summary and Conclusions

1. The bombing of the Imperial Palace in Tokyo is considered disadvantageous to the attainment of United States military and political objectives.

2. The net effect of such an attack will be to increase the will of the Japanese people to carry on the war.

3. The bombing of an important military objective in the heart of Tokyo but not in the immediate vicinity of the Imperial Palace will obtain the chief advantages of bombing the Palace without its disadvantages.

Should The Imperial Palace In Tokyo Be Bombed?

I. Arguments in favor of bombing the Imperial Palace in Tokyo fall into two general categories: those involving the consequences of an attack on the person of the Emperor, and those involving the consequences of an attack on the Imeprial Palace.

A. Arguments for an attack directed toward the person of the Emperor:

1. The possibility of the Emperor's death, or rumors of it, might cause panic among the Japanese people.

2. Elimination of the Emperor from the political scene might be desirable because of his position as center of the Japanese nationalistic tradition, on the assumption that his elimination might shake Japanese faith in the Emperor-concept.

3. The attack would afford satisfaction to Americans demanding revenge for Japanese inauguration of the war and war conduct.

B. Arguments for an attack directed against the Imperial Palace:

1. The attack would demonstrate American ability to launch such a mission, to penetrate Tokyo anti-aircraft defenses, and to perform bombing of great accuracy.

2. Documents of importance for Japanese conduct of the war might be destroyed.

3. An attack on the Palace, which is closely associated with Japanese tradition, might shake Japanese faith as in the case of an attack on the Emperor.

II. In examining the validity of these arguments, the following considerations are pertinent:

A. Arguments against an attack against the person of the Emperor:

1. Because of the Emperor's position as the symbol of Japanese divinity, it is believed that an attack on the Palace, rather than creating panic, would stimulate an offensive spirit among the people and increase effort put into war production, since the attack would tend to outrage the loyalty to the Emperor felt personally by most Japanese and to decrease any existing tendency toward acceptance of defeat. This would reinforce the political position of fanatic leaders preferring a "fight to the death."

2. The desirability of eliminating the present Emperor is questionable; it is possible that he inclines personally toward the more moderate faction and might prove a useful influence later.

3. Even elimination of the present Emperor would not affect the Emperor-concept, which is independent of persons. Several heirs are in existence, who could carry on the tradition unimpaired by the fate of an individual Emperor.

4. The probability of injuring the Emperor and his advisors and staff is small;

even if they are at the Palace at the time of attack, they have access to underground shelters or to other well-protected refuges.

B. Arguments against an attack against the Imperial Palace:

1. It is believed that most documents of vital importance to the Japanese war effort would be kept in the files of government offices outside the Imperial Palace, and therefore would not be affected by this attack.

2. In general, it is believed that damage to the Palace would cause Japanese reactions similar in kind to those caused by injury to the Emperor, even if less intense.

III. A comparison of the advantages accruing from an attack on the Emperor and the Imperial Palace in Tokyo with the disadvantages of such a course indicates that there would be little advantage in this course which could not be obtained by other means, and this advantage would be more than counterbalanced by very serious disadvantages peculiar to this target, both for the present prosecution of the war and for the attainment of future political objectives. Possible alternative targets could be chosen which would have the advantage of demonstrating American ability to penetrate the strongest Japanese air defenses and to bomb a chosen target with great accuracy. The Army and Navy Ministries are obvious targets. Their close physical proximity to the Palace, however, not only increases the danger of hitting it inadvertently, but also invites the interpretation of the mission by Japanese propagandists as an unsuccessful attack on the Palace.

The selection of other important targets within the heart of Tokyo but not too near the Palace, such as the railroad yards or the central railway station in Marunouchi, might have the same advantages as that of targets closer to the Palace. While in any case Japanese propagandists would no doubt represent the mission as an unsuccessful raid on the Palace, eye-witness reports might publicize in certain groups our deliberate avoidance of that objective.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-16 ABDICATION OF HIROHITO

Report CAC-265 Preliminary a — August 2, 1944
Secret

I. THE PROBLEM

Should the United Nations, during the period of military government, attempt to cause the abdication of Hirohito even though recognizing the institution of the emperor and, if so, how might this abdication be brought about?

II. BASIC FACTORS

1. It may be useful first to make it clear that the Rules of Land Warfare of the Hague Convention of 1907 do not grant to a military occupant the right to make any conclusive change in the political structure of the occupied country. "Military occupation... does not transfer the sovereignty to the occupant but simply the authority or power to exercise some of the rights of sovereignty". (Rules of Land Warfare FM/27-10 par. 273.) According to the Japanese constitution sovereignty resides in the Japanese Emperor. The authority of a military occupant does not include the right to transfer the repository of sovereignty from one individual to another. Furthermore, if the emperor escapes from Japan or cannot be found, the authority of a military occupant does not include the right to decide whether such an escape or disappearance is equivalent to abdication, nor, of course, the right to select a successor to the throne. The Japanese will doubtless consider that the emperor continues to reign regardless of where he is until such time as he publicly announces his abdication and will probably make no attempt to implement Article XIX of the Imperial House Law which provides for a regency when the emperor "is prevented by some cause from governing". Under such circumstances, there would be no legal obstacle to the military government requiring that the Japanese invoke Article XIX and establish a regency.

The problem under discussion transcends the compass of purely legal considerations. For example, if the military authorities attempt to force overtly the abdication of Hirohito: a) such a step would be tantamount to giving positive support to the emperor as an institution which should be avoided in view of the previous recommendations made concerning the institution of the emperor (See PWC-116d); and b) the Japanese would refuse to recognize the validity of the emperor's abdication if it were the result of coersion. On the other hand, there enter into the problem political factors of many kinds and the exigencies arising out of Japan's physical condition in defeat which the United Nations might be prepared to ameliorate or relieve to such extent as the Japanese show themselves disposed to conform to the desires of the United Nations. Accordingly, this paper addresses itself to the problem of whether the Japanese can be induced to bring about the abdication of Hirohito through prescribed Japanese processes, if the United Nations desire his abdication.

2. *Japanese Concept of the Emperor Institution and Attitude toward Abdication of Individual Emperors*

The Japanese Emperor Institution corresponds only in a very superficial sense to European monarchial institutions, although the concept of the emperorship may seem to have some resemblance to the doctrine of the divine rights of kings. It is probably not given to any occidental to understand entirely the concept which the Japanese hold of their ruler, but as nearly as it can be discerned the Emperor occupies the essential position that he does in the political and social structure because he is regarded as the only living link between the nation and its mythological progenitors. The fact that this concept has no objective validity and cannot stand the test of reason and scientific rationalism is of little practical significance so long as the Japanese continue to regard the Emperor institution as the key element in their national existence.

This being so, one would suppose that, by reason of their position, individual Japanese Emperors have always exercised great influence and have always been treated with great respect and veneration. Paradoxically, the facts are precisely the contrary. Although military dictators throughout Japan's history have observed the prescribed forms of veneration toward the Emperor and have sought imperial appointment to the position of *Shogun*, the Japanese Emperors who have influenced the course of events can be counted on the fingers of one hand. Deposition or assassination have been the ultimate fate of many of Japan's rulers at the hands of military dictators. These conditions have persisted even to modern times. There is reliable evidence, for example, that the Emperor Komei (great grandfather of Emperor Hirohito) was poisoned in 1866 by the Shogunate for opposing the Shogunate's foreign policies. It is significant that whereas the average reign of the British sovereigns since William the Conqueror (1066) is 20 years plus, that of Japanese Emperors during the same period is only 16 years plus. This fact is rendered particularly significant because, whereas British sovereigns usually were adults when enthroned for long periods in Japanese history the Emperors were minors whose predecessors were living in "retirement" or had been assassinated.

Close scrutiny of the historical pattern of Japanese behavior toward the throne indicates that the individual who occupies the throne and his physical person have counted for little in Japanese eyes. What have counted are the attributes, not only symbolic but functional, within the Japanese political framework of an emperor whose mystical character has been sedulously fostered and nurtured through the centuries; and these attributes, of course, do not vary from one emperor to another. In contrast to the close and informal contacts existing between the British monarch and his peoples of all classes, the Japanese Emperor is visible to the public only on occasions of the most formal character, when he is surrounded by a vast entourage and seen by the masses at a distance. Nor are the constant intimate publicity touches which feature the human side of the British royal family applied to the Japanese imperial family. There is a conscious effort, on the contrary, to cultivate the idea among the people that the emperor moves and has his being in an extradimensional world.

Mention of the Japanese doctrine of responsibility which has recently operated (July 1944) to force the resignation of Premier General Tojo is pertinent here. There is no recognized exception to the rule that a person who fails to discharge his duty must manifest his admission of that failure. In theory, the emperor's responsibilities are assumed by his ministers, but in the unprecedented and disastrous situation which will obtain after Japan's surrender, it would in no sense be surprising if the failure of Hirohito to meet his responsibility (in this case to his ancestors) operated to remove him from the throne.

In view of the considerations which have been outlined it seems likely that the Japanese would be found disposed to bring about the abdication of Hirohito if the United Nations expressed their desire that such action take place. However, if Hirohito should not have abdicated before the occupation of Japan, it would have to be assumed that there were in Japanese eyes circumstances which required his remaining on the throne. Therefore, any public act by the military government designed to cause Hirohito's abdication

might be expected to meet with the determined resistance of the Japanese. And any such attempt by the military governor, if unsuccessful, would have highly undesirable effects. Consequently, it is not possible at this time to foresee the exact devices by which military government could induce the Japanese to take such action. The steps to be taken by military government will depend to a large extent upon the political and other conditions then existing in Japan, and the successful execution of those steps will call for intimate knowledge of these conditions and adroit handling of Japanese political elements.

3. *Desirability of the United Nations for Hirohito's Abdication*

The great weight of opinion among the peoples of the United Nations seems to be that Hirohito, in his constitutional capacity as Emperor, was the source from which the authority flowed for the adoption and pursuit of Japan's aggressive policies; that, regardless of any personal predilection he may have had against these policies, he cannot be absolved from responsibility for signing and promulgating the declaration of war against the United Nations; and that it would be inadmissable, in short, for Hirohito to remain on the throne after Japan's surrender.

While little, of any, argument can be adduced to support the view that Hirohito's continuation on the throne would conduce to the advantage of the United Nations, much can be said to support the contrary view.

It would be a matter of first importance that the end of the past and the beginning of the future be marked by an event which would symbolize in Japanese eyes a transition from one epoch to the other. Nothing, in the Japanese view, would be so conclusive and definitive as a change in emperors. It should be remembered that one of the first acts of a new emperor is to select the title of his reign, and that in Japan each year is universally designated, not in its order after the birth of Christ, but in its order in the reign of the ruling emperor.

Again, the transfer of the throne to Hirohito's successor, who, according to the Imperial House Law, would be his eldest son, who is now a minor, would require the establishment of a regency for the period of his minority. The military government would be in a position to use its influence to bring about the selection of regents disposed to collaborate with the United Nations. The military government would thereby obtain an indigenous political instrumentality of great importance in securing the cooperation of the Japanese people with the military government.

III. Recommendations

1. Military government should not proclaim the abdication of Hirohito or otherwise take any overt act purporting to effect the transfer of the throne from Hirohito to another person. If the emperor escapes from Japan or cannot be found, the occupation authorities should notify the Japanese people that, so long as these conditions obtain, they will consider any action of the emperor without validity and should require the Japanese to invoke Article XIX of the Imperial Household Law and establish a regency.

2. If properly qualified Japanese should take the initiative to effect by recognized Japanese processes the transfer of the throne from Hirohito to another person, the military government should not interfere with such transfer. If a regency should be required, the military government should use its influence to assure the appointment of regents from among those Japanese who may be expected to collaborate with the military government.

3. If the Japanese take no initiative in the matter, the military government should be prepared for a decision from the United Nations that the abdication of Hirohito is desirable. In that event the military government should exert its influence to effect by recognized Japanese processes the abdication of Hirohito, the succession of his eldest son, and the appointment of regents from among those Japanese who may be expected to collaborate with the military government.

4. If, notwithstanding the efforts of the military government, the Japanese should insist on retaining Hirohito on the throne, the military government should make no further effort to bring about his abdication and should refer the matter to the Department of State.

[Source: Dipl. Br., National Archives]

1-17 JAPAN'S EDUCATION SYSTEM UNDER MILITARY GOVERNMENT

Report PWC-287a[12] November 6, 1944
Secret

I. The Problem

What should military government do with the Japanese educational system?

II. Basic Factors

1. *General Observations*

Careful study of the problem leads to the conclusion that there will not be available to military government the large number of competent and qualified American and other foreign personnel which would be required to carry out such fundamental reforms of the Japanese educational system as might seem desirable and to operate it after such reforms have been inaugurated; that modifications in the educational system imposed on the Japanese by military government can do little more than create conditions favorable to a change in the Japanese mental attitude towards religious, political and social problems; and that therefore military government should await the coming forward in sufficient numbers of cooperative Japanese, themselves proponents of liberal ideas, upon whom can be placed the responsibility for carrying to completion those fundamental educational reforms necessary for the elimination of ultra-nationalism and a militaristic spirit. Consequently, this paper makes certain recommendations which aim at removing some of the reactionary and illiberal influences from the Japanese educational system and which, from a practical point of view, the military government will be able to carry out.

The Japanese educational system, which includes nearly 50,000 schools, 400,000 teachers, and almost 16,000,000 students, combines universal compulsory elementary education with an examination system for educational advancement. The effect of this is to reduce drastically the number of students at the secondary level and even more drastically at the higher level.

The system as it now operates and as it is now controlled supports an authoritarian social and political regime. It does not undertake to develop individual initiative and character but aims to create a general high level of educational attainment so that a supply of well trained instruments will be available for national service. While equal educational opportunities are given to the rich and the poor the effect of the system is in the main to produce obedient members of the state.

The selection of students, as they pass from the lowest to the highest level of the system, channels the best brains of the nation into a small leadership group. The graduates of colleges and universities, being the products of a highly selective system, have a distinct advantage in securing favorable positions in both government and private business. In a relatively poor country such as Japan a highly selective system is probably necessary for obtaining the leadership which is requisite to a modern state.

Individual initiative, however, is discouraged by not permitting the student to do original thinking. He is taught not to question the instruction given him by his teachers. His educational development is usually measured by his proficiency in reproducing the statements and problems of his teachers.

Under present circumstances the military clique that rules the nation manipulates education. The inculcation of an extreme nationalism and a glorification of war, combined with the doctrine of the "divine destiny" of Japan, hold the common people under the control of the state for the service of the state. The body of the population is fixed in the status of followers.

Thus the system is somewhat paradoxical. It succeeds in shaping a closely knit, well-integrated nation whose energies can be easily directed by those who exercise the power of the state. However, the social integration of the nation is incomplete, especially in the highest ranks of the educated group where the largest proportion of non-conformists to the prevailing militaristic norm are found. Some of these non-conformists are the repositories of whatever liberal outlook survives in Japan.

[12] This report was first prepared and discussed by the IDAC-FE and later reviewed and revised by the PWC on October 27, 1944.

The present operation of the Japanese educational system is obviously out of harmony with democratic conceptions and ideals. Actually, of course, although it provides for universal education and for education advancement on the basis of proved merit, it is devised more to meet the needs of the state than those of the people. Therefore the many problems which will arise for the occupation authorities can be resolved only as principles are introduced and means adopted which will foster in the mind of the present and future generations of Japanese children and youth the psychological and intellectual basis for a policy of international cooperation by Japan.

2. *Japanese Educational System Centralized*

The Japanese educational system is one of the most centralized, closely knit systems in the world. The ultimate decision of educational policy and administration of schools throughout Japan is concentrated in the Ministry of Education in Tokyo. The Ministry has control over all prefectural and local educational organs, the most important of which is the Division of Educational Affairs of each prefecture.

It is assumed that the military authorities will abolish the purely policy-forming organs of the Ministry of Education (See: *Japan: Suspension of Powers of Government*, PWC-112c). They may find it desirable, however, to continue some or all of the functions of the following bureaus of the Ministry of Education with their administrative machinery: Bureau of General Education (controls the elementary, secondary, normal and middle schools and schools for the blind and deaf); Bureau of Special School Affairs (supervises higher institutions of learning and special schools); Bureau of Technical Education (supervises industrial, commercial and other technical schools); and to continue some or all of the functions of the Division of Educational Affairs in each prefecture. Under close supervisory control they may utilize the non-policy functions of the Bureau of Textbooks and the Bureau of Social Education. The Bureau of Educational Reform should be abolished, the central inspectorate and the "coaching" teachers dismissed.

The supervision of the non-school functions of the Department, such as the control of religions and youth organizations, should be delegated to those Civil Affairs officers in charge of religion and nationalist organizations (See: *Japan: Freedom of Worship*, CAC-117b; and *Japan: Political Parties or Agencies*, CAC-111a).

3. *Textbooks*

Under the present educational system no book may be used in a Japanese school unless it is approved in Tokyo. The Ministry of Education holds exclusive copyright on all indoctrination textbooks. By the careful selection of and control over all textbooks the Ministry of Education with the advice of military officers has a powerful weapon in molding the minds of Japan's students. There was a major revision of elementary texts in 1936 when the militaristic "Showa" morals readers, filled with pictures, stories and illustrations from Japanese history, glorifying Japan's military exploits, were substituted for the more rational "Taisho" morals readers. The "Taisho" readers were written during Japan's peaceful era of the 'twenties and placed little emphasis on the glorification of Japanese military life. The CAA might consider the substitution of these readers for the present militant "Showa" readers.

A study of Japanese textbooks might well be undertaken now by the appropriate authorities in order to determine what material is appropriate and what should be discarded. They might in certain instances, find available in Japan satisfactory new textbooks which could be used or they might encourage the Japanese to provide such material. The inspection of textbooks might commence now or be left to the time when the military occupation of Japan is completed.

4. *Personnel*

It has been previously recommended that the military government retain a considerable number of the Japanese personnel within the Ministry of Education (See *Japan: Suspension of Powers of Government*, CAC-110c) to continue administrative functions. In carrying out this recommendation a distinction should be made between the present administrative personnel and those appointed as inspectors and supervisors of thought and teaching methods. Such inspectors, both in the central administration and on the prefectural and local levels, appointed by the authority now in operation, should be dismissed.

In order to carry out the approved administrative functions of the Department of Education it will be necessary to place civil affairs officers in strategic positions within the Ministry. In order to encourage cooperation it would seem advisable for these officers to make themselves no more obtrusive than would be necessary for the performance of their functions. In addition to the civil affairs education officers in Tokyo, occupation authorities should assign an education officer to each prefectural office, whose duties would be to assist in the enforcement of the education directives from the central authorities. The education program during military occupation will probably function more successfully if these supervisors can be selected from Americans or other established persons who have been teachers and administrators in Japanese schools.

In order to facilitate the carrying out of the functions of the civil affairs education officers and the local Japanese school administrators and teachers it may prove desirable to have carefully selected native-born Japanese educated in mission schools or abroad and Americans of Japanese ancestry (Nisei) employed to assist the civil affairs officers for administration and in carrying out the educational directives.

5. *Schools and Courses*

The great majority of the students, some 12,000,000 are to be found in the elementary schools. Here an undue portion of the student's time is devoted to such indoctrination courses as "morals", Japanese history and group physical training and drill as preparatory to military training. Such basic courses as Japanese language, arithmetic, science, music and penmanship are also taught in the elementary schools.

From the elementary school those students who have met certain scholastic requirements enter the middle schools which provide for a five year course. Here the curriculum is expanded to include the natural sciences and foreign languages. Indoctrination courses become more intensive. Military training is required of all the physically fit boys.

Those students who have finished middle school are admitted to the higher schools after passing the entrance examination. The courses of study in these higher schools include the arts, sciences and the usual indoctrination subjects in "morals", history, etc. Students who desire to study for a profession in a university may take basic courses required for entry into the university. Military training is compulsory for all physically fit men students in the higher schools.

Japanese universities, like those of the West are composed of several colleges, such as Colleges of Medicine, of Law, of Engineering, etc. The course of study is usually three or four years.

Japanese teachers in elementary and middle schools are trained in normal schools established by the prefectures. Each prefecture is required to organize and maintain at least one normal school. An effective and rapid instrument for changing the emphasis in Japanese education from a militaristic to a peaceful philosophy is the normal schools. It would seem advisable for the CAA to place special emphasis on the supervision of these schools.

It would be desirable for appropriate administrative assistants of Japanese ancestry to make periodic visits to the principal cities and towns, when the teachers in the various schools could be brought together for a brief course in reorientation. The program, which should be designed to cover a period of not more than a day for each occasion, should include addresses to disseminate ideas and information on the United Nations and cognate subjects, and motion pictures on appropriate subjects. The service of Japanese liberals who may be prepared to participate in such programs should be utilized. Competent teachers who have been discharged because of their opposition to militarism should be reinstated.

6. *Indoctrination*

The indoctrination courses are designed to reduce personal initiative to a minimum, and the students are trained to conform to directives, and, if necessary, to sacrifice themselves readily for the State. The glorification of Japan's military way of life is drilled into the student's mind through such required courses as "morals", ethics and history and military training. Special lectures, radio programs, motion pictures, and phonograph recordings help to remind the students of their duties as "good" Japanese subjects. This indoctrination program is carried on under the direction of the Bureau of Educational Reform and Social Education and the strict guidance of the military.

Indocrination is also effectively carried on by special convocations, such as those held on national holidays. For example, on the emperor's birthday attendance at school is compulsory and a general assembly is held for several hours in the morning during which the students are subjected to long harangues on the virtues of the sovereign and the superiority of Japan's national characteristics. The emperor's portrait, of which there is one in each school, is the focal point of the program and is treated with awesome respect. Consequently, all such occasions are excellent opportunities for the dissemination of the national cult. To keep the students away from school and a national holiday would be a simple way and an effective way of preventing such indoctrination.

The CAA should bear in mind that modifications of the Japanese educational system during military occupation cannot be far-reaching. It will have neither the time nor the personnel to institute a drastically reformed system of education and to administer it in its completed form. However, the type of initial steps taken to destroy those features which foster militarism in the existing set-up forms the basis for the more permanent re-creation of Japan's education program. The military governments should initiate such steps where possible and give momentum to a program that will break through and break down Japan's "insularity" and teach her students to know and learn to respect the history and accomplishments of other nations and secure if possible a world outlook.

For example, such measures may include nullification of obnoxious laws (See *Japan: Nullification of Obnoxious Laws*, PWC-114), free dissemination of ideas and information from the outside world through the activities of a distributive machinery available in the Bureau of Social Education, and encouragement of the functions of the Bureau of Educational Research in studying foreign systems of education and discussion methods of revising the Japanese system from within.

The fact that the Japanese educational system is so rigidly controlled and so uniform may in some respects make the task of changing it easier. The framework and mechanical channel of control may be used, but the spirit and substance must be to a great extent changed in the course of time.

III. Basic Principles

Measures dealing with the control of the educational system under military occupation should be integrated with the general policy of the United States in building a world in which we can live at peace. In the intellectual field the fundamental proposition is that there should be no areas closed to outside ideas. In applying this policy to the system of education in Japan, the objectives should be (a) to set aside those laws and practices which in recent years have made it a closed ideological area, and (b) to initiate measures or assist indigenous movements which would break down Japan's "insularity", develop personal intellectual initiative, and create conditions under which free intellectual intercourse can develop and expand.

IV. Recommendations

The following recommendations are applicable in the main to all Japanese schools, colleges and universities.

1. To facilitate the maintenance of peace and order, schools should be kept open. Schools closed by Japanese authorities should be reopened. A proclamation should be issued instructing the officials of the Ministry of Education, except the top policymaking officials, to continue their functions and the teachers and students of schools to continue their attendance at school.

2. Where it is practicable administrators and clerical staff in the Ministry of Education and in the Division of Educational Affairs in each prefecture, and teachers in schools, colleges and universities who are willing to cooperate with the occupation authorities should be retained.

3. In conjunction with the abolition of obnoxious laws the Bureau of Educational Reform should be abolished and Japanese inspectors of thought and teaching methods should be dismissed.

4. CAA should use where practicable those Japanese textbooks that are not contrary to the objectives of the United Nations. Textbooks that indoctrinate the student with Japanese militarism and mythology should be revised as rapidly as practicable. As a first step the "Taisho" readers might be substituted for the "Showa" readers.

5. There should be civil affairs education officers placed in strategic positions within the Ministry of Education and the Divisions of Educational Affairs. The civil affairs officers in prefectures should be selected as far as is practicable from United Nations nationals who have had teaching and administrative experience in Japanese schools.

6. Americans of Japanese ancestry (Nisei) might be assigned to civil affairs officers to assist in enforcing the educational directives and to perform such other work as they may designate. At the appropriate time, carefully selected native-born Japanese educated in mission schools or abroad might also be used if they volunteered for such work.

7. Because of the importance of creating a teaching personnel with a new viewpoint, CAA authorities should give special attention to the supervision and curriculum of the normal schools.

8. The curriculum of the schools should be modified to exclude military training and courses, such as "morals" (Shushin) and Japanese history, which indoctrinate the student in the way of Japanese militarism. There should be no effort in the initial stages to revise the curriculum by way of providing instruction with a democratic approach in the suspended or abolished courses and subjects. The phrase "in the initial stages" is defined in the present context as being the period prior to the time when the services of progressive and forward-looking Japanese can be employed to prepare appropriate textbooks and to collaborate in giving instruction in the subjects concerned.

The time available after instruction is given in languages, mathematics, the natural sciences, and in the culture and history of other countries might profitably be employed in vocational training and in home and community activities, and in sports.

9. The CAA should prohibit such special compulsory convocations as those held on national holidays or for purposes of revering the state. On national holidays they should close the schools and the students should be kept away from school. Care should be taken to prohibit as a part of the prescribed school curriculum any ceremony connected with the emperor's portrait.

10. The school, radio, motion picture and recording equipment should be used as much as possible by the civil affairs authorities, and perhaps by Japanese liberals, to break down Japan's "insularity" and teach her students to know the history and accomplishments of other nations and secure if possible a world outlook.

[Source: Dipl. Br., National Archives]

1-18 REVISIONS IN PWC DOCUMENTS

Notes on PWC Meeting No. 66 — November 17, 1944
Secret

Mr. Ballantine reported that the Area Committee had received comments and suggestions on these documents listed in the Agenda of the meeting and prepared revisions of these documents. He added, however, that though the Area Committee had met steadily on the matter it had been unable to prepare a revision to PWC-296a—*Economic Policies During Military Government*—which was acceptable to it, and therefore wished to postpone presentation of a revision of this document until a subsequent meeting of PWC.

Mr. Blakeslee reported that the Committee had given careful consideration to all suggestions made on its documents since the last meeting of PWC and presented for consideration of the Committee revisions of these documents. The changes in these documents have been accepted by the members of PWC originally making suggestions concerning them.

PWC-284a
TERMS OF SURRENDER

Revisions were made on page six and seven to include the statement that this Government should formulate its policy at the earliest possible date and should then take steps to present its views to the United Kingdom and China, and the Soviet Union if it has entered the war against Japan. Minor textual changes were made at the bottom of page ten and in recommendation eight. Recommendation five was revised to conform with the changes on the bottom of page six. This paper was adopted by PWC as presented.

PWC-288b
MEDIA OF INFORMATION

Mr. Blakeslee pointed out to the Committee that a positive statement to the effect that military government should terminate the dissemination of ideas subversive of the purposes of the United Nations had been inserted in the first paragraph under *Basic Factors* and in the introductory paragraph under *Recommendations*. Mr. Haley raised the question as to how it would be possible to maintain freedom of the press and at the same time suppress subversive ideas. Mr. Green hoped that we would be on our guard against thinking that we would be able to do too much in changing and developing the ideas of the Japanese and Germans through the control of education or media of information. Mr. Ballantine then read excerpts from PWC-287a (Japan: The Education System) in which it is stated that modifications in the educational system imposed by military government could do little in changing Japanese mental attitudes. The document was adopted by the Committee.

PWC-289a
JAPAN: TREATMENT OF COURTS

Mr. Blakeslee pointed out to the Committee that the recommendations in this document were in accord with the Rules of Land Warfare and the general custom of military authorities but that the directives on Germany provided that the courts be closed temporarily. The Committee accepted the document as revised.

DIRECTIVES CONCERNING MILITARY GOVERNMENT

The question was raised as to whether these documents or the War Department Field Manual would be followed in case there was an inconsistency between the two. Mr. Blakeslee and Mr. Ballantine pointed out that every attempt had been made to keep the two consistent. Mr. Atcheson noted that these documents had been prepared at the request of the Civil Affairs Division of the War Department and that they would be raw material upon which the War Department would base its directives on military government. When Mr. Pasvolsky asked whether the Department saw these directives before they were sent to the field, Mr. Ballantine answered that the Department had a chance to examine them and see if they were consistent with previous recommendations.

PWC-290a
WORKERS' ORGANIZATIONS

Mr. Blakeslee emphasized that as the workers' organizations contained a potential liberal element the Area Committee recommended that their formation be encouraged by military government. This document was accepted by the Committee.

PWC-293b
THE TAKING OF HOSTAGES

Mr. Hackworth reported to the Committee that the War Department Rules of Land Warfare (FM 27-10) was inconsistent in its statements concerning the execution of hostages. The War Crime Commission in London has already decided that the execution of hostages should be considered as a war crime and hence the War Department is revising FM 27-10 to provide that hostages may not be executed. It was suggested by the Committee that the first sentence on page five be deleted, and that the quotation from the Rules, section 358-d be worded to show that it was inconsistent with the statement of the President. Some members of the Committee asked that the paper recommend that this section be expunged from the Rules. The Committee asked the subcommittee to make revisions in line with the suggestions at the meeting.

POSTWAR JAPAN AND AMERICAN RESPONSIBILITY

Mr. Hornbeck remarked that in considering PWC-284a and similar problems of high policy concerning postwar Japan this Government should constantly keep in mind the danger that the United States may have sole responsibility for controlling Japan after the war and thus will be considered by the Japanese as their main enemy. If such is the case it is possible that our Allies may profit from it at our expense.

FAR EASTERN ADVISORY COMMISSION

Mr. Pasvolsky asked that the Area Committee prepare for later presentation to PWC a paper on the question of the formation of a Far Eastern Advisory Commission. As such a Commission will be necessary sooner or later he thought it advisable to formulate a proposal along those lines now. Mr. Hackworth suggested that the Army and Navy be consulted but Mr. Pasvolsky answered that they should not be called in at this stage. This suggestion was approved by the Committee.

ECONOMIC POLICY

In reference to the revision of the paper on Economic Policy during Military Government, Mr. Pasvolsky stated that it now appears as though the President was anxious to avoid too many details concerning the economic policy for Germany as we did not know what conditions we will find. Mr. Pasvolsky assumed that similar consideration would be applicable to Japan and that those drafting the paper should keep this in mind.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-19 JAPANESE SURRENDER AND POST-SURRENDER RESISTANCE

Report R & A No. 2022.1 November 21, 1944
Office of Strategic Services
Secret

Problem as stated:

1. Assuming surrender of the Japanese in the home islands to American forces, what kind of resistance can be expected from Japanese forces in all presently Japanese-held areas south of a line running east-west through Shanghai?
2. Under the same circumstances, how much resistance should the United Nations forces expect in the same areas from native populations, assuming that for each colonial area the conquest would be made by forces under the leadership of that nation to which the colony belonged before the war?

I. JAPANESE POLICY REGARDING SURRENDER

A. *General*

Japanese forces, whether in Japan or elsewhere in Asia, will continue to resist so long as the High Command or individual commanders believe that resistance will (a) modify favorably toward Japan the peace terms imposed by the United Nations, or (b) promote Japan's long-range plans for hegemony over Eastern Asia and the South Pacific.

Advantages of continued resistance, from the Japanese point of view, would be:

1. To retain a bargaining position for more favorable terms in the final peace settlement, e.g., the preservation of the Japanese Army and Navy, retention of a military or economic foothold in Korea and Manchuria, or securing less harsh terms of industrial and economic disarmament in Japan.
2. To preserve in Japan the spirit of nationalism and militarism.
3. To preserve the prestige of the Japanese soldier in Asia by an example of heroic resistance, rather than by turning over colonial peoples to their former rulers.
4. To create economic and political chaos in Asia which would tend to make it more difficult for the United Nations to establish control in Asia, and thereby improve Japan's opportunity ultimately to regain control of Asia.

B. *Present Strategy*

The present Japanese policy appears to be to continue resistance in the southern regions even after communications with the home islands may be greatly restricted:

1. Using forces about as large as those now in the areas, supplemented by such puppet forces as remain loyal;
2. Using equipment and ammunition on hand, which are possibly sufficient to carry on for a year or more the scale of fighting that has occurred in Burma, but without the possibility of maintaining air strength;
3. Supplementing formal warfare by guerrilla tactics which the Japanese have learned thoroughly in China. This depends somewhat on support and sympathy from native peoples.

This strategy, unless revised, would lead naturally to a decision to continue fighting even after surrender of the Japanese home islands. The decision to revise it will depend upon the circumstances under which surrender of the home islands occurs.

II. CONDITIONS OF SURRENDER IN JAPAN

A. *General Surrender*

This might be the result of agreement by the Japanese Government and High Command that continued resistance would be futile, and that no bargaining advantage could be retained by continued resistance. Some or all of the following circumstances might compel Japanese leaders to consider a general surrender: the defeat of Germany, entrance of the USSR into the Pacific war, the invasion of Kyushu, destruction of most of the Japanese fleet, heavy bombing of Japan. A decision would depend upon conviction by the Japanese leaders that further resistance would lead to rapid and complete defeat, and that the treatment to be accorded Japan after the war would leave better opportunities for regaining the empire if surrender were early rather than late. Such a surrender, if it were concurred in by the major power groups—large industrialists, the High Command, leaders of armies in the field, leaders of secret societies, etc.,—would probably cause cessation of hostilities everywhere, except where local leaders refused to comply. It would be more likely to occur before

rather than after the conquest of Honshu.

B. *Surrender on the Islands Alone*

1. A surrender in Japan might occur before invasion from a reform government that did not have the support of armies in the field. Such a surrender would not be considered by field commanders to be binding upon them, and continued resistance might be expected everywhere, probably under direction of a military junta in Manchuria, Korea, and North China.

2. Surrender in Japan might be the result of invasion of Kyushu and Honshu and the crushing of bitter military resistance. Such a forced surrender, despite capitulation in the name of the Emperor, would leave the Military Command free to decide upon further resistance elsewhere, for which it would have considerable resources and manpower, particularly in Manchuria and North China.

It appears probable that under either of these conditions the decision would be made to continue resistance, for reasons I A: 1-4. These would not be outweighed by advantages of preserving officer cadres, of softer treatment of the population at home, or the belief that the United Nations would be conciliatory if resistance ceased. Resistance would continue south of Shanghai even if the armies in the north were rapidly defeated.

III. Degree of Resistance South of Shanghai

Japanese forces in this region, now numbering over a milion, are believed to have ample stocks of war materiel (except aircraft) and ample supplies of food, to continue a determined resistance until crushed by overwhelming United Nations power; or to continue guerrilla resistance for a year or more. There is no reason to believe that troops would refuse to obey their commanders.

IV. Resistance of Native Populations to United Nations Forces

After surrender of the Japanese homeland it is unlikely that native peoples would present much opposition to United Nations forces, except in Burma. The extent of resistance in former colonial areas would depend upon the concessions which Great Britain, the Netherlands, and France, respectively, might be willing to announce concerning the future status of their colonies, but only in regard to Burma is this decisive. In Thailand and China the United Nations forces may expect assistance from the native population and groups, if in the case of Thailand its independence is guaranteed and Chinese troops are not employed, and in the case of China the British do not attempt to retake Hongkong. Even the latter move would not cause general lack of cooperation with American forces on the mainland.

[Source: Dipl. Br., National Archives]

1-20 A SUMMARY OF THE RECOMMENDATIONS FOR JAPAN

Report CAC-342 Preliminary — January 5, 1945
Secret

A. A Summary of The Recommendations for Japan Approved by the Committee on Post-War Programs

I. *The Post-War Objectives of the United States in Regard to Japan*

"(a) Japan must be prevented from being a menace to the United States and the other countries of the Pacific area.

(b) American interests require that there be in Japan a government which will respect the rights of other states and Japan's international obligations.

In order to achieve these fundamental purposes the policies of the United States should be considered separately for three distinct periods of Japan's post-war development.

The first of these periods will be that during which the immediate terms of surrender for Japan will be enforced, and Japan will undergo the stern discipline of occupation as the inevitable retribution for military aggression.

The second period will be one of close surveillance; restrictions will be progressively relaxed as Japan demonstrates its willingness and ability to live at peace with other nations.

The third period will be one which will look toward the ultimate aim of the United States, namely, a Japan properly discharging its responsibilities in the family of peaceful nations." (PWC-108b)

II. *Unconditional Surrender*

"The Emperor should proclaim that Japan has surrendered unconditionally to the United Nations at war with Japan and should command the armed forces and people of Japan to offer no opposition to any measure which the Allies may adopt. At the same time, a document acknowledging Japan's unconditional surrender and stating that the armed forces and people of Japan have been ordered to offer no opposition to the Allies should receive the Emperor's official signature and privy seal, should be countersigned by the highest available representatives of the Japanese High Command, and should be delivered to the Allied Theatre Commander. This document will constitute the instrument of unconditional surrender of Japan.

Upon Japan's unconditional surrender the Allied Theater Commander for Japan, being duly authorized should deliver to Japan the documents.....which would state (a) the initial military and other measures with which Japan must comply in consequence of unconditional surrender, and (b) the general policy of the United Nations in regard to the treatment of Japan." (PWC-284a)

III. *Military Government*

1. *Composition of Forces to Occupy Japan*

"With the completion of military operations and after the unconditional surrender of Japan, there should be, so far as practicable, allied representation by those countries which have actively participated in the war against Japan in the army of occupation and in military government. It is assumed that such representation will not be so large as to prejudice the dominantly American character of Civil Affairs Administration." (PWC-111)

2. *Authority of the Military Government*

Military Government "will exercise supreme legislative, judicial, and executive authority and power..." (PWC-284a)

3. *Extent of Occupation by Military Forces*

The Army and Navy should be advised:

To have adequate forces available to occupy all important places as soon as possible after the capitulation of Japan. Later, and until such time as a reasonable stable civil government has been established by the Japanese, to concentrate these forces in those centers from which they will be in a position to suppress any undesirable movements which may arise. Finally, to continue the presence of such forces as may be required to support such an Allied supervisory body as may be established for the supervision of Japanese internal affairs. (PWC-110a)

4. *General Character of the Military Government*

"The character of the military government, the degree of severity which may be found necessary or, on the other hand, the extent of assistance may be given, will depend in large measure on the conduct and attitude of the Japanese, their willingness to carry out the terms of surrender and of the treaty of peace, and their cooperation with the military authorities and with the governments of the United Nations.

The military government will naturally take such action as may be found necessary to safeguard the security of the occupying forces. Otherwise, its measures should not aim to be punitive in character or needlessly humiliating to the Japanese people." (PWC-109)

5. *The Political Objectives of Military Government*

The general political objectives of military government in Japan should be the abolition of militarism and the strengthening of democratic tendencies and processes in Japan. Measures to obtain these objectives would include:

(1) Destruction of the military machine;
(2) The prevention of the revival of militarism by
  (a) Nullification of obnoxious laws; (PWC-114)
  (b) Elimination of ultra-nationalistic influences;
  (c) Creation of internal economic conditions favorable to the growth of democracy;
  (d) Encouragement of liberal forces. (PWC-152b)

6. *Special Features and Problems of Military Government*

(1) *Treatment of the Emperor*

"It is recommended that the military authorities adapt as flexible a course as possible which can be altered to meet any situation that may arise. If, considering all circumstances, the military authorities should decide initially to permit the emperor to exercise certain limited functions it is suggested that consideration be given to proceeding as follows: ...the emperor and his immediate family should be placed under protective

custody,...The emperor should be kept in seclusion, but his personal advisers should be allowed to have access to him under reasonable conditions and he should be accorded courtesy normally extended in like circumstances, to a head of state.".....“ the military governor would permit only those functions of the emperor to be exercised which relate to the delegation of administrative duties to subordinate officials. This procedure should facilitate the use of Japanese officials by the civil affairs administration, as such officials would continue in office by order of the emperor but would be, in reality, under the military government.” (PWC-116d); see also PWC-285, PWC-286a.

(2) *Utilization of Existing Officials and Institutions*

"The policy-making agencies which constitute the very core of the modern Japanese Government should be utterly discarded by the military government". (PWC-112c)

It will be important "to keep in office the maximum number of Japanese officials who would be willing to serve directly under the supervision of civil affairs officers, "including Japanese teachers, civil service appointees, police, and workers in the post-office and the public utilities. (PWC-116d, 287a, 289a)

(3) *Political Parties or Agencies*

"Existing political parties, which now consist of the Imperial Rule Assistance Association (and its affiliates) and the Imperial Rule Assistance Political Society, should be dissolved." (PWC-113)

(4) *Freedom of Worship*

"Freedom of religious worship should be proclaimed promptly on occupation." (PWC-115)

(5) *Media of Public Information*

"The military government will aim to terminate the dissemination of ideas subversive of the purposes of the United Nations, such as Japanese ultra-nationalism and the glorification of militarism. It should rescind laws, ordinances and regulations which restrict unduly freedom of expression, and should utilize the press, radio and motion picture to convey essential information and knowledge of the ideals and concepts in which the United Nations believe." (PWC-288b)

(6) *The Educational System*

"To facilitate the maintenance of peace and order, schools should be kept open. Schools closed by Japanese authorities should be reopened. A proclamation should be issued instructing the officials of the Ministry of Education, except the top policy-making officials, to continue their functions and the teachers and students of schools to continue their attendance at school."

Objectionable text books should be revised or discontinued and courses "which indoctrinate the student in the way of Japanese militarism" should be dropped. (PWC-287a)

(7) *The Courts*

"The military government is to supervise the functioning of the courts in Japan. It should announce with the proclamation of occupation that the existing courts, other than the court of administrative litigation, will continue to function with their existing officials except as such functioning is inconsistent with the jurisdiction of military tribunals or is modified by subsequent proclamation." (PWC-289a)

(8) *Worker's Organizations*

"To aid in the maintenance of law and order and to stimulate any production desired by the military government, its policy towards workers' organizations should aim to reduce to a minimum resistance by labor to foster, wherever possible, a cooperative attitude on the part of the workers."

"Employees should be permitted to form, join or assist labor organizations"; and should enjoy associated rights and privileges usually accorded to employees in western countries. (PWC-290a)

(9) *Political Prisoners*

"All cases of persons held in custody, or restrained or restricted under any Japanese law, administrative order or otherwise, shall be subject to review in accordance with principles and procedures laid down by military government, in order that those unjustly or illegally held may be released and relieved of any legal disability arising from the detention." (PWC-291)

(10) *War Criminals*

"It is believed that the provisions for imposition upon Japan at the time of

surrender should include an obligation on the part on the Japanese Government and Japanese military command to apprehend and surrender to the United Nations such persons alleged to have committed war crimes as are designated by the United Nations." (PWC-119)

(11) *Hostages*

The occupation authorities should not take Japanese civilians as hostages unless "other means have been exhausted and there are good grounds for thinking such measures will actually have deterrent effect."

"Hostages should not be punished or be executed unless they themselves have committed offenses justifying such punishment or execution." (PWC-293c)

(12) *Status of Certain Categories of Japanese Property*

The following property in Japanese territory occupied by United States forces "should be assigned the status of public property as the term is used in the Hague Convention, and treated variously according to character and utility, as set forth in that convention": property belonging to the Imperial Family, the Imperial Rule Assistance Association and the similar organizations. (PWC-292)

(13) *Non-Japanese Private Residents in Japan*

"In the absence of emergency conditions...and of other compelling security considerations, the military government should not generally intern or impose other special restrictions on any national or racial class of non-Japanese residents of Japan." (PWC-292)

(14) *Foreign Relations of Japan*

All Japanese diplomatic and consular agents abroad should be recalled. (PWC-118) The principal United Nations at war with Japan should notify all states in which Japanese consulates or missions are located, and the powers protecting Japanese consulates or missions, that such principal United Nations will temporarily control the foreign relations of Japan. (PWC-298)

(15) *Duration of Military Government*

"Military government should continue until order has been re-established, until those terms of surrender requiring immediate execution have been carried out, and until there has been established a Japanese Government capable of discharging civil governmental functions and which will be politically acceptable to the United Nations." (PWC-117b)

B. Other Recommendations in Regard to the Far East Approved by the Committee on Post-War Programs

Recommendations in regard to military government in Formosa, Korea, the Japanese Mandated Islands, and Manchuria have been approved by the Committee on Post-War Programs and by the Department.

These recommendations are all in harmony with the recommendations for Japan and with the Cairo Declaration.

Recommendations in regard to the treatment of archives and in regard to the legal and political status during military government of 22 areas in the Far East involve no important problems of policy.

[Source: Dipl. Br., National Archives]

1-21 COMMENTS ON STATE DEPARTMENT RECOMMENDATIONS FOR MILITARY GOVERNMENT

Memorandum January 19, 1945
To: Colonel David Marcus, Civil Affairs Division
From: Herbert Feis, Special Consultant to the Secretary of War

I have the following impressions and comments in regard to this group of State Department recommendations on various points having to do with the treatment and organization of military government in Japan.

In general, they seem to me slightly saturated with a Sunday School flavor—somewhat out of keeping with the nature of the enemy, his past behavior, and anticipatable future behavior. Regard for the forms of action is too preponderant as compared with the conception of control. It would be impossible without an extensive glossary on the whole text to bear out my impressions. I won't attempt to do that but only to comment on a few selected points.

1. I doubt both the military usefulness and wisdom of the public affirmation sug-

gested in Recommendation 10 of Document No. 275.[13] This suggests that we announce that the measures taken consequent upon surrender of Japan will not be enforced "in a vindictive spirit." Any such statement is capable of being construed a hundred ways and could be used as the basis of objection to any steps taken to control or limit Japanese economic activities within Japan or abroad. The correlated thought that we should affirm that the restrictions will be relaxed certainly ought to be qualified as regards matters in the armament sphere.

2. It is recommended in Document No. 116d and 286a that the Emperor will continue to exercise those functions which relate to the "delegation of administrative duties to subordinate officials."

Unless this proves essential in the exercise of military government, I should think it would be far more satisfactory from all points of view not to continue the Emperor's exercise of authority in this field. It would be calculated to continue the sense of ultimate loyalty to the Emperor on the part of officials appointed. It would leave the whole spirit of Emperor worship unimpaired. While I am not suggesting that we should undertake to destroy the institution of the Emperor, or even directly proceed to bring about constitutional reform, I certainly think we should not take any steps that make it easier for the present system to continue into the future fundamentally unchanged. Fifty years of aggression should be sufficient proof of its inevitable tendencies.

3. At various points it is suggested that the military government should be joint, representative of various other governments besides that of the United States.

This is advisable. However, in the actual plan that is drawn up, I think it should be made clear that directing responsibility would be in our hands, rather than equally shared. This view is, however, subject to the further development of the military and diplomatic situation.

4. In 288b it is suggested that "the military government should, if possible, allow newspaper publishers to continue operations under appropriate censorship and supervision..."

I don't know whether this means that all the present proprietors of Japanese newspapers, including those that have proven themselves violently cruel and nationalistic, should be permitted to retain control of their journals. Both as an act of punishment and as an act of wisdom, I believe that attention ought to be directed to the possibility of arranging for a transfer of ownership—even if this means the temporary suspension of publication of certain newspapers.

The same observations arise in regard to the recommendations having to do with radio.

5. In 289a it is recommended that the courts are to continue to function with their existing officials.

I suggest this ought to be qualified with an instruction to investigate the record of the officials and to remove those that have proven themselves unqualified for any judicial post by virtue of the part they played in events before the war.

I furthermore find myself out of sympathy with the recommendation that military governments should not attempt to institute any reforms in this field except by eliminating gross abuses contrary to Japanese law itself.

6. In 291 it is contemplated that the military government would release "all persons awaiting trial or under sentence under charges arising out of laws which are deemed to be *unduly* restrictive of freedom of political or religious belief."

I suggest that the word "unduly" is unnecessarily restrictive and should not be given effect.

7. In regard to 293c (which refers back to PWC 116d in discussing the Emperor and members of the Imperial family) I do not disagree with the recommendations regarding "taking of hostages." But I am impelled to take note of the concern for the welfare of the Emperor and his family; the opinion that this will have a sobering affect on the Japanese people and deter them from committing acts of disobedience leaves me with a sense of doubt.

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

[13] The numbered documents alluded to in this memorandum are PWC documents which were drafted within the State Department and sent on to the War Department for review and comments on January 4, 1945.

1-22 IMPORTANT POINTS AT INSTITUTE OF PACIFIC RELATIONS CONFERENCE ON MILITARY GOVERNMENT ACTIVITIES

Memorandum January 21, 1945
To: Director, Civil Affairs Division, War Department
From: Office, Chief of Naval Operations, Navy Department

(The following points are listed merely as topical briefs. Detailed reports may be written on any topic, if desired.)

1. *Japan.*

(a) *Governmental changes.* There was a wide split between the "stability or conservative" view and the "reform or liberal" view: the former maintaining that dealing with the status quo in Japan is essential, and the latter upholding the argument that fundamental changes in government must be instituted as early as possible. (The short-term objectives of military government automatically favor the "stability" approach.)

(b) *Zaibatsu.* There was an articulate minority of business men who maintained that under any circumstances we must work with the "zaibatsu", the big business men of Japan.

(c) *Objective of occupation.* General agreement was reached on the ultimate desirability of a democratic Japan worthy of membership in the comity of nations.

(d) *Composition of occupying forces.* Consensus was that occupation should be representative of all Pacific nations engaged in the war against Japan. The possibility of racial conflict was noted if there were no Asiatics among the occupying troops.

(e) *Techniques.* Two specific devices to initiate a more democratic form of government were (1) to put the power of the purse in the hands of the Diet and (2) to limit drastically the power and autonomy of the Army and Navy. The Japanese judiciary were conceded to be fairly trustworthy. The freeing of the press and radio was stressed as a means of disseminating news without the monopolistic censorship which now controls Japan. Chinese, British and Indians all felt there would be great danger in any attempt to reorient the educational system, except for a negative policy of censoring texts. The old "unequal treaties" were suggested as a means of stimulating Japan to improve herself.

(f) *Length of occupation.* The possibility was discussed of a long period of occupation of Japan before Korea and Manchuria are taken. Difficulties with morale of troops and with public opinion at home were stressed in the event of a long occupation. There was no serious attention paid to the "remote control" school, that is, control by blockade with a minimum of troops ashore.

(g) *Preparations.* The U. S. and U. K. stated that preparations were being made for the occupation, and China admitted that "some" were underway. Mr. Shao Yu-ling, 1st Secretary of Chiang Ka-shek's personal secretariat, showed great interest in the collaboration of Chinese with Americans in the training of officers, particularly for Formosa, as well as for Japan, the China Coast, Korea, and Manchuria.

2. *USSR.* As the USSR was conspicuous by its absence from the conference, there was little open discussion of possible Russian activities, but a general undercurrent of suspicion and distrust. Consensus seemed to be in the direction of the "critical stage" theory: that the USSR, at the right time, would move against Japan in order to be in on the Pacific settlement. This implied perhaps use in Korea of the reputed 40,000 army of Koreans in the maritime provinces, possible entrance into Manchuria, North China, and probably annexation of the Kurile Islands and Sakhalin.

3. *Korea.* Koreans interpreted the "in due course" of the independence promise to mean six months.

4. *China.* On the Communist-Kuomingtang split, official attitudes at the conference reflected a tendency to regard this as a domestic problem, and, with the parallel of Spain in mind, it was felt that there should be no external interference in this problem although complete information should be available as to the course of events.

Unofficially it was the opinion of a recently returned correspondent that an American force landing in China north of the Yangtze River would find much better military organization (Communist) here than south of the river (Koumingtang).

There was considerable discussion of the significance of the subversion of captured Japanese military personnel by one Okano, a communist organizer in Red China.

5. *Islands in the Straits of Tsushima.* The question was raised as to whether there would

be a separate administration of Quelpart and Tsushima Islands in the Tsushima Strait between Korea and Japan, and possibly a settlement different from that for the rest of Japan.

6. *Training for occupation.* One round table adopted the report of a subcommittee proposing the establishment of civil affairs training centers in various countries for civilian personnel to relieve the military in the longterm occupation of Japan.

7. *Mandates.* It was a consensus of the conference that there would be no objection to the annexation of the Mandates by the U. S. provided the transfer of sovereignty was done by agreement with the United Nations or the League of Nations, especially Australia and New Zealand, and not by unilateral action.

8. *International Bill of Rights.* A document listing proposed rights of individuals and corresponding duties to supplement the Atlantic Charter and the Cairo and Teheran agreements, is being prepared for publication soon by a private group of international lawyers.

9. *U. S. Economic Policy.* Throughout the conference there was wide-spread suspicion of U. S. economic policy as it is being revealed, in contrast to U. S. political statements. Particular criticism was voiced against the U. S. position at the recent Chicago air conference.

10. *Dumbarton Oaks.* The conference accepted the Dumbarton Oaks plan in principle, but there was skepticism about its implementation and efficacy. Generally speaking, all felt that the nations of the world would build up individual defenses and agreements "just in case" the world security plan did not prove workable.

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

1-23 POSTWAR TREATMENT OF JAPAN

Minutes, 187th Meeting — February 8, 1945
IDAC-FE
Secret

I. CONSIDERATION OF JAPANESE TERRITORIAL PROBLEMS–JAPANESE KARAFUTO (CAC-306c PRELIMINARY)

The question was raised as to the advisability of inserting the argumentation in the first paragraph on page 3 concerning the possible unilateral action by the Soviet Union in the abrogation of the Portsmouth Treaty. After considerable discussion the Committee voted to delete the paragraph.

The Committee voted to insert in the fourth paragraph on page 2 the following: "This declaration, however, is one of policy and not of law and the Soviet Union was not a party to it".

The Committee approved revision of the first sentence in paragraph 2 on page 3 to read in substance as follows: "In reference to the advisability of designating Southern Saghalien as a trust area to be placed under the authority of the proposed international organization with the Soviet Union as administrator, the following considerations should be taken into account:"

It was also voted that the following be inserted in Item 1 in the next sentence, so that it would read as follows: "It would be consistent with the principles in the Atlantic Charter of no aggrandizement, territorial or otherwise."

The Committee approved the paper with the suggested revisions and did not wish to see it again.

II. POSTWAR TREATMENT OF JAPAN

Mr. Dickover reported that at a recent luncheon Mr. Donald Nelson had stated that Japan should be deprived of its business opportunities and that its entire textile industry should be transferred to China. Mr. Dickover added that it was his thought that Japan should be allowed to continue its textile industry as a means of acquiring necessary foreign capital for the continuance of its economy.

Mr. Ballantine stated that the point of view presented by Mr. Nelson was one which would doubtless be held by many influential persons and that consequently it was an argument which the Committee would have to face in its considerations, but that there was no reason why the Committee should necessarily follow this suggestion.

Mr. Dickover also referred to the pattern which is developing in Europe of establishing regencies in countries where monarchies existed before the war. He noted that the situation in Japan was not analogous but that it might be helpful if the Committee had a paper discussing the advisability of a regency in Japan. He suggested that perhaps Mr. Fearey, especially in view of his familiarity with the discussions on this subject at the Institute of Pacific Relations Conference, might prepare such a paper.

III. CONSIDERATION OF ECONOMIC POLICIES TOWARD JAPAN SUMMARY STATEMENT-JANUARY 6. 1945

Mr. Ballantine raised the question as to whether the reorganization of ECA affected the consideration of this paper by the Area Committee at the present time and whether both of the new economic offices were represented.

Mr. Lockhart stated that Mr. Buchanan represented Mr. Haley's office; that the paper had been forwarded by Mr. Mason; and hence was in order for the Area Committee to consider.

Mr. Ballantine then suggested that the Committee consider the paper not as an answer to any specific questions from the Civil Affairs Division of the War Department or other agencies, but to consider it as a summary of basic policy under the terms of which specific papers could be drafted when needed.

In commenting on the paper Mr. Williams noted that the paper contained most of the recommendations and arguments in earlier Committee meetings and treated in general the subjects contained in CAC-160 and CAC-222. He raised the question, however, as to the recommendation concerning the treatment of private property as mentioned on page 8.

Mr. Fearey noted that the discussion concerning the Zaibatsu on page 6 only touched on the problem. While he agreed with the need for some form of control of the Zaibatsu, he questioned the advisability of including in such a paper reference to such control unless it were discussed more fully.

In commenting on the question of the confiscation of private property as stated on page 8, Mr. Wright felt that some qualification should be made. Such qualification might be in terms of whether or not such property contributed to Japan's imperialistic designs.

Mr. Lockhart replied that the proposed action was intended to prevent Japan from again obtaining an economic hold in Far Eastern areas.

Mr. Fearey brought to the attention of the Committee the fact that the IPR Conference had given general approval to the concept of the confiscation of private property.

Mr. Wright added that if governments were given the right to appropriate alien property such action would jeopardize the whole system of overseas investments.

Mr. Williams added that he believed if small private holdings were confiscated in Korea, such action would be counter to international law.

Mr. Lockhart answered that this was not necessarily meant to be implied by the paper.

Mr. Wright noted further that such a recommendation was not unlike the provision in the Versailles Treaty that property in the hands of the Alien Property Custodian could be confiscated but that the owner should be compensated by the German Government. However, he stated international lawyers had condemned this Article as it was tantamount to outright confiscation in view of the fact that the German Government was unable to repay the property owners.

Mr. Blakeslee noted that the issue of reparations was one on which the Committee was not in complete agreement and suggested that the Committee consider other parts of the paper.

Mr. Borton noted that the statement in the second sentence of paragraph 2 on page 2 concerning allied landings might not necessarily be true. He also noted that the dismantlement of the Japanese Empire would not take place until a considerable period of time after surrender and hence the statement was not pertinent to the argument.

Mr. Buchanan suggested that the paper might more profitably be made more definite and specific but realized the difficulties of obtaining agreement on specific recommendations at the present time.

Mr. Blaisdell brought to the attention of the Committee the fact that the general programs concerning the control of industry, reparations and restitution are similar to the policy suggestions for Germany which have been criticized as too lenient by certain elements in the Government. He also noted that a close relationship had been drawn up between long-term controls and an international organization but believed that a policy should be recommended which could be carried out regardless of whether or not such an organization were established.

In answer to Mr. Blaisdell's first point, Mr. Buchanan felt that the paper did not advocate a soft policy, particularly as concerned private property and control of industry.

Mr. Lockhart noted that if this policy were considered soft, then a hard policy would

mean one which threatened the very existence of the Japanese people. He further commented that in drafting the paper he had been faced with two choices; either that a general paper on economic policy be drafted, or a series of papers on special topics be prepared. He had chosen the former alternative and hoped the present paper offered a basis for drafting papers on specific topics.

Mr. Wright continued the discussion on the question of a hard or soft peace by stating that he assumed it was our policy to prevent the Axes from ever becoming great powers again. He believed, however, that it would be to the detriment of permanent peace in the world if a policy were adopted which provided for the starvation of Germany and Japan for any length of time.

Mr. Dooman argued that the question of a soft or hard peace was irrelevant and that the first task was to determine our final objective and when that is decided the policy to be adopted should be one to achieve that goal.

Mr. Blaisdell added that the difficulty arose not necessarily in a divergence of views as to the long-range objective, but in the method to be applied to achieve this objective.

Mr. Blakeslee felt that the Committee had not perhaps defined with sufficient clarity its ultimate objectives with reference to Japan. It was suggested therefore that Mr. Lockhart review the paper on Postwar Objectives (PWC-108) with a view to determining whether this summary of objectives needs clarification in terms of the application of economic policy towards these objectives. The Chairman further asked members of the Committee to try to visualize how the principles stated in PWC-108 would be applicable to the concrete economic problems that might arise in the future.

Mr. Blaisdell again raised the question as to whether or not those advocating a harsh policy would agree with the second paragraph on page 5.

Mr. Lockhart answered by saying that the "control over the war potential and the trade and economy of Japan" would have far-reaching consequences.

Mr. Dooman suggested that the Committee has consistently avoided taking a definite position as to whether or not it would favor economic controls beyond those necessary for the control of Japan's war potential. He added further that some of the advocates of the complete restriction of Japanese trade favored such a policy because of their desire to eliminate Japan as a competitor.

Mr. Buchanan suggested that we should give more consideration to the Chinese point of view on postwar Japan.

Mr. Blakeslee suggested that Mr. Lockhart might consider the criticisms of the Committee members and that a further discussion might be held on the paper in the future.

Mr. Lockhart requested that if Committee members with criticisms could reduce their suggestions to writing it would facilitate revision of the paper.

The Committee adjourned to meet tentatively on Tuesday, February 13th.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-24 TREATMENT OF THE EMPEROR

Minutes, 40th Meeting — March 8, 1945
Secretary of State Staff Committee
Top Secret

Present: Acting Secretary Grew (presiding)
Messrs. Acheson
Dunn
General Holmes
Messrs. Mason (for Mr. Clayton)
Dickey (forMr. MacLeish)
Hiss (for Mr. Pasvolsky)
McGurk (for Mr. Rockefeller)

Bohlen

Brown
Rothwell
Yost

Absent: The Secretary
Messrs. Clayton
Hackworth
MacLeish
Pasvolsky
Rockefeller

URGENT BUSINESS

Japan-Treatment of the Emperor

THE ACTING SECRETARY reported that at a dinner at the Navy Department on March 7, he had discussed with Mr. Biddle the public criticism of his views with regard to the treatment of the Japanese Emperor. He had also talked with Admiral Nimitz, and Admiral King, who feel as he does that after the defeat of Japan in the homeland the Emperor might be the only person who could order the independent Japanese armies on the mainland, especially the Kwantung Army, to lay down their arms. MR. GREW asked whether an appropriate way could be found for clarifying public thinking on this question.

It was suggested that an excellent opportunity would be afforded by the Department's broadcast of March 24, in which Mr. Grew and Mr. Dunn are to discuss the treatment of enemy countries. The preparation of material for this broadcast is now under way. THE ACTING SECRETARY felt that all he should do in this broadcast would be to point out that we should "hold our horses" until we get to Tokyo and then see whether the Emperor is an asset or a liability. He could emphasize that it is not because of the Emperor that the Japanese are militaristic. They were in fact very militaristic during the entire Shogunate period. THE ACTING SECRETARY felt it would be very helpful if it could be brought out that Admiral King and Admiral Nimitz shared this view and said that he would ask Admiral King and Admiral Nimitz whether they would be willing to associate themselves publicly with it.

THE ACTING SECRETARY asked Mr. Dickey to arrange to have included in the draft script of the March 24 broadcast a brief exposition of our policy towards the Emperor, and a reference to the fact that this policy is approved by high officers of the Navy. THE ACTING SECRETARY said that he would use this material in his conversation with Admiral King.

. . . . . .

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-25 COMMENT ON STATE DEPARTMENT DRAFT ON POST-SURRENDER POLICY TOWARD JAPAN

Minutes, 17th Meeting — April 14, 1945
SFE[14]
Top Secret

I. MINUTES OF MEETING.

Minutes of the 16th Meeting approved as amended.

II. STATE DEPARTMENT DRAFT ON POST-SURRENDER POLICY TOWARD JAPAN.

General STRONG asked Lt. Colonel FAHEY to inform THE COMMITTEE of General Hilldring's views on the draft on which THE COMMITTEE deferred examination at the last meeting. Lt. Colonel FAHEY replied that, if acceptable, he preferred to have General Hilldring make his own observations to THE COMMITTEE at a meeting on Monday afternoon.

General STRONG remarked that it was apparent that the "Economic" section of the draft had been prepared by persons other than those who had prepared the first or "Political" section. He stated that the section under question was an utterly impracticable academic approach and cited particularly that part of the draft referring to trade unions, declaring that it showed an utter lack of knowledge of the Japanese government and of Japanese psychology.

In view of General Hilldring's request to personally register his objections to the draft, THE COMMITTEE deferred further consideration until the next meeting.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

[14] State-War-Navy Coordinating Subcommittee for the Far East.

1-26 CONSIDERATION OF STATE DEPARTMENT DRAFT ON POST-SURRENDER POLICY TOWARD JAPAN

Minutes, 18th Meeting — April 16, 1945
SFE
Top Secret

I. Minutes of Meeting

Minutes of the 17th meeting approved as amended.

II. Consideration of State Department Draft on Post-Surrender Policy Toward Japan

In opening discussion of the paper, General STRONG reviewed his objections to the paper and then asked General HILLDRING to present his views.

General HILLDRING said he believed we were making the same mistake as was made regarding planning for Germany in connection with JCS 1067. He said the defect in that paper was that it was not built upon a decision of policy approved by the President. On March 23, he said, the President finally approved a document containing his views as to what he wanted done with Germany. The need for a similar document relating to Japan was imperative, General HILLDRING continued, adding that only upon such a document could one proceed in an orderly way to write a detailed directive to the man in the field. He asked for a short document which would give the basic policy.

Admiral TRAIN said that a copy of the President's memorandum should be on file with the committee.

Mr. DOOMAN asked Mr. MARTIN and Mr. WILLOUGHBY of the State Department to repeat to the Department's highest officials charged with the formulation of economic policy as to what General HILLDRING had said.

General HILLDRING, referring again to the Presidential memorandum on Germany, said it stated clearly the economic policies to be followed and that it gave well-defined lines of general policy. We stated that the draft under consideration was written like a directive. What he feared, he said, was that in addition to the political and economic sections, there would be another paper on administration, another on relief, etc. He reiterated that there should be a statement of basic policy. Once that is received, he added, we can proceed.

Admiral TRAIN questioned as to how THE COMMITTEE could work efficiently without a copy of the document of 23 March. General HILLDRING replied no reproduction was authorized.

Replying to Mr. DOOMAN's suggestion that THE COMMITTEE examine the draft with a view to eliminating points not considered necessary and revising other items, General HILLDRING proposed that a smaller group than the present attendance make the provisions.

Mr. MARTIN asked for an example as to how the political and economic sections of the draft diverged. General STRONG declared that the section which stated as a policy "to complete the disarmament of Japan", was a case in point, since it trespassed on command functions and was vague as to what actually was meant.

Mr. DOOMAN asked General STRONG, Admiral TRAIN, and General HILLDRING to designate representatives to sit as a working group with Mr. MARTIN of the State Department to revise the economic section of the draft. The working group designated is Colonel HARLOE, Colonel HAMILTON, Lt. Commander SPINKS, Major GREY, and Major GROSS.

Mr. DOOMAN said the political section could be correlated by him in conversation with Mr. MARTIN after the economic section had been revised.

(General HILLDRING, Major GREY, Mr. MARTIN and Mr. WILLOUGHBY left the meeting after discussion on the draft was ended.)

[Source: Dipl. Br., National Archives]

1-27 RESPONSIBILITIES FOR MILITARY GOVERNMENT

Telegram WARX 79828 — May 9, 1945
To: Commander in Chief Army Forces, Pacific (AFPAC) in Manila
From: Joint Chiefs of Staff (JCS)
Top Secret

TOPSEC Book Message to MacArthur for action, to Navy Department for transmittal to Nimitz for information from the Joint Chiefs of Staff.

1. Directive to CINCAFPAC (WAR 62774, 3 April 1945; WAR 62773, 3 April 1945) to make plans and preparations for campaign in Japan is reference.

2. Following responsibilities have been fixed by Joint Chiefs of Staff:

a. CINCAFPAC is charged with Military Government of Japan (including the 4 main islands, about 1000 offshore islands, and Karafuto and Tsushima Islands but excluding the outlying islands as defined in J. C. S. 1231).

b. Chief of Staff, U. S. Army, is designated as executive agency for Joint Chiefs of Staff on all matters pertaining to Military Government of Japan.

c. Procurement and training of personnel for Military Government of Japan are War Department responsibilities subject to such administrative arrangements or operational expediencies as are agreed between the services or between services and other agencies of the U. S. Government.

d. War Department is responsible for procurement, shipment, and distribution of supplies necessary to accomplish objectives of the Military Government of Japan as established by the Joint Chiefs of Staff. Foregoing is subject to such administrative arrangements or operational expediencies as are agreed between the services or between the services and other agencies of the U. S. Government.

3. As basis for planning, you will be informed separately in near future as to current status of Joint Chiefs of Staff plans and preparations for Military Government of Japan.

[Source: Mod. Mil. Br., National Archives]

1-28 BRITISH REPORT ON AMERICAN POLICY TOWARD JAPAN

Telegram No. 3666[15] — May 30, 1945
To: British Foreign Office
From: British Embassy in Washington
Top Secret

At Grew's instance Sir G. Sansom was shown yesterday at State Department for his own information and not as an official communication, a draft document setting forth policy of United States Government in respect of Japan. Following is a rough summary of its contents as recollected after hasty perusal.

2. Its preamble states that American objectives are:

(1) Unconditional surrender or total defeat of Japan.
(2) Execution of territorial provisions of Cairo Declaration.
(3) Prevention of future aggression.
(4) Development of a Japanese Government which can be trusted in international relations.
(5) Eventual participation of Japan in the world economic system on terms consistent with (3) and (4)

3. Methods contemplated for realization of those objectives include

(1) Exercise by Supreme Allied Commander of complete authority over all domestic and foreign affairs, the suspension of constitutional powers of the Emperor and of all organs for consideration and formulation of policy (e.g. the Diet), their functions to be assumed by military government.

(2) Military government to be stern but just. It will
(A) repeal obnoxious laws.
(B) dissolve all political parties societies etc.

[15] Cf: British Foreign Office's response of July 17, 1945, which is included in this volume.

(C) proclaim freedom of worship.
(D) institute a new system of public information and expunge existing systems.
(E) control education.

(3) Civil courts of justice will continue to function under control of military government.

(4) There will be three periods (A) severe military government (B) close surveillance during which some restrictions may be relaxed and some civil functions allowed to be performed by Japanese. (C) looking forward to re-entry of Japan into [grp. undec. ? family] of nations. Duration of each period will depend upon behaviour of Japanese.

4. General political aims of United States are abolition of militarism, the emergence and encouragement of liberal political elements, and development of a political system consistent with principles of the United Nations. (It is not explained what those principles are whether American, British, Chinese, or Russian or a synthesis thereof).

5. The document does not enter into detail being only a summary of a much fuller paper but it envisages reparations, though not until productive machinery has to some extent been restored, while it provides for destruction of all industries directly related to war and puts emphasis upon light industries in process of restoration of normal economy. It lays down that programme of industrial rehabilitation shall not aim at a standard of living "out of line with" standards in other parts of Asia, a point probably made in deference to Chinese. It expresses a general intention to encourage local self-government and to provide for a more extended ownership of means of production financial organs etc., this latter clause being probably intended to cover breakdown of monopolies of the great corporations (Zaibatsu) and perhaps also Agrarian reform.

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

1-29 BRITISH REPORT ON UNITED STATES POLICY TOWARD JAPAN

Report June 20, 1945
To: British Foreign Office
From: G. B. Sansom
Top Secret

Information elicited unofficially in Washington by H. M. Embassy indicates that the U. S. authorities are drawing up far reaching plans for the control of Japan after her surrender, on the assumption that with them lies the main responsibility for the defeat of Japan as also for the implementation of the surrender terms. Their attitude appears to be that if the other Allies wish to abstain wholly or in part from participation in the latter work they will not object, but they will on the other hand welcome such participation as may be offered and will readily consider views put before them as to surrender terms, and enforcement machinery. It is clear that the U.S. authorities expect to take the lead and run the show.

2. So far as we know them, the American objectives are:
(1) The unconditional surrender or total defeat of Japan;
(2) The execution of the territorial provisions of the Cairo Declaration;
(3) The prevention of future aggression;
(4) The development of a Japanese Government which can be trusted in international relations;
(5) The eventual participation of Japan in the world economic system on terms consistent with the foregoing.

3. The Americans contemplate for the realization of these aims a period of severe military government, gradually merging into a period of close surveillance during which some civil functions will be transferred to the Japanese, and a third period of which the nature is not quite clear but which, presumably, will be a period of transition to autonomy. The duration of these periods will depend upon the behaviour of the Japanese, but on present information the Americans seem to contemplate not only a total and prolonged occupation of Japan but also a large scale effort to dictate the nature of Japanese political institutions and to re-educate the Japanese people.

4. No exception can be taken to the objectives laid down by the Americans, and it is possible that, in practice, we shall not be able to influence their methods. But they themselves, or at least a number of their officials who are closely concerned with the problems involved, are known to have doubts as to the feasibility of their own plans. It is suggested

therefore that we should formulate our own independent views as to what is desirable and feasible, and tell the Americans, in terms as specific as possible, what conclusions we have reached.

5. Upon defeat, Japan will be in a position analogous to that in which she found herself in 1868. She will be militarily impotent, financially weak, and her industrial equipment will have been in a great measure destroyed. She will be unable to borrow capital—an important point, because she has but scanty capital resources of her own, and, even in the favourable international conditions which obtained for her prior to 1931, she could not have built up her industry as she did without the goodwill of the London and New York money markets.

6. In these circumstances it should be possible to influence the course of events in Japan after defeat, without recourse by the Allies to protracted occupation and a costly machinery of internal controls, by using what, in the long run, will prove a far more effective means of compulsion than prescription by the Allies of specific political and social institutions. Japan after the war is likely to be dependent for her very existence upon the resumption of international trade and the Allies will be in a position to decide, especially in the period immediately following her defeat, the nature and extent of Japan's exports and imports. They will also be able to defer making new treaties with Japan. By exercising the positive power of controlling trade and the negative power of withholding treaties, the Allies should be able, if they remain united, to induce Japan herself to introduce such reforms in her institutions and the working thereof as will justify confidence in her future good behaviour.

7. It was by the exercise of sanctions of this kind that the Western Powers were able to secure the modernization of Japanese institutions after the opening of the country to foreign intercourse. Thus from 1868 Japan had to be content with unequal treaties and conventional tariffs until the Powers were satisfied with her judicial and other organs. She did not get rid of extraterritoriality until 1899 and did not achieve full tariff autonomy until 1911. The denial of tariff autonomy and the refusal to negotiate commercial treaties proved to be a most powerful weapon and while it is not suggested that the precise methods of the 19th Century should be repeated in the very different circumstances of today, it seems useful to bear in mind that these forms of pressure by the Powers achieved the desired results.

8. It is desirable to consider in advance what place in the world economy should be taken by Japan after defeat. It may be argued that the claims of other countries come first, and that Japan can only have such trade as is left after China, India and other countries are satisfied. This may be so, but before reaching such a conclusion we ought to consider whether on balance there would be any advantage, particularly to countries of low average purchasing power, in using what is left of Japan's productive capacity in supplying the needs of, for example, South East Asia for essential consumption goods. It cannot be assumed without proof that China or India or the United Kingdom can entirely replace Japan in those markets, especially in the period of great need immediately after the close of hostilities.

9. If it is decided that even the partial restoration of Japanese industries is of the lowest priority, then we shall have to face a position in which a large proportion of the entire urban population of Japan (more than 50% of the total of 76 million) will be unemployed and inadequately fed if not starving. This will raise the question of relief for Japan, a task which UNRRA, as at present equipped and constituted, obviously cannot undertake; and such conditions are not likely to favour the evolution of a democratic type of government in Japan, since the limited internal resources of the country will have to be husbanded by means of strict controls imposed by autocratic methods. It will be useless for a military government of the kind contemplated by the Americans to embark upon ambitious projects for the political re-education of a starving and miserable people; but the prospects of liberalization of Japanese politics might be improved if Japan, without any burden of armaments, were able to engage in some foreign trade as soon as possible and then to direct her energies to the development of an internal market. There are obvious objections to such concessions but the hard alternative would appear to be the creation of a political vacuum which would have to be filled either by costly total Allied control of the pauperized Japanese population or by violent revolution with its dangerous implications for the future.

10. Upon the foregoing considerations depends, in a greater or less degree, the nature of the first steps to be taken after the defeat of Japan. The choice is probably not a choice between occupying and not occupying Japan, since the nature of the military

operations required for her defeat will doubtless make occupation a necessary sequel, if only for the purpose of implementing the purely military requirements of the Supreme Commander. But there is room for difference of opinion as to the scale and duration of occupation, in which other than military considerations are of importance. Whatever may be the degree of participation of British Empire forces in the final assaults upon Japan, it may be assumed that we shall wish for, and the Americans will welcome, British participation in the Control Comission or whatever body is formed to decide upon control policy. But we should make up our minds what, from our point of view, are the advantages and disadvantages of participation in the political and economic control of Japan as it appears to be envisaged by the Americans. There is a danger that we might be dragged along behind the American chariot and become implicated in policies in which we had little faith.

11. It seems desirable therefore that, before the American plans are officially adopted by the U. S. Government, we should give the latter some indication of our own views as to the best way of controlling Japan. It is hard to believe that the Americans have counted the cost to themselves, whether in manpower or physical resources, of a protracted total occupation of Japan combined with the assumption of all the functions of government. The Japanese are a proud, stubborn race and a foreign military government would only be able to function at all if it were backed up by an army of occupation much larger in proportion to the population of the country than in the case of Germany. Even so the period of foreign rule would be likely to be marked by a series of political assassinations carried out by individual fanatics who would not in the least mind the sacrifice of their own lives. The Allies might have to steel themselves to shoulder this burden if it were the only way to render Japan permanently harmless, but far from that being the case the measures proposed by the Americans might well prove less efficacious than less drastic and less costly arrangements would be.

12. Once deprived of her overseas territories Japan is so poor in natural resources that it should be a fairly straightforward matter, granted agreement between the major powers including Russia, to keep her in order by means of economic controls of the kind outlined in paragraphs 6 and 7 above. The enforcement of these controls would not be dependent on the military occupation of the whole country. It could probably be achieved by the occupation of certain easily held key points, by the presence of Allied war vessels at ports and by occasional demonstration flights of massed aircraft, and even these measures could be relaxed after a short interval.

13. Instead of suspending the constitutional powers of the Emperor it would seem preferable for the Allies to work through those powers or through whatever State administration they find in being in Japan, using the economic sanctions to secure compliance with their requirements such as the repeal of obnoxious laws, the dissolution of political societies, the reform of education, freedom of speech and worship, etc.

14. In order that the U. S. authorities should be aware of our views before their own crystallise, it is suggested that an informal communication of the ideas set out above should be made to the State Department at the earliest opportunity and that at the same time detailed studies of the following problems *inter alia* should be undertaken in London by the Departments concerned.

(a) Will the loss of her colonies and strategic bases, of her navy, airforce and merchant marine, her weapons and arsenals and a great part of her industrial equipment, together with the strain of reparations (if these are economically feasible at all) make Japan so weak that she will not be able to support her present population, still less to build up a warlike potential in any foreseeable period unless she can obtain help from an outside source?

(b) Is it necessary, in addition to the above disabilities, to impose upon Japan, by fiat, terms as to her future domestic, political and social structure, in the hope that a democratic and peace-loving state will emerge? Or are there other means more likely to produce the desired result, at less expense of wealth and effort to the victorious powers?

(c) To what extent is long range economic control physically and politically feasible?

(d) In the event that the Americans insist on total occupation of Japan and total military government would British abstention from anything but token participation injure our interests and prestige (i) in the United States and (ii) in Asia generally?

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

1-30 SELECTION OF EXPERTS FOR MacARTHUR'S STAFF

Memorandum of Conversation July 16, 1945
Participants: Brig. Gen. W. E. Crist
Drafted By: J. C. Grew[16]

Brigadier General William E. Crist called on me today, having just returned from Okinawa, and said that he had been requested by General MacArthur to see me immediately upon his return to Washington to ask my advice on the selection of top-notch men to join General MacArthur and to be prepared to accompany him into Japan after the invasion as political, economic and financial advisers. General Crist said that these men should, if possible, be of high rank in their respective fields, should have had political experience and should have an expert knowledge of Japan itself. The General said that these advisers would no doubt wish to choose other men of lesser rank to serve as assistants, but the important thing was to select the chief counselors at the earliest possible moment. The General said that he expected that he would be obliged to return to General MacArthur's headquarters within about ten days or two weeks and then might have to come back again to Washington after that. He said that they would like to have me myself come as political adviser.

I said to the General that he was posing an exceedingly difficult problem as there were very few high-ranking men who had the qualifications, experience and expert knowledge which would be needed for the job. I pointed out that the Army itself had been training a great many men for just this purpose. The General admitted this but said that these men would be used in subordinate capacities but would not fill the bill as top advisers. I said that in any case it would be essential, in my opinion, that anybody chosen for these positions should themselves have lived in Japan for considerable periods as only those who had lived there could really understand the problems which they would face. The General concurred.

I said that as far as I myself was concerned, I would not under any circumstances consider returning to Japan for, whatever one might think about it, one who had served as Ambassador there for ten years and had known the people well would not wish to return as a conqueror. Merely thinking out loud, I said that I regarded Eugene Dooman as one of our outstanding experts on Japan and he might be more available than others now holding official positions. I said that Mr. Dooman was now at the three-power conference at Potsdam as adviser to the Secretary of State on Japanese affairs.

As an economic adviser, I knew of no better man than Frank Williams, who had recently retired and was about to go into private business at his home in Mississippi. As a financial expert I regarded John L. Curtis of the National City Bank in New York as probably the best man in his field. Both Mr. Williams and Mr. Curtis had spent a great many years in the Far East, especially in Japan and both were not only experts but level-headed men.

The matter was left that I would give the subject further thought and that I would telephone to General Crist when I felt in a position to make further suggestions.

[SOURCE: GREW PAPERS]

1-31 BRITISH GOVERNMENT RESPONSE TO TELEGRAM ON U. S. POST-SURRENDER CONTROL OF JAPAN

Telegram No. 7570[17] July 17, 1945
To: British Embassy in Washington
From: British Foreign Office
Top Secret

Your telegram No. 3754 [of May 29th: United States proposals for post-surrender control of Japan].

Sir George Sansom's summary of State Department's document has been examined with him here. It raises a number of issues which will have to be studied in detail and discussed

[16] Acting Secretary of State.
[17] Cf: Original telegram from Washington on May 30, 1945; also reply from British delegation in Berlin on July 24, 1945.

with the Dominions before final conclusions can be reached. Following comments are entirely tentative and without commitment.

2. The American objectives as described in the preamble of the State Department's document are unexceptional. The question is whether the methods contemplated for their realization are those most likely to achieve this aim.

3. It may be assumed that some form of military occupation of Japan will be a necessary sequel of the military operations required for her defeat, if only for the purpose of implementing the purely military requirements of the Allies. But more than one view is possible regarding its scale and duration. Total and protracted military occupation, combined with the assumption of all the functions of government, is likely to be a strain on both manpower and physical resources. Faced with a proud and stubborn race likely to resort freely to assassination, a foreign military government may require the backing of an army much larger in proportion to the population than that required in Germany. This burden may have to be shouldered if it is the only way to render Japan permanently harmless. But is there no other way?

4. Upon defeat, Japan will be deprived of her overseas territories and will be in a position analogous in 1868. She will be militarily impotent and financially weak. A large part of her industrial equipment will have been destroyed and she will be unable to borrow capital. She will be dependent for her very existence on the resumption of international trade and it should be possible for the Allies, especially in the period immediately following her defeat, to decide and control the nature and extent of her exports and imports. The Allies will also be able to defer making new treaties with Japan. Granted agreement between the major Powers including Russia, should it not be possible for them by exercising the positive power of controlling trade and the negative power of withholding treaties, to induce Japan herself to introduce such reforms in her constitution and the working thereof as will justify confidence in her future good behaviour?

5. It is desirable also to consider what place in world economy is to be taken by Japan after defeat; to what extent, if any, Japan's productive capacity is to be used to supply the needs of, for example, South East Asia for essential consumption goods; and what are likely to be the economic and political consequences, and more particularly the reactions on projects for the political re-education of the Japanese people and on the prospects of the liberalization of Japanese politics, if a large proportion of the urban population of Japan (more than 50% of a total of 76,000,000) is unemployed and inadequately fed.

6. It seems possible that the enforcement of the necessary economic controls might be achieved by the military occupation not (repeat not) of the entire country but of certain easily held key points; by the presence of Allied war vessels at ports; and by occasional demonstration flights of massed aircraft.

7. Might it not be preferable also for the Allies, instead of suspending the constitutional powers of the Emperor, to work through those powers or through whatever state administration they may find in being in Japan, using economic sanctions to secure compliance with such requirements as the repeal of obnoxious laws, the dissolution of political societies, the reform of education, freedom of speech and worship etc.?

8. If you see no objection, please make an oral communication on the above lines to the State Department, emphasizing that it represents the preliminary departmental reactions of the Foreign Office only, and is entirely without prejudice not only to the views of the Dominions (which must be expressly reserved) but also to the final conclusions of His Majesty's Government in the United Kingdom themselves.

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

1-32 STATE DEPARTMENT'S ROLE IN OCCUPATION POLICY FORMULATION

Letter — July 17, 1945
To: J. Forrestal[18]
From: J. C. Grew

Dear Mr. Secretary:

In reply to your telephone inquiry today, I am glad to send you the following facts concerning the status of studies for military government in Japan:

[18] Secretary of the Navy.

1. On February 18, 1944, General Hildring and Captain Pence asked the State Department for the recommendation and advice of the Department in connection with future planning for military government and the administration of civil affairs in Japan and other areas in the Far East, and submitted a list of specific questions.

2. On May 15, 1944, the Department transmitted to General Hildring and Captain Pence sets of twenty-one documents approved by the Department which answered these specific questions.

3. On March 27, 1944, General Hildring and Captain Pence prepared a further list of questions relating especially to the military government in Formosa.

4. In response, sets of fourteen documents, approved by the Department, were submitted to General Hildring and Captain Pence.

5. On August 16, 1944, General Hildring and Captain Sabin submitted an additional list of questions on which they requested the advice and recommendations of the State Department. In response sixteen additional documents, approved by the Department, were submitted to General Hildring and Captain Sabin.

6. Since the organization of the State-War-Navy Sub-Committee on the Far East the State Department has submitted since April 30, 1945, over ten policy documents mainly on military government and the administration of civil affairs, including the basic document on initial post-defeat policy on Japan which has been approved by the Department.

7. The State-War-Navy Sub-Committee on the Far East is organized and is constantly adding further documents to this list. The Sub-Committee is now working on some twenty-five additional documents which will be presented to the State-War-Navy Coordinating Committee in the near future. All of these are submitted by State Department representatives.

We feel that as far as the State Department's contribution is concerned our preparations are very well along as most of the basic policy questions have been covered.

[SOURCE: GREW PAPERS]

1-33 BRITISH SUGGESTIONS FOR AMMENDMENTS TO AMERICAN DRAFT PLAN

Memorandum — July 22, 1945
To: Mr. Dixon
From: "T(?)LR"

Reference the Foreign Secretary's minute to the Prime Minister of July 21 P.M./45/8.T. The Prime Minister saw the President this morning and handed him the enclosure[19] to the Foreign Secretary's minute suggesting amendments to the American draft. I understand from the Prime Minister that the President will now consider these and will produce a revised draft. In the meantime, I am finding out from the Prime Minister the reply to paragraph 3 of the Foreign Secretary's minute.

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

1-34 CONSULTATIONS WITH CHINA

Memorandum — July 23, 1945
To: Mr. Dixon
From: "T(?)LR"
Top Secret

With reference to my minute of July 22, regarding the Foreign Secretary's minute of July 21 P.M./45/8.T, I have now asked the Prime Minister about consulting China and he has replied that the President did not think it necessary to consult Chiang Kai Shek. The Prime Minister himself would greatly deprecate delay in sounding him. The Prime Minister adds that he would much prefer that the appeal should be signed by the President and himself alone.

I enclose a copy[20] of a minute which I am sending to Sir E. Bridges about informing the Cabinet of this.

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

[19] Not Printed.
[20] Not Printed.

1-35 COMMENTS ON BRITISH VIEWS OF OCCUPATION MACHINERY

Letter July 24, 1945
To: J. C. Sterndale Bennett, British Foreign Office
From: L. H. Foulds, British Delegation, Berlin
Top Secret

As I have told you over the telephone, the Secretary of State's principal objection to Foreign Office telegram to Washington No. 7570 of 17th July relates to the terms of paragraph 7.[21]

Will you please refer to my minute of 20th July 1945, of which I sent you a copy two or three days ago. In the third paragraph of that minute I wrote: "but if such a course is adopted it will be necessary for the Allies to work through whatever state administration they find in being in Japan, probably the Emperor." In the following paragraph I suggested that the best chance of getting Japanese forces in the southern areas to lay down their arms would be to require the Emperor to send them his commands.

The Secretary of State has written the following minute about these two passages. "I do not want us to recommend to the Americans that the Emperor should be preserved. They would no doubt like to get such advice, then say they had reluctantly concurred with us".

The danger to which the Secretary of State refers is, of course, one of which we ourselves have long been conscious, and I have no doubt that it will be safer to try to ensure that the Americans are the first to bring up this particular matter. I suggest therefore that we might submit an amendment to paragraph 7 of our telegram to Washington No. 7570 on the following lines. "Might it not be preferable also for the Allies, instead of assuming all the functions of government in Japan, to work through a Japanese administration, using economic sanctions, etc., etc."

As you probably know, the Secretary of State is returning to London tomorrow afternoon and I suggest that you should have a draft ready to lay before him. Henderson has promised to try to get him to take action on it. If the Secretary of State will approve, we could inform both Washington and the Dominions Governments of the amendment and of the reasons for it.

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

1-36 DRAFT PROCLAMATION TO JAPAN

Memorandum July 25, 1945
To: British Foreign Office
From: Chancellor of the Exchequer
Top Secret

I have received from the Prime Minister the attached draft proclamation, to be addressed to Japan, handed to him by the United States Secretary of State, and stating the terms on which the war can be brought to an end, and, at his request, circulate it for the information of the Cabinet. Certain amendments made at the suggestion of the Foreign Secretary have been incorporated and underlined in the draft. I understand that the President felt no difficulty over accepting them, and that he may himself make certain further drafting alterations.

2. The proclamation as drafted is to be made by the heads of the Governments of the United States and the United Kingdom and this being so the President did not, I am informed, think it necessary to consult Chiang Kai Shek.

(ENCLOSURE)

DRAFT PROCLAMATION BY THE HEADS OF GOVERNMENTS[22]

(1) We, the President of the United States, and the Prime Minister of Great Britain, representing the hundreds of millions of our countrymen, have conferred and agree that

[21] Contained in this volume.
[22] Cf. The Potsdam Declaration, July 26, 1945, which is among the documents in this collection.

Japan shall be given an opportunity to end this war.

(2) The prodigious land, sea and air forces of the United States, the British Empire and of China, many times reinforced by their armies and air fleets from the west have now been joined by the vast military might of the Soviet Union, and are poised to strike the final blows upon Japan. This military power is sustained and inspired by the determination of all the Allied nations to prosecute the war against Japan until her capitulation.

(3) The result of the futile and senseless German resistance to the might of the aroused free peoples of the world stands forth in awful clarity as an example to the people of Japan. The might that now converges on Japan is immeasurably greater than that which, when applied to the resisting Nazis, necessarily laid waste to the lands, the industry and the method of life of the whole German people. The full application of our military power, backed by our resolve, will mean the inevitable and complete destruction of the Japanese armed forces and just as inevitably the utter devastation of the Japanese homeland.

(4) The time has come for *Japan* to decide whether *she* will continue *to be controlled by* those self-willed militaristic advisers whose unintelligent calculations have brought the Empire to the threshold of annihilation, or whether *she* will follow the path of reason.

(5) Following are our terms. We will not deviate from them. There are no alternatives. We shall brook no delay.

(6) There must be eliminated for all time the authority and influence of those who have deceived and misled the people of Japan into embarking on world conquest, for we insist that a new order of peace, security and justice will be impossible until irresponsible militarism is driven from the world.

(7) Until such a new order is established and until there is convincing proof that Japan's war-making power is destroyed, *points in* Japanese territory *to be designated by the Allies* shall be occupied to secure the achievement of the basic objectives we are here setting forth.

(8) The terms of the Cairo Declaration shall be carried out and Japanese sovereignty shall be limited to the islands of Honshu, Hokkaido, Kyushu, Shikoku and such minor islands as we determine.

(9) The Japanese military forces, after being completely disarmed, shall be permitted to return to their homes with the opportunity to lead peaceful and productive lives.

(10) We do not intend that the Japanese shall be enslaved as a race or destroyed as a nation, but stern justice shall be meted out to all war criminals, including those who have visited cruelties upon our prisoners. *The Japanese Government shall remove all obstacles to the revival and strengthening of democratic tendencies among the Japanese people.*

(11) Japan shall be permitted to maintain such industries as will sustain her economy and permit the exaction of just reparations in kind, but not those which would enable her to re-arm for war. To this end, access to, as distinguished from control of, raw materials shall be permitted. Eventual Japanese participation in world trade relations shall be permitted.

(12) The occupying forces of the Allies shall be withdrawn from Japan as soon as these objectives have been accomplished and there has been established in accordance with the freely expressed will of the Japanese people a peacefully inclined and responsible government.

(13) We call upon the *Government of Japan* to proclaim now the unconditional surrender of all the Japanese armed forces, and to provide proper and adequate assurances of their good faith in such action. The alternative for Japan is prompt and utter destruction.

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

1-37 ANALYSIS OF POTSDAM PROCLAMATION

Minutes, Meeting No. 213 July 27 1945
IDAC-FE[23]
Secret

I. ANALYSIS OF THE POTSDAM PROCLAMATION OF JULY 26, 1945 (SEE ANNEX A[24])

Mr. Blakeslee analysed the Proclamation as follows: If the Proclamation is accepted by the Japanese there would not be, strictly speaking, the unconditional surrender of Japan and

[23] Inter-Divisional Area Committee on the Far East, State Dept.
[24] Not Printed.

the Allies would not have supreme authority in Japan. The Proclamation implies that the Japanese Government is to continue to function. Article 7 does not seem to give us the right of military government of Japan but persons in the War Department have said that we would have the right of military government subject to the Hague restrictions. There is no indication that the emperor is to be eliminated. Article 8 omits specific reference to the disposition of the Kuriles and the Liuchius but the words "such minor islands" would not necessarily have to be "adjacent" to Japan. Mr. Blakeslee concluded by saying that if these terms were accepted by the Japanese he believed three-fourths of our papers would need revision.

Mr. Wright believed that our supreme authority was not necessarily restricted by this document as Article 11 implied we had such authority. Mr. Borton, who inclined towards Mr. Blakeslee's interpretation, asked how it was possible to have supreme authority when Article 13 states specifically that there shall be unconditional surrender of "all Japanese armed forces" in the government. Mr. Wright answered that this was a strong argument against his case.

It was assumed that if this Proclamation was not accepted then we would have complete authority. In reference to Articles 6, 7 and 10 it was pointed out that the Japanese themselves might be responsible for implementing these terms. Mr. Dickover commented that it would be necessary to amend the Japanese constitution.

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[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-38 COMPARISON OF THE POTSDAM DECLARATION WITH STATE DEPARTMENT POLICY

Report[25] July 30, 1945
Drafted by: Office of Far Eastern Affairs

		Proclamation	*Department Policy*
1.	*Unconditional Surrender*	"Unconditional Surrender of all Japanese armed forces".	Unconditional Surrender of Japan-Government and armed forces
2.	*Terms*	Japan is given an opportunity to end this war on the basis of stated terms.	Japan must obey all directives which may be given by the Allied powers. The powers, however, should announce in advance their basic policies in regard to Japan.
3.	*Legal Powers of Allies in Japan*	Designated points in Japan to be occupied. Authority outside of these points is left uncertain.	The Allies to take over the government of Japan and to possess supreme authority.
4.	*The Japanese Government*	The status of the Japanese Government is left uncertain. It apparently is to continue and to exercise certain functions. (Article 10)	All authority of the Japanese Government is transferred to the Allies. Administrative machinery and most agencies to function under direction of Allies.
5.	*The Emperor*	No mention. Since his removal is not stipulated, it may be assumed that he may remain.	The Emperor is to sign and announce the unconditional surrender of Japan. His powers pass to the Allies. He is to be held in protective custody.
6.	*Objectives*	Irresponsible militarism and Japan's war-making power to be destroyed. Freedom of speech, of religion, and of thought, and respect for fundamental rights. Establishment of a peacefully inclined and responsible government.	No important differences.

[25] The report was submitted as an enclosure for the Secretary of State's Staff Committee on July 30, 1945.

		Proclamation	*Department Policy*
7.	*Enforcement of Objectives*	Not clear. The Japanese Government has the responsibility of carrying out some and possibly all the demands of the Allies. Some of the "terms" would seem to necessitate direct action by Allied authorities.	The Allies' Government in Japan will, itself, enforce its demands.
8.	*Economic Provisions*	Japan to maintain industries necessary to sustain her economy and pay reparations. Industries to be demilitarized.	No important differences.
9.	*Loss of Territories*	Cairo Declaration. Japanese sovereignty to be limited to four main islands "and such minor islands as we determine".	No Department Policy beyond the Cairo Declaration.
10.	*Withdrawal of Occupation Forces*	As soon as stated objectives of Allies have been accomplished and a peacefully inclined and responsible government is established.	No definite provisions.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-39 BRITISH GOVERNMENT'S POLICY TOWARD POST-SURRENDER JAPAN

Report August 7, 1945
Drafted by: S. Bennett, R.J. Campbell, Far Eastern Department, British Foreign Office
Secret

Treatment of Japan after Defeat.

In the memorandum on Far Eastern organization (copy attached) already submitted to the Secretary of State, mention was made of the Far Eastern Committee. One of the tasks about to be laid on the Committee when the change of Government occurred was the elucidation of various issues of policy connected with the treatment of Japan after defeat.

2. Planning for the occupation and control of Japan was impracticable for a long time owing (a) to major preoccupations with the war in the West, and (b) uncertainty as to the attitude of Russia.

3. On May 26th Mr. Eden informed Mr. Churchill in a minute that we had reason to believe that American planning on this subject had reached an advanced stage. His views were that we should take part in the military occupation of Japan if there was an Allied occupation, and that we should share in the political and economic control of Japan and in the planning of that control. Mr. Eden said that if Mr. Churchill agreed, it was important that the study of the problems involved should be set in motion before American views had time to crystallize. The Chiefs of Staff were also in favour of this study being carried out and Mr. Eden suggested that it should be left to the Chiefs of Staff and the Foreign Office to arrange, in agreement, how the work could best be done.

4. Mr. Churchill agreed, with the rider that a report should be made to the Cabinet.

5. This coincided with the receipt of Washington telegram No. 3754 (Flag A) describing the proposed policy of the United States Government as elicited unofficially from Mr. Grew by Sir G. Sansom, Adviser on Far Eastern affairs to His Majesty's Ambassador in Washington. Sir G. Sansom visited England immediately afterwards. The American policy was discussed with him in the Foreign Office. We all agreed with its objectives but had serious doubts about the feasibility and probable success of the policy itself. A memorandum was written by Sir G. Sansom suggesting alternative means of reaching the same objectives. The Washington telegram and the memorandum were then discussed with the Chiefs of Staff, to whom it was suggested that, before any detailed planning could be done, decisions would have to be reached on a number of important general questions, political, economic and strategic in character, which would require a good deal of preliminary in-

vestigation and study. Our suggestion was that the Washington telegram and the memorandum should be considered by the Far Eastern Committee in the first place, with a view to formulating the precise questions to be studied, and deciding which of them fell within the scope of the Chiefs of Staff, the Far Eastern Committee and the Economic and Industrial Planning Staff, respectively.

6. The Chiefs of Staff agreed generally with the views expressed in Sir G. Sansom's memorandum and also with the Foreign Office suggestions for handling the whole matter. With the concurrence of the Chiefs of Staff the views expressed in the memorandum were embodied in Foreign Office telegram No. 7570[26] to Washington (Flag B) as the purely departmental reactions of the Foreign Office, without prejudice either to the views of the Dominions or to those of His Majesty's Government themselves. At the same time the substance of Washington telegram No. 3754 and our telegram to Washington No. 7570 were sent to the Dominion Governments under the same reservation.

7. The intention was at that stage to communicate Washington telegram No. 7570 and the Foreign Office memorandum forthwith to the Far Eastern Committee for further action as agreed with the Chiefs of Staff. Mr. Eden, however, who had been away ill while the consultation with the Chiefs of Staff was proceeding, had some doubts about one passage in our telegram No. 7570 to Washington, and action was held up until Mr. Eden's return from Potsdam, when he withdrew his objection subject to an amendment of paragraph 7. Fresh instructions were sent to Washington in our telegram No. 7943 (Flag C).

8. The change of Government had by that time brought all Cabinet Committees into abeyance. But when the Far Eastern Committee is revived, the way now seems clear for it, in accordance with the understanding with the Chiefs of Staff, to define the specific questions on which reports are required. The following are suggested merely by way of example. They are not exhaustive and it will be for the Far Eastern Committee to formulate the precise terms:-

(a) what kind and amount of export trade will be necessary for the bare maintenance of the Japanese population after the war?

(b) to what extent is Japanese economy necessary to world economy and particularly to that of other Far Eastern countries?

(c) the economic consequences of the Cairo and Potsdam Declarations.

(d) the political consequences of the Cairo and Potsdam Declarations.

(e) to what extent is long-range economic control of Japan for the purpose of preventing her rearmament, physically and politically feasible?

(f) to what extent should the Japanese structure of government be retained?

(g) to what extent will it be necessary for the Allies to press for the repeal of obnoxious laws, the dissolution of political societies, the reform of education, etc.?

9. It is submitted that as soon as the Far Eastern Committee is reconstituted, we ought to press on with this work. It will be for the Foreign Office to initiate action by transmitting the necessary papers to the Committee and informing it of the understanding with the Chiefs of Staff as regards procedure.

10. May we have the Secretary of State's authority to proceed accordingly?

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

1-40 BASIC OUTLINE PLAN FOR "BLACKLIST" OPERATIONS TO OCCUPY JAPAN PROPER AND KOREA AFTER SURRENDER OR COLLAPSE

Drafted by: General Headquarters, U.S. Army Forces, Pacific — August 8, 1945
Top Secret

1. *DIRECTIVE.*

a. This Plan is formulated pursuant to directives of the Joint Chiefs of Staff contained in radiograms WX-17064/14 June 1945, and to verbal directive of the Commander-in-Chief, United States Army Forces, Pacific, 22 June 1945. It covers operations of United States Army and attached forces under CINCAFPAC control, subsequent to sudden collapse or surrender of the Japanese Government and High Command, to occupy JAPAN Proper and KOREA, establish control of armed forces and civil population, and impose thereon

[26] Contained in this volume.

those prescribed terms of surrender requiring immediate military action.

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2. *ASSUMPTIONS.*

a. *Hostile.*

(1) That the Japanese Government and Imperial High Command may surrender at any time.

(2) That surrender of Japanese Commanders in occupied areas outside JAPAN Proper may have to be imposed by force.

(3) That in event the Japanese Government and High Command in KOREA fail to conform to surrender in JAPAN Proper, appropriate offensive measures will be taken without diversion of means allocated to occupation of JAPAN Proper.

(4) That there is reasonable probability of active post-surrender resistance of considerable proportions within JAPAN Proper, particularly by suicidal elements of the armed forces who will take advantage of any weakness on the part of our forces.

(5) That total Japanese forces to be disarmed will probably amount to:

	JAPAN Proper	*KOREA*
Army Ground Combat and Service	1,060,000	233,000
Air Combat and Service (Army & Navy)	425,000	27,000
Naval Crews and Personnel of Shore Establishments	242,000	10,000
	1,727,000	270,000
		1,727,000
Total		1,997,000

(6) That Civilian Volunteer Defense Units requiring disarmament may total:

	JAPAN Proper	*KOREA*
TOKYO PLAIN	1,000,000	
KOBE-KYOTO-OSAKA	700,000	
NAGOYA	375,000	
North HONSHU	60,000	
SHIKOKU	150,000	
KYUSHU	675,000	
Other Areas	250,000	
	3,210,000	35,000
		3,210,000
Total		3,245,000

That armament of these units will be incomplete and confined to light weapons.

(7) That, while at best the civil population of JAPAN Proper will observe an attitude of non-cooperation with our forces, some degree of cooperation may be expected from the civil population of KOREA.

(8) That stocks and production of foodstuffs within JAPAN Proper and KOREA as a whole will, in general, remain adequate to maintain a minimum subsistence level for the population. That, initially, assistance in distribution of foodstuffs, and some reinforcement of supplies to major urban areas, will be required to prevent starvation and epidemic.

(9) That road and rail communications in JAPAN Proper will be sufficiently disrupted by air operations to require widespread rehabilitation of critical facilities prior to resumption of essential transportation of foodstuffs and to large-scale movement of our Occupation Forces into inland areas.

(10) That allocation of ship tonnage will be required during the early post-surrender period for transportation of materials for shelter for considerable elements of urban populations in JAPAN Proper to prevent epidemic and active unrest during the winter season. That such action will be required in KOREA to a lesser degree.

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3. *OPERATIONS.*

a. *Concept.*

This Plan covers the "Occupation Period" only. During this period, control of JAPAN Proper and of KOREA is established by progressive occupation, initially utilizing forces available to CINCPAC and CINCAFPAC at the time of surrender or collapse. JAPAN is disarmed and provisions made for early turn-over to separate "Post-War" Govern-

ments and Armies of Occupation in JAPAN Proper and KOREA.

The preparation and conduct of the operations are decentralized to designated Army Commanders and their corresponding Naval Task Force Commanders to the greatest extent consistent with essential coordination by Superior Headquarters.

For planning purposes, it is visualized that dispatch of AFPAC Forces immediately available, to JAPAN and KOREA, is in strength to occupy selected major strategic centers against local opposition if offered. These forces are mounted with the maximum expedition permitted by availability of sea and air transport and are provided with appropriate naval support. Strong air and mobile ground forces, provided with immediately available naval support and amphibious transportation, are established at these points in order to isolate JAPAN from ASIA, seize control of higher echelons of government in both JAPAN Proper and KOREA, immobilize enemy armed forces, and initiate operations against any recalcitrant elements in the two countries. These strategic centers remain occupied in strength and serve as bases from which air and ground action can be brought to bear wherever required and from which subsequent occupations are conducted as rapidly as the availability of forces, transportation and the internal situation permits.

Follow-up forces are rapidly dispatched to initial objectives by all available transportation means as arranged by the respective Army Commanders.

Additional areas are occupied in two priorities as follows:

Selected strategic points to establish control of remaining major industrial and political centers and avenues of sea communications.

Selected minor areas to establish control of food supply and of principal overland and coastwise communications.

Objectives selected for occupation in the three priorities or phases outlined in preceding paragraphs are:

PHASE I—KANTO PLAIN, SASEBO-NAGASAKI, KOBE-OSAKA-KYOTO, KEIJO (KOREA), AOMORI-OMINATO.

PHASE II—JAPAN: SHIMONOSEKI-FUKUOKA, NAGOYA, SAPPORO (HOKKAIDO).
KOREA: FUSAN.

PHASE III—JAPAN: HIROSHIMA-KURE, KOCHI (SHIKOKU), OKAYAMA, TSURUGA, OTOMARI, SENDAI, NIIGATA.
KOREA: GUNSAN-ZENSHU.
(Reference Map: Eastern Asia, 1/1,000,000, Army Map Service, Revised (AMS 3) 1944. Japanese place names used).

Additional points in PHASES II and III are occupied within means available as deemed necessary by Army Commanders in accomplishment of their missions.

The directed occupations permit control of the political, economic and military life of the two countries. The areas designated in JAPAN include 60 percent of the population, 80 percent of industrial capacity and 48 percent of food production. Those in KOREA include 39 percent of the population, 18 percent of the industrial capacity and 44 percent of the food production.

Occupations in addition to those outlined above which may be required by national policy or Japanese attitude are directed by CINCAFPAC as dictated by the situation existent at the time.

Disarmament of Japanese Armed Forces and establishment of control of communications are primary initial missions of the Occupation Forces.

The United States Pacific Fleet conducts the naval and amphibious phases of the operations.

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2. *Common Tasks.*

The following tasks are common to the several operations projected in this Plan and apply within areas prescribed by the Army Commander concerned:

a. Destroy hostile elements which oppose by military action the imposition of surrender terms upon the Japanese.

b. Disarm and demobilize Japanese armed forces and their auxiliaries as rapidly as the situation permits. Establish control of military resources insofar as is practicable with means available.

c. Control principal routes of overland communications. Control principal routes of coastwise communications, in coordination with Naval elements as arranged with the appropriate Naval Commander.

d. Institute Military Government and insure that law and order are maintained among the civilian population. Facilitate peaceful commerce, particularly that which contributes to the subsistence, clothing and shelter of the population.

e. Recover, relieve and repatriate Allied Prisoners of War and Civilian Internees without delay.

f. Secure and safeguard intelligence information of value to the United States. Arrange with the U. S. Navy for mutual interchange and unrestricted access by each Service to matters of interest thereto.

g. Suppress activities of individuals and organizations which may be inimical to the operations of the Occupation Forces. Apprehend War Criminals as directed.

h. Assist with elements of the initial Occupation Forces the occupation of subsequent objectives as directed.

i. Prepare to impose terms of surrender beyond immediate military requirements as directed.

j. Prepare to extend controls over the Japanese as required to implement policies for post-war occupation and government when prescribed.

k. Prepare to transfer responsibilities to agencies of the post-war Governments and Armies of Occupation when established.

l. Assist the United States Pacific Fleet as necessary in establishment of naval facilities for naval search and control of coastwise communications as arranged.

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[SOURCE: MACARTHUR MEMORIAL]

1-41 DISCUSSION AT SWNCC ON U. S. POLICY TOWARD JAPAN

Minutes, 20th Meeting — August 11, 1945
SWNCC
Top Secret

1. *COMMUNICATIONS TO UNITED KINGDOM, USSR AND CHINA CONCERNING SUPREME COMMANDER*

MR. McCLOY[27] circulated separate draft communications to the United Kingdom, Soviet and Chinese Governments with respect to the designation of General MacArthur as Supreme Commander of the Allied Powers to accept, coordinate and carry into effect the Japanese surrender, and the designation of representatives of each to be present with him. These documents, he explained, were prepared at the request of Secretary of State Byrnes. He pointed out that each communication set forth in general terms the Japanese forces which are to surrender to its designated commander, these provisions to be made specific later in General Order No. 1. He also pointed out that each of the communications included a statement that it was assumed that this procedure would be acceptable and that preliminary instructions were being issued to General MacArthur. He stated also that the War Department, with the approval of Mr. Byrnes, was communicating this information to General MacArthur.

In response to a question by MR. GATES, Mr. McCLOY stated that he was informed that the selection of General MacArthur as Supreme Commander had been directed by President Truman.

THE COMMITTEE approved these three draft communications, on behalf of their respective departments, and agreed that they be delivered to the Secretary of State.

2. *INSTRUMENT OF SURRENDER, DIRECTIVE TO SUPREME COMMANDER AND GENERAL ORDER NO. 1*

MR. McCLOY stated that it had been determined this morning not to have the Emperor sign the surrender instrument and that the note sent to the Japanese had been revised accordingly. This, he stated, required revision of the instrument of surrender. He presented redrafts of (1) the Instrument of Surrender, (2) the Directive to the Supreme Commander for the Allied Powers to be signed by President Truman, and (3) General Order No. 1 to be issued by the Japanese Imperial General Headquarters at the direction of the Supreme Commander for the Allied Powers. He stated that these documents had been approved by the War Department and requested their prompt consideration by the State and Navy Departments.

[27] Assistant Secretary of War.

He explained that the term "Imperial General Headquarters" had been substituted for "High Command" in all documents as a result of research by the War and Navy members of the Joint Staff Planners. He also stated that the draft General Order No. 1 was intended to be forwarded to General MacArthur with instructions to use it as a guide rather than as a document to be literally adhered to, thus giving him the authority to alter it to meet circumstances as they exist at the time of issuance.

THE COMMITTEE agreed that these three documents be processed by the Secretariat as a paper in the SWNCC 21 series for consideration by the Committee.

3. *FURTHER COMMUNICATION TO THE JAPANESE*

MR. McCLOY presented a draft of a further communication to the Japanese Government to be transmitted after receipt of agreement by the Japanese to the note transmitted to it this morning and after agreement by the three Allies to the proposals contained in the communications to be addressed to them (Item 1). This communication sets forth the steps to be taken at once by the Japanese Government. It will not be cleared with our Allies but copies will be sent them after transmission.

THE COMMITTEE approved this draft communication to the Japanese Government.

4. *UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN (SWNCC 150)*

MR. McCLOY presented a redraft of the paper on United States Initial Post-Defeat Policy Relating to Japan. He indicated he desired time to study this document further, and both GENERAL ROBERTS and MR. DOOMAN stated that they had revisions to suggest.

THE COMMITTEE agreed to defer consideration of this paper, instructed the Subcommittee for the Far East to prepare a further revision to be considered by the Committee at a meeting to be held tomorrow, Sunday, 12 August 1945, at 1000.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-42 DISCUSSION AT SWNCC ON U. S. POLICIES TOWARD JAPAN

Minutes, 21st Meeting — August 12, 1945
SWNCC
Top Secret

1. *PROCLAMATION BY THE EMPEROR OF JAPAN*

MR. McCLOY stated that, after the 20th SWNCC meeting yesterday at which it was considered that no proclamation by the Emperor would be required, it had been agreed in a meeting with the Secretary of State that the Emperor of Japan, although not required to sign the instrument of surrender, should issue a proclamation authorizing representatives to sign the instrument of surrender on his behalf for delivery by them to the Supreme Commander and for publication to the people of Japan. He presented a draft proclamation. Certain revisions were discussed and agreed to.

THE COMMITTEE approved the draft Proclamation by the Emperor, with amendments. (The proclamation, as approved, appears as Enclosure "D" of SWNCC 21/6.)

2. *INSTRUMENT OF SURRENDER (SWNCC 21/5, Enclosure "A")*

The Committee reviewed this document. MR. GATES referred to a letter from Secretary Forrestal to the Secretary of State recommending that acceptance of the instrument be countersigned by the United States, Chinese, United Kingdom and Soviet representatives. ADMIRAL GARDNER stated, in support of this recommendation, that signature by representatives of all four powers would serve to impress upon the Japanese from the beginning the unity of the powers. MR. McCLOY and MR. DOOMAN felt that this is a political matter and that, if counter signatures were provided, this might form the basis for insistence by the other powers not only that they pass on the surrender documents but also that every subsequent decision of the Supreme Commander be concurred in by them in advance, thus prejudicing his freedom of action. This question was discussed at length throughout the meeting and was not resolved until after the meeting when provision of spaces for signature by representatives of the four powers, who will be present with the Supreme Commander at the time and place of surrender, was directed by the President.

MR. DUNN read a draft of surrender terms proposed by the British. It was agreed that this draft contained desirable provisions not contained in our draft with respect to (a) the preservation and saving from damage of ships, aircraft and other military and civil property and (b) the liberation, protection, care and maintenance of allied prisoners of war and civilian internees. Similar provisions were incorporated in the United States draft instrument of surrender.

The Committee further revised the instrument of surrender to make it consistent with the signing of a proclamation by the Emperor.

THE COMMITTEE approved the Instrument of Surrender, after providing space for signature by the representatives of the four powers and amending it (a) to include the two provisions taken from the British draft and (b) to be consistent with the issuance of a proclamation by the Emperor. (The approved Instrument of Surrender appears as Enclosure "A" of SWNCC 21/6.)

3. *GENERAL ORDER NO. 1 (SWNCC 21/5, Enclosure "B")*

ADMIRAL GARDNER recommended that further study be given to the division of areas for the purposes of surrender to various allied commanders as provided in paragraph I. The Kuriles, Ryukyus, the Admiralties and Korea, among others, were specifically discussed in this connection.

MR. DUNN stated that the provisions of the General Order as drafted were acceptable to the State Department, subject to further study of the allocation of areas contained in paragraph I.

THE COMMITTEE agreed to defer consideration of General Order No. 1 until it has been reviewed and revised as deemed necessary by representatives of the Joint Chiefs of Staff. It was agreed that Mr. Dunn would obtain further data as to commitments made as to the Kuriles prior to further consideration of the matter by the Committee.

4. *DIRECTIVE TO SUPREME COMMANDER OF THE ALLIED POWERS (SWNCC 21/5, Enclosure "C")*

THE COMMITTEE approved the directive after revising it:

(a) to cover the requirement that the Emperor sign a proclamation; (b) to conform more closely to the language contained in the communications addressed to our three allies on 11 August wherein it was proposed that the Supreme Commander accept, coordinate and carry out the surrender terms; (c) to permit signing of the acceptance by the representatives of the four powers and to provide for the presence of Fleet Admiral Nimitz as U. S. representative; (d) to provide for the issuance of general orders; and (e) to clarify the directive in certain other respects. (The directive, as approved, appears as Enclosure "C", SWNCC 21/6.)

5. *UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN (SWNCC 150 series)*

The SWNC Subcommittee for the Far East presented SWNCC 150/1, a redraft prepared by it pursuant to the instructions of the Committee at its 20th meeting (Minutes, 20th SWNCC meeting, Item 4). The Committee reviewed this draft paragraph by paragraph and agreed upon numerous further changes to be made in the paper.

THE COMMITTEE agreed that, after inclusion of the changes agreed upon at the meeting, the paper be recirculated to the Committee for final action prior to its presentation to the President for approval. (This further revision was subsequently circulated as SWNCC 150/2).

6. *ESTABLISHMENT OF A FAR EASTERN ADVISORY COMMISSION (SWNCC 65 series)*

MR. DUNN brought up for discussion the revision of SWNCC 65/4—Establishment of a Far Eastern Advisory Commission. The question of the location of the headquarters of the Commission and of including Dutch, Australian, New Zealand and French representatives in the membership of the Commission, as well as those of any other powers fighting Japan, was discussed.

THE COMMITTEE agreed that the SWNCC 65 series would be referred back to the Subcommittee for the Far East for further study and report.

7. *POST-WAR MILITARY PROBLEMS IN THE FAR EAST (SWNCC 16/4)*

THE SECRETARY raised the question, in view of recent developments, of the desirability of revising the priority of the Far Eastern subjects listed in SWNCC 16/4.

THE COMMITTEE agreed to refer SWNCC 16/4 back to the Subcommittee for the Far East with instructions to rearrange the order of priority of the subjects listed therein.

8. *DEMOBILIZATION AND REPATRIATION OF JAPANESE ARMED FORCES AFTER SURRENDER (SWNCC 58/6)*

THE SECRETARY brought up for discussion this paper, a memorandum by the Army member of SWNCC recommending the consideration by the Committee of various points respecting demobilization and repatriation.

THE COMMITTEE agreed to refer SWNCC 58/6 to the Subcommittee for the Far East for report.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-43 DRAFT STUDY ON BRITISH PARTICIPATION IN THE MACHINERY FOR THE CONTROL OF JAPAN

Report
Drafted by: Far Eastern Civil Planning Unit
Secret

August 13, 1945

I. AMERICAN POLICY

American policy with regard to the occupation and control of Japan is not yet free from doubt. The original American intention was that there should be a total occupation of Japan and total assumption by the Supreme Allied Commander of all the functions of Government. Some 5,000 American officers have completed their "military government in Japan training", on the assumption that all Japanese officials down to Prefectural level would be directly controlled by agents of the Allied Military Government.

It appears, however, that there is at present a conflict of opinion between the President, supported by the State Department, who would like the occupation to be of an essentially Allied nature, and the U. S. Chiefs of Staff who envisage something almost purely American. In addition to this, the Potsdam Declaration, which in article 7 states that "points in Japanese territory to be designated by the Allies shall be occupied", has apparently meant a revision of most of the previous American planning. Consequently, H. M. Embassy in Washington believes that it is correct to say that the Americans have nothing ready at the moment.

II. BRITISH POLICY

In a Minute dated 26th May, 1945, Mr. Eden informed Mr. Churchill that in his view:-

(a) we should take part in the military occupation of Japan

(b) we should share in the political and economic control

With regard to participation in military occupation, it is understood (Chiefs of Staff 196th Meeting) that the Commonwealth force entering Japan may, subject to the concurrence of the Dominion Governments, be of the order of 4 brigades (U. K., Indian, Australian and Canadian) but is unlikely to be larger and may be smaller. In this paper it is assumed that the Force will be 4 brigades and will not be larger than that. The American force is likely to be of the order of 20 or more Divisions. Thus the main strength of the occupying forces will be American, while British participation will be in the nature of a token. We shall not be able to match the Americans in quantity, and it is, therefore essential that we should select personnel of the very highest quality for working with the Americans in order that our influence in forming the policies that are followed may be greater than the disparity of numbers would indicate.

This disparity in size indicates that there will be great disadvantage in basing the British share in political and economic control on the size of the Commonwealth force employed in occupation duties. On the contrary, the British share in control, if it is to be effective, must be dissociated from our token contribution to the forces of occupation and should be exerted at the highest level and to a large degree independently of the Commander of the British Commonwealth contingent.

This consideration disposes of the question of the creation of a British 'Zone' on the German model. For if that precedent were followed, control at the top would be exercised by a Council of Commanders of which the British Commander would be a member, but only a very junior member in view of his very limited responsibility compared with the disproportionate range and scale of the responsibility of the American Commander.

Moreover we should find it difficult to discharge the responsibility consequent upon accepting a 'Zone', to procure transport and distribute civil supplies, nor have we available the military government staff which would be required.

It follows that the British share in the political and economic control of Japan must be

exercised, not through the Commander of the British Commonwealth contingent of occupying forces, nor by virtue of responsibility for a Zone, but in some other fashion.

It follows also that in the area where the Commonwealth Force is located the functions of Military Government as envisaged by United States policy should be performed by United States officers for the reason that we might otherwise have to conform to a policy of which we disapprove, which we think is doomed to failure, and from which we would wish to dissociate ourselves. The Commonwealth force would, however, include a small staff of Military Government officers whose function would be to maintain the necessary relations with Military Government officers on the staff of the Supreme Commander.

III. RUSSIAN AND CHINESE POLICY

No information is available about Russian or Chinese views on the occupation and control of Japan. As regards Russia, it may be assumed that she will be mainly interested in playing a dominant part in the occupation of Manchuria and Korea, but she is fairly certain to claim an equal voice with the other powers in the control of Japan. There is no indication as to the size of the force which she may be prepared to contribute to the partial or complete occupation of Japan proper.

For prestige reasons, it is likely that China will desire to contribute at least a token force to the occupation of Japan and will insist on being regarded as an equal with the other three powers on the Control Commission. It seems to be assumed in American circles, probably with good reason, that the Chinese will follow the American lead in these matters and will tend to support American views on the Control Commission.

IV. AN ALLIED CONTROL COMMISSION

It is assumed:-

(a) that there will be some form of central Japanese governing authority functioning under the direction of the Allied Supreme Commander.

(b) that metropolitan Japan (Hokkaido, Honshu, Shikoku, Kyushu, and associated islands) will not be divided into 'Zones' under autonomous Commanders as has been done in Germany, and

(c) that inter-Allied control will be expressed through some form of Allied Control Commission of Four (American, British, Soviet and Chinese)

The problem then is to define the structure of such a Commission and the position of the Supreme Commander in relation to it.

In Germany, the Allied Control Council consists of four Commanders-in-Chief, equivalent in status and authority among themselves and largely autonomous in their own zones. In regard to Germany as a whole they act jointly, receiving their separate instructions from, and reporting to, their Governments direct.

In Japan the case will be very different. The Allied Powers will not be represented by four co-equal Commanders-in-Chief. There will be only one Zone and therefore only one Commander taking executive action on behalf of all four Powers. The 'Allied' character of the Supreme Commander is itself in some doubt, seeing that the Army of Occupation will be almost wholly American, and the Military Government staff entirely so. Moreover there is at present no four-power body to which he can report.

It is suggested that to enable the Four Powers to exert four-Power control over Japan an Allied Control Council of Four is essential.

Since the Supreme Commander is to exercise his authority on behalf of the Four Powers, and not for the U. S. A. alone, he must be answerable to, and report to, the Allied Control Council. Therefore he cannot himself be a member of it. He is the agent of the Control Council. As a consequence, his direct connection with the American Government is cut, except in so far as he is the Commanding General of the United States Forces in the theatre.

If the Supreme Commander is not to be a member, there is no cogent reason why the Allied Control Council should be Military in character and membership. It might in fact be embarrassing to the Supreme Commander if it were composed of Service members. It should therefore be civilian. The Control Council would be responsible for the formulation of policy towards Japan, each of the four members receiving instructions from and reporting direct to his own government. The execution of policy would be the responsibility of the Supreme Allied Commander who would excercise his control where practicable through Japanese authorities. Each member of the control council would be assisted by a personal staff of such technical advisers as he might require. In the case of military and economic disarmament, reparations and other matters requiring the direct supervision of the occupy-

ing powers, it would be advisable for representatives of each member to be attached to those executive departments of the Supreme Allied Commander which were responsible for giving effect to the policy of the Control Council.

V. Dominion Representation

It is understood that Canada, Australia and New Zealand can be expected to demand participation as a 'principal' in the machinery for the control of Japan, and South Africa may also do so. France and Holland will doubtless advance similar claims. A Control Council of four will be unwieldy and difficult enough; to expand it to a membership of six or more would wreck its efficiency. Two methods suggest themselves of meeting this difficulty:-

(a) following the Italian precedent, alongside the Allied Control Council of Four there could be an "Advisory Council" of all powers who have engaged actively in the war against Japan, including the Powers represented on the Control Council. The function of the Advisory Council would be to consider matters referred to it by the Control Council, and to make suggestions on its own initiative to the Control Council, or

(b) following in some sort the precedent of the United Nations Conference the Control Council could be considered as the 'Executive Committee' of a "Control Board" composed of all the Powers mainly interested from which it would be impossible to exclude any member of the United Nations who has declared war on Japan.

Of these two the first is clearly preferable.

VI. Recommendations

It is recommended:-

(i) that an Allied Control Council of Four be established, composed of Representatives of the governments of the U. K., U. S. A., U. S. S. R. and China. Each Representative would receive his instructions direct from his own Government.

(ii) that each Representative be assisted by technical advisers, civil and military, as he may require.

(iii) that the Supreme Commander shall act as directed by, and be responsible to, the Allied Control Council.

(iv) that there shall also be established an Allied Advisory Committee for Japan composed of

(a) the Representatives of the Four Powers who are members of the Allied Control Council, and

(b) the Representatives of Canada, Australia, New Zealand, India, France, Holland, etc. All members would be on an equal footing. The Chairman should be the American Representative.

The functions of the Advisory Committee will be to consider control matters referred to them by the Control Council, and to make suggestions to the Control Council. The advisory Committee would be kept fully informed of all matters under consideration by the Control Council.

(v) the Commonwealth force participating in the military occupation of Japan should be confined to garrison and security duties. It should accept no responsibility for the military government of the Japanese civil population in its area, for that will be the responsibility of the Supreme Commander under the Control Council. The Commonwealth Force will include a small staff of 'Civil Affairs' officers who will maintain such liaison as may be necessary with military government officers in the staff of the Supreme Commander.

[Source: British Public Record Office]

1-44 ULTIMATE OCCUPATION OF JAPAN AND JAPANESE TERRITORY

Report JWPC-385/1[28] August 16, 1945
Joint War Plans Committee
Top Secret

1. This outline plan sets forth the optimum desires of the United States with respect to:

a. The Allied control machinery for the main Japanese Islands and Korea.

b. The strength, composition and location of ultimate occupation forces required.

[28] Cf: JCS 1398 series on the national composition of Occupation forces for Japan.

If this optimum can not be attained, every effort should be made to approach it as nearly as possible, keeping in mind the U. S. aim,

"that we take a leading part in establishing policies for the control of Japan and.....insist on control of the implementation of those policies".

2. The term "Japan Proper" as used in this plan is defined to include the four main islands of Japan—Hokkaido, Honshu, Shikoku, Kyushu—and about 1000 small off-shore islands and the Tsushima Islands. It does not include Karafuto, the Kuriles and the Ryukyus. Quelpart Island is included in Korea as used in this plan.

3. It is envisaged that there will be several periods for the control of Japan proper and Korea and that the control machinery and size of occupation forces will vary with each of these periods. These periods will be:

a. PHASE I. An initial period immediately following the end of organized resistance, during which initial occupation and primary Japanese disarmament occurs. The length of this period is estimated to be 3 months from the initiation of occupation.

b. PHASE II. A period of approximately 9 months of Allied occupation whereby disarmament, demobilization, and demilitarization renders Japan incapable of military aggression.

c. PHASE III. The completion of disarmament, demobilization, and demilitarization of Japan by the Allied occupation force, and the governing of Japan and Korea by Allied Control Councils (separate control councils for Japan and Korea). This phase follows Phase II and will be of indeterminate length, being concluded when the United Nations (or the major Allies acting for the United Nations) agree that Allied control of Japan and/or Korea is no longer necessary.

PHASE I (3 months)

4. In the initial period the location, composition and nationality of occupation forces will largely be governed by the availability, capability and location of national forces resulting from military operations conducted prior to and in progress at the cessation of hostilities, which means that the initial occupational forces for Japan will be predominantly U. S. The Supreme Commander for the Allies Powers (SCFAP) will be an American and the occupation force will be predominantly American. However initial occupation by forces of a particular nation should not prejudice the ultimate introduction of forces of other Allies.

5. Initially U. S. forces of occupation should be introduced into Keijo in Korea, and subsequently in other strategic positions in southern Korea such as Fusan and Gunzan. Soviet forces may be expected to initially occupy northern Korea. This has been recognized by the Joint Chiefs of Staff in directives issued to U. S. commanders in the Pacific.

6. *a.* The control machinery during Phase I for Japan will be military in character, with the supreme authority resting with SCFAP.

b. Korea also will be controlled solely by military commanders during Phase I, but there likely will be two distinct areas of command, U. S. in southern Korea, U. S. S. R. in northern Korea.

7. *a.* The forces for initial occupation of Japan are estimated to be 23 divisions with necessary service troops, 25 AAF groups and 43 Navy and Marine air squadrons, totaling approximately 850,000 personnel including approximately 35,000 shore-based naval personnel. Naval forces of the U. S. and British Pacific Fleets will cover the occupation operations, make a display of force, open necessary ports and receive surrender of Japanese naval units.

b. The U. S. forces which may be initially introduced into southern Korea in accordance with approved directives are two divisions plus service troops, 5 AAF groups and 2 Navy air squadrons, a total of approximately 90,000 troops including approximately 4,000 naval shore-based personnel. U. S. naval forces afloat will support the landings in the same manner as outlined above.

PHASE II (9 months)
JAPAN

8. During Phase II the disarmament, demobilization, and demilitarization of Japan will proceed and the return to the main islands of Japanese forces and civilian auxiliaries will be initiated. Approximately 1,700,000 armed forces and 3,200,000 quasi-military forces in Japan must be disarmed and demobilized and 2,750,000 additional returned to the main islands.

9. *Control machinery.* In Phase II the supreme authority in Japan should continue to be SCFAP. An Advisory Council composed of the commanders of the several national occupation forces should be established which would constitute a "high level" staff to advise SCFAP. Allied policies will be recommended by a Far East Advisory Commission, approved

by the Allies and executed by SCFAP. It would be desirable that the Advisory Council include civilian representation from the occupying powers.

10. *Forces.* No sizable reduction in the Phase I forces can be anticipated until the end of Phase II, at which time the reduction of these forces to Phase III strength can begin. During this period certain U. S. forces should be replaced by occupation forces from the U. K., China and the U. S. S. R. A proposed allocation of occupation forces for Phase II follows:

	Divisions	*Air Groups**	*Total*
U. S.	8-1/3	9	315,000**
U. K.	5	3	165,000
China	4	2	130,000
U. S. S. R.	6	6	210,000
Totals	23-1/3	20	802,000

*For purposes of arriving at a distribution of forces AAF groups are considered as the basic air unit. Countries other than U. S. would furnish aircraft and squadrons in number comparable to the U. S. counterpart of an AAF group. Part of the U. S. air occupation forces will be Navy and Marine air squadrons as required for special duties for which they are especially fitted.

**Shore-based naval personnel, 20,000 in number, included in U. S. total commitment.

11. During Phase II the U. S. should maintain a strong strategic air force at bases in the Ryukyus and Marianas, which will back up the occupation forces with a positive threat at all times. Elements of the U. S. Pacific Fleet, in the nature of Fast Carrier Task Groups and bombardment groups of old battleships, cruisers and destroyers, should be based in the Western Pacific to constitute a threat similar to that of the Strategic Air Force. In addition a reserve amphibious task force consisting of a corps of three divisions with the necessary amphibious lift should be available to the Supreme Commander during Phases I and II.

12. *Location of forces.* Forces of the U. K., China and the U. S. S. R. should relieve U. S. forces on a military basis, division for division and corps for corps. For logistical and command reasons, forces of one nationality should occupy contiguous territory. As far as practicable the command areas of occupation should follow the civilian administrative districts of Japan. As of June 1945 Japan was divided into 8 supposedly self-sufficient administrative districts to which the civilian, Army and Navy boundaries closely conformed. A suggested location of forces for Phase II follows:

	Area	*Civilian District*
U. S. S. R.	Hokkaido	Hokkaido
	Northeast Honshu	Tohoku
U .S.	Tokyo Region*	Kanto-Shinetsu
	Nagoya Region	Tokai-Hokuriku
	Osaka Region**	Kinki**
China	Osaka Region**	Kinki**
	Shikoku	Shikoku
U. K.	Western Honshu	Chugoku
	Kyushu	Kyushu

*One division each of British, Chinese and Soviet forces should assist in the occupation of the Tokyo region.

**The Osaka Region, Kinki District, to have one corps of two divisions of Chinese troops under U. S. control to assist in the occupation of this area.

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

1-45 POLITICO-MILITARY PROBLEMS IN THE FAR EAST: MEMO ON UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN: SWNCC 150 SERIES[29]

Memorandum — August 22, 1945
To: Secretary, Joint Chiefs of Staff
From: SWNCC Secretariat

Reference: SWNCC 150/3

1. Attached is a copy of SWNCC 150/3 on the above subject.

[29] Important revisions of SWNCC 150/2 were made and appear in SWNCC 150/3 and subsequent drafts. The text of 150/2 can be found in FRUS, VI, pp. 609-12; SWNCC 150/3 is included in this volume.

2. It is requested that this paper be referred to the Joint Chiefs of Staff as a matter of priority for their comments from the military point of view and that these comments, when obtained, be forwarded to the Secretariat, State-War-Navy Coordinating Committee.

NOTE BY THE SECRETARIES

1. The enclosure, a revision of reference a by the Assistant Secretary of War, is circulated for the consideration of the Committee.

2. A copy of this paper has been referred to the Joint Chiefs of Staff for comment. The comments of the Joint Chiefs of Staff will be circulated to the Committee upon receipt thereof from the Secretary, Joint Chiefs of Staff.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-46 UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN: SWNCC 150/3

Report — August 22, 1945
SWNCC-150/3
Top Secret

PURPOSE OF THIS DOCUMENT

This document is intended as a statement of general initial policies relating to Japan after surrender. Following Presidential approval, it will be distributed to appropriate United States departments and agencies for their guidance in preparing detailed directives. It is recognized that this document does not deal with all matters relating to the occupation of Japan requiring policy determinations. Matters not covered will be dealt with in other documents.

PART I—ULTIMATE OBJECTIVES

The ultimate objectives of the United States in regard to Japan, to which policies in the initial period must conform, are:

(a) To insure that Japan will not again become a menace to the United States or to the peace and security of the world.

(b) To bring about the eventual establishment of a peaceful and responsible government which will respect the rights of other states and will support the objectives of the United States as reflected in the ideals and principles of the Charter of the United Nations. The United States desires that this government should conform as closely as may be to principles of democratic self-government but it is not the responsibility of the Allied Powers to impose upon Japan any form of government not supported by the freely expressed will of the people.

These objectives will be achieved by the following principal means:

(a) Japan's sovereignty will be limited to the islands of Honshu, Hokkaido, Kyushu, Shikoku and such minor outlying islands as may be determined, in accordance with the Cairo Declaration and other agreements to which the United States is or may be a party.

(b) Japan will be completely disarmed and demilitarized. The authority of the militarists and the influence of militarism will be totally eliminated from her political, economic, and social life. Institutions expressive of the spirit of militarism and aggression will be vigorously suppressed.

(c) The Japanese people shall be encouraged to develop a desire for individual liberties and respect for fundamental human rights, particularly the freedoms of religion, assembly, speech, and the press. They shall also be encouraged to form democratic and representative organizations.

(d) The Japanese people shall be afforded opportunity to develop for themselves an economy which will permit the peacetime requirements of the population to be met.

PART II—ALLIED AUTHORITY

1. *Military Occupation*

There will be a military occupation of the Japanese home islands to carry into effect

the surrender terms and further the achievement of the ultimate objectives. The occupation shall have the character of an operation in behalf of the principal allied powers acting in the interests of the United Nations at war with Japan. For that reason, participation of the forces of other nations that have taken a leading part in the war will be welcomed and expected. The occupation forces will be under the command of a Supreme Commander designated by the United States.

Although every effort will be made, by consultation and by establishment of appropriate advisory bodies, to arrive at policies which will satisfy the principal Allied powers, in the event of any differences of opinion among them, the authority of the United States will be decisive.

2. *Relationship to Japanese Government*

The authority of the Emperor and the Japanese Government will be subject to the Supreme Commander who will possess all powers necessary to effectuate the surrender terms and to carry out the United States policies during the period of his responsibility.

In view of the present character of Japanese society and the desire of the United States to attain its objectives with a minimum commitment of its forces and resources, the Supreme Commander will exercise his authority through Japanese governmental machinery and agencies, including the Emperor, to the extent that this satisfactorily furthers United States objectives. The Japanese government will be permitted, under his instructions, to exercise the normal powers of government in matters of domestic administration. This policy, however, will be subject to the right and duty of the Supreme Commander to change the governmental machinery or to act directly if the Emperor or other Japanese authority does not satisfactorily meet the requirements of the Supreme Commander in effectuating the surrender terms. This policy, moreover, does not commit the Supreme Commander to support the Emperor or any other Japanese governmental authority in opposition to evolutionary changes looking toward the attainment of United States objectives. The policy is to use the existing form of Government in Japan, not to support it. Changes in the form of Government initiated by the Japanese people or government in the direction of modifying its feudal and authoritarian tendencies are to be permitted and favored, even at the risk of civil unrest, so long as the unrest is not directed at the occupation authorities and does not imperil their objectives.

3. *Publicity as to Policies*

Every effort will be made to keep the world, including the Japanese people, fully informed as to the objectives and policies of the occupation.

PART III—Political

1. *Disarmament and Demilitarization.*

Disarmament and demilitarization are the primary tasks of the military occupation and shall be carried out promptly and with determination. Every effort shall be made to bring home to he Japanese people the part played by the military and naval leaders, and those who collaborated with them, in bringing about the existing and future distress of the people.

Japan is not to have an army, navy, airforce, secret police organization, or any civil aviation. Japan's ground, air and naval forces shall be disarmed and disbanded and the Japanese Imperial General Headquarters, the General Staff and all secret police organizations shall be dissolved. Military and naval materiel, military and naval vessels and military and naval installations, and military, naval and civilian aircraft shall be surrendered and shall be disposed of as required by the Supreme Commander.

High officials of the Japanese Imperial General Headquarters, and General Staff, other high military and naval officials of the Japanese Government, leaders of ultranationalist and militarist organizations and other important exponents of militarism and aggression will be taken into custody and interned. Persons who have been active exponents of militarism and militant nationalism will be removed and excluded from public office and from any other position of public or substantial private responsibility. Ultra-nationalistic or militaristic social, political, professional and commercial societies and institutions will be dissolved and prohibited.

Militarism and ultra-nationalism, in doctrine and practice, including para-military training, shall be eliminated from the educational system. Recent military and naval officers and exponents of militarism and ultra-nationalism shall be excluded from supervisory and teaching positions in the educational system.

2. *War Criminals.*

Persons charged by the Supreme Commander or appropriate United Nations Agencies with being war criminals, including those charged with having visited cruelties upon United Nations prisoners or other nationals, shall be arrested, tried and, if convicted, punished. Those wanted by another of the United Nations for offenses against its nationals shall, if not wanted for trial or as witnesses or otherwise by the Supreme Commander, be turned over to the custody of such other nation.

3. *Encouragement of Desire for Individual Liberties and Democratic Processes.*

Freedom of religious worship shall be proclaimed promptly on occupation.

The Japanese people shall be afforded opportunity and encouraged to become familiar with the history, institutions, culture, and the accomplishments of the United States and the other democracies. A policy of non-fraternization will be applied in Japan only if and to the extent that the Supreme Commander deems necessary.

Democratic political parties, with rights of assembly and public discussion, shall be encouraged, subject to the necessity for maintaining the security of the occupying forces.

Laws, decrees and regulations which establish discriminations on grounds of race, nationality, creed or political opinion shall be abrogated; those which conflict with the objectives and policies outlined in this document shall be repealed or suspended; and agencies charged specifically with their enforcement shall be abolished or appropriately modified. Persons unjustly confined by Japanese authority on political grounds shall be released. The judicial, legal and police systems shall be reformed as soon as practicable to conform to the policies set forth in Articles 1 and 3 of this Part III and thereafter shall be progressively influenced, consistently with the maintenance of law and order, to protect individual liberties and civil rights.

PART IV—Economic

1. *Economic Demilitarization.*

The existing economic basis of Japanese military strength must be destroyed and not be permitted to revive.

Therefore, a program will be enforced containing the following elements, among others; the immediate cessation and future prohibition of production of all goods designed for the equipment, maintenance, or use of any military force or establishment, the imposition of a ban upon any specialized facilities for the production or repair of, implements of war, including naval vessels and all forms of aircraft: the institution of a system of inspection and control over selected elements in Japanese economic acitivity to prevent concealed or disguised military preparation; the elimination in Japan of those selected industries or branches of production whose chief value to Japan is in preparing for war; the prohibition of specialized research and instruction directed to the development of war-making power; and the limitation of the size and character of Japan's heavy industries to its future peaceful requirements, and restriction of Japanese merchant shipping to the extent required to accomplish the objectives of demilitarization.

The eventual disposition of those existing production facilities within Japan which are to be eliminated in accord with this program, as between conversion to other uses, transfer abroad, and scrapping will be determined after inventory. Pending decision, facilities readily convertible for civilian production should not be destroyed, except in emergency situations.

2. *Promotion of Democratic Forces.*

Encouragement shall be given and favor shown to the development of organizations in labor, industry, and agriculture, organized on a democratic basis. Policies shall be favored which permit a wide distribution of income and of the ownership of the means of production and trade.

Those forms of economic activity, organization and leadership shall be favored that are deemed likely to strengthen the peaceful disposition of the Japanese people, and to make it difficult to command or direct economic activity in support of military ends.

To this end it shall be the policy of the Supreme Commander:

(a) To prohibit the retention in or selection for places of importance in the economic field of individuals who do not direct future Japanese economic effort solely towards peaceful ends; and

(b) To favor a program for the dissolution of the large industrial and banking combinations which have exercised control of a great part of Japan's trade and industry.

3. *Resumption of Peacetime Economic Activity.*

The policies of Japan have brought down upon the people great economic destruction and confronted them with the prospect of economic difficulty and suffering. The plight of

Japan is the direct outcome of its own behavior, and the Allies will not undertake the burden of repairing the damage. It can be repaired only if the Japanese people renounce all military aims and apply themselves diligently and with single purpose to the ways of peaceful living. It will be necessary for them to undertake physical reconstruction, deeply to reform the nature and direction of their economic activities and institutions, and to find useful employment for their people along lines adopted to and devoted to peace. The Allies have no intention of imposing conditions which would prevent the accomplishment of these tasks in due time.

Japan will be expected to provide goods and services to meet the needs of the occupying forces to the extent that this can be effected without causing starvation, widespread disease and acute physical distress.

The Japanese authorities will be expected, and if necessary directed, to maintain, develop and enforce programs that serve the following purposes:

(a) To avoid acute economic distress.
(b) To assure just and impartial distribution of available supplies.
(c) To meet the requirements for reparations deliveries agreed upon by the Allied Governments.
(d) To facilitate the restoration of Japanese economy so that the reasonable peaceful requirements of the population can be satisfied.

In this connection, the Japanese authorities on their own responsibility shall be permitted to establish and administer controls over economic activities, including essential national public services, finance, banking, and production and distribution of essential commodities, subject to the approval and review of the Supreme Commander in order to assure their conformity with the objectives of the occupation.

4. *Reparations and Restitution.*

Reparations.

Reparations for Japanese aggression shall be made:

(a) Through the transfer—as may be determined by the appropriate Allied authorities—of Japanese property located outside of the territories to be retained by Japan.
(b) Through the transfer of such goods or existing capital equipment and facilities as are not necessary for a peaceful Japanese economy or the supplying of the occupying forces.

Restitution.

Full and prompt restitution will be required of all identifiable looted property.

No steps shall be taken, in order to effect deliveries for reparations, which are contradictory to the principles of economic demilitarization.

5. *Fiscal, Monetary, and Banking Policies.*

The Japanese authorities will remain responsible for the management and direction of the domestic fiscal, monetary, and credit policies subject to the approval and review of the Supreme Commander.

6. *International Trade and Financial Relations.*

Japan shall be permitted eventually to resume normal trade relations with the rest of the world. During occupation and under suitable controls, Japan will be permitted to purchase from foreign countries raw materials and other goods that it may need for peaceful purposes, and to export goods to pay for approved imports.

Control is to be maintained over all imports and exports of goods, and foreign exchange and financial transactions. Both the policies followed in the exercise of these controls and their actual administration shall be subject to the approval and supervision of the Supreme Commander in order to make sure that they are not contrary to the policies of the occupying authorities, and in particular that all foreign purchasing power that Japan may acquire is utilized only for essential needs.

7. *Japanese Property Located Abroad.*

Existing Japanese external assets and existing Japanese assets located in territories detached from Japan under the terms of surrender, including assets owned in whole or part by the Imperial Household and Government, shall be revealed to the occupying authorities and held for disposition according to the decision of the Allied authorities.

8. *Equality of Opportunity for Foreign Enterprise within Japan.*

The Japanese authorities shall not give, or permit any Japanese business organization to give, exclusive or preferential opportunity or terms to the enterprise of any foreign country, or cede to such enterprise control of any important branch of economic activity.

9. *Imperial Household Property.*

Imperial Household property shall not be exempted from any action necessary to carry out the objectives of the occupation.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-47 DISCUSSION ON U. S. INITIAL POST-SURRENDER POLICY TOWARD JAPAN

Minutes, 36th Meeting — August 24, 1945
SFE
Top Secret

1. *SFE 109/4* (SWNCC 70/6 and 65/7). *ALLIED CONTROL MACHINERY FOR THE JAPANESE EMPIRE.*

CAPT. DENNISON stated that the Advisory Council as contemplated in SWNCC 70/6 was unrealistic in that it did not go far enough towards meeting the likely demands of other nations for a voice in the control of Japan during either the first or second period of occupation. Therefore, he suggested that SWNCC 70/6 be modified to the extent that a request be made of the Joint Chiefs of Staff as to how far they would feel the United States could go from a military point of view, in order to meet the demands of other nations for participation in the control of Japan.

MR. DOOMAN said that it was only the position already taken by the Joint Chiefs of Staff, to the effect that the United States must dominate in the control of Japan, that permitted the Department of State of stand firm in the face of requests from other governments. He repeated what he had said at the 35th meeting, namely, that the Department of State had countered a British proposal on control machinery with a proposal to establish the Far Eastern Advisory Commission. He said that the idea in proposing the Far Eastern Advisory Commission had been the thought that the Commission would be the arena for the establishment of control machinery.

CAPT. DENNISON remarked that whereas the British Chiefs of Staff had originally planned to offer five divisions for Japan, now their offer had been cut to five brigades. He felt that the British, if they were not allowed to participate in the control of Japan, would be unwilling to furnish troops. He added that the military implications of SWNCC 70/6 as is stands, were that the United States would have to back up its policy of control in Japan by maintaining substantial numbers of troops for a long period.

MR. DOOMAN said that both China and the Soviet Union would probably send troops into Japan under any circumstances, and that the British would have no choice but to follow suit. He said that if there were a possibility that the Joint Chiefs of Staff wished to alter its former position, he hoped that this opinion would be kept strictly within the Joint Chiefs of Staff and not allowed to be known outside.

GEN. ROBERTS expressed the opinion that even if the British were given a substantial share in the control of Japan, they would still try to commit as few British troops as possible and leave the United States with the responsibility of policing the country.

MR. DOOMAN remarked that tactically we would put the U. S. representative on the Far Eastern Advisory Commission in a weak position if there were a prior agreement that he should be prepared to compromise at the first objection.

THE SUBCOMMITTEE mended SFE 109/4 as indicated in SFE 109/5 and approved the paper as amended.

2. *SWNCC 52: BASIC INITIAL POST-SURRENDER DIRECTIVE TO SUPREME COMMANDER FOR THE ALLIED POWERS FOR THE ORGANIZATION AND CONTROL OF JAPAN.*

The procedural relationships between the Subcommittee for the Far East and the Joint Civil Affairs Committee, in order to collaborate on this report, received considerable discussion.

At the request of CAPTAIN SABIN, the Subcommittee did not consider the draft paper which was then before them.

The SUBCOMMITTEE directed the Secretary to make arrangements for a joint meeting of the Subcommittee and the Joint Civil Affairs Committee, as soon as the paper was ready for submission to the Joint Civil Affairs Committee.

3. *SWNCC 176/2/D: INTERNATIONAL AGREEMENTS AS TO OCCUPATION OF KOREA.*

LT. COL. FAHEY suggested that the directive be drawn up with the concept of using the existing administrative machinery as fully as possible, and drew a parallel to the concept for control of Japan.

After some discussion of this point, THE SUBCOMMITTEE agreed that the Working Group should have a free hand with respect to the use to be made of existing administrative machinery in Korea, including Japanese personnel, in view of the fact that the problem was difficult.

It was also agreed that the report should be in the nature of an interim directive.

THE SUBCOMMITTEE appointed the following representation for the Working Group:

STATE—Dr. Blakeslee, Mr. Feary, Mr. McCune
WAR —Lt. Col. Gray, Lt. Col. Davis
NAVY —Lt. Cmdr. Gluckstadt, Lt. Fowle, Lt. Shepard

4. *SFE 113* (SWNCC 16/5): *POLITICO-MILITARY PROBLEMS IN THE FAR EAST.*

THE SUBCOMMITTEE deferred discussion of this item and agreed to attempt informal clearance of the paper.

5. *SFE 104/2* (SWNCC 53 and 58): *POLITICO-MILITARY PROBLEMS OF THE FAR*
104/3 EAST: NATIONAL COMPOSITION OF FORCES TO OCCUPY FORMOSA (INCLUDING THE PESCADORES) IN THE POST-DEFEAT PERIOD: RELATIONS OF THE MILITARY GOVERNMENT OF FORMOSA WITH CHINA AND THE CHINESE.

MR. DOOMAN questioned whether SFE 104/3 would be as acceptable as SFE 104/2, in view of the fact that the former paper did not state fully the reasons for its conclusions.

CAPT. DENNISON remarked that so far as the problem of the paper was concerned, it had been solved by the approval of General Order No. 1. The question of possible U. S. entry into Formosa could be met in a later paper, when the occasion demanded.

CAPTAIN SABIN recalled the fact that on 10 August 1945, the Joint Chiefs of Staff had directed General Wedemeyer to occupy Formosa with Chinese troops, together with a minimum of U. S. forces. In view of this order, he felt, SFE 104/3 would be acceptable.

GENERAL ROBERTS remarked that it was doubtful if the Chinese would be able to go into Formosa in less than six months; consequently, he felt that if an early entry became necessary, it would probably have to be made by U. S. forces.

CAPTAIN DENNISON said that present circumstances all pointed to the fact that China had been designated to accept the surrender of Japanese forces in Formosa. Therefore, all that was needed at the moment was a statement, as had been made in SFE 104/3, to the effect that there was no political objection to U. S. military operations in Formosa. With this much of a policy, the Joint Chiefs of Staff could adequately plan for all contingencies.

At GENERAL ROBERTS' suggestion, the SUBCOMMITTEE agreed to defer action on the paper for a week.

6. *SWNCC 150/3* (SFE 107): *UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN.*

CAPTAIN DENNISON explained that he had asked for this item to be put on the agenda for the following reasons. Mr. Downey, Mr. Martin, Major Sommers, and he had agreed to pool certain changes of a stylistic nature in a single proposed revision of SWNCC 150/3, and to make this revision as a Subcommittee report to SWNCC at the time when the report was being considered by the Joint Chiefs of Staff. Consequently, he was surprised to see SFE 107, published that morning, which stated that the Subcommittee had reviewed 150/3 informally and concluded that no changes were necessary from the point of view of draftsmanship.

GENERAL ROBERTS mentioned that he also had an objection to the reference to "civil unrest" on page 28 of SWNCC 150/3:

> "Changes in the form of government initiated by the Japanese people or Government in the direction of notifying its futile and authoritation tendencies are to be permitted and favored, even at the risk of civil unrest, so long as the unrest is not directed at the occupation authorities and does not imperil their objectives."

On this point MR. DOOMAN offered the interpretation that the reference clearly was that actual changes in the government should be supported, but not movements toward a change. In other words, if there were an actual change in the form of government in Japan, and if this change were in the direction desired by the occupation authority, then the change should be supported even at the risk of civil disturbance from reactionary groups.

GENERAL ROBERTS drew attention to the fact that, in general, U. S. policy at home is to permit the activities of such groups as the Communist Party, but that it is not our policy to allow means of violence to be used in the attainment of political ends.

THE SUBCOMMITTEE agreed that it would make no further changes in SWNCC 150/3, and that Captain Dennison should attempt to get his revision accepted and considered by the Joint Strategic Survey Committee before it reported to the Joint Chiefs of Staff.

MR. DOOMAN agreed to request Col. McCarthy to inform Col. Cress that Captain Dennison was acting within the SWNCC framework.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-48 BUREAUCRATIC DECISION-MAKING IN WASHINGTON

Letter — August 24, 1945
To: British Foreign Office
From: Colonel W. A. Hawkins, Civil Affairs Branch, British Joint Staff Mission, Washington

JAPAN

It is extremely difficult to find out what is going on in the War Department about Japan. The Civil Affairs Division is doing practically nothing itself; the drafting of directives, etc., is still being done on the very high level and practically nothing filters down to anyone in the C. A. Division.

2. My impression is that on the top levels pretty well nothing has been decided, e.g. whether to have a control council or not.

3. I was informed unofficially that a proposal is about to be made formally by the U. S. Government to the U. K. Government that a Far Eastern Advisory Commission would be set up in Washington, which I gather would in the U. S. view make a control council unnecessary. The C. A. Division thought that this proposal had already been sent to the Embassy from the State Department but we know nothing of it here.

4. I attach for information a chart showing the Interdepartmental Committees which are now functioning.[30] Most of the planning for Japan is being done by SWINC and the JCAC feels that it is rather being left out of things; General Hilldring's return may improve this.

5. The C. A. Division is slightly embarrassed that they cannot talk to us yet about Japan.

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

1-49 UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN: SWNCC 150/3

Memorandum — August 27, 1945
To: Secretary, Joint Chiefs of Staff
From: SWNCC Secretary
Top Secret

Reference: SWNCC 150/3

1. Reference is made to SWNCC Memo on the above subject dated 22 August 1945 which transmitted a copy of reference a.

2. Enclosed is a revision[31] of the enclosure to reference a which is the result of informal collaboration between members of the SWNC Far Eastern Subcommittee and members of the Joint Strategic Survey Committee.

3. It is requested that the views of the Joint Chiefs of Staff be based on this paper rather than one submitted with the above mentioned memorandum.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

[30] Not Printed.
[31] Not Printed.

1-50 ANNEX 8 (MILITARY GOVERNMENT) TO OPERATIONS INSTRUCTIONS NO. 4

Directive August 28, 1945
Drafted by: R. K. Sutherland,[32] Lt. Gen., U. S. Army
by command of General MacArthur
Secret

1. a. Military control of Japan will be established by the Commander-in-Chief as the Supreme Commander for the Allied Powers. Japan as used in this annex will include the four main islands of Japan: Hokkaido, Honshu, Kyushu, Shikoku, the Ryukyu Islands, and about one thousand smaller adjacent islands, including the Tsushima Islands, and Korea (South of 38° north latitude).

b. The Supreme Commander for the Allied Powers will exercise control over Japan and the Japanese, to the greatest practicable extent, through the Emperor and the various instrumentalities of the Japanese Imperial Government which prove suitable for this purpose.

c. The Commanding Generals, Tenth, Sixth and Eighth Armies and XXIV Corps, will supervise the functioning of those agencies of the Japanese Imperial Government within the areas of their commands in accordance with this and other directives issued by the Supreme Commander for the Allied Powers, except that, until further orders, the Commanding General, Tenth Army, will continue to be guided by previous directives for those islands of the Ryukyu group now occupied.

2. The principal purposes of the military occupation of Japan are:
   a. To enforce the instrument of surrender.
   b. To advance the post-war objectives of the United Nations. Among these are:
      (1) The abolition of militarism and militant nationalism in Japan.
      (2) The encouragement, subject to the necessity for maintaining military security, of liberal tendencies and processes such as freedom of religion, press, speech and assembly.
      (3) The creation of conditions which will insure that Japan will not again become a menace to the peace and security of the world and which will permit the eventual emergence of a government which will respect the rights of other nations and Japan's international obligations.

3. The following general policies are announced:

a. The Supreme Commander for the Allied Powers will issue all necessary instructions to the Japanese Emperor or to the Imperial Government and every opportunity will be given the Government and the Japanese people to carry out such instructions without further compulsion. If necessary, however, the Supreme Commander for the Allied Powers will issue appropriate orders to the Army and Corps commanders indicating the action to be taken by them to secure obedience by the agencies of the Imperial Government or Japanese people within the areas of their commands. In other words, the occupation forces will act principally as an agency upon which the Supreme Commander for the Allied Powers may call, if necessary, to secure compliance with his instructions to the Japanese Imperial Government.

b. The existing Japanese economy will be controlled only to the extent necessary to achieve the objectives of the United Nations, to meet the needs of the occupation forces and to assure the production of such foodstuffs and supplies and the maintenance of such services for the civilian population as are necessary to prevent disease and unrest.

c. The civilian population will be treated by the occupying forces in such a way as to develop respect for and confidence in the United Nations and their representatives and encourage cooperation in the accomplishment of the desired objectives. They will be required to obey all laws, proclamations, orders and regulations issued by the Japanese Imperial Government pursuant to directives of the Supreme Commander for the Allied Powers. They will be completely free from all unwarranted interference with their individual liberty and property rights.

d. Historical, cultural and religious objects and installations will be carefully protected and preserved. The several Imperial palaces and all shrines will be especially protected from harm of any kind.

[32] Chief of Staff, US Army Forces Pacific.

e. Prices, salaries and wages will be fixed as of 15 August 1945 pending further instructions from this headquarters.

f. The following types of currency will be legal tender:
   (1) In Japan proper:
      (a) Bank of Japan notes
      (b) State notes and coins
      (c) Supplemental yen, Type "B"
      Notes of the Bank of Chosen (Korea) and of the Bank of Taiwan (Formosa) and the military yen currency issued by the Japanese will not be legal tender and their circulation will be prohibited.
   (2) In Korea:
      (a) Bank of Chosen (Korea) notes and supplemental yen, Type "A"
      Bank of Japan notes, notes of the Bank of Taiwan (Formosa) and military yen currency issued by the Japanese will not be legal tender and their circulation will be prohibited. Japanese state notes and coins will be permitted to circulate until further orders.

4. The Commanding Generals, Sixth and Eighth Armies and XXIV Corps, within their respective areas, and the Commanding General, Tenth Army, exclusive of islands now occupied, will:

a. Observe the obligation imposed on the occupation forces by international law and the rules of land warfare.

b. Take all necessary steps to protect and preserve the records of:
   (1) All governmental agencies and quasi-governmental agencies, particularly records concerning Japanese individuals.
   (2) All Japanese political, patriotic and secret societies.

c. Register all nationals of countries with which any of the United Nations is or has been at war, except Japan, and take into protective custody the diplomatic and consular officials of such countries. Prompt reports of such action will be made to this headquarters.

d. Register all nationals of neutral countries and afford full protection to the persons, archives and property of the diplomatic and consular officials of such countries.

e. Take all necessary steps to protect and preserve the property of the United Nations and their nationals.

f. Apprehend and detain, when directed by this headquarters:
   (1) The members of terroristic and secret patriotic societies, officially identified as such by the Counter Intelligence Corps.
   (2) Persons whose names or descriptions are contained in lists of actual or suspected war criminals issued by this headquarters.
   (3) Personnel administering or guarding prisoner of war and internment camps.

g. Arrange with the appropriate Japanese officials for the collection of all arms in the possession of the Japanese civilian population and their safe-keeping pending instructions as to their disposition from this headquarters.

h. Identify and collect all property looted from the governments or citizens of any of the United Nations and submit reports thereof to this headquarters.

i. Permit local courts to function under such supervision as may be prescribed by this headquarters.

j. Establish military occupation courts in accordance with instructions from this headquarters.

k. Subject to the requirements of military security, permit freedom of speech, press, religion and assembly.

l. Make available to the appropriate Japanese officials such foodstuffs, clothing and other supplies as are required for the relief of the civilian population to the extent necessary to prevent disease and unrest. The bulk of these supplies will be secured from specially requisitioned military government supplies, and gratuitous issue of military supplies for civilian relief purposes will be kept to a minimum.

m. Arrange with the appropriate Japanese officials for the provision of civilian labor, real estate and locally available supplies, in accordance with the procedures established by the General Procurement Board of this headquarters.

n. Encourage production of foodstuffs, medical, dental and sanitary supplies, textiles, clothing, footwear, soap, lumber, paper, cement, fertilizers and other items which will reduce requirements for imports.

o. Submit the following reports:

(1) Weekly Military Occupation Activities Report covering the week ending Saturday at 2400 to include:
  (a) The number of civilians being fed from military supplies and the number being fed from military government supplies.
  (b) The quantities of all military government supplies received, issued or otherwise expended for civilian relief purposes.
  (c) Number of civilian laborers requested and assigned.
  (d) Location and extent of serious communicable diseases.
  (e) Major items of food, materials and equipment under control of the military forces which are usable for reconstruction.
  (f) General status of civil administration.
(2) Matters of an urgent character concerning civilians will be made the subject of immediate special reports to the Supreme Commander for the Allied Powers.

5. a. The Commanding General, United States Army Forces, Western Pacific, will be responsible for the procurement, loading, and movement to the United States Army Forces, Pacific Regulating Station or to the objective areas, supplies, transportation and equipment including food, medical and sanitary supplies and other items required for military occupation and the emergency relief of the civilian population and liberated nations, except as indicated in paragraph 5b.

b. Effective 1 January 1946, the Commanding General, United States Army Forces, Western Pacific, will be responsible for military occupation and emergency relief supplies for islands now occupied by the Tenth Army.

[SOURCE: SUITLAND PAPERS]

1-51 SFE MINUTES, 37TH MEETING

Minutes, 37th Meeting — August 29, 1945
SFE
Top Secret

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2. (SWNCC 52). *BASIC INITIAL POST-SURRENDER DIRECTIVE TO SUPREME COMMANDER FOR ALLIED POWERS FOR THE OCCUPATION AND CONTROL OF JAPAN.*

The Joint Civil Affairs Committee draft directive had been approved informally by the JCAC on 25 August 1945, and forwarded to the Subcommittee for collaboration. Comments by Mr. Dooman, General Roberts, and Captain Sabin had been circulated prior to this meeting.

CAPT. DENNISON inquired as to whether the function of the Subcommittee in its collaboration comprised anything more than an examination of the directive in order to assure its consistency with policy.

MR. DOOMAN replied that in view of the fact that the surrender of the Japanese was a somewhat confused issue, this directive should be examined carefully in all details. He remarked that the view of the Department of State was that the surrender was a contractual relation, a negotiated peace.

LT. COLONEL FAHEY said that prior to the establishment of the SWNCC, the Joint Chiefs of Staff would not approve a directive unless the Department of State had approved it in detail.

CAPTAIN SABIN said that the directive was originally a SWNCC paper. Consequently, the Subcommittee bore equal responsibility with the JCAC for the paper and should examine it carefully in the fullest sense of collaboration.

The SUBCOMMITTEE recommended a number of changes in the directive, as indicated in SFE 113.

Among the specific changes suggested by Mr. Dooman was the following: In paragraph. 5 e., pages 9 and 10:

"Full power to review and veto will be retained by you over all courts which are allowed to function *in so far as their decisions affect the carrying out of your mission.* You will take all practicable measures to cause the release of persons held in custody solely under laws or regulations of the type to be abrogated under paragraph 4 f. above ~~or under no specific charge whatever.~~"

There was considerable discussion on this point. MR. DOOMAN and DR. BLAKESLEE felt that, according to the terms of surrender, the Supreme Commander would not have power to review and veto all actions in any courts.

GENERAL ROBERTS remarked that the Supreme Commander would not normally attempt such review. He requested, however, that the directive should not ask the Supreme Commander to make hairline decisions as to which cases he was empowered to review in accordance with the Potsdam Declaration. In fact, he said, this would require the Supreme Commander to justify his review of every case.

CAPTAIN DENNISON said that, in view of the fact that we had an unconditional surrender from the Japanese, there was no limitation on the power of the Supreme Commander to review. He cited the recent speech of the President where the President had said, "I deem this reply a full acceptance of the Potsdam Declaration which specifies the unconditional surrender of Japan. In the reply there is no qualification."

MR. DOOMAN stated that we did not have an unconditional surrender, in spite of the President's statement. He said that the view of the Department of State was that our relations to the Japanese were of a contractual nature.

The SUBCOMMITTEE were unable to agree as to whether the surrender was unconditional or whether it was a contractual agreement. Likewise, there was a divergence of views as to whether the power of the Supreme Commander over the Emperor was unlimited, or whether it was power only to the extent necessary to effectuate the terms of surrender.

With respect to the deletion of the phrase "or under no specific charge whatever, "MR. DOOMAN explained that the normal Japanese practice was to arrest people without a charge, and that a formal charge was made only at the court of first instance. Consequently, he said, if the language were retained, the Supreme Commander would be directed to release all sorts of suspects, against whom no charges had yet been placed.

The SUBCOMMITTEE agreed on the following revision of paragraph 5 e., pages 9 and 10, of the directive:

"Full power to review ~~and veto~~ will be retained by you over all courts which are allowed to function. *You will veto all decisions which are inconsistent with the purpose of your mission.* You will take all practicable measures to cause the release of persons held in custody solely under laws or relations of the type to be abrogated under paragraph 4 f. above ~~or under no specific charge whatever.~~"

The SUBCOMMITTEE approved the directive, subject to the changes as recommended and provided that no further changes were made in SWNCC 150/3, Revised. The SUBCOMMITTEE directed the Secretary to inform the Secretary of the JCAC of this action, and to make arrangements for a joint meeting of the JCAC and the SUBCOMMITTEE, if the JCAC were unable to accept these changes.

Having agreed to reconvene at 1430 in order to complete their Agenda, the Subcommittee adjourned at 1310.

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5. SFE 116 SWNCC 162/D: *POSITIVE POLICY FOR REORIENTATION OF THE JAPANESE.*

The SUBCOMMITTEE discussed briefly paragraph 3 of SFE 116. The question was raised as to the assignment of the preparation of the report mentioned therein.

MR. DOOMAN remarked that the responsibilities involved in the preparation of such a report were great. He said that invitations to participate should be extended to persons outside the three departments, such as prominent educators and missionaries. He was not sure that the Subcommittee should be recommended as the agency to undertake this task.

The SUBCOMMITTEE agreed that the decision as to the proparing agency should be left to the SWNCC, and approved SFE 116 with amendments as indicated by SWNCC 116/1.

6. *INFORMAL BUSINESS*

a. SFE 114 (SWNCC 176/2/D). *BASIC INITIAL POST-SURRENDER DIRECTIVE TO THE COMMANDER IN CHIEF U.S. ARMY FORCES IN THE PACIFIC FOR THE ADMINISTRATION OF CIVIL AFFAIRS IN KOREA SOUTH OF 38 DEGREES NORTH LATITUDE.*

The Secretary reported that the *ad hoc* committee, under the chairmanship of Lt. Col. Hendrick, had met all day Saturday, Monday and Tuesday, 25, 27, 28 August, in the preparation of SFE 114.

The SUBCOMMITTEE deferred consideration of the paper in view of the fact that it had been distributed for the first time at the meeting.

b. SWNCC 150/3 Revised. UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN.

LT. COL. FAHEY reported that the paper was still under consideration by the Joint Strategic Survey Committee.

c. TIME OF MEETING.

In order to expedite and regularize their work, the SUBCOMMITTEE agreed to meet regularly each week on Tuesdays at 1000 and on Fridays at 1415. The Secretary was directed to have Agenda distributed 24 hours in advance of meetings. It was understood that special meetings would be called when the occasion demanded.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-52 MEMO ON INITIAL POST-SURRENDER POLICY FOR JAPAN

Memorandum August 31, 1945
To: SWNCC
From: Secretary Joint Chiefs of Staff

The Joint Chiefs of Staff have considered a revision of SWNCC 150/3, a report by the State-War-Navy Coordinating Subcommittee for the Far East regarding initial post-surrender policy for Japan, and perceive no objections from the military point of view to the statements therein, suggesting the following modifications:

a. Revise the last sentence in Part III, "Political," Section 1, "Disarmament and Demilitarization," to read: "Former ~~military and naval personnel~~ *career military and naval officers, both commissioned and non-commissioned,* and all other exponents of militarism and ultra-nationalism, shall be excluded from supervisory and teaching positions."

b. After the first sentence in Part III, "Political," Section 3, "Encouragement of Desire for Individual Liberties and Democratic Processes," which states: "Freedom of religious worship shall be proclaimed promptly on occupation," insert the following: "*At the same time it should be made plain to the Japanese that ultra-nationalistic and militaristic organizations and movements will not be permitted to hide behind the cloak of religion.*"

c. Insert the following at the end of Part III, "Political," Section 3, "Encouragement of Desire for Individual Liberties and Democratic Processes:" "*While the policy of the United States is thus definitely to encourage among the Japanese a desire for individual liberties and for democratic institutions, the occupational authorities should not permit this to be interpreted by the Japanese as encouraging lawless acts or mob violence.*"

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

1-53 SWNCC MINUTES, 22ND MEETING

Minutes, 22nd Meeting August 31, 1945
SWNCC
Top Secret

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2. *DESTRUCTION OF JAPANESE EQUIPMENT (SWNCC 58 Series)*

MR. McCLOY stated that the problem of Chinese rearmament raised questions as to our policy with respect to destruction of Japanese equipment. He pointed out that the Chinese will have possession of a large quantity of Japanese military equipment and may request equipment captured by U. S. forces. The Chinese may also seek to have the remains of the Japanese Navy transferred to them. GENERAL ROBERTS stated that General MacArthur has asked confirmation of the U. S. policy of destruction of captured equipment set forth in SWNCC 58/5. He suggested that a problem is created since our allies are not committed to such a policy. MR. DOWNEY commented that this policy should be interpreted in the same way as JCS 1067 in Germany. It extends to any areas over which U. S. forces have control and General MacArthur should endeavor to have other national commanders adopt the same policy, if possible.

THE SECRETARY stated that a proposed revision of SWNCC 58/5 had just been received from the Joint Chiefs of Staff and that the revision does not change the policy as to destruction.

THE COMMITTEE agreed that the principle of destruction of Japanese equipment stated in SWNCC 58/5 should be adhered to and that it would be confirmed by the Committee's action on the proposed revision of that paper.

3. *UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN (SWNCC 150/3; Agenda Item No. 2)*

THE SECRETARY circulated the comments of the Joint Chiefs of Staff on this paper. The Joint Chiefs of Staff stated therein that they perceive no objection from the military point of view but suggested three modifications: (1) revision of the last sentence of Part III, Section 1; (2) addition of a sentence after the first sentence of Part III, Section 3; and (3) addition of a sentence at the end of Part III, Section 3. MR. McCLOY suggested that the Committee accept the first two amendments suggested by the Joint Chiefs of Staff but reject the third on the ground that it was inconsistent with the last sentence of Section II, 2, of SWNCC 150/3 which he deemed a preferable statement of policy. He also suggested that in the fourth line of the second paragraph of Section III, 3, the words "United Nations" be changed to "democracies" on the ground that the sentence as written was both indefinite and not in accord with U. S. objectives.

THE COMMITTEE:

a. Approved SWNCC 150/3 after revising Part III, Sections 1 and 3, as suggested by the Joint Chiefs of Staff and changing the words "United Nations" to "democracies" in the fourth line of the second paragraph of Part III, Section 3.

b. Agreed that Presidential approval of the paper be obtained and directed the Secretariat to prepare a letter of transmittal from the Secretary of State for this purpose.

c. Agreed that upon receipt of Presidential approval the paper be transmitted to the Joint Chiefs of Staff and to the State, War and Navy Departments for guidance and necessary implementation.

4. *ALLIED CONTROL MACHINERY FOR THE JAPANESE EMPIRE (SWNCC 70/6—Agenda Item No. 3)*

THE SECRETARY explained that this paper was placed on the agenda, although no comments have yet been received from the Joint Chiefs of Staff, in order to determine whether there is general Committee agreement on the approach of the paper.

MR. DOOMAN stated that advances had already been made by the British on the subject of control machinery and that it was contemplated that this subject would be the first item on the agenda of the Far Eastern Advisory Commission. MR. DOWNEY pointed out that this paper is designed to set forth the United States position on the subject and urged that it be agreed on within the U. S. government now so that we will not be caught unprepared when we are required to discuss it with a foreign power. MR. DUNN emphasized the advantage of being the first to present a proposal on this subject.

GENERAL HILLDRING was concerned because he felt the paper, as drafted, specified two separate periods in the occupation with greater participation by other powers in the second period. He felt this undesirable because it would give the other powers an opportunity to press for an early shift to the second period, a shift which might well jeopardize our position and be detrimental to the occupation objectives. He also felt that emphasis should be placed on there being military control throughout.

MR. DOOMAN pointed out that during the early months of the occupation military considerations would predominate while during the later stages political considerations would be paramount. He stressed the importance of the latter if the stated United States objectives in Japan are to be realized.

MR. McCLOY felt it essential that we be prepared to give the other powers some control over the use of their own forces if we are to have them participate to any appreciable extent in the occupation. He felt also that our Russian relations in Europe would be helped, for example, if we don't adopt an exclusive attitude with respect to Japan. Furthermore, it is highly desirable that the Japanese and our allies fully appreciate that the occupation and control of Japan is a joint venture and not unilateral U. S. action. He felt it essential to have a realistic United States position agreed upon as soon as practicable.

MR. DUNN reviewed the history of the surrender and the appointment of General MacArthur as Supreme Commander for the Allied Powers. He noted that nowhere is a limit set as to the duration of his power. On August 20th the British submitted an Aide-Memoire suggesting the establishment of Japanese control machinery similar to that in Germany. We countered by proposing to China, Russia and the British the establishment of a Far Eastern Advisory Commission and told the British that control machinery could be discussed in it. He then read an Aide-Memoire received from the British on 30 August and a memorandum of his conversation with Mr. Balfou of the British Embassy at the time

it was presented (subsequently circulated for information as SWNCC 70/8). MR. DUNN also stated that the Russians had approached General MacArthur about control machinery but he requested them to take the question up on the governmental level. He felt, in view of this background, that the United States must be ready with its proposal in the near future.

MR. DUNN stated in summary that our objective is to maintain control under one commander throughout the occupation and that we must brace ourselves for a drive by other governments to change the present arrangement.

THE COMMITTEE:

a. Agreed that the basic concept of SWNCC 70/6 should be followed, that language indicating division of the occupation into two distinct periods should be eliminated and that SWNCC 70/6 be referred back to the Subcommittee for the Far East for revision in light of this agreement and the discussion in this meeting.

b. Directed the Secretary to request the Joint Chiefs of Staff to defer action on SWNCC 70/6 pending such revision.

5. *POSITIVE POLICY FOR REORIENTATION OF THE JAPANESE*
(*SWNCC 162/1—Agenda Item No. 4*)

MR. GATES suggested that this matter be referred back to the Subcommittee for the Far East for preparation of a comprehensive report on the positive steps that should be taken in the reorientation of the Japanese to implement our objectives.

MR. DOOMAN agreed but felt that on this problem it is essential to obtain the benefit of the best qualified opinion in the United States, whether in or out of government. This report, he felt, should not be made by people who have only a cursory knowledge of the Japanese people. He felt it would be desirable to have a conference of qualified experts on this subject and stated that special arrangements would have to be made to finance the obtaining the participation of non-government people.

THE COMMITTEE agreed to refer SWNCC 162 series back to the Subcommittee for the Far East for preparation of the comprehensive report recommended therein, the Subcommittee to be authorized to obtain the best available opinion on the subject, whether within or out of the Government, and to approach the State Department with a view to obtaining necessary funds for this project.

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[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

1-54 BACKGROUND OF SWNCC/SFE ORIGINS

Report
SWNCC

January 21, 1948

Informal conversations were held late in 1944 by the Secretary of State and War and Navy Department representatives on the question of improving existing methods of obtaining for the State Department advice on politico-military matters and of coordinating the views of the three Departments on matters in which all had a common interest, particularly those involving foreign policy and relations with foreign nations.

These conversations were followed by a suggestion from the Secretary of State (E. R. Stettinius, Jr.) to the Secretary of War (Mr. H. L. Stimson) and the Secretary of the Navy (Mr. Frank Knox) that a committee of representatives of the three Departments be formed to deal with problems relating to the Far East.

It was generally agreed in the subsequent meeting of the Secretary of State, the Assistant Secretary of War and the Assistant Secretary of the Navy for Air, held on 20 November 1944, that it might be desirable to expand this proposal to provide for a committee which might deal with a much wider range of interdepartmental problems and serve as a convenient channel of interdepartmental communication.

The Secretary of State accordingly suggested the formation of a committee to be composed of representatives of the Secretary of State, the Secretary of War, and the Secretary of the Navy, charged with the duty of formulating recommendations to the Secretary of State on questions having both military and political aspects and of coordinating the views of the three Departments in matters of interdepartmental interest (See Appendix "L").

The Secretary of State further suggested that in view of the fact that much of the work of the proposed committee would deal with foreign policy, the representative of the State

Department should serve as Chairman of the Committee.

During these informal discussions the Secretaries considered that it was imperative that any such committee should be composed of ranking members of each Department, able and authorized to speak for the Departments represented without frequent reference to the Department heads of questions under consideration.

Recognition was given to the operational requirements of delegation of authority by departmental representatives to appropriate panels or subcommittees of the committee which could be formed to deal with particular problems, and to the desirability of calling upon qualified departmental personnel for technical assistance.

It was also appreciated by the Secretaries that many of the problems to be presented to the Coordinating Committee would be matters where military necessity was predominant and consideration by the Joint Chiefs of Staff would be required.

FORMATION OF THE COMMITTEE

The following were designated by their respective Secretaries to serve on this Committee:

State Member Mr. James Clement Dunn, Asst. Secretary of State (Chairman)
War Member Mr. John J. McCloy, Asst. Secretary of War
Navy Member Mr. Artemus L. Gates, Asst. Secretary of the Navy for Air

The above members held their first meeting on Tuesday, 19 December 1944, at 1130 in Room 300 State Building, where they discussed the initial organization of the Committee and agreed that the name of the Committee would be "The State-War-Navy Coordinating Committee."

APPENDIX "C"

STATE-ARMY-NAVY-AIR FORCE COORDINATING SUBCOMMITTEE FOR THE FAR EAST

On 13 January 1945 the Committee appointed an *ad hoc* committee entitled the "*ad hoc* Committee to Consider Problems Which Arise in Connection with Control of Pacific and Far Eastern Areas". The membership of this *ad hoc* Committee was as follows:

Mr. Eugene H. Dooman, Chairman, State
Lt. Colonel Fred W. Sladen, Army
Lt. Colonel Daniel C. Fahey, Army
Rear Admiral Harold C. Train, Navy

On 22 January 1945 the Committee agreed to change the name of the above *ad hoc* Committee to "Tri-Departmental Subcommittee to Consider Problems which Arise in Connection with Control of Pacific and Far Eastern Areas."

On 30 January 1945 SWNCC decided to appoint the Army, Navy and Air Corps members of the Joint Post-War Committee of the Joint Chiefs of Staff as members of the "Tri-Departmental Subcommittee" and to use the offices and facilities of the JPWC Secretariat for this Subcommittee. This arrangement was in effect until about 1 July 1945, at which time a Secretariat for the Far Eastern Subcommittee was procured and the Subcommittee was organized on a full-time working basis with separate offices in the Munitions Building. The Subcommittee continued to maintain separate offices in the Munitions Buildings and later in the New War Building until about 1 December 1946, at which time the SWNCC Secretariat moved from the Old State Building into the space occupied by the Subcommittee in the New War Building, where the Secreatriats were combined.

The following important documents dealing with the Post-Surrender Treatment of Japan originated in this Subcommittee:

Unconditional Surrender of Japan (Instrument of Surrender—Directive to SCAP—Proclamation by the Emperor—General Orders No. 1.) (SWNCC 21/6 and 21/8)
Basic Directive for Post-Surrender Military Government in Japan Proper (SWNCC 52/7)
United States Initial Post-Defeat Policy Relating to Japan (SWNCC 150/4/A)

At their 10th Meeting on 16 February 1945 the Committee agreed to changing the name of this Tri-Departmental Subcommittee to "The State-War-Navy Coordinating Subcommittee for the Far East".

Since 4 November 1947, following the reconstitution of SWNCC as SANACC, this Subcommittee has been known as the "State-Army-Navy-Air Force Coordinating Subcommittee for the Far East".

The present composition of the Subcommittee is as follows:

Mr. James K. Penfield, Chairman, State
Mr. John M. Allison, State
Mr. Edwin M. Martin, State
Colonel H. A. Byroade, Army
Lt. Colonel T. W. Parker, Army
Mr. D. C. Fahey, Army
Colonel Raymond M. Cheseldine, Army
Captain H. R. Hummer, USN, Navy
Lt. Colonel A. F. Metze, USMC, Navy
Colonel Sidney Giffen, Air Force
Lt. Colonel Roy W. Dart, Air Force
Commander J. B. Cresap, Navy, Secretary

The following-named individuals have served as members, alternates or secretaries of the Subcommittee during the period shown opposite their respective names:

Mr. John C. Vincent	State	6 Sep 45—31 Jul 47
Dr. Hugh Borton	State	19 Feb 45—31 Jun 47
Mr. H. Merrell Benninghoff	State	2 Jul 45— 4 Aug 45
Dr. George H. Blakeslee	State	19 Feb 45—25 Jun 46
Mr. Edwin O. Reischauer	State	26 Jun 46— 9 Sep 46
Maj. Gen. George V. Strong	Army	30 Jan 45— 3 Jul 45
Brig. Gen. Frank N. Roberts	Army	4 Jul 45—30 Sep 45
Col. Charles H. Bonesteel III	Army	1 Oct 45—14 Aug 47
Col. C. Stanton Babcock	Army	30 Jan 45—30 Sep 45
Col. James A. McCormack	Army	1 Oct 45— 1 Feb 47
Maj. Gen. John H. Hilldring	Army	30 Jan 45— 3 Sep 45
Brig. Gen. G. F. Schulgen	Army	4 Sep 45—16 Feb 47
Mr. Kenneth D. Johnson	Army	17 Feb 47—15 Aug 47
Maj. Gen. John B. Brooks	Air Force	19 Feb 45—14 Dec 45
Brig. Gen. Wm. L. Ritchie	Air Force	15 Dec 45—17 Feb 46
Col. Royden E. Beebe, Jr.	Air Force	18 Feb 46—31 Apr 46
Col. John A. Hilger	Air Force	1 May 46—19 Feb 46
Col. C. B. Westover	Army	8 Aug 47—30 Dec 47
Capt. Lorenzo S. Sabin	Navy	1 Jun 45— 6 Jan 46
Capt. R. L. Dennison	Navy	28 Aug 45— 6 Mar 46
Comdr. Stephen Jurika	Navy	7 Mar 46—22 May 47
Lt. Col. Wm. R. Forbes	Air Force	20 Feb 46—15 Jan 48
Lt. M.E. McDonald (Secretary)	Army	30 Jan 45—30 Jun 45
Lt. Hugh D. Farley (Secretary)	Navy	1 Jul 45—29 Nov 45
Comdr. A. F. Richardson (Secretary)	Navy	30 Nov 45—30 Jun 46

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2 PRE-OCCUPATION-ECONOMIC

2-1 JAPANESE POST-WAR ECONOMIC CONSIDERATIONS[1]

E-155 (T-354) July 21, 1943
Report of the Committee on Post-war Problems, State Dept.
Secret

Table of Contents

INTRODUCTION
I. CONSEQUENCES FOR JAPANESE ECONOMY OF VARIOUS SECURITY PROPOSALS
  A. Enforced Reversion to an Agricultural Economy
  B. Liquidation of Japanese Heavy Industry
  C. Surrender of the Japanese Merchant Marine
  D. Liquidation of the Japanese Aircraft Manufacturing and Shipbuilding Industries
II. JAPANESE POST-WAR ECONOMIC PROBLEMS
  A. Basic Considerations
    1. Population Pressure
    2. Population Trends
    3. Emigration and Birth Control
  B. Prerequisites for the Attainment of a Tolerable Standard of Living
    1. An Extensive Foreign Trade
    2. Internal Reform in Industry and Agriculture; Further Development of the Domestic Market
III. RESTITUTION OF THE DEPENDENT AREAS: REPARATION DEMANDS
  A. Restitution of the Dependent Areas
  B. Reparation Demands
    1. Expropriation of Japanese Property Abroad
    2. Other Possible Forms of Reparation

Introductory Remarks

Thinking on the subject of American post-war policy toward Japan is still very much in its formative stages. Nevertheless, at least three distinct schools of thought on the problem are already discernible. Difference of opinion arises principally over the extent to which it will be necessary to interefere in and restrict Japanese economy after the war in order to ensure against a resurgence of Japanese military power, and, closely related, the degree of importance which should be attached to the rehabilitation of the Japanese economy and reestablishment within the country of a tolerable standard of living. One group asserts that security against future Japanese aggression will be adequately ensured only if Japan is deprived of her entire modern industrial plant and cut off from foreign trade, i.e. compelled to revert to a dominantly agricultural economy. Another school of thought would leave her her light industries and permit her, after a period, to resume foreign trade, but advocate, either singly or in combination, the liquidation of her heavy industries and surrender of her merchant marine.

The third group is of the opinion that security against future Japanese aggression can and should be achieved by methods involving much less interference with Japanese economy than is contemplated in the above two proposals. They advocate the destruction or confiscation of all remaining Japanese instruments of war and the dismantling or conversion to other purposes of the armament industries, accompanied by a system of inspection by an international agency. Many in this school would deprive Japan also of her aircraft manufacturing and shipbuilding industries. But disarmament beyond this point, this third group

[1] Portions deleted.

holds to be not only unnecessary but also likely to defeat its own purpose by rendering a satisfactory rehabilitation of the Japanese economy extremely difficult or entirely impossible, thereby causing a drastic decline in standards of living and perpetuating and intensifying Japanese resentment and military spirit. In their opinion revival of Japanese peacetime industry and trade and the regaining by Japan of a tolerable living standard, at least equal to that which prevailed there before the war, is a first, if not the first prerequisite for finally ending the "Japanese menace" and turning that country to a course of peaceful and orderly development.

It is not the purpose of this paper to argue the relative merits of these three views. Too many considerations, frequently little concerned with economics, are involved. Instead the economic problems to which the proposals of each school give rise are discussed in as objective a manner as possible. In Chapter I the plans advanced by the first two groups, and the proposals of certain members of the third respecting the Japanese aircraft manufacturing and shipbuilding industries, are appraised from the point of view of their probable effect upon the future operation of the Japanese economy. In Chapter II, the central portion of the paper, a situation is envisaged in which American policy as it is finally determined follows the views of the third school and this country undertakes to assist or actually to direct the rehabilitation and reform of Japanese economy. The many difficult problems which that task would involve are discussed in some detail. In the third and last chapter the economic consequences for Japan of a possible loss of control over her dependencies, i.e. the dependencies which she possessed at the end of 1941, are judged, following which the question of reparations is briefly treated.

I. Consequences for Japanese Economy of Various Security Proposals

A. *Enforced Reversion to a Dominantly Agricultural Economy*

This proposal derives from the fact that Japan has been increasingly a menace to world order with her increasing industrialization, and from the belief that due to her economic position, plus certain special features of Japanese temperament and national ideology, industrialization can only be sustained by a foreign policy which leads to aggression.

The consequences for Japan of such a step may be quite definitely predicted. During the two centuries of Japan's self-imposed seclusion from 1636 to 1854, the population remained practically stationary, at about 30 million. Twenty-four million were farmers, roughly 3 million were handicraft workers, traders and merchants, and approximately another 3 million belonged to the ruling or *samurai* class. With foreign trade forbidden (except for a negligible exchange with the Dutch and Chinese at specified ports), this number, under the prevailing forms of social and economic organization and state of the agricultural art, proved to be the largest which could be sustained.

Rapid population increase, however, began almost immediately following the introduction of modern industry in the final quarter of the last century. Today the Japanese population at 75 million is fully two and a half times greater than during the feudal period, almost the entire increment obtaining their livelihood from manufacturing industry based upon overseas trade. Agriculture, in spite of a pressure of population more intense than in any other country, and notwithstanding the most determined efforts to expand the arable acreage and increase yields, has been able to absorb only an additional 6 million. The total of 30 million in agriculture, authorities agree, represents for all intents and purposes the absolute maximum which the soil can support. The law of diminishing returns has in fact operated to a point where total yield would be appreciably higher were the number on the land reduced by a third or a half.

In the event Japan is again isolated and her factory industries dismantled, a living might be obtained by an appreciable proportion of the population in native handicraft industries, many of which have continued notwithstanding the introduction of modern industrial methods, and in internal trade and the professions. The number which could be absorbed in these occupations, however, would be limited, almost certainly not more than 9 or 10 million persons. Even this estimate may be considerably overstated. During feudal times the proportion in these trades was only 10 percent. A very low general purchasing power, the paucity of domestic raw materials, and a probable trend back to a state of family self-sufficiency in many essential products of everyday use would place definite restrictions upon the volume of employment in activities of this type. The conclusion is inescapable that return of the present Japanese population to an agricultural-handicraft economy would leave over 30 million persons without means of support, except for the charity of the remaining portion of the population, itself impoverished. Standards of living would fall below the subsistence level and extinction

of a fourth or more of the population would be rendered almost inevitable.

B. *Liquidation of Japanese Heavy Industry*

There are those who regard the liquidation of Japan's heavy industries, or their transfer to China, accompanied, some propose, by surrender of her merchant marine, as minimum essential measures to ensure against a resumption of Japanese aggressive policy.

The Japanese metals and machinery industries in 1936 accounted for 32 percent of the total value of factory production, and 28 percent of all factory employment. If the chemical industries were to be included in these totals, the proportions would be respectively 50 and 39 percent. Japan's heavy industries, as those of any modern industrial nation, form a highly important part of her industrial structure. The chief effects of their loss would be:

(a) An important added burden upon the economy imposed by the necessity for importing the country's entire future requirements of heavy industrial products.

(b) Loss of any possibility of participating in the provision of capital goods to an industrializing China, India, or Dutch East Indies.

(c) Serious interference with efforts for the development of the domestic market.

(d) A greatly reduced level of industrial production, employment, and income.

Loss by Japan of her heavy industries would of course be much less keenly felt than the loss of all her factory industries together with her foreign trade, discussed above, but clearly, nevertheless, would very seriously cripple the future operation of her economy. Only the discovery of extensive new overseas markets for the products of her light industries could prevent a sharp reduction in standards of living and very likely also in population.

C. *Surrender of the Japanese Merchant Marine*

Enforced surrender of her merchant marine, or what remains of it, has been suggested as another means of ensuring against further aggression on the part of Japan.

Receipts from shipping and marine insurance (the latter a direct outgrowth of the shipping industry) totalled a little over 400 million yen in 1935 and 1936, the last years for which figures are available, and paid for almost one-sixth of the country's merchandise imports. From two-thirds to three-fourths of Japan's foreign trade has been carried on her own vessels, and practically all of the heavy coastal traffic, the country's principal mode of internal freight carriage. Because the greater part of her foreign trade has been carried on her own ships the expense has of course not shown up in her balance of payments, but if the country were deprived of its merchant marine it would at once appear as a heavy net addition to its annual foreign obligations. Instead of a sizeable net income from shipping the nation's annual balance of international payments would show a much larger net expenditure on shipping account.

This loss too could be borne by Japan without a most serious effect upon the standard of living only if there took place at the same time a marked expansion of the nation's export trade to cover the loss of revenue and meet newly incurred shipping charges.

D. *Liquidation of the Japanese Aircraft Manufacturing and Shipbuilding Industries*

Certain members of the third group mentioned above advocate the destruction of Japan's aircraft manufacturing industry, civil as well as military, and her shipbuilding industry.

Loss by Japan of her peacetime aircraft producing capacity would probably not be felt to an important extent. Although the country's aircraft industry is large it is almost entirely of military origin. Commercial flying has never played a particularly important role in the nation's transportation system, and private flying has been almost non-existent. While it is of course possible that post-war years will witness an extensive development of air transport throughout the Far East and between that area and the rest of the world, loss of her aircraft manufacturing capacity would not necessarily prevent Japan from building up an adequate internal commercial flying system or from competing for an important share of the international traffic. If she should be permitted to purchase or lease planes from abroad, she would very likely be able to restore and expand her airline services at less cost than if she were to produce the necessary planes herself.

A prohibition against Japanese shipbuilding and destruction of her shipbuilding facilities would have a much less serious effect upon Japanese economy than loss of her merchant marine, though just how serious would depend to a large extent upon the number and age distribution of the ships remaining to her at the close of hostilities. Japan's merchant fleet, until the period of intensive building activity during the latter 'thirties, averaged a little under 4 million tons. A normal replacement of 5 percent on this amount would call for an annual construction of about 200,000 tons. At 250 yen per ton, the average rate during the early and middle 'thirties, the expenditure required to maintain this volume of shipping would be roughly 50 million yen a year, plus a small amount for repairs, which was about the average

spent from 1930 through 1935. While the purchase of this value of ships abroad would impose an appreciable burden upon the country's balance of payments, it should be remembered that Japan's shipbuilding industry is in many respects uneconomical, and definitely does not share the low cost advantages of her marine operating service. The industry is heavily subsidized, and depends upon the iron and steel industry, itself reliant to a large extent upon government aid. A large proportion of required building materials must be imported. Providing no artificial restrictions were placed upon the trade, there is every reason to believe that Japan, if deprived of her shipbuilding capacity, would be able to purchase needed replacements in England, Sweden, Denmark and Italy at lower cost than she could build them in her own yards.

It would appear that proposals for the destruction of these two industries, as contrasted with the other proposals discussed, could be carried out without jeopardizing plans for the country's economic rehabilitation.

II. Japanese Post-War Economic Problems

It may be our policy after the war to permit and, within limits, assist Japan to achieve a viable economy with a standard of living at least sufficiently high to make possible the maintenance of a stable society. From what has already been said it would seem quite clear that this purpose would be extremely difficult or utterly impossible of attainment if at the same time Japan's disarmament were carried to the lengths discussed in the first three sections of the foregoing chapter. But even assuming, as for purposes of presentation it is assumed in this and the following chapter, that disarmament is enforced only in the strictest and most literal sense, with the least possible interference with Japanese economy, the problem promises to present difficulties as great or greater than will be faced by any other nation in the post-war period.

A. *Basic Considerations*

1. *Population Pressure:*—Basic to all of Japan's economic problems is her population problem, more acute than in any other nation in the world. An area smaller than that of California, seriously deficient in virtually all mineral resources, and only 16 percent arable, supports a population of approximately 75 million persons.

The pressure of population is greatest in the agricultural districts. Some 14 million peasant farmers, or roughly five and a half million peasant families, are crowded together on an area of only 15 million acres, a little over one acre per worker or 2.7 per farming household. These figures are to be compared with 31 acres per farm worker profitably employed in the United States, 53 in Canada, 62 in Australia, and 7 in England. Under such conditions productivity per worker is necessarily very low, and average income is scarcely sufficient for the barest subsistence.

Population pressure in the industrial districts is also revealed by a very low level of per capita productivity. A large proportion of the industrial population, though working 12 to 15 hours a day, is able to support itself only at the margin of subsistence.

2. *Population Trends:*—The rate of growth of the Japanese population is still extremely heavy. During the decade of the 'thirties the total population rose at a rate of slightly under 900,000 a year, and at the end of that period stood at a little over 73 million. The annual absolute increase was greater than that of either the United States with double Japan's population, or Western and Northern Europe with a population three times as large.

While fertility rates in Japan have definitely begun to decline, the fall in mortality has been even more precipitate, with the result that the rate of increase of the total population had slowed only slightly by the time of the outbreak of the China War. All indications then pointed to a further increase of from 12 to 15 millions by 1960, the population peak to be reached sometime early in the last quarter of the century. At the same time the very large proportion of the population in the minor age groups made it evident that the population of working age was destined to grow at a considerably more rapid pace than the total population. Studies undertaken in this field pointed to the conclusion that employment would have to be found for as many as 400,000 additional workers annually from 1940 to 1960. Some experts placed the figure as high as half a million.

The effect of the fighting in which Japan has been engaged during the last six years upon this prospect has thus far been small. The rate of increase of the total population has, it is true, fallen considerably due to the absence of so large a proportion of the male population from Japan. However, losses among the armed forces have not yet been sufficient materially to affect earlier estimates, as summarized above, of the size of the working population during the next ten or fifteen years. The number of dead and permanently incapacitated (rendered unfit for peacetime employment) from July 1937 through December 1942 was not so very much larger than the number of additional workers which it has been estimated will be coming onto the labor market annually for the next twenty years.*

3. *Emigration and Birth Control:*—The removal of existing obstacles to Japanese emigration offers itself as a possible measure for the alleviation of the problem. The degree of success which could be expected to reward such a plan would almost certainly be very slight, however. Opposition to Japanese immigrants is deep-seated throughout the world, and is not likely to have lessened by the time the war is over. Moreover, the strong reluctance of the Japanese themselves to emigrate to any but a few chosen areas is not likely to have decreased. But even were the number of emigrants annually leaving Japan to be expanded to a number many times larger than ever before, the total effect, considering the extent of the problem, would still be almost negligible.

An increased use of birth control, already a factor of considerable importance in the declining fertility rates of the last twenty years, can be of invaluable assistance in restricting the rate of growth of the Japanese population in the future. Unfortunately, however, it offers no solution for the immediate post-war period. It appears almost inevitable that the pressure of population in Japan in the post-war years will be even more intense than during the pre-war decade. Only extremely heavy loss of life among the military and civilian population during the remainder of the war could alter this prospect.

B. *Prerequisites for the Attainment of a Tolerable Standard of Living*

1. *An Extensive Foreign Trade:* In the future as in the past, Japan will be primarily dependent upon foreign trade for its economic welfare. The country is seriously deficient in almost all of the important industrial raw materials, and is becoming increasingly dependent upon outside sources of food supply also. Imports of a wide variety of products, particularly cotton, wool, rubber, iron, oil, coking coal, rice, soybeans, and sugar will be required if the Japanese people are to be able to feed, clothe, and house themselves and enjoy even the simplest luxuries and amusements. Foreign exchange for the purchase of much the greater part of these imported materials will have to be obtained from exports. The export industries are themselves, however, heavily dependent upon outside sources of raw material supply (the silk trade is the only important exception to this rule), and so will require large additional imports of essential products.

To obtain her minimum requirements of imported materials Japan must develop an extensive export trade. This will be the central, and almost certainly the most difficult, problem to face the nation in the post-war period. Danger that she may not succeed in the task arises principally from the possibility that the post-war era may see a revival of widespread discrimination against Japanese goods, such as so greatly handicapped her export trade during the 'thirties. Tariffs, import quotas, import licensing and exchange control systems, exchange compensation duties, and bilateral trade balancing regulations, aimed specifically at Japan, became increasingly numerous as that decade progressed. By 1936 no less than 31 countries had set up import quotas against Japanese cotton textiles, 14 against Japan's silk tissue exports, 18 against her rayon tissues, 17 against her pottery and porcelain exports—and so on throughout virtually her entire export list. Discriminatory tariffs were scarcely less numerous, and were continually being raised. The reappearance of restrictions of this type in numbers and of a severity in any way comparable to the pre-war period would be likely to render unavailing even the most determined efforts on the part of the Japanese to restore their foreign trade.

There will of course be many other factors affecting Japan's overseas market prospects in post-war years. Much will depend upon the future course of the demand for raw silk in the United States and Europe. While in comparison with the 'twenties the silk trade by the time of the outbreak of war had already undergone a marked decline, it was still at that time, in terms of net return, the country's leading export industry. A further reduction in that trade, now regarded by most authorities as virtually certain to take place, would be very keenly felt.

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* Tentative estimates of losses among the Japanese armed forces from July 7, 1937 to January 1, 1943 by the Military Intelligence Service of the War Department.

	China	Elsewhere	Total
Killed:	240,000	55,000	295,000
Rendered unfit for further military duty:	575,000	100,000	675,000
Lost to active forces through disease:	60,000	20,000	80,000
Total:	875,000	175,000	1,050,000

Another important factor will be the expected extensive industrialization of China, India, and the Netherlands Indies, countries which, with the United States, have heretofore been Japan's leading markets. Industrial development in those countries is likely to proceed slowly, extending over a half century or more. Nevertheless there is reason to believe that imports of a large number of products—textiles, cheap metal, rubber, and glass products, and other light, primary manufactures—whose production the industrializing nations will first undertake on a really large scale, and which heretofore have formed the basis of Japan's export trade, will fall off quite sharply during the first and second post-war decades. Even without tariff protection the above-named countries, with their even cheaper labor and larger raw material resources, will very likely soon be able to undersell corresponding Japanese products. But in all likelihood there will in any case be set up tariff and quota restrictions to protect the infant industries from foreign, particularly Japanese, competition.

It is a well-known fact, however, that the industrialization of "backward" areas tends in the great majority of cases to raise considerably the general level of income and purchasing power in those areas. The development of China, India and the Netherlands Indies, will be almost certain to have that result. It is quite possible that by switching to new lines of export products, tending in general to be of a higher quality and more complex nature than the types of goods previously making up the trade, Japan may be able to take advantage of this increased general demand and maintain or even increase the volume of her exports to those countries. This result is not assured, however. Far Eastern industrialization may lead to a serious decline in the demand for Japanese export products. Of the two possibilities, however, the former at present appears to be the more likely.

Whatever the outcome in this connection, industrial development in East Asia will be certain to give rise to new demands for a wide variety of capital goods. If Japanese heavy industry is not largely destroyed during the war, there is good reason to believe that Japan may be able to develop a substantial export trade in capital goods to the industrializing nations of the Far East. There has, it is true, for many years been a strong preference in China and most other Asiatic nations for European and American over Japanese railroad equipment, machinery, and all but the simplest types of capital goods. However, in the period just prior to the outbreak of the Pacific War there were signs that this situation was changing. The Toyoda loom, for example, of Japanese invention and manufacture, was selling in the Netherlands Indies, South East Asia, and elsewhere in the Far East in preference to English and American makes. Some of these looms were even sold and installed in Britain itself. Japanese locomotives were another of a number of products of Japanese heavy and medium-heavy industry just beginning to make their appearance in Asiatic markets in important amounts at that time.

Her close proximity to China and the Netherlands Indies, and to a lesser extent, India, provides Japan with an advantage in meeting the capital goods demands of those countries which is not shared by any other leading industrial nation. She has already demonstrated her ability to sell certain heavy industrial products of good quality in the area at half or even a third the price of comparable goods of western origin. It is quite possible that the post-war period will find Japan supplying a large part, perhaps the largest part, of the capital goods needs of an industrializing Far East.

There is good reason to believe that Japan may be able to achieve a standard of living equal to or higher than that prevailing during the pre-war period with a volume of foreign trade considerably smaller than during those peak pre-war years—increases in the population notwithstanding. Basis for this belief is provided by the fact that ever since 1937 and, to a lesser extent, since 1931, the volume of Japan's foreign trade has in large degree been determined by the requirements of the war program. Hence it has been but loosely related to standards of consumption and general welfare within the country. It is estimated that in 1936 approximately 25 percent and in 1939 over 45 percent of Japan's imports were for military purposes—either the actual production of armaments or the expansion of the productive capacity of armament industries in Japan, "Manchukuo", Korea, and the other dependent areas.

. . . . . .

In sum, it is impossible to predict at this stage whether or not Japan will be able to develop an export trade adequate for her needs in the post-war period. (The assumption throughout this chapter is that her economy will not be crippled by extreme disarmament measures.) The limiting factor in the case will be the market question, but how severe that constraint will be it is difficult to say. Probably the most important factor involved will be the willingness of other nations to accept Japan's exports in free, or reasonably free, competition with the exports of other countries and with domestically manufactured products. Another factor will be the future course of the demand for natural silk. A third will be the degree of success which she experiences in adjusting her export trade to changing market conditions in an industrializing Far East and throughout the world. In combination these three factors will be instrumental in determining whether she will succeed in maintaining a tolerable standard of living after the war or will fail in that attempt.

2. *Internal Reform in Industry and Agriculture; Further Development of the Domestic Market:*—While an extensive foreign trade is to be considered the first and basic prerequisite for the constitution of a viable Japanese economy in post-war years, it is not the only prerequisite. Fundamental reform of the country's internal economic structure, making possible a more extensive development of the domestic market, will also be essential to that purpose.

Agrarian Reform

The need for thorough-going agrarian reform has long been recognized in Japan. The preoccupation of the nation with military affairs made possible postponement of the problem during the pre-war decade, but its solution will be one of the first tasks facing the nation with the return of peace. Unfortunately the bounds within which direct agrarian reform will be possible will be very limited. This follows from the fact that the basic cause of all the farmer's ills, overpopulation in the farming districts, is remediable only from the side of industry—through a rising level of industrial employment. As already pointed out, the law of diminishing returns in Japanese agriculture has operated to a point where total output would be substantially higher were close to half of the nation's 14 million farmers to transfer to other occupations. The importance of a further expansion of the nation's manufacturing industry, the only field of economic activity even potentially capable of absorbing such a large number of additional workers, is clearly indicated by this fact. However, even under the best of circumstances that expansion is bound to proceed slowly. Consequently measures for the immediate improvement of the farmer's lot must necessarily be confined to the correction of numerous subsidiary evils which have long plagued his class.

Opportunity for advancement within this narrower field is to be found principally in the field of land ownership and the rules of tenancy. At present the land is divided up into innumerable tiny plots, each peasant owning or renting a number of such plots, the combined area of which is generally only a little over two acres. This minute parcellation of the land is one of a number of factors effectively preventing the introduction of large scale, modern farming methods. A second factor tending toward the same result is the prevalence of tenancy (48 percent of the farming land is rented) combined with the fact that with yield per acre higher under the more primitive farming techniques, landlords have no incentive to introduce expensive mechanical farming methods. Rents, paid in kind for the most part, amount to 55 to 60 percent of the tenant's entire crop. Moreover, since the rent is fixed (does not vary with the size of the crop) the tenant must bear the full burden of loss from a poor harvest.

The most promising field for reform is to be found in the reduction of tenancy, the lowering of rents, and scaling down of the high land valuations upon which those rents are based. Further, rents should be made to vary at least to some extent with the size of the crop. Through such measures the million or more landowners who have long profited from the hardship which acute agrarian overpopulation has brought upon the farming class, might be gradually reduced in number and brought under some measure of social control. This accomplished, the way would be opened for the gradual consolidation of land holdings and the development of efficient, large-scale farming methods—proceeding *pari passu* with the flow of workers out of agriculture into industrial occupations.

Reform should also include measures to relieve agriculture of the disproportionately heavy tax burden which it has long been made to bear in the interest of the country's industrial development. In spite of the much lower productivity and average level of income in agriculture than in industry, a farmer's taxes generally speaking have been twice as high as those of a merchant or an industrialist of the same income.*

Further, steps should be taken to bring about a reduction in the heavy burden of debt borne by the farming class, and to provide new and improved farm credit facilities. The farm debt in 1936 amounted to 6 billion yen, or a little over 1,000 yen per household. Interest on that debt averaged 6 to 9 percent for the larger lending institutions, and 20 to 30 percent for the professional money lenders, shops, and "mutual aid societies" upon which the majority of farmers, with little to offer by way of security, were forced to rely. It is

* Shiroshi Nasu, *Aspects of Japanese Agriculture*, 1941.

possible that inflation, already appreciable, will do much to lighten the burden of the farming debt, but the need for improved credit facilities will still remain.

Finally, support and encouragement for the cooperative farm buying and selling organizations (*Sangyo Kumiai*) would do much to eliminate a host of middlemen, speculators, and petty traders subsisting to a large extent at the expense of the peasantry. Encouragement also of village industries would help to provide subsidiary employment to the farming population in at least partial replacement of the dwindling silk industry.

It should be emphasized again that the factor basically responsible for the farmer's plight, agrarian overpopulation, must necessarily remain outside the scope of all these reforms. Only through the expansion of Japanese peacetime industry and trade, making possible the movement of a large proportion of the present farm population into industrial activities, will a satisfactory solution of the agrarian problem be possible.

Monopoly Control in Industry, Commerce, and Finance

The Houses of Mitsui, Mitsubishi, Sumitomo and Yasuda, together with a half dozen or so smaller Zaibatsu (the term by which these giant family concerns are known), control some 70 percent of Japanese industry and trade. In the field of finance they possess a third of the total deposits of all "ordinary" (commercial) banks, 70 percent of all trust deposits, and 25 percent of all insurance funds. The degree of monopoly control and economic power exercised by these giant family concerns is without parallel anywhere else in the world.*

The harm worked by the long-standing control of the Zaibatsu over Japanese industry, trade and finance has appeared principally in an extreme concentration of wealth and income in the hands of these great concerns and the very small number of individuals which control them. Ever since the beginning of the Meiji era in 1868 they have been successful in retaining for themselves the greater part of the responsibility and the profits of enterprise. Smaller, independent concerns outside the sphere of Zaibatsu control have been at a definite disadvantage, and have remained relatively unprofitable. Labor has consistently been prevented from obtaining its proper share of the total industrial return. Part of the income of the Zaibatsu has of course flowed out in the form of wages, dividends, and government disbursements to the larger body of the people. Part has been reinvested in productive enterprise affording increased employment and making for an increased total national income. But a large proportion also has had no other visible effect than to add to the resources of a few very wealthy families, and make possible still further extension of the area of Zaibatsu control. The fact that the people as a whole, though bearing almost the full burden of progress, have obtained far less than their due share of its benefits is to be attributed in large part to the continuing predominance of these great family concerns.

Removal of the Zaibatsu from the Japanese industrial scene is scarcely less important to the nation's future economic welfare than agrarian reform. Their disappearance would in no way decrease the efficiency of production in Japanese industry. The number and size of the firms in the various large-scale trades would remain substantially as before; costs per unit of output might well be considerably reduced in certain industries. Profits, however, instead of flowing up to a few individuals at the top of the industrial pyramid would be distributed directly among a much larger percentage of the people.

This purpose would not be easily accomplished, however. Breaking of the control of these giant combines over the greater part of the nation's liquid capital resources would be the first objective, but by itself would be far from sufficient. The seat of their power is in industry, and it is there that attention would have to be principally directed. The position of one of the leading Zaibatsu in Japanese industry is to be compared not to that of a General Motors, a General Electric or a United States Steel but to a super holding company controlling all of these industrial giants—and Standard Oil of New Jersey, Dupont, the Chase National Bank, and a host of other both large and small concerns besides. This sweeping, "cross industry", horizontal structure of monopoly control—their predominance not in just one but in a large number of leading industries—distinguished the Zaibatsu sharply from the large monopoly concerns of other countries, and is the chief source of their invulnerability.

* Recent years have witnessed the growth of a number of so-called "younger" business groups, risen to importance along with the expansion of the war industries and intensive development of the dependent territories. The most important of these newer concerns are Mangyo (Manchuria Industrial Development Corporation), Nitchitsu and Mori, the first named ranking in size even with Mitsui and Mitsubishi. However, almost all of these younger groups, lacking the capital resources of the Zaibatsu, have been compelled to establish connections with one or another of the older, family groups, and in varying degree have become subservient to them. This fact notwithstanding they serve to increase considerably the degree of concentration of economic power within the country.

One possible approach to the problem of their dissolution would be outright expropriation of Zaibatsu property by the State, with pensioning of the family heads. Another would be nationalization, to be effected by the issue of a much reduced value of Government bonds for Zaibatsu held securities in controlled industrial, trading, and financial institutions, with later resale of the surrendered property to private purchasers. A third might be greatly to increase existing very moderate inheritance taxes. Inflation may, of course, do much to reduce the difficulty of the problem.

Further Development of the Domestic Market

In the further development of the Japanese domestic market is to be found very great opportunity for the expansion of Japanese peacetime industry, the employment of Japanese workers, and raising of the national standard of living in the post-war period. Up to the present time purchasing power among the masses of the people has remained very limited, and per capita consumption not only of the simplest luxuries but of bare necessities has been extremely low. Farming is still carried on with the assistance of simple hand tools, a large part of the nation's industry is unmechanized, and the greater part of the working population lives packed together in houses, which, while orderly and clean, can only be described as hovels. There exists within the country, in short, a very great potential demand for a wide variety of both consumers' and producers' goods.

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In summary, the first prerequisite for the constitution of a viable Japanese economy and the achievement of a tolerable standard of living by the Japanese people in post-war years will be a large foreign trade. A second, scarcely less important pre-condition for the attainment of that goal will be an extensive development of the domestic market. This development will be possible only providing thorough-going reform in industry and agriculture to bring about a higher level of per capita productivity, a wider distribution of the national wealth and income, and an increased level of general purchasing power is successfully carried out.

III. Restitution of the Dependent Areas; Reparation Demands

A. *Restitution of the Dependent Areas*

There is the possibility that Japan will be forced during the war or at the peace to surrender control over all parts of the Japanese Empire outside of Japan Proper—namely, Formosa, Korea, Karafuto, the South Seas Mandated Islands, "Manchukuo" and Occupied China.* In recent years Japan has carried on a very large volume of trade with these territories. In 1936, she obtained 33 percent of her imports from them, and sent to them 40 percent of her exports. By 1939 the respective proportions had risen to 49 and 66 percent. At first sight it would appear that loss of control over the dependent areas might very seriously handicap the operation of the Japanese economy in post-war years.

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B. *Reparation Demands*

1. *Expropriation of Japanese Property Abroad:*—Japanese overseas property investments in early 1942 are estimated to have totalled the relatively large figure of 12 billion yen (approximately 2.8 billion dollars) distributed as follows:

Estimated Japanese Overseas Property Investments, 1942

Area	*Million yen*
"Manchukuo"	7,000
Korea	1,500
North China	1,000
Formosa	800
Karafuto	500
South Seas Mandated Islands	75
Elsewhere	1,000
	11,875

It will be noticed that much the greater part of these investments is to be found in the dependent areas. It has been estimated (Board of Economic Warfare) that by early 1943 no less than a fourth of Japan's total processing (manufacturing) capacity was to be found in "Manchukuo", North China, Korea and Formosa. Expropriation of all or part of this property naturally suggests itself as a reparations measure.

* While Japan still preserves the fiction of "Manchukuo" and Occupied China as independent, sovereign nations, they are for all practical purpose part of the Empire.

It should be pointed out that the above figures show book value, and may be well in excess of the amount which will be realizable upon the property at the close of the war. Considerable capital has been invested in enterprises which, while they have served to increase the degree of the Empire's self-sufficiency in vital war materials, could not be expected to pay a return, on their present valuation, after the cessation of the war demand and renewal of access to sources of supply throughout the world. To this extent expropriation would be a less serious blow to Japan than the investment totals would tend to indicate.

Only two of Japan's dependencies, Formosa and Karafuto, have consistently returned a net profit upon the Japanese capital invested there, and in both cases the amount has been small relative to the total national income. Investments in Manchuria, and to a lesser extent in China and Korea, have been profitable in the past, but their amount was then very much smaller than now, and the nature of the investments was very different. Additional very heavy investments in these three areas since the middle of the last decade have to some extent been definitely unprofitable, but in part also have been too recent to reveal their potential earning power. "Manchukuo" and certain of the other dependencies are rich areas. Although return from her investments in those areas and elsewhere in the world has never in the past been a particularly important source of income for Japan, it is to be expected that a very considerable return upon the recently much increased investment total in the dependencies might be earned in the future. In this sense expropriation of part or all of those investments would be keenly felt. It should be remembered, however, that the loss would be one of future and as yet unrealized income, not income upon which the country has been accustomed to rely in the past.

The manner in which the burden of loss was distributed among the Japanese people would be important. Approximately half the Japanese property in the dependencies is State property and half is private. Expropriation of the former would inevitably bear upon the people as a whole. In the case of private property, reimbursement from the State would almost certainly be sought by the affected interests. Should they be successful in pressing their demands, that loss also would be borne by the general public. Government bonds would probably be issued to owners of the expropriated property, and serviced from the proceeds of general taxation. This additional tax load upon the poorer classes would clearly interfere with efforts to accomplish the country's economic rehabilitation. Because of this fact, if it is decided to seize Japanese private property abroad, it would appear advisable that special steps be taken to ensure that the loss is shouldered by the individuals and corporations which made the investments, and not by the Japanese public.

Expropriation of Japanese investments in the dependencies would also result in some dislocation of the Japanese industrial economy, now based to a very large extent upon the so-called "Inner Zone" overseas productive capacity. But the importance of this factor is easily overestimated. The war economy is heavily dependent upon this capacity, but the peace economy will be very much less so. Expropriation of Japanese overseas property in Asia and elsewhere would appear to be a particularly practicable method of providing at least partial reparation for injury suffered at the hands of the Japanese, without seriously obstructing efforts for the post-war reconstruction of the Japanese economy.

2. *Other Possible Forms of Reparation:*—Beside the surrender of Japanese overseas property various other forms of reparation suggest themselves for consideration. An indemnity to be paid in foreign currency, in kind, or in yen is of course one possibility. Another would be reconstruction with Japanese materials and labor of property damage wrought by the Japanese military forces abroad. Removal of heavy industrial plants from Japan Proper to other areas and the surrender of the Japanese merchant marine already discussed as security measures, have also been suggested as possible forms of reparation.

The crippling effect which the latter two proposals would have upon post-war Japanese economy has already been described. As regards the first two, experience has clearly demonstrated the wisdom of limiting reparation demands well within the ability of the conquered nation to pay. Not only would attempts to reorganize the Japanese economy upon a workable and reasonably satisfactory basis be rendered quite hopeless if the country were overburdened with oppressive reparation payments, but the amount of reparation paid would in the end be much less.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-2 POST-WAR ECONOMIC AND POLITICAL PROBLEMS OF JAPAN

T[2] Minutes 53 July 30, 1943
Division of Political Studies, Department of State
Secret

Mr. Isaiah Bowman

Mr. Hamilton Fish Armstrong	Mr. George H. Blakeslee
Mr. Adolf A. Berle	Mr. Hugh Borton
Mrs. Anne O'Hare McCormick	Mr. Robert A. Fearey
Mr. Leo Pasvolsky	Mr. M. M. Knight
Mr. Joseph W. Ballantine	Mr. Amry Vandenbosch
Mr. H. Merrell Benninghoff	Mr. Frank S. Williams
Mr. Cavendish W. Cannon	Mr. Philip E. Mosely
Mr. Alger Hiss	Mr. C. E. Black

SUMMARY OF THE PREVIOUS DISCUSSION OF THE DISPOSITION OF THE JAPANESE TERRITORIES

Resumé of the Subcommittee's Discussions

At the request of the Chairman, Mr. Borton read the resumé which he had prepared for the subcommittee on the discussion during the past two meetings on the disposition of Japanese territories (See Annex I—Discussion on Far Eastern Problems in the Territorial Subcommittee: Meetings June 25 and July 16, 1943). Mr. Borton reminded the members of the subcommittee that the following territories had already come under discussion: Korea, Formosa and the Pescadores, the Japanese Mandated Islands, Karafuto (Southern Sakhalin), the Kuriles, the Liuchiu Islands and the Spratly group. The subcommittee had agreed on certain broad principles which covered the disposition of these territories in general, and had discussed the special problems represented by each territory.

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POST-WAR ECONOMIC PROBLEMS OF JAPAN

Alternative Methods of Dealing With Japan

At the invitation of the Chairman, Mr. Fearey proceeded to sketch briefly the principal problems facing Japan after the war with special reference to the effects on Japan of various security proposals which had been put forward. He suggested that three schools of thought had been expressed with regard to the security aspects of Japan's post-war economy. The first was the drastic proposal that all modern industry in Japan be dismantled and the country cut off from foreign trade, forcing a return to an agricultural economy such as had existed there in the years from 1636 to 1854. The second school of thought believed that it was necessary only to deprive Japan of her heavy industry and her merchant marine. The third school of thought believed in the necessity of affording Japan the opportunity to revive its economic life. The country would be disarmed but its essential industries would be left intact. Mr. Fearey expressed the belief that only limited restrictions of Japanese industry would be necessary in order to assure security in the Far East.

Mr. Fearey continued by pointing out that it would be easy to show, if the time were available, that the first two points of view which he mentioned would have catastrophic effects upon Japanese economy. In the case of the first, one-quarter of the population would probably perish and if the second were carried out, Japan would be permanently crippled. With regard to the third school of thought, however, which would permit Japan opportunity to restore her economy and achieve at least a tolerable standard of living within adequate security restrictions, a number of problems would arise for which solutions would have to be found. Of these much the most important would be the development of an extensive foreign trade. Virtually the only obstacle in the way of the achievement of that central purpose would be the market problem.

Mr. Fearey expressed the view that the degree of success which Japan experienced in solving that problem would depend on three principal factors. One was the future course of the demand for natural silk, concerning which most experts are extremely pessimistic. In the years just before the war raw silk was still Japan's leading export product. Loss of the trade would be very keenly felt. The second factor was the possibility that many parts of

[2] Refers to the Committee on Territorial Problems.

the Far East might become industrialized in the near future. If this were to take place, the markets which Japan had developed in recent years might be lost. While he admitted the dangers to Japanese economy of this possibility, Mr. Fearey believed that if Japan achieved a sufficient degree of flexibility in its export trade to adjust to changing demands in these areas, shipments could very likely be maintained and even increased above former levels. The third factor, and the one which Mr. Fearey believed to be crucial, would be the willingness of other countries to accept Japan's export products in free or reasonably free competition with the products of domestic industries and the products of other countries. There was some chance that many of the countries in the Far East as well as in other parts of the world might be reluctant to arrange their economic life in such a way as to permit any extensive participation in it of Japan. If this were to be the case, Japan would fail in her efforts to increase her foreign trade regardless of the quality of her products. When the Chairman raised the question as to whether Japanese commercial methods had not resulted in justifiable discrimination against that country in the past, Mr. Fearey expressed the view that while Japan had undoubtedly used dishonest methods in the past, he believed that they had been greatly misrepresented and exaggerated in the public press.

Apart from the need for developing her foreign trade, Mr. Fearey pointed out that certain essential reforms in agriculture and industry would have to be carried out before Japan could attain a stable economy after the war. In the case of agriculture, the essential problem was over-population in the agricutural districts and here the migration of millions of farmers into industry appeared to be the only feasible solution. So far as industry was concerned, it would be necessary to dissolve the large holding corporations, known as the *Zaibatsu*. The benefits to be derived from these reforms would be an increased per capita productivity, a wider distribution of wealth and income and a consequent increase in the purchasing power of the Japanese people. It was Mr. Fearey's view that Japan will have to place great emphasis on the development of its domestic market after the war. Regarding the probable effect on Japan of the loss of many of her territories, Mr. Fearey did not believe that the effect would be serious so long as that country had equal or substantially equal economic opportunities in these areas and throughout the rest of the world.

In conclusion Mr. Fearey expressed his personal opinion that the third, or moderate, point of view would offer the best results. His reasons for this conclusion were first humanitarian, since either the first or second solutions would mean very widespread suffering in Japan. The second reason was that lasting peace in the Pacific could be achieved only if Japan were economically healthy. If she were poverty-stricken she would represent a malignant cancer in the body of the economic life of the Far East. Mr. Fearey's third reason for supporting the moderate view was that a healthy Japanese economy would offer important opportunities for American business. Before the war Japan had been our third market and our second foreign source of supply. While her role in our economy might very likely be less important after the war, it would nevertheless be a factor which could not be ignored. Furthermore, low-income groups all over the world had in the recent past profited by the cheap products which Japan had produced. At the same time, Japan still represented in many ways the most logical source of capital goods for the countries of the Far East.

The Chairman complimented Mr. Fearey on the clarity of his report, and remarked that rarely had a better statement been presented to the subcommittee by a member of the research staff.

Japan's Opportunities For Post-War Recovery

With regard to the last statement in Mr. Fearey's report, the Chairman raised the question as to whether Japan's success in providing capital goods for the Far East had not been the result more of its strategic position in that part of the world in the years immediately following the World War than of any permanent factors. It was his impression that since Japan had played a relatively slight role in the last war and had not concentrated as heavily as other countries in war production, it had been able to change swiftly after the war to the production of capital and consumer goods for the Far Eastern market. It was therefore his view that since Japan would be in an entirely different position after this war, she would not have the same success in capturing the Far Eastern market. Mr. Fearey agreed that there was a great deal to be said for this point of view and asserted that the answer would depend on the degree to which Japan's heavy industry was destroyed in the course of the military operations themselves.

On being asked for his opinion by the Chairman, Mr. Knight expressed the view that the period of Japan's greatest industrial expansion had come some ten years after the war rather than in the immediate post-war period and that he was therefore inclined to agree

with Mr. Fearey's original statement. The Chairman, however, recalled that Demangeon's book on *The Decline of Europe* which came out in the early 1920's, had startled the world with figures showing the rapid expansion of Japanese industry. Mr. Borton added, however, that the greatest Japanese industrial expansion had not come until 10 years later. Mr. Williams came out in support of Mr. Bowman and asserted that Japan had been well able to take advantage of its opportunities immediately after the last war. He said that Japanese businessmen had remarked to him in person concerning the difference between the two wars in this respect. At the present time, however, a large part of the industry had been converted to military uses and such peace-time production as textile output had been greatly reduced. Mr. Knight added that the engineering capacity of the Japanese was quite remarkable.

Mrs. McCormick raised the question as to whether the disarmament of Japan might not be of great aid to her in restoring her peace-time industries and that while other countries would have to keep up their armies and navies, she would be able to go ahead with normal production. Mr. Pasvolsky expressed the opinion, however, that it would take some time before Japan would be in a position to do this. At the same time, he added, it was quite possible that the industrial expansion accompanying the war might ultimately prove to be a permanent contribution to Japan's economy. Mr. Fearey remarked that people in this country had underestimated the Japanese in the past. The Japanese engineers had copied Western models because it was more sensible to do this than to invent new ones of their own. In spite of this, however, they had also produced some commendable inventions of their own. Mr. Pasvolsky asked whether the Japanese machine tool industry was not one of their weaker points. Mr. Williams replied that they had a very good machine tool industry but that it was handicapped by the lack of certain vital materials. The Chairman commented on the opportunities which the American industrial system enjoyed as compared with that of Japan. The great market which we had served as a spur to our energies and the youth of the nation had many encouragements to enter into industry and to exercise its ingenuity in devising new methods of production. Mr. Ballantine added that we had accomplished a great deal more than the Japanese in the field of industrial research and Mr. Williams admitted that was where the Japanese were weakest. The Chairman concluded by saying that while it was easy and logical for the Japanese to copy the designs and machines of others, in doing this they lost the aptitude—building qualities which our industrial system stimulated.

Post-War Political Problems of Japan

In the few minutes left before adjournment, the Chairman asked Mr. Borton to summarize as briefly as possible the main political problems that Japan would face after the war. He reminded the members of the subcommittee that these issues would be taken up in more detail at the next meeting and that now Mr. Borton would only have time to consider the main problems.

Mr. Borton raised a number of questions which would face Japan at the end of the war. The first concerned the changes in Japan's governmental structure. Another regarded the responsibilities which the United States in particular, and the United Nations in general, have in enforcing these political changes in Japan. Should they be made compulsory or should the Japanese be free to run their own government after the general framework had been agreed upon? Finally Mr. Borton raised the question as to whether there was any hope that the military oligarchy could be checked and its privileges extinguished.

With regard to the first question, concerning possible changes in the Japanese political system, Mr. Borton stated that our aim should be to abolish the privileges of the military group, which had permitted the dual system of government to exist in which the civilian administrators had no control over the military and naval authorities. Under that system a few persons of high military and naval rank could control the Cabinet. If they were displeased with the way things were going they ordered the ministers of war and navy to resign and forced the Cabinet out of office. It was Mr. Borton's view that a change in this system could be brought about by the application of two measures, first by amendments to the Constitution and second by the introduction of Western ideas. The amendments to the Constitution were closely connected with the maintenance of the Emperorship, for the Emperor had the power to decree amendments to the Constitution. It would therefore be possible to make fundamental changes in the Constitution merely by bringing pressure to bear on the Emperor. When Mr. Armstrong asked whether there had been any public pressure for changes in the Emperor's prerogatives, Mr. Borton replied that there had been. In 1929 and 1930 important changes had been discussed by the moderate groups. It was his view

it had been the fear on the part of the military groups that their powers might be reduced which had spurred them on to aggression in Manchuria.

When Mr. Armstrong asked whether there was any possibility of a change in the Japanese belief in the infallibility of the Emperor, Mr. Borton replied that the Japanese were not consistent in their political views. While they admitted that the sovereign had the power to make decisions and to appoint ministers, they blamed the Cabinet rather than the Emperor when anything went wrong. This attitude was based on the theory that the Emperor had been ill-advised. Mr. Ballantine added that with the exception of the uneducated peasants, the Japanese did not take the idea of the divinity of the Emperor very seriously. With regard to the position of the Emperor, Mr. Borton summarized his conclusions by saying that he did not believe any government could stand without the support of the Emperor, that the Emperor could be very useful in inaugurating constitutional amendments and that it would be impossible to legislate popular respect for the Emperor out of existence.

Mr. Borton continued with a discussion of the possibilities of changing the political structure of Japan by the introduction of Western ideas. He warned the members of the subcommittee that owing to the Japanese concept of government it would be no use to try to make changes in their form of government simply by writing clauses into a treaty of peace or by changing the working of the Constitution. The Japanese believe in government by men rather than government by law, and no Constitutional changes would have any significance unless the political leaders gave them their backing. Mr. Borton agreed with Mr. Ballantine's view that the most effective way of influencing Japanese opinion in this regard was by moral suasion. We must tell them that we cannot treat them as equals unless the special privileges of the military oligarchy are abolished. The terms of the peace treaty should be general and the real interpretation of our peace aims should be made informally and by direct contact between our diplomats and their statesmen. Mr. Ballantine added that he had been informed by a distinguished Japanese jurist that the Japanese Constitution was so broad that it could fit any system. If this were the case, it might be better not to make any formal changes in the Constitution but rather to impress the leaders of the post-war governments with the changes which we regarded as essential.

The Chairman brought the meeting to a close and announced that the subcommittee would meet again on September 17th at an hour to be announced later.

C. E. Black

[Source: Dipl. Br., National Archives]

2-3 JAPAN: UNITED STATES ECONOMIC POLICIES

CAC-165 Preliminary
IDAC-FE[3] Report
Secret

April 15, 1944

I. The Problem

What should be the major economic policies of the United States towards Japan after the war?

II. Discussion

To assure a proper perspective of American interests, future United States-Japanese relations must be examined realistically and without hate or other emotion and economic policies must be considered in their proper relation to military and political policies.

The dominant factor in our future attitude towards Japan will be security against the possibility of renewed aggression. The obvious moves to accomplish this and relate to control of Japan's war making potential and encouragement of a transfer of Japanese political control from military to civilian element. But of equal importance in the long run will be permitting Japan to achieve a reasonable degree of prosperity, and to have hope that in a peaceful course there will be opportunity for economic improvement and a recapture of her self-respect in the concert of nations. Failure in these will cause—if history is any guide—a psychological state in the Japanese people which may again result in resort to war and the skill and craft of millions of Japanese may again be bent to this end as the other nations, more prosperous and contented, inevitably relax their guard.

[3] Inter-Divisional Area Committee on the Far East.

Accomplishment of American objectives requires a restraint based on recognition of the fact that unnecessary harshness will defeat its own objective. Permitting Japan to play her part in the modern economic world is as important for the American security as the actual disarmament of the Japanese and the break-up of their imperial power.

The policies which may be persued are closely interrelated. The carrying out of one must be examined as to its effect on others we may wish to follow. In general, it would appear that there are five major policies which the United States may adopt:

1. *Military Disarmament:*

There would appear to be little disagreement as to the need for:

(a) The stripping of Japan of her major overseas possessions.

(b) The removal or destruction of all Japanese military and naval installations and of all war equipment except such equipment as can be converted to civilian use and would be obsolete or useless for reconversion to effective war purposes after a very few years.

(c) The destruction of industrial plants, facilities, machinery or parts engaged in armaments production not capable of conversion to peacetime civilian use.

2. *Control of Rearmament:*

Japan, as an island, cannot become again a threat to the world security without command of both neighbouring seas and the air. Control of rearmament in Japan presents, therefore, a much simpler problem than in Germany and may be less rigorous. The degree and means of such control are subject of divergent views, although there is little disagreement as to the first and most obvious step. The methods for controlling rearmament would appear to be:

(a) The establishment of naval and air bases by the United Nations individually or collectively at strategic points designed to prevent Japanese agression.

(b) Prohibitions against new military and naval installations and the manufacture if military equipment. To enforce such prohibitions there must be an intensive inspection system, and a determination on the part of the United Nations to enforce the prohibitions. While such prohibitions and inspection will be expected by both victor and vanquished during the first years after the war, the attempt if undertaken for a long, indefinite period may well become ineffectual for any of several reasons, and may also bring about that psychological state which will defeat the very security it is designed to assure. A fixed period of total prohibitions followed by a further fixed period of prohibitions which can be enforced with minimum of inspection would seem desirable and more in accordance with United States security aims. Such prohibitions might relate to fortifications, military bases, battleships.

(c) Establishment of collective control of Japanese imports through international export control agreements. It is believed that the United States should join in any universal collective agreement to curb exports to Japan of products, from time to time specified, particularly important in the manufacture of war materials in order to prevent any stockpiling of such products in excess of normal civilian industrial needs.

(d) Prohibition against Japan continuing certain industries. It is believed that there should be no prohibitions against civilian enterprise even though such enterprise might be an asset in wartime. During any rehabilitation period, however, assistance should be directed for economic reasons in other directions. Examples of prohibitions frequently suggested follow:

1. Although civilian aircraft is not readily convertible to military use—other than transport—it is argued by many that only through a total prohibition of aircraft manufacture will it be possible to prevent growth of a dangerous capacity to manufacture military planes. But industrial plants other than civilian aircraft plants can be converted to the manufacture of military planes on relatively short notice. It is believed that if the inspection against production of military equipment is adequate and competent, no prohibition against civilian aircraft production is required. If such inspection is inadequate no prohibition against civilian aircraft manufacture will be affective. The suggested restriction would deny to the Japanese the right to engage in a modern civilian enterprise in which all the world will be competing. Its unfortunate effect on Japanese psychology would more than off set any security factor than such a measure might be expected to assure.

2. Prohibitions against ship-building are even less justified as a security measure. Merchant ships are of negligible value in naval warfare and inspection against the manufacture of important war vessels relatively easy to carry out. The Japanese are dependent on their carrier service for income to aid in keeping their economy in balance.

3. Complete destruction and prohibition of heavy industry in Japan would, it is believed, condemn to slow death from malnutrition and starvation millions of men, women

and children—representing the increase in population attendant on intensive industrialization. A machine-gun would be more humane and safer. Aside from the inhumanity of the proposal which would never be accepted by the American people if its full implications were understood, is the danger inherent in the desperation of the Japanese people condemned by such a program.

3. *Economic Disarmament:*

By this term is meant the stripping of Japan of the means of establishing autarchic independence in war essentials. There are three measures which can be taken, although determination as to the details or degree of application will not be easy.

(a) The stripping of Japan of her overseas, non-Japanese possessions. With the exception of a few islands acquired solely to serve as military bases, Japan's overseas territories have been acquired so that Japan would be assured of all needed war materials under the Japanese flag and that these resources could be exploited for her sole benefit.

(b) The forfeiture of all Japanese property in the overseas possessions taken from Japan; and all Japanese property acquired during or within "x" years prior to the occupation or invasion of the countries comprising the "co-prosperity sphere".

The older rules of international law governing treatment of enemy property and distinguishing sharply between public and private property are scarcely applicable in these days of totalitarianism. Japanese economic exploitation in overseas territories has been mainly a partnership between government and private capital. In other areas much of the Japanese property has been acquired as part of a natural policy of aggression backed with official sanction and subsidy.

In overseas territories taken from Japan it would seem imperative to take all Japanese property—private as well as public (except of course *bona fide* personal possesseions and possibly certain other classification of property) leaving the private owner to look to the Japanese Government for reimbursement. If this is not done such territories will continue economically a part of Japan, will continue to serve Japanese self-sufficiency, and will prevent the proper adjustment of the territories in their new relationship.

In the areas of the "co-prosperity sphere" Japanese public property should be taken; all interests (public and private) in communications and utilities; and all Japanese property (public and private) acquired during Japanese occupation or invasion (actual as well as nominal, viz. "Manchukuo") or within five years prior thereto. (Again, *bona fide* personal possessions and possibly certain other classifications of property should be excluded.) Probably compensation should be paid for private interests in communication or utilities acquired more than five years prior to occupation or invasion on the theory that such acquisition was a *bona fide* investment. But property acquired during occupation or invasion or in apparent anticipation thereof should not be respected by the United Nations; rather the owners should look to the Japanese government for reimbursement of their losses. If such property is not taken from the Japanese not only will improper exploitation result; but the areas, especially those where the railroads or utilities are Japanese owned, will continue to be dominated economically by Japan, and the move for economic disarmament fail.

(c) Restitution of stolen property and reparations. Identifiable stolen property should be returned to the rightful owners wherever possible. All other property, both public and private, which it is proposed should be forfeited, should be taken over by a reparations agency of the United Nations, fairly valued, disposed of pursuant to agreement among the nations, and the proceeds or the agreed valuation credited against the reparations imposed upon Japan. Such property (plus the value of war material and shipping taken from Japan) should constitute the major part, if not all, the reparations to be demanded of Japan. Any other reparations should be based on the principle that Japan should not be permitted to effect an economic recovery at a speed in excess of the victims of its agression. The amount of such reparations should depend in large part on the amount of devastation which the Japanese armies perpetrated in the areas from which they are still to be driven.

It is believed that any such additional reparations should be used primarily to aid the economy of such countries; but it is urged that, in general, payment be not industrial equipment else Japan will have established a permanent post-war market on which to stage a rapid recovery. Payment of cash reparations, it should be observed, would depend on Japan's ability to acquire foreign exchange through foreign trade.

4. *Control of Economic Disarmament:*

It will be necessary to see that Japan cannot again build up its economic control or domination of other areas and make such areas essentially subordinate parts of the Japanese economic system. As such control will require the cooperation of the nations which might

be directly affected, international agreement will presumably be required to make such control effective. It would appear to be to the interests of the United States to initiate if need be and to participate in international agreements:

(a) To prevent such economic agreements between Japan and any other country as will establish an economic bloc, bring such country under the economic domination of Japan, or make Japan self-sufficient in some particular item needed in time of war.

(b) To prevent Japan (or for that matter any country) acquiring by investment or otherwise, direct or indirect control of transportation facilities or utilities in any other country, or such other holdings abroad as would threaten the security or administrative integrity of such other country.

5. *Development of a Balanced Economy:*

Desparation at their plight or even extreme discontent among the Japanese may well be a substantial factor of insecurity. The suggestions heretofore made would, it is thought, minimize the opportunity for aggression by the Japanese—but coupled with these should be a policy of permitting the Japanese economy to develop to a point of economic equilibrium if not prosperity.

(a) International trade is essential for this purpose, and no unreasonable restriction should be placed upon Japanese participation in such trade.

(b) Japan should have equal access with other nations to sources of raw materials and markets (but equally Japan should be required to adopt on its part a policy of non-discrimination and equal access in her relations with others) and conversely other nations must not construct blocs or tariff barriers to the virtual exclusion of Japanese trade.

(c) Advice and assistance toward the reorganization of the internal economy of Japan should be provided if they are desired by the Japanese Government, but in general interference in Japanese internal economic affairs should be avoided once the military occupation is over.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-4 SECURITY POLICY VIS-A-VIS JAPAN: ECONOMIC ASPECTS

CAC-194 Preliminary
IDAC-FE Report
Secret

April 30, 1944

It may be assumed that measures to ensure security from future Japanese aggression will include the destruction, dismantlement or removal of all remaining Japanese war equipment not convertible to peacetime use, military and naval installations, and industrial equipment specifically associated with arms production (e.g. special dies and tools). Also, it seems assured that an inspection system either by itself or in conjunction with other security arrangements will be established to prevent Japan's rearmament.

There are those, however, who consider that disarmament and armament controls in this limited sense will not be sufficient, who have proposed in addition restrictions on specific categories of Japanese normal, non-military industry. The most drastic of these proposals advocates Japan's complete isolation, cutting her off from all foreign trade and forcing a return to an agrarian-handicraft economy as in the feudal period. The mildest confines itself to a prohibition on the manufacture of any type of aircraft, civil or military. In between are plans for the destruction of all Japan's heavy industries, selected heavy industries—e.g. shipbuilding, iron and steel, machine tools, and synthetic oil—and confiscation of all or part of the Japanese merchant marine.

Whether or not one or more of these proposals should form part of a comprehensive security plan for Japan depends on several considerations. Would a given proposal if implemented be effective for the purpose of preventing Japanese aggression? Is it necessary to that purpose? A particular restriction may be highly effective in reducing the Japanese war potential but other facts may indicate equal security can be ensured without it. Thirdly, how seriously would it handicap the normal operation of Japanese economy?

The importance of this third factor is frequently underestimated, as indicated by the following facts. The threat of renewed aggression by Japan—if it is to reappear—would be most apt to show itself not five or ten, but fifteen, twenty or twenty-five years hence. By that time, experience shows, years of peace will have reduced the consciousness of danger in the United States and other Pacific countries, and the restrictions imposed on Japanese military strength at the peace settlement will very likely have been relaxed to a point where

they will have lost their effectiveness. Our determination to keep Japan militarily impotent will have weakened, but Japan's desire to free herself from the restrictions will have strengthened. As the years pass it is reasonable to believe security from Japanese aggression will come to depend more and more on how greatly Japanese attitudes, motivations and policies change and reduce the impetus toward war within Japan—and it is to be hoped, also, on effective international security arrangements,—and progressively less on the various restrictions we impose.

Such changes, however, will be possible only in an atmosphere of reasonable prosperity. We cannot be certain an economically viable Japan will become a peaceful Japan—Germany with one of the highest living standards in Europe has started three major wars and two minor wars in the last 75 years. But we can be certain that if Japan is kept impoverished and destitute, especially if her destitution is the result of economic restrictions imposed upon her by the victors, she will not change. Rather the military spirit will be intensified and perpetuated. It is only if she is afforded opportunity to achieve a reasonably satisfactory living standard through legitimate enterprise, that an environment will be created in which her conversion to peaceful attitudes can be accomplished. In principle, therefore, Japanese normal industry should not be restricted to achieve a theoretically perfect condition of disarmament where such restriction would seriously handicap the operation of the peacetime economy.

In the first section below security proposals involving restrictions of Japanese normal, non-military industry will be examined from this point of view—i.e. the extent to which they would be likely to cripple Japan's post-war economy. The conclusions reached will have relation only to this aspect of the question. In the second section the effectiveness of these proposals in curbing Japanese aggression and their necessity, if any, for that purpose will be appraised. On the basis of the evidence accumulated the basic features of a security plan vis-a-vis Japan, in so far as security with respect to Japan involves economic considerations, will be set forth.

I

A. *Separation of the outlying portions of the empire from Japanese control.*

This "proposal" differs from others later discussed, first, because it has already been adopted, at Cairo, and second, because security against the possibility of renewed Japanese aggression is only one of several objects sought. Nevertheless, it is important for our purposes to know to what extent the loss of her 1941 dependencies (Occupied China, Manchuria, Korea, Formosa, the Mandated Islands, and, possibly, Southern Sakhalin) is likely to handicap Japan's post-war economy. She has relied on these areas as controlled sources of raw materials and food products, and as protected markets and investment outlets. Also, the movement of close to 3 million Japanese to the dependencies has permitted some easing of population pressure in the main islands.

Japan has pursued a well-defined policy of empire self-sufficiency for several decades. After 1931 this policy was greatly intensified. Although in 1936 a third, and in 1939 almost half of her imported raw material and food product requirements were met from empire sources the great majority of items obtained there were available to her in sufficient quantity and often at much lower cost from other sources, upon which she had formerly relied but had in whole or in part deliberately abandoned.

For a certain few products, however, she is genuinely dependent on these areas. These are coking and anthracite coal from North China, Manchuria and Korea, rice from Korea and Formosa (dependence in this case derives entirely from the Japanese preference for the particular type of rice grown in those colonies) and soybeans and soybean products, horse beans, and broad beans from Manchuria. None of these products are available in sufficient quantity from any other point within reasonable shipping distance from Japan. Nevertheless, *if she possesses the necessary foreign exchange*, there is reason to believe that the normal working of economic forces will assure her her full requirements of all of those products after the areas have passed to other controls.

The importance of the dependent areas as protected markets for Japanese products increased rapidly in prewar years. In 1929 they took 30 percent, in 1936 ("Manchukuo" having by then been added to the list) 40 percent, and in 1939, 66 percent of Japan's total exports. However, of the shipments during the latter part of the decade some 40 percent consisted of capital goods ordered by Japanese firms in the dependencies for the development of those areas. Only about 60 percent were consumers' goods, and even this trade was heavily dependent upon the purchasing power provided by Japanese capital expenditures. A large part of the total, moreover, was for consumption by Japanese military forces throughout the empire.

External markets are of economic value to a country only to the extent that they make possible imports of genuinely useful goods. Exports in and of themselves are, of course, only a drain upon a nation's resources. It is significant, therefore, that the steadily growing volume of Japanese exports to the dependent territories during the 'thirties was accompanied by only a very small increase in imports from those areas. During the latter part of the decade exports exceeded imports in a ratio of between two and three to one. The disparity, moreover, was not made up multilaterally, imports from other areas declining slightly over the period. Further, such increase as did take place in imports from the dependencies was made up almost entirely of products of military value. Imports of civilian consumers' goods from empire sources showed little or no increase; in some cases they even declined as the decade progressed. Again the difference was not made up multilaterally.

A total of approximately 11 billion yen (U.S. $ 2,500,000,000) had been invested in the dependent areas by the Japanese by the end of 1941. The return on this property during the last decade, when its total amount almost tripled, was small, however. While some of the investments paid well, many were definitely unprofitable, justified only in the cause of empire self-sufficiency and heavily dependent on State aid. Allowing for supporting expenditures of all types—military and administrative expenses and government subsidization of industry and agriculture—it is in fact doubtful if any return at all was earned.

The Japanese population in the dependencies in 1941 totalled approximately 2,700,000 persons. Probably the greater part of this number will be required, or of their own accord will prefer, to return to Japan after these areas have been transferred to other controls. Their repatriation, in conjunction, perhaps, with the return of large numbers of Japanese from other parts of the world, will mean an appreciable further overcrowding of the Japanese main islands.

The Japanese dependencies are rich areas, particularly Manchuria, and in losing the exclusive right to their development Japan will be suffering an important loss. The relevant consideration, however, is not what future, potential gains she will be losing, but whether she will be losing important advantages upon which her economic welfare and the living standards of her people have heretofore depended. Enough has been said to show that such will not be the case. The over-all advantages Japan has derived from her special position in Manchuria and the other dependencies in terms of real wealth contributing to the well-being of her people have been small or entirely non-existent. In part this is to be attributed to the fact that the development of these areas is still at a comparatively early stage, so that large returns could not be expected as yet. But a factor of even greater importance is the manner in which Japan has dissipated the fruits of their development for the furtherance of her military program. Exploitation has been directed almost exclusively to military ends, particularly the end of self-sufficiency. The Japanese people as a whole have derived little or no advantage from the growing trade with these areas or investments therein. Formosa's sugar plantations give the island the appearance of a highly profitable colony. But the sugar imported from Formosa in Japan could be obtained at approximately half the cost in Java. The Japanese people, through the higher price they must pay for sugar, make Formosa profitable.

For the most part loss of the dependencies will mean the loss of future and as yet unrealized benefits rather than benefits upon which the country has been accustomed to rely in the past. Nevertheless Japan will continue to be dependent upon Manchuria, North China, Korea and Formosa for certain vitally necessary products, particularly beans, coal and rice. Up to now her domination of these areas and the fact that she could make all needed purchases in yen have made the acquisition of the above items a simple matter. In the future, however, her exports to the now dependent territories will be faced with the competition of domestic industries and the exports of other nations, and there will be import restrictions of various kinds to surmount. If she is afforded substantially equal opportunity with other nations to markets in these territories and in the world at large she will probably be able to obtain sufficient foreign exchange to maintain an adequate volume of imports from these and other areas. If on the other hand her products are widely discriminated against this will be impossible, and the loss of her dependencies will mean reduced living standards.

It is possible, in short, to imagine the market problem becoming so acute for Japan that notwithstanding the fact that the dependencies in the pre-war period were actually more of a drain on her economy than an asset she would nevertheless be the worse for their loss. Almost any expenditure of Japanese currency, even for such wasteful purposes as the support of a high-cost sugar industry in Formosa or an army in Manchuria, is worthwhile if it makes

possible imports of essential products which a lack of foreign exchange would otherwise make impossible. The consequences for Japanese economy of the loss of the dependencies will not be known until it is seen what success Japan had in developing an adequate export trade, which in turn will depend upon the treatment accorded Japanese products in world market. Only if substantially equal treatment is shown Japanese products will the loss of these territories probably not be seriously felt.

. . . . . .

All of the above proposals, except that for the destruction of the aircraft manufacturing industry, would, if implemented, in varying degrees be harmful to Japanese economy, and so would reduce the likelihood of Japan's conversion to peaceful attitudes. There is reason to believe, moreover, that they are unnecessary for the purpose that they are intended to serve, to prevent a revival of Japanese military power.

The argument of those advocating restrictions on Japanese, normal, non-military industry proceeds from the view that in the space of fifteen or twenty years our watchfulness will have relaxed. It is held that it will be relatively easy for her after a time to throw the restrictions off. But if in addition she has been deprived of her aircraft, shipbuilding, iron and steel and certain other key heavy industries and possesses no merchant marine, rearmament and renewed aggression will be difficult or impossible.

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[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-5 JAPAN: ECONOMIC POLICIES DURING MILITARY OCCUPATION

CAC- 222[4] July 4, 1944
PWC-296
IDAC-FE Report
Secret

It is important that the economic policies followed by military government during the occupation of Japan be of a type not only to promote the purposes and effectiveness of the occupation authorities but also to help ensure an early elimination of the military elements of Japanese national life and character.

It is recognized that decisions relative to details of these economic policies must be worked out in collaboration among all Government agencies concerned by groups especially designated for the purpose. No attempt, therefore, is made here to give detailed recommendations. The broad policies, however, on which such decisions are based are of fundamental importance in our future external relations and as to these the State Department offers the following observations and opinions.

I. CONTROL OF INFLATION

Every effort should be made to counteract inflationary tendencies stimulated by the pressure of large volumes of excess purchasing power on short supplies of goods.

A. The already existing price control machinery should be utilized and there should be continued efforts to stamp out black markets. Strict rationing and allocation of consumers supplies should be continued, as should the machinery now being used with substantial success to control the basic elements in the cost of production—wages, rents, interest and profits. Steps should be taken to ensure the uninterrupted movement of farm products and other consumers' goods to consuming centers.

B. The pressure of excess monetary purchasing power on the price control system should be reduced wherever possible. Anti-inflationary financial, monetary and fiscal controls should be maintained in so far as they are consistent with the other policies of the occupation authorities. Measures to be taken may well include the following, with such modification as experience shows to be necessary:

1. At the termination of any period of bank closure withdrawals from financial institutions should be limited, probably to the sums necessary for living and business expenses, until conditions warrant relaxation of these restrictions.

2. Currency issue and central bank operations should be controlled and, if necessary, notes of large denomination withdrawn from circulation.

[4] The title of this report changed in a later revision. Cf. CAC-222a (PWC-296b revised), November 22, 1944, appearing in this volume.

3. Bank advances should be restricted, as should the use of government securities as collateral for such advances.

4. Security prices and trading in securities should be brought under control and efforts should be made to prevent speculation in securities, currencies and commodities.

5. A high level of taxation should be maintained to absorb excess purchasing power. Conversely, Japanese Government expenditures should be kept at a minimum so as to reduce the need for deficit financing.

6. Expenditures of Allied troops on the Japanese market should be kept at a minimum.

7. Opportunities and inducements for savings should be provided as soon as possible. The postal savings system, savings banks, and similar institutions through which excessive currency can be withdrawn from circulation should be reopened or reestablished.

8. The policy should be adopted of resuming service on the internal public debt when military and fiscal conditions permit. Such resumption will probably be necessary to enable the banks and financial institutions to function and through these institutions to facilitate financial controls, including the control of inflation. Prompt steps should be taken by the occupation authorities to examine fiscal conditions in Japan, so that a decision on the resumption of the public debt service can be made without delay.

C. An important factor in the inflation problem will be the exchange rate of the yen in terms of the currencies of the principal United Nations. The rate, which will have been fixed prior to the occupation, should be established at a level which will have the least disturbing effect upon the Japanese economy. Deliberate undervaluation or overvaluation of the yen in terms of foreign exchange should be avoided. The attempt should be made, taking into account the inflationary effect of the relaxation of controls which will accompany military defeat, to set a rate which offers the most reasonable prospect of being maintained.

However, every effort should be made to avoid too low a rate, which would aggravate inflationary tendencies in several ways: (a) the prices of foodstuffs and relief goods, in so far as they were imported into Japan and distributed commercially, would be increased to the extent of the undervaluation; (b) the domestic prices of Japanese export products would tend to rise; (c) the pay of Allied troops in terms of local currency and their purchasing power over goods and services in Japan would be raised. The fact that an overvalued currency would increase occupation costs is relatively unimportant for the reason that payments may be in special military yen and may eventually become a charge upon the Japanese government.

II. RELIEF

It will be incumbent upon the occupation authorities to see that needed relief is provided the civilian population. This is necessary, first, to assist the occupation authorities in maintaining order; second to meet the dictates of common humanity; and third to permit the development of democratic ideas. However, in planning imports into Japan, the needs of China, Korea, the Philippines and other liberated areas must be determined and preferential treatment given to these areas if, because of shortness of supply, it proves impossible to meet the requirements of all.

Through prompt and efficient distribution of indigenous supplies, supplemented when necessary by importation of food, a minimum diet which is nutritionally sound should as far as possible be assured throughout Japan, taking into account, of course, the varying needs attendant upon different occupation. So far as may be practicable, the food imported should be in accordance with Japanese food habits and needs. In addition to food, there should also be available for the civilian population such other necessaries as medical and sanitary supplies, including soap, and clothing, blankets, fuel and the like, as may be required for the preservation of public health and to prevent unrest. Care should be taken, however, not to make available types or amounts of consumable goods in excess of what it will be possible subsequently to keep available during the occupation through imports and indigenous production.

It is difficult to determine in advance how substantial the need for imported relief commodities will be. If Japan is cut off from continental sources of supply for a considerable period before surrender, if her fishing operations are further curtailed, and if the country is heavily bombed and becomes the scene of land combat operations, its relief needs may be very great. If on the other hand final surrender is occasioned by the loss of strategic zones well outside Japan proper, and the country is not blockaded and does not suffer extensive military destruction, primary relief needs will probably be small.

1. *Food.* Unless the Japanese dig themselves in and fight to the last ditch we may expect to find Japan with adequate short-term stores of food. While domestic production of several leading items in the national diet, namely rice, beans and sugar, is insufficient for the country's needs, Japan has had access to some of the world's leading sources of these products, rice from Korea, Formosa, Indochina, Thailand and Burma, beans from Manchuria and Korea, and sugar from Formosa, Java and the Philippines, and is known to have built up large stocks of all three. Reports from Japan indicate further that the domestic farm output has not been impaired by the war, due in part to the diversion of much of the mulberry acreage to food crops. Production of fruits and vegetables has always been sufficient for the population's needs. Fish may be short, but probably not acutely so; even with a further shortage of motor fuel the fishing fleet, largely reconverted to sail, can probably continue to operate on a restricted basis.

But while food relief requirements after surrender are likely to be small due to stores, these stores will be exhausted in at the most six months to a year. By that time, if food shortages are not to become acute, arrangements must have been completed for a resumption of imports of essential foodstuffs from the former Japanese dependencies and southeast Asia. Also, imported vegetable and chemical fertilizers from the mainland will be necessary to maintain domestic food production. Most of the land under cultivation in Japan today has been worked for centuries and lack of adequate fertilizing is immediately manifested in reduced crops.

2. *Clothing.* It is known that considerable stocks of silk and cotton textiles were being held in reserve in Japan before Pearl Harbor for sale abroad when the war ended. It is questionable in view of the current shortage whether the cotton stocks still exist, but it is quite probable that Japan will have a large accumulation of raw silk and silk fabrics, part of which might be exported and part used for emergency clothing. Though costly, and normally worn only by a small proportion of the population, silk is durable, light and warm. Whatever wool and wool fabrics Japan held before the war have almost certainly been utilized. However, because of the temperate climate and relatively mild seasonal changes over most of Japan, even a marked shortage of clothing would not present problems comparable to those likely to be faced in Europe.

3. *Housing.* Japanese dwellings, though easily destroyed, are also easily replaced. This factor, and the family solidarity of the Japanese, permitting ready absorption into the houses of relatives of those who have been affected by bombing, should prevent the development of a serious housing problem.

4. *Fuel.* Charcoal, a widely used fuel in Japan, is produced locally by the rural population and should be in adequate supply. Sufficient coal and gas, used in the larger cities, will be available unless production and transportation facilities are damaged, in which case there may be a temporary shortage.

5. *Sanitation.* Sanitation and health conditions in Japan are normally good by Far Eastern standards. However, modern sewage systems are to be found only in parts of the larger cities and pollution of water and food arising from the presence of privies is an ever-present danger. Also, though in late years rigid quarantine restrictions and compulsory inoculation and vaccination have freed Japan of periodic epidemics, the large influx of Japanese troops from the mainland before and after surrender, combined with conditions of disorder in Japan, will create a definite threat of disease in epidemic form. Supplies of drugs, chemicals, and other equipment to combat cholera, smallpox, bubonic plague, typhoid and other diseases, may be Japan's most important relief need.

III. Supplementary Assistance

In addition to providing for relief it is considered essential that the occupation authorities should render certain assistance so as to help the people of Japan to help themselves. In this way the amount of supplies that the United Nations may have to furnish Japan will be reduced, releasing shipping space and supplies for other areas and for normal commercial transactions: employment opportunities will be increased, thereby contributing towards the maintenance of order and easing the work of the occupation authorities; and, presently, the supply of available goods will be augmented, thereby reducing inflationary tendencies.

It is contemplated that this assistance should consist of such repairs, machinery, spare parts, or raw materials as are needed to permit an industry, or to assist agriculture, to resume or to increase production of urgently needed products. Reconstruction or new construction, except where such new construction is entirely incidental to some repair undertaking, is not contemplated. Subject to the same limitation as indicated in connection with

actual relief commodities, namely that where required items are in short supply our Allies shall have preferential treatment, the occupation authorities should undertake to give such assistance along the following lines:

Transportation. Transportation facilities which are essential to the civilian economy should be restored to reasonable effectiveness as rapidly as possible. A large proportion of the repair machinery, spare parts, and transportation equipment needed for this purpose will probably be obtainable in Japan. Necessary supplies which cannot be procured in Japan should be imported.

Public Utilities. Similar attention should be given to the prompt repair of essential public utilities, such as water, power and light.

Agriculture. As of particular importance for the purpose of keeping at a minimum imports of essential products into Japan agriculture and fishing should be assisted to the extent necessary to maintain production at a high level. Certain types of fertilizer normally unobtainable in Japan should be imported, and if possible, should be made available for the first planting following surrender.

Industries Capable of Producing Relief Supplies. Industrial enterprises which can produce relief supplies, tools, equipment and raw materials which otherwise would have to be imported should be assisted where necessary by the provision of imported repair materials, parts and raw materials in cases where these are unobtainable in Japan. However, decision on such assistance should be referred to the appropriate agency in Washington in any case where there may be doubt as to the economic soundness of aiding the industry, or where because of supply and shipping conditions it may seem preferable to plan continued importation of goods rather than to assist an industry capable of making such goods.

Other Industries. There would be no objection to furnishing other industries a minimum of repair material and spare parts where such industries can thereafter operate on the basis of supplies domestically produced and their operation will help to reduce unemployment.

Production of Surpluses for Relief in Other Areas. It may also be advisable to give similar assistance to agriculture or to certain industries, such as perhaps, the textile or cement industries, in order to secure production of surpluses of products needed for relief or reconstruction in other areas in the Far East.

The production of such surpluses, whether agricultural or industrial, above local minimum standards of consumption for use in other areas should be undertaken only if the occupation authorities are satisfied that production and distribution controls are firmly enough established to ensure that such surpluses can in fact be made available for export, and if programs of such production have been previously approved by the appropriate agencies in Washington.

Essential Information. For the successful execution of the program of supplementary assistance here outlined the occupation authorities should be prepared to obtain and forward to Washington as soon as possible after occupation takes place complete information as to production capacity in the light of war damage, with as much detail as possible as to the condition of specific factories, the material, spare parts and other equipment needed to achieve stated goals, the labor supply, the time element involved and other pertinent data. Such information is a prerequisite to final determination of requirements, and is particularly essential in the matter of planning production of desired surpluses. Recommendations as to such production goals should be made by the occupation authorities in the light of known conditions in Japan, but final determination on production programs should be made in Washington in the light of world needs, production capacity in the other liberated areas, and the time element involved.

IV. Destruction of War Material

The dismantling of military installations and the collection and probable destruction of military material following surrender will clearly be one of the important purposes of the occupation. It is assumed that the terms of surrender will grant the necessary powers for the destruction of such installations and material. There should be no destruction except in accordance with the powers granted therein. There, however, obviously cannot be specified in detail and there is danger that destruction may, unless carefully guarded against, extend beyond strictly military items the destruction of which is essential to the disarmament of Japan. Except for equipment palpably military in character, the dismantling or destruction of property should not be permitted until the necessity for its destruction is fully determined by the occupation authorities in accordance with strict procedures which would prevent the destruction of property without specific approval of the military government.

It is considered of utmost importance that no factory equipment or material which could

be of value to civilians or which could be converted to civilian use should be destroyed. It may be that such property will be wanted for distribution in countries liberated from the Japanese or such property may presently be made available to the Japanese people. The unnecessary destruction of property which might be of use in a peaceful Japan would needlessly delay achievement of American objectives and might place a substantial additional drain on American supplies which may have to be furnished for the relief and economic assistance of Japanese civilians and in the Far East as a whole.

V. Public Works Projects: Social Security

One of the principal problems facing the occupation authorities may be unemployment. Unemployment will call for relief, and public works projects which are likely to further the general operations of the occupation authorities may be undertaken. Such projects are preferable to a straight relief handout and should be commenced as rapidly as possible. It may be that payment of pensions, security benefits and other public and private insurance payments, as well as collection of premiums, should be resumed if they have not been continued.

VI. Export Industries

In their exercise of economic controls in Japan the occupation authorities should give consideration to the needs of the export industries. This will be advisable for several reasons:

a) Until such time as the export industries and export trade have revived necessary relief and repair materials furnished Japan by the United Nations will probably have to be provided on a credit basis. It is desirable that Japan should be enabled to pay for these materials at the earliest possible time.

b) Revival of the export industries will be necessary to ameliorate widespread unemployment. Even if adequately cared for in a relief system large numbers of unemployed workers would constitute a threat to peace and order and intensify the problems of occupation.

c) In the event that reparation payments from current production are required of Japan she will be able to make such payments on a substantial scale only if she has been permitted to resume foreign trade.

VII. General Economic Guidance

Through their financial control, their control of imports and exports, their control of distribution and particularly the allocation of materials and commodities which may be in short supply, the occupation authorities will be in a position to dominate and control the economic life of Japan for a considerable period.

In many ways, they will be compelled by circumstances to make decisions affecting the economy of Japan for which no specific guidance has been offered.

It is suggested that when any such decisions must be made, the occupation authorities should in general.

a) Favor those policies and those industries which will most simplify the work of the occupation authorities and especially the reduction of unemployment.

b) Favor those policies and those industries which will help meet current internal needs of Japan, the operation of which is not dependent on heavy protective duties.

c) Favor those policies and those industries which will help revive an export trade—especially in the lighter industries.

It is believed that, except as they may be specifically directed, the occupation authorities should not attempt long-range reform or reorganization of Japanese internal economy.

VIII. Repatriation

The return of Japanese repatriates from overseas should be regulated so as to minimize the strain on Japanese economy and the burden on the occupation authorities. Where such persons are without resources financial assistance by the Japanese Government should be required.

IX. Reparation

Reparation policies towards Japan have not yet been determined, but it may be assumed that they will not be such as to invalidate the basic recommendations made in this paper.

Prepared and reviewed by the Inter-Divisional Area Committee on the Far East.

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2-6 JAPAN: ECONOMIC POLICY

CAC-160[5]
IDAC-FE Report
Secret

July 24, 1944

I. The Problem

What should be the general features of American economic policy toward Japan after the war?

II. General Considerations

Economic policy with respect to Japan should seek primarily the creation of conditions within Japan and relations between that country and other states best fitted to remove the threat of future Japanese aggression. Disarmament, armament controls, and the prevention of imperialistic trade and investment policies will for an indefinite period involve restriction of certain phases of Japanese economic activity. Restrictions and controls should correspond as precisely as can be defined to meet the needs of security, however severe might be their effects on the Japanese population, and *per contra* economic disabilities should not have the object of preventing Japan from achieving a reasonably satisfactory living standard, with hope for the gradual betterment of that standard through legitimate enterprise. Lack of adequate economic opportunity would mean the perpetuation and intensification of the military spirit in Japan.

In the planning of economic policy provision should be made for progressive liberalization during three successive periods through which the control of Japan will pass. As set forth in PWC 108b, *Post-War Objectives of the United States in Regard to Japan*, these are: (1) a period "during which the immediate terms of surrender will be enforced and Japan will undergo the stern discipline of occupation as the inevitable retribution for military aggression": (2) a period of "close surveillance" with restrictions "progressively relaxed as Japan demonstrates its willingness and ability to live at peace with other nations" and during which "Japan is to be permitted within the framework of the restrictions necessary for international security, and having due regard for the matter of reparations, to begin to share in the world economy on a reasonable basis": (3) a period "which will look toward the ultimate aim of the United States, namely, a Japan properly discharging its responsibilities in the family of nations".

It should be borne in mind that economic policies dealing with a wide range of subjects must have continuity to be effective and cannot be precisely fitted into the three periods as defined above. Consequently, CAC-222, *Japan: Economic Policy During Military Occupation* deals with the first two periods where provision is made for measures which will "promote the purposes and effectiveness of the occupying authorities", and this paper deals with all three periods, but is concerned primarily with the second and third periods.

The breakup of the Japanese Empire, as provided by the Cairo Declaration of December 1, 1943, may be expected to bring about a sweeping and permanent change in the economic situation of Japan. The economic consequences to Japan of the loss of her dependencies and the drastic economic adjustments which this will necessitate must be given full weight in the determination of every aspect of economic policy.

[5] This statement first appeared as CAC-160 Preliminary, "Japan: United States Economic Policy", April 12, 1944.

III. Recommendations

1. *Disarmament and Control of the War Potential*

The loss of the dependencies will be a highly significant feature of Japan's disarmament and its war potential will thereby be greatly reduced. The defeat of Japan will be followed by the introduction of such measures within Japan as are found to be necessary to bring about the effective disarmament of the country. Japanese war equipment will be destroyed or removed, Japanese military and naval installations dismantled, and steps taken to prevent the manufacture of war equipment. The effective disarming of Japan should be followed by appropriate measures for the control of the Japanese war potential.

However, in carrying out disarmament and control of the war potential it is recommended that:

a) Equipment or industrial plants which can be converted to peacetime civilian use should not be destroyed, nor should the necessary controls be used to prevent the operation or development of any peacetime industry with the exception of the manufacture of civilian aircraft and vessels which are essentially auxiliary to naval use.

b) Supplementing such inspection as may be established within Japan to prevent rearmament, consideration should be given to the establishment by international agreement of collective limitation on exports to Japan of petroleum, iron and and steel, bauxite, and other specified strategic war materials to the amounts required for legitimate peacetime industry and trade so as to prevent stockpiling of such materials for war purposes.

c) The above restrictions and controls should be eliminated and Japan permitted to attain a status of equality with other nations when the United Nations are satisfied that Japan will thereafter adhere to the principles of peace and order in international affairs or when general international security arrangements shall be provided capable of preventing military aggression.

2. *Reparation and Restitution*

Identifiable property taken by the Japanese will be returned to its owners, and replacement will be required of certain kinds of property lost or destroyed as a result of Japanese action, but the concept of replacement should be limited to a very few specified categories of property.

It is expected that an important contribution toward reparations will be the surrender of Japanese overseas public holdings, especially in countries occupied by Japan, such as China. Any additional reparation from existing Japanese goods and equipment, or from current post-war production should be so dealt with as to produce the least disturbing effect on international trade.

In carrying out measures of reparation it is recommended that:

a) Japanese overseas holdings should be dealt with under a concept of public property broadly interpreted so as to include property with substantial government ownership, support, or interest as well as that used for governmental purposes.

b) Additional reparations from existing Japanese goods and equipment, or from current post-war production should be demanded only if: (1) it is determined that Japan has the capacity to pay such reparations, and (2) payment is to be predominantly through the direct transfer of goods or services for domestic use by the recipient country.

The amount and kind of such additional reparation should be determined as promptly as possible and provision should be made for payment over a definite short period of years.

3. *Foreign Commerce*

Japan has been greatly dependent upon foreign trade for her economic welfare. Loss of the protected markets of her former overseas territories will act to increase this dependence. For some time after defeat Japanese trade will be subjected to definite restrictions for reasons of security, but it is believed that the following policies should be brought into operation as soon as feasible:

a) Japan should be allowed to trade on a basis of equality with other nations and should be afforded an opportunity to secure through legitimate trade processes the goods which it needs for developing and maintaining its economy. In accordance with its general policy the United States should avoid and should seek to influence other countries to avoid, the maintenance of discrimination or other unreasonable barriers to Japanese trade. As a condition of receiving these benefits, Japan should be required to adopt and carry out similar foreign trade policies.

b) Japan should be prevented from reestablishing any Japanese controlled economic blocs or foreign areas of Japanese economic domination by means of commercial policy, currency policy or investments directed toward that end.

4. *Control of Japanese Internal Economy*

Control of the Japanese internal economy during the post-war period should be limited to such measures as are required to achieve the objectives set forth above. Long range reform and reorganization of the internal economy of Japan should be undertaken only in accordance with express directives from Washington.

Prepared and reviewed by the Inter-Divisional Area Committee on the Far East.

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[Source: Dipl. Br., National Archives]

2-7 CARTELS FROM THE POINT OF VIEW OF JAPAN

Memorandum — August 3, 1944
To: G.H. Blakeslee
From: C.F. Remer

Mr. Rudolph, Mr. Woolley, Mr. Lockhart and I met for some time yesterday morning and went over an outline on cartels which Mr. Rudolph had prepared. We made very few changes in this outline, which promises to be the basis for a highly useful report.

Mr. Rudolph tells me that he has had a conference with Mr. Fearey on the relations between the proposed work on cartels and that on the Zaibatsu which Mr. Fearey has done. It was agreed between them that the emphasis indicated by the title, "Zaibatsu", is on the national problems of Japan. On the other hand, the emphasis of the work on cartels must be upon the international relations of Japanese corporations. This distinction is important, especially from the point of view of the materials to be used and the method of study.

In view of this difference of emphasis, I hope that Mr. Fearey will be willing to prepare a statement for the use of the Area Committee on the Zaibatsu, for it seems to me desirable that it should be done. I believe that any paper which he prepares should be considered both by the Economic Subcommittee and by the Area Committee in connection with the paper on cartels, which Mr. Rudolph is preparing with Mr. Fearey's collaboration. There is sufficient relation between the two subjects to make it desirable to consider them together, even though the difference between them is sufficient to call for separate work.

I am to be out of the city for several weeks and I hope you will be willing to speak to both Mr. Fearey and Mr. Rudolph if you are in agreement with my recommendations.

[Source: Dipl. Br., National Archives]

2-8 JAPAN: WORKERS' ORGANIZATIONS DURING THE PERIOD OF MILITARY OCCUPATION

PWC-290a[6] — November 15, 1944
Secret

I. The Problem

What policy towards Japanese workers' organizations should the occupation authorities follow during the period of military occupation?

II. Basic Factors

Wage earners and those dependent on them constitute an increasingly important element of the population of Japan. More than a fourth of the gainfully employed population is engaged in manufacturing, mining and transportation. In more socially advanced countries,

[6] This report derived from CAC-254 of August 15, 1944. It later became the basis for SWNCC 92 (SFE. 140), "Treatment of Japanese Workers' Organizations."

labor in those industries is usually organized. While before 1938 only about six percent of the Japanese workers in these industries belonged to independent trade unions, it is reported that by July 1939 twenty-five percent were included in the government-controlled Patriotic Industrial Associations, membership of which has increased greatly in succeeding years to cover most industrial workers. The Japanese trade union movement in the past found substantial expression in the political field. It secured at one time one-tenth of the seats in the Lower House of the Diet, it was one of the most important factors in Japanese life in the development of progressive social and political concepts, and it should therefore be an important instrumentality in the development of democratic thought and processes. To aid in the maintenance of law and order and to stimulate any production desired by the military government, its policy towards workers organizations should aim to reduce to a minimum resistance by labor and to foster, wherever possible, a cooperative attitude on the part of the workers. Such a policy should simplify the tasks of the occupation authorities and help lay the groundwork for the later implementing of American long-range political, social and economic policies towards Japan.

The occupation authorities may find Japanese workers' organizations a useful medium in preserving order within labor's ranks, procuring labor for the occupation forces, organizing and carrying on production to meet the requirements necessary to the objectives of military government. The assistance which these workers' organizations may render through their leadership and institutions may reduce the demands on the personnel of military government. Even if the military government neither desire nor require the assistance of Japanese workers' organizations, the mere existence of such organizations creates a need for a policy towards them. The occupation authorities will have to deal with (1) Patriotic Industrial Associations and probably, (2) employee committees formed in single factories or shops, and (3) restored and new trade unions organized on an industrial and nationwide basis. At the commencement of the occupation, the Patriotic Industrial Associations may be the most prevalent type of workers' organization, while newly created employee committees in single factories or shops and restored and new trade unions may enter the Japanese economic scene as the occupation continues.

The *Patriotic Industrial Associations* are of recent origin (1938) and are government-controlled (April 24, 1939). Since 1942 they have been affiliated with and subordinate to the Imperial Rule Assistance Association. It has been recommended in previous documents that this latter organization and its affiliates be dissolved during the period of military occupation (*Japan: Political Parties or Agencies*, PWC-113; *Japan: Abolition of Militarism and Strengthening of Democratic Processes*, PWC-152b). Therefore, the continued existence of the Patriotic Industrial Associations as now constituted would not be compatible with these recommendations.

Through the Patriotic Industrial Associations, labor has been integrated into the war economy and the totalitarian political pattern of Japan. In addition to promoting ultra-nationalistic and patriotic feeling among the Japanese workers, these associations are intended to prevent interruptions of war production for economic or social reasons and to dissipate labor's real or potential opposition to Government policies. Membership is compulsory for those employed in industry, and even workers in the smallest industrial units are included in these associations.

Since the Patriotic Industrial Associations attempt to maintain peaceful relations between employer and employee, they have procedures for settling employer-employee differences, means for preventing overt exploitation of the workers by employers, and methods for improving the morale of the workers. After careful investigation of the structure and functions of the Patriotic Industrial Associations, the occupation authorities may find that certain of these procedures and techniques are adaptable to their use. There would be no objection to the preservation or modification of such desirable procedures and techniques if they are not inconsistent with other occupation policies and if they are acceptable to the Japanese workers.

Another type of workers' organization, which may exist in the period of military occupation, is the *employee committee*. Such a committee would be composed on an *ad hoc* basis of employees in single factories, or shops, who do not belong to the trade unions but yet have need for organization on a local scale. If economic conditions are severe, employees in these local industrial units may organize to protect themselves or to assist production during this period of economic disorder. Although this local type of organization may not be customary in Japanese economic life, the Patriotic Industrial Associations, in which even employees in the smallest production units hold membership, may have created a foundation for non-governmental labor organization where it did not exist prior to 1938.

Trade unions, which were of little consequence in the Japanese economy, will probably attempt to reorganize during the period of military occupation. New trade unions may develop to protect the workers' interests in the economic depression following hostilities. The Japanese workers, having experienced organization under the Patriotic Industrial Associations since 1938, may wish to reorganize these associations free of government domination or create entirely new organizations for their mutual aid and protection.

The traditional Japanese economic and social structure had its own ways and means for providing economic security for the worker. Aside from wages, this system depended heavily upon the employers' fulfilling their traditional obligations with respect to such arrangements as dismissal bonuses, retirement benefits, capital gifts for starting independent enterprises, housing and commissary facilities, etc. These were not necessarily uniform either throughout the country or throughout each industry. As long as Japanese employers met their obligations, employer-employee friction over economic matters and the economic necessity of workers' organizations were at a minimum. It should be recognized, however, that since 1918, economic depressions, severe competition, and industrial rationalization have weakened the customary methods of protecting the Japanese worker. Between the two wars, a trade union movement developed as some employees organized into trade unions for self-protection and promotion of their interests.

The Japanese trade union movement never achieved a position where it could exert strong influence in Japanese economic and political affairs although the unions of transport workers, including the seamen, and of miners possessed sufficient strength to gain economic concessions in their respective industries. The peak of trade union membership in Japan was reached in 1936 with a total of about 420,000 out of an estimated 7,500,000 workers engaged in manufacturing, mining and transportation. Approximately half of the factory workers were employed in shops of five workers or less. Only one-third of the trade union members were covered by collective agreements. By 1939, the trade unions were reduced to impotence.

Workers' organizations, such as the Yuai Kai, which previous to the World War of 1914-1918 engaged primarily in mutual aid and social activities, assumed a greater interest in employer-employee relations under the stimulus of increased economic activity during the war. Following 1919, the trade unions, to brace themselves against the post-war economic let-down and to protest through joint action the Government's method of selecting the workers' representative to the International Labor Conference, combined their strength into such federations as the General Federation of Japanese Labor (Nippon Rodo Sodomei), and the Confederation of Labor Unions (Rodo Kumiai Domei Kai) on a national basis and other federations, such as the Japanese Seamen's Union (Nippon Kaiin Kumiai) and the All-Japan Miners' Federation (Zen Nihon Kofu Sorengokai) on an industry-wide basis.

The late 'twenties found the trade unions seriously weakened by the decline of economic activity, by internal strife, and by government interference. The extension of manhood suffrage in 1925 encouraged the trade unions to participate in political activities which activities served to magnify the differences within the trade union movement. The schisms among the right-wing, center, and left-wing trade unions resulted in neglect of the workers' economic interests. At the same time the government used these political activities as an excuse to weaken the trade union movement by applying the Peace Preservation Act of 1925. An attempt at reconciling the different elements within the trade union movement and recovering labor's earlier gains was made in the creation of the Japanese Labor Club (Nihon Rodo Kurabu) in June 1931, reorganized a year later into the Japanese Trade Union Congress (Nihon Rodo Kumiai Kaigi).

Although in the early 'thirties, the Japanese trade union movement attempted to set its household in order and, through the small group of labor party representatives in the Imperial Diet, criticized various domestic and foreign policies of the Government, it did not exercise enough political or economic power to force the Government to modify such policies. With the national consequences ensuing upon the "China Incident" labor was geared to the war effort through the formalities of self-dissolution or were finally suppressed. The war accelerated the demise of the Japanese union movement.

The following factors have conditioned the development of the Japanese trade union movement, and have generally militated against its achieving even an important, to say nothing of a dominant, position in Japanese economic life.

1. *Rapid Industrialization*

Industrialization in Japan created social and economic problems for the workers more rapidly than organized protection of the workers developed to cope with these problems. In its attempt to catch up with western industrial progress, Japan did not permit interference

with its program of industrialization for social or welfare reasons. Trade unionism, as a means of bringing pressure to bear on employers through strikes, etc., had little, if any, opportunity to develop.

2. *Feudal Economy*

Industries developed within the framework of the Japanese feudal system. Such characteristics of that framework as a small group of hereditary capitalists closely associated with the political power of the State, customary obligations of social classes, subordination of the individual, and the household unit of production have been carried over into Japanese industrial life. Notwithstanding the large number of small production units which characterize the Japanese economic structure, concentration of economic power in the hands of a few capitalists has continued. Although these capitalists have hindered and resisted the Japanese trade union movement with considerable success, trade unionism in Japan has represented a challenge to their power.

3. *Imperial System*

The traditional Japanese Imperial system appears irreconcilable with trade unionism free of government control or direction. The former stresses the subordination of the individual and his interests to the State and the identification of the State with the interests of the ruling group. Surrounding the emperor and exercising predominant political power is a small ruling group which determines the interests of the State. This system is associated with and reinforced by religious and patriotic manifestations, in which spiritual values, duty, and discipline are emphasized. Trade unionism is a popular movement designed to protect and promote the materialist interests of the individuals who comprise the movement. In its early stages, it depends upon a harmony and satisfaction of individual interests; in later phases, it often stresses the interests of the union rather than those of the individual. In its political aspects, trade unionism helps prepare the mass of people for political action. In Japan, this attention to individual satisfaction, sometimes to special group interests, and to the people's participation in politics seems incompatible with subordination of the individual to the State, unity of State interests, and the existence of a small ruling class.

Aware of this situation, the Government has on several occasions brought legal and political pressure to bear for the suppression of trade unions. The application of Article 17 of the Police Regulations of 1900, which prohibited forceful persuasion in trade union organizing and in disputes with employers, and of the Peace Preservation Regulation of 1925, previously mentioned, is an example. In 1938, the government sponsored Patriotic Industrial Associations to replace free trade unions in Japan.

4. *Paternalism*

The responsibilities of the Japanese Government, especially the Bureau of Social Affairs, and of employers in many industries with respect to the workers' welfare have often minimized the economic usefulness of trade unions to the workers. Those relations between employer and employee which are rooted in custom and tradition provide the employee with a sense of security which is often lacking even in countries with advanced labor legislation. Through custom and regulations, workers in most industries have been assured of dismissal bonuses and other protection.

5. *Surplus Labor Supply*

There has existed a chronic surplus of unskilled and semi-skilled labor in Japan. The Japanese economy has not been able to absorb available labor services, although during the war period the situation has been noticeably changed. Over-supply of mobile unskilled and semi-skilled labor has meant easy replacement of workers and stiff competition for available employment with resultant low wages and long hours of work. These conditions reduce the bargaining power of trade unions, weaken their ability to defend the interests of their membership, and obstruct the successful recruitment of additional members.

6. *"Home Industry" System*

Japanese economic life is generally characterized by the great number of small industrial units, often consiting of two or three workers who may be members of the employer's family. This dispersion of industrial production through systems of subsidiaries and subcontracting has made it difficult for Japanese trade unions to organize workers. However, the Patriotic Industrial Associations have included workers in such shops among their membership. Since 1937 a major change has been taking place in the Japanese economic structure. Industries, especially heavy industries producing war material, have been organized on a large scale and employ large numbers of workers. The productive importance of the "home industry" system has declined during this industrial reorganization in Japan. Following the war, it is likely that the "home industry" system will regain its pre-war position as production of war equipment and supplies is eliminated and light industries are encouraged.

7. *Recruitment of Labor*

The Japanese system of recruiting industrial labor through arrangements with families in rural areas has proved to be an obstacle in the trade union movement. Parental influence supplements employer control over the employee to the disadvantage of trade union organizing compaigns. Furthermore, many workers from the agrarian districts are occupied in industry temporarily and return to their farms during declines in industrial production. Recruiting of labor deprives the working population of a "class tradition" and "working class solidarity", which are often considered necessary for a strong trade union movement.

8. *Employment of Women*

The large percentage of women employed in Japanese industries, especially the textile industry, has not been conducive to development of trade unions. The social and working conditions of Japanese women are generally controlled by their employers after the employer and the woman's family have agreed upon terms of service. Japanese women usually remain in employment only for a short time, a period in which to earn an amount of money for a suitable dowry. They then leave industrial employment for married life. This practice has hindered trade unions in industries which employ women on a large scale.

9. *Internal Trade Union Disputes*

The Japanese trade union movement has not escaped internal differences, which almost every other national trade union movement has experienced. Right-wing, center and left-wing trade unions resulted from disagreement over the structure of trade unions, type and extent of trade union activities, as well as the political inclinations of certain trade union leaders. The left-wing unions included communistic elements, whose extreme statements and contemplated activities were described as a menace to the Japanese political and social structure and were publicly denounced by moderate and right-wing leaders.

10. *Political Activities of the Japanese Trade Union Movement*

The Japanese trade unions sponsored political parties to supplement their economic activities. No single labor party developed. By 1932 three principal workers' parties emerged on the political scene. The Labor-Farmer Party (Rono To)—left wing; Social Mass Party (Shakai Taishu To)—center; National Social Party (Kokka Shakai To)—right-wing. The Social Mass Party maintained a vociferous representation in the Diet, although the most seats it ever possessed were 36 out of 466, in 1937. The political differences among Japanese workers contributed to the lack of trade union solidarity and further weakened labor's resistance to the Government's policy of promoting Patriotic Industrial Associations.

A strong, democratic trade union movement in post-war Japan would be made possible only by major changes in the Japanese political, social and economic structure. If such a movement were to develop, it would, along with basic reforms, contribute to the abolition of militarism and the strengthening of democratic processes in that nation. (See: *Japan: Abolition of Militarism and Strengthening of Democratic Processes*, PWC-152b). Trade unionism will give the Japanese working population a voice in matters of direct concern to it and especially experience in self-rule, which can be carried over into the political sphere. Not only would such a movement assist in counter-balancing the militaristic, anti-democratic forces, but it would also facilitate the return of the Japanese people to the international community through association with the trade union movements of other nations and the International Labor Organization.

III. Recommendations

During the period of military occupation in Japan, subject to military considerations, the occupation authorities in their policy towards Japanese workers' organizations should be guided by the following recommendations:

1. Those Japanese laws and regulations relating to workers' organizations, which are inconsistent with the other recommendations in this paper, should be suspended or rescinded.

2. Patriotic Industrial Associations, which are affiliates of the Imperial Rule Assistance Association, should be dissolved.

3. The military government should investigate the structure and functions of the dissolved Patriotic Industrial Associations to ascertain which of their procedures and techniques are not inconsistent with the development of non-governmental workers' organizations and might be adaptable for use by the military government to facilitate its relations with Japanese workers through utilization of procedures and techniques familiar to and acceptable by those workers.

4. Employees should be permitted to form, join or assist labor organizations.

5. Membership in government-sponsered or in employer-dominated unions as a condition of employment should be prohibited.

6. Employees should be permitted to bargain collectively, to be represented on boards of conciliation or arbitration, and to engage in concerted activity for the purpose of mutual aid or protection.

7. Employees should have the right of peaceful assembly, free speech, and access to radio broadcasting and press facilities on a non-discriminatory basis. Demonstrations of workers inspired by Japanese government functionaries or ex-leaders of the defunct Patriotic Industrial Associations for the purpose of interfering with the development of free trade unions should be prohibited.

8. In those plants or shops where trade unions have not yet been formed or are not functioning as the representative of the employees, the formation of employee committees should be permitted.

9. Formation of labor-management committees for the purpose of removing causes of friction between employers and employees should be permitted.

10. Representatives of employees should have an equal opportunity with other groups to consult with the appropriate officials or authorized representatives of the military government in accordance with publicly announced procedures.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-9 JAPAN: MILITARY GOVERNMENT: INITIAL ECONOMIC POLICIES

CAC-222a November 22, 1944
PWC-296b revised
Secret

Initial economic policies pursued by the military authorities upon the occupation of any part of Japan should be such as to promote the purposes and effectiveness and to ease the tasks of the occupation authorities. During military occupation, "the authority of the legitimate power having in fact passed into the hands of the occupant, the latter shall take all measures in his power to restore, and insure, as far as possible, public order and safety, while respecting, unless absolutely prevented, the laws in force in the country" (War Department, *Rules of Land Warfare*, FM27-10, October 1940, par. 282). Economic policies should be designed to assist in the discharge of this duty. At the same time to the extent possible from a military viewpoint and consistent with other responsibilities of military government, such policies should aim at contributing toward the elimination of the military elements of Japanese national life and character.

It is recognized that decisions relative to details of these economic policies must be worked out in collaboration among all Government agencies concerned, by groups especially designated for the purpose. No attempt, therefore, is made here to give detailed recommendations. The broad policies initially adopted, however, will have important effects in easing or making more difficult the task of the military authorities. At the same time, care should be taken that these initial policies should not prejudice future decisions on longer-range economic policies.

I. DESTRUCTION OF WAR MATERIAL

One of the primary purposes of the military occupation will be the dismantling of military installations and the collection of military material for probable subsequent destruction or use elsewhere. What property should be dismantled or destroyed cannot be specified at this time, but except for equipment strictly military in character, the dismantling or destruction of property should not be permitted until the necessity for its destruction is determined in accordance with strict procedures designed to prevent the destruction of property without the specific approval of the military government.

Care should be taken not to extend such dismantling or destruction beyond military items the dismantling or destruction of which is essential to the disarmament of Japan. It is considered of utmost importance that no factory equipment which could be converted to civilian use and no material which could be of value in a civilian economy should be destroyed. It may be that such equipment and material will be wanted for use in countries liberated from the Japanese or in Japan. The unnecessary destruction of such property

would needlessly delay achievement of American objectives and might meanwhile place a substantial additional drain on American supplies and shipping for the Far East.

II. ECONOMIC CONTROLS

The military government should as rapidly as possible institute such economic controls as it may deem necessary to further its military mission. Wherever possible, methods of economic control with which the people are familiar should be employed.

Substantial acceleration of inflation during the period of military occupation would greatly increase the difficulties of the military government, and steps should be taken from the beginning to combat inflationary tendencies resulting from shortages of supply (whether from actual shortages, inadequate distribution or hoarding) or from an increase of currency in circulation, or from both.

A. If feasible, the existing price control machinery should be utilized, with such adjustments as may be found necessary, and there should be constant efforts to stamp out black markets. Similarly, strict rationing and allocation of consumers' supplies should be continual, as should machinery to control the basic elements in the cost of production. Steps should be taken to ensure the uninterrupted movement of farm products and other consumers' goods to consuming centers.

B. The pressure of excess monetary purchasing power should be reduced wherever possible. Anti-inflationary financial, monetary and fiscal controls should be maintained in so far as they are consistent with the policies of the occupation authorities. It is suggested that the occupation authorities consider the prompt adoption of the following measures, among others, with such modification as experience shows to be necessary:

1. Limitations on withdrawals from financial institutions, until conditions warrant relaxation of these restrictions. Such withdrawals, if total prohibition is not considered essential, might well be limited to the sums necessary for living and business expenses.
2. Restrictions on the extension of new credit by banks or other financial institutions.
3. Control of currency issue and central bank operations and, if necessary, the withdrawal from circulation of notes of large denomination.
4. Control of trading and speculation in securities, currencies and commodities.
5. Maintenance of taxation at a high level so as to absorb excess purchasing power and holding of Japanese Government expenditures to a minimum so as to reduce the need for deficit financing.
6. Reasonable limitations on allied troop expenditures in the Japanese market.
7. Early provision of opportunities and inducements for savings, such as the reopening and reestablishment of the postal savings system, savings banks, and similar institutions through which excessive currency can be withdrawn from circulation; also, to the same end, prompt examination by the occupation authorities of fiscal conditions in Japan looking to a decision as to resumption of the public debt service when military and fiscal conditions permit.

Although not a matter for action by the occupation authorities, it should be noted that the exchange rate for the yen will have an important bearing upon price movements, confidence in the currency, and other aspects of the inflation problem.

III. CIVILIAN SUPPLIES AND SERVICES

As set forth in the Army-Navy Manual of Military Government and Civil Affairs, it is of greatest importance for military government, "first, to revive economic life and stimulate production in order to reduce to a minimum the needs of the area for United States and allied assistance and to develop the area as a source of supply for further operations, and second, to use available goods and services as efficiently as possible for the satisfaction of military and civilian needs". (War and Navy Departments, 22 December 1943, *Field Manual* 27-5, Sec. 1, par. 9k.)

To these ends, the military government should exercise its control to see that there is prompt and efficient distribution of essential indigenous supplies—especially food, medical and sanitary supplies, clothing, blankets, fuel, the elements of shelter and the like. To the extent necessary to prevent disease and unrest, essential supplies should be imported to supplement indigenous supplies, but in planning such imports, consideration should be given to similar needs in China, Korea, the Philippines and other liberated areas, and if supplies are short, preferential treatment should be given to these areas. It must not be overlooked that as

time passes from the stage of actual combat operations a greater amount of supplies will be required to prevent disease and unrest among the civilian population. As in other areas, any supplies which must be imported should correspond as far as possible to local habits and needs.

Prompt rehabilitation of essential services should be undertaken to the extent necessary to protect public health and to aid production and distribution of essential supplies. Particular emphasis should be placed on the rehabilitation of water, power and light utilities and of transportation facilities on which the distribution of civilian supplies depends. To the extent that necessary repair parts and equipment are not available in Japan for this purpose, they should be imported, but where shortages of supply exist our Allies must have preferential treatment.

IV. Indigenous Production of Essential Supplies

The military government should require the maximum production by the Japanese of supplies needed by the civilian population. Such production would reduce the amount of essential supplies which the United States may have to furnish and release shipping space and supplies for other areas and for normal commercial transactions; increase employment opportunities and contribute towards the maintenance of order and ease the work of the occupation authorities; and, presently, augment the supply of available goods and so aid in reducing inflationary tendencies.

In connection with such production by the Japanese whether agricultural or industrial, the military government should render such assistance as may be found essential, subject to the limitation that where items requiring importation are in short supply our Allies should have preferential treatment.

As to agricultural production, which is of particular importance for the purpose of keeping at a minimum imports of essential products into Japan, agriculture should be assisted to the extent necessary to maintain production at a high level. Necessary fertilizers and seeds should be imported, and should, if possible, be made available for the first planting following occupation.

Repair materials, parts and raw materials, unobtainable in Japan, may be imported for use in industrial enterprises which can produce domestic consumer supplies, or tools and other needed production equipment. However, decision on such importation should be referred to the appropriate agencies in Washington in any case where there may be doubt as to the economic soundness of aiding the industry, or where because of supply and shipping conditions it may seem preferable to plan continued importation of goods rather than import equipment on material to assist on industry capable of making such goods.

There would be no objection to furnishing other non-military industries a minimum of repair material and spare parts if such industries can thereafter operate on the basis of supplies domestically produced and if their operation will help to reduce unemployment.

V. Distribution of Civilian Supplies

The military government may furnish supplies to meet urgent relief needs without reimbursement, but when possible, recipients should be put to work on projects useful to the military government.

All imported supplies, except those distributed to meet urgent relief needs, should be sold under such conditions as will ensure proper distribution to the ultimate consumers or should be used for payment of wages in kind. Such scales should, if possible, be through commercial channels. In the pricing of imported supplies, the military government should take into consideration the effect which these prices will have on the distribution of supplies, on inflation, and on the local economy generally. It has been found elsewhere that the pricing of imported commodities can also be used to stimulate the recruitment of labor, to increase production and to achieve other objectives desired by the military government.

VI. Production of Surpluses for Other Areas

It may prove advisable to give assistance, similar to that proposed for domestic needs, to agriculture or to certain industries, such as perhaps the textile or cement industries, in order to secure production of surpluses of products needed elsewhere.

The production of such surpluses, whether agricultural or industrial, above minimum standards of domestic consumption, for use in other areas should be undertaken only if the occupation authorities are satisfied that production and distribution controls are firmly enough established to ensure that such surpluses can in fact be made available for export, and if

programs of such production have been previously approved by the appropriate agencies in Washington.

VII. Essential Information

The occupation authorities should obtain and forward to Washington, as soon as possible after occupation, complete information as to production capacity in the light of war damage, with as much detail as possible as to the condition of specific factories, the material, spare parts and other equipment needed to achieve stated goals, the labor supply, the time element involved and other pertinent data. Recommendations as to production goals of surpluses for export should be made by the occupation authorities in the light of known conditions in Japan, but final determination on production programs should be made in Washington in the light of world needs, production capacity in the other liberated areas, and the time element involved.

VIII. Long-Range Reform

Through their financial control, their control of imports and exports, their control of distribution and particularly the allocation of materials and commodities which may be in short supply, the occupation authorities will be in a position to dominate and control the economic life of Japan. However, it is believed that, except as they may be specifically directed, they should not attempt long-range reform or reorganization of Japanese internal economy.

[Source: Dipl. Br., National Archives]

2-10 ECONOMIC FOREIGN POLICY OF THE UNITED STATES WITH RESPECT TO JAPAN

Second Revised Draft — January 1, 1945
Prepared by: Far Eastern Division, Liberated Areas Branch, Foreign Economic Administration
Confidential

ECONOMIC POLICY OF THE UNITED STATES WITH RESPECT TO JAPAN

In order to fulfill the operational responsibilities which the United States will have to undertake in the Far East, detailed planning for which has already begun it is imperative that basic economic policy be formulated promptly with respect to Japan. The following statement is intended to outline United States objectives with regard to Japan, to examine the alternative economic policies and to suggest a series of economic programs.

I. United States Objectives with Regard to Japan

The fundamental, long-term interest of the United States in the world is enduring peace. The primary objectives of United States policy with regard to Japan, therefore, are to prevent that country from again disturbing the peace and to integrate Japan ultimately into a peaceful Far East.

To a very large extent, the attainment of such objectives is a problem in international security, to be handled by an international organization on the basis of the Moscow Four-Power Declaration, Dumbarton Oaks and other international agreements. United States economic policy towards Japan cannot be a substitute for an international security system. Instead, it should be used to buttress such a system and give fuller content to the framework of the new organization.

A. *Elimination of Japan as a Warlike Nation.* In order to prevent Japan from again becoming a military threat to her neighbors and to the world, it will be necessary to do away with both her capacity and her will to wage war. Complete dependence on the elimination of either would be hazardous. On the one hand, any scheme for the reduction of Japanese military power will rest upon present-day technological premises and may not correspond to future realities. On the other hand, measures taken towards the elimination of Japan's desire to war will rely heavily on the response and strength of democratic elements in Japan and their immediate success even in the best of circumstances cannot be confidently relied upon. It is clear that in the earliest post-war period, the primary reliance will be on the reduction of Japanese military power, while the eventual success of American policy towards Japan will rest upon Japanese acceptance of a peaceful world.

1. *Elimination of Japan's capacity to wage war* is a purely strategic objective which implies first, the reduction of physical or technological facilities and second, the recrimination of the remaining facilities so that they cannot be easily availed of for aggressive purposes.

2. *Elimination of Japan's will to wage war* must ultimately depend upon the enlightened self-interest of the Japanese people. It implies that:

a. The Japanese post-war economy must be one in which it is to the best interest of the great majority of Japanese to have peace rather than war,

b. The great majority of Japanese must be oriented to see that their best interests lie in peace, and

c. This great majority must be in effective control of the Japanese government.

It is recognized that b) and c) above are not primarily economic questions. The thoroughgoing changes in the Japanese educational and political system which they imply are essential to the successful elimination of Japan's will to war but are beyond the scope of this memorandum. To the extent that economic measures may facilitate such changes, however, they are considered here.

B. *Utilization of Japanese Resources to Restore and Improve the Economy of East Asia.* In the course of her aggresisons and military occupation Japan has impoverished large sections of the Far East. On the assumption that a sound and prosperous East Asia is to the best economic interest of the United States, a major objective of the United States policy towards Japan should be the fullest possible use of Japanese plant and resources, within the framework of the type of peace-time economy deemed desirable below, to restore and improve the economy of the devastated regions.

II. Alternative Economic Policies towards Japan

In accordance with the Cairo Declaration, Manchuria, Formosa, Korea and the Pacific Islands will be removed from the Japanese empire. The possible lines of future economic development for the Japan which will remain are limited by natural conditions. The relative poverty of Japan's natural resources makes an autarchy impossible; Japan must import a fifth of her food requirements, and no matter what its economic organization, will have to export sufficient goods to pay for the food. At the other extreme, it would be unwise for Japan to devote all her resources for export because some of her requirements can be more cheaply satisfied by domestic production than by foreign trade. The Japanese economy of the future, will, therefore, have to combine production of domestically consumed goods, of exports and of capital goods in varying proportions. Under those conditions, three major alternative types of Japanese post-war economy are possible:

1. An economy primarily directed towards the production of heavy capital goods, and secondarily towards the production of consumer goods for both foreign and internal markets,

2. An economy primarily directed towards the production of consumer goods for the foreign market, and secondarily towards the production of heavy capital goods and of consumer goods for the internal market, or

3. An economy primarily directed towards the production of consumer goods for the internal market, and secondarily towards the production of heavy capital goods and of consumer goods for the foreign market.

The implication of each of these types are discussed briefly in the paragraphs which follow:

A. *Heavy industry economy* is the kind of an economy which Japan has had since the late thirties. The key industry in such an economy is the iron and steel industry, supplemented by the production of other metals, chemicals, machinery, electric power, shipbuilding and vehicles. Its biggest customers in the past have been the Japanese armed forces and the semi-official "development companies" which have been organized by the Japanese government to exploit the resources of the continent and build war industries in the conquered regions. If such an economy were to be diverted to the production of peacetime capital goods after the war even for the purpose of continuing the industrialization of the Far East, there would be a constant danger that it might be utilized for building up an army and navy. Finally, a heavy industry economy is uneconomic in Japan. Its key industry, iron and steel, relies almost entirely on foreign sources of both iron ore and coking coal. Even if it were possible to utilize the iron and resources in Japan Proper, the finished products could not compete with foreign imports, unless the industry continues to be heavily subsidized as in the past.

B. *An economy primarily directed towards production of consumer goods for the foreign market* is the kind of an economy which Japan had until the early thirties. Its prosperity depends largely upon its ability to undersell its competitors by means of sub-standard wages and a heavily taxed agriculture. In the past, the labor and peasant unrest resulting from such conditions has been mobilized by war-like factions in Japan in support of military radicalism domestically and imperial expansion abroad. Carried to its logical conclusion, such an economy implies the transplantation of Japanese industry to areas outside of Japan where labor is even cheaper, as evidenced by the establishment of Japanese textile mills in the Shanghai area, and thereby undermines the prosperity and living standards of the home islands. The economic penetration of overseas areas effected by this movement of Japanese industry, moreover, furnishes the Japanese government with ready instruments of economic aggression, "Fifth Column" activity and espionage in those countries. Finally, this sort of an agressively expanding export economy is bound to meet with severe competition or opposition from other producing countries and is confronted with increasing tariffs, restrictive import quotas and exclusion acts. To secure markets free from competition and restrictions, Japanese business accepts the conquest and maintenance of a "co-prosperity sphere" in which Japanese interests would enjoy a virtual monopoly by force of arms.

C. *An economy primarily devoted to production of consumer goods for the internal market* appears to satisfy United States objectives most fully. In such an economy capital goods-industries and public services, and the industrial plans of the country will be unsuited for the manufacture of armaments. Since the prosperity of such an economy will depend primarily upon the development of the market at home, its natural expansion will not conflict with American interests in the rest of the Far East, in India or in the Americas. Because the volume of foreign trade required to support a given level of production (and prosperity) will be much smaller than in an export economy, the nature of the trade can more easily be restricted to items which will complement the economics of the other Pacific countries. Japan, by importing food, raw materials and semi-processed goods, will provide a market for the other countries of East Asia, while its exports to those countries in return would be of a type in which American industry in the past has not been primarily interested, e.g., cheap textiles and rubber goods, household utensils, bicycles and the like. Instead of competing with United States exports the stimulation of Japan's domestic production is expected to bring demands for American machinery and capital goods equipment. Ultimately, as living standards are raised to adequate levels, Japan will attain a larger measure of social stability and be less inclined to risk military adventures.

III. United States Economic Programs with Respect to Japan

To ensure the transformation of the Japanese economy in a fashion consistent with United States long-term interests, the United States must be prepared to exercise extensive direct or indirect controls over Japan for a period of several years after the war. The United States government must, therefore, prepare a consistent and detailed program for each of the major lines of activity which it will need to pursue. Such a program is outlined below for seven major fields of economic activity.

The treatment of each field sets forth special United States objectives therein, the extent to which the control authorities can hope to effect them and the specific direct measures which should be taken by the control authorities to this end. The direct measures will fall into two categories according to whether they involve detailed administrative responsibilities will be restrictive or prohibitory in nature and will be enforceable throughout the entire period of United States of Allied control. However, the relatively few measures which do imply such detailed administrative responsibilities will usually be applicable only during the early period, when control is exercised through the Military Government, and are designated as such below.

A. *Control of Heavy Industry.* To obtain the kind of an economy consistent with United States objectives, heavy industry in Japan must be drastically curtailed and kept curtailed by the control authorities. The post-war territorial settlement involving the separation of Manchuria, Korea and Formosa from Japan will not be sufficient. Generally speaking, decisions should be made in advance as to what portions of the industrial machine are necessary to war but superfluous to peace. Such portions should be eliminated. Specifically:

1. End-product war industries, such as aircraft, radio and radar, naval shipbuilding and ordnance, will have to be eliminated entirely. Conversion to peace-time industrial operations should generally be opposed, although much of the equipment might be salvaged for use outside of Japan.

2. The production of heavy basic industries should be restricted to the levels required by consumer industries and maintenance of public services. The war industries make exceedingly heavy demands on basic industries such as iron and steel. If steel ingot production were cut from an annual total of some 10,000,000 metric tons to 3,000,000 metric tons or less, it would be impossible for Japan under present technological conditions speedily to build a modern army and navy of effective striking power. Other basic industries whose production might be sharply curtailed are aluminum, magnesium, copper and coal.

3. Multi-purpose industries such as chemicals, machinery and merchant ship-building, should be converted to civilian production and the volume of such production should be restricted to demonstrated peace-time requirements. In the case of the nitrogen fixation industry, it might be necessary to conbine production limitations with import controls, so that all allowable production of ammonia would have to go to fertilizers and essential industrial consumption. In other cases, such as merchant ship-building, the industry might be converted to peace-time production by restrictions on specifications of products, e.g., prohibition on constructing any merchant ships of over 500 or 1,000 gross tons, plus a limitation on the size of the merchant marine to be allowed Japan after the war.

4. The imports of such raw materials and fuels as iron ore, bauxite, petroleum and coking coal, for which Japan is particularly dependent on foreign sources of supply, should be kept down to the amounts required by civilian goods production.

5. Over-all control over Japanese industry may be maintained by strict regulation of the electric power permitted each industry or even each of the important factories. A more general check would be the reduction of present electric power production of about 50,000,000,000 kilowatt-hours to the 1937 level of 30,000,000,000 kilowatt-hours. (A detailed plan, "Regulation of the Electric Power Industry as a Technique for Controlling Japanese Industry and War Potential, has been prepared in the Foreign Economic Administration.)

B. *Reorganization of Business.* In the past, Japanese business has been organized for war and integrated with the war machine. The thorough-going reorganization of Japanese business institutions which will be necessary to adjust the Japanese economy to peace-time conditions is essentially an internal Japanese matter. However, it will be the responsibility of the United States or Allied control authorities to delimit the area within which such reorganization will take place in order that Japanese business does not again serve as a tool of economic aggression and warfare, and also in order that an economy primarily devoted to production for the domestic market may emerge in the post-war period and that conditions favorable to a democratic government shall prevail.

The sine-qua-non of these objectives will be the removal from positions of power and leadership of that score of giant business combines, popularly known in Japan as the *zaibatsu* or "oligopoly" which have dominated Japanese economic life for decades. On the basis of past experience, the continuance of *zaibatsu* predominance cannot but endanger United States interests in the Far East.

The *zaibatsu* combines have been indispensable partners in the Japanese course of economic aggression and conquest. The foreign offices of *zaibatsu* trading companies have served as instruments of economic aggression, espionage and "Fifth Column" activity. In Japan, as in Manchuria and Korea, the *zaibatsu* have developed uneconomic war industries and have been reimbursed with public funds. In close cooperation with the Japanese government, the *zaibatsu* have organized smaller business concerns into semiofficial cartels, or "Industry Control Associations", and by virtue of their predominant position in those cartels now direct the Japanese industrial war effort. In return, they have obtained broad powers in the conquered regions.

Through their monopoly control of credit, shipping, insurance and industrial raw materials, the *zaibatsu* have retarded the development of the internal market by preventing the emergence of a middle class of small and medium businessmen, by monopolizing the labor market and depressing wages, and by fixing prices on domestically consumed goods at artificially high prices.

Finally, the *zaibatsu* have extended their economic powers to the political arena and have inhibited the growth and influence of democratic elements in Japan.

The United States should look with favor upon measures taken by the Japanese themselves, to reduce the power, wealth and influence of the *zaibatsu*. However, the United States government should insist on certain specific measures aimed at breaking up the *zaibatsu* and divorcing big business from government, as follows:

1. Remove from business and government positions officials and directors, and former officials and directors, of *zaibatsu* companies and all other individuals who by their records before the war proved themselves to be enemies of the United States and international peace.

2. Transfer without compensation to the new Japanese government stocks owned by individuals in the *zaibatsu* parent and holding companies.

3. Government officials and the Imperial Household Ministry, if continued, should be prohibited from holding stock in corporations of more than $ 1,000,000 authorized capitalization (or some more suitable standard).

4. No compensation should be permitted to the *zaibatsu* companies for overseas holdings which have been or may be seized for reparations purposes (see F2 below), or for the destruction or removal of industrial plant and equipment in the course of applying the heavy industry control policy outlined in the preceding section.

5. All government subsidies for heavy industry and export trade, whether in the form of pilot plants, direct grants of money, guaranteed profits, special tax reductions or pricefixing at the expense of agriculture and light industry should be summarily discontinued.

6. Membership in the *zaibatsu*-dominated Industry Control Associations (semi-official cartels) should be made voluntary instead of compulsory as at present. Officials and directors of *zaibatsu* companies, government officials and high military and naval officers, active or retired, should be barred from holding office in these Associations and in any other industry or trade association.

7. Under Military Government, small and medium business enterprises (e.g., employing 50 or less workes and with an authorized capitalization of less than $ 500,000) should be given preferential treatment in the allocation of raw materials and electric power, and in the extension of credits.

C. *Encouragement of Consumer Goods Industries and Building Trades.* The direction of the post-war Japanese economy towards the domestic market is in accord with United States long-range interests. The United States should, therefore, look with favor upon the development of the building trade and of consumer goods and farm supply industries such as clothing, cheap textiles, furniture and household equipment, fertilizers, bicycles, medicines, electric light bulbs and glassware, etc. Specifically:

1. Facilities in Japan Proper for producing consumer goods should not be destroyed or removed except as reparations to meet emergency needs (see section F3 below).

2. Repair of housing and restoration of public services should be permitted first in light industry centers such as Kyoto, Oita and Kurume. Only minimum relief aid should be permitted in Yawata, Tobata, Nagasaki, Kokura, Wanishi, Hirohata, Kawasaki and other heavy industry centers.

3. Under the Military Government, preferential treatment in the allocation of raw materials, transportation priorities and electric power should be granted consumer goods industries and residential construction.

D. *Assure the Farmer an Adequate Return For His Produce.* The most neglected potential market in Japan has been the farmer. In the past he has been held to an extremely low living standard by high taxes, excessive rents, an enormous debt burden and discriminatory prices, while at the same time his produce was used to support war and export industry. As a consequence, he has been easy prey to militarist and fascist demagogues.

It will be impossible for Japan to develop a large internal market and a stable peace-time economy without a sharp increase in agricultural income. Such an increase can be brought about only when the Japanese themselves solve their fundamental agriculture problems through the abolition or reduction of tenancy, the cancellation, reduction or adjustment of the farm debt, and the removal of disparities between the price levels of agricultural produce, on the one hand, and manufactured consumer goods and artificial fertilizers, on the other. The United States Government should look with favor upon such measures and all other actions undertaken by the Japanese to assure the cultivator a fair return for his produce. However, while Japan is under United States or Allied control certain specific measures to aid in bringing about the kind of an agriculture which will support a subsequent consumer economy can be applied. They are:

1. Dissolve nominal farmer organizations directed by the government. Recognize and encourage bona-fide organizations representing farmers and peasants.

2. Abolish the land tax on agricultural land and proclaim a corresponding reduction in farm rentals. Suspend seizure of agricultural land for non-payment of taxes for the period of military occupation.

3. Apply a blanket moratorium on agricultural evictions for non-payment of rent during the period of military occupation.

4. Invalidate all farmer debts carrying interest in excess of legal maximum. Invoke a blanket moratorium on mortgage foreclosures for the period of military occupation.

5. Remove tariffs on the importation of artificial fertilizer from outside Japan. During the period of Military Government and under its direction, have the semi-official distribution monopoly, the Japanese Fertilizer Company, reduce artificial fertilizer prices.

E. *Raise Labor Income.* An important part of the post-war domestic market will consist of the 20,000,000 laborers and their families. An industrial economy which rests on substandard wages cannot hope to develop an important internal market for its manufacturers. The actual wage levels in Japan are not matters for the United States Government to decide, but the United States should insist on the removal of artificial devices for keeping wages low and of restrictions on the freedom of collective bargaining. Specifically:

1. Dissolve all Fascist labor organizations, particularly the Patriotic Labor movement.

2. Grant and protect the right of labor to organize and bargain collectively for higher wages and better conditions.

3. Repeal the job-freezing and labor-service provisions of the National Mobilization Laws and ordinances enacted pursuant thereto.

4. Restore female and child labor provisions of the Factory and Mining Acts which have been suspended since 1937.

5. Declare all labor contracts involving Koreans and minors invalid at the option of the laborer. Eventually arrange for transportation facilities for the large number of impressed Koreans to return home.

F. *Reparation and Restitution.* It is presumed that, in accordance with international agreements among the affected nations, Japan will be required to make reparation or restitution for damages inflicted in the course of its aggressions. While the reparations agreements will aim primarily at assisting the rehabilitation and reconstruction of the victim nations, their execution will also have an important effect on the economy of Japan. It is essential, therefore, that the payments required of Japan would not hinder the emergence of the kind of a Japanese economy desired by the United States, and moreover, that reparations payments would be used as a means of bringing about that kind of an economy wherever possible.

In amount and in the time allowed, this means that the terms of payment should not be so severe as to preclude the maintenance of a viable economy for Japan. It is evident, further, that for purposes of enforcement the schedule payments should not extend beyond the time for which the United States and the affected countries are willing to exert close control over Japan. As to form of payment, reparations items should be of such a nature that their transfer will help reduce Japan's capacity and will to wage war, that a large amount can be collected in a short time and that the transferred items be of assistance to the claimant countries.

Certain forms of reparations will be undesirable. The organization of Japanese labor battalions to restore the devastated areas, for example, would not meet the principal rehabilitation and reconstruction requirement of the Far Eastern countries for goods and equipment, but instead would provide manpower of which there is an abundance already. Furthermore, while making a relatively small contribution to reconstruction, the impressment of labor battalions will tend to depress wage standards in the claimant countries, will be difficult to enforce and will produce a strongly adverse reaction in Japan.

Other forms of reparations will have limited utility. Transfer of gold reserves of foreign exchange, for example, will be entirely inadequate in amount. Reparations out of current production while necessary to meet emergency needs of claimant countries will be undesirable if carried beyond that point because they may help restore Japanese heavy industry to a point where it will support a rearmament scheme. In addition, reparations in this form may result in undesirable economic dependence on Japan on the part of the claimant countries and when they are eventually terminated serious dislocations in the Far Eastern economy may be expected.

The most fruitful source of reparations will be rather the immense surplus of heavy industry capital goods whose operation in Japan will not be permitted by United States heavy industry control policy (see section A above) and whose removal would aid in the enforcement of that policy. Another valuable source of reparations will be the overseas property holdings of the Japanese government and Japanese private or quasi-public companies, particularly the *zaibatsu* companies. Finally, considerable stores of civilian use goods in Japan will probably be available. Transfer of these items will be of great assistance to the victim

nations, may be accomplished in a short time, and will not prejudice the development of a consumer goods economy in Japan while insuring against the return of a heavy industry economy contrary to United States interests.

Specifically the reparations program should provide:

1. Transfer to the impoverished countries of Asia without cost or below present value the following types of capital equipment: multi-purpose equipment (prime-movers, motors, generators); transportation equipment (locomotives, rolling stock, tankers and other merchant shipping); such basic industry equipment as it is technically feasible to move (steel and aluminum rolling mills); and metal fabricating machinery (lathes, presses, jigs and fixtures). The cost of transportation should be borne by Japan.

2. Transfer without compensation to the governments of the liberated areas all property owned in those areas by the Japanese government, the *zaibatsu* and those other Japanese business firms uses as quasi-public instruments of economic aggression.

3. Transfer without cost stockpiles of Japanese military and naval equipment suitable for civilian use, e.g., clothing shoes and medical equipment, to the impoverished areas for relief purposes.

4. Transfer to the impoverished areas without cost and for a very limited period a certain proportion of current production of medicines, textiles, shoes, cement, etc. for relief and rehabilitation purposes.

G. *Japanese Foreign Trade.* Post-war Japanese foreign trade concerns the United States in three respects: a) it should be consistent with the kind of economy which the United States is interested in maintaining in Japan: b) it should be conducive to the improvement of the economy of East Asia and the maintenance of prosperity in the Far East: and c) it should provide the United States opportunities for export trade equal to those of all other countries.

Except for a prohibition on importing armaments and excessive amounts of raw materials for heavy industry for security reasons, it will be undesirable for the United States in cooperation with the United Nations to exercise long-term controls over particular items in Japanese trade. Through its temporary controls over the internal economy of Japan and through its control of the movements of American goods, American shipping, and American loans, the United States government will be in a position to help determine the general nature of Japanese foreign trade. Specific measures will depend in large part upon the circumstances of the moment and are therefore not suggested in this paper, but the kind of trade which will satisfy United States objectives will have the following general characteristics:

1. Japanese export trade should not be so large as to demand a major portion of Japanese productive facilities and labor.

2. Japanese export trade should not depend upon substandard labor or subsidized industry.

3. Japanese trade with the rest of the Far East should supplement the economies of the other East Asiatic countries, i.e., exchange of cheap consumer goods designed for the low standard Oriental market in return for food and light industry raw materials. In general, Japanese exports of the above type will not compete with American goods designed to sell to a higher quality market at a higher per unit profit.

4. Japan should grant equal opportunities to United States export trade and, in return, the United States should grant similar opportunities to Japan. Japan may be expected to export special types of goods, e.g., silk, art goods, processed foods, and possibly toys to the United States in exchange for raw cotton and capital goods equipment for light industry.

(Detailed studies aimed at determining suitable Japanese export items to the Far East and possible Japanese markets for United States goods after the war are now being carried on by the U.S. Tariff Commission at the request of the Foreign Economic Administration.

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

2-11 JAPAN: ECONOMIC POLICIES DURING MILITARY OCCUPATION

Proposed Revision CAC-222a (PWC-296b revised) — March 16, 1945 and May 19, 1945
Secret

I. INTRODUCTION

This document is based on two assumptions: first, that there will be a full-scale military

occupation of Japan: and second, that an adequate number of Japanese, including civil servants, will cooperate so that a civil administration can be developed after surrender which will function with fair effectiveness under the policy directives of the military authorities. It is recognized that as a result the functions of the occupation authorities will be for the most part supervisory rather than administrative. It is of the utmost importance, therefore, that these authorities lay down a clearly defined framework of policies to govern the operations of the Japanese administrative staff.

The immediate objectives of economic policy toward Japan are:

1. to enforce a program of demilitarization with the aim of preventing Japan from again developing an economic war potential;
2. to control the Japanese economy so as to meet the needs of the occupation forces and to prevent starvation or such disease and civil unrest as would interfere with the operations of military government;
3. to arrange for relief to the United Nations and liberated areas, for restitution of identifiable looted property and for reparations, in accordance with decisions of the appropriate authorities.

A technical demilitarization commission operating in conjunction with military government should determine within the limits of general policy directives the most suitable disposition of facilities and materials for the production of armaments, whether for conversion to civilian use in Japan, transfer to liberated or other areas, or destruction.

In establishing control over the Japanese economy the occupying authorities must concern themselves with financial controls, the distribution and allocation of materials and commodities, and the rehabilitation of essential services and of industries producing needed civilian goods. Policies with respect to such controls should so far as possible be in harmony with the long-range objectives of the United States in the Far East.

In accord with those objectives military government should encourage the development of democratic organizations in labor, industry, and agriculture, and should favor a wider distribution of ownership, management and control of the Japanese economic system. However, except as they may be specifically directed, the occupation authorities should not take the initiative with respect to long-range reform or reorganization of the Japanese internal economy. Only where internally generated reform movements reach significant proportions, should the occupying forces consider taking any positive action with respect to them and then only upon specific direction of the appropriate authorities in Washington.

It is expected that decisions with respect to reparation and restitution deliveries conforming to the policies laid down in this paper will be made by a reparation commission, noting in consultation with the military government.

II. Demilitarization

The first step in demilitarization will be to see that all military and navy installations, arsenals, and specialized facilities used for the production of armaments cease functioning, except as they may be taken over and used by our forces. In some cases the Theater Commander may consider that for the safety of his forces such facilities must be destroyed. However, as a general rule, the dismantling and especially the destruction of facilities readily convertible to civilian use in Japan or to some use in liberated or other areas should be postponed until the demilitarization commission can decide on the most suitable disposition.

The same policies should govern the treatment of stocks of raw materials and finished products which are readily convertible to civilian use.

Japan should be permitted to retain no specialized facilities for the production or repair of implements of war or aircraft of any type and should be deprived of the excessive heavy industry capacity and those key industries upon which an extensive war industry could be redeveloped. Control measures should be formulated with the aim of insuring that the Japanese are unable to develop an armaments industry in the future. Military government will be responsible for putting those controls into effect.

III. Financial Controls

The military government should from the beginning require the Japanese administrative staff to institute measures designed to combat inflationary tendencies resulting from shortages of supply or from an increase of currency in circulation, or from any other cause. In this connection, it may be observed that discouragement of expenditures by Allied troops would help to curtail inflationary forces. In this connection, the following are important issues:

1. *Commodity controls.* The existing price control machinery should be utilized if feasible, and appropriate measures to stamp out black markets should be enforced. Steps should be taken to facilitate the uninterrupted movement of farm products and other consumers' goods to consuming centers.

2. *Currency and banking control.* Control of banking operations and particularly of currency issue will be necessary. The extension of large credits by financial institutions should be subject to control by military government. No credit should be extended Japan or any Japanese person, natural or juridical, by foreign persons or governments, except with the approval of military government.

It may be necessary to close banks and other financial institutions temporarily until arrangements can be made for the necessary control measures. If a moratorium is necessary, commercial banks, savings banks, and the postal savings system should be reopened as early as possible in order to establish confidence and encourage deposits. Such measures as an over-all freezing of bank deposits should be avoided if possible since they tend to discourage deposits. If such measures become necessary, withdrawals should be limited to the sums necessary for living and business expenses until conditions warrant relaxation of these restrictions.

3. *Fiscal control.* Taxation should be maintained at a high level and public expenditures should be held to a minimum in order to reduce inflationary deficit financing. Steps should be taken to regularize governmental fiscal operations and to assist in reestablishing confidence in financial institutions. Resumption of partial or complete service on the internal public debt at the earliest feasible date is deemed desirable.

IV. Japanese Assets Abroad

Subject to certain sepcific classes of exceptions, foreign assets of Japanese persons should be seized and held for disposition by the reparations and restitution commission. Title to all foreign assets of the Japanese Government and of Japanese persons domiciled in the main islands should be seized and held for later disposition. Neither the Japanese Government nor Japanese persons domiciled in the main islands may acquire foreign assets except foreign exchange and movable commodities necessary to approved export and import transactions.

[Source: Dipl. Br., National Archives]

2-12 POLITICO-MILITARY PROBLEMS IN THE FAR EAST: THE POST-SURRENDER MILITARY GOVERNMENT OF THE JAPANESE EMPIRE: POLICY WITH RESPECT TO PROBLEMS OF RURAL LAND TENURE (SWNCC 100)

SWNCC-100 April 7, 1945
Secret

Report by the
State-War-Navy Coordinating Subcommittee for the Far East

The Problem

1. To recommend the procedure to be followed in the preparation and processing of statements of policy to be incorporated in a paper on the subject: "The Post-Surrender Military Government of the Japanese Empire: Policy with Respect to Problems of Rural Land Tenure".

Facts Bearing on the Problem

2. SWNCC 16/2, approved by the State-War-Navy Coordinating Committee on 23 February 1945, directs that the Subcommittee for the Far East maintain as a general guide for its activities a master list of Pacific-Far Eastern problems, arranged in approximate order of priority, and that prior to initiating action on any one of such problems the Subcommittee submit in each case to SWNCC a detailed recommendation showing (1) a statement of the problem, (2) the agency or agencies to be charged with initiation of the basic documents involved, and (3) the method of processing and coordination thereof, including recommendations for ultimate implementation.

3. The subject, "The Post-Surrender Military Government of the Japanese Empire: Social and Economic Problems; consideration of Such Problems as: Adjustments in Systems of Land Tenure" appears as Item VI, 10, c, on SWNCC 16/4.

4. The conclusions and recommendations which follow are submitted in compliance with paragraph 6 b of SWNCC 16/2.

CONCLUSIONS

5. It is concluded that:

a. In general, the scope of the paper should include:

(1) a brief statement of the pre-war situation in Japanese rural land tenure; and

(2) policies which should be followed, depending upon the conditions which may develop during the period of military occupation.

b. The Department of State should be requested by SWNCC through its Secretary to prepare a draft paper on the above subject.

c. The draft of the paper prepared by the Department of State should be submitted to the SWNCC Secretary who will issue a numbered SWNCC paper on the subject.

d. The SWNCC Secretary should then simultaneously:

(1) Request the JCS through its Secretary to designate the appropriate JCS agency to consider the subject.

(2) Direct the Coordinating Subcommittee for the Far East to collaborate with the appropriate JCS agency designated to consider the subject.

(3) Direct the Coordinatitng Subcommittee for the Far East to secure appropriate views of the State, War, and Navy Departments, and coordination with other civilian agencies as may be appropriate. (Such views and coordination should generally be secured after collaboration by the appropriate JCS agency and the Coordinating Subcommittee has resulted in tentative agreement.)

e. The appropriate JCS agency should then report to the JCS. This report should reflect the results of the collaboration and coordination outlined above.

f. Upon receipt of a report from the JCS, SWNCC should consider the report with such further advice as may be necessary from the appropriate officials within the three Departments.

g. The final paper as approved by SWNCC should be transmitted to the interested governmental departments and agencies as approved governmental policy for their guidance, and, where appropriate, for proper implementation.

RECOMMENDATIONS

6. It is recommended that the State-War-Navy Coordinating Committee:

a. Approve the above conclusions.

b. Dispatch the letter in the Appendix to Mr. Eugene H. Dooman, Special Assistant to the Assistant Secretary of State, Mr. Dunn.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-13 ECONOMIC POLICY TOWARD JAPAN: SUMMARY STATEMENT[7]

Report by the Secretary's Staff Committee — April 17, 1945
SC-101
(CC-45)
Secret

THE PROBLEM

To formulate the general lines of long-run economic policy toward Japan, as requested by Executive Committee on Economic Foreign Policy.

RECOMMENDATION

The Coordinating Committee recommends that the Secretary's Staff Committee approve the attached paper as a summary statement of long-range economic policy toward Japan, and that following such approval the statement be transmitted to the ECEFP for comment.

SUMMARY OF OBJECTIVES

Economic policies affecting Japan should be directed fundamentally toward:

1. *Demilitarization and control of Japanese economic capacity to wage war.*

This will involve destruction by the armed forces of the United Nations of Japanese naval and military installations, including specialized war industries, the seizure or destruction of existing supplies of war materials, and the seizure and removal from Japan of surplus stocks of industrial materials; reconstitution and maintenance of the Japanese economy on a level adequate to meet minimum needs and to prevent or alleviate epidemic or serious disease and serious civil unrest and disorder; and control of the Japanese economic war potential by conversion to civilian purposes of economic capacity heretofore directed to war aims and by measures that will prevent reconversion to a war economy, such as control of certain industries and strategic imports.

2. *The elimination of Japanese economic domination in non-Japanese areas and the reorientation of Japanese economy toward economic interdependence among free nations.*

This will involve the provision to China, with her former territories restored to her, of an opportunity to achieve a position of economic and industrial importance, particularly in the Far East; the assurance to new states that will arise in the Far East of equal opportunity of engaging in economic relations with other nations; the establishment in other Pacific areas previously under Japanese domination of economic conditions that will aid peaceful development; the prevention of overseas holdings of strategic properties by the Zaibatsu and similar organizations that have been and might again be availed of for purposes of economic penetration and ultimate domination of the business and financial relationships of non-Japanese areas; and the development of international trade relations on a basis of economic interdependence among free nations, as contrasted with the system of ultra-nationalistic or imperialistic economic self-sufficiency.

3. *Restitution and Reparation.*

In principle there should be an unlimited obligation on Japan to return all identifiable stolen property and to relinquish all rights, claims, and controls over property in occupied areas that have been obtained by duress or fraud. Substantial but supportable reparation should be obtained from existing stocks and equipment, from Japanese property abroad, and to a limited extent, from current production. Payment of reparation from current production should be predominantly by direct transfer of goods and services to the recipient country for its domestic use.

[7] Approved by and referred from the Coordinating Committee.

ANNEX I

ECONOMIC POLICY TOWARD JAPAN

I. INTRODUCTION

The victory of the United Nations over Japan will bring to an end a half century of Japanese aggression in the Far East. The military, political and economic phases of that aggression have been intimately interrelated and mutually supporting. No permanent peace can be hoped for unless these several means of aggression are brought under control.

The attainment of the objective of enduring peace involves not only military features but political and economic arrangements as well. The destruction of existing military establishments and the maintenance of peace and order in vanquished countries during the period of occupation are obviously the task of the military and naval forces. Preparedness adequate to check at its inception any future attempt at military aggression is the task both of those forces and of the legislative or appropriating power. The creation of, and United States participation in, a general international organization for the maintenance of peace and security throughout the world is the task of political agencies. Economic measures cannot provide a substitute for military and political measures but can and should support these means of maintaining peace by helping to create conditions in the economic sphere that will tend to remove the danger of future aggression from whatever source.

The complete defeat of Japan, to which the United Nations are committed, will involve economic consequences of the first magnitude. It has already been decided that Japan is to be stripped of all her dependencies acquired during the past half century, with the possible exception of Karafuto. The economic effects of the Cairo decisions must be examined and brought into proper relation with the economic policies which the United States intends to implement in the Far East. Japan must not again be permitted to dominate East Asiatic trade and development through an economic regionalism or "co-prosperity sphere" backed by force of arms, and effective control must be maintained over the industries that have formed the specific basis of Japanese military aggression.

It is not possible to reach definite decisions on all aspects of economic policy toward Japan before ascertaining actual conditions in that country at the time of surrender. Never-

theless, the responsibilities which the United States will face in that regard when the war in the Pacific comes to an end will not be met adequately and promptly if problems of general economic policy have not been carefully examined in advance. A provisional statement of the economic policy of the United States in the Far East and particularly toward Japan, with special reference to the longer-run, should be formulated at an early date and should contribute to the development of a common economic policy in that area among the United Nations. While the economic measures to be applied during military occupation may differ sharply from the controls that may later be introduced, underlying policy should at all times have in view the ultimate objective of an enduring peace. Such a general statement should articulate economic policy with this objective and should at the same time provide a basis for the formulation of guides and directives and for their adaption to particular situations as circumstances may require.

II. General Economic Objectives

The fact of defeat will be brought home sharply to the Japanese by military events. The presence of Allied troops on Japanese soil, military destruction both preceding and following occupation, and—perhaps above all—the ensuring dismemberment of the Empire as determined upon at Cairo, cannot fail to shock the Japanese people into a realization of the utter failure of the plans of their leaders for domination of the Far East. Economic policy toward Japan should be such as to confirm the fact of complete defeat and to destroy the hope and desire for future aggression.

The goal of lasting peace and the traditional policies of the United States in the Far East, as well as international pronouncements on policy in war and peace, necessarily imply that economic policies affecting Japan should be directed fundamentally toward:-

(a) the destruction of specialized Japanese war industries and the control of Japanese economic capacity to wage war in the future;

(b) the elimination and the prevention of attempts at renewal of Japanese economic domination in non-Japanese areas and the reorientation of Japanese economy toward economic interdependence among free nations, developed through peaceful trade processes, as contrasted with the system of ultranationalistic or imperialistic economic self-sufficiency; and

(c) restitution and reparation, though these objectives are of subordinate importance for the long run.

Under these main headings certain more immediate or specific objectives groups themselves roughly as follows:

Under (a):

(1) Destruction by the armed forces of the United Nations of Japanese naval and military installations, including specialized war industries, and the seizure or destruction of existing supplies of war materials;

(2) Reconstitution and maintenance of Japanese economy on a level adequate to meet minimum needs and to present (or alleviate) epidemic or serious disease and serious civil unrest and disorder;

(3) The seizure and removal from Japan of surplus stocks of industrial materials (some of which may of course fall also within the category of war materials); and

(4) Control of the Japanese economic war potential by conversion to civilian purposes of economic capacity heretofore directed to war aims and by measures that will prevent reconversion to a war economy.

Under (b):

(1) The provision to China, with her former territories restored to her, of an opportunity to achieve a position of economic and industrial importance, particularly in the Far East;

(2) The assurance to new states that will arise in the Far East of equal opportunity of engaging in economic relations with other states;

(3) The establishment in other Pacific areas previously under Japanese domination of economic conditions that will aid peaceful development and will, in turn, support appropriate political development;

(4) The prevention of overseas holdings of strategic properties by the Zaibatsu and somewhat similar organizations that have been and might again be availed of for purposes of economic penetration and ultimate domination of the business and financial, relationships for non-Japanese areas; and

(5) The development of international trade relations on a basis of economic interdependence among free nations and discouragement of efforts of the Japanese to attain economic self-sufficiency.

Under (c):

(1) Restitution of stolen property;

(2) Requirement of substantial but supportable payments on reparation account from existing stocks and equipment, from Japanese property abroad, and, to a limited extent, from current production.

III. Economic Policy and Objectives in Relation to Time Periods

Three periods may be distinguished in the developments of economic measures to carry out the objectives of the United States towards Japan, although measures applied in one period may continue into the succeeding period.

1. The first of these is a relatively short period of military occupation and stern enforcement of the directives, military and economic, consequent upon unconditional surrender. The period will be characterized by disarmament, by destruction of remaining military and naval stores and installations and, selectively, of all plants and machinery suited only to production of munitions as determined by competent technicians. Restitution of stolen or expropriated property and reparation in the form of capital equipment and stocks of materials transferred to claimant countries may assume some importance.

Provisional, temporary, or emergency economic measures will be required: economic life will have been seriously disorganized and the occupation authorities must be prepared to take all practicable steps to prevent the development of a chaotically unmanageable economic situation. They must give attention to urgent problems of relief and particularly to the restoration of essential facilities of trade and transportation. Measures of security taken should not be unnecessarily disruptive of established Japanese economy; for the livelihood of the people, relief supplies for use in Japan or in other Far Eastern countries, and the payment of reparation may all depend in greater or lesser degree upon the operation of Japanese industry at a minimum level of effectiveness. To these ends it is highly important that the Japanese civil administrative staff be kept functioning as far as possible.

2. The second period will be one of close control of Japanese economy. Its duration, preferably, should not exceed five years. Interest will center in reparation and in the development of means of enduring control of Japanese capacity to wage war. The insular position of Japan, the relative paucity of raw and industrial materials and of arable land in the Islands, and the stage of industrial development in other parts of the Far East all combine to make Japanese livelihood dependent upon a considerable foreign trade. This trade may with world-wide cooperation be used as a principal means of control toward the ends of peace and may even moderate the Japanese urge to aggression. Within Japan, rigid inspection of industrial establishments and production will be necessary but, presumably, will not involve complete military occupation. Production will be directed to meet the requirements of claimant countries under reparation, after providing sufficient consumption goods for minimum domestic needs. It is not contemplated, however, that this period should be extended merely for the sake of obtaining larger reparation payments.

3. The third period will be distinguished from the preceding periods by the absence of direct control from within Japan; its duration cannot now be determined. It is assumed that through the general international organization, or otherwise, requisite external controls over the war potential of Japan will be established. It should be expected that in due course such special controls would be merged in controls applicable as well to any nation that appeared to the organization to be building a war potential beyond that required by its special responsibility for the maintenance of the peace. Japan should be expected ultimately to share in such international arrangements.

A more complete statement with respect to certain objectives of economic policy toward Japan may now be attempted. Since that policy is expected to continue to guide action in successive phases of the post-war world, it is neither necessary nor practicable to relate this statement closely to the time periods that have just been described, or to indicate in the statement the relative importance of the specific objectives.

IV. Control of Japanese Internal Economy

The destruction wrought by war, the dismemberment of the Empire as contemplated in the Cairo Decisions, and the mere fact of military occupation of the homeland will be highly disruptive in their effects on Japanese economy and industry. As indicated above, these effects must be kept under control, if only for reasons of security; the economy should continue

to function at least with minimum effectiveness. In particular, the occupation authorities must give attention to such immediately urgent problems as relief, inflation, and the re-establishment of transportation and of the ordinary processes and agencies of industry, trade, and finance.

The necessity of keeping Japanese economy and industry operating at a minimum level of effectiveness inevitably conditions the measures of control to be taken by the occupying authorities, whether of an emergency nature or of a more permanent character, and should be taken into account in determining the scope and character of the destruction of industrial facilities that should be undertaken. It will be necessary also to consider the extent to which supplies of food, fertilizers, and industrial materials that have been drawn from overseas are requisite to the peace-time livelihood of the people. Requisite supplies should continue to be provided and shipping should be made available for their transport. It may be observed in this connection that former Japanese dependencies must not be left without markets for their export surplus.

Control over the internal economy is, furthermore, necessary to the attainment of the general economic objectives of the United States, including the collection of reparation. This control must, however, look chiefly to the future; the paramount objectives are control of the Japanese war potential and the elimination of Japanese economic domination in the Far East, and the substitution therefor of peaceful international trade relations on the basis of economic interdependence among free nations. The period of control thus runs through the three time-periods previously described, but the scope and intensity of control should progressively diminish, merging into the world-wide arrangements established by the general international organization.

There are certain features of the existing economy of Japan that are believed to have interfered with the development of such a climate of general prosperity as is thought to encourage a contented and peaceful attitude among the people. Among these features are the great Japanese corporations, including the family corporations or *Zaibatsu*. Regulative measures are called for, and should include such a revision of the banking structure as would separate financial and industrial control. If at the same time legislation and industrial practice were to encourage an effective labor movement, a long step would have been taken toward opening the door of economic opportunity to all classes. It is recognized, however, that remedy of the existing situation is not easily effected within the short span of years within which direct control of the Japanese economy by the victor nations can be expected to continue, and measures of this sort are therefore suggested with some hesitation. Only if a liberal government should become firmly established in Japan could there be great hope of enduring reform along these lines.

V. Restitution and Reparation

An early and continuing task of the occupying authorities will be the supervision of restitution and reparation.

1. *Restitution*

In principle there should be an unlimited obligation on Japan to return all identifiable stolen property and to relinquish all rights, claims, and controls over property in occupied areas that have been obtained by duress or fraud. Such property should be returned to the governments of the areas where it had its situs rather than to the former owners individually. The value of such returned property should not be credited against Japan's oligation in respect of reparations, nor charged against the claim of the recipient country on reparation account. The appropriate authorities of the United Nations should have the right in their discretion to prevent or postpone the restitution of equipment in Japan that is deemed essential to the restoration of Japanese economy to a minimum level of effectiveness.

2. *Reparation*

The guiding principle in all reparation should be that the requirements should support the long run objectives of United States policy, or interfere with them as little as possible. Substantial reparation should be required of Japan, but it would be unrealistic to assume that the just claims of countries ravaged by Japanese aggression could be taken as a measure of collectible reparation. Such a sum would far exceed Japan's capacity to pay and the attempt to collect it would doom to failure the realization of the economic objectives of the United States in the Far East, if not in the entire world. Nor is it practicable now to attempt to determine Japan's capacity to pay. Further study is required both of damages and of capacity to pay reparation, but no comprehensive estimates can be arrived at prior to an examination of conditions existing at the time of surrender both within Japan and

within the areas of her aggressive action.

The most immediate source of reparation within Japan will consist of capital equipment and stockpiles of industrial materials and finished goods, which should be surveyed as soon as practicable after occupation. Surplus stocks and capital equipment, including shipping, not considered essential to the livelihood of the Japanese people, should be transferred to claimant countries as rapidly as those countries can make effective use of them. Such transfers, however, are proposed as measures of reparation, not for the industrial development of claimant countries.

Another source of reparation may be found in Japanese property abroad. The treaty of peace should reserve to the several United Nations the right to retain and liquidate all Japanese property rights and interests within the territories of the respective United Nations, including territories ceded to them. The value of property so taken should be credited against reparation claims of the country in which the property is located. However, small holdings of resident Japanese should not be disturbed if free from the taint of imperialistic design. Japanese nationals should look to their Government for compensation for any of their property that may be taken under these reserved rights. The treaty of peace should also make provision of this general sort concerning Japanese property in the Mandated Islands. The foregoing provisions should apply equally to Japanese property in Korea, which might be placed under the trusteeship of one or more of the United Nations until the ultimate disposition of such property has been determined. Policy with respect to the taking of such property should, if possible, be uniform among the United Nations. Pending formal ratification of the treaty, the military governments in occupied areas should assume control of such properties; and should retain control of them in such areas as Formosa and Korea pending decision as to their disposition.

The economic aim of the foregoing proposals should be clear. Properties that are technically private in nature have been the means of Japanese control over large sections of the economies of other countries. There can be no real independence for Korea or sovereignty of China in Formosa and in more recently occupied portions of China unless Japanese control of such significant properties as railways, utilities, mines, and certain important industries is completely broken. Continuation of these properties under their present ownership is inconsistent with the aim of preventing future aggression on the part of Japan. To so large an extent have the great Japanese corporations served as the tools of imperialistic ambition that their property, as well as that under direct government ownership in these areas, must be taken over or its control radically changed. Moreover, there are instances of apparently private and individual holdings that are, in fact, but part of a great imperialistic colonization scheme which cannot be permitted to continue.

Current production in Japan may be availed of as an additional source of reparation. The several claimant countries are generally less developed industrially than is Japan, and vary considerably in the degree of their development and in the extent to which they can utilize capital equipment and stockpiles of materials. Furthermore, Japanese property holdings are unequally distributed among them. If reparation were confined to these readily available sources, an inequitable distribution of reparation among the several claimants could scarcely fail to result. This situation would be corrected by requiring reparation also from current production.

This proposal suggests the need of some sort of formula to indicate the amount that may be taken from current production. It is obvious that reparation can come only from the volume of production remaining after a minimum allowance for current consumption. An annual sum equal to that which Japan has been devoting to war purposes may be regarded as the upper limit of reparation payments.* It would prove impracticable on both economic and political grounds to collect as reparation any such sum over any considerable period. The minimum standard of living which must be permitted if the Japanese economy is to continue to function cannot be defined precisely but such a standard may be approximated experimentally, based on statistical evidence of the per capita consumption of basic commodities at various periods in Japan's recent history. In giving effect to such a standard it would be particularly helpful if the occupation authorities should find it possible to retain

* An indication of this sum may be found in the amount designated for civilian consumption in the annual Japanese budget estimates. This amount has markedly decreased since 1941, when ¥17 billion (out of a total estimated national income of ¥40 billion) were allotted to civilian use. The corresponding figure for 1944-45 was ¥11.5 billion out of a total estimated income of ¥65 billion. The same amount, ¥11.5 billion, will be available for civilian use in 1945-46, although the estimate for national income is ¥90 billion.

in considerable part the Japanese staff that had been employed in rationing consumer goods prior to surrender.

Another qualification of any such measure of annual reparation as that suggested must be noted. To a not inconsiderable extent Japanese industry, and in some part Japanese food, is dependent upon supplies from abroad. These supplies must be paid for out of the product of Japanese industry. It follows that the total amount available for reparation from current production constitutes only the excess of that production over (1) requirements of the minimum standard of living, and (2) the amount of exports necessary to pay for essential imports. The total amount of reparation that may be collected from current production obviously depends both on the annual amount and on the number of years in which it is collected. As previously indicated, this period preferably should not exceed five years; it should not be extended merely to obtain larger total payments. On the other hand, diligent efforts on the part of the Japanese people to increase their production should increase the amount available for annual reparation and should shorten the period of payment.

Payment of reparation from current production should be predominantly by direct transfer of goods and services to the recipient country for its domestic use. Payment in cash received from the sale of goods and services to third countries should be discouraged except under special conditions.

There remains the possibility of reparation from labor services. While industry in Far Eastern countries other than Japan might well benefit from the use of Japanese technicians, supervisors, and even skilled labor, the forced employment of such labor might prove to be of doubtful utility and might lead to serious disturbances. The reparation commission should give careful consideration to these possibilities before deciding to seek reparation from labor services as such, having in mind the main objective of peace and satisfactory international economic relationships.

VI. Control of Japanese Economic War Potential

Control of the Japanese economic capacity to wage war is of course vital to the political and economic objectives of the United States. Such control will begin with disarmament and destruction of specialized war industries and stores, but must obviously extend beyond the first time period described in Section III above. Certain industries should be prohibited, such as the production of aircraft and the construction of ships readily convertible to naval auxiliary uses. The synthetic petroleum industry also should be destroyed or closely controlled. Rigid inspection of industrial establishments and production will be required, particularly if the scope of military occupation is limited. Aid in this regard might be afforded by close control of the sources and distribution of electric power. Discretion, supported by competent technical advice, should be employed in marking particular industries or plants for destruction or for conversion to peacetime production to meet minimum needs of the occupying forces and of the Japanese people as well as of the peoples of liberated areas.

Aside from measures of the sort just indicated, positive measures for controlling the war potential will take the form of control of the current operations of industry and trade. After the termination of military occupation and of inspection within Japan, perhaps one of the chief of these controls will take the form of control or rationing of imports, particularly of such strategic materials as oil, iron ore, coal, and bauxite, whose requirements for legitimate peacetime industry can be closely estimated. The effectiveness of import control will depend on the cooperation of exporting countries, which might be obtained through the general international organization or other international arrangements. Measures such as these of course cannot be completely foreseen. They are obviously closely related to economic policy with reference to Japan's internal economy and to the guidance of Japanese industry and trade toward economic interdependence among free nations, as opposed to self-sufficiency and domination in particular areas.

VII. The Relation of Economic Policy Toward Japan to General Economic Policy in the Far East

Economic foreign policy must be based on and consistent with general foreign policy. One of the paramount aims of United States foreign policy is enduring peace. On the economic side, United States foreign policy found expression in the principle of equality of commercial opportunity, as illustrated in the Open Door policy in China and in later declarations of policy. Japan's attempt at hegemony in the Far East, political and economic, ran headlong into this principle and into what has been officially described as the correlated

principle of national integrity. United States foreign policy in the Far East thus came to be specifically directed to the prevention of imperialistic aggression, whether sought by force of arms or by initially peaceful devices for controlling trade and investment in the interest of the aggressor country.

In consequence of the historical interest of the United States in China, and perhaps in part of Japan's failure to maintain peace during the period of her ascendency in the Far East, United States Far Eastern policy has inclined toward the development of a strong and united China as a bulwark of peace in the Far East. China is well equipped by resources of population and natural welath to assume a more important place in world industry and commerce. Such a development would enlarge the political power and influence of China in the Far East and that influence, it is confidently believed, would be exerted toward the maintenance of international peace.

Economic foreign policy thus has as its fundamental long-run objective the creation and maintenance of international economic relations that are consistent with and support continued peace. But it is not enough to focus attention on international economic relations if the domestic situation in the various countries of the world is not one of reasonable prosperity. Consequently, economic foreign policy in the post-war world must embrace within its scope the eventual development of conditions that make for a reasonable degree of prosperity in the conquered countries as well as in the member states of the United Nations.

The paramount problem of economic policy toward Japan is to bring about the peaceful acceptance of a state of interdependence in the international economic field as opposed to one of discriminatory, exclusive, or compulsory trade relationships. The treatment accorded Japan under the controls that will be necessary in the earlier phases of the post-war world should seek as rapidly as possible to develop a receptive attitude toward this idea on the part of the Japanese Government and people. A corollary of this economic objective is the discarding of the idea and practice of economic self-sufficiency whereby industries closely related to the war potential are developed with little regard to cost and the principle of comparative advantage or international division of labor is ignored.

The necessity of eliminating the ownership of overseas properties by large Japanese corporations acting as agencies of aggression in the Far East has been indicated under the head of Restitution and Reparation. Moreover, the general foreign policy of the United States requires that the activities of such corporations must be curbed in so far as they restrict the free flow of goods in international commerce.

In view of Japan's inevitable interest in and dependence on foreign trade, firm and wise policy on the part of the dominant nations should facilitate the integration of Japan into the family of economically interdependent and peace-loving nations. But that integration cannot be achieved unless other countries also pursue appropriate policies and develop agencies of international collaboration. Failure to accept economic interdependence among nations would spell failure to attain the objective of an enduring peace.

[Source: Dipl. Br., National Archives]

2-14 ECONOMIC POLICY TOWARD JAPAN (DOCUMENT SC-101)

Minutes, 72nd Meeting — April 23, 1945
Secretary's Staff Committee
Top Secret

Present: The Under Secretary (presiding)
Mr. Acheson
General Holmes
Messrs. Phillips
.....
Butler (for Mr. Rockefeller)
Flourney (for Mr. Rackworth)
Stevenson (for Mr. MacLeish)
.....
Raynor, Hayden
.....
Benninghoff
Lewis
Yost

Absent: The Secretary
Messrs. Clayton
Dunn
Hackworth
Lynch
MacLeish
Pasvolsky
Rockefeller

AGENDA ITEM[8]

THE UNDER SECRETARY said Mr. Clayton was unable to be present because of a very important meeting. THE UNDER SECRETARY said that he had read the document on Economic Policy Toward Japan very carefully and that he would have a few suggestions for changes. For example, MR. GREW said, he thought it would be desirable to require Japanese labor to do reconstruction work, especially in China.

MR. ACHESON said he thought the document was very poor. He thought it was full of meaningless platitudes up to pages 5, 6, and 7, where it was full of dangerous platitudes. He said it seemed absurd to recommend that we should see that Japan has a vigorous international trade so that it can pay reparations.

THE UNDER SECRETARY said he thought the idea was that Japan should be allowed to have the minimum economic activity required to keep that country from starving and hence, from being a festering sore in the future. He pointed out that the Japanese population of 70,000,000 cannot possibly live when all the outlying possessions are taken away, unless some provision is made for the minimum economy necessary to enable them to engage in international trade. He also mentioned that the document had been in preparation for many weeks and that it probably represented many compromises.

MR. ACHESON said he thought it would be better if the drafters of the document would analyze Japanese industry and trade (utilizing especially FEA and OSS studies) and make specific recommendations regarding the elements Japan should be allowed to retain or required to give up. He said this document was not unlike the paper on Germany which had got the Department into trouble. He said Treasury and Army would doubtless consider it to be a recommendation for a "soft peace". GENERAL HOLMES agreed that the presentation seemed superficial. He thought our objectives should be stated and indication made so far as possible of the specific means of accomplishing those objectives.

THE UNDER SECRETARY said he felt there were too many imponderable factors which would make it very difficult to spell out the recommendations in advance. MR. ACHESON suggested that if this were the case, it might be better not to have any paper at this time. He said the conclusions reached in the document were fundamentally inconsistent with one another, and that the effect of the paper was to give a false sense of security.

THE COMMITTEE agreed that Mr. Clayton should be informed of the consensus of opinion in the Committee—i.e. that the recommendations were too general, and that detailed studies of Japanese industry and trade should be utilized to make concrete suggestions and recommendations.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-15 POLITICO-MILITARY PROBLEMS IN THE FAR EAST: POST-SURRENDER MILITARY GOVERNMENT OF THE JAPANESE EMPIRE: FINANCIAL PROBLEMS

SWNCC-114
Secret

April 23, 1945

Report by the State-War-Navy Coordinating Subcommittee for the Far East

THE PROBLEM

1. To recommend the procedure to be followed in the preparation and processing of statements of U.S. policy on the subject: "Post-Surrender Military Government of the Japanese Empire: Financial Problems".

[8] The following item appears in the minutes of the Secretary's Staff Committee's 78th Meeting of April 30.

FACTS BEARING ON THE PROBLEM

2. SWNCC 16/2, approved by the State-War-Navy Coordinating Committee on 23 February 1945, directs that the Subcommittee for the Far East maintain as a general guide for its activities a master list of Pacific-Far Eastern problems, arranged in approximate order of priority, and that prior to initiating action on any one of such problems the Subcommittee submit in each case to SWNCC a detailed recommendation showing (1) a statement of the problem, (2) the agency or agencies to be charged with initiation of the basic documents involved, and (3) the method of processing and coordination thereof, including recommendations for ultimate implementation.

3. The subject: "Post-Surrender Military Government of the Japanese Empire: Financial Problems", appears as Item VI-12 on the revised list. (SWNCC 16/4).

4. While the preparation of a paper on this subject will require assistance from the Department of State and the Treasury Department, comparable papers for use by military government in other areas have been prepared by the Civil Affairs Division of the War Department and the Military Government Section, Central Division Office of the Chief of Naval Operations. Personnel particularly qualified to prepare this paper on "Financial Problems" is available in these two agencies.

5. The conclusions and recommendations which follow are submitted in compliance with paragraph 6b of SWNCC 16/2.

CONCLUSIONS

6. It is concluded that:

a. In general, the scope of the paper or papers should encompass financial problems arising within the Japanese Empire except for Japanese Investments in Formosa (SWNCC 56) and except Formosan Problems—Currency (SWNCC 74). The paper or papers should indicate:

(1) Policies relative to Japanese finance; e.g., functioning of financial machinery, currency inflation, foreign exchange controls, and public finance, including servicing of the public debt.
(2) Present Japanese financial institutions to be retained.
(3) The extent of financial control over national or other governmental assets and a listing of such other assets that should be blocked or otherwise controlled by military government.

b. The War Department (Civil Affairs Division) should be requested by SWNCC:

(1) To prepare the initial draft of a paper or papers on the above subject.
(2) To collaborate with the Military Government Section Central Division, Office of the Chief of Naval Operations, and with other appropriate Federal agencies in the preparation of the report, and
(3) To submit the report to the State-War-Navy Coordinating Committee.

c. The draft of the paper prepared by the War Department in collaboration with the other governmental agencies, when received by the SWNCC Secretary, should be issued as a numbered SWNCC paper.

d. The SWNCC Secretary should then simultaneously:

(1) Request the J.C.S. through its Secretary to designate the appropriate J.C.S. agency to consider the subject.
(2) Direct the Coordinating Subcommittee for the Far East to collaborate with the appropriate J.C.S. agency designated to consider the subject.
(3) Direct the Coordinating Subcommittee for the Far East to secure appropriate views within the State, War, and Navy Departments, and coordination with other civilian agencies as may be appropriate. (Such views and coordination should generally be secured after collaboration by the appropriate J.C.S. agency and the Coordinating Subcommittee has resulted in tentative agreement.)

e. The appropriate J.C.S. agency should then report to the J.C.S. This report should reflect the results of the collaboration and coordination outlined above.

f. Upon receipt of a report from the J.C.S., SWNCC should consider the report with such further advice as may be necessary from the appropriate officials within the three Departments.

g. The final paper or papers as approved by SWNCC should be transmitted to the interested governmental departments and agencies as approved governmental policy for their

guidance, and, where appropriate, for proper implementation.

RECOMMENDATIONS

7. That the State-War-Navy Coordinating Committee:

a. Approve the above Conclusions.

b. Send an appropriate memorandum to the Civil Affairs Division, War Department, and the Military Government Section, Control Division, Navy Department, requesting that they collaborate in the preparation of an initial draft of a paper or papers.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-16 POST-WAR ECONOMIC PLANNING AND REPRESENTATION OF GOVERNMENT DEPARTMENTS

Memorandum May 15, 1945
To: Eugene Dooman, Chairman SWNCC Subcommittee for the Far East
From: Joseph C. Grew
A-D-Mr. Dooman:

Mr. Clayton suggests that if the Treasury Department proposes the setting up of a broader committee to deal with the economic and financial aspects of our post-war treatment of Japan it would be well for me to refer the proposal to your subcommittee and to have your subcommittee go on record, in writing, to the effect that this subcommittee has functioned effectively in dealing with the various problems that have been brought before it, and that to create another committee with representatives of the Treasury Department and FEA as members would inevitably open the way for other Departments of the Government such as Commerce and Agriculture to ask for similar representation. It might at the same time be said that your subcommittee will be glad, whenever matters of interest to the Treasury Department of FEA arise, to invite representatives thereof to attend the meetings when such subjects are to be discussed.

It seems to me that this would be a logical way of dealing with the matter and it would certainly strengthen my hand in meeting such representations as may be made to me by Mr. Morgenthau or Mr. Crowley.

Joseph C. Grew

[SOURCE: GREW PAPERS, HARVARD UNIVERSITY]

2-17 UNITED STATES INITIAL POST-DEFEAT POLICY TOWARD JAPAN

Letter June 23, 1945
To: Frank Coe, Director of Monetary Research, Treasury Department
From: Edwin M. Martin, Advisor, Far East Economic Affairs, State Dept.
Secret
Dear Frank:

You will recall that a little over six weeks ago I left with you for your informal comments a draft of the "General" and "Economic" sections of a summary statement of United States initial post-defeat policy toward Japan. Two weeks later, on May 28, I left with Mr. Friedman a revised draft incorporating changes which had been agreed to by myself and Mr. Fowler of the Foreign Economic Administration. At that time I told Mr. Friedman that there was heavy pressure to complete the document and secure Presidential approval, and that I was uncertain how much longer I could hold it up for Treasury comments.

Since then a number of additional steps have been taken with respect to the paper and I now find that partly as a result of the pressure to reach policy decisions preliminary to the meeting of the Big Three, any opportunities I might have for securing considerations of further changes are gone or will be so within the next day or two. I hope that the absence of comments from you means substantial agreement with the document as it was submitted to you. If this should not be the case, I am still anxious to know your views and am willing to do what I can to have any changes incorporated, although my opportunities for doing so are by now quite limited.

Sincerely yours,
Edwin M. Martin

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-18 DISCUSSION OF AGRARIAN REFORM

Minutes June 23, 1945
Meeting of Interdivisional Committee on Economic Policy Toward Japan
Secret

1. The Chairman[9] made a number of announcements concerning recent developments in connection with the so-called "Presidential Directive", the recent activities of the Far Eastern Subcommittee of SWNCC, and the discussions on the CAD draft of the Directive from the JCS to the Theater Commander on the initial post-surrender policy of military government in Japan. Mr. McGuire reported on conversations initiated by CAD with State and Treasury with respect to the financial section of this Directive.

2. The three statements of possible military government policy with respect to agrarian reform, which was circulated with the agenda, were discussed at length. The conclusions of this discussion may be summarized as follows:

a. While we are committed to encouraging democratic reforms and a wider distribution of ownership, management and control of the Japanese economic system, primarily because of the desirable political effects of such changes in increasing our security against Japanese aggression, the implementation of these policies must be conditioned by the costs. It is necessary to consider the effect of agrarian reforms on the production of food and the burden which they would place on the number of military government officers required to carry them out.

b. So long as military government has as its primary objective the restoration and maintenance of law and order, and the Japanese civil and criminal courts are continued in operation with full support from the present police, and so long as military government assumes all policy forming powers, no important channels are open for readjustment and reform of a substantial character on the initiative of the Japanese themselves. By the time prefectural or higher legislative bodies are permitted to function and assume a broad enough jurisdiction to permit them to take steps in the direction of basic reform, much if not all of the steam behind such reforms will probably have been dissipated. They should be given the broadest possible powers as soon as possible, but not much reliance can be placed on them.

c. Therefore, no important agrarian reform can be expected in the military government period unless the initiative can be and is taken by military government, although they may expect assistance in carrying out their measures from a number of groups of the Japanese population.

d. After considering the value of their economic and political effects it is not judged wise to undertake the abolition of tenancy and of farm indebtedness, particularily because of the effect of such measures in reducing the supply of food available in urban areas, their lack of permanent and substantial effect on the economic position of farmers and, hence, their lack of political value to us, and the cost in personnel of carrying out such complex operations. It is possible, however that Japanese tenants and their sympathizers may take steps to effect a radical change in their position and that the problem will reach such proportions that military government will be compelled to take sides. In such case a full report should be made to Washington, along with a request for specific directives.

e. Our political objectives can more usefully be served by measures which increase the income of agriculture. Some minor steps in this direction can be usefully taken by military government at a low cost in personnel, but no major improvement can be made except as a reflection of a general raising of the Japanese national income and such an improvement in its distribution as will appreciably reduce the number of people dependent upon the land for a living.

f. Among those specific measures whose value will justify their cost to military government may be a readjustment of taxes so that agriculture and the low income classes generally bear a fairer share of the total load; the active encouragement of agriculture credit, purchasing and marketing cooperatives; a reduction in the price to the farmer of artificial fertilizers; the continued support of stable prices of rice and raw silk; careful review of present legislation with respect to land tenure and farm debts to insure that the landlord-tenantry relationship is on the most equitable possible basis and, that the full financial re-

[9] Edwin M. Martin.

sources of government are committed to providing the cheapest possible credit to farmers.

3. After discussion it was generally agreed that though their application may differ, the same general principles should be used in approaching the role of military government in the reform of Japanese industrial and Japanese labor organizations.

The meeting adjourned at 4:30 p.m.

[SOURCE: DPIL. BR., NATIONAL ARCHIVES]

2-19 ROLE OF TREASURY DEPARTMENT IN DIRECTIVE ON JAPAN

Memorandum of Conversation, Department of State — June 25, 1945
Participants: Mr. Henry Morgenthau Jr. (Secretary of the Treasury)
Mr. Grew (Acting Secretary of State)

Secretary Morgenthau telephoned this morning to say that under what was known as an "Informal Committee for Germany", headed by Mr. Clayton as chairman, we got out what everybody seemed to think was a pretty good directive. He said he understood that there was now a group, not headed by Clayton, getting out a directive on Japan, and that the Treasury Department, as well as the State Department, was wholly on the outside. Mr. Morgenthau said that the Treasury Department had a real interest in this directive and he would appreciate it if I would make some inquiries about the matter.

I told Secretary Morgenthau that the directive was not yet in final form and there would perhaps be modifications before it was sent out anywhere. I inquired if there was a financial angle in it, to which Mr. Morgenthau replied that there was a financial angle in all of these questions once we begin to occupy these countries, adding that the Army has a strong finance section. Mr. Morgenthau said that Treasury had been in on the directive for Germany and also on the one for Austria, and he wondered now why they were being excluded regarding Japan. Secretary Morgenthau said that they would like to get in on these things while they were still in the formative period. To an inquiry of Mr. Morgenthau as to why Clayton was not chairman of the group on Japan, I told him that Mr. Clayton was not conversant with the Japanese situation, and that in order to solve all the problems relating to this situation, it was necessary to know all about conditions in Japan, the psychology of the people and all the rest of it.

I told Mr. Morgenthau that this matter would have to be passed by our Staff Committee in the Department before we submitted it to anyone else. Mr. Morgenthau said that he and his assistants would like to have a look at it before it was too late. I said that nothing had as yet crystallized and that the question would have to be put to the War and Navy Departments. I added that we would let him have a look at the paper in due course.

Joseph C. Grew

[SOURCE: GREW PAPERS, HARVARD UNIVERSITY]

2-20 COMMENTS ON JUNE 23, 1945 MINUTES OF COMMITTEE ON ECONOMIC POLICY TOWARD JAPAN

Memorandum — July 7, 1945
To: Mr. Edwin M. Martin
From: Eleanor Hadley
Secret

CD[10] has several reservations and one correction to record with respect to the minutes of the June 23, 1945 meeting of the Committee on Economic Policy Toward Japan.

2a. It is felt that this paragraph does not reflect the spirit of the presidential directive which states without qualification that it shall be the policy of this Government to "encourage the development of democratic organizations in labor, industry and agriculture, and" to "favor a wider distribution of ownership, management and control of the Japanese economic system". The directive contains no conditioning clause as is indicated in the minutes that this action will be taken provided it does not place an undue burden on military government. It would seem more appropriate to try to adjust the number of military government personnel to the problems that will exist, rather than to attempt the reverse. For this reason, on matters of vital security importance to the United States, it is not thought advisable to

[10] Commodities Division, State Dept.

use as the criterion for action in Japan the accidental decision of some military commander on the number of men to be trained by July 1945.

2b. The statement that military government has as its primary objective the restoration and maintenance of law and order is accepted with considerable doubt. Section I, paragraph 4 of *Military Government and Civil Affairs* states: "The object of civil affairs control through military government is to assist military operations, to *further national policies* and to fulfill the obligations of the occupying forces under international law."

2d. It is not thought that this paragraph represents the concensus of the Committee. The Committee was given no factual information on Japanese farm tenancy and indebtedness, and consequently the members had no common and authentic background of information with which to judge the three policy papers. Furthermore, since discussion centered on the first paper, alternative approaches received little attention. With the facts at their disposal it is not perceived how it would have been possible for the Committee to have reached any judgements on the economic and political effects of the reform of tenancy and the reduction of farm indebtedness.

3. Mr. Rudolph intended to convey the opposite impression from that recorded in this section of the minutes which suggests that the reform of the Japanese industrial organization will be undertaken in the spirit that any measures put forward will "lack permanent and substantial effect", and thus will be of no political value to us and that considerable weight should be attached to the fact that personnel for such operations will be costly. Instead Mr. Rudolph intended to suggest that the problem should be thought of less broadly, that attention should be concentrated on specific steps that could be taken which would work toward the stated objective of this Government of favoring the wider distribution of ownership, management and control. He did not intend to convey that no fundamental changes were to be made.

In view of the points discussed above, CD would like to see certain changes made in the minutes as they now stand of the June 23 meeting.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-21 AGRICULTURE AND FOOD IN JAPAN

Civil Affairs Guide — July 15, 1945
War Department Pamphlet, No. 31-10
Confidential

PREFATORY NOTE

Civil Affairs Guides on Japan are designed to aid officers responsible for military government in that country. Each Guide is focused on a specific problem which may confront military government authorities and contains (a) pertinent information organized in such a way as to be useful in dealing with the problem, and (b) an analysis of the various steps which might be taken in meeting the problem.

The *Guides* are not basic collections of factual information as are the *Civil Affairs Handbooks*, nor are recommendations in the Guides intended to take the place of plans prepared in the field. They are rather designed to point information and analysis toward the making and executing of plans by Civil Affairs Officers in the theater of operation. *In no sense is a Guide to be taken as an order. Such orders will be issued in the normal manner.*

The Committee on Civil Affairs Studies consists of representatives of the Department of State, Department of Agriculture, Office of Strategic Services, Foreign Economic Administration, the Navy, and the Civil Affairs Division, War Department Special Staff. Each Guide is cleared by all agencies represented on the Committee before it is issued.

This document contains information affecting the national defense of the United States within the meaning of the Espionage Act, 50 U.S.C., 31 and 32 as amended. Its transmission or the revelation of its contents in any manner to an unauthorized person is prohibited by law.

FOOD AND AGRICULTURAL PROGRAM FOR JAPAN

Contents

I. INTRODUCTION and SUMMARY[11]

[11] This portion only included.

II. JAPAN'S FOOD POSITION
Japan's Food Supply, 1944-45
Statistical Picture
Non-Statistical Factors
Conclusion
Japan's 1944-45 Food Supply by prefectures
Japan's Food Supply During Military Occupation
Crop Outlook, 1945
Food Supply Outlook, 1946
Program for Early Period of Occupation
1. Proclamation on Food Policy
2. Emergency Control of Food Distribution
3. Seizure of Food Stocks
4. Inventories of Food Stocks
5. Food Transport
6. Protection of Records
III. AGRICULTURAL CONTROLS
Production Control
1. The Problem
2. The Situation
3. Recommendations
Procurement Control
1. The Problem
2. The Situation
3. Recommendations
Price Control
1. The Problem
2. The Situation
3. Recommendations
Distribution Control
1. The Problem
2. The Situation
3. Recommendations
Over-all Recommendations
(a) Concerning Changes in Existing Controls
(b) Concerning Employment of Japanese Administrative Machinery and Personnel
Concerning Utilization of Personnel of Agricultural
Educational Facilities
Universtities
Experiment Stations
Time Factors and Controls
Agricultural Associations as Factors of Control
Recommendations
IV. PROGRAM FOR THE LONGER PERIOD OF MILITARY OCCUPATION
Land Utilization
1. Pre-war Factors
2. Wartime Factors
3. Recommendations
Labor, Draft Power and Machinery
1. The Problem
2. The Situation
3. Recommendations
Fertilizers
1. The Problem
2. Pre-War Fertilizer Consumption
3. Wartime Production and Consumption
4. Effects of Fertilizer Elimination
5. Recommendations
a. Farm-supplied
b. Commercial Organic

c. Commercial Chemical
6. General Recommendations
Sericulture
1. The Problem
2. The Situation
3. Recommendations

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I. Introduction and Summary

Introduction

Japan did not produce enough food for itself before the war and upon its defeat and occupation this situation will be aggravated. With the threat to public order and military security which such deficiencies invite, remedial measures must be taken. It is essential that Japanese production of food and of agricultural raw materials be maintained at the highest level, and that the most economical utilization of the food supply be made by means of regulated food collection and distribution.

As an aid in achieving these ends the Guide aims (1) to analyze the Japanese agricultural and food situation that is likely to prevail at the time of defeat and (2) to indicate the principal requirements for maintaining production and distribution during the period of occupation. In addition, the Guide suggests possible approaches to the question of sericulture and silk production in Japan, in the immediate post-war period.

In framing ultimate policies and action, it probably will be necessary to modify the goals suggested and the means of achieving them. These goals are primarily of technical nature but nevertheless, they may have to be modified or the means for their achievement altered according to the actual conditions found upon occupation. For this reason actual conditions that will ultimately govern the over-all program for any segment of the economy can only be determined on the spot.

Summary

1. Japan's agricultural economy will emerge from the war with a reduced productive capacity. The means available for restoring it to the pre-war level shortly upon the occupation of Japan will be insufficient. It is recommended, therefore, that any plan of land utilization and of production goals should not aim to exceed the pre-war. A five or ten percent reduction in production would be more in accord with a rational goal.

2. The pre-war land utilization system of Japan with its emphasis upon food-grains suited well the country's needs. A defeated Japan will be in need of obtaining an even greater amount of energy food from its cultivated acreage. It is therefore recommended that, with the exception of the shift in acreage under mulberries, the pre-war character of land utilization in Japan should remain substantially unchanged.

3. If agricultural production of Japan is to be restored to or near to, the pre-war level in the shortest time, fertilizer consumption of 110 pounds of nitrogen (N), 61 of phosphoric acid (P_2O_5) and 67 pounds of potash (K_2O) per cultivated acre would be required. Since these rates will be hardly obtainable during the first or second year of occupation, the goal of fertilizer consumption should be based on 100, 60 and 40 percent of N, P_2O_5 and K_2O, respectively, or 110, 37 and 27 pounds per acre. In the event that the suggested level of fertilizer utilization is beyond attainment, the largest reductions should be made in P_2O_5 and K_2O, and the smallest in the nitrogenous fertilizers.

4. The Civil Affairs Administration should regulate the expected population shift during the early period of occupation, with the view of insuring an adequate supply of farm labor. As a further aid to agricultural production, horses taken from the farms should be returned upon the demobilization of the army, and, if possible, the manufacture of farm equipment in the quantities suggested in the Guide should be initiated.

5. Japan's domestic production before or immediately after occupation will be sufficient to satisfy domestic requirements based on a minimum consumption pattern. Irrespective of the agricultural season during which the occupation might take place, the urban centers will be found short of food. It is advisable that the food program of the period following the occupation should provide for (a) the immediate seizure of all available food stocks before they are diverted to the black market, stolen or otherwise dissipated; and (b) the distribution of food during the emergency period.

6. It is desirable to carry out the agricultural program, initiated by the occupation authorities, within the framework of existing controls in order that our work may have a firm

indigenous foundation. This will be more necessary if the Civil Affairs Administration should find production, procurement, price and distribution controls functioning fairly smoothly. Modification might be desirable, however, in order to bring down production and delivery quotas to realizable levels. In the event of a breakdown of the control machinery, it would be advisable to link farm deliveries with consumer goods (including fertilizer). If, on the other hand, consumer goods are lacking, imports of foodstuffs might be used as a means of preventing hoarding and black marketing.

7. Price policies and provision of fertilizer, farm equipment and civilian supplies for farmers should be used as a means of inducing or strengthening the producers' willingness to comply with delivery regulations.

8. For purposes of efficiency and economy of personnel in administering the agricultural controls, it is desirable to utilize existing Japanese agricultural personnel whenever their use will not interfere with the objectives of the occupation authorities.

9. The Japanese village associations and cooperatives touch upon the work and life of every Japanese farmer. With proper safeguards, the intimate knowledge and long years of experience of these organizations might be profitably put to use by the Civil Affairs Administration in promulgating its agricultural program.

10. Because of the expected sharp decline in the United States' demand for Japanese silk, it is recommended that the part of the mulberry acreage converted to food crops during the war should be maintained as such. If foreign demand for silk after the war should prove greater than presently anticipated, an upward adjustment in the mulberry acreage could be effected with little difficulty. Any acreage revision should be subject to the approval of the Civil Affairs Administration.

2-22 CONTROL AND USE OF THE BANK OF JAPAN

Civil Affairs Guide
War Department Pamphlet No. 31-6
Confidential

August 1945

TABLE OF CONTENTS

Summary[12]
Analysis of the Problem
Organization and Position of the Bank of Japan
1. The Legal Character of the Bank of Japan
2. The Relations between the Bank of Japan and Special Institutions with Central Banking Functions
3. The Position of the Bank of Japan is the National Financial Control Organization
4. The Position of the Bank of Japan in the "Greater East Asia Co-prosperity Sphere"
5. Policies and Operations of the Bank of Japan
Utilization of the Bank of Japan by the Civil Affairs Authorities[12]
I. Organization and Control
1. Changes in organization and personnel
2. Organization of Military Government Control
3. Functions of Military Government
II. Note Issue and Reserves
1. Issuance of currency
2. Note issue and monetary reserves of the Bank of Japan
3. Circulation of other yen notes
4. Administration of foreign exchange control
III. Other Operations
1. Relations to governmental administration
2. Control over credit and savings institutions

[12] These portions only included.

3. Financing of industrial activities
IV. Regulation of Special Institutions with Central Banking Functions

SUMMARY

The Bank of Japan is the key financial organ of the Japanese Empire and the nucleus of the financial structure of the "Greater East Asia Co-prosperity Sphere". The Military Government may find it expedient to assume the broad powers previously vested in the Japanese Government with respect to the Bank of Japan and to use the Bank of Japan as the executive agency for enforcing an overall control over the monetary system and the financial institutions of Japan proper. With a view toward attaning the objectives of the military occupation of Japan, the Military Government may find it necessary to make certain changes in the administration and staff of the Bank of Japan and to issue new directives concerning its management and operations, as follows:

1. To remove all officials of the Bank of Japan appointed by the Japanese Government or Minister of Finance, and to place administrative functions in the hands of new officials promoted from within the staff of the Bank itself:

2. To exercise direct control over the Bank of Japan through a Central Control Staff entrusted with determining monetary and credit policies and supervising the central administration, and Branch Control Officers entrusted with supervising activities and operations of branches and agencies;

3. To make provision for the preparation of new notes for supplementing (and, under certain conditions, exchanging) the outstanding legal tender currency, and to prohibit the circulation in Japan proper of any Japanese currency other than the coins and subsidiary notes of the Japanese Government and the notes of the Bank of Japan:

4. To place under special custody gold, silver and other precious metals held by the Bank of Japan and other banking and governmental depositories, and to investigate private hoards of such metals;

5. To suspend the administrative functions of foreign exchange control of the Bank of Japan and the Yokohama Specie Bank, to prohibit all foreign exchange transactions, to invesitgate and assume control of foreign accounts of Japanese nationals, and to declare a moratorium on foreign claims arising from pre-occupation transactions;

6. To direct the Bank of Japan to provide all banking and credit facilities required by the Military Government and to make advances to Japanese governmental organs in the amount necessary for the maintenance of the national, provincial and local administrations;

7. To direct the Bank of Japan to exercise functions of control over financial institutions, to grant them credit in the amounts necessary for covering legitimate requirements, and to make its lending facilities directly available to industrial enterprises of essential character;

UTILIZATION OF THE BANK OF JAPAN BY THE CIVIL AFFAIRS AUTHORITIES

The Law of the Bank of Japan of 1942 and the other legislation pertaining to currency, savings and credit place unrestricted powers of control over financial institutions and their activities in the hands of the Japanese Government and the Ministry of Finance, of which the Bank of Japan is the official executive agency. This will facilitate the task of the Civil Affairs authorities, as they will not be faced with the problem of introducing controls and setting up supervisory organs anew. By virtue of the military occupation, the Military Government will assume all powers previously vested in the Japanese Government and the Ministry of Finance, including the power to direct the Bank of Japan to exercise administrative functions of monetary and banking control. The Military Government, however, will find it necessary to make certain changes in the administration and staff of the Bank of Japan and to issue new directives concerning its management and operations, as may be required for the attainment of the objectives of the military occupation of Japan.

I. Organization and Control

The measures designed to bring the Bank of Japan under the control of the Military Government may be generally classified in three groups, namely (1) changes in organization and personnel; (2) organization of a Civil Affairs Control Staff, and (3) functions of the Civil Affairs Control Staff.

1. *Changes in organization and personnel*

a. There will be little need for changes in the organization of the Bank. As soon as

part or the whole of Japan proper is occupied, the Civil Affairs authorities may designate the office of the Bank of Japan situated in the center of the military government for Japan as the "head office" of the Bank; however, the head office may be moved along with the headquarters of the military government as more important centers are occupied and placed under the jurisdiction of the Military Government. The head office would conduct its own business and supervise the activities of all branches and agencies in the occupied area in accordance with the directives and instructions of the Military Government.

b. Considerations of political character and military security suggest that all Bank officials appointed by the Japanese Government or the Minister of Finance (Governor, Vice-Governor, Directors, Auditors, Councillors and Inspectors) be removed from office. This measure would involve some twenty officials altogether, of whom, however, only seven (Governor, Vice-Governor and Directors) are actively engaged in administrative duties, while the others have auditing, advisory or supervisory functions largely of nominal character.

The Military Government could then appoint a Japanese Commissioner and three to five Managing Directors and vest them with the duty and authority to carry on the administration and management of the Bank. The Commissioner and the Directors could be directed to exercise all the functions of the Governor and the Administrative Board of the Bank, under the direct control of the Military Government. In order to make this control effective, the Commissioner and the Directors could be charged with full responsibility for the administration and management of the Bank, and in particular be made jointly and severally responsible to the Military Government for all acts reserved by law to the Board of the Bank or requiring the advance approval of the Civil Affairs authorities. In particular, it would be their responsibility to pass upon all matters related to terms and conduct of the Bank's business, relations with other banks and Japanese public bodies, and staff appointments and regulations.

c. The appointment of the Japanese Commissioner and the Managing Directors could be by promotion from within the staff of the Bank. In addition to assuring that officials technically equipped would be selected for the tasks, this system would also result in the formation of a class of personnel directly interested in the maintenance of positions newly achieved.

Reasons of military security and political control would recommend that persons who had been directly associated with Japan's policies of foreign aggression not be permitted to occupy leading positions under the Civil Affairs authorities. This rule is of particular importance in the case of the Bank of Japan, as this institution would work in closest contacts with the Military Government authorities, be charged with operations directly related to the objectives of the military occupation, and be entrusted with functions of supervision over other financial institutions. By way of suggestion, persons who since July 7, 1937 had occupied positions of "Shin-nin" or "Choku-nin" ranks or of equivalent importance in the Japanese Government; or who had held directive positions in the Imperial Rule Assistance Association or other organizations of similar character; or who had served in official executive positions or other important capacities in "Manchoukuo" and the rest of Occupied China, or in any other of the "Greater East Asia Co-prosperity Sphere" countries might be declared ineligible for the positions of Commissioner and Managing Director of the Bank of Japan. Similar restriction might be applied to persons who had maintained close contacts with military and "patriotic" factions at any time during the China or the Pacific Wars, either by having received military or naval appointments or by having been members of certain societies of extranationalist tendencies and potentially dangerous character.

These precautionary limitations would not hamper seriously the Civil Affairs authorities in their selection of persons for the positions of Commissioner and Managing Director, as it is believed that few of the Bank of Japan's employees of managerial rank would be affected. It is also suggested that the Civil Affairs authorities take precautions similar to those outlined above in promoting personnel to managerial ranks in the head office and branches. For an additional and general precautionary measure, officers and employees of the Bank could be retained in the legal category of "personnel engaged in a public function," and thereby come under the special control which it is assumed will be applied by the Military Government with regard to the Japanese civil service.

d. It may be noted that these precautionary measures, which have been suggested for adoption by the Military Government in the initial period of the military occupation, would not prejudice in any way different courses of action which may be decided upon subsequently in order to meet special conditions and on the basis of strict investigations of officials and personnel of the Bank of Japan.

2. *Organization of Military Government Control*

a. Obvious reasons of administrative convenience would suggest that Civil Affairs control over the Bank of Japan be set up in conformity with such lines of control as will be decided upon for other organs of the Japanese State. In order to maintain close contacts between the Military Government and the Bank of Japan and to control effectively its activities at the center and the periphery, it will probably be found necessary to have a Central Control Staff stationed at the head office and Branch Control Officers attached to the various branches of the Bank.

b. One of the tasks of the Military Government authorities will presumably be to insure a rapid resumption of activities on the part of the Bank of Japan, combined with an immediate imposition of control. The task would be facilitated if the Central Control Staff were appointed and the Branch Control Officers were designated by the Civil Affairs authorities in advance of the invasion and occupation of Japan proper.

c. The personnel requirements for Military Government control over the Bank of Japan cannot be precisely estimated in advance. The number of Military Government officers to be attached to the Bank will vary in accordance with three main considerations; namely, (a) the extent to which it will be necessary to extend control from policy and administration to management and operations; (b) the extent to which it will be necessary to impose detailed control upon the activities of branches and agencies; (c) the extent of which the Bank of Japan will be used as agency of control over other banking institutions, and (d) the availability of technical personnel with qualifications and training for the functions of control.

In a general way, the number of Military Government officers to be assigned to the Bank of Japan may be estimated on the basis of the number of Japanese officials, who will be made directly responsible to, and whose activities will be subjected to direct supervision by, the Military Government. On this basis, some 25 to 30 Civil Affairs officers would be required—with four to six officers in charge of the head office and one officer for each Bank branch.* In case even such limited number of qualified officers could not be obtained, two or more branches conveniently located may be grouped under the control of a single officer. It should be noted again that a well organized and distributed control over the Bank of Japan would greatly reduce the need for direct control over other banking institutions (particularly those outside Tokyo) and the number of officers required for that purpose.

In order to attain effective control and facilitate the task of the Civil Affairs officers, consideration might be given to ways and means of utilizing fully the competence of such specialists on Japanese banking and finance and other persons with knowledge of both Japanese and English and accounting practices as may be obtained through civilian agencies of the United States Government. These could be attached—in civilian or other capacities—to the Central Control Staff of the Bank of Japan, to be charged with preparing research surveys, conducting special investigations, analyzing reports and statistics, and doing "spot checking" of books and accounts, as may be deemed necessary. Their assistance would relieve the Military Government officers of these matters and permit them to dedicate their full activities to policy and administrative duties.

3. *Functions of Military Government*

a. The reopening of branches and agencies of the Bank of Japan need not be deferred until the head office in Tokyo or one of its leading branches has been placed under the military government and a systematic contact is established. If conditions require, the Military Government officers in charge in occupied areas could be empowered to order the managers of less important offices of the Bank of Japan to reopen and provide banking and pertinent facilities even before a "head office" has been set up. These offices could temporarily operate as autonomous units. They could be placed under the direction of Branch Control Officers, who could be charged with performing all necessary functions of control subject to such directives as the Military Government authorities of the area may issue.

b. As soon as one of the branches has been designated as "head office" or the head office in Tokyo has been taken over by the Military Government, the Central Control Staff could be placed in control of the entire system of the Bank of Japan. The Central Control Staff could be vested with all the powers which the Japanese Government and the Minister of Finance previously exercised over the Bank. It could determine policy on all monetary and credit matters, subject to the overall supervision of the Civil Affairs authorities, and

* Osaka, Moji, Nagoya, Otaru, Kyoto, Fukushima, Hiroshima, Hakodate, Kanazawa, Niigata, Matsumoto, Kumamoto, Akita, Matsuye, Okayama, Kobe, Matsuyama, Sendai, Fukuoka, Sapporo, Takamatsu, Shizuoka and Kagoshima.

perform the following functions in particular:

(i) to order or authorize the reopening of branches and agencies of the Bank in accordance with the military requirements of the Allied forces and the needs of the Military Government authorities in charge of civil administration;

(ii) to pass upon and review all acts of the Commissioner and the Managing Directors of the Bank, to suspend any operation of the Bank deemed "disadvantageous" to the policies laid down by the Military Government authorities, and to order the Bank to perform any operation essential for the attainment of the objectives of the military occupation;

(iii) to transmit all communications from the Commissioner, Managing Directors and other officers of the head offices to branches and agencies, to issue directives to the Branch Control Officers and to instruct them with regard to the activities of branches and agencies under their control in order to coordinate the activities of the Bank at the center and the periphery;

(iv) to obtain weekly reports from the Branch Control Officers concerning the activities of branches and agencies under their control, and to analyze them in order to take appropriate action in accordance with the policies laid down by the Military Government authorities;

(v) to cooperate fully with other Civil Affairs control organs in Japan in shaping financial policies and taking measures—such as limitations on deposits, priorities for loans and advances, and regulations governing domestic remittances—in accordance with the overall economic objectives of the military occupation.

c. The general function of the Branch Control Officers would be to direct the activities of the Bank branches, and of the agencies within a branch district, in accordance with the directives and instructions issued by the Central Control Staff. In particular, they could be entrusted with the following functions:

(i) to serve as "liaison" between the head office and the branches and agencies of the Bank, transmitting communications from the Commissioner, the Managing Directors and other officials of the head office to the branch managers and chiefs of agencies, and transmitting all communications from branches and agencies to the head office;

(ii) to pass upon and review all acts of the branch managers and chiefs of agencies concerning amounts in excess of some agreed-upon sum, such as 25,000 yen, to suspend any operation deemed contrary to the law and statutes of the Bank and to the directives and instructions of the Central Control Staff, and to order branch managers and chiefs of agencies to perform any operation requested by the Central Control Staff;

(iii) to make available to other local Civil Affairs control organs banking and safekeeping facilities and to provide them with the necessary financing facilities for carrying on activities approved by the Civil Affairs authorities.

(iv) to require from branch managers and chiefs of agencies daily reports on all operations involving more than, for example, 10,000 yen, with detailed information on terms and conditions, purposes and persons or institutions involving daily statements of currency notes paid out, received sums outstanding; and weekly balance sheets of assets and liabilities, with separate tabulation of "old" accounts outstanding at the date of occupation and "new" account arising from transactions concluded during the occupation accompanied by detailed reports covering the following items:

Total value of yen notes issued and on hand—with breakdown of (a) Bank of Japan notes, (b) Japanese Government notes, and (c) Occupation yen notes;

Total value of outstanding discounts, loans and advances—with breakdown by categories of borrowers (Civil Affairs and governmental organs, banks, industrial corporations, and others);

Total investments—with breakdown by categories of securities (Treasury bills and notes, government bonds, government-guaranteed debentures, other debentures, and stocks);

Total deposits—with breakdown by depositors (Civil Affairs and governmental organs, bank, industrial corporations, and others);

Any information pertinent to the position of the local branches and agencies, relations to other banks and financial conditions of the local district.

. . . . . .

2-23 DRAFT FINANCIAL DIRECTIVE FOR JAPAN

Inter-Office Communication (for information), Treasury Department — August 28 1945

To: Secretary Vinson
From: Mr. White[13]
Secret

1. Attached hereto is a draft financial directive for Japan agreed to at working level by representatives of the Treasury, State, Navy, and War Departments.

2. The proposed directive is very similar to the financial directive for Germany, and, in our judgment, furnishes the basis for an effective program to prevent Japan from using her financial resources to help initiate a policy of aggression within the foreseeable future. The degree of the effectiveness of the directive in this regard, of course, will be dependent upon the political and economic programs for Japan. The Treasury Department has not been asked to comment on these latter programs.

3. Although State Department representatives on the working party level agreed to the present draft of financial directive, they indicated quite clearly that their superiors may vigorously oppose on political grounds the directive as now drafted.

4. The present draft directive will now be sent for consideration to the State-War-Navy Coordinating Committee which is composed of Assistant Secretaries of those three Departments. If this Committee finds objections to the proposed financial directive, the Treasury Department may be called upon to defend its position.

5. In view of the possibility that opposition may develop to the proposed financial directive, I wish to inform you now of the issues about which such opposition may center.

(a) *Machinery for Executing Financial Policies in Japan.*

The directive provides that General MacArthur will, in general, use the administrative machinery of the Japanese Government to carry out his financial policies except where he believes that the effective execution of such policies requires him to set up machinery of his own. In addition, he is specifically directed to establish his own organization to supervise (or if necessary to execute) the programs for foreign exchange control, seizure of Japanese external assets, and the blocking of the property and removal from positions of influence of those individuals and organizations which, according to the Potsdam Declaration, have "deceived and misled the people of Japan" and which must be "eliminated for all time."

It is quite possible that the State Department will object to this provision. Upon the basis of the discussions we have had in the working party, we have the impression that the political people in the State Department may be taking the position that MacArthur must do everything through the Emperor and can only act independently in the event of a refusal or failure of the Emperor to act. We do not contend that the Emperor should not sign all necessary orders, proclamations, etc. But our position is that it is an absurdity to tell MacArthur that he must rely entirely upon Japanese administrative machinery to carry out the important financial programs indicated above and that he cannot immediately set up a staff of his own to supervise directly any Japanese organizations that may be used for this program. It is our view, for example, that the effective execution of any program of foreign exchange control will require the Military Government itself to exercise detailed supervision over the licensing policy which is followed and to exercise this supervision from the very outset of the occupation before the Japanese have had an opportunity to arrange their affairs to suit themselves. If MacArthur is not in a position to know directly what foreign exchange transactions are being licensed and to prevent their licensing if he deems it necessary, we obviously will not be exercising any real control. That is exactly what will happen if we leave the matter entirely in Japanese hands.

(b) *Elimination from the Financial Life of Japan of Undesirable Individuals and Organizations.*

In order to implement in the financial field the decision stated in the Potsdam Declaration to eliminate from positions of authority and influence those persons who have led the Japanese people into wars of aggression and conquest, the proposed financial directive contains provisions for the control of the property of such individuals and organizations and for the exclusion from positions of importance in the financial field of the individuals in question. The directive states that in the absence of evidence to the contrary persons who have

[13] Assistant Secretary of the Treasury.

held key positions in the financial field are to be presumed to have been exponents of militarism and aggression and are to be excluded from positions of importance. Among the organizations and individuals whose property we intend to control are included the Japanese Government itself and the Imperial Household. The Imperial Household controls a substantial part of the wealth of Japan.

The political people in the State Department may oppose these provisions. They may take the position that we cannot eliminate from positions of influence those notorious financial overlords who have played such an important part in making Japan the war-like and aggressive nation she is, unless such persons actually held positions in the military forces of Japan. This would mean, of course, that practically all of these war-makers would actually go untouched. They may also argue that our acceptance of the Emperor and the Japanese Government as General MacArthur's channels of command precludes us from controlling the property of the Japanese Government or of the Imperial Household. It is our position that the provision of the Potsdam Declaration that we intend to destroy Japan's war-making power cannot be carried out in the financial field without such measures.

(c) *Foreign Exchange Control and Seizure of External Assets.*

The proposed financial directive provides for a strict control of Japanese foreign exchange transactions. It also contains a provision for the seizure by the Allies of all Japanese external assets. It is our view that these measures are indispensable if we are to implement in the financial field the requirement of the Potsdam Declaration that the "Japanese war making power" be destroyed.

The State Department may oppose any such measure on the ground that we intend to let the Japanese Government remain in power, and that the only interference with Japan's foreign interests or relations will be to take away from her the territories specifically enumerated in the Cairo Declaration (Korea, Formosa, Manchuria, etc.). They may also argue that taking away external assets has nothing to do with depriving Japan of her war-making potential.

It is our firm conviction that there can be no effective program to prevent Japan from embarking on a policy of aggression which does not provide for the effective and complete elimination of the octopus-like holdings in the Far East of those notorious Japanese private empires such as Mitsui, Mitsubishi, Sumitomo, Ogura, etc.

Moreover, these measures are essential if the economic and financial basis for the independence of Korea and the restoration of Manchuria and Formosa to China is to be established.

. . . . . .

Part III - Financial

30. You will make full application in the financial field of the principles stated elsewhere in this directive, acting through the Japanese government to the extent that effective execution of the policies and programs hereinafter enumerated will permit, but establishing administrative machinery not dependent upon Japanese authorities and agencies to the extent necessary to execute or assure the effective execution of such policies and programs. You are specifically directed to establish such independent administrative machinery in order to execute or assure the effective execution of the provisions of paragraphs 36, 37, 41, 42 and 43 of this directive.

31. Japanese financial organizations and the public finance system will be expected to function on the basis of Japanese resources. You will take no steps designed to maintain, strengthen, or operate the Japanese financial structure except in so far as may be necessary for the purposes specified in this directive.

32. You may authorize or require the Bank of Japan or any other bank or agency to issue bank notes and currency which will be legal tender; without such authorization no Japanese governmental or private bank or agency will be permitted to issue bank notes or currency.

33. You will require the Japanese authorities to make available to you legal tender yen notes or yen credits free of cost and in amounts sufficient to meet all expenses of your forces including the costs of your military occupation.

34. In the event that for any reason adequate supplies of regular legal tender yen notes are not available you will use supplemental military yen (Type "B") issued pursuant to military proclamation. Supplemental yen will be declared legal tender and will be interchangeable at par without distinction with other legal tender yen currency.

35. You will not announce, establish or permit the use or publication, until receipt of further instructions, of any general rate of exchange between the Japanese yen on the one hand and the U.S. dollar and other currencies on the other. However, a rate of conversion to be used exclusively for pay of has already been communicated to you.

36. You will remove and exclude from positions of important responsibility or influence in all public and private financial institutions, agencies or organizations all persons who have been active exponents of militant nationalism and aggression or who have actively participated in the organizations enumerated in paragraph ____ of this directive. It may be generally assumed in absence of evidence to the contrary that any persons who have held key positions in any such institutions, agencies, or organizations are active exponents of militant nationalism and aggression. You will also prevent the retention in or selection for places of importance in the financial field of individuals who do not direct future financial effort solely towards peaceful ends.

37. You will close and not allow to reopen banks and other financial institutions whose paramount purpose has been the financing of war production or the mobilization or control of financial resources in colonial or Japanese occupied territories. These include

(1) the Wartime Finance Bank;

(2) the National Financial Control Association and its member control associations;

(3) offices, in the area, of the Bank of Chosen and the Bank of Taiwan;

(4) the various banks and development companies whose fields of operation have been outside Japan proper, such as the Southern Development Company, the Southern Development Bank and the Tokyo offices of the Central Bank of Mancheu, Bank of Mongolia, Federal Reserve Bank of China, and Central Reserve Bank of China.

You will take custody of all the books and records of these banks and other institutions.

38. You are authorized to take such financial measures as you may deem necessary to accomplish the objectives of your military occupation, specifically including, without limitation, the following:

(1) Close banks, other than those indicated in paragraph 37 above, only where clearly necessary for the purpose of introducing satisfactory control, removing objectionable personnel and taking measures to effectuate the program for the blocking of certain accounts and transfers or the determination of accounts to be blocked. You should reopen any closed banks, except those indicated in paragraph 37 above, as promptly as is consistent with the accomplishment of the foregoing purposes.

(2) Prohibit, or prescribe regulations regarding, transfer or other dealings in private or public securities or real estate or other property.

(3) Establish a general or limited moratorium or moratoria only to the extent clearly necessary to carry out the objectives of your Military occupation.

(4) Close stock exchanges, insurance companies and similar financial institutions for such periods as you deem appropriate.

39. You will prohibit the payment of

a. all military pensions, or other emoluments or benefits, except compensation for physical disability limiting the recipient's ability to work, at rates which are no higher than the lowest of those for comparable physical disability arising from non-military causes;

b. all public or private pensions or other emoluments or benefits granted or conferred

(1) by reason of membership in or services to the Political Association of Great Japan, the Imperial Rule Assistance Association (Taisei Yokusankai), the Imperial Rule Assistance Political Society (Taisei Soijikai), their affiliates and agencies of any successor or similar organizations, the League of Greater Japan Women's Associations (Dai Nippon Rengo Fujinkai), and all Japanese nationalistic, terroristic and secret patriotic societies and their agencies and affiliates.

(2) to any person who has been removed from an office or position in accordance with paragraphs ____ ____ or ____ of this Directive.

(3) to any person interned in accordance with paragraph ____ of this Directive, during the term of his internment, or permanently in case of his subsequent conviction.

40. (a) Any laws, ordinances and regulations or practices relating to taxation or other fields of finance which tend to discriminate for or against any person because of nationality, race, creed or political opinion will be amended, suspended or abrogated to the extent necessary to eliminate such discrimination. The collection of contributions of any kind for nationalistic, imperialistic, militaristic, or anti-democratic societies of any kind will be prohibited.

(b) You will insure that Japanese public expenditures are consistent with the objectives stated elsewhere in this directive.

41. You will impound or block all gold, silver, platinum, currencies, securities, accounts

in financial institutions, credits, valuable papers, and all other assets within the categories listed below.

a. Property owned or controlled directly or indirectly, in whole or in part, by any of the following:

(1) The Japanese national, prefectural and local governments, or any agency or instrumentality of any of them, including all utilities, undertakings, public corporations or monopolies under the control of any of the above;

(2) Governments, nationals or residents of other nations, including those of territories occupied by them, which have been at war with the United Nations at any time since 1 September 1939;

(3) The Japanese Imperial Household;

(4) The Political Association of Great Japan, the Imperial Rule Assistance Association, the Imperial Rule Assistance Political Society, their affiliates and agencies or any successor or similar organizations; the League of Greater Japan Women's Associations and all Japanese nationalistic, terroristic and secret patriotic societies, agencies and affiliates and their officials, leading members and supporters;

(5) The National Shinto;

(6) All organizations, clubs or other associations prohibited or dissolved by you;

(7) Absentee owners of non-Japanese nationality including United Nations and neutral governments and Japanese outside of Japan;

(8) Any person or concern in any area under Japanese control at any time since 1894, except the islands of Honshu, Hokkaido, Kyushu, Shikoku and whatever minor islands are left to Japan;

(9) Persons subject to internment under provisions of paragraph____, and all other persons specified by Military Government by inclusion in lists or otherwise.

b. All Japanese (public and private) foreign exchange and external assets of every kind and description located within or outside Japan.

c. Property which has been the subject of transfer under duress, wrongful acts of confiscation, dispossession or spoliation, whether pursuant to legislation or by procedure purporting to follow forms of law or otherwise.

d. Works of art of cultural or material value of importance, regardless of ownership.

You will take such action as will insure that any impounded or blocked assets will be dealt with only as permitted under licenses or other instructions which you may issue. In the case particularly of property blocked under a (1) above, you will proceed to adopt licensing measures which while maintaining such property under surveillance would permit its use by you or by the licensees in consonance with this directive. In the case of property blocked under c above, you will institute measures for prompt restitution, in conformity with the objectives of this directive and subject to appropriate safeguards to prevent the cloaking of militaristic and other undesirable influence.

You will require from the Japanese Government such reports as you deem necessary to obtain full disclosure of all assets mentioned in b above.

42. You will seek out and reduce to the possession and control of a special agency established by you within your command all Japanese (public and private) foreign exchange and external assets of every kind and description located within or outside Japan.

43. All foreign exchange transactions, including those arising out of exports and imports, will be controlled with the aim of preventing Japan from developing a war potential and of achieving the other objectives set forth in this directive. To effectuate these purposes you will

a. Prohibit, except as authorized by regulation or license, all dealings in gold, silver, platinum, foreign exchange, and all foreign exchange transactions of any kind.

b. Make available any foreign exchange proceeds of exports for payment of imports directly necessary to the accomplishment of the objectives of this directive, and authorize no other outlay of foreign exchange assets without specific approval of your government through the Joint Chiefs of Staff.

c. Establish effective controls with respect to all foreign exchange transactions, including:

(1) Transactions as to property between persons inside Japan and persons outside Japan;

(2) Transactions involving obligations owed by or to become due from any person in Japan to any person outside Japan; and

(3) Transactions involving the importation into or exportation from Japan of any foreign exchange asset or other form of property.

d. You will provide full reports to your government with respect to all Japanese foreign and external assets.

44. No extension of credit to Japan or Japanese by any foreign person, agency or government will be permitted except as may be authorized by your Government through the Joint Chiefs of Staff upon your recommendations.

45. It is not anticipated that you will make credits available to the Bank of Japan or any other bank or to any public or private institution. If, in your opinion, such action becomes essential, you may take such emergency actons as you may deem proper, but in any such event, you will report the facts to your Government through the Joint Chiefs of Staff.

46. You will maintain such accounts and records as may be necessary to reflect the financial operations of your Military occupation and you will provide the Joint Chiefs of Staff with such information as it may require, including information in connection with the use of currency by your forces, any governmental settlements, occupation costs, and other expenditures arising out of operations or activities involving participation of your forces.

[SOURCE: NATIONAL ARCHIVES]

2-24 JAPAN'S ACCEPTANCE OF THE POTSDAM DECLARATION AND LABOR POLICY

Memorandum August 28, 1945
To: Mr. Mulliken
From: Mr. Phillip B. Sullivan
Subject: Revised Directive to the CINC, USAF, PAC for the Military Government of Japan.

A meeting of the Committee on Economic Policy Towards Japan was called for yesterday afternoon by Mr. Martin of AC. The agenda concerned a revised draft of the economic section of the "Directive To The CINC, USAF, PAC For The Military Government of Japan". This revised directive has been written on the basis of the revision of SWNCC 150, the "Presidential Directive". In view of the basic changes in SWNCC 150, resulting from the acceptance by Japan of the Potsdam Declaration, this new directive to the CINC has been considerably altered. In general, it may be said that the amount of detailed instructions contained within the directive has been reduced in view of the fact that a functioning Japanese Government is expected to be operating. Military Government to a large extent, therefore, will issue general orders, leaving the implementing of these orders to the Japanese themselves.

The labor sections of the revised draft has been cut considerably, and read as follows:

"19. *a.* It is the policy of the United States Government that encouragement shall be given and favor shown to the development of democratic organizations in labor, industry and agriculture and policies shall be favored which *permit* a wide distribution of income and of the ownership of the means of production and trade.

To this end you will:

. . . . . .

"(4) Remove all legal obstacles to self-organization of employees along democratic lines, subject to such safeguards as may be necessary to prevent the perpetuation of militaristic or nationalistic influences under any guise or the continuation of any group hostile to the objectives and operations of the occupying forces.

"*b.* You will prevent or prohibit strikes or other work stoppages only when you consider that such stoppages would interfere with military operations or military security or directly prejudice the objectives or needs of your occupation."

In view of the urgency in putting something into General MacArthur's hands, the document, which had only recently been completed, was not put into our hands until after we reached the meeting, hence time for study and consultation was not available. I did not like the *sound* of 19 a (4) because it mentioned *legal obstacles* only, and since now the Japanese Government would be functioning instead of our Military Government I feared that other obstacles to self-organization of employees, such as organized opposition by employers or police persecution might be allowed to continue or to grow, thus blocking or retarding the organization of genuine trade unions. Also I objected to the complete deletion of any reference to collective bergaining. In fact the whole tone of the section seemed to emphasize the safeguards against rather than the desirablity of workers' organizations.

Extensive alteration of the document by our Committee was deemed inadvisable in view

of the urgency of the matter, hence instead of trying to rewrite sections we followed the practice of patching here and there. As a result of the discussion the Committee had recommended the following wording: (changes italicized)

"19. a. It is the policy of the United States Government that encouragement shall be given and favor shown to the development of democratic organizations in labor, industry and agriculture and policies shall be favored which *promote* a wide distribution of income and of the ownership of the means of production and trade.

"(4) Remove all legal obstacles to *and favor free collective bargaining and* self-organization of employees along democratic lines, subject to such safeguards as may be necessary to prevent the perpetuation of militaristic or nationalistic influences under any guise or the continuation of any group hostile to the objectives and operations of the occupying forces."

b. (No change)

These alterations, particularly the inclusion of the word "favor" may or may not get past Mr. Wilcox's office, but since the details of policy implementation are no longer the duty of Military Government the argument that Military Government officers will not have the time to "encourage" the growth of trade union no longer applies, to the same extent at least. My belief is that Military Government officers can now tell the Ministry of Welfare to take all necessary steps to encourage the growth of workers' organizations, which order would include taking any necessary steps to prevent unwarranted interference with labor activities.

It is of interest to note that the "strike" clause, 19 b, was not substantially changed from the pre-Potsdam version. The retention of this indicates that it is intended that Military Government should take an active interest in labor matters. Moreover the talk now is that the political sections of the report are going to be interpreted in such a way that democratic movements of all kinds, insofar as they are not directed against our operations, even if they result in extensive social unrest and disorder, are not to be interfered with by the occupation forces. "Let the pot brew what it may" so long as it properly seasoned with popular sentiment and not too highly flavored with the spice of Communism. Under such conditions we may get a real labor movement started.

Philip B. Sullivan

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

3 GENERAL POLICY

3-1 ATLANTIC CHARTER

Joint Proclamation August 12, 1941
Issued By: F.D. Roosevelt and Winston Churchill

Joint declaration of the President of the United States of America and the Prime Minister, Mr. Churchill, representing His Majesty's Government in the United Kingdom, being met together, deem it right to make known certain common principles in the national policies of their respective countries on which they base their hopes for a better future for the world.

"First, their countries seek no aggrandizement, territorial or other;

"Second, they desire to see no territorial changes that do not accord with the freely expressed wishes of the peoples concerned;

"Third, they respect the right of all peoples to choose the form of government under which they will live; and they wish to see sovereign rights and self-government restored to those who have been forcibly deprived of them;

"Fourth, they will endeavor, with due respect for their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity;

"Fifth, they desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic advancement, and social security;

"Sixth, after the final destruction of the Nazi tyranny, they hope to see established a peace which will afford to all nations the means of dwelling in safety within their own boundaries, and which will afford assurance that all the men in all the lands may live out their lives in freedom from fear and want;

"Seventh, such a peace should enable all men to traverse the high seas and oceans without hindrance;

"Eighth, they believe that all of the nations of the world, for realistic as well as spiritual reasons, must come to the abandonment of the use of force. Since no future peace can be maintained if land, sea, or air armaments continue to be employed by nations which threaten, or may threaten, aggression outside of their frontiers, they believe, pending the establishment of a wider and permanent system of general security, that the disarmament of such nations is essential. They will likewise aid and encourage all other practicable measures which will lighten for peace-loving peoples the crushing burden of armaments.

FRANKLIN D. ROOSEVELT
WINSTON S. CHURCHILL

3-2 THE CAIRO DECLARATION

Joint Proclamation December 1, 1943
Issued by: F. D. Roosevelt; Chiang Kai-shek; Winston S. Churchill

UNITED STATES OF AMERICA: PRESIDENT ROOSEVELT
CHINA: GENERALISSIMO CHIANG KAI-SHEK
UNITED KINGDOM: PRIME MINISTER CHURCHILL

The several military missions have agreed upon future military operations against Japan. The Three Great Allies expressed their resolve to bring unrelenting pressure against their brutal enemies by sea, land, and air. This pressure is already rising.

The Three Great Allies are fighting this war to restrain and punish the aggression of Japan. They covet no gain for themselves and have no thought of territorial expansion. It is their purpose that Japan shall be stripped of all the islands in the Pacific which she has

seized or occupied since the beginning of the first World War in 1914, and that all the territories Japan has stolen from the Chinese, such as Manchuria, Formosa, and the Pescadores, shall be restored to the Republic of China. Japan will also be expelled from all other territories which she has taken by violence and greed. The aforesaid three great powers, mindful of the enslavement of the people of Korea, are determined that in due course Korea shall become free and independent.

With these objects in view, the three Allies, in harmony with those of the United Nations at war with Japan, will continue to persevere in the serious and prolonged operations necessary to procure the unconditional surrender of Japan.

3-3 SOVIET ENTRY IN PACIFIC WAR

Memorandum May 12, 1945
To: Secretary of War
From: J.C. Grew[1]
Top Secret

In order to determine the policy of the United States Government in the Far East in connection with the political effects of the expected Soviet entry into the Pacific war and the relationship of the Yalta Agreement on this subject, I would appreciate receiving from you the views of the War Department on the following questions:

1. Is the entry of the Soviet Union into the Pacific war at the earliest possible moment of such vital interest to the United States as to preclude any attempt by the United States Government to obtain Soviet agreement to certain desirable political objectives in the Far East prior to such entry?

2. Should the Yalta decision in regard to Soviet political desires in the Far East be reconsidered or carried into effect in whole or in part?

3. Should a Soviet demand, if made, for participation in the military occupation of the Japanese home islands be granted or would such occupation adversely affect our long term policy for the future treatment of Japan?

In the opinion of the Department of State it would be desirable politically to obtain from the Soviet Government the following commitment and clarifications regarding the Far East prior to any implementation on our part of the Yalta Agreement:

1. The Soviet Government should agree to use its influence with the Chinese Communists to assist this Government in its endeavors to bring about the unification of China under the National Government headed by Chiang Kai Shek. The achievement of Chinese unity on the basis considered most desirable by the United States Government should be agreed to by the Soviet Union before the United States Government should make any approach to the Chinese Government on the basis of the Yalta Agreement. The difficulties in regard to Sinkiang should be settled by amicable agreement between the Soviet and Chinese Governments.

2. Unequivocal adherence of the Soviet Government to the Cairo Declaration regarding the return of Manchuria to Chinese sovereignty and the future status of Korea.

3. Definite agreement of the Soviet Government that immediately Korea is liberated, whether before final capitulation of Japan or after, it be placed under the trusteeship of the United States, Great Britain, China, and the Soviet Union. This agreement should make clear that the four trustees are to be the sole authority for the selection of a temporary Korean Government.

4. Before giving final approval to the annexation by the Soviet Union of the Kurile Islands it might be desirable to receive from the Soviet Government emergency landing rights for commercial planes on certain of these islands.

[SOURCE: GREW PAPERS, HARVARD UNIVERSITY LIBRARY]

[1] Acting Secretary of State.

3-4 POTSDAM DECLARATION[2]

Joint Proclamation July 26, 1945
Issued by: H. Truman; W. Churchill; Chiang Kai-shek

(1) We—the President of the United States, the President of the National Government of the Republic of China, and the Prime Minister of Great Britain, representing the hundreds of millions of our countrymen, have conferred and agree that Japan shall be given an opportunity to end this war.

(2) The prodigious land, sea and air forces of the United States, the British Empire and of China, many times reinforced by their armies and air fleets from the west, are poised to strike the final blows upon Japan. This military power is sustained and inspired by the determination of all the Allied Nations to prosecute the war against Japan until she ceases to resist.

(3) The result of the futile and senseless German resistance to the might of the aroused free peoples of the world stands forth in awful clarity as an example to the people of Japan. The might that now converges on Japan is immeasurably greater than that which, when applied to the resisting Nazis, necessarily laid waste to the lands, the industry, and the method of life of the whole German people. The full application of our military power, backed by our resolve, *will* mean the inevitable and complete destruction of the Japanese armed forces and just as inevitably the utter devastation of the Japanese homeland.

(4) The time has come for Japan to decide whether she will continue to be controlled by those self-willed militaristic advisers whose unintelligent calculations have brought the Empire of Japan to the threshold of annihilation, or whether she will follow the path of reason.

(5) Following are our terms. We will not deviate from them. There are no alternatives. We shall brook no delay.

(6) There must be eliminated for all time the authority and influence of those who have deceived and misled the people of Japan into embarking on world conquest, for we insist that a new order of peace, security and justice will be impossible until irresponsible militarism is driven from the world.

(7) Until such a new order is established *and* until there is convincing proof that Japan's war-making power is destroyed, points in Japanese territory to be designated by the Allies shall be occupied to secure the achievement of the basic objectives we are here setting forth.

(8) The terms of the Cairo Declaration shall be carried out and Japanese sovereignty shall be limited to the islands of Honshu, Hokkaido, Kyushu, Shikoku and such minor islands as we determine.

(9) The Japanese military forces, after being completely disarmed, shall be permitted to return to their homes with the opportunity to lead peaceful and productive lives.

(10) We do not intend that the Japanese shall be enslaved as a race or destroyed as a nation, but stern justice shall be meted out to all war criminals, including those who have visited cruelties upon our prisoners. The Japanese Government shall remove all obstacles to the revival and strengthening of democratic tendencies among the Japanese people. Freedom of speech, of religion, and of thought, as well as respect for the fundamental human rights, shall be established.

(11) Japan shall be permitted to maintain such industries as will sustain her economy and permit the exaction of just reparations in kind, but not those which would enable her to re-arm for war. To this end, access to, as distinguished from control of, raw materials shall be permitted. Eventual Japanese participation in world trade relations shall be permitted.

(12) The occupying forces of the Allies shall be withdrawn from Japan as soon as these objectives have been accomplished and there has been established in accordance with the freely expressed will of the Japanese people a peacefully inclined and responsible government.

(13) We call upon the government of Japan to proclaim now the unconditional surrender of all Japanese armed forces, and to provide proper and adequate assurances of their good faith in such action. The alternative for Japan is prompt and utter destruction.

[SOURCE: *Pol. Reorientation of Japan*, II, p. 413]

[2] Cf: Draft Proclamation, July 25, 1945; very few changes appear in this, the final draft.

3-5 DIRECTIVE TO THE SUPREME COMMANDER FOR THE ALLIED POWERS

Directive[8] August 13, 1945
To: Gen. D. MacArthur
From: President H. Truman

In accordance with the agreement among the Governments of the United States, Chinese Republic, United Kingdom, and Union of Soviet Socialist Republics to designate a Supreme Commander for the Allied Powers for the purpose of enforcing the surrender of Japan, you are hereby designated as the Supreme Commander for the Allied Powers.

You will require the issuance of a proclamation signed by the Emperor authorizing his representatives to sign the instrument of surrender. The proclamation to be signed should be substantially in the form appended hereto. You will take the necessary steps to require and receive from the duly authorized representatives of the Japanese Emperor, the Japanese Government, and the Japanese Imperial General Headquarters the signed instrument of surrender. The text of the instrument of surrender is appended hereto. You will accept the surrender for the four Governments concerned and in the interests of the other United Nations at war with Japan.

I have asked the heads of state of China, Great Britain and the Union of Soviet Socialist Republics each to designate a representative who may be present with you at the time and place of surrender. I have designated Fleet Admiral Chester W. Nimitz to be present as the United States representative for this purpose. As soon as I have received the other designations you will be advised. You will make the appropriate arrangements.

Having accepted the general surrender of Japanese armed forces, you will require the Japanese Imperial General Headquarters to issue general orders which will instruct Japanese commanders wherever situated as to the mechanics of surrender and other details effectuating the surrender. You will effect any necessary coordination of arrangements with the Japanese Imperial General Headquarters with regard to the surrenders to the Allied Commanders concerned of Japanese armed forces abroad.

From the moment of surrender, the authority of the Emperor and Japanese Government to rule the state will be subject to you and you will take such steps as you deem proper to effectuate the surrender terms.

You will exercise supreme command over all land, sea and air forces which may be allocated for enforcement in Japan of the surrender terms by the Allied Powers concerned.

Your appointment as Supreme Commander for the Allied Powers is effective upon receipt of this directive.

[SOURCE: *FRUS*, 1945, VI, pp. 647-48]

3-6 GENERAL ORDER NO. 1, MILITARY AND NAVAL

To: Japanese Armed Forces and Civilian Agencies September 2, 1945
From: SCAP

I. The Imperial General Headquarters by direction of the Emperor, and pursuant to the surrender to the Supreme Commander for the Allied Powers of all Japanese Armed Forces by the Emperor, hereby orders all of its Commanders in Japan and abroad to cause the Japanese Armed Forces and Japanese-controlled Forces under their command to cease hostilities at once, to lay down their arms, to remain in their present locations and to surrender unconditionally to Commanders acting on behalf of the United States, The Republic of China, The United Kingdom and the British Empire, and the Union of Soviet Socialistic Republics, as indicated hereafter or as may be further directed by the Supreme Commander for the Allied Powers. Immediate contact will be made with the indicated Commanders, or their designated representatives, subject to any changes in detail prescribed by the Supreme Commander for the Allied Powers, and their instructions will be completely and immediately carried out.

(a) The senior Japanese Commanders and all ground, sea, air and auxiliary forces within China, (excluding Manchuria), Formosa and French Indo-China North of 16 degrees North latitude, shall surrender to Generalissimo Chiang Kai-Shek.

(b) The senior Japanese Commanders and all ground, sea air and auxiliary forces within Manchuria, Korea North of 38 degrees North latitude, Karafuto, and the Kurile Islands, shall surrender to the Commander in Chief of Soviet Forces in the Far East.

(c) (1) The senior Japanese Commanders and all ground, sea, air and auxiliary forces within the Andamans, Nicobars, Burma, Thailand, French Indo-China South of 16 degrees North latitude, Malaya, Sumatra, Java, Lesser Sundas (including Bali, Lombok, and Timor), Boeroe, Ceram, Ambon, Kai, Aroe, Tanimbar and islands in the Arafura Sea, Celebes, Halmahera and Dutch New Guinea shall surrender to the Supreme Allied Commander, South East Asia Command.

(2) The senior Japanese Commanders and all ground, sea, air and auxiliary forces within Borneo, British New Guinea, the Bismarks and the Solomons shall surrender to the Commander-in-Chief, Australian Military Forces.

(d) The senior Japanese Commanders and all ground, sea, air and auxiliary forces in the Japanese mandated Islands, Bonins, and other Pacific Islands shall surrender to the Commander-in-Chief, U. S. Pacific Fleet.

(e) The Imperial General Headquarters, its Senior Commanders, and all ground, sea, air and auxiliary forces in the main islands of Japan, minor islands adjacent thereto, Korea South of 38 degrees North latitude, Ryukyus, and the Philippines shall surrender to the Commander-in-Chief, U. S. Army Forces, Pacific.

(f) The above indicated Commanders are the only representatives of the Allied Powers empowered to accept surrender, and all surrenders of Japanese Forces shall be made only to them or to their representatives.

The Japanese Imperial General Headquarters further orders its commanders in Japan and abroad to disarm completely all forces of Japan or under Japanese control wherever they may be situated, and to deliver intact and in safe and good condition all weapons and equipment at such times and at such places as may be prescribed by the Allied Commanders indicated above.

Pending further instructions, the Japanese Police Force in the main Islands of Japan will be exempt from this disarmament provision. The Police Force will remain at their posts and shall be held responsible for the preservation of Law and Order. The strength and arms of such Police Force will be prescribed.

II. The Japanese Imperial General Headquarters shall furnish to the Supreme Commander for the Allied Powers, without delay after receipt of this order, complete information with respect to Japan and all areas under Japanese control, as follows:

(a) Lists of all land, naval, air and anti-aircraft units showing locations and strengths in Officers and Men.

(b) Lists of all aircraft, Military, Naval and Civil, giving complete information as to the number, type, location and condition of such aircraft.

(c) Lists of all Japanese and Japanese-controlled Naval Vessels, surface, and submarine and Auxiliary Naval Craft, in or out of commission and under construction, giving their positions, condition and movement.

(d) Lists of all Japanese and Japanese-controlled Merchant Ships of over 100 gross tons, in or out of commission and under construction, including Merchant Ships formerly belonging to any of the United Nations which are now in Japanese hands, giving their positions, condition and movement.

(e) Complete and detailed information, accompanied by maps, showing locations and layouts of all mines, minefields, and other obstacles to movement by land, sea or air, and the safety lanes in connection therewith.

(f) Locations and descriptions of all military installations and establishments, including airfields, seaplane bases, anti-aircraft defenses, ports and naval bases, storage depots, permanent and temporary land and coast fortifications, fortresses and other fortified areas.

(g) Locations of all camps and other places of detention of United Nations Prisoners of War and Civilian Internees.

III. Japanese Armed Forces and Civil Aviation Authorities will insure that all Japanese Military, Naval and Civil Aircraft remain on the ground, on the water, or aboard ship, until further notification of the disposition to be made of them.

IV. Japanese or Japanese-controlled Naval or Merchant vessels of all types will be maintained without damage and will undertake no movement pending instructions from the

[8] President Truman signed the document on August 12, and it was circulated as SWNCC 21/6 on August 13.

Supreme Commander for the Allied Powers. Vessels at sea will immediately render harmless and throw overboard explosives of all types. Vessels not at sea will immediately remove explosives of all types to safe storage ashore.

V. Responsible Japanese or Japanese-controlled Military and Civil Authorities will insure that;

(a) All Japanese mines, minefields and other obstacles to movement by land, sea and air, wherever located, be removed according to instructions of the Supreme Commander for the Allied Powers.

(b) All aids to navigation be reestablished at once.

(c) All safety lanes be kept open and clearly marked pending accomplishment of (a) above.

VI. Responsible Japanese and Japanese-controlled Military and Civil Authorities will hold intact and in good condition pending further instructions from the Supreme Commander for the Allied Powers the following:

(a) All arms, ammunition, explosives, military equipment, stores and supplies, and other implements of war of all kinds and all other war material (except as specifically prescribed in section IV of this order).

(b) All land, water and air transportation and communication facilities and equipment.

(c) All Military installations and establishments, including airfields, seaplane bases, anti-aircraft defenses, ports and naval bases, storage depots, permanent and temporary land and coast fortifications, fortresses and other fortified areas, together with plans and drawings of all such fortifications, installations and establishments.

(d) All factories, plants, shops, research institutions, laboratories, testing stations, technical data, patents, plans, drawings and inventions designed or intended to produce or to facilitate the production or use of all implements of war and other material and property used by or intended for use by any military or part-military organization in connection with its operations.

VII. The Japanese Imperial General Headquarters shall furnish to the Supreme Commander for the Allied Powers, without delay after receipt of this order, complete lists of all the items specified in paragraphs (a), (b), and (d) of section VI above, indicating the numbers, types and locations of each.

VIII. The manufacture and distribution of all arms, ammunition and implements of war will cease forthwith.

IX. With respect to United Nations Prisoners of War and Civilian Internees in the hands of Japanese or Japanese-controlled authorities:

(a) The safety and well-being of all United Nations Prisoners of War and Civilian Internees will be scrupulously preserved, to include the administrative and supply services essential to provide adequate food, shelter, clothing, and medical care until such responsibility is undertaken by the Supreme Commander for the Allied Powers.

(b) Each camp or other place of detention of United Nations Prisoners of War and Civilian Internees together with its equipment, stores, records, arms, and ammunition, will be delivered immediately to the command of the senior officer or designated representative of the Prisoners of War and Civilian Internees.

(c) As directed by the Supreme Commander for the Allied Powers, Prisoners of War and Civilian Internees will be transported to places of safety where they can be accepted by Allied authorities.

(d) The Japanese Imperial General Headquarters will furnish to the Supreme Commander for the Allied Powers, without delay after receipt of this order, complete lists of all United Nations Prisoners of War and Civilian Internees, indicating their locations.

X. All Japanese and Japanese-controlled Military and Civil Authorities shall aid and assist the occupation of Japan and Japanese-controlled areas by forces of the Allied Powers.

XI. The Japanese Imperial General Headquarters and appropriate Japanese Officials shall be prepared, on instructions from Allied Occupation Commanders, to collect and deliver all arms in the possession of the Japanese Civilian population.

XII. This and all subsequent instructions issued by the Supreme Commander for the Allied Powers or other Allied Military Authorities will be scrupulously and promptly obeyed by Japanese and Japanese-controlled Military and Civil Officials and private persons. Any delay or failure to comply with the provisions of this or subsequent orders, and any action which the Supreme Commander for the Allied Powers determines to be detrimental to the Allied Powers, will incur drastic and summary punishment at the hands of Allied Military

Authorities and the Japanese Government.

XIII. The Japanese Imperial General Headquarters will immediately advise the Supreme Commander for the Allied Powers the earliest date and time at which information called for in Parts II, VII and IX (d) can be submitted.

[SOURCE: *Pol. Reorientation*, II, pp. 442-44]

3-7 SCAP'S PROCLAMATIONS TO THE JAPANESE PEOPLE

Proclamations Nos. 1, 2, 3.[4] September 2, 1945
To: Japanese People
From: Gen. D. MacArthur

APO 500
1 September 45

MEMORANDUM FOR: Chief of Staff

I. THE PROBLEM PRESENTED.

Signature of General MacArthur on file copies of Proclamations for Japan, numbers 1, 2, and 3.

II. FACTS BEARING UPON THE PROBLEM.

Proclamations 1, 2, and 3 were approved for printing and dissemination. They are to be issued to the Army Commanders for posting and publication in the areas as they are occupied by their troops.

III. ACTION RECOMMENDED.

Request one copy of each of the attached Proclamations be signed by the Commander-in-Chief and placed in the files of General Headquarters. The place of signing should be Yokohama under date of September 2, 1945.

W. E. CRIST
Brigadier General, U. S. Army
Chief Military Government Officer

[4] These were withdrawn by SCAP before posted. Cf: *Finance* No. 104, July 1974, p. 74.

聯合国軍代表最高指揮官総司令部
布告（第一号）

日本国民ハ聯合国軍代表最高指揮官ノ権限ニ服シ本日以降日本国政府ハ聯合国軍代表最高指揮官ノ命令ニ従フコトヲ誓ス

戦争ノ終結ニ伴ヒ日本国政府ハ聯合国ニ対シ日本国ノ主権ハ本州、北海道、九州及四国ニ限ラレ而シテ我ガ国ハ聯合国ノ指定スル諸小島ニ局限セラルベキコトヲ宣言シタリ

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日本国ノ政治的伝統ニ鑑ミ聯合国ハ日本国ヲシテ其ノ国家ノ組織ヲ自由ニ選ブ権利ヲ有スルモノトス

聯合国ノ目的ハ日本国ヲシテ其ノ国家ノ組織ヲ自由ニ選ブ権利ヲ有スル日本国ノ人民ノ意思ニ基ク平和的傾向ヲ有シ且ツ責任ヲ負フ政府ガ樹立セラルルニ至ルベキ条件ヲ満ス様ニ日本国政府ヲシテ之ニ対スル障害ヲ除ク為ノ必要ナル一切ノ事項ヲ遂行スルコトヲ要求ス

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聯合国軍代表最高指揮官
アメリカ合衆国陸軍元帥
ダグラス・マクアーサー

年　月　日
於

GENERAL HEADQUARTERS
SUPREME COMMANDER FOR THE ALLIED POWERS
PROCLAMATION NO. 1

TO THE PEOPLE OF JAPAN:

As Supreme Commander for the Allied Powers, I do hereby proclaim as follows:

The unconditional surrender of the Imperial Japanese Government to the Allied Powers has brought to an end the armed conflict which has long existed between these forces. By the terms of the Instrument of Surrender, signed by command of and in behalf of the Emperor of Japan, the Japanese Government and the Japanese Imperial General Headquarters, the victorious military forces under my command will today occupy the territory of Japan.

By virtue of the authority vested in me as Supreme Commander for the Allied Powers, I hereby establish military control over all of Japan and the inhabitants thereof, and announce the following conditions of the occupation:

ARTICLE I

All powers of the Imperial Japanese Government, including the executive, legislative and judicial, will henceforth be exercised under my authority.

ARTICLE II

All governmental, public and honorary functionaries and employees, as well as all officials and employees, paid or voluntary, of all public utilities and services, including public welfare and public health, and all other persons engaged in essential services shall continue to perform their usual functions and duties subject to my order, and shall preserve and safeguard all records and property.

ARTICLE III

All persons will obey promptly all my orders and orders issued under my authority. Acts of resistance to the occupying forces or any acts which may disturb public peace and safety will be punished severely.

ARTICLE IV

Your personal and property rights and religious beliefs will be respected. You will pursue your normal occupations, except as I shall otherwise order.

ARTICLE V

For all purposes during the military control, English will be the official language. In event of any ambiguity or diversity of interpretation or definition between any English and Japanese text, the English text shall prevail.

ARTICLE VI

Definition of "military control" as used herein and in all other official communications and publications includes "Military Administration".

ARTICLE VII

Further proclamations, ordinances, regulations, notices, directives and enactments will be issued by me or under my authority, and will specify what is required of you and what you are forbidden to do.

Given under my hand at...YOKOHAMA...
THIS.....SECOND.....DAY OF.....
SEPTEMBER.....1945

DOUGLAS MacARTHUR
General of the Army of the United States Supreme Commander for the Allied Powers

聯合国軍代表最高指揮官総司令部
布告（第二号）
犯罪及罪科ニ関スル件

本官ハ聯合国軍代表最高指揮官トシテ本官麾下全軍ノ安全並占領区域ニ於ル安寧秩序ヲ維持センカ為茲ニ布告ス

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(イ)降伏条約及聯合国軍代表最高指揮官ノ権限下ニ発スル各種布告命令及訓令ニ違犯スル者

(ロ)公共ノ安寧秩序ヲ紊ス者

(ハ)アメリカ合衆国並ニ其ノ聯合国ノ所有物又ハ人命ノ安全若クハ保全ニ対シ有害ナル行為ヲ為ス者

(ニ)公共ノ安寧秩序ヲ攪乱スル目的ヲ以テ行動スル者

右布告ス

年　月　日
於

聯合国軍代表最高指揮官
アメリカ合衆国陸軍元帥
ダグラス・マクアーサー

GENERAL HEADQUARTERS
SUPREME COMMANDER FOR THE ALLIED POWERS
PROCLAMATION NO. 2
CRIMES AND OFFENSES

TO THE PEOPLE OF JAPAN:

In order to make provision for the security of the armed forces under my command and for the maintenance of public peace, order and safety in the occupied area, as Supreme Commander for the Allied Powers, I do hereby proclaim as follows:

ANY PERSON WHO:

Violates the provisions of the Instrument of Surrender, or any proclamation, order, or directive given under the authority of the Supreme Commander for the Allied Powers, or does any act to the prejudice of good order or the life, safety, or security of the persons or property of the United States or its Allies or does any act calculated to disturb public peace and order or prevent the administration of justice, or wilfully does any act hostile to the Allied Forces, shall, upon conviction by a Military Occupation Court, suffer death or such other punishment as the Court may determine.

Given under my hand at...YOKOHAMA...
THIS.....SECOND.....DAY OF.....
SEPTEMBER.....1945

DOUGLAS MacARTHUR
General of the Army of the United States Supreme Commander for the Allied Powers

聯合国軍代表最高指揮官
アメリカ合衆国陸軍元帥
ダグラス・マクアーサー

年　月　日　於

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第二条　日本国政府ハ日本国民ニ告ク

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GENERAL HEADQUARTERS
SUPREME COMMANDER FOR THE ALLIED POWERS
PROCLAMATION NO. 3
CURRENCY

TO THE PEOPLE OF JAPAN:

As Supreme Commander for the Allied Powers, I hereby proclaim as follows:

Article I

1. Supplemental military yen currency, marked "B", issued by the Military Occupation Forces is legal tender in Japan for the payment of all yen debts public or private.

2. Supplemental military yen currency, marked "B", issued by the Military Occupation Forces, regular yen currency issued by the Bank of Japan and Japanese state notes and coin shall be equivalent in all respects and interchangeable at their face value.

Article II

JAPANESE MILITARY CURRENCY

3. All military and all occupational currency which has been issued by the Japanese Government, Army or Navy, is void and valueless and the giving or accepting of such currency in any transaction is prohibited.

Article III

EXPORT AND IMPORT OF CURRENCY PROHIBITED

4. All foreign financial transactions, including the export and import of currency, coin and securities, are prohibited except as authorized by me.

5. All financial transactions shall be deemed to be foreign except those between Honshu, Hokkaido, Shikoku, Kyushu, and the adjacent waters.

Article IV

REGULATION OF OTHER CURRENCY

6. Currency of the United States of America and the Allied Powers and all other currency, except that mentioned in Article I, is not legal tender in Japan and the delivery or acceptance of such currency is prohibited, except as authorized by me.

Article V

PENALTIES

7. Any person violating the provisions of this proclamation shall, upon conviction by a Military Occupation Court, suffer such punishment as the Court shall determine.

Given under my hand at...YOKOHAMA... this.....SECOND.....day of..... SEPTEMBER.....1945.

DOUGLAS MacARTHUR
General of the Army of the United States Supreme Commander for the Allied Powers.

[Source: Justin Williams MSS]

3-8 DIRECTIVES AND THE AUTHORITY OF THE SUPREME COMMANDER

Telegram CA 51630[5] September 3, 1945
To: Gen. G. C. Marshall (U. S. Army Chief of Staff)
From: Gen. D. MacArthur
Top Secret

I have reviewed with gravest concern the preliminary draft of the directive which Hull forwarded to Sutherland.

I feel that as drawn it practically removed from me the detailed methods of execution of the mission which has been assigned to the Supreme Commander. I feel that such a rigid and stringent directive, going into the most minute detail of execution, completely reverses the sound policy of giving a Field Commander his mission and permitting him to accomplish the results in the light of local conditions which exist and may develop.

I believe the suggested directive would exercise 10,000 miles away from the scene a degree of local control which would seriously hamper and perhaps prevent the successful execution of the mission for which I am held responsible.

Many of the matters are handled in such detail as to give little scope for that exercise of judgment in execution which is essential to the success of such a difficult and delicate problem.

I believe that studies made in Washington of these various subjects should be referred to me for information and assistance and for guidance in broad policy but that placed in the form of a specific directive they will make my position infinitely more difficult if not untenable. More overall directive has already been issued and I feel that it should not be vitiated by detailed prescriptions of methods of execution.

The basic orders are complete in themselves and constitute a firm and secure basis for action. While I realize that the draft has not been approved, I feel I must express my opinion to you, particularly since the proposed directive appears to me to go in certain respects far beyond the principles set forth in the surrender terms and the Potsdam Declaration.

Its execution would involve a complete revision of occupation plans which would require a much greater force for a greater length of time than is now contemplated.

[Source: Mod. Mil. Br., National Archives]

3-9 AUTHORITY OF THE SUPREME COMMANDER

Telegram No. WARX 59245[6] September 4, 1945
To: D. MacArthur
From: G. C. Marshall
Top Secret

The directive which is the subject of your CA 51630 is a departmental matter primarily the responsibility and concern of the State Department. Because of detailed interest of U. S. governmental departments, the U. S. people, and foreign governments, it has been proven essential by experience to cover with reasonable thoroughness by policy directive from the governmental level the different aspects of policy relating to control of a conquered nation by U. S. Military Forces. The JCS have been used as the transmitting agency for governmental policy directives to the Military Commanders who in turn have the responsibility for implementing, although they do not have the authority or the responsibility for determining the policy.

The scope of policy guidance furnished to Military Commanders is determined in part by the necessity for adequate definition on which to base the integration of departmental actions and policies, with the implementations going forward under military command. In this connection, the policy guidance you receive may eventually be the subject of agreement with the Allied Powers and will in all probability be published as has been the directive on Germany.

I am raising for consideration the suggestion that the directive have written into it the

[5] Cf: General Marshall's reply on September 4.
[6] This is Marshall's reply to MacArthur's telegram the day before.

understanding that it is furnished you for guidance and on the basis that you are free to recommend changes and to exercise reasonable latitude in execution of points raised in your recommendations pending decision thereon. I am having the directive in its present form transmitted to you with a request for any recommendations you wish to make as to detailed changes in the text.

On the matter of your questions as to the interpretation of the scope and nature of your authority, the State Department is now preparing a statement on the matter which should be available to you shortly.[7]

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

3-10 AUTHORITY OF GENERAL MacARTHUR AS SUPREME COMMANDER FOR THE ALLIED POWERS

Government Statement — September 6, 1945
Drafted by: Department of State, War Department, and Navy Department

The text of a message transmitted on September 6 through the Joint Chiefs of Staff to General MacArthur follows. It was prepared jointly by the Department of State, the War Department, and the Navy Department and approved by the President on September 6. The message is a statement clarifying the authority which General MacArthur is to exercise in his position as Supreme Commander for the Allied powers.

"1. The authority of the Emperor and the Japanese Government to rule the State is subordinate to you as Supreme Commander for the Allied powers. You will exercise your authority as you deem proper to carry out your mission. Our relations with Japan do not rest on a contractual basis, but on an unconditional surrender. Since your authority is supreme, you will not entertain any question on the part of the Japanese as to its scope.

2. Control of Japan shall be exercised through the Japanese Government to the extent that such an arrangement produces satisfactory results. This does not prejudice your right to act directly if required. You may enforce the orders issued by you by the employment of such measures as you deem necessary, including the use of force.

3. The statement of intentions contained in the Potsdam Declaration will be given full effect. It will not be given effect, however, because we consider ourselves bound in a contractual relationship with Japan as a result of that document. It will be respected and given effect because the Potsdam Declaration forms a part of our policy stated in good faith with relation to Japan and with relation to peace and security in the Far East."

[SOURCE: *Pol. Reorientation of Japan*, II, pp. 427]

3-11 BRITISH ANALYSIS OF WHITE HOUSE STATEMENT OF THE 22ND SEPTEMBER, ON UNITED STATES GENERAL INITIAL POST-SURRENDER POLICY IN JAPAN

Draft Memorandum F. E. (0) (45) 41 — October 3, 1945
By: Far Eastern Civil Planning Unit, Cabinet Far Eastern Official Committee

Object of this Paper.

1. The object of this paper is to study the above statement in the light of the statements of agreed Four-Power policy towards Japan which have been previously issued. This policy has so far been expressed in:-

(1) the Potsdam Declaration.
(2) the Message to the Japanese Government of the 11th August sent by the United States Government on behalf of the Governments of the United States, United Kingdom, U. S. S. R. and China.

General

2. The White House Statement does not refer explicitly to any earlier statement of policy and the Potsdam Declaration itself is nowhere mentioned by name. The Statement is a formulation of American policy. It can be said to represent the policy of the major

[7] Cf: Authority of General MacArthur as Supreme Commander for the Allied Powers, issued on September 6, 1945 and included in this volume.

Allies, only insofar as it is a reaffirmation of the policies already agreed upon by the Allies. Hitherto these policies have been set out only in the most general terms. Consequently no document which (like this Statement) defines policy over a wide field in considerable detail can possibly be an expression of Allied policy if it is issued by one Government without the prior consent of the Allies.

3. *Comparison with Previous Statements of Allied Policy.*

The Statement appears to be based to no small extent upon the Potsdam Declaration and upon the Message to the Japanese Government of the 11th August; there are however some outstanding passages, to which attention is drawn below, where the Statement goes beyond the terms of the previous documents. The Statement will be considered section by section.

4. Part I of the Statement (Ultimate Objectives) is broadly speaking a reformulation of the Articles in the Potsdam Declaration which set out (a) the basic objectives of Allied policy towards Japan and (b) the principal means whereby these are to be achieved.

5. (a) As regards the *ultimate objectives*, briefly stated in the Potsdam Declaration, the Statement attempts fuller definition as follows:

(i) Where the Potsdam Declaration speaks of "a peacefully inclined" Government, the Statement requires the Japanese Government to be one which will "respect the rights of other States and support the objectives of the United States as reflected in the ideals and principles of the Charter of the United Nations".

(ii) The Potsdam Declaration requires the establishment of a "responsible Government". The Statement speaks of the United States desire that the Government should "conform as closely as may be to the principles of democratic government".

(iii) While the Potsdam Declaration states the Japanese Government shall remove all obstacles to the revival and strengthening of democratic tendencies among the Japanese people", and requires that the Government shall be "in accordance with the freely expressed will of the Japanese people", the Statement places a more positive responsibility upon the Japanese by saying that "it is not the responsibility of the Allied Powers to impose upon Japan any form of Government not supported by the freely expressed will of the people".

(Incidentally, it may be mentioned here that this section of the Statement contains the first of several references to the "Allied Powers").

(b) The *principal means* whereby the ultimate objectives as given in the Statement are to be achieved are given in four sub-sections (a) to (d) which are closely related to Articles 8—11 of the Potsdam Declaration. Of these, Subsection (a) differs from Article 8 by stating that Japanese sovereignty shall be limited to the four main islands and to such minor *outlying* islands as may be determined in accordance with the Cairo Declaration and *other Agreements to which the United States is or may be a party*. Subsection (b) differs little from Article 9 and contains some features of Article 6 of the Potsdam Declaration. The Statement however demands the elimination of militarism from the *economic and social life of Japan*. (c) adds *freedom of assembly* and the *freedom of the press* to the freedoms mentioned in Article 10. The Statement declares that the Japanese *shall be encouraged* to form democratic and representative organizations. This is an extension of the Potsdam demand that the Japanese Government shall remove obstacles which stand in the way of the revival and strengthening of democratic tendencies.

6. Part II (Allied Authority) is to some extent based upon the Message to the Japanese Government of the 11th August incorporated in the Instrument of Surrender and purports to define the nature of the Allied military occupation and of the relationship to the Japanese Government of the Supreme Commander for the Allied Powers.

1) *Military Occupation*

7. Both the Potsdam Declaration and the Statement postulate that there will be a military occupation of Japan until the basic objectives of policy have been achieved. The Potsdam Declaration was issued before the occupation began and does not touch upon the form which this occupation would take. The Statement declares that:- (a) the occupation shall have the character of an operation on behalf of the principal Allied Powers acting in the interests of the United Nations at war with Japan. (b) participation of the forces of other nations that have taken a leading part in the war against Japan will therefore be welcomed and expected, and (c) the occupation forces will be under the command of a

Supreme Commander designated by the United States. This is a description of the situation as it actually exists, in which an Allied character has in fact been given to what is to all intents and purposes a purely United States undertaking. The Supreme Commander for the Allied Powers however should excute Allied and not merely American policy and there is no warrant in anything which has been agreed upon hitherto by the Allies for the assertion that "although every effort will be made by consultation and by the consitution of appropriate *advisory* bodies to establish policies for the conduct of the occupation and control of Japan which will satisfy the principal Allied Powers, *in the event of any differences of opinion among them the policies of the United States will govern.*" This, if acquiesced in, would relegate the Allies in the last resort to the role of passive observers of the formulation of policy which is to be executed in their joint name.

2) *Relationship to the Japanese Government.*

The trend of this sub-section is summarized in the words:- "the policy is to use existing form of government not to support it". The United States Government have publicly stated that they do not regard themselves as being in any contractual relationship with Japan, their relations with Japan resting upon unconditional surrender. The Statement makes it clear that the United States Government intend to use Japanese Governmental machinery so far and only so far as their objectives can thereby be furthered. The Supreme Commander, according to the Statement, is not committed to support the Emperor or any Japanese regime in opposition to any evolutionary changes in Japan favourable in themselves to United States objectives which call for a change in the form of Government. Indeed changes initiated by the Japanese in the direction of modifying the feudal and authoritarian form of Government are to be "permitted and favoured". Even if force is used by the Japanese for this purpose, the Supreme Commander is informed that he should intervene only to ensure the security of his forces and the attainment of all the other objectives of the occupation.

3) *Political*

Sections 1, 2 and 3 on disarmament and de-militarization, on war criminals and on re-education cover ground which has been covered in the U. K. "Additional Requirements to be Imposed on Japan". They contain important details which go altogether beyond anything in previous statements. Section 3 for example contains a reference to fraternization which is a subject which has not been mentioned before.

Part IV

Economic

All that the Potsdam Declaration says on the economic side is:-

(a) "Japan shall be permitted to maintain such industries as will sustain her economy, and allow the exaction of just reparations in kind.

(b) but not those industries which will enable her to re-arm for war"

(c) To this end access to, as distinguished from control of raw materials shall be permitted.

(d) Eventual Japanese participation in world trade relations shall be permitted.

The Statement goes very much further than this, giving the views of the United States Government on Economic Demilitarization, Promotion of democratic forces in industry, Industrial and Banking Combines, Reparations, etc. These are matters which have not yet been the subject of Allied statements and they are moreover matters upon which the views of His Majesty's Government have for the most part not yet been formulated. The Economic and Industrial Planning Staff (Foreign Office) are studying these matters with a view to drafting papers on them.

[SOURCE: BRITISH PUBLIC RECORD OFFICE]

3-12 BASIC DIRECTIVE FOR POST-SURRENDER MILITARY GOVERNMENT IN JAPAN PROPER

Directive: JCS-1380/15[8] November 3, 1945

To: Supreme Commander for the Allied Powers

From: Joint Chiefs of Staff.

1. *The Purpose and Scope of This Directive.*

a. This directive defines the authority which you will possess and the policies which

[8] The directive was approved by SWNCC. Cf: JCS 1380 series.

will guide you in the occupation and control of Japan in the initial period after surrender.

b. Japan, as used in this directive, is defined to include: The four main islands of Japan: Hokkaido (Yezo), Honshu, Kyushu and Shikoku and about 1,000 smaller adjacent islands including the Tsushima Islands.

c. This directive is divided in Part I: General and Political; Part II: Economic and Civilian Supply and Part III: Financial.

Part I—General and Political

2. *The Basis and Scope of Military Authority.*

The basis of your power and authority over Japan is the directive signed by the President of the United States designating you as Supreme Commander for the Allied Powers (SWNCC 21/6 (J. C. S. 1467)) and the Instrument of Surrender (SWNCC 21/6 (Annex "4" to J. C. S. 1380/5)), executed by command of the Emperor of Japan (SWNCC 21/6 (Annex "B" to J. C. S. 1380/5)). These documents, in turn are based upon the Potsdam Declaration of 26 July 1945 (SWNCC 149/1 (Annex "C" to J. C. S. 1380/5)), the reply of the Secretary of State on 11 August 1945 to the Japanese communication of 10 August 1945 (SWNCC Memo for Info. No. 19 (Annex "E" to J. C. S. 1380/5)), and the final Japanese communication on 14 August 1945 (SWNCC Memo for Info. No. 19 (Annex "F" to J. C. S. 1380/5)). Pursuant to these documents your authority over Japan, as Supreme Commander for the Allied Powers, is supreme for the purpose of carrying out the surrender. In addition to the conventional powers of a military occupant of enemy territory, you have the power to take any steps deemed advisable and proper by you to effectuate the surrender and the provisions of the Potsdam Declaration. It is contemplated, however, that unless you deem it necessary, or are instructed to the contrary you will not establish direct military government, but will exercise your powers so far as compatible with the accomplishment of your mission through the Emperor of Japan or the Japanese Government. In the exercise of your powers you will be guided by the following general principles.

3. *Basic Objectives of Military Occupation of Japan.*

a. The ultimate objective of the United Nations with respect to Japan is to foster conditions which will give the greatest possible assurance that Japan will not again become a menace to the peace and security of the world and will permit her eventual admission as a responsible and peaceful member of the family of nations. Certain measures considered to be essential for the achievement of this objective have been set forth in the Potsdam Declaration. These measures, include, among others, the carrying out of the Cairo Declaration and the limiting of Japanese sovereignty to the four main islands and such minor islands as the Allied Powers determine; the abolition of militarism and ultra-nationalism in all their forms; the disarmament and demilitarization of Japan, with continuing control over Japan's capacity to make war; the strengthening of democratic tendencies and processes in governmental, economic, and social institutions; and the encouragement and support of liberal political tendencies in Japan. The United States desires that the Japanese Government conform as closely as may be to principles of democratic self-government, but it is not the responsibility of the occupation forces to impose on Japan any form of government not supported by the freely expressed will of the people.

b. As Supreme Commander for the Allied Powers your mission will be to assure that the surrender is vigorously enforced and to initiate appropriate action to achieve the objectives of the United Nations.

c. This directive does not purport finally to formulate long-term policies concerning the treatment of Japan in the post-war world, nor does it seek to prescribe in detail the measures which you are to take throughout the period of your occupation of Japan in the effort to give effect to the surrender and the Potsdam Declaration. Those policies and the appropriate measures for their fulfillment will in large measure be determined by developing circumstances in Japan. It is, therefore, essential that surveys dealing with economic, industrial, financial, social and political conditions in Japan be constantly maintained by you and made available to your government. These surveys should be developed in such a manner as to form the basis for effecting modifications in the initial measures of control set forth herein as well as for the progressive formulation of policies to promote the ultimate objectives of the United Nations. Supplemental directives will be issued to you through the Joint Chiefs of Staff as may be required.

4. *The Establishment of Military Authority over Japan.*

a. Immediately upon the surrender of Japan you will require the Emperor, the Japanese Government and the Japanese Imperial General Headquarters to issue orders to all

the armed forces of Japan and all armed forces under Japanese control to cease hostilities and to surrender their arms and to issue such other orders as may be required to give effect to the instrument of surrender and the policies set forth in the Potsdam Declaration. You will require the Emperor and the Japanese Government to take all necessary steps to assure that all orders issued to effectuate the objectives of your mission are promptly and fully complied with by all persons in Japan.

b. You will occupy the Imperial capital of Tokyo, and the capitals of such prefectures as you deem necessary in order to facilitate your control over the Japanese Government. You will also occupy such strategic places as you may deem necessary. Otherwise you should not occupy any part of Japan unless it becomes essential to impose direct military government therein. However, you may temporarily utilize your forces in any area of Japan as may be required for the fulfillment of your mission. Subject to the provisions of subparagraph 4 c below, you will take prompt action to assure the restoration and maintenance of law and order by Japanese authorities or by your forces, if necessary.

c. Where action is necessary in order to carry out the surrender, you have the right to act directly from the outset. Otherwise, subject always to your right as the Supreme Commander to take direct action in the event of the unwillingness or failure of the Emperor or other Japanese authority to act effectively, you will exercise your supreme authority through the Emperor and Japanese governmental machinery, national and local. The policy is to use the existing form of government in Japan, not to support it. Changes in the direction of modifying the feudal and authoritarian tendencies of the government are to be permitted and favored. In the event that the effectuation of such changes involves the use of force by the Japanese people or government against persons opposed thereto, you as Supreme Commander should intervene only where necessary to ensure the security of your forces and the attainment of all other objectives of the occupation. You may, as circumstances require, exercise your supreme power and authority in the fullest measure including the imposition of direct military government. If it becomes necessary to impose direct military government in any part of Japan, you will immediately thereafter advise the Joint Chiefs of Staff. You will not remove the Emperor or take any steps toward his removal without prior consultation with and advice issued to you through the Joint Chiefs of Staff.

d. You will take appropriate steps in Japan to effect the complete governmental and administrative separation from Japan of (1) all Pacific islands which she has seized or occupied under mandate or otherwise since the beginning of the World War in 1914, (2) Manchuria, Formosa and the Pescadores, (3) Korea, (4) Karafuto, and (5) such other territories as may be specified in future directives.

e. By appropriate means you will make clear to all levels of the Japanese population the fact of their defeat. They must be made to realize that their suffering and defeat have been brought upon them by the lawless and irresponsible aggression of Japan, and that only when militarism has been eliminated from Japanese life and institutions will Japan be admitted to the family of nations. They must be told that they will be expected to develop a nonmilitaristic and democratic Japan which will respect the rights of other nations and Japan's international obligations. You will make it clear that military occupation of Japan is effected in the interests of the United Nations and is necessary for the destruction of Japan's power of aggression and her war potential and for the elimination of militarism and militaristic institutions which have brought disaster on the Japanese. With this end in view, and to insure the security of the troops, a policy of nonfraternization may be applied in Japan if and to the extent that you may deem it to be desirable. Your officers and troops, however, should so treat the Japanese population as to develop confidence in the United States and the United Nations and their representatives.

f. You will require the Emperor to abrogate all laws, ordinances, decrees and regulations which would prejudice the achievement of the objectives set forth in the Potsdam Declaration or which conflict with the instrument of surrender or with directives which may be issued to you through the Joint Chiefs of Staff. You will, in particular, assure the abrogation of all laws, orders and regulations which established and maintained restrictions on political and civil liberties and discriminations on grounds of race, nationality, creed or political opinion. Agencies or parts of agencies charged specifically with the execution of legislation abrogated or to be abrogated shall be abolished immediately.

g. You will establish such military courts as may be necessary with jurisdiction over offenses against the forces of occupation and over such other matters as are consistent with the implementation of the surrender. You will, however, except as otherwise deemed necessary by you assure that Japanese courts exercise an effective jurisdiction over cases not

of direct and predominant concern to the security of your troops.

h. Representatives of civilian agencies of the United States Government or of other United Nations governments shall not participate in the occupation or function independently within Japan except upon your approval, and subject, as to purpose, time and extent, to decisions communicated to you by the Joint Chiefs of Staff.

5. *Political and Administrative Reorganization.*

a. Local, regional and national agencies of governmental administration, excluding those with functions and responsibilities inconsistent with the purposes of the occupation will be permitted to continue to function after the removal of officials who are unacceptable as described in paragraph 5 h below, or who are ascertained to be unreliable. Such agencies and their personnel will be held responsible for the administration of government and will be charged with the execution of your policies and directives. At all times, however, and in all circumstances you are empowered yourself to take direct action if and to the extent that Japanese authorities fail satisfactorily to carry out your instructions.

b. Except as indicated in paragraph 7 c below, in no circumstances will persons be allowed to hold public office or any other positions of responsibility or influence in public or important private enterprise who have been active exponents of militant nationalism and aggression, who have been influential members of any Japanese ultra-nationalistic, terroristic or secret patriotic society, its agencies or affiliates, who have been influential in the activities of the other organizations enumerated in paragraph 5 g below, or who manifest hostility to the objectives of the military occupation.

c. You will assure that at all times, so long as the present form of government is retained, the posts of Lord Privy Seal, Privy Council, Prime Minister and Cabinet members are held only by persons who may be relied upon to further the purposes of your mission. You will require the immediate abolition of the Ministry of Greater East Asia but may retain such of its machinery and personnel as may be necessary to carry out the separation of colonies provided for by paragraph 4 d above. You will progressively disband and eliminate the Ministries of War, Navy, and Munitions during the process of disarmament and demobilization.

d. Local Responsibility for the local enforcement of national policy will be encouraged.

e. Ordinary criminal and civil courts in Japan will be permitted to continue to function subject to such regulations, supervision and control as you may determine. As rapidly as possible, judges and other court personnel who are unacceptable under the provisions of paragraph 5 b above will be removed. Such officials will be replaced with acceptable and qualified successors. Full power of review will be retained by you over all courts which are allowed to function. You will veto all decisions which are inconsistent with the purpose of your mission. You will take all practicable measures to cause the release of persons held in custody solely under laws or regulations of the type to be abrogated under paragraph 4 f above.

f. Criminal and ordinary police agencies, and such others as you may consider proper to be retained under appropriate supervision, must be purged of undependable and undesirable elements, in particular, of members of ultra-nationalistic, terroristic and secret patriotic societies.

g. Throughout Japan you will assure the dissolution of the Political Associations of Great Japan, the Imperial Rule Assistance Association (Taisei Yokusankai), the Imperial Rule Assistance Political Society (Taisei Seijikai), their affiliates and agencies or any successor organizations, and all Japanese ultra-nationalistic, terroristic and secret patriotic societies and their agencies and affiliates.

h. You will direct the Japanese Government to recall such Japanese diplomatic and consular officials and other agents abroad as the Department of State may request through the Joint Chiefs of Staff. You will also direct the Japanese Government to arrange for the turning over to the custody of properly accredited representatives of the Allied governments of archives and property of Japanese diplomatic and consular establishments for the purposes of effectuating the surrender.

i. All property, real and personal, owned or controlled by any of the organizations referred to in paragraph 5 g above, should be considered public property. If there is any doubt as to the public status of any property (e.g., property of quasi-official companies or of private companies in which the Japanese Government or the Japanese Imperial Household has an important interest), it should be considered public property. Imperial Household property shall not be excepted from any action necessary to carry out the objectives set forth in this directive.

6. *Demilitarization.*

a. You will assure that all units of the Japanese armed forces including the Gendarmerie (Kempei) (but not the civil police), Civilian Volunteer Corps, and all para-military organizations are promptly disarmed. Personnel of such units will not be held as prisoners of war, but as disarmed units under their own officers and will be demobilized in accordance with directives issued or to be issued by you. You will require that provision be made against any inequitable treatment of or disabilities against any member of the Japanese armed forces taken as a prisoner of war who is returned to Japan.

b. You will provide for the permanent dissolution of all military and para-military organizations, including the Supreme Military Council, the Board of Field Marshals and Fleet Admirals, the Imperial General Headquarters, the Army and Navy General Staffs, the Army, Navy, Civilian Volunteer Corps and Gendarmerie, together with all reservists and other militaristic associations which might serve to keep alive the military tradition in Japan. You may, however, for a brief period of time, utilize military and naval agencies, including those enumerated above, for the limited purpose of giving effect to the surrender with particular reference to demobilization. All military and para-military training on land and sea and in the air will be prohibited.

c. In accordance with the provisions of the directive already issued you*, you will seize or destroy all arms, ammunition, naval vessels, and implements of war, including aircraft designed for civil use, and stop the production thereof.

d. You will take proper steps to destroy the Japanese war potential, as set forth in Parts II and III in this directive.

7. *Arrest and Internment of Japanese Personnel.*

a. The following will be arrested as rapidly as practicable and held as suspected war criminals, pending further instructions concerning their disposition:

(1) All members of the Supreme Military Council, the Board of Field Marshals and Fleet Admirals, the Imperial General Headquarters, and the Army and Navy General Staffs;

(2) All commissioned officers of the Gendarmerie (Kempei), and all officers of the Army and Navy who have been important exponents of militant nationalism and aggression.

(3) All key members of ultra-nationalistic, terroristic and secret patriotic societies; and

(4) All persons who you have reason to believe are war criminals or whose names or descriptions are contained in lists of suspected war criminals which have been or may be furnished to you.

b. All persons who have played an active and dominant governmental, economic, financial or other significant part in the formulation or execution of Japan's program of aggression and all high officials of the Political Association of Great Japan, the Imperial Rule Assistance Association, the Imperial Rule Assistance Political Society and their agencies and affiliates or successor organizations will be interned pending further disposition. You may intern other civilians as necessary for the achievement of your mission.

c. You may, however, for a brief period of time, utilize the closely supervised services of those persons within the categories enumerated in subparagraphs 7 a (1) and (2) above, who are absolutely required by you to insure the demobilization of the Japanese armed forces.

d. You will receive further instructions concerning your responsibility with relation to war criminals, including those who have committed crimes against peace and crimes against humanity.

e. No differentiation shall be made or special consideration be accorded to civilian or military personnel arrested as war criminals either as to manner of arrest or conditions of detention, upon the basis of wealth, or political, industrial, or other rank or position.

f. All nationals of countries except Japan with which any of the United Nations are or have been at war in World War II (Bulgaria, Finland, Germany, Hungary, Italy, Roumania, and Thailand) will be identified and registered and may be interned or their activities curtailed as may be necessary under the circumstances. Diplomatic and consular officials of such countries will be taken into protective custody and held for further disposition.

g. Property, real and personal, owned or controlled by persons who have been detained or arrested under the provisions of paragraph 7 will be taken under your control pending directions as to its eventual disposition.

* SWNCC 58/9 (J. C. S. 1328/5).

8. *Prisoners of War, United Nations Nationals, Neutrals, and Other Persons.*

a. You will insure that prisoners of war and displaced persons of the United Nations are cared for and repatriated.

b. Nationals of neutral countries will be required to register with the appropriate military authorities. They may be repatriated under such regulations as you may establish. However, all nationals of neutral nations who have actively participated in any way in the war against one of the United Nations will be arrested for disposition in conformity with later instructions. Nationals of neutral nations will be accorded no special privileges of communications or business relationships with their home countries or people resident outside Japan. The persons, archives and property of diplomatic consular officials of neutrals will be accorded full protection.

c. All civilians who are nationals of the United Nations, resident or interned in Japan will be identified, examined closely, and if you deem it advisable, may be placed in custody or restricted residence. All such nationals who fall within the provisions of paragraph 7 b above shall be arrested and held as suspected war criminals. All other United Nations nationals who have actively participated in any way in the war against one or more of the United Nations will be arrested and held for later disposition. Thereafter, they will be dealt with in accordance with instructions to be furnished you. In general, practical measures will be taken to insure the health and welfare of United Nations nationals.

d. You will treat Formosan-Chinese and Koreans as liberated peoples in so far as military security permits. They are not included in the term "Japanese" as used in this directive but they have been Japanese subjects and may be treated by you, in case of necessity, as enemy nationals. They may be repatriated, if they so desire, under such regulations as you may establish. However, priority will be given to the repatriation of nationals of the United Nations.

e. Within such limits as are imposed by the military situation, you should take all reasonable steps necessary to preserve and protect the property of the United Nations and their nationals.

9. *Political Activity.*

a. The dissemination of Japanese militaristic and ultra-nationalistic ideology and propaganda in any form will be prohibited and completely suppressed. You will require the Japanese Government to cease financial and other support of National Shinto establishments.

b. You will establish such minimum control and censorship of civilian communications including the mails, wireless, radio, telephone, telegraph and cables, films and press as may be necessary in the interests of military security and the accomplishment of the purposes set forth in this directive. Freedom of thought will be fostered by the dissemination of democratic ideals and principles through all available media of public information.

c. You will immediately place under control all existing political parties, organizations and societies. Those whose activities are consistent with the requirements of the military occupation and its objectives should be encouraged. Those whose activities are inconsistent with such requirements and objectives should be abolished. Subject to the necessity of maintaining the security of the occupying forces, the formation and activities of democratic political parties with rights of assembly and public discussion will be encouraged. Free elections of representative local governments should be held at the earliest practicable date, and at the regional and national levels as directed, after consideration of your recommendation, through the Joint Chiefs of Staff. Your action in connection with the program referred to in this subparagraph should be taken in the light of one of the ultimate objectives of the occupation, the establishment, in accordance with the freely expressed will of the Japanese people, of a peacefully inclined and responsible government.

d. Encouragement will be given to the development of democratic organizations in labor, industry and agriculture.

e. Freedom of religious worship shall be proclaimed promptly by the Japanese Government. To the extent that the security of your military occupation and the attainment of its objectives are not prejudiced and subject to paragraph 9 a and c above, you will insure freedom of opinion, speech, press and assembly.

10. *Education, Arts and Archives.*

a. As soon as practicable educational institutions will be reopened. As rapidly as possible, all teachers who have been active exponents of militant nationalism and aggression and those who continue actively to oppose the purposes of the military occupation will be

replaced by acceptable and qualified successors. Japanese military and para-military training and drill in all schools will be forbidden. You will assure that curricula acceptable to you are employed in all schools and that they include the concepts indicated in paragraph 3 a above.

b. You should cause to be preserved for your information and use the records of all governmental and quasi-governmental, important private financial, industrial, manufacturing and business concerns, and the Japanese organizations referred to in paragraph 5 f above.

c. You will, so far as practicable, cause to be protected and preserved, all historical, cultural and religious objects, against depredations by the occupational forces, or others.

Part II—A. Economic

Objectives and General Basic Principles.

11. The policies of the American Government in regard to the economic affairs of Japan during the period of occupation are intended simultaneously to accomplish the following purposes:

a. To eliminate existing specialized facilities for the production of arms, munitions, or implements of war of any kind.

b. To destroy the economic ability of Japan to create or support any armaments dangerous to international peace.

c. To execute such program of reparations and restitution as may be decided upon by the appropriate Allied authorities.

d. To encourage the development within Japan of economic ways and institutions of a type that will contribute to the growth of peaceful and democratic forces in Japan.

e. To supervise and guide the operation of Japanese economic arrangements and operations to assure that they conform to the general purposes of the occupation, and make possible the eventual readmission of Japan to the ranks of peaceful trading nations.

The instructions composing the economic part of the directive are intended to advance these objectives during the first and immediate period of occupation that lies ahead; they will be subject to addition and revision in the light of circumstances which you encounter and the conduct of the Japanese people.

12. Your supreme authority as Supreme Commander for the Allied Powers in Japan will extend to all matters in the economic sphere. In the exercise of that authority, to the extent that the accomplishment of your objectives permits, you will use the services of the Emperor and the machinery of the Japanese Government to accomplish your objectives. You will require them to carry out your orders, and to make such changes in the administrative organization of those branches of government concerned with economic matters as may seem to you necessary to carry out your objectives.

You should act directly:

a. If because of the very nature of the task action through Japanese authorities will not effectively accomplish your economic objectives.

b. In the event that operation through the Japanese Government clearly fails in any particular phase of your operations to prove a satisfactory method.

In acting directly, you will establish administrative machinery independent of and superior to the Japanese officials and agencies to execute or assure the execution of the economic measures contained in this directive until such time as you may deem that the tasks can be satisfactorily assigned to the Japanese Governmental authorities.

13. You will not assume any responsibility for the economic rehabilitation of Japan or the strengthening of the Japanese economy. You will make it clear to the Japanese people that:

a. You assume no obligations to maintain, or have maintained, any particular standard of living in Japan, and

b. That the standard of living will depend upon the thoroughness with which Japan rids itself of all militaristic ambitions, redirects the use of its human and natural resources wholly and solely for purposes of peaceful living, administers adequate economic and financial controls, and cooperates with the occupying forces and the governments they represent.

It is not the policy of the United States to prevent the eventual achievement by Japanese working effort and resources of conditions of living in Japan consistent with objectives specified in paragraph 11.

Economic Disarmament.

14. In order to effect the economic disarmament of Japan:

a. You will stop immediately and prevent the future production, acquisition, development, maintenance, or use of all arms, ammunitions, and other implements of war; naval vessels; all types of aircraft including those designed for civilian use; and all parts, components, and materials especially designed for incorporation in any of the foregoing.

b. You will take such measures as you deem necessary to safeguard the facilities used or intended for use in the production or maintenance of any of the items above mentioned. Pending further instructions as to their ultimate disposition such facilities are not to be destroyed except in emergency situations.

c. You will not postpone the enforcement of the prohibitory program specified in subparagraph a or carrying out instructions that you will receive pursuant to subparagraph b without specific approval through the Joint Chiefs of Staff. Should you, however, find that production of any of the items enumerated in subparagraph a is essential to meet your requirements for military operations, the occupying forces, or temporary military research, you will make suitable recommendations to the Joint Chiefs of Staff; and pending the decision of the Joint Chiefs of Staff, you are authorized to make arrangements for production to the minimum extent necessary therefor.

15. Instructions which will be subsequently transmitted to you for carrying out programs for economic disarmament, reparations and restitution will involve the reduction or elimination of certain branches of Japanese production, such as iron, steel, chemicals, non-ferrous metals, aluminum, magnesium, synthetic rubber, synthetic oil, machine tools, radio and electrical equipment, automotive vehicles, merchant ships, heavy machines, and important parts thereof.

Pending, however, final and specific decision on these matters, you will permit continued production in those industries and the repair of production facilities to the minimum extent required to meet the needs of the occupation forces, and the minimum peaceful requirements of the population.

You will make clear to the Japanese that any permission to continue production or to repair production facilities is granted without prejudice to final decisions, as to either the limitations that may be imposed upon any branch of the Japanese economy or deliveries which may be required as reparations or restitution.

16. You may also permit the conversion of plant and equipment, including those types mentioned in paragraphs 14 and 15, to the production of essential consumer goods. You will satisfy yourself that any such conversion undertaken is a genuine move towards a peaceful economy and not a disguised attempt to preserve capacity to produce for military purposes.

You will also make clear to the Japanese that any such permission to convert is granted without prejudice to subsequent decisions as regards removal of plant or equipment on account of reparations or restitution or scrapping for security reasons under paragraph 11.

17. You will:

a. Immediately establish a system of inspection, and control to insure that production of the type forbidden in paragraphs 14 and 15 is not undertaken in concealed or disguised form.

b. Have prepared as rapidly as possible inventory reports upon all significant facilities that have been producing or are intended to produce the products covered in paragraph 14, and in all the industries specifically mentioned in paragraph 15. These reports should specify the condition and capacity of plant and equipment and the extent of raw materials stocked, finished goods, and goods in process. You will also inventory the Japanese merchant fleet.

In order to furnish the information necessary for further decisions concerning economic policy you will communicate those reports to the Joint Chiefs of Staff.

c. Develop and recommend to the Joint Chiefs of Staff controls which will prevent Japanese rearmament after termination of your occupation.

18. You will insure that all laboratories, research institutes, and similar technological organizations are closed immediately except those you deem necessary to the purposes of the occupation. You will provide for the maintenance and security of physical facilities thereof when deemed necessary, and for the detention of such personnel as are of interest to your technological or counter-intelligence investigations. You will at once investigate the character of the study and research conducted in such closed organizations and as rapidly as possible permit the resumption of those forms of study and research that have an obviously peaceful purpose under appropriate regulations which (1) define the specific type of research permitted, (2) provide for frequent inspection, (3) require free disclosure to you of the results of the research, and (4) impose severe penalties, including permanent closure of the offending institution whenever the regulations are violated.

The Operation of the Japanese Economic System.

19. The Japanese authorities will be expected to develop and effectively carry out programs of working activity that will enable them out of their own resources and labor to

accomplish the following:

a. To avoid acute economic distress.

b. To assure just and impartial distribution of available supplies.

c. To meet your demands for the needs of the occupying forces.

d. To meet the requirements for such reparations deliveries as may be agreed upon by the Allied Governments.

In order to achieve these aims, the Japanese authorities will have to make the utmost effort to maximize production of agricultural and fishery products, coal, charcoal, housing repair materials, clothing and other essentials. In the event that they fail to do so, you will direct them to take such measures as in your judgment are necessary.

20. You will require the Japanese authorities to provide goods and services to meet the needs of the occupying forces to the extent that this can be effected without causing starvation, widespread disease and acute physical distress.

21. The Japanese authorities shall be permitted on their own responsibility to establish and administer any controls over economic activities that are appropriate or necessary in order to achieve the economic ends specified in paragraph 19. Both the policy and the administration of these controls shall be subject to your approval and supervision particularly in so far as they may conflict with paragraph 15. This paragraph shall not preclude your taking direct action as provided in paragraph 12.

22. Serious inflation will substantially retard the accomplishment of the ultimate objectives of the occupation. You will, therefore, direct the Japanese authorities to make every feasible effort to avoid such inflation. However, prevention or restraint of inflation shall not constitute a reason for limiting the removal, destruction, or curtailment of productive facilities in fulfillment of programs for reparations, restitution, demilitarization, or economic disarmament.

Elimination of Certain Elements in the Japanese Economic System.

23. You will prohibit the retention in or selection for positions of important responsibility or influence in industry, finance, commerce, or agriculture of all persons who have been active exponents of militant nationalism and aggression, of those who have actively participated in the organizations enumerated in paragraph 5 g (above, Political and General Part) of this directive, and of any who do not direct future Japanese economic effort solely towards peaceful ends. (In the absence of evidence, satisfactory to you, to the contrary, you will assume that any persons who have held key positions of high responsibility since 1937, in industry, finance, commerce or agriculture have been active exponents of militant nationalism and aggression.)

24. You will require the protection from destruction and the maintenance for such disposition as may be determined by this and other directives of all plants, equipment, patents, books and records and all other significant property of the large Japanese industrial and financial companies and trade and research associations that have played an important part in the Japanese war effort or economy.

Democratization of Japanese Economic Institutions.

25. It is the intent of the United States Government to encourage and show favor to:

a. Policies which permit a wide distribution of income and of ownership of the means of production and trade.

b. The development of organizations in labor, industry, and agriculture organized on a democratic basis. Accordingly, you will:

(1) Require the Japanese to establish a public agency responsible for reorganizing Japanese business in accordance with the military and economic objectives of your government. You will require this agency to submit, for approval by you, plans for dissolving large Japanese industrial and banking combines or other large concentrations of private business control.

(2) Establish and maintain surveillance, until satsifactory plans for reorganization have been approved, over the Japanese businesses described in subparagraph (1) above in order to ensure conformity with the military and economic objective of your government.

(3) Dissolve the Control Associations. Any necessary public function prevsouily performed by these associations should be transferred to public agencies, approved and supervised by you.

(4) Abrogate all legislative or adiministrative measures which limit free entry of firms into industries to be reorganized where the purpose or effect of such measures is to foster and strengthen private monopoly.

(5) Terminate and prohibit all Japanese participation in private international cartels or other restrictive private international contracts or arrangements.

(6) Require the Japanese to remove, as rapidly as practicable, wartime controls over labor and reinstate protective labor legislation.

(7) Require the removal of all legal hindrances to the formation of organizations of employees along democratic lines, subject to any necessary safeguards to prevent the perpetuation of militaristic influences under any guise or the continuation of any group hostile to the objectives and operations of the occupying forces.

(8) Prevent or prohibit strikes or other work stoppages only when you consider that these would interfere with military operations or directly endanger the security of the occupying forces.

Foreign Economic Transaction

26. You will establish controls over all Japanese foreign trade in goods and services. Such controls should be so operated as to give effect during the initial period to the following policies:

a. Exports shall not be approved if such goods are clearly needed to meet minimum domestic requirements.

b. No exports of plant and equipment shall be permitted until determination has been made as to whether they may be required for reparation or restitution.

c. Exports other than those directed to be shipped on reparation account or as restitution may be made only to those recipients who agree to provide necessary imports in exchange or agree to pay for such exports in foreign exchange.

d. All procceds of exports shall be controlled by you and made available in the first place for the payment for approved imports. No person, corporation or organization in Japan shall be permitted to acquire foreign assets of any kind except with your special approval.

e. Approval should be given only to imports which are clearly in accord with the economic policies elsewhere set down in this directive.

f. Neither the need for imports or exports (including exports that might be made on reparations account) shall be deemed a reason for requiring or permitting any branch of Japanese industry to be restored or developed to an extent that might significantly contribute to Japan's warmaking potential, or promote dependence by other countries on Japan for strategic products.

27. The Japanese authorities are to enter into no economic agreements of any kind with foreign governments or interests except after prior consultation with you by your express approval. Any such proposed agreements should be submitted to the Joint Chiefs of Staff for their consideration.

Reparations and Restitutions.

28. You will assure the execution of programs of reparations in kind and of restitution of identifiable looted property in accordance with decisions of the appropriate Allied authorities transmitted to you by the Joint Chiefs of Staff. Reparations will be accomplised:

a. Through the transfer of Japanese property located outside of the territories to be retained by Japan;

b. Though the transfer from Japan of goods, existing plant, equipment, and facilities that are not necessary to the operation of a peaceful Japanese economy, or the supplying of the occupying forces.

All requests received by you, for reparations or restitution from the United Nations which have been victims of Japanese aggression will be reported with your recommendations to the Joint Chiefs of Staff.

B. Civilian Supply and Relief

Civilian Supply Policy and Standard of Provision.

29. a. You will assure that all practicable economic and police measures are taken to achieve the maximum utilization of essential Japanese resources in order that imports into Japan may be strictly limited. Such measures will include production and price controls, rationing, control of black markets, fiscal and financial controls and other measures directed toward full employment of resources, facilities and means available in Japan.

b. You will be responsible for providing imported supplies only to supplement local resources and only to the extent supplementation is needed to prevent such widespread disease or civil unrest as would endanger the occupying forces or interfere with military operations. Such imports will be confined to minimum quantities of food, fuel, medical and sanitary supplies and other essential items, including those which will enable local production of such supplies which you would otherwise have to import.

c. Supplies necessary to be imported under paragraph 29 b above will be obtained to the extent possible from surpluses available from other Asiatic and Pacific Ocean areas. To the extent that such surpluses are available in areas under the jurisdiction of other United States commanders, arrangements may be made by you directly with such other commanders. To the extent that such surpluses are available in areas under the jurisdiction of governments other than the United States, or the military commanders of such governments, negotiations necessary to obtain such surpluses will be conducted by or with the approval of local United States diplomatic representatives in the areas in question. In the event such diplomatic representatives are not available, you will report the situation, with your recommendations to the Joint Chiefs of Staff.

d. If you deem that you should assume responsibility for additional imports to accomplish the objectives of your occupation, you will submit your recommendations to the Joint Chiefs of Staff.

Methods and Conditions of Distribution.

30. You will require that all practicable steps be taken to assume the fair and equitable distribution of supplies under uniform ration scales.

31. To the maximum extent consistent with military expediency, import supplies for the civilian population should, in so far as practicable and desirable, be delivered to such Japanese public supply agencies or other consignees as are acceptable to you and under your direct supervision or control. Whenever possible, such deliveries will be at ports of entry, but if necessary, deliveries may take place at appropriate inland centers of distribution.

32. You may make sales directly to wholesalers or other commercial dealers in the event that no satisfactory public supply agency exists or that operational or other reasons render distribution of civilian supplied through such an agency impracticable. In order to limit direct provision and distribution of supplies by you to the civilian population, you should assure that the Japanese do not unnecessarily involve the occupying forces in such responsibility. Such direct sales by you as are necessary will be paid for by the purchaser in local currency at prices determined by you to be consistent with the internal economy.

33. Supplies delivered to supply agencies or other consignees will be sold by them through distribution channels and in accordance with distribution policies satisfactory to you and at prices determined by you to be consistent with the internal economy. When military necessity requires, civilian supplies may be made the subject of direct relief issue by you or by supply agencies under your supervision or control.

Part III—Financial

34. In the financial field you will make full application of the principles stated elsewhere in this directive, acting through the Japanese Government to the extent that effective execution of the policies and programs hereinafter enumerated will permit, but establishing administrative machinery not dependent upon Japanese authorities and agencies to the extent necessary to execute or assure the effective execution of such policies and programs. You are specifically directed to establish such independent administrative machinery in order to execute or assure the effective execution of the provisions of paragraphs 40, 41, 45, 46, and 47 of this directive.

35. Japanese financial organizations and the public finance system will be expected to function on the basis of Japanese resources. You will take no steps designed to maintain, strengthen, or operate the Japanese financial structure except so far as may be necessary for the purposes specified in this directive.

36. You may authorize or require the Bank of Japan or any other bank or agency to issue bank notes and currency which will be legal tender; without such authorization no Japanese governmental or private bank or agency will be permitted to issue bank notes or currency.

37. You will require the Japanese authorities to make available to you legal tender yen notes or yen credits free of cost and in amounts sufficient to meet all expenses of your forces including the costs of your military occupation.

38. a. In the event that for any reason adequate supplies of regular legal tender yen notes are not available you will use supplemental military yen (Type "B") issued pursuant to military proclamation. Supplemental yen will be declared legal tender and will be interchangeable at par without distinction with other legal tender yen currency.

b. Regular yen currency will include currencies which are now legal tender in the area.

c. Japanese military yen issued for circulation in territories occupied by the Japanese will not be legal tender and will not be acceptable nor interchangeable with supplemental yen or regular yen currencies.

39. You will not announce, establish or permit the use or publication, until receipt of further instructions, of any general rate of exchange between the Japanese yen on the one hand the U. S. dollar and other currencies on the other. However, a rate of conversion to be used exclusively for pay of military and naval personnel and for military and naval accounting purposes, namely 15 regular or supplemental yen equal one U. S. dollar, has already been communicated to you.

40. You will remove and exclude from positions of important responsibility or influence in all public and private financial institutions, agencies or organizations all persons who have been active exponents of militant nationalism and aggression or who actively participated in the organizations enumerated in paragraph 7 of this directive. It may be generally assumed in absence of evidence to the contrary that any persons who have held key positions in any such institutions, agencies, or organizations are active exponents of militant nationalism and aggression. You will also prevent the retention in or selection for places of importance in the financial field of individuals who do not direct future financial effort solely towards peaceful ends.

41. You will close and not allow to reopen banks and other financial institutions whose paramount purpose has been the financing of war production or the mobilization or control of financial resources in colonial or Japanese occupied territories. These include:

a. The Wartime Finance Bank,

b. The National Financial Control Association and its member control associations,

c. Offices, in the area, of the Bank of Chosen and the Bank of Taiwan,

d. The various banks and development companies whose fields of operation have been outside Japan proper such as the Southern Development Company, the Southern Development Company Bank and the Tokyo offices of the Central Bank of Manchou, Bank of Mongolia, Federal Reserve Bank of China, and Central Reserve Bank of China. You will, take custody of all the books and records of these banks and other institutions.

42. You are authorized to take such financial measures as you may deem necessary to accomplish the objective of your military occupation, specifically including, without limitation, the following:

a. Close banks, other than those indicated in paragraph 41 above, only where clearly necessary for the purposes of introducing satisfactory control, removing objectionable personnel and taking measures to effectuate the program for the blocking of certain accounts and transfers or the determination of accounts to be blocked or for other reasons of military necessity. You should reopen any banks so closed except those indicated in paragraph 41 above, as promptly, as is consistent with the accomplishment of the foregoing purposes;

b. Prohibit, or regulate transfers or other dealings in private or public securities or real estate or other property;

c. Establish a general or limited moratorium or moratoria only to the extent clearly necessary to carry out the objectives of your military occupation;

d. Close stock exchanges, insurance companies and similar financial institutions for such periods as you deem appropriate.

43. You will prohibit the payment of:

a. All military pensions, or other emoluments or benefits, except compensation for physical disability limiting the recipient's ability to work, at rates which are no higher than the lowest of these for comparable physical disability arising from nonmilitary causes;

b. All public or private pensions or other emoluments or benefits granted or conferred:

(1) By reason of membership in or services to the Political Association of Great Japan, the Imperial Rule Assistance Association (Taisei Yokusankai), the Imperial Rule Assistance Political Society (Taisei Seijikai), their affiliates and agencies or any successor or similar organizations, and all Japanese nationalistic, terroristic and secret patriotic societies and their agencies and affiliates.

(2) To any person who has been removed from an office or position in accordance with paragraphs 5 or 40 of this directive.

(3) To any person interned in accordance with paragraph 7 of this directive, during the term of his internment, or permanently in case of his subsequent conviction.

44. a. Any laws, ordinances and regulations or practices relating to taxation or other fields of finance which tend to discriminate for or against any person because of nationality, race, creed or political opinion will be amended, suspended or abrogated to the extent necessary to eliminate such discrimination. The collection of contributions of any kind for

nationalistic, imperialistic, militaristic, or anti-democratic societies of any kind will be prohibited.

b. You will insure that Japanese public expenditures are consistent with the objectives stated elsewhere in this directive.

45. You will impound or block all gold, silver, platinum, currencies, securities, accounts in financial institutions, credits, valuable papers and all other assets within the categories listed below:

a. Property owned or controlled directly or indirectly, in whole or in part, by any of the following:

(1) The Japanese national, prefectural and local governments, or any agency or instrumentality of any of them, including all utilities, undertakings, public corporations or monopolies under the control of any of the above;

(2) The Governments, nationals, or residents of Germany, Italy, Bulgaria, Rumania and Hungary, including those of territories formerly occupied by them and by Japan;

(3) The Japanese Imperial Household;

(4) The Political Association of Great Japan, the Imperial Rule Assistance Association, the Imperial Rule Assistance Political Society, their affiliates and agencies or any successor or similar organizations, and all Japanese nationalistic, terroristic and secret patriotic societies, agencies and affiliates and their officials, leading members and supporters;

(5) The National Shinto;

(6) All organizations, clubs or other associations prohibited or dissolved by you;

(7) Absentee owners of non-Japanese nationality including United Nations and neutral governments and Japanese outside of Japan;

(8) Any person or concern in any area under Japanese control at any time since 1894, except the islands of Honshu, Hokkaido, Kyushu, Shikoku and whatever minor islands are left to Japan;

(9) Persons subject to internment under provisions of paragraph 7, and all other persons specified by Military Government by inclusion in lists or otherwise.

b. All Japanese (public and private) foreign exchange and external assets of every kind and description located within or outside Japan.

c. Property which has been the subject of transfer under durees, wrongful acts of confiscation, dispossession or spoliation, whether pursuant to legislation or by procedure purporting to follow forms of law or otherwise.

d. Works of art of cultural or material value of importance, regardless of ownership.

You will take such action as will insure that any impounded or blocked assets will be dealt with only as permitted under licenses or other instructions which you may issue. In the case particularly of property blocked under a (1) above, you will proceed to adopt licensing measures which while maintaining such property under surveillance would permit its use by you or by the licensees in consonance with this directive. In the case of property blocked under c above, you will institute measures for prompt restitution, in conformity with the objectives of this directive and subject to appropriate safeguards to prevent the cloaking of militaristic and other undesirable influence.

You will require from the Japanese Government such reports as you deem necessary to obtain full disclosure of all assets mentioned in b above.

46. You will seek out and reduce to the possession or control of special agency established by you within your command all Japanese (public and private) foreign exchange and external assets of every kind and description located within or outside Japan.

47. All foreign exchange transactions, including those arising out of exports and imports, will be controlled with the aim of preventing Japan from developing a war potential and of achieving the other objectives set forth in this directive. To effectuate these purposes, you will:

a. Prohibit, except as authorized by regulation or license, all dealings in gold, silver, platinum, foreign exchange, and all foreign exchange transactions of any kind.

b. Make available any foreign exchange proceeds of exports for payment of imports directly necessary to the accomplishment of the objectives of this directive, and authorize no other outlay of foreign exchange assets without specific approval of your government through the Joint Chiefs of Staff.

c. Establish effective controls with respect to all foreign exchange transactions, including:

(1) Transactions as to property between persons inside Japan and persons outside Japan;

(2) Transactions involving obligations owed by or to become due from any person in Japan to any person outside Japan; and

(3) Transactions involving the importation into or exportation from Japan of any foreign exchange asset or other form of property.

d. You will provide full reports to your government with respect to all Japanese foreign and external assets.

48. No extension of credit to Japan or Japanese by any foreign person, agency or government will be permitted except as may be authorized by your government through the Joint Chiefs of Staff upon your recommendations.

49. It is not anticipated that you will make credits available to the Bank of Japan or any other bank or to any public or private instituion. If, in your opinion, such action becomes essential, you may take such emergency actions as you may deem proper, but in any such event, you will report the facts to your government through the Joint Chiefs of Staff.

50. You will maintain such accounts and records as may be necessary to reflect the financial operations of your military occupation and you will provide the Joint Chiefs of Staff with such information as it may require, including information in connection with the use of currency by your forces, any governmental settlements, occupation costs, and other expenditures arising out of operations or activities involving participation of your forces.

[SOURCE: *Pol. Reorientation of Japan*, II]

3-13 ESTABLISHMENT OF FAR EASTERN COMMISSION AND ALLIED COUNCIL FOR JAPAN

Joint Agreement — December 27, 1945

By: Foreign Ministers of the USSR, UK, USA.

The Foreign Ministers of the Union of Soviet Socialist Republics, the United Kingdom, and the United States of America met in Moscow from December 16 to December 26, 1945, in accordance with the decision of the Crimea Conference, confirmed at the Berlin Conference, that there should be periodic consultation between them. At the meeting of the three Foreign Ministers, discussion took place on an informal and exploratory basis and agreement was reached on...

FAR EASTERN COMMISSION AND ALLIED COUNCIL FOR JAPAN

A. Far Eastern Commission

Agreement was reached, with the concurrence of China, for the establishment of a Far Eastern Commission to take the place of the Far Eastern Advisory Commission. The Terms of Reference for the Far Eastern Commision are as follows:

I. Establishment of the Commission

A Far Eastern Commission is hereby established composed of the representatives of the Union of Soviet Socialist Republics, United Kingdom, United States, China, France, The Netherlands, Canada, Australia, New Zealand, India, and the Philippine Commonwealth.

II. Functions

A. The functions of the Far Eastern Commission shall be:

1. To formulate the policies, principles, and standards in conformity with which the fulfillment by Japan of its obligations under the Terms of Surrender may be accomplished.

2. To review, on the request of any member, any directive issued to the Supreme Commander for the Allied Powers or any action taken by the Supreme Commander involving policy decisions within the jurisdiction of the Commission.

3. To consider such other matters as may be assigned to it by agreement among the participating Governments reached in accordance with the voting procedure provided for in Article V-2 hereunder.

B. The Commission shall not make recommendations with regard to the conduct of military operations nor with regard to territorial adjustments.

C. The Commission in its activities will proceed from the fact that there has been formed an Allied Council for Japan and will respect existing control machinery in Japan, including the chain of command from the United States Government to the Supreme Commander and the Supreme Commander's command of occupation forces.

III. Functions of the United States Government

1. The United States Government shall prepare directives in accordance with policy decisions of the Commission and shall transmit them to the Supreme Commander through the appropriate United States Government agency. The Supreme Commander shall be charged with the implementation of the directives which express the policy decisions of the Commission.

2. If the Commission decides that any directive or action reviewed in accordance with Article II-A-2 should be modified, its decision shall be regarded as a policy decision.

3. The United States Government may issue interim directives to the Supreme Commander pending action by the Commission whenever urgent matters arise not covered by policies already formulated by the Commission; provided that any directives dealing with fundamental changes in the Japanese constitutional structure or in the regime of control, or dealing with a change in the Japanese Government as a whole will be issued only following consultation and following the attainment of agreement in the Far Eastern Commission.

4. All directives issued shall be filed with the Commission.

IV. Other Methods of Consultation

The establishment of the Commission shall not preclude the use of other methods of consultation on Far Eastern issues by the participating Governments.

V. Composition

1. The Far Eastern Commission shall consist of one representative of each of the States party to this agreement. The membership of the Commission may be increased by agreement among the participating Powers as conditions warrant by the addition of representatives of other United Nations in the Far East or having territories therein. The Commission shall provide for full and adequate consultations, as occasion may require, with representatives of the United Nations not members of the Commission in regard to matters before the Commission which are of particular concern to such nations.

2. The Commission may take action by less than unanimous vote provided that action shall have the concurrence of at least a majority of all the representatives including the representatives of the four following Powers: United States, United Kingdom, Union of Soviet Socialist Republics and China.

VI. Location and Organization

1. The Far Eastern Commision shall have its headquarters in Washington. It may meet at other places as occasion requires, including Tokyo, if and when it deems it desirable to do so. It may make such arrangements through the Chairman as may be practicable for consultation with the Supreme Commander for the Allied Powers.

2. Each representative on the Commission may be accompanied by an appropriate staff comprising both civilian and military representation.

3. The Commission shall organize its secretariat, appoint such committees as may be deemed advisable, and otherwise perfect its organization and procedure.

VII. Termination

The Far Eastern Commission shall cease to function when a decision to that effect is taken by the concurrence of at least a majority of all the representatives including the representatives of the four following Powers: United States, United Kingdom, Union of Soviet Socialist Republics and China. Prior to the termination of its functions the Commission shall transfer to any interim or permanent security organization of which the participating governments are members those functions which may appropriately be transferred.

It was agreed that the Government of the United States on behalf of the four Powers should present the Terms of Reference to the other Governments specified in Article I and invite them to participate in the Commission on the revised basis.

B. Allied Council for Japan

The following agreement was also reached, with the concurrence of China, for the establishment of an Allied Council for Japan:

1. There shall be established an Allied Council with its seat in Tokyo under the chairmanship of the Supreme Commander for the Allied Powers (or his Deputy) for the purpose of consulting with and advising the Supreme Commander in regard to the implementation of the Terms of Surrender, the occupation and control of Japan, and of directives supplementary thereto; and for the purpose of exercising the control authority herein granted.

2. The membership of the Allied Council shall consist of the Supreme Commander (or his Deputy) who shall be Chairman and United States member; a Union of Soviet Socialist Republics member; a Chinese member; and a member representing jointly the United Kingdom, Australia, New Zealand, and India.

3. Each member shall be entitled to have an appropriate staff consisting of military and civilian advisers.

4. The Allied Council shall meet not less often than once every two weeks.

5. The Supreme Commander shall issue all orders for the implementation of the Terms of Surrender, the occupation and control of Japan, and directives supplementary thereto. In all cases action will be carried out under and through the Supreme Commander who is the sole executive authority for the Allied Powers in Japan. He will consult and advise with the Council in advance of the issuance of orders on matters of substance, the exigencies of the situation permitting. His decisions upon these matters shall be controlling.

6. If, regarding the implementation of policy decisions of the Far Eastern Commission on questions concerning a change in the regime of control, fundamental changes in the Japanese constitutional structure, and a change in the Japanese Government as a whole, a member of the Council disagrees with the Supreme Commander (or his Deputy), the Supreme Commander will withhold the issuance of orders on these questions pending agreement thereon in the Far Eastern Commission.

7. In cases of necessity the Supreme Commander may take decisions concerning the change of individual Ministers of the Japanese Government, or concerning the filling of vacancies created by the resignation of individual cabinet members, after appropriate preliminary consultation with the representatives of the other Allied Powers on the Allied Council.

[SOURCE: *Pol. Reorientation of Japan*, II, pp. 421-22]

3-14 UNITED STATES POLICY WITH RESPECT TO OCCUPIED AREAS

SWNCC Directive April 8, 1946
Drafted by: SWNCC

ORGANIZATION AND PROCEDURE FOR THE DEVELOPMENT AND PROMULGATION OF UNITED STATES POLICY WITH RESPECT TO OCCUPIED AREAS

1. Jurisdiction

(*a*) Consistent with existing international agreements and within the scope of its charter of organization, the State-War-Navy Coordinating Committee (hereinafter referred to as SWNCC) shall coordinate United States policy with respect to occupied areas. The term "occupied areas" shall include Germany, Austria, Japan and Korea. The term "United States Policy" for the purposes of this directive shall mean all policy which requires concerted study, consideration or coordination by the State, War and Navy Departments.

(*b*) The War Department shall continue to be responsible for the execution and administration of policy with respect to United States participation in the occupation or government of the occupied areas.

(*c*) The Assistant Secretary of State for Occupied Areas shall be directly responsible to the Secretary of State for the coordination of State Department policy with respect to all occupation matters. He shall be the State Department member of SWNCC on all matters of occupation policy.

(*d*) The Assistant Secretary of State for Occupied Areas shall take the initiative in submitting to SWNCC, or to any appropriate sub-committee thereof, such policy matters as may require concerted study, consideration or action. All occupation policy matters or decisions shall be presented by the State Department to SWNCC or communicated outside the State Department through him or with his concurrence.

2. Departmental Secretariat

The coordination of Department policy, whether political, cultural or economic, provided for in 1 (*c*) above, shall be accomplished by the Assistant Secretary of State for Occupied Areas and under his direction and control through the mechanism of the Secretariats herein provided for, to be.

(*a*) Germany-Austria Secretariat: The Departmental position with respect to any and all matters of United States policy in respect of Germany and/or Austria shall be developed by a Secretariat organized and maintained for the purpose under the Chairmanship and administration of the Chief Division of Central European Affairs.

(*b*) Japan-Korea Secretariat: The Departmental position with respect to any and all matters of United States policy in respect of Japan and Korea shall be developed by a Secretariat organized and maintained for the purpose under the Chairmanship and administration of the Director, Office of Far Eastern Affairs, or his designee.

(*c*) Each Secretariat shall include appropriate membership from ORI, OIC, EUR, FE, ESP, OFD, Le and such other offices of the Department as the Chairman may determine.

(*d*) Each Secretariat shall hold stated meetings and a record of its proceedings shall be maintained. Each Chairman shall compile a list of projects and studies in respect of occupational affairs, as suggested by the members of the Secretariat. These projects shall be assigned for study and preparation and submission to SWNCC on the basis of relative urgency as determined by the Assistant Secretary for Occupied Areas.

(*e*) Subject to the approval of the Assistant Secretary for Occupied Areas, each Chairman shall prescribe the rules of conduct of his Secretariat, the time and place of its meetings, and the functional relationship thereof to the Central Secretariat of the Department. All inter-departmental liaison by members of the Secretariat with respect to matters within its cognizance shall be accomplised as the Assistant Secretary of State for Occupied Areas may determine.

(*f*) Subject to the approval of the Assistant Secretary for Occupied Areas, or by his direction, the Chairman of each Secretariat shall place matters on the SWNCC agenda for consideration. He shall recommend to the Assistant Secretary for Occupied Areas duly qualified candidates for State Department membership on any SWNCC sub-committee appointed to consider any matter in respect of occupation affairs, and no one shall be appointed as the State Department member of any such sub-committee of SWNCC without the approval of, or clearance by, the Assistant Secretary for Occupied Areas.

(*g*) The Chairman of each Secretariat shall report and be responsible to the Assistant Secretary for Occupied Areas with respect to the operation of his Secretariat.

3. Utilization of Departmental Resources

The Directors of all Offices of the Department are hereby severally directed to take any and all action as may be necessary or appropriate fully to implement the foregoing. Upon the approval of the Assistant Secretary of State for Occupied Areas, the Chairman of each Secretariat established in 2 above may apply from time to time, or at any time, to the Assistant Secretary for Administration for such personnel and facilities as, in his opinion, may be necessary or appropiate for the proper execution of the mission hereby assigned to such Secretariat. The Assistant Secretary for Administration shall, to the extent necessary, in his opinion, levy on any Office or Division of the Department for such personnel and facilities as the Secretariats may require.

4. Policy Directives

Policy Directives of SWNCC shall be transmitted as follows:

(*a*) With respect to German and Austrian matters, to the United States Military Governor or to the United States Representative on the appropriate Allied Control Council as the case may be, through War Department channels.

(*b*) With respect to Japanese and Korean matters, to the United States Representative on the Far Eastern Commission or, where appropriate, to the Supreme Commander Allied Powers, through War Department channels.

[SOURCE: Dept. of State, *Occupation of Japan: Policy and Progress*, pp. 82-84]

3-15 PRESS INTERVIEW WITH MacARTHUR

Press Interview[9] March 19, 1947
Statements by MacArthur

Gen. MacArthur: "I am now on the record for your questions."

Question—"General, you were quoted recently as proposing Japanese be placed under the United Nations. Would you care to elaborate on that?"

Answer—"The time is now approaching when we must talk peace with Japan. Our occupation job here can be defined as falling roughly into three phases—military, policitcal and economic.

[9] Released by Associated Press on the basis of notes taken; no verbatim or official text available.

"The military purpose, which was to insure Japan will follow the ways of peace, and never again be a menace, has been, I think, accomplised.

"We have demobilized the troops, demilitarized the country, torn down military installations.

"Psychologically, I believe the success has been equally propitious. Japan today understands as thoroughly as any nation that war does not pay. Her spiritual revolution has been probably the greatest the world has ever known.

"The political phase is approaching such completion as is possible under the occupation.

"We have changed laws, standards and ideals of this country, from the feudalistic ideals of the past into the concept of what is the greatest thing in life, next to spiritual beauty—the dignity of man. We made them think that nations exist for the welfare for those who compose them, instead of the reverse....

"I don't, by that, mean to say that this thing called Democracy had been accomplished. The process of democratization is one of continual flux. It takes years.

"But insofar as you can lay down the framework, it has been already accomplished. There is little more, except to watch, control and guide.

"Democracy is a relative thing. It is a question of the degree of freedom you have. If you believe in the Anglo-Saxon idea, you will believe this will stay here.

"If you are a cynic, or believe in totalitarianism, you may doubt it is here to stay.

"I believe sincerely and absolutely that it is here to stay.

"The third phase is economic. Japan is still economically blocked by the Allied Powers. Economic warfare along those lines still is as bitter here as when the guns were firing. And now strangulation is worse, because we have returned millions of repatriates from abroad.

"No weapon, not even the atom bomb, is as deadly in its final effect as economic warfare.

"The atom bomb kills by thousands, starvation by the millions.

"Japan was thoroughly exhausted economically at the end of the war. All she had left was men. She was living on stockpiles and our blockade after the fall of the Philippines kept materials from coming in. Now they are scraping the bottom of the stockpiles.

"Each little family had its stockpile—of clothes and heirlooms. Now these are being sold to keep the men alive. Every resource have been placed under tight Government control but even under strict rationing, Japan is not producing enough to satisfy her needs. The difference must be filled by the Allies.

"If we keep this economic blockade up, more and more will we have to support this country.

"It is an expensive luxury. But we will pay for it or let the people die by millions."

"There is not the same unity among the Allies" in the economic phase of the occupation as in the military and policitcal phases.

"Nor a clear-cut economic framework has been outlined for Japan or Germany either, for that matter. But this is not a phase that the Occupation can settle. We can only enforce economic strangulation."

"It would be advisable for the world to initiate at this time peace talks with Japan. But Peace won't mean complete relaxation of all guidance or controls....

"Japan on her initiative and without coercion has completed a Constitution which takes the great step of renouncing war. There was a great deal of criticism when this first appeared, but it remains....She also has abolished military installations under the Potsdam Declaration.

"Therefore, they will be unprotected when we withdraw. Who is going to protect them?"

SCAP said one method would be to backtrack and permit small military establishment... "but the Japanese are relying upon the advanced spirituality of the world to protect them against undue aggression...."

It is on this basis, SCAP said, that he suggested recently to the visiting editor (Irwin Canham, of the *Christian Science Monitor*), that the United Nations should exercise control over Japan.

"If the United Nations is ever to succeed, this is the most favorable opportunity it ever had. Japan would be willing and would desire it."

"If the United Nations cannot provide mild controls, it cannot meet anything."

Question—"Would you care to elaborate a little more on the Peace Treaty. When do you think it should be?"

Answer—"I will say as soon as possible.

"In Japan there is a functioning Government. But in Germany the Government had to be built from the ground up and there is no Government to sign the Peace Treaty.... Over here there is no problem of what to do with Japan.

"She has been squeezed out pretty nearly of everything we can expect to squeeze out of her.

"I am not talking of the reparations now. But she has already lost Manchuria, Korea and Formosa. There is little left...."

"The days of SCAP should cease completely with the Peace Treaty because, I think, conditions are ripe for it now...."

Question—"How long would you say the United Nations would have to continue the controls of democratization?"

Answer—"I would not want to speculate that." The Japanese would accept it.... It would be considered protective rather than repressive. It could continue as long as it was munificent.

"I would not envision any military formations of any sort after the Peace Treaty. Bayonet control would be a mockery."

General MacArthur then was asked about the restoration of Japan's economy. He pointed out Japan is economically poor; in fact, that was one reason she went to war, she was reaching out to get resources. He pointed out that trade was the lifeblood of these Islands and that in order to stimulate trade, she must import such necessities as cotton and wool.

"We do not allow Japan to trade. She must be allowed to trade with the world. Japan is only permitted the barter system through the bottleneck to SCAP. We have got to take it out of the hands of the Government and put it in the hands of private traders.

"Eighty million people and 20,000,000 tons of food (annually). Seventeen million tons are produced here.... There is no way I can see, within appreciable future, that these people can get enough food from indigenous products."

The job of occupation, he said, is to restore Japan's production to self-sufficiency. "I once read a statement Winston Churchill made in one of his moments of profound inspiration. Speaking of Germany, he said, 'The problem is not to keep Germany down, but to keep it up.'

"I didn't understand it then, but I do now. Our problem is to keep Japan up."

In recounting the difficulties of this, General MacArthur said, "Japan cannot sell her raw silk in United States. The scientists have outdone them. Milady would rather have nylon than a silk hose and they are the boss, as any man will tell you.

"Scientists have relegated silk to a secondary position—just as they relegated armies and navies to secondary position with air power and the atomic bomb.

"Well, that is not quite true, but it illustrates what I mean."

General MacArthur said the Japanese are "magnificent farmers," but in working the land overtime, had exhausted its richness. Therefore they used fertilizers extensively. For this, they formerly imported something like a million and half tons of salt ingredient from China and Manchuria. "But not a pound has come in since the end of the war."

He cited this to show the difficulties of restoring production.

General MacArthur mentioned he had read the proposal of a Congressman to cut off Japan's foreign trade for 50 years.

Question—"What would happen if you did it?"

Answer—"There would not not be anybody left alive."

Question—"What do you see as final reparations program?"

Answer—"I don't think there is any intent to take away from the industrial capacity of Japan that which would destroy it."

He noted here "some disagreement" between the Pauley and the Strike reports on reparations but "they both were working on the big problem of trying to find the proper balance on the questions.

"If reparations are cut too deeply, the United States will have to support Japan because we have undertaken the major burdens of the Occupation."

Question—"What is the possibility of a United States loan to Japan?"

Answer—"I think Japan can pay back all the dollars we appropriate, but I think we should hold a first lien against anything we take out of her" in the way of trade.

"United States has not adopted a formula of loans yet, but we are operating on Army Budget and the expenditures probably will be charged against the costs of Occupation."

[SOURCE: *PRJ*, II, pp. 765-66]

3-16 HUSSEY'S REPORT ON WASHINGTON'S ATTITUDE REGARDING ASPECTS OF THE OCCUPATION

Memorandum December 6, 1947
To: Chief, Government Section
From: A. R. Hussey Jr., Chief Government Powers Division

1. Between 3 November 1947, and 25 November 1947, I conferred in Washington with officials in the State Department, the Department of the Army and the Far Eastern Commission. I was given access to current files. Outside of official circles, both in Massachusetts and at Washington, I talked at length with men whose position and influence affect Washington thinking and policy, men such as Governor Bradford, Senator Saltonstall, Former Ambassador Grew, Arthur Krock. The material herewith submitted represents both information officially tendered and conclusions arrived at as a resut of talks and conferences. I am well satisfied that the situation is indeed grave.

2. *The Peace Treaty.* This information is official and exact. In the early fall China announced its decision to support the USSR in insisting upon a four power peace conference with full veto power. China informed the United States that it was forced to take this position because of that article in the Sino-Russian treaty of 1945 which bound the contracting parties not to make a separate peace with Japan. China expressed fear that were it to assent to the United States' proposals the USSR would consider it a breach of the treaty. Subsequently, the USSR despatched a note to China calling attention to this article and stating that if China did make a separate peace, the USSR would be forced to take steps to protect its own interests. The Chinese Foreign Minister has recently offered a compromise solution, proposing that an eleven power conference be called with a voting procedure similar to that used in the Far Eastern Commission. Secretary of State Marshall went to London intending to explore with Russia and China the possibility of reaching agreement. Failing this, there will be no separate peace. It was made quite clear to me that a peace treaty with Japan without Russian and Chinese adherence is out of the question. It is considered that such a move would play directly into Russian hands, permitting them either to make their own peace on better terms or to claim that we had dictated the terms to our own puppet government, one not truly representative of the Japanese people.

3. Neither in State nor Army is there any real optimism over the treaty situation. It is not anticipated that the Secretary of State will meet with success in London and the opinion seems very generally to be held that there could be no peace treaty for several years to come. In the meantime, preliminary work on a draft treaty continues to be carried on. Both the State Department and the Department of the Army sent out the most positive assurances that no draft treaty would be prepared and no negotiations concerning subject matter would be undertaken until after conference with and the concurrence of General MacArthur.

4. *Economic Reform v. Economic Recovery.* During the past few months serious opposition has developed in the United States toward what are termed the "reforms" being undertaken by SCAP, with particular reference to the economic purge, the elimination of Zaibatsu families and family appointees from positions of influence, economic decentralization, etc. The so-called Kauffman Report is illustrative of this thinking. American business interests which had Japanese connections before the war, those which had large investments in Japan and those which hope to control the Japanese market are pushing for a complete change of policy from one which is, to their way of thinking, depriving Japan of the only people with the know-how to put Japan back on its feet, to a program of economic recovery. Under Secretary of the Army Draper, Secretary of Defense Forrestal, Acting Secretary of State Lovett, are sympathetic to this point of view. According to CAD, influential members of Congress have expressed themselves also. Mr. Claxton and other members of General Saltzman's Office for Occupied Areas, Mr. Butterworth, Mr. Pennfield, Mr. Martin, Dr. Borton, all of the Division of Far Eastern Affairs, Col. Fahey, Mr. Pollard and others of CAD, and General McCoy all expressed serious concern over this development. At the Bureau level in both State and Army, there is full agreement with and support of SCAP. It is the thinking at the top policy level that is disturbing.

5. With the possibility of an extended period of military occupation, serious concern has been expressed over the willingness of Congress to continue heavy appropriations for occupation purposes. It is considered to be of the utmost importance to assure the Congress

that every effort is being made to make Japan self-supporting. There is considerable opposition to any further allocation of food to Japan unless definite assurances can be given that it will aid in recovery.

6. Already consideration has been given to the issuance either unilaterally or through the Far Eastern Commission of a new policy statement which would in effect constitute a complete reversal of the economic policies established under JCS 1380/15 and other JCS, SWNCC and FEC papers. It may be recalled that 1380/15 specifically stated that the economic recovery of Japan was not a responsibility of SCAP. So far, both the State Department and the Department of the Army have, on the working level, successfully resisted such a move. The attached documents (Annex A) indicate the farthest extent to which State and Army are willing to go in redefining economic policy for this occupation. Both General Saltzman's office in State and Civil Affairs Division in Army desired me to make it perfectly clear to the Supreme Commander that no one at that level desires to have any action taken which would either hamper current operations of SCAP or would be interpreted as criticism of SCAP. FEC 230 has not been withdrawn, but is being revised in form to avoid too detailed statement. Even the proposed revision (the concluding portion of which is attached as Annex B) there would be no radical departure from policy already established.

7. Great concern was shown by Secretary Royall, Under Secretary Draper, Assistant Secretary Gray, over the Holding Company Liquidation Commission bill and at one point the Army was prepared to direct SCAP to withdraw the bill from Diet consideration. This move was fortunately forestalled. After a conference with Assistant Secretary Gray in which I participated, a radio was drafted withdrawing any suggestion that further consideration of the bill be suspended and going no further than expressing the hope that in implementation of the measure certain principles would be borne in mind, such as economic stability, economic recovery, adequate opportunity for hearing and review, etc. When I left Washington this message was still awaiting final approval.

8. The crux of the matter is that the United States cannot issue a unilateral policy directive radically reversing established policy, and at the same time it is quite well realized that the Far Eastern Commission would never adopt a radical restatement. Nevertheless, it felt in both State and Army, at the working level that it would be extremely helpful if General MacArthur were to make a strong detailed public statement on the economic aims and accomplishments of the Occupation, should the opportunity present itself. Such a statement, reiterating the Supreme Commander's well-known position and pointing out that sound economic recovery can only come after the dead and diseased wood has been cleared away, would have the effect of answering the growing criticism and relieving much of the pressure. This is of particular importance at this time when both departments are about to present to Congress requests for deficiency appropriations largely concerned with occupation responsibilities, and when the question of further food allocations is under consideration.

9. *Organization.* At the present time, all consideration of plans for a takeover of responsibility for the Occupation by State Department have been shelved. The Department of the Army will continue to carry primary responsibility for the Occupation. At the same time, there has been considerable discussion in both State and Army of the possibility of reorganizing and reducing the occupation forces and occupation costs. It was unofficially suggested that SCAP itself might undertake a gradual reorganization and reduction that would eventually result in a small vertical occupation paralleling the Japanese Government, national and local, and charged only with responsibility for observation and control, supported by a small and separate military garrison force. This would have the effect of securing for Japan many of the benefits hoped to be secured through a peace treaty. Many of the officials at the working level in both departments feel that, if we are to have no peace treaty for several years, the reorganization of the Occupation machinery into a control and supervisory agency would have the effect of relieving much of the pressure and removing many of the practical restrictions upon the conduct of domestic affairs in Japan and, in the field of private enterprise at least, would permit a considerable amount of freedom. At the same time, it would enable us to observe just how far the Japanese can operate in a democratic manner and give life to their new institutions. Furthermore, it was suggested that the reduction of the overall size of the occupation forces would contribute materially to Japanese recovery in that the requirements of these forces now constitute a heavy drain upon Japanese resources. Economic advisers in both State and Army expressed their views on this point at considerable length.

10. *Policy Directives.* The feeling at the working level now is that, aside from FEC 230 or its revision, no further policy directives should be issued. It is believed that the Supreme Commander has now ample authority to carry the occupation forward to a successful conclusion. It is believed however, that it would be of the greatest possible value if the Supreme Commander were either to invite top ranking government officials to Japan or to send a group of top SCAP officials to Washington to confer upon all phases of the Occupation. In recent months it has been the lack of accurate knowledge, not only of SCAP activities but even more of the plans and opinions of the Supreme Commander that has hampered the work of full support of SCAP. It is this lack of adequate official SCAP representation at Washington that has resulted in the apparent gaps in policy thinking on Japan. This cannot be too strongly emphasized. Washington so frequently hears only one side of the case, that of what are popularly known as the "Old Jap Hands." Few officials in Washington have any real knowledge or understanding either of the great accomplishments of the Occupation or of the underlying beliefs that have motivated them. The men who have some knowledge are those on the working level. The top policy-making officials lack it, and SCAP is not at the present time represented at that level.

11. *Civil Liberties.* I cannot conclude this report without adding a word on the subject of civil liberties. It is with a great deal of pride that I can report that the American people are now thoroughly aroused on this matter and are determine that no agency of government shall continue to act in violation of those basic liberties. The President's Special Civil Liberties Committee has made a splendid and striking report on the subject, and the President has now cause to be set up a Loyalty Review Board that will ensure adequate protection of the rights of employees.

[SOURCE: HUSSEY PAPERS]

3-17 ROYALL'S SPEECH ON AMERICAN POLICY TOWARDS JAPAN

Speech — January 6, 1948
Delivered by: K. C. Royall, Secretary of the U. S. Army
To: Commonwealth Club, San Francisco

To many American citizens—including myself—the most surprising development—and one of the most disappointing aspects of our victory over Germany and Japan has been the responsibility and cost which have been placed upon us in the matter of occupation. There were few who originally recognized the extent of this burden. And today every citizen of our country is justified in asking the 'what' and the 'why' of our occupation policies.

On this occasion I will speak specifically of Japan. Immediately after the surrender, the objectives of our policy were stated to be, first, 'to insure that Japan will not again become a menace to the peace and security of the world', and, second, 'to bring about the earliest possible establishment of a democratic and peaceful government which will carry out its international responsibilities, respect the rights of other states, and support the objectives of the United Nations'.

The underlying idea was the prevention of future Japanese aggression—direct prevention by disarmament, and indirect prevention by creating a type of government unlikely to develop again the spirit of aggressive war. The real well-being of Japan—or her strength as a nation—was decidedly a secondary consideration—secondary to protection of ourselves against Japan, and secondary to payment of reparations to the victorious Allies for the damages inflicted upon them.

This attitude is clearly shown by the emphasis in the original directive, which stated in part: 'Japan shall be permitted' (not encouraged but permitted) 'to maintain such industries as will sustain her economy and permit the exaction of reparations...but not...enable her to rearm...Access to, as distinguished from control of, raw materials shall be permitted. Eventual Japanese participation in world trade...shall be permitted.'

It is clearly understandable—and it was fully in accord with the then feelings and opinions of our people—that in 1945 the main purpose of occupation should be protection against an enemy which had viciously attacked us and which had committed brutal atrocities against our troops and our private citizens.

Since then new conditions have arisen—in world politics and economics, in problems of national defence, and in humanitarian considerations. These changes must now be fully taken into account in determining our future course, but it should be remembered that these developments arose in large part after the original policies were set.

These original policies were promptly carried out. Within a few months after the end

of hostilities, all Japanese tactical units had been dissolved and all implements of war destroyed or insulated. The top Japanese military organizations, as well as the infamous secret and terroristic societies, were abolished. Those who formulated the Japanese policies of conquest and aggression were removed from important political and economic positions.

War-making industries were marked for removal and reparation. This included arsenals, private munitions plants, aircraft factories, military research laboratories, synthetic rubber and oil plants, shipbuilding installations, and certain chemical, machine tool, precision bearing, thermo-electric, and metal factories, non-ferrous and others. Commitments were made to other nations for payment of reparations with those plants.

Other steps followed, including those leading to the dissolution of concentrations of property ownership and economic power. At the end of the war—and for a long period before the war—land ownership had been in the hands of a comparatively small part of the population. The system was analogous to the feudal system of past centuries, and in Japan the 'land barons' used their power to encourage war.

In the business field, the Zaibatsu, or 'money cliques,' dominated completely and ruthlessly the Japanese economy—through holding companies and monopolies. A dozen families controlled over 75 per cent of the country's commerce, industry and finance.

The influence over the Japanese Government of these and other monopolies was almost unbounded, and they were linked inseparably with the militarists. This joint group over a course of years—and particularly in the year and a half before Pearl Harbour—encouraged Japan toward war and destruction.

Steps were taken to break both types of concentrations. Under a directive issued by the Supreme Allied Commander, the Japanese Diet enacted in the Fall of 1946 a Land Reform Law under which, through local land commissions, the 5½ million Japanese farm families could acquire land from the present owners at a reasonable price and pay for it over a period of years. This programme will be completed by the end of 1948. Just as in America the small landowner is symbolically and factually democracy in practice, so we expect that in time the strength of Japanese democracy will find roots in similar soil.

Action against the Zaibatsu has proceeded vigorously, and its control has now been virtually abolished. Sixty-seven holding companies with 4,000 subsidiaries and affiliates, have been marked for liquidation. The two largest holding companies—Mitsubishi and Mitsui—have been closed. Others of the larger ones have been almost wholly liquidated.

The Japanese Government has been directed to prepare legislation prohibiting international cartels. Stringent anti-trust and deconcentration legislation has been prepared and passed in part. A Holding Company Liquidation Commission has been established and is functioning in the supervision of the entire programme.

While these various steps were being taken, new developments were arising, and old factors were changing in importance. Japan had never been able to provide all of its own food—nor to produce enough of many other necessities of life. Seventy-eight million Japanese occupy an area smaller than California, and of that area only 16 per cent is capable of cultivation.

The population is still growing at an enormous rate. It is expected to reach 84 million by 1951. The current troubled condition in Asia leaves practically no food available for import into Japan, even if the currency and Japanese exports situation would make food purchases possible—which they would not.

And yet without food and other necessities, Japan would be faced with widespread starvation and disease—would seethe with unrest and disorder and hopelessness. Even aside from the simple principles of humanity, we could not, under such conditions, accomplish our original objective of a peaceful Japanese government. Nor could we hope that Japan would be other than susceptible to totalitarian demagogues from within and without. Without help the country would become a prey to non-democratic ideologies of aggression.

To meet this situation America has supplied Japan with food and other necessities. This assistance has given the country a base upon which to build, and it has been possible to supplant totalitarianism and Shintoism with democracy, to begin to replace educational regimentation with academic freedom, and to build the foundations for a peace-loving government of the people.

For this and other achievements in Japan, great credit must be given to General Mac Arthur and his staff. America was indeed fortunate that for this vital task it had an outstanding leader who could bring the Japanese to a complete realization of their defeat and at the same time obtain their full co-operation in forming a free and stable government.

But the Department of the Army and the Department of State—which shares the policy

responsibility of occupation—both Departments realize that for political stability to continue and for free government to succeed in the future, there must be a sound and self-supporting economy, and General MacArthur in command of the occupation can be depended upon to implement these policies.

We also realize that the United States cannot forever continue to pour hundreds of millions of dollars annually into relief funds for occupied areas, and that such contributions can end without disaster only when the occupied countries can pay for their own necessities with their own production and exports.

These factors have resulted in efforts to improve in many fields the economic situation in Japan. And with this increasing economic approach there has arisen an inevitable area of conflict between the original concept of broad demilitarization and the new purpose of building a self-supporting nation.

In the case of agriculture the two purposes do happen to run practically parallel. The breaking down of feudal holdings has ended a war-making influence. At the same time the wider division of lands tends to produce incentive on the part of the larger number of landowners and thereby to increase overall production.

But it is a different situation with manufacturing. The destruction of synthetic rubber or shipbuilding or chemical or non-ferrous metal plants will certainly destroy the war potential of Japan, but such destruction may also adversely affect the peace potential.

The dissolution of the Zaibatsu may present in itself no serious economic problem, but at some stage extreme deconcentration of industry, while further impairing the ability to make war, may at the same time impair manufacturing efficiency of Japanese industry—may, therefore, postpone the day when Japan can become self-supportng.

Such is our dilemma. It is clear that Japan cannot support itself as a nation of shopkeepers and craftsmen and small artisans any more than it can exist as a purely agricultural nation. We can expect a continuing economic deficit in Japan, unless there is at least some degree of mass industrial production.

Another borderline situation between demilitarization and economic recovery is presented in the case of personnel. The men who were the most active in building up and running Japan's war machine—militarily and industrially—were often the ablest and most successful business leaders of that country, and their services would in many instances contribute to the economic recovery of Japan.

What should we do about them now? We cannot afford to leave the Japanese war system intact nor forget that there is danger in retaining in power leaders whose philosophy helped bring on World War II. On the other hand we cannot afford to sterilize the business ability of Japan.

Nor can we believe without qualification individual Japanese protestations of war innocence or of peacetime reformation. One Senator said to me in Germany shortly after VE Day: 'I have inquired everywhere, and I have not yet found a single Nazi in Germany,' to which could perhaps now be added, 'nor a war-lord in Japan.'

All these matters present questions of degree, and the decisions are matters of judgement. These decisions are not difficult at a cocktail party or from an easy chair or on a rostrum, if made by those who have no responsibility for the decisions or their results. It is somewhat different when you must live and suffer with any errors that you might make.

The Departments of State and Army are trying to draw the lines in the right place. And in doing so they are giving—and will give—full weight to the changes in political and military and economic considerations which have occurred since the initial days of occupation.

We realize that deconcentration must stop short of the point where it unduly interferes with the efficiency of Japanese industry. Earlier programmes are being re-examined—as for example the details of the programme stated in the paper submitted some months ago to the Far Eastern Commission, and recently given wide publicity as FEC 230.

We are not averse to modifying programmes in the interests of our broad objectives. A bill recently submitted to the Japanese Diet setting up procedure for deconcentration of excessive economic power was changed before its final enactment—changed with a view to giving added weight to the economic needs of Japan.

In the case of plant dismantling and reparations—in addition to the matter of disarmament—we are bound by certain agreements with other nations—agreements which must be carried out unless breached by those others or altered by consent. However, since last summer we have had a competent group of industrial engineers in the Pacific selecting the specific plants which, consistent with our obligations, can be dismantled with the minimum

of detriment to Japanese economic recovery. The report and recommendations of this committee should reach the Department of the Army during this month.

I would not leave the impression that questions of demilitarization or reparation or deconcentration or disqualification of personnel are the most immediate obstacles to Japanese recovery. The principal difficulties arise from the destruction which war brought to Japan and to the chaotic condition which has existed in the Far East since VJ Day.

The flimsy nature of Japanese construction and the concentrated population centres made these islands most vulnerable targets for our incendiary and other missiles. Even aside from the effects on Hiroshima and Nagasaki of the atomic bombs, many Japanese cities were largely destroyed. I believe that on a percentage basis greater Tokyo—with about 7 million people as of 1940—was as badly damaged as any enemy city in the entire world.

Japan has long been dependent on the rest of Asia not only for foodstuffs but for raw materials needed in their manufacturing and business life, and it has relied largely on general commerce with China and other neighbours. With the war and its aftermath these sources of import and export are largely non-existent.

Many affirmative steps have been and are being taken to meet these and other difficulties —and to promote recovery and thereby hasten the day when Japan will cease to be a financial burden to the United States. I wish that time permitted me to discuss in detail our activities in many fields, including those of finance and credit and foreign trade.

Some results of our efforts are apparent. Overall Japanese industrial production has risen from 18 per cent of the 1930-34 level in January 1946 to 40 per cent in August 1947. In the case of coal—basically needed for business recovery—the present production is 86 per cent of the 1930-34 level. Fertilizer has increased fourfold during occupation. One-fourth of the war-destroyed houses in Tokyo and vicinity have been replaced. Six hundred thousand acres of land have been reclaimed for cultivation, and a million more should be added by 1950.

In this whole picture of Japan do not forget that we are supervising an entire Government—and one disorganized by an unsuccessful war. We have all the many normal policy and operating problems of a stable and successful Government plus the added ones produced by the unusual and distressing conditions peculiar to present-day Japan.

The differences from our own country are such that we cannot expect to impose on the Japanese people an exact reproduction of American democracy. It follows that often there is no precise precedent for our problem, and the Departments must do as our forefathers did in the early days of our own government—reach the best results we can by trial and error.

The lines to be drawn are, of course, not always easy to draw, and as in the case of all decisions of importance one cannot be too dogmatic. There can be—and are likely to be—differences of opinion among sincere and informed people. Nor do I have any illusion that everything we do will be perfect.

But I can assure you that our decisions will be made with realism and with a firm determination of doing all possible to prevent Japan from again waging unprovoked and aggressive and cruel war against any other nation. We hold to an equally definite purpose of building in Japan a self-sufficient democracy, strong enough and stable enough to support itself and at the same time to serve as deterrent against any other totalitarian war threats which might hereafter arise in the Far East.

3-18 UNITED STATES POLICY FOR JAPAN (McCOY STATEMENT)

Statement — January 21, 1948
At Far Eastern Commission Meeting
Made by: Maj. Gen. F. R. McCoy[10]

U. S. Government has reviewed the accomplishments of the first two years of the occupation of Japan in the light of the ultimate Allied objectives as set forth in the Potsdam Declaration and elaborated in subsequent policy statement. This review has revealed that in implementation of the basic policy, SCAP (Supreme Commander for the Allied Powers) has destroyed Japan's ability to make war on the land, on the sea, and in the air. Exceptional progress has been made in establishing political and economic institutions which will

[10] Chairman, Far Eastern Commission (US representative).

permit the development of a democratic and peaceful Japan capable of assuming the responsibilities of a member of the community of nations.

The framework of a democratic Japanese Government has been established in accordance with the provisions of a new constitution adopted by the Japanese people and a popularly elected Government is now in office.

However, the establishment of a self-supporting economy in Japan, without which the achievements of the occupation cannot be consolidated, has not yet been accomplished.

Japanese industry and commerce are not yet sufficient to sustain the Japanese economy, there is not yet final Allied determination of the reparations which Japan will be required today and Japan is not yet in a position to participate fully in world trade and to contribute its part to the rehabilitation of world economy.

Economic chaos in Japan has been prevented only at the expense of the American people who have financed the importation of vital food and other materials required to prevent widespread disease and unrest.

It is the view of the U. S. Government that if the fundamental objectives of the occupation are to be achieved, and if there are to be established the conditions necessary to enable Japan to make its proper contribution to the economic rehabilitation of world economy and to take its place in the community of nations, a much greater effort must be made to bring about the attainment of self-supporting Japan with a reasonable standard of living.

To this end, my Government believes that the Japanese Government and people, the Far Eastern Commission and its member states, and the Supreme Commander, recognizing the conditions which now require that more emphasis be placed on such a program, should take all possible and necessary steps, consistent with the basic policies of the occupation, to bring about the early revival of the Japanese economy on a peaceful, self-supporting basis.

The Japanese Government, under the supervision of SCAP, must prepare and implement plans under which Japan can become self-supporting at the earliest possible time. Progress has already been made in this direction. Although the primary responsibility [for the] preparation and execution of such a plan rests on the Japanese Government and people, SCAP must take the requisite steps to ensure that the Japanese Government and people energetically and effectively discharge that responsibility.

Greater efforts by the Japanese people, coupled with such assistance as the U. S. Government may be able to provide for a temporary period, should eliminate the burden on the American taxpayer of supporting the Japanese economy. While the American people will not continue indefinitely to subsidize the economy of Japan, the U. S. Government will shortly begin discussions in the Congress of a proposal to provide funds for the fiscal year 1949 in addition to funds requested for subsistence items for the procurement of such imports as industrial raw materials and spare parts to assist Japan to expand the output of its peaceful industries towards status of self-support.

The Far Eastern Commission has already agreed on a number of policies directed towards this goal. For example, it has already declared that measures should be taken or continued to stimulate Japan's production of goods required for export and to ensure that goods produced are those in demand in countries requiring supplies from Japan: it recently opened Japan to limited private trade and authorized the establishment of a revolving fund to aid in financing peaceful foreign trade. The U. S. Government, recognizing that the cooperation of the Far Eastern Commission and its member states is essential to the successful accomplishment of a program for bringing about a self-supporting economy in Japan, requests favorable consideration of future policies to be presented to the Commission towards this end.

[SOURCE: *Documents Concerning the Allied Occupation of Japan* II, pp. 13-15]

3-19 MANUAL OF MILITARY GOVERNMENT IN JAPAN

Manual (Provisional) — September 1, 1948
To: Occupation Officials
From: Headquarters Eighth Army

Chapter 2

ORGANIZATION AND FUNCTIONS OF MILITARY GOVERNMENT IN JAPAN

1. GENERAL.—Military government as defined by FM 27-5 is the substitution of military authority in an occupied country for that of the previous government. Since the

Japanese government is organized and functioning, even though under direction and limitation, military government in Japan is actually a civil affairs organization. In general this organization operates on two levels, as follows:

a. *The Policy and Planning Level.*—General Headquarters, Supreme Commander for the Allied Powers (GHQ, SCAP).

b. *The Operating Level.*—Eighth United States Army.

2. GHQ, SCAP.

a. Authority.—The Supreme Commander for the Allied Powers is vested with the authority to effectuate the surrender of Japan and to carry out the provisions of the Potsdam Declaration and the directives of the Joint Chiefs of Staff. He exercises his powers to the greatest practicable extent through the Japanese government. He issues all policies and directives to that government. He plans and directs programs to effect the various objectives of the occupation of Japan. His principal staff sections which are concerned primarily with the military government (civil affairs) aspects of the occupation are:

(1) Civil Information and Education Section.
(2) Civil Property Custodian Section.
(3) Economic and Scientific Section.
(4) Government Section.
(5) Natural Resources Section.
(6) Public Health and Welfare Section.
(7) Reparations Section.

b. *Basic Occupation Documents.*—Important basic documents concerned with the surrender of Japan and its subsequent occupation are reproduced here as appendices A, B, C, and D as follows:

Appendix A—The Cairo Conference Declaration
Appendix B—The Potsdam Declaration
Appendix C—The Instrument of Surrender
Appendix D—The Basic Post Surrender Policy for Japan

Their thorough study by all military government personnel is indispensable to an understanding of the authority for and concepts of the occupation and, accordingly, to a wise implementation of the occupation force programs.

3. EIGHTH UNITED STATES ARMY.

a. *Mission.*—The military government mission of the Eighth Army is to effect surveillance and supervision of the Japanese in executing directives issued to their government by the Supreme Commander. To accomplish this, operational directives designed to implement the policies, plans and directives of the Supreme Commander are issued to tactical units and military government teams by the Commanding General, Eighth Army.

b. *Organization.*—Military government units are organized in accordance with the attached command, location and organization charts. Since the Army Commander must handle at the operating level most of the phases of military government with which the staff of the Supreme Commander is concerned, the Eighth Army organization for military government contains sections to handle these phases. From this point of view it parallels the GHQ, SCAP organization. As shown by the attached charts, it comprises three principal agencies.

(1) A staff section at Eighth Army Headquarters.
(2) Two American corps headquarters, each of which has a military government staff section.
(3) Fifty-three military government teams stationed throughout Japan.

There is one team for each of the forty-six prefectures and one for each of the seven administrative regions. With the exception of the Tokyo, Kanagawa and Shizuoka prefectural teams, the regional and prefectural teams within each corps area are attached to the corps and operate under the direct supervision of the corps commanders. The three excepted teams and all regional and prefectural teams in the British Commonwealth Occupation Force area operate under the direct supervision of the Eighth Army Commander. Although the General Officer Commanding the British Commonwealth Occupation Force has no military government responsibilities, he provides several officers and men as members of the eleven military government teams in his area. Because of the limited amount of personnel assigned to military government work, all teams are frequently reinforced temporarily by personnel from tactical units to aid in supervising the implementation of important programs.

c. *Army and Corps Staff Section Responsibilities.*—The responsibilities of the army and corps military government staff sections are:

(1) Handling for their respective commanders all administration, correspondence, investigations and reports pertaining to military government acitivities.
(2) Planning the implementation of SCAP's policies and directives to the Japanese government.
(3) Preparing operational directives and other plans and instructions on military government matters for issue to teams and tactical units. (Operational directives—OD's—will be issued only by the Eighth Army.)
(4) Inspection, training and guidance of subordinate echelons in their work of surveillance, investigation, encouragement and instruction of the Japanese people and their governmental, political, economic and social agencies.
(5) Supervision of the administration and supply of regional and prefectural teams. (Logistic support of teams directly under army and corps headquarters is, respectively, the responsibility of the army and corps commanders.)
(6) Maintaining liaison on military government matters with higher headquarters by means of staff visits and conferences.
(7) Preparing and transmitting periodic and special reports to higher headquarters.

d. *Military Government Teams.*

(1) Regional Teams.—The primary function of the regional teams is to provide enthusiastic leadership to the prefectural teams and, by encouragement, long-range planning, and a detailed knowledge of all programs, coordinate the work of these teams and guide them into maximum productive effort. By means of timely and well planned visits to these teams, the regional commander and his principal staff members will insure that their personnel have a thorough knowledge of the problems to be handled, the results to be achieved, and the best methods of attaining these resulsts. The operational activities of the regional team should be limited strictly to dealing with regional governmental bureaus and non-governmental agencies whose authority is region wide. To this extent it has direct functions of surveillance as prescribed below for prefectural teams. Regional commanders will exercise supervision over the administration, discipline and supply of their teams and make recommendations as appropriate relative thereto.

(2) Prefectural Teams.—The prefectural teams are the field operating units. To be effective, their personnel must come in close contact with the Japanese people and observe conditions at first hand. These teams will exercise surveillance and supervision of the work of the Japanese and provide essential guidance to insure compliance with all orders and instructions of the Supreme Commander and all Eighth Army operational directives issued pursuant thereto. In view of the importance of their field work, they must be favored to the maximum practical extent in personnel, transportation and other aids to the efficient accomplishment of their mission.

(3) General Considerations.

a. The military government team commander is responsible for all activities of the team. The spirit and success of the team will be directly proportional to his capacity for commanding a unit, to his dynamic leadership, common sense, and ability to plan, direct and coordinate the work of his various sections and provide to the maximum extent for the comfort and welfare of his personnel. While the surveillance, inspection, investigation and guidance of governmental, economic, educational, informational, welfare and health activities should be delegated to the chiefs of section, the commander should be in the field with them a great deal, both individually and as a group.

b. Military government team commanders are in no sense military governors. The issuance of orders to or direct operation or supervision of any Japanese governmental agency by these commanders or their subordinates will be undertaken only in an emergency or where specifically authorized by the Commanding General of the Eighth Army.

c. The administration of the detachment and the supervision of the team's physical installations should be delegated to the detachment commander.

d. The supervision of office personnel and military government administration and the coordination of military government section activities are proper-

functions of the executive officer.

e. A clear distinction should be made between the military government work of the team and the administrative functions of the detachment. This distinction is indicated in the table of organization and should be followed to the maximum extent permitted by available personnel. In view of the limited number of personnel in a team, it is essential that they be used to maximum advantage. Those allotted to administrative and housekeeping functions should carry the maximum practical load in order that those allotted to purely military government work be given the maximum time to accomplish their surveillance activities. The team exists solely to perform military government functions. While administrative, supply and maintenance functions are essential, the tendency to divert to these functions more personnel than absolutely necessary must be guarded against in the interest of the team's primary mission.

Chapter 3

GENERAL OPERATING PROCEDURE

1. PROCEDURES OF GENERAL APPLICATION.—The procedures suggested herein are of general application to all team commanders and chiefs of sections. They are placed here to avoid repetition in each of the subsequent chapters. Detailed procedures and suggestions applicable to a particular phase of military government work will be found in the chapter dealing with that phase. Good general operating procedure of any section demands that it:

a. Observe and check frequently the activities of the Japanese for compliance with SCAP directives applicable to the section's various programs.

b. Inform the Japanese of the mission of the occupation and of specific directives and programs.

c. Report to higher headquarters compliance or non-compliance with SCAP directives, together with recommendations relative thereto.

d. Make suggestions for local corrections of non-compliance in cases covered by specific directives.

e. Encourage and advise the Japanese in all fields of activity covered by the section's program within limits of established policies.

f. Keep the team commander and higher headquarters informed on all matters pertaining to the activities of the section.

2. REGIONAL-LEVEL PROCEDURES.—To accomplish the procedures outlined above on a regional level it is essential that each chief of section should:

a. Organize, train, supervise and direct the work of the regional section and effect staff supervision over the corresponding sections of the prefectural teams.

b. Maintain liaison with the officials of all pertinent Japanese governmental bureaus and non-governmental agencies whose authority is region wide. By frequent conferences, explain policies and directives of higher headquarters and keep informed of the activities engaged in by these agencies. Encourage officials to give all assistance within their authority on matters of particular urgency. Encourage the local solution of as many problems as possible without appeal to higher headquarters, or to the central government. Insure that these officials are thoroughly informed on new laws and directives applicable thereto. Determine the adequacy of measures taken by these officials to successfully implement the laws.

c. Study the problems that are submitted by the prefectural military government teams and refer pertinent problems to the regional bureaus of the Japanese government when they can be solved by those bureaus. Those which cannot be solved locally as determined through conferences with Japanese agencies or studies made by prefectural military government teams or spot checks made by regional military government teams, should be submitted to higher headquarters with specific recommendations.

d. Maintain an activities file on each operational directive and the corresponding work done by each military government team. Make timely and well planned visits to prefectural military government teams in order to channel their efforts in right directions. Check the aggressiveness of their operations and their knowledge of current activities, problems and remedies. Determine that proper action is being taken on all directives. Advise teams on proper approaches to their problems.

e. In company with prefectural team representatives, spot check pertinent agencies and organizations throughout the region for information on compliance with SCAP directives

and for first hand knowledge of problems within these agencies and organizations. Stimulate to a maximum the interest of the Japanese on matters of particular significance.

f. Keep informed on all applicable policies and programs by studying all directives, letters, bulletins and special reports from higher headquarters and all information received from regional bureaus. This can be accomplished most efficiently by maintaining files of the information that should be in the hands of the military government teams and periodically checking the teams to see that the information is on file in their offices and that they are familiar with it. The military government teams should be further informed through instructions supplied by individual interviews or through regional conferences.

g. Upon the receipt of a new directive, take immediate steps to insure that copies are in the hands of the appropriate officers of prefectural teams and that prompt action is being taken. Make systematic checks and inspections to insure that appropriate personnel of each team understand the directive and have adequate plans for checking its implementation.

h. During visits to the teams, check on the amount, quality, breadth and character of a particular section's activities. Channel its efforts in the right direction, provide expert guidance and suggestion. Assist in the solution of its problems. Gain ideas worth passing on to other teams.

i. Maintain close liaison with the regional information officer in order to plan with him effective information programs to support and inform the Japanese people of each of the section's important programs. Submit these information plans to appropriate sections of prefectural teams and urge the preparation of final plans and materials suitable to local situations.

j. Instruct appropriate team officers in the preparation of recurring military government activities reports. Study copies of the reports received. Evaluate them for useful and unusual information. Where problems, deficiencies or irregularities which the team commander has not been able to solve or correct, have been reported, take appropriate action on the regional level if possible.

k. Encourage special reports on existing problems which cannot be solved locally. Determine whether the condition is region wide. If a solution at regional level cannot be effected, add recommendations determined from additional surveys, if such surveys would further clarify the problem or add emphasis to its importance or seriousness, and forward to higher headquarters. Before these reports are forwarded to higher headquarters, ascertain and report whether the Japanese have made such reports, applications and/or recommendations, if appropriate, through their own governmental channels.

3. PREFECTURAL-LEVEL PROCEDURES.—To accomplish on the prefectural level the procedures outlined in paragraph 1, above, it is necessary that each chief of section should:

a. Organize, train and direct the work of his own section.

b. By individual and collective conferences maintain liaison with appropriate Japanese prefectural officials and representatives of organizations engaged in or concerned with the particular section's activities. Check into and, as far as practicable, insure full compliance with SCAP directives. Through frequent conferences with these officials and representatives, explain policies and directives of higher headquarters and become familiar with their activities. Encourage them to give assistance within their authority on any matters of particular urgency.

c. Determine the adequacy of measures taken by officials to successfully implement the laws resulting from SCAP directives. If such measures are inadequate, make suggestions for corrections and report to higher headquarters if there is any failure in compliance. Examples of non-compliance with SCAP directives, lack of knowledge of these directives, lack of interest or cooperation in particular programs initiated by SCAP, and failure to carry out laws resulting from SCAP directives will be reported to the proper Japanese authorities for correction and, when appropriate, to the next higher military government headquarters. Corrective measures or lack thereof taken by Japanese will also be reported.

d. Confer frequently with local (city, town, village and district) agencies, associations and organizations whose functions deal with those phases of the life of the prefecture over which the section is exercising surveillance, to explain particular programs initiated by SCAP.

e. Make timely and well planned field trips to all parts of the prefecture, to visit appropriate individuals, organizations and agencies, and talk with representatives of all groups directly concerned with his section's activities. Explain the pertinent measures of the occupation, the reasons therefor, and the restrictions or lack of restrictions in various fields. Listen

to their problems. And while you will frequently make suggestions to the proper Japanese authorities for solutions, it is much more important that you urge the people to take their problems to their "Congressmen". Obtain whatever information is needed to keep adequately informed on the state of the section's various activities within the prefecture with the view to assisting in the solution of critical problems within the limits established by SCAP.

f. Encourage self-reliance on the part of private and governmental agencies to solve as many of their problems as possible on the local level without appeal to the central government.

g. Make careful studies of pertinent problems and determine what attempts are being made by the Japanese to solve them. When solution is beyond the means of the prefectural government, the next agency is usually the Diet. Never lose an opportunity to impress upon the people that it is the responsibility of their prefectural and national government elected representatives to solve their problems for them. At the same time make a special report of the problem with specific recommendations to the next higher military government headquarters. These studies should be confined to those which are representative throughout the prefecture; however, special reports on local problems which have a far-reaching effect on, or special significance to a community are encouraged. This type of report requires facts and justification, not opinions. In no case should the military government team become a forwarding office of applications brought in by the Japanese.

h. Keep up-to-date and informed on all policies and programs of interest to the section by studying directives, letters, publications and special reports from higher headquarters.

i. Consult the next higher headquarters for clarification of points not covered by directives or publications or when in doubt concerning any of the points covered by such directives or publications.

j. Upon receipt of a new directive, establish a sound plan of action regarding its implementation. Advise the next higher headquarters of the action being taken if the directive does not call for a report. Maintain activity files on each directive, to include the plan or schedule of action for the team, action taken by the Japanese and a record of progress made.

k. Through the monthly activities reports, keep higher headquarters advised of activities engaged in, including those required by directives and those assumed on individual initiative.

l. Make recommendations for changes in directives or practices where observation indicates that such directives do not fully cover the situation or where practices resulting from such failure in coverage would bring about conditions detrimental to the interests of the occupation.

m. Maintain close liasion with the team civil information officer in order to plan with him effective information programs to support the various programs and activities of your section. Study information programs applicable to your section which come from higher headquarters. Consult with the civil information officer concerning which of the suggested methods and techniques are applicable to local conditions or circumstances. Japanese officials and leaders should be included in the planning phases of information activities and programs.

n. Coordinate efforts of your section with the efforts of other sections of the team, giving particular emphasis to getting as much information about various reforms and practices directed by SCAP into the hands of the Japanese as possible. Many failures and delays are caused by lack of adequate and widespread information by the Japanese.

[SOURCE: SUITLAND PAPERS]

3-20 NSC RECOMMENDATIONS WITH RESPECT TO U.S. POLICY TOWARD JAPAN (NSC 13/2)

Report NSC-13/2[11] October 7, 1948
by: National Security Council

1. *Timing and Procedure.* In view of the differences which have developed among the interested countries regarding the procedure and substance of a Japanese peace treaty and in view of the serious international situation created by the Soviet Union's policy of aggressive Communist expansion, this Government should not press for a treaty of peace at this time. It should remain prepared to proceed with the negotiations, under some generally acceptable voting procedure, if the Allied Powers can agree among themselves on such a procedure. We should, before actually entering into a peace conference, seek through the diplomatic channel the concurrence of a majority of the participating countries in the principal points of content we desire to have in such a treaty. Meanwhile, we should concentrate our attention on the preparation of the Japanese for the eventual removal of the regime of control.

2. *The Nature of the Treaty.* It should be our aim to have the treaty, when finally negotiated, as brief, as general, and as nonpunitive as possible. To this end we should try to clear away during this intervening period as many as possible of the matters which might otherwise be expected to enter into the treaty of peace. Our aim should be to reduce as far as possible the number of questions to be treated in the peace treaty. This applies particularly to such matters as property rights, restitution, etc. Our policy for the coming period should be shaped specifically with this in mind.

SECURITY MATTERS

3. *The Pre-Treaty Arrangements.* Every effort, consistent with the proper performance of the occupational mission as envisaged in this policy paper and with military security and morale, should be made to reduce to a minimum the psychological impact of the presence of occupational forces on the Japanese population. The numbers of tactical, and especially non-tactical, forces should be minimized. In determining the location of occupation forces, their employment, and support from the Japanese economy in the pre-treaty period, full weight should be given to the foregoing.

4. *The Post-Treaty Arrangements.* United States tactical forces should be retained in Japan until the entrance into effect of a peace treaty. A final U.S. position concerning the post-treaty arrangements for Japanese military security should not be formulated until the peace negotiations are upon us. It should then be formulated in the light of the prevailing international situation and of the degree of internal stability achieved in Japan.

5. *The Ryukyu Islands.* (Recommendations on this subject are to be submitted separately.)

6. *Naval Bases.* The United States Navy should shape its policy in the development of the Yokosuka base in such a way as to favor the retention on a commercial basis in the post-treaty period of as many as possible of the facilities it now enjoys there. Meanwhile, it should proceed to develop the possibilities of Okinawa as a naval base, on the assumption that we will remain in control there on a long-term basis. This policy does not preclude the retention of a naval base as such at Yokosuka if, at the time of finalizing the U.S. position concerning the post-treaty arrangements for Japanese military security, the prevailing international situation makes such action desirable and if it is consistent with U.S. political objectives.

7. *The Japanese Police Establishment.* The Japanese Police establishment, including the coastal patrol, should be strengthened by the re-enforcing and re-equipping of the present forces, and by expanding the present centrally directed police organization.

THE REGIME OF CONTROL

8. *Supreme Commander for the Allied Powers.* This Government should not at this time propose or consent to any major change in the regime of control. SCAP should accordingly be formally maintained in all its existing rights and powers. However, responsibility should be placed to a steadily increasing degree in the hands of the Japanese Government. To this end the view of the United States Government should be communicated to SCAP that the scope of its operations should be reduced as rapidly as possible, with a corresponding reduction in personnel, to a point where its mission will consist largely of general supervisory observation of the activities of the Japanese Government and of contact with the latter at high levels on questions of broad governmental policy.

9. *Far Eastern Commission.* (Recommendations on this subject are to be submitted separately.)

10. *Allied Council.* The Allied Council should be continued, with its functions unchanged.

OCCUPATONAL POLICY

11. *Relations with the Japanese Government.* (See paragraph 8 above.)

12. *Internal Political and Economic Changes.* Henceforth emphasis should be given to Japanese

[11] President Truman approved NSC 13/2 on Oct. 9, 1948.
In this draft, paragraphs 5, 9, and 20 were deleted and submitted subsequently. A revised version of NSC 13/2 (NSC 13/3) is included in this volume.

assimilation of the reform programs. To this end, while SCAP should not stand in the way of reform measures initiated by the Japanese if he finds them consistent with the overall objectives of the occupation, he should be advised not to press upon the Japanese Government any further reform legislation. As for reform measures already taken or in process of preparation by the Japanese authorities, SCAP should be advised to relax pressure steadily but unobtrusively on the Japanese Government in connection with these reforms and should intervene only if the Japanese authorities revoke or compromise the fundamentals of the reforms as they proceed in their own way with the process of implementation and adjustment. If exigencies of the situation permit, SCAP should consult with the U. S. Government before intervention in the event the Japanese should resort to action of such serious import. Definite background guidance embodying the above principles and indicating the United States Government's view as to the nature and extent of the adjustment to be permitted should be provided SCAP in the case of certain reforms.

13. *The Purge.* Since the purpose of the purge has been largely accomplished, the U.S. now should advise SCAP to inform the Japanese Government informally that no further extension of the purge is contemplated and that the purge should be modified along the following lines: (1) Categories of persons who have been purged or who are subject to the purge by virtue of their having held relatively harmless positions should be made re-eligible for governmental, business and public media positions; (2) certain others who have been barred or who are subject to being barred from public life on the basis of positions occupied should be allowed to have their cases re-examined solely on the basis of personal actions; and (3) a minimum age limit should be fixed, under which no screening for public office would be required.

14. *Occupation Costs.* The occupational costs borne by the Japanese Government should continue to be reduced to the maximum extent consonant with the policy objectives of the pre-treaty period as envisaged in this paper.

15. *Economic Recovery.* Second only to U. S. security interests, economic recovery should be made the primary objective of United States policy in Japan for the coming period. It should be sought through a combination of United States aid program envisaging shipments and/or credits on a declining scale over a number of years, and by a vigorous and concerted effort by all interested agencies and departments of the United States Government to cut away existing obstacles to the revival of Japanese foreign trade, with provision for Japanese merchant shipping, and to facilitate restoration and development of Japan's exports. In developing Japan's internal and external trade and industry, private enterprise should be encouraged. Recommendations concerning the implementation of the above points, formulated in the light of Japan's economic relationship with other Far Eastern countries, should be worked out between the State and Army Departments after consultation with the other interested departments and agencies of the Government. We should make it clear to the Japanese Government that the success of the recovery program will in large part depend on Japanese efforts to raise production and to maintain high export levels through hard work, a minimum of workstoppages, internal austerity measures and the stern combatting of inflationary trends including efforts to achieve a balanced internal budget as rapidly as possible.

16. *Property Matters.* SCAP should be advised to expedite the restoration or final disposal of property of United Nations members and their nationals in such a way that the process will be substantially completed by July 1, 1949. It should be the objective of United States policy to have all property matters straightened out as soon as possible and certainly well in advance of a treaty of peace in order that they may not hamper treaty negotiations.

17. *Information and Education.*

a. Censorship. Censorship of literary materials entering Japan should be conducted with the minimum of delay and pre-censorship of the Japanese press should cease. This should not operate, however, to prevent SCAP from exercising a broad post-censorship supervision and from engaging in counter-intelligence spot-checking of the mails.

b. Radio. The United States Government should immediately undertake a regular program of medium-and long-wave broadcasts to Japan from a suitably located transmitter station possibly on Okinawa. These programs should be carefully prepared with a view to developing an understanding and appreciation of American ideas and at the same time to maintaining as wide a Japanese radio audience as possible.

c. Interchange of Persons. The interchange between Japan and the United States of scholars, teachers, lecturers, scientists and technicians should be strongly encouraged. SCAP should continue the policy of permitting approved Japanese to go abroad for cultural as well as economic purposes.

18. *War Crime Trials.* The trial of Class A suspects is completed and decision of the court is awaited. We should continue and push to an early conclusion the screening of all "B" and "C" suspects with a view to releasing those whose cases we do not intend to prosecute. Trials of the others should be instituted and concluded at the earliest possible date.

19. *Control of Japanese Economic War Potential.* Production in, importation into, and use within Japan of goods and economic services for bona fide peaceful purposes should be permitted without limitation, except:

a. Japan's economic war potential should be controlled by restrictions on allowable stockpiling of designated strategic raw materials in Japan.

b. Japan's industrial disarmament should be limited to the prohibition of the manufacture of weapons of war and civil aircraft and the minimum of temporary restrictions on industrial production which can be advocated in the light of commitments already made by the United States regarding the reduction of the industrial war potential.

20. *Japanese Reparations.* (Recommendations on this subject are to be submitted separately.)

[SOURCE: *FRUS*, 1948, VI, pp. 858-62]

3-21 SCAP'S SCOPE OF AUTHORITY

Telegram: C-66402[12] December 18, 1948
To: W. Draper, Under Sec., Dept. of Army
From: MacArthur
Top Secret

Reurad W-81345. The purport of your message is not understood. Few of the policy decisions contained in NSC 13/2 and none of those referred to for report are within the field of responsibility of CINCFE and as pointed out in ourad C-65997 the international character of SCAP under the Moscow Agreement of 1945 renders him subject solely to Allied policy either formulated by the FEC or under specific limited circumstances by the United States, if transmitted as an interim directive pursuant to the procedures set forth in the formers terms of reference. Both such international character and the proper procedures have previously been fully recognized and followed, the latest example being in your W-81058 transmitting an interim directive of the United States on the stabilization of the Japanese economy. The danger inherent in confused thinking as to the differentiation between the responsibilities of CINCFE and SCAP is well illustrated in urad W-80599 wherein you pointed out "that because international character of SCAP this message being addressed to CINCFE for his confidential info. Any overt acts carrying out this policy almost certain to be inconsistent with FEC policy directives particularly pending paper 'conduct of trade with Japan'. Utmost importance therefore such actions, if taken, do not become known by foreign or unauthorized persons in Japan." Because of this very distinction and the danger so clearly recognized, it should be understood by all United States agencies concerned that the policy decisions contained in NSC 13/2 are controlling upon the executive departments and agencies of the United States Government within the several fields of their responsibility but not rpt upon SCAP whose office is international both in origin and control and that under the terms of the Moscow Agreement SCAP is subject to the direct orders of the United States only in its nature as the channeling agency designated by the Moscow Agreement to transmit policy and communications of the FEC and interim directives of its own for implementation by SCAP. The distinction has just been enunciated with marked clarity by the Solicitor-General in arguing the war crimes appeals before the United States Supreme Court and his argument that if that court assumed jurisdiction the high court of any other member of the FEC could with equal legality assume jurisdiction is no rpt no less controlling upon every other phase of SCAPs administration. The direct intervention of the United States into the formulation of policy controlling upon Japan, under limited circumstances, was specially reserved in the Moscow Agreement and the provisions therefor have been exercised by the United States in the issuance of interim directives. Apart from this method of proceedings, however, it would be an abrogation of the controlling international agreement fraught with the most dangerous and unpredictable consequences if the nations in the FEC membership or any of them were to attempt to assume the right of unilateral policy

[12] Cf: Telegram W81792.

action.

As to the progress in the implementation of the United States policy decisions contained in NSC 13/2 I should be glad to give you informal advice at any time as to any phase of the occupation. Indeed there is little that could be added to the routine activity reports which are regularly submitted to the Department of the Army. NSC 13/2 has not rpt not been conveyed as an order to SCAP by appropriate directive as prescribed by international agreement and SCAP is not rpt not therefore responsible in any way for its implementation or for any form of report which might imply SCAP responsibility for implementation. In this connection it should not rpt not be ignored that SCAP is responsible and answerable for all official acts in the administration of Japan to the FEC and to a limited extent to the Allied Council for Japan and is confronted with the missions of every member government of the FEC, except New Zealand, sitting in Tokyo and constantly alert to any action even remotely violative of FEC policy decisions or which might lay the basis for impeachment before the several governments concerned of SCAPs stewardship of his international responsiblity.

3-22 AUTHORITY OF SCAP

Telegram: W 81792
To: MacArthur
From: Draper

December 25, 1948

Your C 65997 has been carefully considered. W 80454 may not have been entirely clear. It was intended that you should implement the policy decisions of NSC 13/2 within your field of responsibility which includes both the area of your jurisdiction and authority as CINCFE as well as your executive discretion as SCAP. SCAP's position as an international officer is fully understood but there is still a considerable latitutde in the interpretation and execution of FEC directives within which you as SCAP have discretion and within which you should take into account US National Policy. Our present policy does contemplate exercise of US control over the implementation of policy in Japan to the extent practicable but still within the framework of the Moscow Agreement. The US attitude toward the FEC is clearly indicated in Par 9 of NSC 13/2 which I understand you had not received when C 65997 was dispatched.

The US directives mentioned in Par 3 of W 80454 were not intended to refer to directives transmitting Far Eastern Commission policy decisions or to US unilateral interim directives as provided for in the terms of reference of the Far Eastern Commission, but to pre-FEC US directives and to US directives and instructions issued to you unilaterally.

The State Department considers that there is full international recognition of primary US interest in the conduct of the executive authority and responsibility in Japan. For Example, 1st and most important is the agreement that SCAP shall be appointed by the President of US, 2d that the FEC should recognize the existing chain of command, and 3d, the unique right given to the US to issue unilateral directives to SCAP. It would be utterly unreasonable to contend that the US could not advise SCAP in the exercise of his executive authority, within the limitations of existing policy decisions of the FEC.

Under the Moscow Agreement the FEC was set up to deal with Post-Surrender Policies in the period following surrender at a time when an early treaty of peace was anticipated. Three years have passed and a peace treaty is still not a practicable probability in the near future. The US alone has been bearing the cost of occupation and is contemplating increased appropriations for recovery. The US Government is not only furnishing all the funds but has the principal responsibility for the success of the occupation. It is our task here and yours there to find the ways and means to implement US Policy as it develops from time to time but keeping within the FEC framework and directives. Implementation should be accomplished to the greatest possible extent through appropriate interpretations and appropriate use of SCAP's executive discretion and when necessary or desirable through issuance here of a specific and when necessary or desirable through issuance here of a specific US Interim Directive to SCAP through the JCS, with a copy filed with the FEC as already provided for within the terms of reference of the FEC. This latter action was taken in issuing the directive concerning economic stabilization.

. . . . . .

In preparing NSC 13/2 it was recognized that, in many instances, in light of previous policies and commitments, it posed no easy task for you. The National Security Council

felt, however, that you would find, in the authority that you possess and in your wide background of experience, means for seeing that progress is made, gradually and with a minimum of disturbance of public opinion, in the direction of the goals outlined in the NSC paper.

The Chief of Staff and acting Secretary of State agree with this message.

[SOURCE: MACARTHUR MEMORIAL]

3-23 NSC RECOMMENDATIONS WITH RESPECT TO U. S. POLICY TOWARD JAPAN (NSC 13/3)

Report NSC-13/3[13]
By: National Security Council

May 6, 1949.

THE PEACE TREATY

1. *Timing and Procedure.* In view of the differences which have developed among the interested countries regarding the procedure and substance of a Japanese peace treaty and in view of the serious international situation created by the Soviet Union's policy of aggressive Communist expansion, this Government should not press for a treaty of peace at this time. It should remain prepared to proceed with the negotiations, under some generally acceptable voting procedure, if the Allied Powers can agree among themselves on such a procedure. We should, before actually entering into a peace conference, seek through the diplomatic channel the concurrence of a majority of the participating countries in the principal points of content we desire to have in such a treaty. Meanwhile, we should concentrate our attention on the preparation of the Japanese for the eventual removal of the regime of control.

2. *The Nature of the Treaty.* It should be our aim to have the treaty, when finally negotiated, as brief, as general, and as nonpunitive as possible. To this end we should try to clear away during this intervening period as many as possible of the matters which might otherwise be expected to enter into the treaty of peace. Our aim should be to reduce as far as possible the number of questions to be treated in the peace treaty. This applies particularly to such matters as property rights, restitution, etc. Our policy for the coming period should be shaped specifically with this in mind.

SECURITY MATTERS

3. *The Pre-Treaty Arrangements.* Every effort, consistent with the proper performance of the occupational mission as envisaged in this policy paper and with miliary security and morale, should be made to reduce to a minimum the psychological impact of the presence of occupational forces on the Japanese population. The numbers of tactical, and especially non-tactical, forces should be minimized. In determining the location of occupation forces, their employment, and support from the Japanese economy in the pre-treaty period, full weight should be given to the foregoing.

4. *The Post-Treaty Arrangements.* United States tactical forces should be retained in Japan until the entrance into effect of a peace treaty. A final U. S. position concerning the post-treaty arrangements for Japanese military security should not be formulated until the peace negotiations are upon us. It should then be formulated in the light of the prevailing international situation and of the degree of internal stability achieved in Japan.

5. *The Ryukyu, Nanpo and Marcus Islands.* The United States intends to retain on a long-term basis the facilities at Okinawa and such other facilities as are deemed by the Joint Chiefs of Staff to be necessary in the Ryukyu Islands south of 29° N., Marcus Island and the Nanpo Shoto south of Sofu Gan. The military bases at or near Okinawa should be developed accordingly. The United States agencies responsible for administering the above-mentioned islands should promptly formulate and carry out a program on a long-term basis for the economic and social well-being and, to the extent practicable, for the eventual reduction to a minimum of the deficit in the economy of the natives. At the proper time, international sanction should be obtained by the means then most feasible for United States long-term strategic control of the Ryukyu Islands south of latitude 29° N., Marcus Island and the Nanpo Shoto south of Sofu Gan.

[13] Adopted at the NSC's 23rd. Meeting, May 6th., as a revision of NSC 13/2, Oct., 7th., 1948.

The United States has determined that it is now in the United States national interest to alleviate the burden now borne by those of the Ryukyu Islands south of latitude 29° N. incident to their contribution to occupation costs, to the extent necessary to establish political and economic security. While it would not be in the interest of the United States to make a public announcement on this matter, and while it is not believed appropriate to obtain international sanction of this intent at this time, the United States national policy toward the Ryukyu Islands south of latitude 29° N. requires that United States Armed Forces and other Government agencies stationed therein pay their way to the extent necessary and practical to carry out the above-mentioned program for the economic and social well-being and towards eventual reduction to a minimum of the deficit in the economy of the natives in this area beginning sixty days after this date, and that these Islands must then no longer be financially dependent upon or obligated to any other occupied area.

6. *Naval Bases.* The United States Navy should shape its policy in the development of the Yokosuka base in such a way as to favor the retention on a commercial basis in the post-treaty period of as many as possible of the facilities it now enjoys there. Meanwhile, it should proceed to develop the possibilities of Okinawa as a naval base, on the assumption that we will remain in control there on a long-term basis. This policy does not preclude the retention of a naval base as such at Yokosuka if, at the time of finalizing the U. S. position concerning the post-treaty arrangements for Japanese military security, the prevailing international situation makes such action desirable and if it is consistent with U. S. political objectives.

7. *The Japanese Police Establishment.* The Japanese Police establishment, including the coastal patrol, should be strengthened by the re-enforcing and re-equipping of the present forces, and by expanding the present centrally directed police organization.

The Regime of Control

8. *Supreme Commander for the Allied Powers.* This Government should not at this time propose or consent to any major change in the regime of control. SCAP should accordingly be formally maintained in all its existing rights and powers. However, responsibility should be placed to a steadily increasing degree in the hands of the Japanese Government. To this end the view of the United States Government should be communicated to SCAP that the scope of its operations should be reduced as rapidly as possible, with a corresponding reduction in personnel, to a point where its mission will consist largely of general supervisory observation of the activities of the Japanese Government and of contact with the latter at high levels on questions of broad governmental policy.

9. *Far Eastern Commission.* The United States Government should ensure for its own part, and urge upon other FEC member Governments, that proposals considered by the FEC be confined strictly to policy matters directly related to the fulfillment by Japan of its obligations under the Terms of Surrender, and be couched in broad terms leaving questions of implementation and administration to SCAP. The position of the United States should further be based upon the fact that these surrender terms, as envisaged by the Potsdam Declaration, have been substantially implemented. On matters still within the purview of the FEC, such as civil aviation policy in Japan, the United States Government should seek to establish as promptly as possible firm United States positions and then adopt an aggressive and positive attitude, by direct discussions with FEC member Governments and by forceful backing in the FEC of policie desired by the United States. In matters of urgency, where it has become evident that, after efforts to achieve maximum international support, agreement cannot be promptly reached, we should not hesitate to use the interim directive. SCAP should also be encouraged to make greater use of his authority as sole executive for the Allied Powers, asking where necessary for the United States Government's views. On the other hand, the United States Government should not hesitate to render assistance to SCAP by elucidating its interpretation of previous directives and general policies, notably those appearing in the "Basic Post-Surrender Policy for Japan".

10. *Allied Council.* The Allied Council should be continued, with its functions unchanged.

Occupational Policy

11. *Relations with the Japanese Government.* (See paragraph 8 above.)

12. *Internal Political and Economic Changes.* Henceforth emphasis should be given to Japanese assimilation of the reform programs. To this end, while SCAP should not stand in the way of reform measures initiated by the Japanese if he finds them consistent with the overall objectives of the occupation, he should be advised not to press upon the Japanese Government any further reform legislation. As for reform measures already taken or in process of preparation by the Japanese authorities, SCAP should be advised to relax pressure steadily but unobtrusively on the Japanese Government in connection with these reforms and should intervene only if the Japanese authorities revoke or compromise the fundamentals of the reforms as they proceed in their own way with the process of implementation and adjustment. If exigencies of the situation permit, SCAP should consult with the U. S. Government before intervention in the event the Japanese should resort to action of such serious import. Definite background guidance embodying the above principles and indicating the United States Government's view as to the nature and extent of the adjustment to be permitted should be provided SCAP in the case of certain reforms.

13. *The Purge.* Since the purpose of the purge has been largely accomplished, the U. S. now should advise SCAP to inform the Japanese Government informally that no further extension of the purge is contemplated and that the purge should be modified along the following lines: (1) Categories of persons who have been purged or who are subject to the purge by virtue of their having held relatively harmless positions should be made re-eligible for governmental, business and public media positions; (2) certain others who have been barred or who are subject to being barred from public life on the basis of positions occupied should be allowed to have their cases re-examined solely on the basis of personal actions; and (3) a minimum age limit should be fixed, under which no screening for public office would be required.

14. *Occupation Costs.* The occupational costs borne by the Japanese Government should continue to be reduced to the maximum extent consonant with the policy objectives of the pre-treaty period as envisaged in this paper.

15. *Economic Recovery.* Second only to U. S. security interests, economic recovery should be made the primary objective of United States policy in Japan for the coming period. It should be sought through a combination of United States aid program envisaging shipments and/or credits on a declining scale over a number of years, and by a vigorous and concerted effort by all interested agencies and departments of the United States Government to cut away existing obstacles to the revival of Japanese foreign trade, with provision for Japanese merchant shipping, and to facilitate restoration and development of Japan's exports. In developing Japan's internal and external trade and industry, private enterprise should be encouraged. Recommendations concerning the implementation of the above points, formulated in the light of Japan's economic relationship with other Far Eastern countries, should be worked out between the State and Army Departments after consultation with the other interested departments and agencies of the Government. We should make it clear to the Japanese Government that the success of the recovery program will in large part depend on Japanese efforts to raise production and to maintain high export levels through hard work, a minimum of work-stoppages, internal austerity measures and the stern combatting of inflationary trends including efforts to achieve a balanced internal budget as rapidly as possible.

16. *Property Matters.* SCAP should be advised to expedite the restoration or final disposal of property of United Nations members and their nationals in such a way that the process will be substantially completed by July 1, 1949. It should be the objective of United States policy to have all property matters straightened out as soon as possible and certainly well in advance of a treaty of peace in order that they may not hamper treaty negotiations.

17. *Information and Education.*

a. Censorship. Censorship of literary materials entering Japan should be conducted with the minimum of delay and pre-censorship of the Japanese press should cease. This should not operate, however, to prevent SCAP from exercising a broad post-censorship supervision and from engaging in counter-intelligence spot-checking of the mails.

b. Radio. The United States Government should immediately undertake a regular program of medium- and long-wave broadcasts to Japan from a suitably located transmitter station possibly on Okinawa. These programs should be carefully prepared with a view to developing an understanding and appreciation of American ideas and at the same time to maintaining as wide a Japanese radio audience as possible.

c. Interchange of Persons. The interchange between Japan and the United States of scholars, teachers, lecturers, scientists and technicians should be strongly encouraged. SCAP should continue the policy of permitting approved Japanese to go abroad for cultural as well as economic purposes.

18. *War Crime Trials.* The trial of Class A suspects is completed and decision of the

court is awaited. We should continue and push to an early conclusion the screening of all "B" and "C" suspects with a view to releasing those whose cases we do not intend to prosecute. Trials of the others should be instituted and concluded at the earliest possible date.

19. *Control of Japanese Economic War Potential.* Production in, importation into, and use within Japan of goods and economic services for bona fide peaceful purposes should be permitted without limitation, except:

a. Japan's economic war potential should be controlled by restrictions on allowable stockpilling of designated strategic raw materials in Japan.

b. Japan's industrial disarmament should be limited to the prohibition of the manufacture of weapons of war and civil aircraft and the minimum of temporary restrictions on industrial production which can be advocated in the light of commitments already made by the United States regarding the reduction of the industrial war potential.

20. *Japanese Reparations.* It should be the policy of the United States Government that current transfers of reparations under unilateral U. S. directive should be terminated and every effort made to secure acceptance by the other reparations claimant countries of the principle that the reparations question as a whole should be reduced to the status of a dead letter. After advising friendly FEC nations of our intended course and of the considerations underlying our position, the United States should take the following specific actions:

a. Rescind the Advance Transfers Directive of April 4, 1947 (JCS Directive No. 75),* except for allocations already processed under that directive.

b. Withdraw its proposal of November 6, 1947, on reparations shares.

c. Announce to the FEC and publicly that it has no intention of using its unilateral powers to make possible additional industrial reparations removals.

d. Announce to the FEC and publicly its views:

(1) That all industrial facilities, including so-called "primary war facilities", presently designated as available for reparations which can contribute to Japanese recovery should be utilized as necessary, except for scrapping, in Japan's peaceful economy for recovery purposes.

(2) That with regard to "primary war facilities", all of which were some time ago stripped of their special purpose equipment and thus of their "war facilities" characteristics, SCAP, under the authority granted in paragraph 10 of the FEC decision on Reduction of Japanese Industrial War Potential, should as rapidly as practicable require the dismantlement, dispersion or other action for the utilization in Japan's peaceful economy of such of these facilities as are required to meet the needs of the occupation, which needs prominently include economic recovery. Under paragraph 10 SCAP may develop a suitable system for using such facilities, individually or collectively, upon notification and explanation to the Allied Council for Japan. Pursuant to the above-mentioned FEC decision requiring their "impounding", remaining "primary war facilities" should continue to be protected, in the sense of preventing loss or scrapping of individual items. Impounding does not, however, include requirement that the facilities be kept in their present locations or that the Japanese or the occupation authorities devote resources to preserve their value or maintain them in working order.

(3) That there should be no limitation on Japan's production for peaceful purposes or on levels of Japanese productive capacity in industries devoted to peaceful purposes.

e. Submit to the FEC proposals, regardless of likely unfavorable reception, for the rescission or amendment of existing and pending FEC reparations and "levels-of-industry" policy papers so as to bring them in as close conformity as possible with U. S. policy that there should be no further industrial reparations removals from Japan and no limitation on levels of Japanese peaceful productive capacity; and prevent action by the FEC contrary to U. S. policy.

[SOURCE: *FRUS*, 1949, VOL. VII, PART 2]

* *Foreign Relations*, 1947, vol. VI, p. 376.

3-24 UNITED STATES POLICY TOWARD ASIA

Memorandum[14] June 10, 1949
To: S. W. Souers, Exec. Sec., NSC.
From: Louis Johnson (Secretary of Defense)

1. I am becoming increasingly concerned at the course of events in Asia. The advance of communism in large areas of the world and particularly the successes of communism in China seriously affect the future security of the United States. I am aware that this critical situation is being watched closely in the several departments of the government, and I appreciate that the current problems are being handled as realistically as circumstances permit. It occurs to me, however, that this day-to-day, country-by-country approach may not develop a broad program in our best long-range interests.

2. A major objective of United States policy, as I understand it, is to contain communism in order to reduce its threat to our security. Our actions in Asia should be part of a carefully considered and comprehensive plan to further that objective. I therefore request that the staff of the National Secutiry Council undertake as soon as practicable a study of the current situation in Asia to re-examine and correlate current policies and to appraise the commitments and risks involved in the various courses of action—political, economic and military—which might be undertaken in support of the broad objective and recommend for the consideration of the National Security Council an appropriate plan of action outlining specific objectives to be achieved.

[SOURCE: *United States-Vietnam Relations*, 1945-1967, Book 8, Department of Defense]

3-25 POSITION OF THE UNITED STATES WITH RESPECT TO ASIA (NSC 48/2)

Policy Statement: NSC-48/2[15] December 30, 1949
Drafted by: NSC
To: The President
Top Secret

CONCLUSIONS

1. Our basic security objectives with respect to Asia* are:

a. Development of the nations and peoples of Asia on a stable and self-sustaining basis in conformity with the purposes and principles of the United Nations Charter.

b. Development of sufficient military power in selected non-Communist nations of Asia to maintain internal security and to prevent further encroachment by communism.

c. Gradual reduction and eventual elimination of the preponderant power and influence of the USSR in Asia to such a degree that the Soviet Union will not be capable of threatening from that area the security of the United States or its friends and that the Soviet Union would encounter serious obstacles should it attempt to threaten the peace, national independence and stability of the Asiatic nations.

d. Prevention of power relationships in Asia which would enable any other nation or alliance to threaten the security of the United States from that area, or the peace, national independence and stability of the Asiatic nations.

2. In pursuit of these objectives, the United States should act to:

a. Support non-Communist forces in taking the initiative in Asia;

b. Exert an influence to advance its own national interests; and

c. Initiate action in such a manner as will appeal to the Asiatic nations as being compatible with their national interests and worthy of their support.

3. As the basis for realization of its objectives, the United States should pursue a policy toward Asia containing the following components:

[14] Cf: NSC 48/2, December 30, 1949, which is included in this Volume.

[15] Cf: NSC 48/1, which is not included in this volume, in *United States-Vietnam Relations*, Book 8, pp. 225-64. Also NSC 48/4, May 17, 1951, which is included in this volume.

* For the purposes of this report "Asia" is defined as that part of the continent of Asia south of the USSR and east of Iran together with the major off-shore islands—Japan, Formosa, the Philippines, Indonesia and Ceylon.

a. The United States should make known its sympathy with the efforts of Asian leaders to form regional associations of non-Communist states of the various Asian areas, and if in due course associations eventuate, the United States should be prepared, if invited, to assist such associations to fulfill their purposes under conditions which would be to our interest. The following principles should guide our actions in this respect:

(1) Any association formed must be the result of a genuine desire on the part of the participating nations to cooperate for mutual benefit in solving the political, economic, social and cultural problems of the area.

(2) The United States must not take such an active part in the early stages of the formation of such an association that it will be subject to the charge of using the Asiatic nations to further United States ambitions.

(3) The association, if it is to be a constructive force, must operate on the basis of mutual aid and self-help in all fields so that a true partnership may exist based on equal rights and equal obligations.

(4) United States participation in any stage of the development of such an association should be with a view to accomplishing our basic objectives in Asia and to assuring that any association formed will be in accord with Chapter VIII of the Charter of the United Nations dealing with regional arrangements.

b. The United States should act to develop and strengthen the security of the area from Communist external aggression or internal subversion. These steps should take into account any benefits to the security of Asia which may flow from the development of one or more regional groupings. The United States on its own initiative should now:

(1) Improve the United States position with respect to Japan, the Ryukyus and the Philippines.

(2) Scrutinize closely the development of threats from Communist aggression, direct or indirect, and be prepared to help within our means to meet such threats by providing political, economic, and military assistance and advice where clearly needed to supplement the resistance of the other governments in and out of the area which are more directly concerned.

(3) Develop cooperative measures through multilateral or bilateral arrangements to combat Communist internal subversion.

(4) Appraise the desirability and the means of developing in Asia some form of collective security arrangements, bearing in mind the following considerations:

(a) The reluctance of India at this time to join in any anti-Communist security pact and the influence this will have among the other nations of Asia.

(b) The necessity of assuming that any collective security arrangements which might be developed be based on the principle of mutual aid and on a demonstrated desire and ability to share in the burden by all the participating states.

(c) The necessity of assuring that any such security arrangements would be consonant with the purposes of any regional association which may be formed in accordance with paragraph 3-a above.

(d) The necessity of assuring that any such security arrangement would be in conformity with the provisions of Article 51 of the Charter relating to individual and collective self-defense.

c. The United States should encourage the creation of an atmosphere favorable to economic recovery and development in non-Communist Asia, and to the revival of trade along multilateral, non-discriminatory lines. The economic policies of the United States should be adapted to promote, where possible, economic conditions that will contribute to political stability in friendly countries of Asia, but the United States should carefully avoid assuming responsibility for the economic welfare and development of that continent. Such policies might be projected along the following lines:

(1) Vigorous prosecution of the Point IV program in friendly countries of Asia, in an endeavor to assist them, by providing technical assistance, to make a start toward the solution of some of their long-range economic problems.

(2) Maintenance of a liberal United States trade policy with Asia and stimulation of imports from Asia. The special problems concerning trade with China are treated in paragraph 3-f-(4) below.

(3) Execution of a stockpiling program for strategic materials, based upon United States needs for strategic reserves and upon immediate and long-range economic effects in the supplying countries.

(4) Negotiation of treaties of friendship, commerce and navigation with non-Communist countries of Asia to define and establish conditions facilitating capital movements, trade and other economic relations between them and the United States.

(5) Encouragement of private United States investment in non-Communist countries and support of the early extension of credits by the International Bank and the Export-Import Bank for specific key economic projects of a self-liquidating nature, especially those directed towards increasing production of food in this area.

(6) Efforts to obtain the adherence of Asiatic countries to the principles of multilateral, non-discriminatory trade as embodied in the General Agreements on Tariffs and Trade, as a means of reducing trade barriers and expanding the international and intra-regional trade of the region on an economic basis. This would include, for example, further efforts to secure the benefits of most-favored-nation treatment for Japan.

d. The question of a peace settlement with Japan, now receiving separate consideration, will be presented for the consideration of the National Security Council at a later date and policies with respect to Japan will be re-evaluated after the decision regarding a peace treaty has been made.

e. (1) The United States should continue to provide for the extension of political support and economic, technical, military and other assistance to the democratically-elected Government of the Republic of Korea.*

(2) The United States should therefore press forward with the implementation of the ECA, MDAP, USIE and related programs for Korea, and should continue to accord political support to the Republic of Korea, both within and without the framework of the United Nations.

f. (1) The United States should continue to recognize the National Government of China until the situation is further clarified.** The United States should avoid recognizing the Chinese Communist regime until it is clearly in the United States interest to do so. The United States should continue to express to friendly governments its own views concerning the dangers of hasty recognition of the Chinese Communist regime but should not take a stand which would engage the prestige of the United States in an attempt to prevent such recognition. In general, however, it should be realized that it would be inappropriate for the United States to adopt a posture more hostile or policies more harsh towards a Communist China than towards the USSR itself. It should also be realized that the according of recognition by other friendly countries would affect the bargaining position of the United States in the absence of United States recognition and would affect United States private and national interests in China. In the event that recognition of the Chinese Communists is anticipated, appropriate steps should be taken to make it clear that recognition should not be construed as approval of the Chinese Communist regime, or abatement of our hostility to Soviet efforts to exercise control in China.

(2) The United States should continue the policies of avoiding military and political support of any non-Communist elements in China unless such elements are willing actively to resist Communism with or without United States aid and unless such support would mean reasonable resistance to the Communists and contribute to the over-all national interests of the United States.** In determining whether or in what manner any such assistance or encouragement should be given, consideration would have to be given to the protection which Chinese Communist authorities, as they become generally recognized by other governments, would be able to claim under international law and the Charter of the United Nations. The United States should maintain so far as feasible active contact with all elements in China and maintain our cultural and informational program at the most active feasible level.

(3) The United States should exploit, through appropriate political, psychological and economic means, any rifts between the Chinese Communists and the USSR and between the Stalinists and other elements in China, while scrupulously avoiding the appearance of intervention. Where appropriate, covert as well as overt means should be utilized to achieve these objectives.**

(4) The United States should, as a security measure, seek to prevent the USSR, its European satellites, and North Korea from obtaining from abroad through China supplies of strategic materials and equipment which are currently denied them by the United States and its European allies through direct channels. The United States should also use every

* NSC 8/2, approved March 23, 1949.
** NSC 34/2.

effort to prevent the Chinese Communists from obtaining from non-Soviet sources supplies of materials and equipment of direct military utility (1A items). The United States should, on the other hand, permit exports to China of 1B items within quantitative limits of normal civilian use and under controls which can be applied restrictively if it becomes necessary to do so in the national interest, and should place no obstacle in the way of trade with China in non-strategic commodities. The United States should seek the support and concurrence of its principal European allies in these policies. The United States should not extend governmental economic assistance to Communist China or encourage private investment in Communist China.

g. (1) The United States should continue the policy set forth in NSC 37/2 and 37/5 of attempting to deny Formosa and the Pescadores to the Chinese Communists through diplomatic and economic means within the limitations imposed by the fact that successful achievement of this objective will primarily depend on prompt initiation and faithful implementation of essential measures of self-help by the non-Communist administration of the islands, and by the fact that freedom of U. S. diplomatic and economic action will be influenced, necessarily, by action taken by other countries.

(2) Since the United States may not be able to achieve its objectives through political and economic means, and in view of the opinion of the Joint Chiefs of Staff (reaffirmed in NSC 37/7 of August 22, 1949) that, while Formosa is strategically important to the United States, "the strategic importance of Formosa does not justify overt military action....so long as the present disparity between our military strength and our global obligations exists", the United States should make every effort to strengthen the over-all U. S. position with respect to the Philippines, the Ryukyus, and Japan. The United States should, for example, proceed apace with implementation of the policy set forth in regard to the Ryukyus in paragraph 5 of NSC 13/3.

h. The United States should continue to use its influence in Asia toward resolving the colonial-nationalist conflict in such a way as to satisfy the fundamental demands of the nationalist movement while at the same time minimizing the strain on the colonial powers who are our Western allies. Particular attention should be given to the problem of French Indo-China and action should be taken to bring home to the French the urgency of removing the barriers to the obtaining by Bao Dai or other non-Communist nationalist leaders of the support of a substantial proportion of the Vietnamese. With the successful conclusion of the Round Table Conference at The Hague the United States should give immediate consideration to the problems confronting the new Republic of United Indonesia and how best it can be aided in maintaining its freedom in the face of internal and external Communist pressures.

i. Active consideration should be given to means by which all members of the British Commonwealth may be induced to play a more active role in collaboration with the United States in Asia. Similar collaboration should be obtained to the extent possible from other non-Communist nations having interests in Asia.

j. Recognizing that the non-Communist governments of South Asia already constitute a bulwark against Communist expansion in Asia, the United States should exploit every opportunity to increase the present Western orientation of the area and to assist, within our capabilities, its governments in their efforts to meet the minimum aspirations of their people and to maintain internal security.

k. The United States should undertake an information program, both foreign and domestic, and publish United States policies and programs vis-a-vis Asia designed to gain maximum support both at home and abroad.

l. Nothing in this paper shall be construed as amending approved NSC papers unless a specific statement to that effect has been made on each point.

m. The sum of $ 75,000,000 for assistance to the general area of China, which was made available under Section 303 of the Mutual Defense Assistance Act of 1949, should be programmed as a matter of urgency.

[SOURCE: *United States-Vietnam Relations*, 1945-1967, Book 8, Department of Defense]

3-26 UNITED STATES OBJECTIVES, POLICIES AND COURSES OF ACTION IN ASIA (NSC 48/4)

Policy Statement, NSC-48/4[16] May 17, 1951
Drafted by: NSC

The President has this date approved the statement of policy contained in NSC 48/4 as amended and adopted at the 91st meeting of the National Scurity Council (NSC Action No. 471), and directs its implementation by all appropriate executive departments and agencies of the United States Government under the coordination of the Secretaries of State and Defense.

The approved statement of policy is accordingly circulated herewith for information and appropriate action. Also enclosed for information is the NSC staff study on the subject contained in the Annex to NSC 48/3, appropriately revised.

The President has also approved the Council's recommendation in NSC Action No. 471-c. Accordingly, the statements of policy contained in NSC 48/2, the NSC 13 Series, the NSC 22 Series, the NSC 34 Series, the NSC 37 Series and the NSC 81 Series are superseded herewith; further action on the NSC 101 Series is canceled, but NSC 60/1 is not superseded.

JAMES S. LAY, JR.

[Annex 1]

STATEMENT OF POLICY ON ASIA

GENERAL CONSIDERATIONS

1. United States objectives, policies, and courses of action in Asia should be designed to contribute toward the global objective of strengthening the free world vis-á-vis the Soviet orbit, and should be determined with due regard to the relation of United States capabilities and commitments throughout the world. However, in view of the communist resort to armed force in Asia, United States action in that area must be based on the recognition that the most immediate overt threats to United States security are currently presented in that area.

2. Current Soviet tactics appear to concentrate on bringing the mainland of Eastern Asia and eventually Japan and the other principal off-shore islands in the Western Pacific under Soviet control, primarily through Soviet exploitation of the resources of communist China. The attainment of this objective on the mainland of Eastern Asia would substantially enhance the global position of the USSR at the expense of the United States, by securing the eastern flank of the USSR and permitting the USSR to concentrate its offensive power in other areas, particularly in Europe. Soviet control of the off-shore islands in the Western Pacific, including Japan, would present an unacceptable threat to the security of the United States.

3. The United States should, without sacrificing vital security interests, seek to avoid precipitating a general war with the USSR, particularly during the current build-up of the military and supporting strength of the United States and its allies to a level of military readiness adequate to support United States foreign policy, to deter further Soviet aggression, and to form the basis for fighting a global war should this prove unavoidable. This should not preclude undertaking calculated risks in specific areas in the over-all interest of the defense of the United States.

4. The United States should seek the firm establishment and effective application of the principle of collective security and should, except in those instances when on balance the need for unilateral action outweighs other considerations, act in and through the United Nations, preserve solidarity with its principal allies, and maintain the continued cooperation of other friendly nations.

LONG-RANGE OGJECTIVES

5. The long-range national security objectives of the United States with respect to Asia are:

a. Development by the nations and peoples of Asia, through self-help and mutual

[16] Approved by U. S. President. Cf: NSC 48 series, NSC Action No. 471, NSC 13, 22, 34, 37, 81, 101 series.

aid, of stable and self-sustaining non-communist governments, friendly to the United States, acting in accordance with the purposes and principles of the United Nations Charter, and having the will and ability to maintain internal security, withstand communist influence, and prevent aggression.

b. Elimination of the preponderant power and influence of the USSR in Asia or its reduction to such a degree that the Soviet Union will not be capable of threatening from that area the security of the United States or its friends, or the peace, national independence and stability of the Asiatic nations.

c. Development of power relationships in Asia which will make it impossible for any nation or alliance to threaten the security of the United States from that area.

d. Insofar as practicable, securing for the United States and the rest of the free world, and denying to the communist world, the availability through mutually advantageous arrangements, of the material resources of the Asian area.

CURRENT OBJECTIVES

6. In view of the threat to United States security interests resulting from communist aggression in Asia, it should be the policy of the United States to:

a. Detach China as an effective ally of the USSR and support the development of an independent China which has renounced aggression.

b. Maintain the security of the off-shore defense line: Japan-Ryukyus-Philippines-Australia and New Zealand. Deny Formosa to any Chinese regime aligned with or dominated by the USSR and expedite the strengthening of the defensive capabilities of Formosa. Attempt by all practicable means to forestall communist aggression in South and Southeast Asia.

c. Assist Japan to become a self-reliant nation friendly to the United States, capable of maintaining internal security and defense against external aggression and contributing to the security and stability of the Far East.

d. Promote the development of effective security and economic relationships among the free nations of Asia and the Pacific area, including the United States, on the basis of self-help and mutual aid, with appropriate United States assistance.

e. Continue as an ultimate objective to seek by political, as distinguished from military means, a solution of the Korean problem which would provide for a united, independent and democratic Korea. Seek, through appropriate UN machinery, as a current objective a settlement acceptable to the United States, of the Korean conflict which would, as a minimum (1) terminate hostilities under appropriate armistice arrangements; (2) establish the authority of the Republic of Korea over all Korea south of a northern boundary so located as to facilitate, to the maximum extent possible, both administration and military defense, and in no case south of the 38th Parallel, (3) provide for the withdrawal by appropriate stages of non-Korean armed forces from Korea; (4) permit the building of sufficient ROK miltary power to deter or repel a renewed North Korean aggression. Until the above current objective is attainable, continue to oppose and penalize the aggressor.

f. Consistent with *e* above and the protection of the security of U. S. and UN forces, seek to avoid the extension of hostilities in Korea into a general war with the Soviet Union, and seek to avoid the extension beyond Korea of hostilities with Communist China, particularly without the support of our major allies.

g. Assist the countries of South and Southeast Asia to develop the will and ability to resist communism from within and without, and to contribute to the strengthening of the free world.

h. In accordance with 5-*d* above, take such current and continuing action as may be practicable to maximize the availability, through mutually advantageous arrangements, of the material resources of the Asian area to the United States and the free world generally, and thereby correspondingly deny these resources to the communist world.

7. In accordance with the above, the United States should pursue in the respective areas of Asia the courses of action set forth in the following paragraphs.

8. While continuing to recognize the National Government as the legal government of China, the United States, with respect to Comminist China, should now:

a. Continue strong efforts to deflate Chinese Communist political and military strength and prestige by inflicting heavy losses on Chinese forces in Korea through the present UN operation.

b. Expand and intensify, by all available means, efforts to develop non-communist leadership and to influence the leaders and people in China to oppose the present Peiping regime and to seek its reorientation or replacement.

c. Foster and support anti-communist Chinese elements both outside and within China with a view to developing and expanding resistance in China to the Peiping regime's control, particularly in South China.

d. Stimulate differences between the Peiping and Moscow regimes and create cleavages within the Peiping regime itself by every practicable means.

e. Continue United States economic restrictions against China, continue to oppose seating Communist China in the UN, intensify efforts to persuade other nations to adopt similar positions, and foster the imposition of United Nations political and economic sanctions as related to developments in Korea.

f. In order to be prepared for Chinese aggression outside Korea, to protect the security of UN and U. S. forces, and to provide for appropriate military action in the event that UN forces are forced to evacuate Korea, expedite the development of plans for the following courses of action, if such action should later be deemed necessary:

(1) Imposing a blockade of the China coast by naval and air forces.

(2) Military action against selected targets held by Communist China outside of Korea.

(3) Participation defensively or offensively of the Chinese Nationalist forces, and the necessary operational assistance to make them effective.

g. Continue as a matter of urgency to influence our allies to stand with us and fully support the taking of such actions as those indicated in *f* above if military operations outside Korea should be required.

9. With respect to the situation in Korea, the United States should:

a. Seek an acceptable political settlement in Korea that does not jeopardize the United States position with respect to the USSR, to Formosa, or to seating Communist China in the UN.

b. In the absence of such a settlement, and recognizing that currently there is no other acceptable alternative, continue the current military course of action in Korea, without commitment to unify Korea by military force, but designed to:

(1) Inflict maximum losses on the enemy.

(2) Prevent the overrunning of South Korea by military aggression.

(3) Limit communist capabilities for aggression elsewhere in Asia.

c. Continue its efforts to influence our allies to increase their support of and contribution to the UN operations in Korea.

d. Develop dependable South Korean military units as rapidily as possible and in sufficient strength eventually to assume the major part of the burden of the UN forces there.

e. If the USSR commits units of Soviet "volunteers" sufficient to jeopardize the safety of UN forces in Korea, give immediate consideration to withdrawing UN forces from Korea and placing the United States in the best possible position of readiness for general war.

f. If the USSR precipitates a general war, withdraw UN forces from Korea as rapidly as possible and deploy United States forces for service elsewhere.

g. Working in and through the organs of the United Nations where feasible, continue to strengthen the government and democratic institutions of the Republic of Korea, and continue to contribute to the United Nations efforts for economic recovery and rehabilitation in the Republic of Korea and in areas of Korea liberated from communist control.

10. With respect to Japan the United States should:

a. Proceed urgently to conclude a peace settlement with Japan on the basis of the position already determined by the President, through urgent efforts to obtain agreement to this position by as many nations which participated in the war with Japan as possible.

b. Proceed urgently with the negotiation of bilateral security arrangements with Japan on the basis of the position determined by the President to be concluded simultaneously with a peace treaty.

c. Assist Japan to become economically self-supporting and to produce goods and services important to the United States and to the economic stability of the non-communist area of Asia.

d. Pending the conclusion of a peace settlement continue to:

(1) Take such steps as will facilitate transition from occupation status to restoration of sovereignty.

(2) Assist Japan in organizing, training, and equipping the National Police

Reserve and the Maritime Safety Patrol in order to facilitate the formation of an effective military establishment.

e. Following the conclusion of a peace settlement:

(1) Assist Japan in the development of appropriate military forces.

(2) Assist Japan in the production of low-cost military materiel in volume for use in Japan and in other non-communist countries of Asia.

(3) Take all practicable steps to achieve Japanese membership in the United Nations and participation in a regional security arrangement.

(4) Establish appropriate pscyhological programs designed to further orient the Japanese toward the free world and away from communism.

11. With respect to Formosa the United States should:

a. Continue, as long as required by United States security interests, the mission presently assigned to the 7th Fleet.

b. Encourage political changes in the Nationalist regime which would increase its prestige and influence in China proper.

c. Provide military and economic assistance to increase the potential of the Chinese forces on Formosa for the defense of Formosa and for such other uses as may be determined as a result of the planning pursuant to 8-*f* above.

12. The United States should continue the policy with respect to the Philippines set forth in NSC 84/2.

13. The United States should continue the policy with respect to South Asia set forth in NSC 98/1.

14. With respect to Southeast Asia, the United States should:

a. Continue its present support programs to strengthen the will and ability to resist communist encroachment, to render communist military operations as costly as possible, and thus to gain time for the United States and its allies to build up the defense of the off-shore chain.

b. Continue programs of information and educational exchange in the countries of Southeast Asia.

c. Encourage the countries of Southeast Asia to restore and expand their commerce with each other and the rest of the free world stimulate the flow of the raw material resources of the area to the free world, and assist in establishing small arms production in appropriate locations in Southeast Asia under suitable controls.

d. In Indochina:

(1) Continue to increase the military effectiveness of French units and the size and equipment of indigenous units by providing timely and suitable military assistance without relieving the French authorities of their basic military responsibilities or committing United States armed forces.

(2) Continue to encourage internal autonomy and progressive social and economic reforms.

(3) Continue to promote international support for the three Associated States.

e. In Indonesia, the United States should seek to strengthen the non-communist political orientation of the government, promote the economic development of Indonesia, and influence Indonesia toward greater participation in measures which support the security of the area and Indonesian solidarity with the free world.

15. With respect to regional security arrangements, the United States should:

a. Conclude the post-treaty security arrangements with Japan as provided for in 10-*b* above.

b. Maintain the security relationships with the Philippines as provided for in 12 above.

c. Conclude a security arrangement with Australia and New Zealand.

d. Consider the desirability of security arrangements with other countries of Asia, either on a bilateral or multilateral basis.

e. Encourage and support closer economic and political cooperation with and among the countries of Asia in keeping with the objective stated in 6-*d* above.

[SOURCE: *United States-Vietnam Relations*, 1945-1967, Book 8, Department of Defense pp. 425-45]

3-27 DESIRED REPEAL OF REVISION OF OCCUPATION LAWS AND ORDINANCES

Letter April 9, 1951
To: MacArthur
From: Premier Shigeru Yoshida

My dear General,

Now that Japan is reasonably assured of a peace settlement in the near future, thanks to your vigorous support and untiring effort, the Japanese government deems it opportune to seek your advice concerning the problem of repealing or revising certain laws and ordinances promulgated during these past years of Allied occupation, as enumerated and explained on the attached sheets.

Of course, my government has no intention to alter the fundamentals of democratic government. The proposed measures are calculated rather to secure democracy more firmly by adapting the existing legislation to the actual conditions of the country.

It is strongly desired for the sake of Japanese-American friendship that the repeal and revisions will be effected prior to the termination of the Occupation.

Yours sincerely,
Shigeru Yoshida

LAWS AND ORDINANCES PROMULGATED UNDER OCCUPATION OF WHICH REPEAL OR REVISION IS DESIRED.

I. LAWS

Enumerated below are the principal laws, ordinances and orders, which in the light of the opinions expressed from various circles as well as actual experience in their enforcement, are considered as requiring revision. The purpose of the proposed revisions is to adapt our national legislation to the current realities of the country without deviating from the spirit of the Constitution and at the same time to promote the economic self-support of Japanese economy.

A. The National Public Service System

The National Public Service Law.

This law in its operation has revealed several points not only unsuited to the existing conditions of the country but also detrimental to the enhancement of efficiency. It is desired:

(a) To put in the Special Positions category such part-time officials as commissioners and advisers and also to render the personnel administration regulations more elastic with respect to high rank officials such as vice ministers of various ministers.

(b) To simplify the structure of the National Personnel Authority and to make it an organ of the Cabinet with its functions limited to giving advices and recommendations and to supervision and readjustment.

(c) To curtail the scope of the matters delegated to the Authority under the present law.

(d) To extend the scope of appointment by reelection, to introduce the efficiency basis to a degree into the pay system, and to give more elasticity to the Position Classification System.

B. The Local Self-Government System

The Local Autonomy Law.

Because of the emphasis placed on the importance of local autonomy, a considerable number of affairs which intrinsically belong to the State have been delegated to local public entities. Under the existing system the Cabinet's position is too weak without adequate authority for unified execution of these affairs. It is desired to render more effective the Cabinet's directive authority over local public entities with respect to these State affairs.

C. *The Family System*

The Civil Code

The present Civil Code lays too great an emphasis on marriage—or the husband-and-wife relationship—as the central factor of family life. This has produced a mistaken notion that it is proper to disdain or reject the old virtues of filial piety, deference to elders and kindness to the young, which had characterized the social and spiritual life of Japanese

people. They are fast losing the sense of family honor and dignity and veneration for ancestors.

The need is felt with special urgency today to preserve and foster the institution of family built on the traditions of ages, while seeking to harmonize it with the basic Constitutional principles of individual dignity and equality. It is desired:

(a) To recognize legally the head of a household as the center of family life with authority necessary for ensuring unity and harmony.

(b) To let the kinsmen's council solve family disputes, instead of leaving the settlement of such disputes solely to family courts as under the existing system.

(c) To make special provisions in the Property Succession Law for the person who succeeds to the family genealogical records and tombs and conducts memorial rites for ancestors, and must shoulder the financial burden thereof.

(d) To ensure the preservation of small farms and business enterprises by providing against the dispersion of their meager assets through succession by equal division.

D. *The Police System*

The Police Law

The existing police system is defective in more than one way for the preservation of law and order. For rectification it is considered necessary:

(a) To effect readjustment in the system for mutual assistance between the National Rural Police and the Autonomous Police.

(b) To bring about closer relationships among the Public Safety Commission, the Cabinet and the heads of local public entities.

(c) To create a Capital Police system under State control; and to raise the population limit for cities, towns and villages required to maintain an autonomous police force.

E. *The Educational System*

1. The Board Education Law

(a) The present system under which a Board of Education is made an independent body while other similar organs are subject to the authority of governor or mayor, does not operate satisfactorily. It would seem advisable to make the Board of Education an advisory organ to the head of local public entity.

(b) In order to simplify the country's educational administration, it is desired to repeal the existing provision requiring every city, town and village to set up a Board of Education and to limit such requirement to prefectures (To, Do, Fu and Ken).

2. The School Education Law and Related Laws and Orders.

It is desired to re-examine the 6-3-3-4 System and the respective curricula with a view to adapting them to the actual conditions of the country.

F. *Economic Laws*

1. The Law relating to Prohibition of Private Monopoly and Preservation of Fair Trade.

In view of the backwardness of Japanese economy and the scarcity of accumulated capital and of the country's need to achieve a self-supporting economy, it would be desirable to relax certain of the provisions of this anti-monopoly legislation.

2. The Enterprise Organization Law

To be relaxed for the same reasons as above.

G. *The Legal Procedure*

The Code of Criminal Procedure

Experience in the enforcement of this code has shown the need of substantial relaxation with respect to several points including the provisions such as those relating to the requirement to inform the suspect of the charges against him upon his detention for prosecution; the collection of evidence; the right to parole, and the right of the suspect or defendant not to testify against himself.

H. *Labor Laws*

1. The Labor Standards Law

This law and especially its Rules of Procedure are unadapted to the realities of Japan's labor situation, so that violators are inevitable, inviting distruct of all laws, and sowing the seeds of unwarranted labor disputes. It is deemed imperative to relax the restrictions on female, young, and outdoor workers, to expand the scope of exemptions from the Safety and Sanitation Standards, and to relax their application to small enterprises.

2. The Mariners Law

For the same reasons as stated above, this law requires modifications. It is especially necessary to incorporate special provisions relating to fishing boats and other small craft.

II. Potsdam Ordinances

It is desired to preserve permanently the Potsdam Ordinances listed below by enacting them into national laws with slight adjustments in certain cases. All the others are slated for repeal, excepting those of which retention may be required under the peace treaty.

1. Price Control Ordinance
2. Land and House Rent Control Ordinance
3. National Police Reserve Order
4. Poisonous Comestibles, etc. Control Ordinance
5. Organization Control Ordinance (including the Cabinet Order concerning Administration and Disposal of dissolved organizations)
6. Cabinet Order concerning the Maintenance of Order among Repatriates.
7. Order re Internal Air Transportation
8. Cabinet Order concerning the transfer of Land under the Owner-Farmer Establishment Special Measures Law and the Agricultural Land Readjustment Law.
9. Cabinet Order concerning Acquisition of Properties by Foreign Nationals.
10. Cabinet Order concerning Business Activities of Foreign Nationals.
11. Cabinet Order concerning Acquisition of Real Property and/or Rights thereto by Foreign Governments.
12. Cabinet Order concerning Immigration Surveillance.
13. Alliens Registration Ordinance
14. Immigration Agency Establishment Order
15. Repatriation Relief Agency Establishment Order
16. (Imperial) Ordinance Prohibiting the Possession of Fire Arms and Other Weapons.

III. Revision of the Administrative Structure

1. Concerning the National Administrative Organization Law and the Laws for the establishment of various Ministries and Agencies, it is considered in the light of experience that they will require rather extensive changes inasmuch as not only do they contain features unadapted to the actual conditions of the country but also they tend to be too complex and unwieldy for efficient operation.

A. Simplification of the Central Government Machinery

The Postal Services Ministry and the Tele-Communications Ministry to be amalgated into a single ministry.

The Attorney General's Office to be organized similar to other ministries.

The external organs of various ministries, such as the Tax Administration Agency, Smaller Enterprises Agency, Economic Research Agency, Agency of Industrial Science and Technology, Reparations Agency, and National Fire Defence Agency, should either liquidated or simplified as much as possible and made internal organs of the respective ministries.

With the reform of the Public Service System, the National Personnel Authority should be simplified and made an auxiliary organ of the office to the Prime Minister, with its functions confined to giving recommendations and advices and to supervision and readjustments.

B. The System of Independent Commissions

The system of independent commissions conflicts in certain respects with the responsibilities of the Cabinet in a parliamentary government established under the Constitution. Accordingly, these commissions should be abolished as far as possible in order to make clear that these responsibilities rest with the Cabinet. For instance, the Foreign Exchange Control Commission, Statistics Commission, Radio Regulatory Commission, Public Utilities Commission, Land Adjustment Commission, National Offenders' Prevention Rehabilitation Commission, Securities and Exchange Commission, Foreign Investment Commission, Local Finance Commission, etc., should be transferred to the respective ministries concerned as their internal organs. The National Public Safety Commission and the Fair Trade Commission require reorganization with a view, the former, to establish close relationship with the Cabinet; and the latter, to confine its function to the role of referee, all the other functions being transferred to the Ministry of International Commerce and Industry.

[Source: Suitland Papers]

3-28 UNITED STATES OBJECTIVES AND COURSES OF ACTION WITH RESPECT TO JAPAN (NSC 125/1)

Report July 18, 1952
To: The National Security Council
By: The Executive Secretary
Top Secret

General Considerations

1. *Estimates*

The United States should proceed in its determination of policy with respect to Japan on the basis of the following estimates:

a. Japan will maintain a close alignment with the United States at least through 1954.

b. Japan's basic national objectives will be to rebuild its national strength and to enhance its position in the Far East. The most probable longterm prospect is that Japan will seek to increase its freedom of action in Asia within the framework of a generally pro-Western orientation.

c. Japan will take all feasible military measures to defend its territory from attack and the United States and Japan will develop combined measures to maintain Japan's security.

2. *United States security interests in the Pacific area*

a. The security of Japan is of such importance to the United States position in the Pacific area that the United States would fight to prevent hostile forces from gaining control of any part of the territory of Japan.

b. It is in the interest of the United States to assist Japan rapidly to develop (1) the means for its own defense, thereby relieving the United States of sole responsibility for Japan's security, and thereafter (2) the capability to contribute to the defense of other free nations of the Pacific area.

c. The United States should encourage and assist Japan to rearm itself with conventional weapons.

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e. For the foreseeable future it will be in the interest of the United States to maintain adequate armed forces in the Pacific area and to encourage appropriate arrangements in the Far East which would strengthen the security of Japan, the Ryukyus, and other areas vital to U.S. defense.

3. *The power position in the Pacific area*

a. The military capability of Soviet and Chinese Communist forces in the Far East presents a major threat to Japan and to the security of the United States in the Pacific area. A sovereign Japan faces a power complex in which the USSR and the United States each possesses military potential far superior to that of Japan. However, it is probable that Japan will in time develop sufficient power to become a major element in Far Eastern affairs.

b. For at least the immediate future Japan will be aligned with the United States and largely dependent upon the United States for security from external attack and for economic stability. It is in the interest of the United States that Japan rapidly develop the capability for self-defense and that, in the face of Soviet and Chinese Communist power in the Far East, Japan's military strength be developed to the extent that it can contribute significantly to the security of the free nations of the Pacific area and of the northern portion of the off-shore island chain.

c. Japan will increasingly seek to achieve an independent role in Far Eastern affairs. Japan's flexibility of maneuver and freedom of choice will increase as Japan develops the capability for self-defense and economic and military self-support. In this situation Japan's policies and actions will be determined on the basis of Japan's conception of self-interest, and this conception may come into conflict with the interests of the United States.

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e. The continuance of Japan's alignment with the United States will depend in large degree upon maintenance by the United States of a strong military posture in the Pacific and the pursuance of policies by the United States and other free nations which encourage the growth in Japan of basic economic strength and the close participation by Japan with the United States in developing satisfactory security relationships among all the non-Communist countries of the Pacific area and satisfactory economic relationships both among them and between them and other parts of the free world.

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4. *The relationship between Japan and the United States*

a. For the time being the security interests of Japan and the United States in the Pacific area are generally parallel. The United States should act in such a way that this mutuality of interest, which is necessary to effective cooperation, is maintained and that Japan is convinced of its reality. The achievement of this result will require, among other things, maintenance of a strong United States power position in the Pacific, respect for Japan's status as a sovereign independent state, and the development and implementation of policies designed to accord Japan opportunities for the satisfaction of legitimate economic needs.

b. It should be the policy of the United States to encourage the development and strengthening by Japan of the principles and practices of representative government. It is in the interest of the United States to avoid actions which would have the effect of undermining the stability and popular position of the responsible pro-Western political forces in Japan. The United States should not interfere in Japanese domestic affairs except to carry out Article I of the United States-Japan Security Treaty.

5. *Japan's Position in the Pacific*

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b. In the long run, Japan's access to raw materials and markets for her exports will significantly affect Japan's basic orientation. At present Japan has a comfortable foreign exchange reserve position and may expect sizeable dollar earnings from military expenditures for at least two years. Over the longer term, however, Japan's position requires that every effort be made to expand Japan's earnings from normal commerce and from programs of U.S. military and economic assistance to other countries, with a view to avoiding, if possible any requirement for direct economic assistance; at the same time should these measures prove inadequate, consideration should also be given to the provision of direct economic assistance when and if necessary.

c. United States policy should aim to encourage Japanese participation in the economic development of the free nations of the Pacific. Satisfactory economic arrangements between Japan and South and Southeast Asia will strengthen these areas against Communist exploitation.

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e. As a long term policy, the United States should encourage and where desirable participate in collective security arrangements in the Pacific area which would include Japan as an important member. Such arrangements would facilitate Japan's contribution to the security and economy of the free nations of the area, would encourage Japan's adherence to the free world, and would tend to allay fears among Pacific nations of a resurgence of Japanese ambition to dominate Asia.

Objectives

6. In accordance with the general considerations above, the United States should seek in Japan the following objectives:

a. Preservation of the security and independence of Japan;

b. A Japan allied to the United States;

c. A prosperous Japanese economy with satisfactory economic relationships, particularly those providing access to sources of food, raw materials and markets, between Japan and other free countries;

d. A politically stable Japan maintaining the principles of representative government;

e. A Japan capable of defense against internal subversion and external aggression;

f. A Japan willing and able to contribute to the security of the Pacific area;

g. The development of Japan's industrial potential as a source of supply for the free world;

h. The inclusion of Japan in arrangements in the Pacific area for purposes of mutual security and economic benefit;

i. The obtaining of Japanese membership in the United Nations.

Courses of Action

7. With respect to Japan, the United States should pursue the following courses of action in lieu of those contained in Paragraph 10 of NSC 48/5:

a. Political

(1) Strive to maintain a political relationship of trust and confidence between

Japan and the United States, observing the principle of consultation between United States and Japanese authorities on matters related to all inter-governmental arrangements and agreements, and avoiding acts which interfere in Japanese domestic affairs, except to carry out Article I of the United States-Japan Security Treaty.

(2) Take such steps as are feasible to achieve membership for Japan in the United Nations and other international organizations.

(3) Negotiate with Japan on behalf of the Unified Command, the establishment of appropriate rights and responsibilities for all United Nations forces engaged in the Korean action when within the national boundaries of Japan.

(4) Encourage Japan and other free countries of the Pacific area to develop relationships which will contribute to their security and the development of their economic ties through such arrangements as may be determined to be consistent with the interest of the United States.

(5) Encourage Japan to preserve and maintain the priciples and practices of representative government.

(6) Encourage and appropriately assist Japan to deal with the internal communist menace in ways believed most effective and desirable and encourage Japan to reach a realistic appraisal of the dangers inherent in "business as usual" relationships with the Soviet Union and Soviet-dominated Communist governments.

(7) Conduct in Japan an information, cultural relations, and other psychological programs designed among other things to create and develop in the Japanese Government and people recognition and understanding of the basic mutual interests of the United States and Japan and one which will combat the misconceptions widely circulated by Soviet propaganda agencies.

(8) In order to strengthen friendly relations between United States personnel in Japan and the Japanese people, maintain procedures for minimizing friction and settling disputes between instrumentalities of the United States and Japanese (particularly in the case of employer-employee relationships) and conduct continuing orientation and information programs among U.S. personnel stationed in Japan.

b. Military

(1) The long-term military requirements of the United States in and about the Ryukyus, Bonins and other islands covered by Article III of the Peace Treaty with Japan, will be sought in accordance with recommendations to the President by the Departments of State and Defense.

(2) Assist Japan to develop military forces which will eventually be capable of assuming responsibility for defense of Japan against external aggression. As a first stage, assist Japan to develop a balanced ten-division ground force and appropriate air and naval arms.

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(4) Until Japanese forces are adequate for the defense of Japan, maintain in and around Japan United States forces in sufficient strength so that, in collaboration with Japanese forces, they can secure Japan against external aggression, and enter into agreement with Japan as soon as possible to establish working arrangements which will permit, in event of hostilities or the imminent threat thereof, the creation of effective combined forces.

(5) Continue to maintain forces in Japan for the support of United Nations operations in Korea, so long as they are required.

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c. Economic

(1) Facilitate the achievement by Japan of an economy which is self-supporting, expanding and capable of maintaining adequate living standards, supporting the defense of Japan, and contributing to the defense of the Pacific area.

(2) Keep Japan's internal and external financial position under constant review in connection with United States security objectives, including in the review the possibility of rendering appropriate economic assistance if necessary.

(3) Encourage the expansion of international trade on a non-discriminatory, multilateral basis between Japan and other free nations, through the general lowering of tariffs and other governmentally imposed trade restrictions in accordance with the principles of GATT. In particular, the entry of Japanese goods into the United States market should be facilitated.

(4) Encourage the reestablishment of mutually beneficial business relationships between United States and Japanese nationals through the development of trade and investment opportunities.

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(6) Seek to prevent Japan from becoming dependent on China and other Communist-dominated areas for essential food and raw material supplies through stimulation of Japan's trade with other free nations and through implementation of programs designed to develop sources of supply for Japan among the free nations.

(7) Encourage Japanese contribution to the economic development of countries of South and Southeast Asia through participation in arrangements, including especially those dealing with trade and investment, formed for the purpose of increasing the economic strength and political stability of the Far East.

(8) Encourage the expansion, rehabilitation and modernization of Japan's industries on a sound economic basis so as to increase Japan's export potential and to improve its competitive position in world markets.

(9) Encourage Japan to maintain a free, competitive economy and to carry on its foreign trade and commerce in conformity and internationally accepted fair trade practices.

(10) Seek adequate financial and material contribution by Japan to mutual security objectives, having due regard for the political sensitivities of the Japanese Government and people and for the essential requirements of the civilian sector of the Japanese economy.

(11) Continue the understanding with the Japanese Government that it will maintain substantially its present export controls as part of its support of United Nations action in Korea, and that those controls will be maintained as long as there is Communist aggression in the Far East and while the United Nations is taking action against such aggression. In any event this understanding should be continued until a multilateral agreement has been reached as provided in paragraph (12) below.

(12) Export controls to be maintained in the post-aggression period should be determined through agreement reached by immediate negotiation among the free nations principally interested in trade with the Far East areas of the Soviet bloc. The United States should, in cooperation with Japan, the UK, France and Canada seek to establish a multilateral organization for consideration of Far Eastern economic defense measures. This organization should be expanded to include other countries having significant interest in the security problems of the Far East.*

[SOURCE: NATIONAL ARCHIVES]

* Defense-DMS-Commerce proposal.

4 NATIONAL SECURITY AND EXTERNAL RELATIONS

4-1 OCCUPATION FORCE IN JAPAN

Summary of Agreement January 30, 1946
Participants: U. S., Australia, Acting on behalf of the U. K., New Zealand, and India.

1. As a result of discussion between members of the British Commonwealth, proposals for a joint British Commonwealth Force to participate in the occupation of Japan were agreed upon and conveyed to the United States Government by the Australian Government, acting on behalf of the British Commonwealth Government concerned.

2. Following recent representations in Washington by the Australian Minister for External Affairs, Dr. H. V. Evatt, the United States Government has now formally accepted the participation of British Commonwealth forces in the occupation of Japan. Arrangements are now well advanced for the force to proceed on the following basis.

3. The force is drawn from the United Kingdom, Australia, New Zealand, and India. The Commander in Chief of the force it Lt. Gen. J. Northcott, C. B., M. V. O., of the Australian Military Forces. His headquarters are fully integrated with representatives drawn from each service and from each Commonwealth country contributing to the force. Air Commodore F. M. Bladin, C. B. E., of the Royal Australian Air Force, has been appointed Chief of Staff to Lieutenant General Northcott.

4. The force comprises:

(a) force and base troops drawn from each of the contributing countries;

(b) a land component, organized as a corps, consisting of one British Indian division and two independent brigade groups—one each from Australia and New Zealand:

(c) an air component comprising sqaudrons drawn from the Royal Air Force, the Royal Australian Air Force, the Royal New Zealand Air Force, and the Royal Indian Air Force.

5. A squadron of the British Pacific fleet, which includes ships of the Royal Navy, the Royal Australian Navy, and the Royal Indian Navy is stationed in Japanese waters under operational control of the admiral commanding the detachment of the United States fleet.

6. The British Indian division is commanded by Maj. Gen. D. T. Cowan, C. B., D. S. O., M. C., Indian Army, and includes the 5th Brigade of the 2nd British Division and the 268th Indian Infantry Brigade. The Australian Infantry Brigade group includes the 34th Australian Infantry Brigade commanded by Brigadier R. H. Mimmo. The Commander of New Zealand Brigade, which is coming from Italy, is Brigadier K. L. Stewart, C. B. E., L. S. O.

7. The Commander of the air component is Air Vice Marshal C. A. Bouchier, C. B., C. B. E., D. F. C., Royal Air Force. His senior air staff officer is Air Commodore I. D. McLaughlan, D. F. C., Royal Australian Air Force. The air component includes the 81st Australian Fighter Wing of three Mustang Fighter Squadrons; numbers 11 and 17 Spitfire Squadrons, and number 96 Medium Transport Squadron, Royal Air Force; number 4 Spitfire Squadron, Royal Indian Air Force; and number 14 Corsair Squadron, Royal New Zealand Air Force.

8. The British Commonwealth Occupation Force (BCOF) will form part of the occupation forces in Japan under the supreme command of General Douglas MacArthur, Supreme Commander for the Allied Powers (SCAP). He has assigned the land component to the general operational control of the Commanding General, 8th United States Army, who is in military control of the whole area of Japan. The air component has been assigned to the general operational control of the Commanding General, Pacific Air Command, United States Army (PAC USA). Lieutenant General Northcott, as Commander in Chief, BCOF, is entirely responsible for the maintenance and administration of the British Commonwealth Occupation Force as a whole. He has direct access to General MacArthur on matters of major policy affecting operational commitments of the force. On policy and administrative matters affecting the force, the Commander in Chief is responsible to the British Commonwealth Governments concerned through a British Commonwealth organization set up in Melbourne and known as the Joint Chiefs of Staff in Australia. Their instructions to the Commander in Chief, BCOF' will be issued by the Australian Chiefs of Staff. The Joint Chiefs of Staff in Australia (JCOSA) comprise the Australian Chiefs of Staff and representatives of Chiefs of Staff in the United Kingdom and New Zealand and of the Commander in Chief in India. This organization is fully associated with Australian Joint Service machinery. The Commander in Chief BCOF has the right of direct communication with the Joint Chiefs of Staff in Australia on administrative matters affecting the force. On matters of governmental concern affecting the policy and operations of BCOF, he will communicate through JCOSA to the Australian Government, which acts as the representative of the other Commonwealth Governments concerned.

9. The BCOF will be initially located in the Hiroshima Prefecture including the cities of Kure and Fukuyama. It will be responsible for the demilitarization and disposal of Japanese installations and armaments. It will exercise military control of the area but will not be responsible for its military government, which remains the responsibility of United States agencies. The BCOF area will not constitute a national zone. The BCOF may be called upon to conduct military operations outside its normally allocated area. When air support for the land component of the BCOF is required, this will be provided primarily by the BCOF air component. Kure will be the base port for BCOF which will be responsible for the working of the entire port. The Kure Naval Yard will remain under United States naval control.

10. Provision is being made for the BCOF to be represented in the Tokyo Prefecture by a detachment which probably will be of battalion strength. This detachment will be drawn in turn from each national component in the force.

11. The British Commonwealth Occupation Force may be withdrawn wholly or in part by agreement between the United States Government and the Commonwealth Governments concerned or upon six months notice by either party. It has been agreed also that progressive reduction in the strength of the force will be made from time to time in conformity with progressive reductions which may be made in the strength of United States occupation forces in Japan.

12. The Australian Services Mission, hitherto located in Tokyo, has been transformed into an advanced echelon of Headquarters BCOF with an addition of officers from other Commonwealth components. For the present it remains in the Tokyo area to facilitate liaison with General MacArthur's headquarters.

13. Details of the move to Japan of the various components of BCOF cannot yet be announced but detailed planning is now in progress on the following basis:

(a) naval port parties for the working of Kure port to arrive in the first week of February:

(b) leading elements of the Australian components, including an airfield-construction squadron, to arrive in the third week of February;

(c) leading elements of the British Indian Division and the advanced parties of the British Indian air component to arrive about the first of March;

(d) leading elements of the New Zealand Brigade, which is moving from Italy, to arrive about March 23.

General of the Army Douglas MacArthur, Supreme Commander for the Allied Powers, made the following statement concerning the employment of British Commonwealth Forces in the occupation of Japan:*

"The present occupation forces in Japan extend the heartiest possible welcome to the British Commonwealth forces who are about to share with them the arduous and difficult duties which are involved. Their presence will materially broaden the base along international lines of a burden which up to this time has, of necessity, been carried to a large extent unilaterally by United States forces and cannot fail to be of over-all beneficial effet. It will enable a diminution in our own strength, and will thereby bring welcome relief to many individuals. The Australian contingent served under my personal command with brilliant honor to itself during the long and arduous campaigns on the road back, and I take a special personal pride in again being associated with it. The reception of the entire force will be of the warmest."

When the exact composition and time of arrival of the British Commonwealth force are known to General MacArthur he will determine the number and schedule of withdrawal of

* The remaining statements were released in Washington and Tokyo only.

American troops from his command.

The participation of British Commonwealth forces in the occupation of Japan is in line with the policy made public by the President on September 22 which stated that the "participation of the forces of other nations that have taken a leading part in the war against Japan will be welcomed and expected."

In accordance with this declaration, invitations were extended also to the Governments of China and the Union of Soviet Socialist Republics to send troops to participate in the occupation. The Chinese Government has informed this Government that, while it is willing to provide a contingent of troops, it is not in a position to do so at the present time. The Union of Soviet Socialist Republics has not accepted the invitation to participate.

[SOURCE: *Pol. Reorientation of Japan*, II, pp. 440-41]

4-2 REAPPRAISAL OF UNITED STATES SECURITY INTERESTS AND POLICIES IN REGARD TO JAPAN

Memorandum[1] April 17, 1946
Drafted by: R. Fearey
To: Secretary of State
From: George Atcheson Jr., U. S. Political Advisor for Japan
Secret

I have the honor to enclose a memorandum "Reappraisal of United States Security Interests and Policies in Regard to Japan" prepared by Mr. Fearey of the staff of this Mission prior to my return to Japan but delayed in typing due to shortage of clerical help.

The memorandum is summarized in its opening paragraphs.

SUMMARY

The fundamental objective of the United States with respect to Japan, toward which all policy should in the last analysis be directed, is the future peace and security of the United States and of the world. It is important to consider, therefore, whether preoccupation with the current programs of Japanese democratization and demilitarization may not have diverted attention from other, probably over the long run more important aspects of a realistically conceived United States security policy toward Japan, namely, future Japanese economic conditions, and the tendency of the Japanese in future to align themselves politically, economically and sentimentally with the United States or with a potential enemy of the United States.

It should not be assumed, as the basic policy papers for Japan and the course of the occupation thus far indicate it may have been assumed, that the Japanese military threat will revive, if it revives, in substantially the same form as before, i.e., through the efforts of an ambitious group of military fanatics to launch an independent program of Far Eastern or world aggression. Unless methods of warfare change so drastically in future as to necessitate a complete re-evaluation of the war potentials of the various nations it would seem inconceivable that Japan, surrounded, with the hoped-for unification of China, by three far more powerful nations than itself, could, by itself and of its own efforts, again presume with reasonable prospect of success to embark on a course of military expansion.

It seems clear, therefore, that Japan exists as a potential threat to United States and world security only as the ally of some other, stronger power, and that the United States will be protecting itself from an imagined threat while ignoring a real one if it fails to take account of that fact. The means by which the United States may hope to prevent the possible alliance of Japan at some future date with a more powerful potential enemy of the United States would seem to be, first, to endeavor to assure Japan economic opportunities sufficient to enable it to maintain standards of living which will not drive it into the arms of such a power and, second, to endeavor to align Japan in future, against no nation, but securely with the United States. The importance of a viable economy to the continued peaceful disposition of the Japanese people having been long recognized, attention is directed toward factors which might tend to align Japan in years to come primarily with the United States or with the Soviet Union, China or Great Britain.

The current attitudes of the Japanese people toward the American, Soviet, Chinese and

[1] Cf. John Emmerson's comments on May 15, 1946, also published in this volume (4-3).

British peoples are of course one such factor. Examination of this question leads to the conclusion that seven months of occupation have witnessed the revival of American popularity and prestige in Japan to a point if not above at least not far below the peak of the 'twenties. While Americans are regarded with respect and even liking, the Chinese are still looked down upon, with no strong feelings either of liking or animosity, the British are little liked nor greatly respected, but are not hated, and the Russians are strongly feared and hated. Regarding future Japanese-American, Soviet, Chinese and British trade relations, while there is at least the possibility of the revival of a sizeable export trade to the United States, depending on United States trade policies, American exports to Japan are likely to be only a fraction of former levels. Trade with China may be large, that with Great Britain and the Soviet Union probably small to insignificant as in the past. Japanese political ideologies and institutions in normal circumstances are likely to have far more in common with the American, British, and possibly, Chinese systems than with Soviet doctrines.

Present indications, in short, all point to the maintenance of a friendlier attitude within Japan in future toward the United States than toward any other power. It must be recognized, however, that in changing circumstances offering sufficient provocation current pro-American, pro-democratic and anti-Soviet, anti-communist tendencies could be completely reversed. Persistently adverse economic conditions, particularly if it were felt that the United States through its demilitarization or commercial policies was largely responsible for those conditions, or the withdrawal of American forces from the western Pacific, would be the likeliest causes of such a change. Current resistance to communism is strong, but many of the factors responsible for this resistance are in process of dissolution, and balanced against them are a number of inherent characteristics of the Japanese, their amenability to discipline and centralized authority and the elements of communalism in their present mode of life, which render the adoption of the current Soviet version, a native Japanese version, or some other form of communism entirely possible at some future time in favorable circumstances. But irrespective of whether the Japanese succumb to communism or not, even a confirmedly democratic-capitalistic Japan if impelled by acute economic distress or national insecurity, possibly combined with Soviet pressure, would be likely to forego the friendship of the United States to align itself with a potential enemy of the United States if it believed it might thereby overcome the difficulties facing it.

A number of steps, the greater part for long-range rather than immediate implementation, may be proposed to prevent such an eventuality: (1) a concerted effort to improve the conduct of the misbehaving minority among the occupation forces; (2) readmission at a later stage of the occupation of a significant number of persons scarcely meriting the title "active exponents of militant nationalism", in a large proportion of cases men of outstanding ability and of pro-American viewpoint, excluded by the January 4 purge directive; (3) development of closer cultural, educational and tourist relationships and exchanges between the United States and Japan; (4) minimum necessary restriction of Japanese peacetime industry; (5) reduction of American-Japanese trade barriers; and (6) the maintenance of American armed forces in the western Pacific and elsewhere of adequate strength, and, necessarily, backed by an adequate popular determination, to prevent the domination of Japan by another power.

American foreign policy today wisely and fortunately is based upon the principles of continuing friendship among the Great Powers and the development of a system of collective security under the UNO. In no circumstances should our Japan policies be of a type to impair the success of these larger aims. The proposed measures if properly implemented, however, would not have that effect, and, pending the establishment of effective security arrangements capable of controlling the great as well as the small powers, would seem a logical and an important element of United States security planning.

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[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

4-3 COMMENTS ON "REAPPRAISAL OF UNITED STATES SECURITY INTERESTS"

Memorandum[2] May 15, 1946
Drafted by: J. Emmerson (State Dept.)
Secret

Mr. Fearey has written a thoughtful and valuable memorandum worth reading in its entirety. A report of this nature highlights the regrettable fact that in view of the reorganization of the Tokyo office, we may expect no more such frank and critical political analyses from our officers in Japan. Henceforth we must depend for interpretation and analysis upon reports written or passed by SCAP.

The theme of Mr. Fearey's memorandum is that Japan's potential threat to the United States does not lie in the recrudescence of an independent form of militant nationalism and expansionism but rather in an alliance of Japan with a potential enemy of the United States, the Soviet Union. He believes that U.S. basic policies for Japan and the course of occupation thus far have neglected this fact.

Mr. Fearey is quite ready to admit that, in spite of immigration restrictions and other unfavorable factors, there has always been more good will in Japan for the United States than for any other nation. He further states that "seven months of occupation have witnessed the revival of popularity and prestige in Japan to a point if not above at least not far below the peak of the 'twenties'." Furthermore he emphasizes the weakness of the Communist Party in Japan and the deep antagonism held by most Japanese for the Soviet Union. Nevertheless he feels that changing circumstances, particularly adverse economic conditions, could completely reverse the present pro-American, anti-Communist and anti-Soviet tendencies. His apprehension of this possibility leads to certain recommendations:

1) A concerted effort to improve the conduct of the misbehaving minority of the occupying forces
2) Readmission to public office at a later stage of the occupation of persons excluded by the January 4 "purge" directive, not believed to merit the title of "active exponents of militant nationalism"
3) Development of closer cultural, educational, and tourist exchanges between the U. S. and Japan
4) Minimum necessary restriction of Japanese peacetime industry
5) Reduction of American-Japanese trade barriers
6) Maintenance of adequate American armed forces in the western Pacific and elsewhere to prevent Japan's domination by another power.

Mr. Fearey goes so far, in discussing Japan's future status, as to propose that Japan should be permitted "to build up defensive fortifications and forces rather than to commit itself to remain disarmed indefinitely".

There is little argument with the six suggestions noted above. The carrying out of 2) might involve some practical difficulties in the choice of individuals to be exonerated. It may be noted that no one expects the "purge" directive to remain in force beyond the actual military occupation period.

The sections of the report dealing with Japan's trade relations are particularly illuminating and deserve consideration.

As Mr. Fearey himself admits, it is unfortunate that questions of "Balance of power" need to be discussed at a time when the United Nations is being so carefully nurtured. I believe it is also unfortunate that propaganda should be permitted or encouraged that a Soviet-American war is inevitable and that Japan will be a future battleground. If, as Walter Lippmann suggests, Germany is profiting from a Soviet-British rivalry over her, it would be most unfortunate if the spectacle arose of Soviet-American rivalry over Japan.

We should by every means encourage the strengthening of cultural and commercial ties between the United States and Japan and should endeavor to retain and stimulate the good-will still existing for us among the Japanese. Our best approach should continue to be one of positive aid in the education and democratization of Japan but not one of attempts to set the Japanese against the Russians. There are too many places in the world where the issues between ourselves and the Soviets are graver and more explosive.

[2] A reply to Fearey's memorandum, April 23, 1946.

The memorandum concludes with the statement that the United States should seek its security and that of the Pacific independently, *but by methods which do not in any way impair* the achievement of Great Power amity and the development of a working system of collective security. One can agree completely with this statement and with the underlining, which is Mr. Fearey's.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

4-4 DRAFT TREATY OF DISARMAMENT AND DEMILITARIZATION

Drafted by Department of State[3] June 21, 1946

PREAMBLE

The Governments of the United Kingdom, China, the Union of Soviet Socialist Republics and the United States have declared their intention to effect the total disarmament and demilitarization of Japan. This intention was expressed in the Potsdam Declaration of July 26, 1945. In substantial measure, it has already been fulfilled. Nothing shall prevent or delay the completion of the process. It remains to ensure that the total disarmament and demilitarization of Japan will be enforced as long as the peace and security of the world may require. Only this assurance will permit the nations of Asia and the world to return singlemindedly to the habits of peace. To achieve this objective, the governments of the United Kingdom, the Republic of China, the Union of Soviet Socialist Republics, and the United States agree to engage in the common undertaking defined in this treaty.

ARTICLE I

The High Contracting Parties agree that they shall take steps jointly to ensure that:

(*a*) All Japanese armed forces, including land, air, anti-aircraft and naval forces, all para-military forces, such as the Gendarmerie (Kempei Tai), the Grade Mobile (Keipei Tei) and the Special Police (Tokka Ka), and all organizations auxiliary to the foregoing shall be and shall remain completely disarmed, demobilized and disbanded.

(*b*) The Japanese Imperial General Headquarters, the staffs of the Army and the Navy, and the staffs of any para-military organizations shall be and shall remain disbanded.

(*c*) No Japanese military or para-military organizations in any form or guise shall be permitted in Japan.

(*d*) The manufacture, production, or importation of military equipment in Japan shall be prevented. In particular, the High Contracting Parties shall prevent the manufacture, production, or importation of:

(1) All arms, ammunition, explosives, military equipment, military stores and supplies and other implements of war of all kinds;
(2) All fissionable materials for any purpose, except under conditions approved by the high contracting parties;
(3) All naval vessels of all classes, both surface and submarine, and auxiliary naval-craft;
(4) All aircraft of all kinds, aviation equipment and devices, and equipment for anti-aircraft defense.

(*e*) The establishment, utilization or operation for military purposes of any of the following shall be prevented:

(1) All military structures, installations and establishments, including but not limited to military air fields, seaplane bases, and naval bases, military and naval storage depots, permanent and temporary land and coast fortifications, fortresses and other fortified areas;
(2) All factories, plants, shops, research institutions, laboratories, testing stations, technical data, patents, plans, drawings and inventions, designed or intended to produce or to facilitate the production of items listed in the paragraph (*d*) above.

(*f*) Under conditions which may be established by the High Contracting Parties, the demilitarization and disarmament required by this Article shall be subject to the following exceptions and to no others:

(1) The formation and employment of such detachments of Japanese civil police, and their equipment with such types and quantities of imported small arms

[3] Similiar to treaty draft for the disarmament and demilitarization of Germany.

as may be essential to the maintenance of public security; and

(2) The importation of minimum quantities of those items listed in paragraph (*d*) (1) above, such as explosives or ingredients of explosives, which may be essential for purposes of construction, mining, agriculture, or for other peaceful purposes.

ARTICLE II

To implement the disarmament and demilitarization provisions set forth in Article I, the High Contracting Parties agree that they shall make provision for a system of quadripartite inspection, which shall become operative upon the termination of the Allied occupation of Japan. This system of inspection shall be conducted through a Commission of Control to be established by the High Contracting Parties on a quadripartite basis. The Commission of Control, through its officers and agents, shall conduct, in any and all parts of Japanese territory, such inspections, inquiries and investigations as it may deem necessary to determine whether the disarmament and demilitarization provisions set forth in Article I are being observed.

ARTICLE III

The High Contracting Parties agree that for the duration of the period of Allied occupation of Japan, they shall support the strict enforcement of the disarmament and demilitarization provisions set forth in Article I. They agree further that the express acceptance by Japan of the provisions of Articles I and II shall be an essential condition to the termination of Allied occupation of Japanese territory.

ARTICLE IV

The Commission of Control provided for in Article II shall keep the high contracting parties and the Security Council of the United Nations informed of the results of the inspections, inquiries and investigations authorized by that article. The Commission of Control shall submit a report to the high contracting parties whenever in the opinion of a majority of the members of the Commission, it has reason to believe that a violation of the disarmament and demilitarization provisions of Article I has occurred or is about to occur. In conjunction with such report the Commission shall submit a recommendation for action on the part of the high contracting parties which appears appropriate to a majority of the members of the Commission. Upon receipt of such report and recommendations, the High Contracting Parties will, by common agreement, take such prompt action—including action by air, sea or land forces—as may be necessary to assure the immediate cessation or prevention of such violation or attempted violation. The high contracting parties shall immediately report to the Security Council of the United Nations the action taken or to be taken.

The high contracting parties agree that, within six months of the effective date of this treaty, they shall consult for the purpose of negotiating special quadripartite agreements which shall provide in the greatest practicable detail for inspection, inquiry and investigation by the Commission of Control, for the numbers and types of forces which each party shall make available for purposes of this treaty, for their degree of readiness and general location, and for the nature of the facilities and assistance which each shall provide. Such special quadripartite agreements shall be subject to ratification by the high contracting parties in accordance with their respective constitutional processes.

ARTICLE V

This treaty shall be ratified by the High Contracting Parties in accordance with their respective constitutional processes. The ratifications shall be deposited with the Government of ———, which shall notify all the High Contracting Parties of each deposit. This treaty shall come into force upon the deposit of ratifications by each of the High Contracting Parties. This treaty shall remain in force for a period of twenty-five years from its effective date. The High Contracting Parties agree to consult six months before the date of expiration of this treaty for the purpose of determining whether the interests of international peace and security require its renewal, with or without modification, or whether the Japanese people have so far progressed in the reconstruction of their life on a democratic and peaceful basis that the continued imposition of the controls defined herein is no longer necessary.

[SOURCE: *Occupation of Japan: Policy and Progress*. Department of State, pp. 85-88]

4-5 SOVIET INTENTION WITH REGARD TO JAPAN

Memorandum August 10, 1946
To: Dept. of State
From: J. P. Davies, First Sec., U. S. Embassy in Moscow
Secret

Current Soviet policy toward Japan springs from a sense of profound frustration. The defeat and occupation of Japan by the United States, far from removing in Soviet eyes the Japanese threat to the U. S. S. R., has only meant that the Soviet Far East now has on its doorstep a first-class rather than a second-class power. The U. S. S. R. may have felt during the past decade that it could effectively resist a Japanese attack. It is not likely to believe that the conversion of Japan into at least a temporary or potential American "place d'armes" represents an improvement in the defensive position of the Soviet Far East.

The U. S. S. R. can, of course, look forward to the withdrawal of American military forces from Japan. But given the Soviet self-induced belief that the United States is by its very nature committed to a course of imperialistic militarism and that the U. S. S. R. must inevitably come into armed conflict with the capitalist West, the Kremlin's suspicions of American intentions regarding Japan cannot be dispelled by any measures short of those which would assure the U. S. S. R. predominant influence in Japan.

Proceeding from this fundamental outlook, current Soviet policy toward Japan is designed to disrupt to the greatest possible degree the development of a healthy Japan oriented toward the United States. To this end the U. S. S. R. seeks to hamstring by all possible means the American program for the rehabilitation of Japan.

The U. S. S. R. is utilizing the Far Eastern Commission and the Allied Council of Japan as a sounding board for criticism of American policies in the hope that thereby it may discredit SCAP administration and provoke international and domestic American interference in an effort to disrupt that administration. Other international organizations, such as the WFTU, are likely to be exploited, so far as the U. S. S. R. is able, for the same purpose.

As a second course the Kremlin is undoubtedly seeking to use the Japanese Communist Party for the immediate purpose of creating confusion in Japan and opposition to the United States. In long range terms, the Kremlin presumably hopes to develop and utilize the Japanese Communist Party and associated front organizations as a Trojan Horse in a bid for Soviet control over Japan.

While it is undoubtedly true that no evidence has come to hand showing direct connections between the Japanese Communist Party and the U. S. S. R., we must, in our own interest, assume that such connections do exist. To do otherwise would be ignoring past experience with all Communist Parties. While these parties may not get daily or periodical directives, the leaders of the parties are all cast from the same Moscow-inspired mold and undoubtedly receive basic directives from Kremlin sources.

In view of the exclusive philosophy of the U. S. S. R. in international affairs—a philosophy which dictates that he that is not with me is against me—it is worse than idle, it is a delusion, to assume that Japan can be reconstructed as a neutral, self-sufficient nation, enjoying friendly relations with both the United States and Soviet Union. The American and Soviet frontiers meet in the Japan Sea. At present we occupy Japan. If we withdraw from Japan without having assured ourselves of a favored position there, Japan may in all probability sooner or later be captured by the Soviet Union. The tables will have been turned and we shall be confronted with Japan as a "place d'armes" of the only other first-class power.

[SOURCE: *FRUS*, 1946, VIII, pp. 285-86]

4-6 JAPANESE PEACE TREATY

Memorandum[4] October 25, 1946
Drafted by: R. E. Bacon, Spl. Assisant to J. C. Vincent,
Dir., Off. of F. E. Affairs
Secret

I. Demilitarization

Generally agreed:

To take Article I of the 25-year treaty as basis for provisions in the draft treaty with alterations (1) to make provisions binding upon Japan and (2) to integrate control machinery with other provisions of draft treaty relating to controls.

Questions still outstanding:

Should diarmament provisions be made binding upon Japan in perpetuity (duration of peace treaty) or be synchronized with duration of control machinery, or be subject to modification by agreement?

II. Control Machinery

Generally agreed:

(1) that the Working Group should operate on the assumption that the Japanese treaty would be concluded sometime during the fall of 1947, this assumption to be subject to revision in the light of developments.

(2) that provisions relating to control to be included in the treaty should take into account two periods: (*a*) pending withdrawal of military forces and (*b*) pending withdrawal of remaining controls.

Questions outstanding:

(1) Should the control authority to be established under the treaty have supreme authority similar to that now possessed by SCAP?

(2) In the light of answer to question (1) above, is the conclusion of a peace treaty with Japan in the near future in the best interests of this country?

(3) Should the proposed new control council or commission be established in Tokyo or Washington?

(4) Should the proposed new control council or commission be an outgrowth of the FEC or a new start? Might consultations at the ambassadorial level in Washington take the place of more formalized machinery?

III. Question of What States are to sign, et cetera

Generally agreed:

(1) that this question should be broken down to include successive stages: preparation of draft; discussion of draft with formulation of recommendations; preparation of final draft; signatories; approvals essential to bring treaty into force.

(2) that the original draft of the treaty would probably be prepared either by the Big Four or by the FEC.

[SOURCE: *FRUS*, 1946, VIII, pp. 348-49]

4-7 LIMITS OF ALLIED COUNCIL AUTHORITY

40th Meeting Minutes September 3, 1947
Allied Council for Japan

MEMBERS PRESENT

Mr. William J. Sebald, Deputy for the Supreme Commander, Chairman, and Member for the United States

His Excellency, General Shang Chen, Member for China

Mr. Patrick Shaw, Member representing jointly the United Kingdom, Australia, New Zealand and India

Major General A. P. Kislenko, representing the Member for the Union of Soviet Socialist Republics

[4] Notes on Meeting of the Working Group on Japan Treaty within the Department of State, October 25, 1946.

It should be obvious that this Council has no authority to make rules of procedure which bind either the SUPREME COMMANDER or General Headquarters. This does not mean, of course, that this Council is not empowered to make its own rules of procedure.

It was in conformity with what I have just said that the CHAIRMAN announced at the meeting of August 7, 1947 that General Headquarters is discontinuing the compilation of special reports in special form, except in case of appropriate need.

The reasons underlying this decision are clear, and need no further explanation. General Headquarters is a body separate and distinct from this Council, and I repeat, is not bound by our rules of procedure.

. . . . . .

By its Terms of Reference, this Council is a subordinate body. Its principal function is to provide helpful and constructive advice to the SUPREME COMMANDER. Throughout the life of this Council the Soviet Member has misused this body. To accede to the Soviet Member's objection would merely be to strengthen his hand to continue misusing this body. I know of no occasion when the Soviet Member has ever given helpful or constructive advice. On the contrary, he has used this Council to further his ends of obstructionism. He has used this Council to support an ideology which is not wanted in Japan, and he has used this Council, by indirection, to criticize the SUPREME COMMANDER. I see nothing helpful or constructive in such misuse.

I think we might as well face the issue squarely. I feel that we should bring this Council back to where it belongs and allow it to exercise its functions in accordance with the Terms of Reference.

. . . . . .

MAJOR GENERAL KISLENKO: I am extremely surprised at MR. CHAIRMAN'S statement that the Allied Council for Japan is a subordinate body. As far as the procedural rules for the Council are concerned, it is a matter for all Members of the Allied Council. Then, I am also extremely surprised at MR. CHAIRMAN's contention that the Member for the U. S. S. R. has throughout the life of the Allied Council misused the Council for the purpose of obstructionism. That is a very serious charge which is an extra proof that the rights of the Members of the Allied Council are being violated. I reject the charge brought against the Member for the U. S. S. R. and I fully disagree with an unilateral method of settling procedural matters.

. . . . . .

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

4-8 INTERESTS AND ATTITUDES OF F. E. C. POWERS ON QUESTIONS RELATING TO THE PEACE SETTLEMENT WITH JAPAN

Report February 19, 1948
Drafted by: Division of Research for Far East, Department of State
Secret

1. SUMMARY REPORT

A. *Major Conclusions*

The most immediate problem regarding the peace conference for Japan is that of conference composition and procedure. The United States, supported by the British Commonwealth, France, the Netherands, and the Philippines, desires a peace conference composed of the nations represented on the Far Eastern Commission (FEC) and reaching its decisions without the great power veto and by an affirmative vote of any seven of the eleven members. The Soviet Union, on the other hand, regards the Far Eastern settlement, like the European settlement, as initially and primarily a concern of the Council of Foreign Ministers (CFM), in which each of the great powers exercises a veto. The Chinese, reluctant to attend a conference at which the USSR is not represented and in an attempt to compromise between the American and Soviet views, have proposed that the composition of the conference be as advocated by the United States but that the FEC voting procedure, under which such of the great powers exercises a veto, be retained.

Questions of conference composition and procedure aside, the USSR will not, it appears, accept certain major features of the kind of peace settlement with Japan on which the other members of the Far Eastern Commission (FEC) appear able to agree. The Soviet Union

will insist upon a veto in the enforcement of the treaty. Such a veto would be aimed at preventing Japan's resurgence under American domination. Such a veto would be far more powerful than the vetoes now held by the US, UK, USSR, and China in the FEC, since stalemate in the FEC has only a limited effect in view of the action that the US has taken and can now take, unilaterally if necessary.

There appear to be no such basic differences between American interests and the positions likely to be taken by the other nine FEC powers. Providing American policy continues to follow the general lines laid down in the FEC "Basic Post-Surrender Policy for Japan" (see *Activities of the Far Eastern Commission*, Appendix 5), the general American position can probably be sustained on most issues by care in wording proposals and in manner of negotiating. On many questions there will be no serious difficulty in obtaining the necessary majorities, since some powers will be in agreement with the US on substance and others will not feel strongly enough to want to oppose the American position. Where necessary, pressure by the US can probably bring at least a minimum acquiescence, especially if American influence is exercised in a spirit of conciliation and compromise. In view of this prospect, there appears to be no serious direct danger to basic American interests in conducting the peace conference without the veto.

Five countries may be expected to give general support, often strong support, to the US: the Philippines, Canada, the Netherlands, UK, and New Zealand. The Philippines and the Netherlands will follow the US lead very closely except on a few issues. The UK, Canada, and New Zealand may on occasion find themselves torn between national or British Empire interests on the one hand and American interests on the other. In most cases, however, these interests will not diverge widely.

The most sensitive powers, aside from the USSR, will probably be China, India, and Australia. China will be motivated to a large extent by a desire to gain face. India will speak not only as a newly independent power but, as far as possible, also as spokesman for Southeast Asia, especially the dependent peoples there, and for colored races against the white race. The strength with which India presses this position, however, will depend to a considerable extent upon the degree of progress that has been made in solving internal problems at the time that the conference is convened. Australia will probably continue to attempt to act as the leader and spokesman for the British Commonwealth in the Far East, but it has recognized the leadership of the Unites States in the peace settlement subject to Australia's recognition as a "principal power".

Conflict between the US and powers other than the USSR appears to be most probable on economic questions, especially reparations, restitution, and economic recovery. On reparations, probably the most difficult issue will be apportionment among claimant countries. The issue of Japanese economic recovery raises before various FEC countries the specter of Japanese economic and military aggression as well as the more immediate likelihood of commercial rivalry.

The question of giving the US power to take unilateral action in Japan may be the subject of considerable disagreement. The USSR fears that the US would build a strong Japan oriented toward the US and ready to serve as a base for military action against the Soviet Union. Australia fears the commercial and military potential of Japan and wants a voice in deciding what is to be done to Japan. India would oppose as imperialism any arrangement that would place the US in control of Japan's economic or political future, and China, France, and the Philippines would be opposed if it should appear that a motive for seeking unilateral powers was a desire to grant American aid for economic recovery to Japan before such aid is given to countries devastated by Japan. It seems likely that any proposal for such power of unilateral action would have to be made most circumspectly and probably would not be acceptable unless tied with substantial advantages to other powers. Even so, there seems to be no chance of getting Soviet acceptance of such broad American powers.

B. *Summary of Position of Each Power*

1. *Australia.* Australia will persue a threefold peace treaty policy. It will seek recognition as a principal power and Commonwealth leader in the Pacific. It will wish to prevent a resurgence of Japan's war potential. It will desire the promotion of democratic institutions in Japan and the coordination, without undue Japanese domination, of Japan's economy with that of East Asia and the Pacific. Evatt's acceptance of the reality of democratic progress in Japan has led Australia to modify its previous position that the achievement of its aims requires a hard peace. According to Evatt, Australia is now in accord with the broad principles of American policy toward Japan.

3. *China.* Chinese representatives at the peace conference will be affected by basically contradictory considerations. On the one hand, Chinese public opinion, considerations of China's prestige, and the hope of making economic gains at Japan's expense will impel the conference to seek a harsh peace. Opposing these considerations and making for moderation will be China's fear of the USSR and dependence upon the US and the prospect that relations with a reviving Japan might help the National Government to cope with its pressing economic difficulties.

Intitially, therefore, the Chinese may be expected to resist proposals susceptible of being interpreted as "softness" toward Japan. At a later stage, however, China will probably be ready to accept the substance of the American attitude on all points except those such as voting procedure and reparations, where Chinese public opinion or questions of China's prestige make a palatable compromise imperative.

8. *Philippines.* Officially the Philippines Government has gone on record as favoring an early and moderate peace treaty with Japan. The strength of Philippine-American economic and political relations indicates that the Philippines will follow American leadership on most peace treaty issues. The Philippines probably will argue for a larger reparations share and a more ambitious removals program than that proposed by the US. It may also resist proposals to revive Japanese light industries. On neither of these questions, however, is the Philippine position likely to be so intransigent as to result in an outright vote against the American proposals.

9. *U. S. S. R.* The Soviet Union is concerned primarily with preventing Japanese recuperation under the strong influence of another great power and is dissatisfied, if not alarmed, by the preponderance of American influence in Japan at present. Interpreting American intentions as designed to build Japan into a buffer against the Soviet Union, the USSR is not likely to attend the prospective Japanese peace treaty conference unless it secures veto or near-veto in the deliberations. If its conditions on participation were to be met at some future time, the Soviet delegation to the conference would be guided by the desire to retain the Soviet veto in the post-treaty control structure and the create conditions leading in time to the weakening of American influence and the strengthening of Soviet influence in Japan.

10. *United Kingdom.* The United Kingdom policy of limited liability in Japan is closely linked to the maintainence of US strategic interest in the Pacific and, given Britain's present economic weakness, can be persued only with American support. It is consequently axiomatic that the UK will not in general oppose American recommendations on the Japanese peace settlement. Departure from this policy may occur on questions that engage Britain's Commonwealth-Imperial or commercial interests in that area. Coincidence of UK and US views on most treaty questions was strengthened at the Canberra Conference, and it is highly unlikely that the UK would adopt any position at the peace conference that would seriously compromise the essential coordination of aims.

If any marked divergence arises, it will be over the issues of reparations and post-occupation controls. While the UK recognizes that reparations are limited by capacity to pay and the need for making Japan self-sustaining, for political reasons it favors a larger share of reparations for Burma and Malaya and will plead that these countries are being discriminated against in favor of China and the Philippines. A corollary is continued British insistence that external assets be given full weight in computing total reparations. The UK will advocate stricter demilitarization controls and, in general, much tighter supervision by an Allied control body during the period of tutelage than US official opinion now favors. In addition, the United Kingdom favors strict economic controls, including import licensing, to prevent the creation of war potential, and certain other types of control designed to check Japanese "economic aggression". To stop "malpractices" arising from child labor, underpaid labor, abuse of trade-marks, and discriminatory practices against foreign firms, the UK favors writing into the treaty the obligation to conform to the requirements and regulations of international multilateral conventions (ILO, ITO, etc.), with infringements subject to sanctions by the control machinery. Aside from these issues, and some British reservations with regard to the degree of democratization that can be secured by treaty, US and UK views on most issues will coincide and the Foreign Office may be expected to accept any reasonable accommodation proposed by the US.

C. *Summary of Prospects on Individual Issues*

The issues discussed here and in later sections of the present estimate are arranged to correspond with the chapters in the draft treaty prepared by the Working Group and dated August 5, 1947.

Chapter I. Territorial Questions

a. *Kuril Islands.* An attempt by the US to assign to Japan several of the southernmost of the Kuirl Islands (in Working Group's draft Kunashiri, Etorofu, Shikotan, and the Habomais) will undoubtedly appear to some powers as an attempt to violate the Yalta agreement at the expense of the USSR and in favor of Japan. Naturally the USSR would be hostile to this suggestion, and no American concession that appears practical seems likely to change the Soviet attitude. Other opposition may arise from China. Principal support for such an American proposal would probably come from Australia. New Zealand would favor a strategic area for trusteeship for the Kurils if politically feasible.

b. *Return of Ryukyus to Japan.* Strong opposition to this proposal may be expected from China, the USSR, Australia, and New Zealand. Strong support from India is probable, as well as acquiescence by the Philippines. The positions of other powers are not now clear.

Chapter II. Political Questions. Since the political provisions proposed by the Working Group are couched in general terms and are subject to enforcement by the eleven powers now represented on the FEC, it is possible that little opposition will arise to the provisions themselves and that discussion will center around the system of control and what it may be expected to accomplish. The Soviet Union, which is strongly dissatisfied with the new Japanese Constitution, may demand that the Japanese accept more specific undertakings with regard to their future form of government. On the other hand, the UK favors reduction of such provisions to a minimum.

Chapter III. War Criminals. No major issue is likely to arise in connection with this chapter, but China, the USSR, and the Philippines will find fault with what will appear to them undue leniency in the provision that the Japanese government should be the enforcement agency for carrying out the uncompleted sententces imposed by Allied (i.e., international) military tribunals.

Chapter IV. Interim Supervision and Assistance. This chapter is expected to be the subject of major differences of opinion in peace discussions.

a. *Abolition of FEC, ACJ, and SCAP and the termination of all US and Allied directives to SCAP and of all SCAP directives to the Japanese Government.* General support for this proposal may be predicted, with the qualification that any strong objection to the proposed machinery for enforcing the treaty may be reflected in a preference to keep at least some of the present machinery. Chinese desire to have more of a voice than countries that do not have a veto in the FEC may lead to Chinese objections to abolition of the FEC. Further, there may be some opposition, especially from the Soviet Union and Australia, to the termination of all directives, and these powers may propose that present directives be continued in force until changed or terminated by the new authority set up to enforce the treaty.

b. *Complete withdrawal of all Allied troops from Japan within six months.* If the US makes this proposal, strong support may be expected from India and acquiescence from most other powers. The Netherlands may object on the ground that troops are necessary in Japan to insure treaty enforcement.

If, on the other hand, the US should propose leaving some forces in Japan, strong opposition may be expected from the USSR and India.

c. *Creation of an eleven-power Council of Ambassadors to enforce the provisions of the treaty.* In itself, separate from the questions of powers and of voting procedures, this is not an issue that should cause major difficulty, although China will be disturbed by the weight of British Commonwealth representation. India may propose some form of UN control of Japan. China would prefer a four-power control body.

d. *Voting procedure in Council of Ambassadors for Japan.* At present it looks as though it would be very difficult, perhaps quite impossible, to propose any voting formula for the Council of Ambassadors for Japan that would be accepted by all ten powers concerned. It may be worth recalling here that the Terms of Reference of the FEC were written and agreed to by a few major powers, after which the others concerned had only the choice of accepting or rejecting membership under those terms.

The proposal of the Working Group that action in the Council be by affirmative vote of seven will probably not be accepted by the USSR or China. The USSR wants to retain the "Big Power" veto; China favors a three-fourths vote of the "Big Powers" and objects to granting France and the Netherlands parity with China. Australia and New Zealand, on the other hand, may be expected to favor strongly the vote of seven, and Australia will surely oppose vigorously any attempt to introduce the veto into the Council, especially if veto power is not granted to Australia.

e. *Broad enforcement powers for the Council of Ambassadors for Japan.* Most FEC powers would approve of giving to the Council of Ambassadors for Japan broad powers to supervise and assist Japan in carrying out all the terms of the peace treaty. The Indians, however, would object to "interference" in Japan, an Asiatic power, by "outside" powers and, accordingly, would greatly prefer a narrow grant of power to the Council. Soviet ends would be served by broad powers in the hands of the Council only if, first, the Soviet member were in a position to block action opposed by the USSR, and, second, there appeared to be a reasonable chance that such broad powers might be used to further Soviet objectives in Japan. Those states such as the Philippines and China, which favor strict policing of severe provisions against Japan, will be in favor of broad powers for the Council, especially if voting procedure and other factors seem to indicate that the Council will be able to operate effectively.

f. *Extensive executive powers for American Chairman of the Council.* Such powers would be opposed by India; the USSR's opposition or support will depend upon the scope of executive discretion. Most other FEC states may be expected to go along with the proposals in the Working Group's draft.

If the US were to go beyond the provisions of this draft, however, and seek power of unilateral action, the USSR and India might be joined by Australia and New Zealand in opposing such action. Commonwealth motives would lead the UK to support Australian and New Zealand objections, which might overcome, however, if a face-saving formula could be worked out.

Chapter V. Disarmament and Demilitarization

a. *Direct military strength.* There will be strong general approval for the draft provision prohibiting military or para-military forces or organizations, war industries, and related research, except for some possible qualifications on the part of India.

b. *War-supporting industries.* Provisions for the reduction of Japan's war-supporting industries, however, may run into considerable difficulty. The USSR, China, the Philippines, New Zealand, and Australia (with UK support) are particularly serious about enforcing effective disarmament upon Japan and have opposed what appears to them to be American softening, especially with respect to the limitation of war-supporting industries in Japan. Since the Working Group's draft goes much further than any previous US position in allowing Japan freedom to develop and operate war-supporting industries, strong opposition from all these countries is expected. There is a possibility that Mr. Evatt's conversion by General MacArthur may lessen Australia's opposition on this matter.

c. *Separate treaty on Japan's disarmament and demilitarization.* The proposal of the Working Group to broaden this treaty from four-power to eleven-power participation and to assign enforcement to the Council of Ambassadors for Japan constitutes a substantial change for the draft proposed by Mr. Byrnes in the spring of 1946. The extension to eleven powers greatly weakens the chance of getting Soviet support and reduces China's interest in the treaty. The form announced by Mr. Byrnes was acceptable to the United Kingdom, especially as an agreement to take effect before the peace settlement. It is somewhat doubtful that the British will feel that the new version is very valuable. On the other hand, Australia and New Zealand may be expected to support the proposed eleven-power form strongly. In general, positions on this treaty will probably follow positions on Chapter IV of the peace treaty, since the machinery provided in each is the same.

Chapter VI. Claims Arising Out of the War

a. *Reparations.* There is as yet insufficent evidence of willingness to retreat from positions taken in the FEC on the reparations question to make clear what sort of compromise may be worked out, or even that any compromise is likely. The USSR apparently is not going to accede to a consideration of Japanese external assets as potential reparations, and the reparations program that the Soviets would accept appears to be one that omits these assets. On the other hand, the UK refuses to retreat from the position that full weight be given to external assests in computing reparation shares. The compromise may bring agreement on the distribution of reparations is not yet in sight.

b. *Restitution of looted property.* The present conflict between US views and those of most other FEC powers on restitution questions relates primarily to property known to have been looted but not identifiable as to source. The majority of the powers feel that such property in Japan should be divided in equitable proportions among the former occupied countries. The US has maintained that the unidentified looted property should be used in a revolving fund for the revival of the Japanese economy. It is believed that this issue will be the paramount one to arise at the peace conference in connection with the restitution of looted property.

Chapter VII. Property, Rights and Interests. The only objection to be expected in connection with this chapter is the Soviet exception to the provision that Japanese assets in the territory of an Allied Power on September 2, 1945 may be taken over by that Allied Power. This provision appears to open the way for a dispute between the USSR and China over Japanese assets removed by the Soviets from Manchuria.

Chapter VIII. Other Economic Provisions

a. *Economic reform program.* The prospect for proposed provisions on economic reform in Japan is good. There is considerable room for debate on the strictness of language, the amount of detail to be provided, and the security of enforcement procedures, but only basic objection now anticipated is India's opposition to "outside" interference in Japan's affairs.

b. *Economic recovery program.* This proposed US policy is opposed by China, the Philippines, and India, as well as the Soviet Union. The fear of Indian leaders that the US intends this program to be primarily a means of building up Japan as a bulwark against the USSR will be very hard to allay. Certain powers, notably Australia, New Zealand, and the Netherlands, see international advantages in Japanese economic recovery and may be expected to support the program. The UK and Canada will also give their support, although the former will probably wish to see an economic reform program and firm sanctions against "economic aggression" tied in with economic recovery. France may feel that the economic recovery of Japan should not precede that of the Allies.

c. *Civil aviation.* The USSR and Australia will probably oppose Japanese participation in civil aviation. The latter will probably take a more extreme stand than the US on the question of allowing Japanese nationals to work for foreign-owned civil airlines. It is believed that China and the Philippines may also be expected to object to terms that permit any Japanese aviation.

d. *Other economic questions.* It is difficult to anticipate how the remaining economic provisions of the Working Group's draft will be received by the FEC powers. In general, however, there appears no reason to expect serious opposition.

Chapter IX. Settlement of Disputes. No comment

Chapter X. Formal Provisions. No comment.

Other Questions

a. *Peace conference voting procedure.* Peace treaty discussions to date have proceeded on the basis of generally expressed agreement among the powers concerned that an early treaty is desirable. Disagreements have arisen not on the question of timing but on that of the composition and procedure of the peace conference itself. The United States, supported by the British Commonwealth, France, the Netherlands, and the Philippines, desires a peace conference composed of the nations represented on the Far Eastern Commission (FEC) and reaching its decisions without the great power veto and by an affirmative vote of any seven of the eleven members.* The Soviet Union, on the other hand, regards the Far Eastern settlement, like the European settlement, as initially and primarily a concern of the Council of Foreign Ministers (CFM), in which each of the great powers exercises a veto. The Chinese, in an attempt to compromise between the American and Soviet views, have proposed that the composition of the conference be as advocated by the United States but that the FEC voting procedure, under which each of the great powers exercises a veto, be retained.

b. *Advisability of peace discussions despite the failure of the USSR to participate.* Up to the time when the Chinese made known their reluctance to participate in a peace conference from which the Soviet Union was absent, it seemed probable that the other powers concerned would be willing to participate in a conference organized on the basis of the American proposal regardless of the attitude of the Soviet Union. The other FEC powers, however, would regard as futile a peace conference at which neither China nor the Soviet Union was represented.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

* This formula would of course be modified in the event of the inclusion of Pakistan or any other Far Eastern states.

4-9 POLICE REFORM

Telegram: W92991 November 23, 1948
To: CINCFE
From: CSCAD
Top Secret

1. Re Para 7 of NSC 13/2, approved by the President as of 9 Oct. 48.

2. Without compromising fundamental tenets of police reforms, urgent that problem of internal security be satisfactorily met in order that post-occupation disarmed Japan may have effective police protection. Recognized that responsibilities for insuring solution this problem through improvement in numbers, equipping and training standards of police and through steady realization of provisions of Maritime Safety Authorization Bill will devolve upon you. In this connection, early shipment from ZI of Cal. 38 revolvers contemplated.

3. Understood here legislation amending police law is contemplated at next regular session Diet. Therefore, following principles considered basic to Japanese internal security are furnished.

A. Creation of adequate mobile national police reserves for handling disaster or civil violence.

B. Establishment of separate national agency for internal security directly under one of the ministries, possibly Attorney General's Office. Such agency would be similar to FBI and like organizations in other democratic countries. Such agency would be primarily investigative and surveillance agency for advising national government and all police authority re state of internal security.

C. Provisions of broadened powers and responsibilities for national police in order that there will be standardized police enforcement of national laws, and coordination of activities all police units, both local and national at all times.

[SOURCE: MACARTHUR MEMORIAL]

4-10 STAFF STUDY "GUNPOWDER", 2ND., EDITION

Memorandum April 12, 1949
From: General Headquarters Far East Command
To: Distribution List, Far East Command
Top Secret

1. Staff Study "GUNPOWDER", 2nd Edition, prepared pursuant to directives contained in JCS 1259/27 of 11 December 1946, is circulated in order that commands concerned can bring up to date their plans to meet the general emergency visualized. In the event of such an emergency, it will be used as the basis for directives for initial action by forces of the Far East Command. This Staff Study is not of itself a directive.

2. Staff Study "GUNPOWDER", 2nd Edition is also distributed to the Joint Chiefs of Staff; Commanding General, Strategic Air Command; Commander-in-Chief, Pacific; Commander-in-Chief, Alaska and Commander, United States Naval Forces, Western Pacific.

3. Owing to the character of the emergency to which Staff Study "GUNPOWDER", 2nd Edition applies, strictest security measures will be taken to prevent knowledge of its existence or of its basic concept from falling into unauthorized hands. It will be handled in accordance with Top Secret Control Procedures specified in Army Regulation 380-5 and Chapter 15, U. S. Navy Regulation, 1948. The following additional measures governing its dissemination and use are prescribed within the Far East Command:

a. Distribution of "GUNPOWDER", 2nd Edition will be strictly limited by addressees of this communication to such of their key United States staff officers as must use it in formulation of their implementing plans. It will not be divulged to any individual of a command subordinate to the addressees nor to any foreign national.

b. Plans prepared by the recipients of "GUNPOWDER", 2nd Edition, which are oriented to it and which indicate the over-all tactical concept will not be distributed below U. S. Army Corps, Air Force Headquarters as designated by CG, FEAF and U. S. Task Forces of U. S. Naval Forces, Far East as designated by COMNAVFE. Such plans will be complete in themselves and will not refer to "GUNPOWDER", 2nd Edition by title.

c. Plans, or extracts of plans, prepared by commanderd enumerated in paragraph b above, which are disseminated to their lower echelons of command, will in no manner reveal the over-all tactical concept of "GUNPOWDER", 2nd Edition nor make reference to any foreign power but will be limited to an outline of the local tactical concept of the issuing headquarters.

d. Knowledge of all plans oriented to this Staff Study will be restricted to the minimum of those officers concerned whose duties require them to be familiar with war plans. Information imparted to any individual will be the minimum required in the performance of his duties.

e. Staff Study "GUNPOWDER", 2nd Edition will be accounted for by holders in the Far East Command to the Commander-in-Chief, Far East (Attention: Joint Strategic Plans and Operations Group), as of the first day of each month by Top Secret letter.

4. The Commander, United States Naval Forces Far East and the Commanding Generals: Far East Air Forces; Eighth Army; Philippine Command; Ryukyus Command; Marianas-Bonins Command and United States Army Forces in Korea will prepare general emergency plans based on this study and forward a copy to the Commander-in-Chief, Far East (Attention: Joint Strategic Plans and Operations Group) not later than 1 June 1949.

5. Staff Study "GUNPOWDER", 2nd Edition supersedes Staff Study GUNPOWDER (revised 8 September 1948). Copies of the latter study, including all annexes and appendices, will be destroyed by burning and destruction reported to the Commander-in-Chief, Far East (Attention: Joint Strategic Plans and Operations Group) by Top Secret letter.

BY COMMAND OF GENERAL MacARTHUR:

EDWARD M. ALMOND
Major General, General Staff Corps
Chief of Staff

TABLE OF CONTENTS

ORGANIZATION OF FORCES
PARAGRAPH 1
a. GENERAL SITUATION
b. ENEMY FORCES
c. FRIENDLY FORCES
d. ASSUMPTIONS
PARAGRAPH 2
a. MISSIONS
b. GENERAL CONCEPT
PARAGRAPH 3 MAJOR COMMANDS
a. FAR EAST AIR FORCES
b. NAVAL FORCES FAR EAST
c. EIGHTH ARMY
d. USAFIK
e. MARBO
f. PHILCOM
g. RYCOM
x.
PARAGRAPH 4 LOGISTICS
PARAGRAPH 5 COMMAND AND COMMUNICATIONS

ORGANIZATION OF FORCES (See Paragraph 5 and Annex "A")

a. *FAR EAST AIR FORCES* — CG, FEAF
(1) U. S. Air Forces assigned Far East Command.
(2) U. S. Army with Air Forces (ARWAF) in the Far East Command

b. *NAVAL FORCES FAR EAST* — COMNAVFE
(1) U. S. Naval Force assigned Far East Command.
(2) U. S. Naval Forces afloat assigned Naval Forces Western Pacific.
(3) Naval facilities and local Naval forces in the MARIANAS and BONINS.

c. *EIGHTH ARMY* — CG, EIGHTH
(1) U. S. Army Forces in JAPAN.

d. *USAFIK* — CG, USAFIK
(1) U. S. Armed Forces in KOREA.

e. *MARIANAS-BONINS COMMAND* — CG, MARBO

(1) U. S. Army Forces in the MARIANAS and VOLCANOES-BONINS.

f. *PHILIPPINES COMMAND* — CG, PHILCOM
(1) U. S. Army Forces in the PHILIPPINES.

g. *RYUKYUS COMMAND* — CG, RYCOM
(1) U. S. Army Forces in the RYUKYUS

1. a. *GENERAL SITUATION*

(1) The continuing success of the uncompromising, aggressive Communist offensive is widening the front of Soviet domination. The USSR, without recourse to arms, is supporting this action. This results in a daily change in the military situation and presents an immediate threat to the position of the UNITED STATES in the Far East.

(2) War may occur at any time if the USSR miscalculates the determination of the UNITED STATES or other Western Powers to resist the Communist expansion policy. The USSR is the only power today possessing sufficient military potential to risk attack against the UNITED STATES and her possible allies. It must be assumed that the USSR will not hesitate to resort to war for the purpose of achieving world domination, if and when it appears advantageous to her.

(3) The USSR is consolidating a Communist front on the land mass of ASIA. With the disintegration of the Nationalist Government of China, the UNITED STATES can expect little or no assistance from the Asiatic Continent. Opposing this front is the island chain extending from JAPAN to the PHILIPPINES, In event of war, UNITED STATES bases on these islands are vulnerable and the long line of air and sea communications from the UNITED STATES is subject to enemy air and submarine attack.

b. *ENEMY FORCES*

(1) For an estimate of the strength, disposition and capabilities of Enemy Forces available for action against the Far East Command, see Annex "B", Intelligence Estimate and current intelligence documents published by G-2 Section, GHQ, FEC.

(2) *Soviet Military Capabilities*

(a) *General*

1 Since the USSR possesses superiority in numbers in all arms, except Naval, and can be expected to be strategically deployed on all probable fronts, the enemy is capable of securing the Asiatic Rimland north of the 30 degree parallel in 20 to 30 days and ports of the south coast of CHINA in D+50 to 60 days.

2 The USSR can employ biological and chemical warfare which would be particularly effective against JAPAN and OKINAWA.

3 The USSR cannot employ atomic bombs prior to 1952 but can employ limited quantities of radiological material.

(b) *Asiatic Mainland*

The USSR can move administratively and in secrecy through MANCHURIA and MONGOLIA as far as the Great Wall of CHINA in the vicinity of KALGAN, CHENGTE and CHIN HEIN prior to D Day. From these positions, further movement to the south can be accomplished as swiftly as lines of communication will permit. With the Chinese Communist Forces in control of all the area north of the Yangtze River, the Soviet Forces need occupy only the most strategic ports, airfields and line of communication control points on the Asiatic Mainland. Soviet Forces attacking KOREA could move rapidly from the adjacent Maritime Province and could effectively reduce all organized resistence by D+20 days. Such action would outflank JAPAN and OKINAWA and bring these areas within range of Soviet fighter aircraft based in CHINA and KOREA.

(c) *Japan and Okinawa*

1 No large scale invasion of JAPAN or OKINAWA is likely unless the Far East Air Forces lose control of the air. Minor airborne attacks for the purpose of sabotage may be expected and an invasion of HOKKAIDO by air and sea is a possibility in the early stages of the war. Such an invasion would be for the purpose of securing air and submarine bases in order to extend the range of Soviet fighters, to improve the effectiveness of the air and submarine blockade of JAPAN and possibly to secure a base for eventual invasion of HONSHU.

2 The principal initial threat lies in the enemy's capabilities for air and submarine action. The Soviet Air Force may be expected to launch an immediate all-out air attack to destroy U. S. bombers in the Far East Com-

mand and then to devote a major effort to the neutralization of air bases in JAPAN and the RYUKYUS by means of bombing and possibly airborne attack. From the outset of hostilities, Soviet submarines can be expected to attempt the interdiction of sea communications to the Far East Command.

3 Nuisance mining of the principal harbors of JAPAN and OKINAWA may be undertaken by submarines on initiation of hostilities. Effective mine blockade can be accomplished by the Soviet Air Force if a sufficient number of bombers are utilized for night mining missions.

4 Soviet Agents and Saboteurs can be landed in JAPAN and OKINAWA to support the Communist Fifth Column.

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d. *ASSUMPTIONS*

It is assumed that:

(1) In the Far East the Soviet primary objectives will be to secure their positions on the Asiatic Mainland and to neutralize U. S. air power and deny air base to U. S. strategic bombers.

(2) The initial attacks will come without warning.

(3) The USSR will make an attempt in the early stages of the war to seize HOKKAIDO by a combination of airborne and seaborne attack.

(4) Communist agents will intensify their subversive activities throughout the area of the Far East Command and that sabotage of U. S. lines of communication, base installations and air facilities will be particularly active in JAPAN.

(5) The USSR will employ chemical and biological warfare.

(6) A Communist dominated Government controls China, at least as far south as the Yangtze River, including the Shanghai area, and will make air bases available to the USSR.

(7) All U. S. forces have been withdrawn from the territory of China.

(8) The Japanese Government and people will support defense of Japan.

(9) The atomic bomb will be used by the UNITED STATES.

2. a. *MISSIONS*

Commander-in-Chief, Far East exercises unified command over all forces allocated to him by the Joint Chiefs of Staff, or other authority, and will carry out the following missions:

(1) Maintain the security of the Far East Command, including the protection of sea and air communications.

(2) Support United States policy within the scope of his command responsibility.

(3) Support Pacific, Alaska*, and Strategic Air* commanders in their missions.

(4) Make plans and preparations within the resources assigned to him and prospectively available to him in case of a general emergency to:

(a) Provide for the safety of U. S. Forces in Korea and China.

(b) Oppose enemy advances.

(c) Secure Japan, the Ryukyus, the Marianas and the Bonins.

(d) Discharge U. S. military responsibilities in the Philippines.

(*The above missions have been assigned by the Joint Chiefs of Staff, except those starred which are derived.)

b. *GENERAL CONCEPT*

(1) The general area of operations of the Far East Command includes the Sea of OKHOTSK, JAPAN, YELLOW and EAST CHINA Seas, and the land and water areas of JAPAN, KOREA and MANCHURIA, CHINA, the USSR FAR EAST, the RYUKYUS, PHILIPPINES, MARIANAS-VOLCANOES-BONINS.

(2) The general concept of operations is based on the strategic defense of JAPAN and the RYUKYUS and the protection of sea and air communications within the Far East Command.

(3) The general scheme of operations includes: the early destruction or neutralization of enemy air power; a major effort in defense of JAPAN and the RYUKYUS by the bulk of the forces of the Far East Command; and operations by Air and Naval forces to secure the air and sea lines of communications within the Far East Command. HOKKAIDO is defended by all available means and will not be abandoned except on specific orders of CINCFE. The evacuation of U. S. Forces from KOREA is effected as practicable and in accordance with decisions rendered at the time.

(4) When sufficient air units become available, the Air Forces of the Far East Command, in conjunction with elements under the control of the Commanding General, Strategic Air Command, initiate an air offensive against Soviet military potential which poses a threat to the Far East Command.

(5) Mining operations are conducted as feasible, by Air and Naval forces, when made available, in accordance with the provisions of CINCPAC's Over-All Mining Plan for the purpose of combatting the submarine menace at its source.

(6) Operations are based on the employment of U. S. Forces only. British Commonwealth Occupation (Army, Navy and Air) Forces remain in their current locations until receipt of further instructions from SCAP.

(7) Upon declaration of a general emergency Naval Forces afloat affecting CHINA report to CINCFE and are passed to the command of COMNAVFE.

(8) The Japanese Government maintains internal order and the processes of civilian economy under established procedures; conducts passive air defense for the Japanese population and renders such additional aid and services as may be directed by SCAP.

3. *MAJOR COMMANDS*

a. *FAR EAST AIR FORCES*

(1) *Tasks*

(a) Conduct active air defense of the Far East Command.

(b) Conduct such offensive air operations as are consistent with air defense of JAPAN and RYUKYUS to neutralize enemy air capabilities and to stabilize the situation in the Far East.

(c) Conduct the defense of the VOLCANO-BONINS.

(d) Provide facilities for administrative and logistic support for Strategic Air Command operations as directed.

(e) Support the operations of other major commands of the Far East Command.

(2) *Concept of Air Operations*

(a) The concept of air operations is based on: first, the active air defense of JAPAN and the RYUKYUS; second, an immediate tactical offensive against enemy airfields to reduce enemy air capabilities; third, (provided additional forces become available), an air offensive against that enemy military potential which constitutes a threat to the Far East Command; and fourth, cooperation with the Strategic Air Command in its offensive against the vital elements of the Soviet war-making potential.

1 Air defense by fighter aircraft and AAA is of prime importance to the security of JAPAN and the RYUKYUS. It is a continuous and over-riding requirement.

2 Fighter elements not required for defense, light bombardment units, and medium bombardment units as available, are employed in an immediate tactical offensive initially against enemy air fields basing aircraft, the performance characteristics of which permit strikes against U.S. installations in JAPAN and the RYUKYUS, or against troop evacuation in KOREA.

3 FEAF units must be prepared to strike at enemy air bases and sea ports in Sakhalin and the Kuriles from which an invasion of HOKKAIDO could be mounted.

4 As additional forces become available, the offensive is increasingly shifted to the destruction of other vital targets in support of the over-all defense of the Far East Command. This will include destruction of enemy air bases, ports, naval forces, stockpiles and industrial installations.

5 During the initial phase of the conflict, all available medium bombers with supporting elements are based on Okinawa and are available to CG, FEAF for employment in accordance with plans approved by the Joint Chiefs of Staff. Thereafter, these bombers, the VLR Reconnaisance units and Fighter Escort will be supervised by Commanding General, Strategic Air Command in the offensive against the vital elements of the Soviet war-making potential. When not so employed, these groups will be available to CINCFE for mining and other missions in support of his plans.

(b) The coordination and integration of mining operations in the Pacific, including the air aspect thereof, is a CINCPAC responsibility. CINCFE is responsible for implementing that portion of the operation assigned to him. Since assigned Naval air lift will probably be inadequate for this purpose, the medium bomb units, when made available to CINCFE, may be diverted from their primary mission of bombing to the collateral mission of aerial mining. Such diversion would be made only after full consideration of the relative threat to the security of the Far East Command of enemy submarines as opposed to enemy

air and other military potential.

(c) Aerial reconnaissance is conducted to the extent permitted by limited forces available and consistent with the losses sustained.

(d) FEAF units are employed in the protection of friendly ship movements and in support of naval operations. Of primary importance is the furnishing of air cover for COMNAVFE's evacuation of USAFIK.

(e) The limited cargo carrying aircraft available to the Far East Command are employed in the following priorities:

1 Redeployment of Air units from GUAM and the PHILIPPINES.

2 Combat reinforcements to HOKKAIDO when directed.

3 Transportation of critical supplies to all armed forces in JAPAN and the RYUKYUS.

4 Evacuation of casualties within JAPAN.

(f) The Commanding General, Far East Air Forces is responsible for initiation of action for, and coordination of, Search and Rescue Operations.

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c. *EIGHTH ARMY*

(1) *Tasks*

(a) Conduct ground defense of JAPAN.

(b) Support the operations of CG, FEAF and COMNAVFE.

(c) Provide necessary Army Forces for the discharge of occupation missions until such missions are withdrawn by SCAP.

(2) *Concept of Eighth Army Operations*

(a) Initially, the Eighth Army concentrates its major combat elements so as to provide for the maximum practicable defense of major airfields as designated by CG, FEAF and so as to be prepared to move to counter hostile landings both amphibious and airborne. Priority is given to the defence of HOKKAIDO and the AOMORI-OMINATO area of northern HONSHU.

(b) The KANTO Plain is initially occupied in sufficient force to counter a hostile airborne attack. If forced to withdraw from outlying areas, Eighth Army concentrates the maximum available force for the defense of this, the vital areas of JAPAN.

(c) The KANSAI Plain is occupied in sufficient force to assure the protection of vital airfields located therein and to guard against sabotage in the port areas.

(d) The Eighth Army covers the debarkation of USAFIK at ports in northwest KYUSHU as coordinated with COMNAVFE. CG, Eighth Army assumes command of USAFIK upon arrival in JAPAN and assumes control of all personnel, military and civilian, evacuated from KOREA. The Air Force and Marine components of USAFIK are moved to locations as arranged with CG, FEAF and COMNAVFE and passed to their respective commands.

(e) Dependents and non-essential civilians, including those evacuated from KOREA, are evacuated to the ZI when directed by CINCFE. Eighth Army provides for the internment of enemy nationals, the seizure of enemy installations and the control of neutral activities, especially communications in JAPAN, in accordance with instructions issued by CINCFE.

[SOURCE: MACARTHUR MEMORIAL RG-6]

4-11 UNITED STATES OBJECTIVES AND PROGRAMS FOR NATIONAL SECURITY (NSC-68)

Report — April 14, 1950
To: The National Security Council
By: The Executive Secretary

NOTE BY THE EXECUTIVE SECRETARY
to the
NATIONAL SECURITY COUNCIL
on
UNITED STATES OBJECTIVES AND PROGRAMS FOR NATIONAL SECURITY

References: A. NSC 20/4

B. Memo for NSC from Executive Secretary, same subject, dated April 14, 1950

The enclosed letter by the President and the Report by the Secretaries of State and Defense referred to therein are transmitted herewith for consideration by the National Security Council, the Secretary of the Treasury, the Economic Cooperation Administrator, the Director of the Bureau of the Budget, and the Chairman, Council of Economic Advisers, at the next regularly scheduled meeting of the Council on Thursday, April 20, 1950.

A proposed procedure for carrying out the President's directive as a matter of urgency is being circulated for concurrent consideration in the reference memorandum of April 14.

It is requested that this report be handled with special security precautions in accordance with the President's desire that no publicity be given this report or its contents without his approval.

JAMES S. LAY, JR.
Executive Secretary

Washington
April 12, 1950

Dear Mr. Lay:

After consideration of the Report by the Secretaries of State and Defense, dated April 7, 1950, re-examining our objectives in peace and war and the effect of these objectives on our strategic plans, I have decided to refer that Report to the National Security Council for consideration, with the request that the National Security Council provide me with further information on the implications of the Conclusions contained therein. I am particularly anxious that the Council give me a clearer indication of the programs which are envisaged in the Report, including estimates of the probable cost of such programs.

Because of the effect of these Conclusions upon the budgetary and economic situation, it is my desire that the Economic Cooperation Administrator, the Director of the Bureau of the Budget, and the Chairman, Council of Economic Advisers, participate in the consideration of this Report by the Council, in addition to the regular participation of the Secretary of the Treasury.

Pending the urgent completion of this study, I am concerned that action on existing programs should not be postponed or delayed. In addition, it is my desire that no publicity be given to this Report or its contents without my approval.

HARRY S. TRUMAN

A REPORT TO THE PRESIDENT
PURSUANT TO THE PRESIDENT'S DIRECTIVE
OF JANUARY 31, 1950

April 7, 1950

CONTENTS

Terms of Reference
Analysis
I. Background of the Present World Crisis
II. The Fundamental Purpose of the United States
III. The Fundamental Design of the Kremlin
IV. The Underlying Conflict in the Realm of Ideas and Values Between the U. S. Purpose and the Kremlin design
A. Nature of the Conflict
B. Objectives
C. Means
V. Soviet Intentions and Capabilities—Actual and Potential
VI. U. S. Intentions and Capabilities—Actual and Potential
VII. Present Risks
VIII. Atomic Armaments
A. Military Evaluation of U. S. and U. S. S. R. Atomic Capabilities
B. Stockpiling and Use of Atomic Weapons
C. International Control of Atomic Energy
IX. Possible Courses of Action

CONTENTS
(Cont'd)

Introduction
The Role of Negotiation
A. The First Course—Continuation of Current Policies, with Current and Currently Projected Programs for Carrying Out These Projects
B. The Second Course—Isolation
C. The Third Course—War
D. The Remaining Course of Action—a Rapid Build-up of Political, Economic, and Military Strength in the Free World
Conclusions
Recommendations

Terms of Reference

The following report is submitted in response to the President's directive of January 31 which reads:

"That the President direct the Secretary of State and the Secretary of Defense to undertake a reexamination of our objectives in peace and war and of the effect of these objectives on our strategic plans, in the light of the probable fission bomb capability and possible thermonuclear bomb capability of the Soviet Union."

The document which recommended that such a directive be issued reads in part:

"It must be considered whether a decision to proceed with a program directed toward determining feasibility prejudges the more fundamental decisions (a) as to whether, in the event that a test of a thermonuclear weapon proves successful, such weapons should be stockpiled, or (b) if stockpiled, the conditions under which they might be used in war. If a test of a thermonuclear weapon proves successful, the pressures to produce and stockpile such weapons to be held for the same purposes for which fission bombs are then being held will be greatly increased. The question of use policy can be adequately assessed only as a part of a general reexamination of this country's strategic plans and its objectives in peace and war. Such reexamination would need to consider national policy not only with respect to possible thermonuclear weapons, but also with respect to fission weapons—viewed in the light of the probable fission bomb capability and the possible thermonuclear bomb capability of the Soviet Union. The moral, psychological, and political questions involved in this problem would need to be taken into account and be given due weight. The outcome of this reexamination would have a crucial bearing on the further question as to whether there should be a revision in the nature of the agreements, including the international control of atomic energy, which we have been seeking to reach with the U. S. S. R."

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V. Soviet Intentions and Capabilities

A. *Political and Psychological*

The Kremlin's design for world domination begins at home. The first concern of a despotic oligarchy is that the local base of its power and authority be secure. The massive fact of the iron curtain isolating the Soviet peoples from the outside world, the repeated political purges within the U. S. S. R. and the institutionalized crimes of the MVD are evidence that the Kremlin does not feel secure at home and that "the entire coercive force of the socialist state" is more than ever one of seeking to impose its absolute authority over "the economy, manner of life, and consciousness of people", (Vyshinski, "The Law of the Soviet State", P. 74). Similar evidence in the satellite states of Eastern Europe leads to the conclusion that this same policy, in less advanced phases, is being applied to the Kremlin's colonial areas.

Being a totalitarian dictatorship, the Kremlin's objectives in these policies is the total subjective submission of the peoples now under its control. The concentration camp is the prototype of the society which these policies are designed to achieve, a society in which the personality of the individual is so broken and perverted that he participates affirmatively in his own degradation.

The Kremlin's policy toward areas not under its control is the elimination of resistance

to its will and the extension of its influence and control. It is driven to follow this policy because it cannot, for the reasons set forth in Chapter IV, tolerate the existence of free societies; to the Kremlin the most mild and inoffensive free society is an affront, a challenge and a subversive influence. Given the nature of the Kremlin, and the evidence at hand, it seems clear that the ends toward which this policy is directed are the same as those where its control has already been established.

The means employed by the Kremlin in pursuit of this policy are limited only by considerations of expediency. Doctrine is not a limiting factor; rather it dictates the employment of violence, subversion and deceit, and rejects moral considerations. In any event, the Kremlin's conviction of its own infallibility has made its devotion to theory so subjective that past or present pronouncements as to doctrine offer no reliable guide to future actions. The only apparent restraints on resort to war are, therefore, calculations of practicality.

With particular reference to the United States, the Kremlin's strategic and tactical policy is affected by its estimate that we are not only the greatest immediate obstacle which stands between it and world domination, we are also the only power which could release forces in the free and Soviet worlds which could destroy it. The Kremlin's policy toward us is consequently animated by a peculiarly virulent blend of hatred and fear. Its strategy has been one of attempting to undermine the complex of forces, in this country and in the rest of the free world, on which our power is based. In this it has both adhered to doctrine and followed the sound principle of seeking maximum results with minimum risks and commitments. The present application of this strategy is a new form of expression for traditional Russian caution. However, there is no justification in Soviet theory or practice for predicting that, should the Kremlin become convinced that it could cause our downfall by one conclusive blow, it would not seek that solution.

In considering the capabilities of the Soviet world, it is of prime importance to remember that, in contrast to ours, they are being drawn upon close to the maximum possible extent. Also in contrast to us, the Soviet world can do more with less,—it has a lower standard of living, its economy requires less to keep it functioning and its military machine operates effectively with less elaborate equipment and organization.

The capabilities of the Soviet world are being exploited to the full because the Kremlin is inescapably militant. It is inescapably militant because it possesses and is possessed by a world-wide revolutionary movement, because it is the inheritor of Russian imperialism and because it is a totalitarian dictatorship. Persistent crisis, conflict and expansion are the essence of the Kremlin's militancy. This dynamism serves to intensify all Soviet capabilities.

Two enormous organizations, the Communist Party and the secret police, are an outstanding source of strength to the Kremlin. In the Party, it has an apparatus designed to impose at home an ideological uniformity among its people and to act abroad as an instrument of propaganda, subversion and espionage. In its police apparatus, it has a domestic repressive instrument guaranteeing under present circumstances the continued security of the Kremlin. The demonstrated capabilities of these two basic organizations, operating openly or in disguise, in mass or through single agents, is unparalleled in history. The party, the police and the conspicuous might of the Soviet military machine together tend to create an overall impression of irresistible Soviet power among many peoples of the free world.

The ideological pretensions of the Kremlin are another great source of strength. Its identification of the Soviet system with communism, its peace campaigns and its championing of colonial peoples may be viewed with apathy, if not cynicism, by the oppressed totalitariat of the Soviet world, but in the free world these ideas find favorable responses in vulnerable segments of society. They have found a particularly receptive audience in Asia, especially as the Asiatics have been impressed by what has been plausibly portrayed to them as the rapid advance of the U. S. S. R. from a backward society to a position of great world power. Thus, in its pretensions to being (a) the source of a new universal faith and (b) the model "scientific" society, the Kremlin cynically identifies itself with the genuine aspirations of large numbers of people, and places itself at the head of an international crusade with all of the benefits which derive therefrom.

Finally, there is a category of capabilities, strictly speaking neither institutional nor ideological, which should be taken into consideration. The extraordinary flexibility of Soviet tactics is certainly a strength. It derives from the utterly amoral and opportunistic conduct of Soviet policy. Combining this quality with the elements of secrecy, the Kremlin possesses a formidable capacity to act with the widest tactical latitude, with stealth and with speed.

The greatest vulnerability of the Kremlin lies in the basic nature of its relations with the Soviet people.

That relationship is characterized by universal suspicion, fear and denunciation. It is a relationship in which the Kremlin relies, not only for its power but its very survival, on intricately devised mechanisms of coercion. The Soviet monolith is held together by the iron curtain around it and the iron bars within it, not by any force of natural cohesion. These artificial mechanisms of unity have never been intelligently challenged by a strong outside force. The full measure of their vulnerability is therefore not yet evident.

The Kremlin's relations with its satellites and their peoples is likewise a vulnerability. Nationalism still remains the most potent emotional-political force. The well-known ills of colonialism are compounded, however, by the excessive demands of the Kremlin that its satellites accept not only the imperial authority of Moscow but that they believe in and proclaim the ideological primacy and infallibility of the Kremlin. These excessive requirements can be made good only through extreme coercion. The result is that if a satellite feels able to effect its independence of the Kremlin, as Tito was able to do, it is likely to break away.

In short, Soviet ideas and practices run counter to the best and potentially the strongest instincts of men, and deny their most fundamental aspirations. Against an adversary which effectively affirmed the constructive and hopeful instincts of men and was capable of fulfilling their fundamental aspirations, the Soviet system might prove to be fatally weak.

The problem of succession to Stalin is also a Kremlin vulnerability. In a system where supreme power is acquired and held through violence and intimidation, the transfer of that power may well produce a period of instability.

In a very real sense, the Kremlin is a victim of its own dynamism. This dynamism can become a weakness if it is frustrated, if in its forward thrusts it encounters a superior force which halts the expansion and exerts a superior counterpressure. Yet the Kremlin cannot relax the condition of crisis and mobilization, for to do so would be to lose its dynamism, whereas the seeds of decay within the Soviet system would begin to flourish and fructify.

The Kremlin is, of course, aware of these weaknesses. It must know that in the present world situation they are of secondary significance. So long as the Kremlin retains the initiative, so long as it can keep on the offensive unchallenged by clearly superior counterforce—spiritual as well as material—its vulnerabilities are largely inoperative and even concealed by its successes. The Kremlin has not yet been given real reason to fear and be diverted by the rot within its system.

B. *Economic*

The Kremlin has no economic intentions unrelated to its overall policies. Economics in the Soviet world is not an end in itself. The Kremlin's policy, in so far as it has to do with economics, is to utilize economic processes to contribute to the overall strength, particularly the war-making capacity of the Soviet system. The material welfare of the totalitariat is severely subordinated to the interests of the system.

As for capabilities, even granting optimistic Soviet reports of production, the total economic strength of the U. S. S. R. compares with that of the U.S. as roughly one to four. This is reflected not only in gross national product (1949: U. S. S. R. $65 billion; U. S. $250 billion), but in production of key commodities in 1949:

	U. S.	U. S. S. R.	U. S. S. R. and European Orbit Combined
Ingot Steel (Million Met. tons)	80.4	21.5	28.0
Primary aluminum (thousands Met. tons)	617.6	130-135	140-145
Electric power (billion kwh.)	410	72	112
Crude oil (million Met. tons)	276.5	33.0	38.9

Assuming the maintenance of present policies, while a large U. S. advantage is likely to remain, the Soviet Union will be steadily reducing the discrepancy between its overall economic strength and that of the U. S. by continuing to devote proportionately more to capital investment than the U. S.

But a full-scale effort by the U. S. would be capable of precipitately altering this trend.

The U. S. S. R. today is on a near maximum production basis. No matter what efforts Moscow might make, only a relatively slight change in the rate of increase in overall production could be brought about. In the U. S., on the other hand, a very rapid absolute expansion could be realized. The fact remains, however, that so long as the Soviet Union is virtually mobilized, and the United States has scarcely begun to summon up its forces, the greater capabilities of the U. S. are to that extent inoperative in the struggle for power. Moreover, as the Soviet attainment of an atomic capability has demonstrated, the totalitarian state, at least in time of peace, can focus its efforts on any given project far more readily than the democratic state.

In other fields—general technological competence, skilled labor resources, productivity of labor force, etc.—the gap between the U. S. S. R. and the U. S. roughly corresponds to the gap in production. In the field of scientific research, however, the margin of United States superiority is unclear, especially if the Kremlin can utilize European talents.

C. *Military*

The Soviet Union is developing the military capacity to support its design for world domination. The Soviet Union actually possesses armed forces far in excess of those necessary to defend its national territory. These armed forces are probably not yet considered by the Soviet Union to be sufficient to initiate a war which would involve the United States. This excessive strength, coupled now with an atomic capability, provides the Soviet Union with great coercive power for use in time of peace in furtherance of its objectives and serves as a deterrent to the victims of its aggression from taking any action in opposition to its tactics which would risk war.

Should a major war occur in 1950 the Soviet Union and its satellites are considered by the Joint Chiefs of Staff to be in a sufficiently advanced state of preparation immediately to undertake and carry out the following campaigns.

a. To overrun Western Europe, with the possible exception of the Iberian and Scandinavian Peninsulas; to drive toward the oil-bearing areas of the Near and Middle East; and to consolidate Communist gains in the Far East;

b. To launch air attacks against the British Isles and air and sea attacks against the lines of communications of the Western Powers in the Atlantic and the Pacific;

c. To attack selected targets with atomic weapons, now including the likelihood of such attacks against targets in Alaska, Canada, and the United States. Alternatively, this capability, coupled with other actions open to the Soviet Union, might deny the United Kingdom as an effective base of operations for allied forces. It also should be possible for the Soviet Union to prevent any allied "Normandy" type amphibious operations intended to force a re-entry into the continent of Europe.

After the Soviet Union completed its initial campaigns and consolidated its positions in the Western European area, it could simultaneously conduct:

a. Full-scale air and limited sea operations against the British Isles;

b. Invasions of the Iberian and Scandinavian Peninculas;

c. Further operations in the Near and Middle East, continued air operations against the North American continent, and air and sea operations against Atlantic and Pacific lines of communication; and

d. Diversionary attacks in other areas.

During the course of the offensive operations listed in the second and third paragraphs above, the Soviet Union will have an air defense capability with respect to the vital areas of its own and its satellites' territories which can oppose but cannot prevent allied air operations against these areas.

It is not known whether the Soviet Union possesses war reserves and arsenal capabilities sufficient to supply its satellite armies or even its own forces throughout a long war. It might not be in the interest of the Soviet Union to equip fully its satellite armies, since the possibility of defections would exist.

It is not possible at this time to assess accurately the finite disadvantages to the Soviet Union which may accrue through the implementation of the Economic Cooperation Act of 1948, as amended, and the Mutual Defense Assistance Act of 1949. It should be expected that, as this implementation progresses, the internal security situation of the recipient nations should improve concurrently. In addition, a strong United States military position, plus increases in the armaments of the nations of Western Europe, should strengthen the determination of the recipient nations to counter Soviet moves and in event of war could be considered as likely to delay operations and increase the time required for the Soviet Union to overrun Western Europe. In all probability, although United States backing will stiffen their de-

termination, the armaments increase under the present aid programs will not be of any major consequence prior to 1952. Unless the military strength of the Western European nations is increased on a much larger scale than under current programs and at an accelerated rate, it is more than likely that those nations will not be able to oppose even by 1960 the Soviet armed forces in war with any degree of effectiveness. Considering the Soviet Union military capability, the long-range allied military objective in Western Europe must envisage an increased military strength in that area sufficient possibly to deter the Soviet Union from a major war or, in any event, to delay materially the overrunning of Western Europe and, if feasible, to hold a bridgehead on the continent against Soviet Union offensives.

We do not know accurately what the Soviet atomic capability is but the Central Intelligence Agency intelligence estimates, concurred in by State, Army, Navy, Air Force, and Atomic Energy Commission, assign to the Soviet Union a production capability giving it a fission bomb stockpile within the following ranges:

By mid-1950	10- 20
By mid-1951	25- 45
By mid-1952	45- 90
By mid-1953	70-135
By mid-1954	200

This estimate is admittedly based on incomplete coverage of Soviet activities and represents the production capabilities of known or deducible Soviet plants. If others exist, as is possible, this estimate could lead us into a feeling of superiority in our atomic stockpile that might be dangerously misleading, particularly with regard to the timing of a possible Soviet offensive. On the other hand, if the Soviet Union experiences operating difficulties, this estimate would be reduced. There is some evidence that the Soviet Union is acquiring certain materials essential to research on and development of thermonuclear weapons.

The Soviet Union now has aircraft able to deliver the atomic bomb. Our intelligence estimates assign to the Soviet Union an atomic bomber capability already in excess of that needed to deliver available bombs. We have at present no evaluated estimate regarding the Soviet accuracy of delivery on target. It is believed that the Soviets cannot deliver their bombs on target with a degree of accuracy comparable to ours, but a planning estimate might well place it at 40-60 percent of bombs sortied. For planning purposes, therefore, the date the Soviets posseses an atomic stockpile of 200 bombs would be a critical date for the United States for the delivery of 100 atomic bombs on targets in the United States would seriously damage this country.

At the time the Soviet Union has a substantial atomic stockpile and if it is assumed that it will strike a strong surprise blow and if it is assumed further that its atomic attacks will be met with no more effective defense opposition than the United States and its allies have programmed, results of those attacks could include:

a. Laying waste to the British Isles and thus depriving the Western Powers of their use as a base;

b. Destruction of the vital centers and of the communications of Western Europe, thus precluding effective defense by the Western Powers; and

c. Delivering devastating attacks on certain vital centers of the United States and Canada.

The possession by the Soviet Union of a thermonuclear capability in addition to this substantial atomic stockpile would result in tremendously increased damage.

During this decade, the defensive capabilities of the Soviet Union will probably be strengthened particularly by the development and use of modern aircraft, aircraft warning and communications devices, and defensive guided missiles.

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C. *Military*

The United States now possesses the greatest military potential of any single nation in the world. The military weaknesses of the United States vis-a-vis the Soviet Union, however, include its numerical inferiority in forces in being and in total manpower. Coupled with the inferiority of forces in being, the United States also lacks tenable positions from which to employ its forces in event of war and munitions power in being and readily available.

It is true that the United States armed forces are now stronger than ever before in other times of apparent peace; it is also true that there exists a sharp disparity between our actual military strength and our commitments. The relationship of our strength to our present commitments, however, is not alone the governing factor. The world situation, as well as commitments, should govern; hence, our military strength more properly should be related to the world situation confronting us. When our military strength is related to the world situation and balanced against the likely exigencies of such a situation, it is clear that our military strength is becoming dangerously inadequate.

If war should begin in 1950, the United States and its allies will have the military capability of conducting defensive operations to provide a reasonable measure of protection to the Western Hemisphere, bases in the Western Pacific, and essential military lines of communication; and an inadequate measure of protection to vital military bases in the United Kingdom and in the Near and Middle East. We will have the capability of conducting powerful offensive air operations against vital elements of the Soviet war-making capacity.

The scale of the operations listed in the preceding paragraph is limited by the effective forces and material in being of the United States and its allies vis-a-vis the Soviet Union. Consistent with aggressive threat facing us and in consonance with overall strategic plans, the United States must provide to its allies on a continuing basis as large amounts of military assistance as possible without serious detriment to United States operational requirements.

If the potential military capabilities of the United States and its allies were rapidly and effectively developed, sufficient forces could be produced probably to deter war, or if the Soviet Union chooses war, to withstand the initial Soviet attacks, to stabilize supporting attacks, and to retaliate in turn with even greater impact on the Soviet capabilities. From the military point of view alone, however, this would require not only the generation of the necessary military forces but also the development and stockpiling of improved weapons of all types.

Under existing peacetime conditions, a period of from two to three years is required to produce a material increase in military power. Such increased power could be provided in a somewhat shorter period in a declared period of emergency or in wartime through a full-out national effort. Any increase in military power in peacetime, however, should be related both to its probable military role in war, to the implementation of immediate and long-term United States foreign policy vis-a-vis the Soviet Union and to the realities of the existing situation. If such a course of increasing our military power is adopted now, the United States would have the capability of eliminating the disparity between its military strength and the exigencies of the situation we face; eventually of gaining the initiative in the "cold" war and of materially delaying if not stopping the Soviet offensives in war itself.

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Conclusions and Recommendations

Conclusions

The foregoing analysis indicates that the probable fission bomb capability and possible thermonuclear bomb capability of the Soviet Union have greatly intensified the Soviet threat to the security of the United States. This threat is of the same character as that described in NSC 20/4 (approved by the President on November 24, 1948) but is more immediate than had previously been estimated. In particular, the United States now faces the contingency that within the next four or five years the Soviet Union will possess the military capability of delivering a surprise atomic attack of such weight that the United States must have substantially increased general air, ground, and sea strength, atomic capabilities, and air and civilian defenses to deter war and to provide reasonable assurance, in the event of war, that it could survive the initial blow and go on to the eventual attainment of its objectives. In turn, this contingency requires the intensification of our efforts in the fields of intelligence and research and development.

Allowing for the immediacy of the danger, the following statement of Soviet threats, contained in NSC 20/4, remains valid:

"14. The gravest threat to the security of the United States within the foreseeable future stems from the hostile designs and formidable power of the U. S. S. R., and from the nature of the Soviet system.

"15. The political, economic, and psychological warfare which the U. S. S. R. is now waging has dangerous potentialities for weakening the relative world position of the United States and disrupting its traditional institutions by means short of war, unless sufficient resistance is encountered in the policies of this and other non-communist countries.

"16. The risk of war with the U. S. S. R. is sufficient to warrant, in common prudence, timely and adequate preparation by the United States.

"a. Even though present estimates indicate that the Soviet leaders probably do not intend deliberate armed action involving the United States at this time, the possibility of such deliberate resort to war cannot be ruled out.

"b. Now and for the foreseeable future there is a continuing danger that war will arise either through Soviet miscalculation of the determination of the United States to use all the means at its command to safeguard its security, through Soviet misinterpretation of our intentions, or through U. S. miscalculation of Soviet reactions to measures which we might take.

"17. Soviet domination of the potential power of Eurasia, whether achieved by armed aggression or by political and subversive means, would be strategically and politically unacceptable to the United States.

"18. The capability of the United States either in peace or in the event of war to cope with threats to its security or to gain its objectives would be severely weakened by internal developments, important among which are:

"a. Serious espionage, subversion and sabotage, particularly by concerted and well-directed communist activity.

"b. Prolonged or exaggerated economic instability.

"c. Internal political and social disunity.

"d. Inadequate or excessive armament or foreign aid expenditures.

"e. An excessive or wasteful usage of our resources in time of peace.

"f. Lessening of U. S. prestige and influence through vacillation or appeasement or lack of skill and imagination in the conduct of its foreign policy or by shirking world responsibilities.

"g. Development of a false sense of security through a deceptive change in Soviet tactics."

Although such development as those indicated in paragraph 18 above would severely weaken the capability of the United States and its allies to cope with the Soviet threat to their security, considerable progress has been made since 1948 in laying the foundation upon which adequate strength can now be rapidly built.

The Analysis also confirms that our objectives with respect to the Soviet Union, in time of peace as well as in time of war, as stated in NSC 20/4 (para. 19), are still valid, as are the aims and measures stated therein (paras. 20 and 21). Our current security programs and strategic plans are based upon these objectives, aims, and measures:

"19.

"a. To reduce the power and influence of the U. S. S. R. to limits which no longer constitute a threat to the peace, national independence and stability of the world family of nations.

"b. To bring about a basic change in the conduct of international relations by the government in power in Russia, to conform with the purposes and principles set forth in the U. N. Charter.

"In pursuing these objectives, due care must be taken to avoid permanently impairing our economy and the fundamental values and institutions inherent in our way of life.

"20. We should endeavor to achieve our general objectives by methods short of war through the pursuit of the following aims:

"a. To encourage and promote the gradual retraction of undue Russian power and influence from the present perimeter areas around traditional Russian boundaries and the emergence of the satellite countries as entities independent of the U. S. S. R.

"b. To encourage the development among the Russian peoples of attitudes which may help to modify current Soviet behavior and permit a revival of the national life of groups evidencing the ability and determination to achieve and maintain national independence.

"c. To eradicate the myth by which people remote from Soviet military influence are held in a position of subservience to Moscow and to cause the world at large to see and understand the true nature of the U. S. S. R. and the Soviet-directed world communist party, and to adopt a logical and realistic attitude toward them.

"d. To create situations which will compel the Soviet Government to recognize the practical undesirability of acting on the basis of its present concepts and the necessity of behaving in accordance with precepts of international conduct, as set forth in the purposes and principles of the U. N. Charter.

"21. Attainment of these aims requires that the United States:

"a. Develop a level of military readiness which can be maintained as long as necessary as a deterrent to Soviet aggression, as indispensable support to our political attitude toward the U. S. S. R., as a source of encouragement to nations resisting Soviet political aggression, and as an adequate basis for immediate military commitments and for rapid mobilization should war prove unavoidable.

"b. Assure the internal security of the United States against dangers of sabotage, subversion, and espionage.

"c. Maximize our economic potential, including the strengthening of our peacetime economy and the establishment of essential reserves readily available in the event of war.

"d. Strengthen the orientation toward the United States of the non-Soviet nations; and help such of those nations as are able and willing to make an important contribution to U. S. security, to increase their economic and political stability and their military capability.

"e. Place the maximum strain on the Soviet structure of power and particularly on the relationships between Moscow and the satellite countries.

"f. Keep the U. S. public fully informed and cognizant of the threats to our national security so that it will be prepared to support the measures which we must accordingly adopt."

In the light of present and prospective Soviet atomic capabilities, the action which can be taken under present programs and plans, however, becomes dangerously inadequate, in both timing and scope, to accomplish the rapid progress toward the attainment of the United States political, economic, and military objectives which is now imperative.

A continuation of present trends would result in a serious decline in the strength of the free world relative to the Soviet Union and its satellites. This unfavorable trend arises from the inadequacy of current programs and plans rather than from any error in our objectives and aims. These trends lead in the direction of isolation, not by deliberate decision but by lack of the necessary basis for a vigorous initiative in the conflict with the Soviet Union.

Our position as the center of power in the free world places a heavy responsibility upon the United States for leadership. We must organize and enlist the energies and resources of the free world in a positive program for peace which will frustrate the Kremlin design for world domination by creating a situation in the free world to which the Kremlin will be compelled to adjust. Without such a cooperative effort, led by the United States, we will have to make gradual withdrawals under pressure until we discover one day that we have sacrificed positions of vital interest.

It is imperative that this trend be reversed by a much more rapid and concerted build-up of the actual strength of both the United States and the other nations of the free world. The analysis shows that this will be costly and will involve significant domestic financial and economic adjustments.

The execution of such a build-up, however, requires that the United States have an affirmative program beyond the solely defensive one of countering the threat posed by the Soviet Union. This program must light the path to peace and order among nations in a system based on freedom and justice, as contemplated in the Charter of the United Nations. Further, it must envisage the political and economic measures with which and the military shield behind which the free world can work to frustrate the Kremlin design by the strategy of the cold war; for every consideration of devotion to our fundamental values and to our national security demands that we achieve our objectives by the strategy of the cold war, building up our military strength in order that it may not have to be used. The only sure victory lies in the frustration of the Kremlin design by the steady development of the moral and material strength of the free world and its projection into the Soviet world in such a way as to bring about an internal change in the Soviet system. Such a positive program—harmonious with our fundamental national purpose and our objectives—is necessary if we are to regain and retain the initiative and to win and hold the necessary popular support and cooperation in the United States and the rest of the free world.

This program should include a plan for negotiation with the Soviet Union, developed and agreed with our allies and which is consonant with our objectives. The United States and its allies, particularly the United Kingdom and France, should always be ready to negotiate with the Soviet Union on terms consistent with our objectives. The present world situation, however, is one which militates against successful negotiations with the Kremlin—for the terms of agreements on important pending issues would reflect present realities and would therefore be unacceptable, if not disastrous, to the United States and the rest of the free world. After a decision and a start on building up the strength of the free world has been made, it might then be desirable for the United States to take an initiative in seeking negotiations in the hope that it might facilitate the process of accommodation by the Kremlin

to the new situation. Failing that, the unwillingness of the Kremlin to accept equitable terms or its bad faith in observing them would assist in consolidating popular opinion in the free world in support of the measures necessary to sustain the build-up.

In summary, we must, by means of a rapid and sustained build-up of the political, economic, and military strength of the free world, and by means of an affirmative program intended to wrest the initiative from the Soviet Union, confront it with convincing evidence of the determination and ability of the free world to frustrate the Kremlin design of a world dominated by its will. Such evidence is the only means short of war which eventually may force the Kremlin to abandon its present course of action and to negotiate acceptable agreements on issues of major importance.

The whole success of the proposed program hangs ultimately on recognition by this Government, the American people, and all free peoples, that the cold war is in fact a real war in which the survival of the free world is at stake. Essential prerequisites to success are consultations with Congressional leaders designed to make the program the object of non-partisan legislative support, and a presentation to the public of a full explanation of the facts and implications of the present international situation. The prosecution of the program will require of us all the ingenuity, sacrifice, and unity demanded by the vital importance of the issue and the tenacity to persevere until our national objectives have been attained.

RECOMMENDATIONS

That the President:

a. Approve the foregoing Conclusions.

b. Direct the National Security Council, under the continuing direction of the President, and with the participation of other Departments and Agencies as appropriate, to coordinate and insure the implementation of the Conclusions herein on an urgent and continuing basis for as long as necessary to achieve our objectives. For this purpose, representatives of the member Departments and Agencies, the Joint Chiefs of Staff or their deputies, and other Departments and Agencies as required should be constituted as a revised and strengthened staff organization under the National Security Council to develop coordinated programs for consideration by the National Security Council.

[SOURCE: NATIONAL ARCHIVES]

4-12 MacARTHUR'S MEMO ON FORMOSA

Memorandum June 14, 1950
Drafted by: Gen. MacArthur

1. Since the Fall of 1948 when the military capability of the Chinese Communist to engulf all of the mainland of China became clearly evident I have been concerned as to the future status of Formosa and I have been convinced that the strategic interests of the United States will be in serious jeopardy if Formosa is allowed to be dominated by a power hostile to the United States. In my personal conversations with distinguished civilian and military representatives of the Government of the United States who have visited this Headquarters during the past eighteen months I have reiterated the premise that Formosa should not be allowed to fall into the hands of a potential hostile power or of a regime which would grant military utilization of Formosa to a power potentially hostile to the United States. On the 29th of May last I forwarded to the Joint Chiefs of Staff my estimate of the strategic consequences which would result from the capture of Formosa by the Chinese Communists.

2. The front line of the Far East Command as well as the western strategic frontier of the United States rests today on the littoral islands extending from the Aleutians through the Philippine Archipelago. Geographically and strategically Formosa is an integral part of this offshore position which in the event of hostilities can exercise a decisive degree of control of military operations along the periphery of Eastern Asia. In the event of a war United States striking forces based on this line would have the capability to interdict the limited means of communication available to the Communists and deny or materially reduce the ability of the USSR to exploit the natural resources of East and Southeast Asia. This essential capability on the part of the United States is dependent to a large degree upon the retention of Formosa by a friendly or a neutral power.

3. The geographic location of Formosa is such that in the hands of a power unfriendly to the United States it constitutes an enemy salient in the very center of that portion of our position now keyed to Japan, Okinawa and the Philippines. At the present time there is on Formosa a concentration of operational air and naval bases which is greater than any similar concentration on the Asiatic mainland between the Yellow Sea and the Strait of Malacca. Additional bases can be developed in a relatively short time by an aggressive exploitation of World War II Japanese facilities not now utilized by the Chinese Nationalist Forces. Formosa bases are 100 miles closer to Okinawa than any point on the Chinese mainland and are 150 miles closer to Clark Field and Manila than any other area which would be acquired by Communist military forces. An enemy force utilizing those installations currently available on Formosa could increase by 100 per cent the air effort which could be directed against Okinawa as compared to operations based in China proper and at the same time could direct damaging air attacks with fighter type aircraft against our installations in the Philippines which are currently beyond the range of fighters based on the mainland of Asia.

4. As a result of its geographic location and base potential, utilization of Formosa by a military power hostile to the United States may either counterbalance or overshadow the strategic importance of the central and southern flank of the United States front line position. Formosa in the hands of the Communists can be compared to an unsinkable aircraft carrier and submarine tender ideally located to accomplish Soviet offensive strategy and at the same time checkmate counteroffensive operations by United States Forces based on Okinawa and the Philippines. This unsinkable carrier-tender has the capacity to operate from ten to twenty air groups of types ranging from jet fighters to B-29 type bombers as well as to provide forward operating facilities for the short-range coastal submarines which are predominant in the Russian Asiatic Navy. If Formosa should be acquired by the Chinese Communists and bases thereon made available to the USSR, Russia will have acquired an additional "fleet" which will have been obtained and can be maintained at an incomparably lower cost to the Soviets than could its equivalent of ten or twenty aircraft carriers with their supporting forces.

5. Current estimates of Soviet air and submarine resources in the Far East agreed to by both Washington and Tokyo military intelligence agencies satisfy me that the Russians have the capability to extend their forces southward from their present positions and still maintain an imposing degree of military strength in both the Maritime Provinces and the Chinese seaboard. The ability of the USSR Chinese Communist hordes to meet promptly logistic requirements either by improvisation or by the import of critical materials from Europe is being demonstrated daily by military activities extending from Tientisin to the southern border of China. The interest of the USSR in the southward displacement of terminii of the Trans-Siberian Railroad has been reported by competent observers whose information indicated that rail lines are being extended through China southward from the vicinity of Lake Baikal and eastward from Russia Turkestan in the vicinity of Alma Ata. A Trans-Siberian railhead in the vicinity of Shanghai would materially assist in the logistic build-up of Formosa. Pending the actual outbreak of hostilities United States military forces will be unable to prevent the stockpiling of essential military supplies on Formosa if that area is acquired by the Communists.

6. Historically Formosa has been used as a springboard for military aggression directed against areas to the south. The most notable and recent example was the utilization of Formosa by the Japanese in World War II. At the outbreak of the Pacific War in 1941, Formosa played an important part as a staging area and supporting base for the various Japanese invasion convoys. The main strength of the forces which landed at Lingayen Gulf on Luzon were staged from Keelung, Takao, and the Pescadores. The supporting air forces of Japan's army and navy were based on fields situated along Southern Formosa at Takao, Koshun, and Taichu. Takao also served as a staging area for the invasion of Java in February 1942. From 1942 through 1944 Formosa was a vital link in the transportation and communications chain which stretched from Japan through Okinawa and the Philippines to Southeast Asia. In 1944-45 Formosa was the key staging point for troops and air reinforcements deployed to the Philippines in preparation for the all-important operation to hold the Philippine areas. As the United States carrier forces advanced into the Western Pacific, the air bases on Formosa assumed an increasingly greater role in the defense scheme of the Japanese. After the invasion of Luzon in January 1945 the Japanese air forces withdrew to Formosan fields to take up forward operational positions to be used against our advancing forces. The military utility of Formosa is sharply underlined by the fact that

Japan in 1941 controlled not only the Ryukyus but the entire eastern periphery of China.

7. In addition to its military value, Formosa has not only been self-sufficient as regards food for its own population of more than eight million but it has exported since 1910 with a favorable balance of external trade. In normal times Formosa held the position of a food surplus area in a generally food-scarce locality. Its prewar export of rice and wheat exceeded imports by approximately 600,000 metric tons annually. There is no reason to believe that able political and economic advisors cannot once more establish Formosa as a prosperous economic unit. Such a factor, particularly the availability of a food surplus, may be of considerable importance in re-establishing the economies of those Oriental nations now largely dependent upon United States assistance.

8. Formosa represents a political area of no less importance to western ideology than other areas in the Orient. The Taiwanese are a homogeneous racial group who as individuals have resisted the intrusion of foreign blood. Although Formosa was promised to China as a consequence of World War II this promise was given in consonence with a political situation entirely different than that which now exists. There is every basis from a moral standpoint to offer to the Taiwanese an opportunity to develop their own political future in an atmosphere unfettered by the dictates of a Communist police state. In view of the moral implications, as well as the geographic proximity of this area to other endangered peoples on and near the periphery of China, the future status of Formosa can well be an important factor in determining the political alignment of those national groups who have or must soon make a choice between Communism and the West.

9. There can be no doubt but that the eventual fate of Formosa largely rests with the United States. Unless the United States' political-military strategic position in the Far East is to be abandoned, it is obvious that the time must come in the foreseeable future when a line must be drawn beyond which Communist expansion will be stopped. As a means of regaining a proper United States posture in the Orient it is apparent to me that the United States should initiate measures to prevent the domination of Formosa by a Communist power. I am equally certain that it would be a fundamental error with regard to any part of the Orient to fail to take appropriate measures in those areas still open to our influence.

10. At this time I am unable to recommend the exact political, economic and military measures which should be taken to prevent the fall of Formosa either into the hands of a potential hostile power or into the hands of a power who will grant military utilization of Formosa to a hostile power. It is my firm conviction that a realistic estimate of requirements can only be based upon a physical survey of the area made by experienced military, economic and political observers. I concur wholeheartedly with the recommendations made by the Joint Chiefs of Staff on 23 December 1949 to the effect that the Commander-in-Chief Far East should make an immediate survey of the need and extent of the military assistance required in Formosa in order to hold Formosa against attack. Although this recommendation was apparently not acceptable at the time to the National Security Council, I note that the Joint Chiefs reaffirmed this recommendation on 4 May 1950.

11. Formosa has not yet fallen to Communist domination. There are conflicting reports as to the capability and will of the Chinese Nationalist Forces as now constituted and equipped to prevent either the military or political conquest of the island of Formosa. I cannot predict what the cost may be of preventing Communist domination of that island, although I have advised the Joint Chiefs of Staff what the cost may be if such an event transpires. I am satisfied, however, that the domination of Formosa by an unfriendly power would be a disaster of utmost importance to the United States, and I am convinced that time is of the essence. I strongly believe that the Commander-in-Chief Far East should be authorized and directed to initiate without delay a survey of the military, economic and political requirements to prevent the domination of Formosa by a Communist power and that the results of such a survey be analyzed and acted upon as a basis for United States national policy with respect to Formosa.

[SOURCE: MACARTHUR MEMORIAL]

4-13 MacARTHUR'S MEMO ON THE PEACE TREATY PROBLEM

Memorandum June 14, 1950
Drafted by: Gen. MacArthur

1. Three years ago I publicly expressed the view to the Allied Press in Tokyo that the Allied Powers should proceed at once in the formulation of a peace treaty for Japan.

I pointed out that in my opinion Japan was then ready for a peace settlement and should not be called upon arbitrarily to remain under the strictures of an economic blockade with consequent limitations upon her rehabilitation because of undue delay in the restoration of peace. I warned that historically military occupations had been shown to have a maximum utility of from three to five years, whereafter people under occupation became restive and the occupying forces assumed increasingly the complex of entrenched power. I added that a post-treaty unarmed Japan should be able to look to the machinery of the United Nations for the safeguard of her political and territorial integrity.

2. Since then the issue of a peace treaty has been constantly upon the agenda of international discussion and has undergone many changes in form as the several Powers from time to time reoriented their respective viewpoints. Basically, however, since the issue was first raised, all of the Powers have found common agreement in the desirability of peace and only a procedural conflict between the Soviet and the other Powers has prevented the holding of a peace conference—the Soviet insisting that it involved a matter which should first go before the Conference of Foreign Ministers while the other Powers, including the United States, adhered to the proposition that it was an issue for direct action by the member nations of the Far Eastern Commission. It is problematical whether the Soviet would have participated in such a parley between all of the Powers as the same was never actually called.

3. During this period the United States has quietly worked upon the preparation of a treaty draft and the nations of the British Commonwealth have held three successive meetings hoping through an exchange of ideas to crystallize a firm Commonwealth peace policy. More recently, the Soviet and Communist China publicly espoused an immediate peace treaty for Japan as part of their treaty of alliance and entered upon a campaign of propaganda charging that the Western Powers and particularly the United States bear responsibility for the treaty delay, alleging for its purpose the "colonization" of Japan and its use as a military base from which to mount aggressive warfare against the Soviet and Communist China. Adding to the general confusion and furnishing the Soviet and her Asian Communist satellites with ammunition of destructive value, the international press has made much of revelations that the United States is unable to arrive at a peace policy because of conflicts in viewpoint between the Defense and State Departments, giving emphasis to the idea that the conflict lies in the insistence by the Defense Department that Japan be held as a vital security adjunct of the United States.

4. Only recently the Joint Chiefs of Staff have reviewed their previous position on the treaty problem and reaffirmed their belief that certain conditions must be present to warrant our entry into treaty negotiations. All of such conditions may be discounted as offering no unsurmountable difficulties with the exception of one which requires that the Soviet and Communist China be among the signatories of the final treaty. This, of course, is impossible if the document is to contain adequate security reservations and we are to maintain our present political policy vis-a-vis Communist China. Indeed, if such a condition is to prevail it will foreclose any possibility of treaty action.

5. Although neither as SCAP nor as CINCFE do I share authority for the treaty making, as SCAP I have long been deeply concerned over the psychologically adverse effect upon the Japanese people of protracted delay in moving toward such a treaty, and as CINCFE I have observed with grave misgivings the progressive deterioration of our military potential under the impact of political and military reverses on the mainland of Asia, with concomitant pressure upon vital segments of our strategic island frontier off of the Asian coast. Indeed, my observation of passing events in Asia and understanding of Oriental psychology have long convinced me that it has been a fundamental error to do nothing pending assurance that we could accomplish all. Thus, even granting the soundness of the JCS premise that the interests of the United States demand inclusion of the Soviet and Communist China as signatories to any treaty arrangement, it does not necessarily follow that all action leading to a treaty must be suspended pending assurance of their agreement to the treaty conditions we ultimately determine.

6. The Japanese people have faithfully fulfilled the obligations they assumed under the instrument of surrender and have every moral and legal right to the restoration of peace. On this point, as before stated, all of the Allied Powers concerned are in full accord and publicly committed and their failure to protect Japan in this right would be a foul blemish upon modern civilization. For this reason and irrespective of the issues joined and ultimate policy objectives, we should not allow ourselves to be deterred from moving invincibly forward along a course which we ourselves and the entire world recognize to be morally

and legally right. We should proceed to call a peace conference at once, work out just and proper treaty terms among those in attendance, invite all of the nations concerned whether participants or not, to ratify the peace formula agreed upon, and thereafter let the nation which obstructs this normal procedure in international affairs or refuses to ratify a just and equitable treaty assume the full onus for any failure to reach an overall accord. Then, not now, would be the time to determine in the light of the existing situation whether to effectuate such a treaty without the Soviet or to maintain the status quo pending Soviet ratification. Thereby Japan and all of Asia would witness the resurgence of our moral leadership and renewal of our initiative in the conduct of Asian affairs.

7. This is our most impelling need of the moment in this quarter of the globe—the regaining of our lost initiative over the events which are stirring all of the Asian peoples. For, it is in the pattern of Oriental psychology to respect and follow aggressive, resolute and dynamic leadership but quickly turn from a leadership characterized by timidity or vacillation. Only recently this found emphasis in the great harm done us in the eyes of the Asian masses by irresponsible official statements suggesting the possibility of our withdrawal from our Western Pacific positions under Soviet pressure—harm which may only be overcome though the drama of a reassertion of positive leadership, the regaining of forceful initiative. The resolute move toward the holding of a peace conference because it is morally right that such a peace conference should be held—irrespective of its potentialities—would go a long way toward reasserting that leadership and regaining that initiative.

8. On the other hand, our continued delay in calling a peace conference with the view to giving the Japanese that degree of freedom from international restraint which they have well earned and to which they are now morally and legally entitled, cannot fail to result in a progressive deterioration of our position both here and abroad—a deterioration which if long enough extended will inevitably confront us with a situation of general hostility. Soviet propaganda is already attributing to us responsibility of the delay of a treaty. It is not inconceivable that an early Soviet move may be to seize itself the initiative in calling upon the powers to join it in such a peace conference or proceed directly toward a separate Soviet peace with Japan. In either such eventuality the United States would indeed be placed on the horns of a dilemma and our position would become virtually irretrievable.

9. To safeguard against such an eventuality and to compose the situation in Japan resulting from recent appeals to nationalist sentiment, existing conflicts within the United States Government must be bridged to permit early action toward the effectuation of peace. The nature of such conflicts has only recently come to my attention, and it is encouraging to note the relatively small area of disagreement which appears now to exist, providing reason to hope that there is no irreconcilable point of difference.

10. It is my understanding that both Departments agree that the United States policy as expressed in NSC 13/3,

> "1. *Timing and Procedure:* In view of the differences which have developed among the interested countries regarding the procedure and substance of a Japanese peace treaty and in view of the serious international situation created by the Soviet Union's policy of aggressive Communist expansion this Government should not press for a treaty of peace at this time. It should remain prepared to proceed with the negotiations, under some generally acceptable voting procedure, if the Allied Powers can agree among themselves on such a procedure. We should, before actually entering into a peace conference seek through the diplomatic channel the concurrence of a majority of the participating countries in the principal points of content we desire to have in such a treaty. Meanwhile, we should concentrate our attention on the preparation of the Japanese for the eventual removal of the regime of control."

has been "overtaken by events", although it appears to be the view of State that such events have made it mandatory that the United States now press for a peace treaty, while Defense on the other hand interprets them as necessitating a more positive prohibition against entry into *any* peace treaty negotiations in the foreseeable future. State's position is based primarily upon political considerations, while that of Defense finds its direction in overall security requirements. The solution sought is that which will serve the one without doing violence to the other.

11. Two alternative security arrangements have been proposed and currently form the basis of discussion within the government:

> "*Alternative Security Arrangement I*—Concurrently with the conclusion of a treaty of peace, a collective security arrangement consistent with the United Nations Charter would be concluded with Japan. The membership might include, initially, in addition to Japan, those participating FEC powers which would be interested in joining. The parties other than Japan would undertake to come to the assistance of any party which was the victim of an act of aggression committed by Japan. All of the parties would undertake to assist in defending Japan in the event that an act of aggression were committed against Japan from any source. In connection with this latter undertaking, Japan would make available to the United States such bases in Japan as might be required for the purpose of securing Japan's defense against aggression."
>
> "*Alternative Security Arrangement II*—An agreement would be entered into with Japan which would restore to Japan full sovereignty in matters relating to its internal government and to the conduct of its political and economic affairs with other nations. On the ground that the security objectives of the Potsdam Proclamation have not yet been achieved, the treaty would leave unchanged the existing legal authority furnished by Allied wartime agreements and the Instrument of Surrender for the occupation regime of control (including SCAP, the FEC and occupation forces in Japan), although this authority would be closely restricted to matters of security and would not be exercised in the subject matters covered by the treaty except in case of a grave emergency."

12. The first proposed security arrangement, providing for a collective security agreement to be entered into concurrently with the conclusion of a treaty of peace, with bases made available to the United States, could not now fail to be interpreted as dictated by primary American security requirements—with accent upon the defense of the United States rather than the defense of Japan. Such interpretation would reflect a comparatively recent change in Japanese thinking largely brought about by ill-advised statements made by influential persons in the United States laying great stress upon the need for Japanese bases in the United States Western Pacific defense line as a means of preserving United States security. This has aroused a wave of intense nationalistic opposition within Japanese political circles which has been fanned by Communist propaganda that the reservation of such military bases to the United States would be a move toward the "colonization" of Japan and an aggressive threat against the mainland of Asia. In these circumstances, while such a collateral agreement is entirely possible of legal consummation, its value to the United States would be limited by the bitterness and resentment which would thereafter dominate the Japanese mind.

13. The second proposed security arrangement providing for a partial peace with retention under limited application of the present regime of control would be worse than maintaining the status quo, as the resulting situation would be little different from that which now exists, whereunder there has been a progressive relaxation of internal political control and the basis established for the lifting of restraint on external activity as individual nations invite resumption of bilateral intercourse, and far short of what the Japanese have a right to expect from formal treaty action. While the proposed arrangement would legalize and hasten an enlarged scope of Japanese autonomy in its international affairs, it might be viewed as a betrayal by the United States by many Japanese, who would neither understand nor voluntarily accept any formal treaty arrangement which failed to restore full autonomous authority in the conduct of Japanese public affairs. There would be no convincing argument to justify in the eyes of the Japanese the retention of such controls in a formal treaty for which they have worked, and been led to believe offered the means toward the restoration of sovereign freedom. They have heretofore fully understood and accepted the fact that the delay in the restoration of such freedom has been due to the procedural difficulties preventing the holding of a peace conference, but once a formula is found for arriving at a peace settlement, even if only based upon partial representation of the Allied Powers, it would be impossible to explain with any semblance of sincerity or validity the failure to grant the same. Further than this, such failure would furnish the Communists with a propaganda weapon against which there would be no defense, and it would convince many Japanese who have loyally supported the occupation and worked diligently to achieve its stated objectives, that the aims and purposes of the United States conform indeed to the line of Communist propaganda. Such an arrangement would find little willing Japanese support and arouse much bitter opposition. Its easily discernible weakness would lie not only in its failure to accord the Japanese full political autonomy, but even more in its patent effort to mask the continued occupancy of military bases behind the pretended need for indefinite extension of the existing regime of Allied control.

14. The pertinent provisions of the Potsdam Declaration which set forth the security

objective and establish the conditions prerequisite to the withdrawal of Allied forces are as follows:

> "(6) There must be eliminated for all time the authority and influence of those who have deceived and misled the people of Japan into embarking on world conquest, for *we insist that a new order of peace, security and justice will be impossible until irresponsible militarism is driven from the world.*"
>
> "(7) *Until such a new order is established and* until there is convincing proof that Japan's war-making power is destroyed, *points in Japanese territory to be designated by the Allies shall be occupied to secure the achievement of the basic objectives we are here setting forth.*"
>
> "(12) *The occupying forces of the Allies shall be withdrawn from Japan as soon as these objectives have been accomplished* and there has been established in accordance with the freely expressed will of the Japanese people a peacefully inclined and responsible government."

The foregoing provisions create in themselves a legal basis for security reservations in a peace treaty which are deserving of careful consideration. Narrowly interpreted they might be construed as appertaining solely to "irresponsible militarism" in *Japan*, with the condition stipulated held satisfied once the same is brought under effective control. Such narrow interpretation would unquestionably be given by elements hostile to the United States. However, it is quite clear to me that a broader interpretation was intended by the framers of the Declaration, (U. S., Britain and China) who clearly sought to see arise in Japan "a new order of peace, security and justice" and correctly estimated that such a new order in an unarmed Japan would be "impossible until irresponsible militarism is driven *from the world*" and so provided that "until such new order is established.....points in Japanese territory to be designated by the Allies shall be occupied." Indeed, no other interpretation could reasonably and logically be given the language of the document. True, the framers of the Declaration probably did not then envision that so soon after the formalities of surrender the world would again be aflame in the wake of predatory forces embarked upon military conquest; that an unarmed Japan and its "new order of peace, security and justice" would lie prostrate at the mercy of such predatory forces victorious on the adjacent mainland once "points in Japanese territory" ceased to be occupied by Allied forces. But by specifically stipulating the time element for occupation as "until irresponsible militarism is driven from the world" they provided the legal basis to secure against just the threat which in such circumstances would exist, and made clear their intention that not only would "irresponsible militarism" be suppressed within Japan but that Japan's war making potential would not be available for exploitation by "irresponsible militarism" on the march abroad. They thereby set the stage for a secure basis upon which an unarmed Japan's permanent neutrality ultimately might rest, and made unequivocally clear by so doing that such a destiny alone could foster the well-being of the Japanese people and serve the essential interest of all of the other nations of the earth.

15. Some persons decry as visionary and unreal the road to ultimate political neutrality for Japan. But such persons are blind to realities. They fail to understand that Japan has been completely disarmed and demilitarized by order of the Allied Powers and consequently her neutrality in practical effect has been already decreed by Allied edict—that neutrality in such circumstances is not a concept but an actuality. Overlooking this, they see in the existing international tension mandatory requirements to guide the political pattern of Japan's present and long range future. The exigencies of the present must of course be bridged to the potentialities of the future, but to ignore the realities is to plan unsoundly for either present or future. Any effort to reverse Allied policy toward the rearmament of Japan at this time would be accompanied by convulsions in Australia, New Zealand, Indonesia, the Philippines and throughout Asia, and might very well solidify a Pacific bloc against American policy vis-a-vis Japan. Any such move would be accompanied by no less convulsive reactions in Japan itself where the people with irrefutable sincerity have turned scornfully from the militarists and militarism, as the root causes of Japan's disastrous adventure into the conquest and exploitation of others. Additionally, despite remarkable progress toward economic self-sufficiency through the re-development of industrial energy, Japan still requires American aid to cover its food deficit and only with greatest difficulty can obtain a bare minimum of raw materials essential to sustain industrial production. Consequently, from a practical standpoint, Japan could not rearm from her own impoverished indigenous resources but would require billions in American aid to build military strength beyond that level merely provocative of attack and exploitation by others. Moreover from every standpoint, it is more

essential that Japan be denied to the Soviet than that she be an active military ally of the United States. Such denial can best be assured through a firm political alignment resting upon the good will and faith of the Japanese people, with our access to military and naval bases and other available facilities adequate to meet the needs of our security operations. This is in complete consonance with the status of neutrality, both present and future, and Japan's insular location renders such neutrality feasible both from a military and political standpoint. Our military policy vis-a-vis Japan, therefore, should be oriented to the denial of Japan to the Soviet through the safeguard of its neutrality, rather than an approach to something resembling an outright military alliance.

16. The referenced Potsdam conditions should be fully availed of in the shaping and implementation of treaty policy. For a treaty of peace reserving to the Allies the right to continue to occupy "points in Japanese territory" until "irresponsible militarism is driven from the world" and there is no longer threat to "peace, security and justice" in unarmed Japan would not only adhere to the conditions expressly laid down in the Potsdam Declaration but would preserve the legal continuity of Allied action. It would place the retention of military garrisons squarely up to the Potsdam Declaration upon which the Japanese Communists and the Soviet repeatedly have called in support of their position. Provision should be made in such a treaty for the relinquishment by the Allied signatories of all political power and authority over Japan not directly appertaining to security requirements, and in order to make clear such intention, it should be specifically provided that the existing regime of control, i.e., SCAP, the Far Eastern Commission and the Allied Council for Japan, shall be rendered inoperative coincident with the treaty's effectuation.

17. To insure that such a course does not generate widespread disappointment and resentment and become a focus for destructive propaganda both in Japan and on the continent of Asia, provision should be made for the ratification of such a treaty, not only by the Government of Japan with the approval of the National Diet, but through a plebiscite by the Japanese people as well, leaving to their ultimate choice acceptance of such Potsdam-provided security requirements as a corollary to the restoration of political freedom, or continued adherence to the status quo.

18. I was never in agreement with the reasoning advanced by some that a peace treaty without the Soviet would either favorably alter the Soviet's legal position vis-a-vis the Japanese problem or be seized upon by the Soviet as the basis for intensified pressure upon Japan. The Soviet has demonstrated time and again that his decisions are based solely upon political expediency and relative military capabilities, without the slightest regard for prior commitment or legalistic reasoning. Any move which the United States makes is fraught with the danger of Soviet retaliation but hardly more so than is maintaining the status quo vis-a-vis Japan, whereunder the Soviet is smarting with a sense of complete frustration.

19. In view of the foregoing, it is believed that in the search for an acceptable solution which will make-possible full accord within our own government and provide it the basis for unified treaty action, consideration should be given to the following:

> *Alternative Security Arrangement III*—That a normal treaty be consummated embodying, however, a security reservation to the effect that so long as "irresponsible militarism" exists in the world as a threat to "peace, security and justice" in Japan, the pertinent security conditions of the Potsdam Declaration shall be deemed unfulfilled and, in view of the attendant threat to unarmed Japan's "new order of peace, security and justice", points in Japanese territory continue to be garrisoned by the Allied Powers signatory thereto through United States forces; that when such threat from "irresponsible militarism" ceases to exist, all provisions of the surrender terms shall be deemed fulfilled and all Allied garrisons shall be permanently withdrawn from Japan.

[SOURCE: MACARTHUR MEMORIAL]

4-14 MacARTHUR'S MEMO ON SECURITY IN POST-WAR JAPAN

Memorandum June 23, 1950
Drafted by: Gen. MacArthur

1. The concept that the defense of a land area necessitates only reservation of predetermined points for air, ground and naval concentrations has been outmoded by the accelerated speed and power of modern war. In place thereof, the entire land mass must

be regarded as a potential area for maneuver with adequate provision made to insure complete freedom of strategic planning and tactical disposition to meet any change in the requirements for successful defense.

2. Translated into specific reference to the Japanese problem, the following general formula should prevail: The entire area of Japan must be regarded as a potential base for defensive maneuver with unrestricted freedom reserved to the United States as the protecting power through her local commander, acting in the normal chain of command to the Department of Defense, to take such strategic despositions as may be necessary to adjust defense planning adequately to cope with any change in the potentiality of external threat and in the event of hostilities to take such tactical dispositions as the military situation may from time to time require. Thus, by avoiding emphasis upon any specific points to be reserved as "bases" for use of the security forces, not only will the reservations be realistically drawn to meet the requirements of modern defense but the distasteful connotation given the term "bases", as legitimate spoils of war, may be avoided. To further correct any adverse psychological effect upon the national sentiment of the Japanese people, provision should be made that except in time of hostilities or imminently threatened hostilities no major change in the disposition of the security forces shall be made without first consultation between the United States Military Commander and the Prime Minister of Japan; apart from this, the protecting power should maintain security forces on Japanese soil on a fully "pay as you go" basis, with the identical responsibilities, vis-a-vis the local populace which exist in the United States, i.e., the security forces should have neither responsibility nor authority to intervene in the internal affairs of Japan and should under conditions of peace bear full responsibility for damage to property and injury to persons resulting from military operations or the tortuous acts of military personnel. The Japanese police forces would of course be increased to a size and character adequate for internal security.

3. Such a reservation would be fully understood and I believe accepted by the Japanese people who from experience have come to hold as beneficent the presence of American troops in their midst, and would welcome the contribution to their national economy reflected from a "pay as you go" basis which under present conditions would mean approximately $300,000,000 annually or about the difference between the existing deficit economy and a completely self-sustaining economy. There appears to be no insuperable problem in the working out of a security reservation along these lines.

4. In any study of the Japanese problem it must be understood that despite Japan's constitutional renunciation of war its right to self-defense in case of predatory attack is implicit and inalienable. In such a situation Japan would muster all of its available human and material resources in support of the security forces committed to its defense.

[SOURCE: MACARTHUR MEMORIAL]

4-15 AUTHORIZATION OF NATIONAL POLICE RESERVE

Letter
To: Premier Yoshida
From: Gen. MacArthur

July 8, 1950

"Dear Mr. Prime Minister:

"In keeping with my established policy to re-invest autonomous authority in the Japanese Government as rapidly as the situation permits, I have visualized the progressive development of law enforcing agencies adequate to the maintenance of internal security and order and the safeguard of Japan's coastline against unlawful immigration and smuggling.

"By letter of September 16, 1947 I approved the recommendation of the Japanese Government for an increase in the overall strength of Japan's police force to 125,000 men, making provision for a new national rural police force of 30,000 men. It was then the view of the government, in which I fully concurred, that the strength recommended and authorized was not an arbitrary determination of future police requirements but designed to provide an adequate force around which might be built a modern and democratic police system oriented to an effective decentralization of the police responsibility in harmony with the constitutional principle of local autonomy.

"Subsequent action in the recruitment, equipping and training of the police force then authorized has proceeded with commendable efficiency. The concept of autonomous responsibility has been faithfully observed, essential coordination has been carefully developed

and the proper relationship between the police and private citizenry has been progressively forged. As a consequence, the Japanese people today may take justifiable pride in this agency for the enforcement of law at all levels of government. Indeed, it may be credited to both organizational police efficiency and the law-abiding character of the Japanese people that, despite a much lower police strength in relation to population here than is to be found in most of the other democratic states and the general post-war impoverishment and other adverse conditions usually conductive to lawlessness, Japan stands out with a calmness and serenity which lends emphasis to the violence, confusion and disorder which exist in other nearby lands.

"To insure that this favorable condition will continue unchallenged by lawless minorities, here as elsewhere committed to the subversion of the due processes of law and assaults of opportunity against the peace and public welfare, I believe that the police system has reached that degree of efficiency in organization and training which will permit its augmentation to a strength which will bring it within the limits experience has shown to be essential to the safeguard of the public welfare in a democratic society.

"Insofar as maritime safety in the harbors and coastal waters of Japan is concerned the Maritime Safety Board has achieved highly satisfactory results but events disclose that safeguard of the long Japanese coastal line against unlawful immigration and smuggling activity requires employment of a larger force under this agency than is presently provided for by law.

"Accordingly, I authorize your government to take the necessary measures to establish a national police reserve of 75,000 men and expand the existing authorized strength of the personnel serving under the Maritime Safety Board by an additional 8000. The current year's operating cost of these increments to existing agencies may be made available from funds previously allocated in the General Account of the National Budget toward retirement of the public debt. The appropriate sections of this Headquarters will be available, as heretofore, to advise and assist in the technical aspects of these measures.

[SOURCE: SUITLAND PAPERS]

4-16 STAFF STUDY "INCREASE IN JAPANESE SECURITY AGENCIES"[5]

Memorandum
From: General Headquarters Far East Command
Top Secret

July 14, 1950

AG 353 (10 Jul 50) GC
MEMORANDUM TO: Maj. Gen. W. P. Shepard
G-1
G-2
G-3
G-4
AG

SUBJECT: Establishment of the Advisory and Control Group for the National Police Reserve

1. Maj. Gen. W. P. Shepard is hereby authorized to initiate action to establish an advisory and control group for the purpose of providing guidance to the Japanese Government concerning the organization, training, and control of the National Police Reserve. Recommended occupational personnel strength, by category, to form this group will be submitted to this headquarters for approval. The target date for the completion of the recruitment of the National Police Reserve is 15 September 1950; the target date for the completion of individual and small unit training is 15 December 1950.

2. The Commanding General, Eighth Army, will make school facilities at the Eta Jima School Command available for necessary cadre training of the National Police Reserve. The Commanding General, Eighth Army, will be responsible for providing logistic support required by the National Police Reserve as approved by this Headquarters.

3. The Assistant Chief of Staff, G-1, Far East Command, will furnish the military personnel for the establishment of the advisory and control group, and will provide the necessary office space.

4. The Assistant Chief of Staff, G-2, through the Public Safety Division, will furnish

[5] Approved by Chief of Staff on July 12, 1950.

guidance on matters relating to recruitment. He, through Japanese Liaison/G-2 and Public Safety Division, will advise and assist in establishing liaison with the Japanese Government.

5. The Assistant Chief of Staff, G-3, Far East Command, will furnish guidance on matters of initial deployment and subsequent utilization of the National Police Reserve.

6. Maj. Gen. W. P. Shepard is hereby authorized direct communication with agencies of the Japanese Government on matters pertaining to the National Police Reserve.

7. A copy of this Memorandum (less Inclosure 1) has been forwarded separately for action to CG, Eighth Army and for information to COMNAVFE and CG FEAF.

BY COMMAND OF GENERAL MacARTHUR:

K. B. BUSH
Brigadier General, USA,
Adjutant General.

CHECK SHEET
(Do not remove from attached sheets)

File No: Subject: Increase in Japanese Security Agencies

Note No: From: DC/S, SCAP To: Chief of Staff Date: 10 July 50

1 1. As directed by you, submitted herewith is a plan (Tab 1) for the activation of the National Police Reserve.

2. Tab 2 outlines the procedure to increase the strength of the Maritime Safety Agency. This increase does not require a detailed plan as it only requires the expansion of a government agency already in existence, and utilizes existing facilities and installations.

3. Tab 3 is ESS financial estimate in support of both plans.

4. Brief of Tab 1 is attached. Tabs 2 and 3 require no brief.

5. Recommend approval of:
   a. Plan (Tab 1)
   b. Plan (Tab 2)
   c. Financial estimate (Tab 3)

6. G-2 and G-3 concur.

3 Incls:
1. Tab 1—National Police Reserve Plan w/Annexes A thru G
2. Tab 2—Coast Guard Augmentation Plan
3. Tab 3—ESS Financial Estimate

A. P. F.

AD HOC COMMITTEE
(DCofS, SCAP, G-2, G-3)
Brief of TAB 1—"National Police Reserve"

The organization, equipping, and control of the National Police Reserve should be the responsibility of a general officer designated by the C-in-C, assisted by an advisory and control group comprised by members of the general and special staffs and technical services. This group should be under the general supervision of the Deputy Chief of Staff, SCAP. The Eta Jima School Command should be used as required in training Japanese cadres and technicians in the use and employment of United States arms and equipment furnished.

"Cover" for the initiation of the program (general recruiting and processing in Japanese Channels) should be furnished by the Public Safety Division/G-2.

Assistant Chief of Staff, G-2 utilizing the Japanese Demobilization Bureau, PSD, and other agencies under his control, should assist in the selection of key Japanese ex-military, non-purgee personnel for command, staff and technical positions in the force.

Concurrently with processing of recruits at the six (6) National Rural Police regional schools, concentration and training areas should be selected and organized to receive trainees in groups of 1,000 from the reception centers (National Rural Police regional schools). To speed up the initial recruitment, processing and concentration, vacant military installations should be utilized as required and feasible.

The National Police Reserve of 75,000 should be organized as rapidly as possible into four (4) Japanese infantry-type divisions of approximately 15,000 each, with normal maintenance and technical service support. They should be located in the four (4) main military regions of Japan which conform generally to our present four (4) divisional areas.

The National Police Reserve should be armed initially and as rapidly as possible with United States carbines, caliber 30 now available in Eighth Army stocks. These should later be replaced by United States individual and organic weapons and equipment as available and required. To the extent feasible, non-military type equipment will be procured from indigenous sources. The estimated cost of complete operations of the National Police Reserve for the first six months is eighteen billion four hundred and five million (¥18,405,000,000). This fund should be made available from the General Account of the JFY 1950-51 budget, and the Japanese Government so informed.

Target date for the completion of recruitment and processing of the National Police Reserve is 15 September 1950.

AD HOC COMMITTEE
(DCofS, SCAP, G-2, G-3)
GENERAL HEADQUARTERS
FAR EAST COMMAND

10 July 1950

THE PROBLEM

1. To determine the size, organization, equipment, scheme of recruiting, and method of control of the National Police Reserve.

FACTS BEARING ON THE PROBLEM

2. Partial United States Military strength in the Far East Command has been committed to action in Korea.

3. The possibility exists that it may be necessary to commit the remaining ground forces in Japan to Korea, Formosa, the Philippine Islands, or Indo-China.

4. The four division force previously available to Japan was insufficient to insure the accomplishment of the missions assigned to CINCFE by the JCS Short Range Emergency War Plan. With the diminution of this force, the problem has become seriously aggravated.

5. The Japanese police system composed of the National Rural Police and Municipal Police Department consisting of 30,000 and 95,000 men, respectively, armed with revolvers and with negligible other equipment, are inadequate to maintain law and order in Japan without the presence of four United States divisions or a back-up force substituted therefor.

6. The Japanese police, as now constituted, have little, if any capability for protecting vital installations against sabotage, nor does any Japanese force exist which has the paramilitary qualifications to perform this function.

7. Japanese military forces have been demobilized. Further, the Japanese Constitution outlaws the use of force as a means of settling international disputes. On the other hand, the 1950 New Year's statement by the C-in-C indicated a need for Japanese forces capable of self protection.

8. Any increase in Japanese Government forces for any stated purpose, may be construed as military, or quasi-military forces, and will have internal as well as external implications and therefore must be instituted under a cover plan.

DISCUSSION

9. See Annex "A".

CONCLUSIONS

10. a. There is an immediate requirement for the establishment of a National Police Reserve to reinforce the Japanese police in case of serious internal disorders or possible rebellion, and also to fill the vacuum created by the deployment from Japan of U. S. Army Forces.

b. A strength of 75,000 men in the National Police Reserve, properly organized, equipped, trained and located, should be adequate to meet the current situation.

c. The organization, equipping and control of the National Police Reserve should be the responsibility of the General Officer designated by the C-in-C, assisted by an advisory and control group composed of member of the general and special staffs and technical services. This group should in no way exercise control or supervision over the existing police organizations or facilities. This group should be under the general supervision of the Deputy Chief of Staff, SCAP,

d. Cover must be complete. As long as a cover organization is necessary, the office of the Public Safety Division/G-2 should be utilized. The employment of any questionable personality in this organization should be permitted only upon the recommendation of the Assistant Chief of Staff, G-2, through channels. The existing recruiting machinery of the National Rural Police, should induct and receive recruits in the six National Police Regional Schools assisted by the Japanese Demobilization Bureau. As the organizations are built to strength they will be passed to other areas under control of the General Officer designated by the C-in-C. This officer and the advisory and control group should, as long as necessary, remain under cover of the Public Safety Division, G-2 organization.

e. The National Police Reserve should be organized initially in 1,000 man unit, which progressively may be equipped and trained and ultimately consolidated into four large units; each of which, upon further addition of appropriate headquarters and service units will eventually become a Japanese infantry-type division. These four divisions will approximate 15,000 men each, totaling 60,000; the remaining 15,000 men will be required for National and Corps Headquarters and for service troops. A senior indigenous body, capable of coordinating, administering and training these units, should be established at the inception of this program.

f. The location and activation of the initial 1,000 man units should be at each of the six National Rural Police Regional Schools now operating in Japan. These and subsequent units, as they become organized, should be moved to locations which lend themselves to consolidation into battalion, regiment and division type units. These locations, furthermore, should be strategically located within Japan so as to approximate the geographic regions of the four United States divisions.

g. The National Police Reserve should be armed initially with United States carbines, Cal 30, currently available in Eighth Army stocks, or on requisition from the Zone of Interior. Subsequently, light and heavy machine guns, mortars, rocket launchers, light tanks, 105 mm howitzers and certain other armament currently standard issue to a United States Infantry division should be added.

h. The training of unit cadres, headquarters and staffs for the National Police Reserve should be initiated by the advisory and control group of the General Officer designated by the C-in-C, fully utilizing the existing facilities of the Eta Jima School Command.

i. Recruitment of personnel to speed up training should be from available ex-military personnel, except purgees and career officers.

j. The Japanese Demobilization Bureau and the recruiting machinery of the National Rural Police should conduct and control the general recruitment for this program.

k. The development of divisions from 1,000 man units should progress by a series of steps, the rapidity of which will be determined by the international situation and attitude and ability of the Japanese nation.

l. The movement of units from the National Rural Police regional schools to training areas should be effected by the Japanese Government under the supervision and control of the General Officer charged with this program, assisted by his advisory and control group.

m. The National Police Reserve should function as a separate entity. It should not be affiliated in any way with the present National Rural Police or municipal police systems, other than utilizing the latter, as long as necessary, for cover purposes. Therefore, the Japanese Government should set up immediately the necessary functional echelons of government to insure efficient administration and logistical support.

n. Training and organization from inception should be so formed and conducted as to permit immediate commitment of personnel in case of internal emergency.

o. The Japanese Government should be directed by SCAP to augment the Police system by a National Police Reserve.

p. The target date for completion of recruitment and processing of the National Police Reserve should be 15 September 1950.

Recommendations

11. It is recommended that:

a. The conclusions in paragraph 10 above be approved.

b. Annex "B": Directive to the General Officer to be designated by the C-in-C to implement this program, be approved.

c. Annex "C": Recruiting plan for the National Police Reserve, be approved.

d. Annex "D": The method of SCAP control of the National Police Reserve, be approved.

e. Annex "E": Concept of the ultimate organization of the National Police Reserve, be noted.

f. Annex "F": Concept of the progressive equipping of the National Police Reserve, be noted.

g. Annex "G": The ultimate locations of the National and Corps headquarters and divisions, be noted.

ANNEX "A"

Discussion

a. With the departure and employment of partial United States troop strength stationed in Japan, an immediate requirement exists for the establishment of some force within the framework of the Japanese government to augment existing forces in the maintenance of law and order and internal security. The vacuum created by the employment of United States Forces in Korea must be filled as rapidly and effectively as possible. The Allied Powers acting in concert have denied Japan the right and privilege of maintaining an army or navy as an effective means of preventing the return to militarism. The Japanese Government, however, has been permitted by the United Nations to maintain a police force adequate to meet the need of safeguarding law and order and protecting vital installations from sabotage. Because of this it is permissible and logical, therefore, to increase the size, and to adequately equip, the police force to meet the needs of safety and security in Japan. It should be noted also that no other body or agency is qualified, or adequate, to perform this function; that no other organization, framework, structure exists that will serve this purpose.

b. The metropolitan police forces of Japan total 95,000 men. These forces perform metropolitan and civic duties which restrict and limit their use and capabilities to meet potential emergencies which may arise at any point within the nation. The National Rural Police, consisting of 30,000 men perform as the national security agency. Their responsibilities and duties may readily be adapted on a national range to provide specifically the protection now required. It is considered, therefore, advisable to increase the national police by 75,000 men. These 75,000 men could be called the National Police Reserve. This group, because of its size, strength, and possible employment, must be completely divorced from the police agency. No risk is warranted which might ultimately permit the police to assume or effect control of this force. This group properly organized, equipped, trained and located should be adequate to meet the current situation. This need has long been recognized by the Far East Command.

c. The SCAP agency or agencies under which this group should be controlled is highly debatable. First consideration was given to complete control by G-2. This offers an already established and working liaison with the Japanese Government; a knowledge of police recruiting methods and an established police training network; an ideal disguise, centralized control and necessary communications. This, however, has a distinct disadvantage in severe personnel limitations. Complete control vested in the G-3 Section has the above disadvantages and the added limitations of no established lines of communication and liaison, and no experience in police recruitment. The combined responsibility under G-2/G-3 combines the full advantages above and greatly lessens the personnel weakness; however, lack of a singleness of purpose and centralized control would be a severe handicap. The creation of a new staff section headed by a Senior officer could utilize the total experience, communications and facilities of the FEC and SCAP staff. The cover afforded by the Public Safety Division/G-2 could still lend itself by the simple expediency of locating the required staff, in whole or in part, in the NYK Building and labeling it the Public Safety Division/G-2, National Police Reserve Branch. This would have a singleness of purpose which is imperative if this plan is to be brought to a prompt and efficient fulfillment.

d. Prior to any release concerning this project (a strong infantry division-type police reserve) the Public Safety Division/G-2 will be, to all outward appearances, the section controlling this reserve. Utilizing the recruiting facilities that now exist in the National Rural Police Agency and the personnel of the Japanese Demobilization Bureau, Public Safety Division can cause volunteers to be called for the police reserve. The Japanese Demobilization Bureau can contact likely members, and request that they apply for this employment. The National Rural Police will screen, test and recruit in the same manner for this force as they have in the past, except that further guidance and controls will be added. The recruits can then be dispatched to the six National Police regional schools, which, again for cover purposes, may install a few police instructors. As units are formed in these schools

and dispatched to other areas the guise of police training will, as long as necessary, be continued. The employment of any questionable personality must be only upon the recommendation of the Assistant Chief of Staff, G-2, and processed through proper channels. The Commander-in-Chief cannot condone the use of any personnel in the purgee class for reasons which are obvious.

e. Study of the infantry division Table of Organization and Equipment of both the United States Army and the former Japanese Army has been made. The standard United States battalion is slightly less than 1,000; the Japanese battalion is slightly greater. From this it is determined that the basic units should be formed in groups of 1,000 men. This is a round figure. It cannot be considered a pattern of any organization. It is a logical figure that might have been determined to facilitate organization. Groups of 1,000 augmented by necessary officers can be rapidly formulated into the desired organizations. These may be broken down into units of convenient size which will form the companies. They may be grouped into larger units forming regiments. And upon addition of appropriate headquarters and service units may eventually become a Japanese infantry-type division. With a maximum figure of 75,000 it is feasible to expand to four of these divisions. This, making a total of 60,000, permits the remaining 15,000 for national and corps headquarters, and for service groups. It is recognized that some indigenous body capable of coordinating, administering, and training these units must be established at the inception of this program.

f. Available through Public Safety Division facilities are six regional schools capable of receiving between 8,000 and 10,000 men initially. The Japanese Government must initiate immediate action to locate other areas and facilities, and rehabilitate them if necessary, where processed personnel of the six schools may be relocated. Only by this effort may these reception centers continue to receive men as rapidly as they volunteer. It is feasible to anticipate the use of areas evacuated by United States Troops. It is also envisaged that there must be many other areas in Japan capable of billeting and training troops. The former geographical divisions of the main four islands of Japan as conceived by the Japanese Army almost coincide with those recently used by Allied Forces. It is highly desirable for reasons of over-all security, that the four divisions to be formed be strategically located within these boundaries. As the 1,000-man units are formed in the regional schools they should be dispatched to those areas for further training.

g. Available in Eighth Army stocks are individual weapons formerly used by the Japanese in sufficient quantity to supply this reserve. The State implications involved in disclosing this fact is considered too great a risk to be taken at this time if any other solution is possible. Also available from Eighth Army stocks are 20,000 serviceable and 90,000 unserviceable United States carbines, caliber 30 M-1. On order from Zone of Interior are 75,000 more, earmarked by the Chief of Staff for this purpose. In addition to arming the Japanese police reserves with this weapon it is ultimately planned to furnish light and heavy machine guns, mortars, rocket launchers, light tanks, 105 mm howitzers, and certain other armament currently standard issue to a United States Infantry Division. In keeping with the Potsdam Declaration this will not provide the cause whereby the Japanese nation can reconstruct its heavy armament. The recruit would be armed with individual weapons as rapidly as possible and the 1,000-man units should be augmented progressively with other equipment in keeping with its availability and in accordance with their ability to absorb and master required techniques.

h. The SCAP agency assigned this responsibility must commence immediately training of unit cadres; must select, screen, organize and assist headquarters and staffs for the National Police Reserve. Already available to aid this training are facilities available at the Eighth Army Service School at Eta Jima. They should be utilized. The Assistant Chief of Staff, G-2, will assist in the screening of personnel.

i. There are three categories of potential recruits to be considered available for this force. One is to accept any and all applicants. While this plan affords the greatest manpower and maximum speed in fulfilling quotas, it includes the purgees and career officer group. This as determined above violates SCAP policy. To bar all ex-military personnel excludes not only the majority of available manpower but also the skilled, educated and highly trained group. A happy medium therefore is to accept any applicants other than purgees and career officers. This will include the 23 year old and under groups which have received no training. The Demobilization Bureau will aid this plan greatly by personal contact with qualified and likely individuals. The Japanese can materially assist in the elimination of subversive personnel, but all records available to both United States and Japanese agencies should be used. It is highly desirable that the National Police Reserve

be officered by ex-military personnel.

j. While it is understood that the National Police Reserve is not to be a function of the police department, it is obvious that an immediate emergency may arise which will require a force capable of direct action. For this reason, therefore, it is advisable, at the inception of this program, to authorize the National Rural Police to request assistance from this force. To eliminate the possibility of misuse, this request should go through the channels of the advisory group of SCAP.

[SOURCE: MACARTHUR MEMORIAL RG-4]

4-17 PERSONNEL FOR NATIONAL POLICE RESERVE FORCES

Memorandum August 9, 1950
To: Gen. Willoughby
From: R. J. Rinalducci (Military Intelligence Section, FEC).
Top Secret

1. An exhaustive study on the question of purged and non-purged former Japanese Army line officers discloses that all full generals numbering 38, all lieutenant generals numbering 629, all major generals numbering 955, all full colonels numbering 3,072, all lieutenant colonels numbering 2,625, and all majors (with the exception of 47) numbering 8,011 were purged. Research further shows that 7,914 captains were purged; 7,515 were not purged; 3,635 first lieutenants were purged and 53,092 were not purged; 5,243 second lieutenants were purged and 91,986 were not purged. The non-purged officers were formerly special reserve officer candidates, warrant officers and noncommissioned officers. All of those purged were graduates of the Military Academy. For a comprehensive chart showing purgees and non-purgees, see Tab 1.

2. The officer replacement system of the Japanese Army is entirely different from that prevailing in the Army of the United States or the United States Army. There is a vast difference between schooling undergone by officers who became members of the Regular Army and Reserve Officers. Courses offered in the Army Reserve Officers' School were the minimum which would enable a junior officer to perform his duty. The Army Reserve Officers' School was first established in 1938. Graduates of this school were holding the rank of first lieutenant when the war ended. The majority of the captains who are shown as non-purged on the chart, Tab 1, obtained their commissions before the Army Reserve Officers' School was established in 1938. A number of captains, first lieutenants and second lieutenants who possessed college educations and disclosed good qualities of leadership were selected for either the Military Academy or the Military Academy Preparatory School and were sent there for a period of six months or one year. These were referred to as Special Volunteers. After graduating from either of these schools they were integrated into the Regular Army and the highest rank that they could attain during their career was that of captain. Because of their limited training they were unable, generally, to advance any further. However, a few of them attained the rank of major. Second lieutenants who attended the Military Academy for a period of one year were able to attain the rank of lieutenant colonel and those who entered as cadets in the Military Academy and took training for a period of four years and ten months became qualified to perform the duties of senior officers. However, all of these categories were integrated into the Regular Army and were purged at the end of the war. (See Tab 2).

3. The military capabilities of non-regular officers or non-purged officers fall far below those of the purged classes who were members of the Regular Army. Of the regular officers, those who entered the Army Preparatory School at the age of approximately fourteen and those who took the Military Academy Preparatory Course at approximately the age of seventeen, upon graduation from their courses, became second lieutenants in the Army after undergoing seven years and ten months of military training for the former, and four years and ten months for the latter. In contrast to this, among the non-regular officers the outstanding reserve officer candidates received only two years plus one month of military training upon joining their units. However, the curriculum of the latter was far below the standard of the former as is shown on comparative chart showing military capabilities of regular officers and non-regular officers, Tab 3.

4. From the foregoing and a thorough perusal of Tabs 1, 2 and 3, it can be seen that the use of former regular army officers, now purged, colonels and officers of lesser rank, as

leaders in the Police Reserve is an indispensable condition in order to realize the purpose of establishing an adequate Police Reserve Force. The majority of those who will answer the call for Police Reserves will, no doubt, be inferior persons who are unable to make a living. This statement is based on the fact that preliminary results of an inquiry instituted at 1630, 7 August up to 1030, 9 August, showed that of the 4,772 non-purgees inquiries made by the First Demobilization Bureau (Army), 3,471 answers were received. Of these answers, less than 5% indicated an interest in joining the proposed Police Reserves and more than 95% (3,240) showed no interest. These inquiries were made by the local Assistance Bureaus in the forty six Prefectures of Japan. (See Tab 4). In such a situation, it is essential that army officers of the higher grades who possess the proper qualities of leadership and who are now purged from holding office should be unpurged for the purpose of enabling them to occupy positions on the staff, in order to maintain patriotism, unity and military leadership. If immature or non-regular officers are placed in these responsible positions it will no doubt lower the efficiency of the organization and make it subject to Communist infiltration.

5. Matters which required the most attention in Japan during the five years since the termination of the war have been the expansion of Communistic ideas and the spread of anti-American propaganda. In creating a mob filled with such elements, it is inevitable that the Police Reserve would soon become a target of ideological offensive by the Communists, especially if they are led by incompetent leaders. Clever plots of the Communists were detected to rapidly infiltrate their comrades into the Police Reserve, as soon as the plan to establish the Police Reserve in Japan was made public.

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7. There is definite evidence that there are a considerable number of Communist elements in the various departments of the National Rural Police. According to Tokyo Report No. 146, dated 22 July 1950, powerful Japanese Communist Party sympathizers have rapidly infiltrated into the First Police Defense Sub-Section of the Headquarters of the National Rural Police and the Judicial Bureau of the Attorney General's Office, and have transmitted information on these Government offices to the Japan Communist Party's Special Investigation Committee for the organization of the Second Front. Moreover, the report further discloses that the Japan Communist Party has issued a secret directive ordering the gathering of information on the establishment of a 75,000 man Police Reserve Force of the following nature: (1) composition; (2) confidential regulations for the selection of recruits; (3) matters pertaining to the equipment and training of the reserve unit and (4) members who comprise the governing body. The Communist Party feels as though it would have no difficulty in obtaining the information, as its mission will be facilitated by the fact that the National Rural Police Headquarters, the Special Investigation Bureau and the Municipal Police Headquarters are disunited, with no coordinated liaison between them in matters pertaining to information and activity. (See Tab 5)

8. It has also been established that: (1) 15 or 16 listed Communists are petty officials of the Public Prosecutor's Office; (2) one or two National Rural Police Inspectors are members of the Aoba Kai, Communist Party spy organization; (3) at least one Metropolitan Police Board Inspector is a Communist Party member, and 15 or 16 others are suspected members; (4) "several" officers and secretaries of the Maritime Safety Board are Communists; and (5) "some influential party members" hold responsible positions in the Labor Ministry. (See Tab 6).

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13. At a secret meeting of the Liberal Party, Chief Secretary OKAZAKI stated on 2 August 1950: "We want to create a Police Reserve as strong as an Army." However, he emphasized that the 75,000 man Reserve would not be an Army and pointed out that the difference between the Army and the police lies in where they function. That is to say, an Army may engage in action outside of the country, but the police must limit their activities to within the border, and that the Police Reserves were for the purpose of keeping domestic order and should be as powerful as possible. At the same meeting, Attorney General OHASHI said ex-service men might be recruited for the Police Reserve and said that some ex-officers might even be released from the purge to fill the need for trained personnel (Police Expansion-Daily Intelligence Summary, 2 August 1950, Press Analysis). The foregoing is an indication that the Japanese Government is changing its position relative to the use of purged officers in the Police Reserves.

14. In addition to the above, there have been numerous comments in the Japanese newspapers relative to the need to release purgees in order to utilize them in the Police

Reserves. From the standpoint of public opinion in the United States relative to the armament of Japan and Germany, the press is full of editorials and opinions stating that Germany and Japan, who were formerly enemy nations, should be allowed limited armament so that the Democratic nations could fight Communism and avert the fear of World War III.

15. It is the consensus among the United States Army officers who formerly had service in Japan (as well as some of those presently serving in Japan) that it is necessary and essential that purgees be used in the establishment of the Police Reserve Force.

16. The National Police Reserve Force of 75,000 men could more or less be called the anti-Communist Police Force. Some individuals are criticizing this as a re-creation of a police state with the police army and a revival of militarism which are the only words they know. The Russians are utilizing former Nazi army officers as well as former Japanese Imperial Army officers to good advantage, and there is no good reason why we should not do likewise. It would take many years to build up an efficient force with the use of unpurged officers; whereas, by utilizing the skills and training of the purgees, an efficient organization could be built, as one might say, overnight, as the latter would be able to select and adequately train the men required within a short period of time.

17. Recommendation:

It is therefore recommended that appropriate steps should be taken to release from the purge the necessary qualified officers to fill the need for trained personnel as commanders in the Police Reserve.

[SOURCE: WILLOUGHBY PAPERS, MACARTHUR MEMORIAL]

4-18 MEMORANDUM OF SEVEN POINTS

Memorandum — September 22, 1950
Submitted to: United Nations
By: J. F. Dulles

Memorandum of Seven Points:

1. The treaty should be signed by all the states which had been at war with Japan, forty-nine in all, including China.
2. All signatories of the treaty should undertake to support Japan's admission to the United Nations.
3. The Bonin and Ryukyu Islands should be placed under United States trusteeship, while Korea was to become independent. The future of the Kurile Islands and of Formosa was to be settled by the Big Four, or, if they failed to produce an agreed settlement within one year, by the U. N. General Assembly.
4. Japan to make facilities available to the armed forces of the United States to assure Japan's security.
5. Japan to observe international agreements on fishing, drug-control, etc., and, pending the conclusion of new commercial agreements, to extend most-favoured-nation treatment, subject to the normal exceptions.
6. Signatories of the treaty were to retain Japanese assets within their territories, but to waive all claims against Japan for reparation.
7. All disputes concerning claims to be referred to a special tribunal of the International Court at The Hague or to be settled by the conventional machinery of diplomacy.

[SOURCE: *New York Times*, NOVEMBER 25, 1950]

4-19 YOSHIDA LETTER ON CHINA

Letter — December 24, 1951
To: Dulles
From: Premier Yoshida

Dear Ambassador Dulles:

While the Japanese Peace Treaty and the U. S.-Japan Security Treaty were being debated in the House of Representatives and the House of Councillors of the Diet, a number of questions were put and statements made relative to Japan's future policy towards China.

Some of the statements, separated from their context and background, gave rise to misapprehensions which I should like to clear up.

The Japanese Government desires ultimately to have a full measure of political peace and commercial intercourse with China which is Japan's close neighbor.

At the present time it is, we hope, possible to develop that kind of relationship with the National Government of the Republic of China, which has the seat, voice and vote of China in the United Nations, which exercises actual governmental authority over certain territory, and which maintains diplomatic relations with most of the members of the United Nations. To that end my Government on November 17, 1951, established a Japanese Government Overseas Agency in Formosa, with the consent of the National Government of China. This is the highest form of relationship with other countries which is now permitted to Japan, pending the coming into force of the multilateral Treaty of Peace. The Japanese Government Overseas Agency in Formosa is important in its personnel, reflecting the importance which my government attaches to relations with the National Government of the Republic of China. My government is prepared as soon as legally possible to conclude with the National Government of China, if that government so desires, a Treaty which will reestablish normal relations between the two Governments in conformity with the principles set out in the multilateral Treaty of Peace. The terms of such bilateral treaty shall, in respect of the Republic of China, be applicable to all territories which are now, or which may hereafter be, under the control of the National Government of the Republic of China. We will promptly explore this subject with the National Government of China.

As regards the Chinese Communist regime, that regime stands actually condemned by the United Nations of being an aggressor and in consequence, the United Nations has recommended certain measures against that regime, in which Japan is now concurring and expects to continue to concur when the multilateral Treaty of Peace comes into force pursuant to the provisions of Article 5(*a*)(iii), whereby Japan has undertaken 'to give the United Nations every assistance in any action it takes in accordance with the Charter and to refrain from giving assistance to any State against which the United Nations may take preventive or enforcement action'. Furthermore, the Sino-Soviet Treaty of Friendship, Alliance and Mutual Assistance concluded in Moscow in 1950 is virtually a military alliance aimed against Japan. In fact there are many reasons to believe that the Communist regime in China is backing the Japan Communist Party in its program of seeking violently to overthrow the constitutional system and the present Government of Japan. In view of these considerations, I can assure you that the Japanese Government has no intention to conclude a bilateral Treaty with the Communist regime of China.

Shigeru Yoshida.

[SOURCE: John Wheeler-Bennett and Anthony Nicholls, *The Semblance of Peace*, pp. 615-16.]

4-20 ASSISTANCE FOR SELF-DEFENSE FORCES AND TRADE

Japanese Memorandum — October 19, 1953
Ikeda-Robertson Consultation
Confidential

The past proceeding of the conference indicates that the representatives of both countries are brought very much closer toward an understanding of some difinitive nature on problems embodied in the agreed agenda. The Japanese representatives feel more confident that such an understanding as may be reached will be endorsed and authorized by their government so that their mission may end fruitfully. The present paper is designed to summarize the result so far attained and (points which are) as yet to be agreed upon, in the order of the agenda.

1. Japanese defense forces and an assistance

1) The Japanese representatives have emphasized that there are four restrictions placed upon a full realization of adequate defense forces. They are legal, political or social, economic and physical.

(i) The legal restriction is one of the constitution. The Japanese Constitution reads in its Article 9 that:

"Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international dispute,"

"In order to accomplish the aim of the preceding paragraph, land, sea and air forces as well as other war potential will never be maintained, the right of belligerency of the state will not be recognized."

and the cautions taken by the original drafters of the Constitution have made the amendment procedure extraordinary difficult. An amendment does not seem feasible in the foreseeable future even if the national leaders should be convinced that such a step is advisable.

(ii) The political or social restriction stems from the very same policy which the occupation authority had taken in writing the Constitution. Japanese were educated in the eight years of occupation not to take up guns no matter what may happen. And the ones who were mostly affected by this education are these youngsters who are first to be called into service.

Besides, there are women, "the intellectuals", and the bereaved families who are least amenable to persuasion otherwise.

(iii) Economic restriction is self evident. Comparisons with other countries in terms of percentage of the defense cost out of the national income, or in terms of per capita share of defense cost would have a greater significance if the level of the living standard in Japan is in any way comparable to that of those nations. For a country whose soldiers were beaten down and had to take the blame to themselves, whose bereaved had to find a means of livelihood by themselves, the first step in national defense efforts should start with the protection of these people; and this is costing Japan a great deal even in its present initial stage Japan is vulnerable to natural disasters. A disaster may upset the budget program at any time. In this fiscal year the total damages made by disasters so far is estimated at 150 billion yen, while the total amount of the national budget is 1,000 billion yen. These are some of the difficulties inherent in the Japanese economy of today.

(iv) The physical restriction is one of recruitment. Unless the people are firmly held in conviction that nobody but themselves will defend them, which is a matter of education or matter of re-orientation in the case of Japan, and which accordingly will take a considerable time to accomplish, a hasty recruitment of large number of youths will merely create a force of mob; the infiltration policy of the communists is such that there is no assurance that these youths will not direct their guns towards Japan. All this means that a speedly recruitment of relatively a large number of youths is either impossible or very dangerous in Japan-that is short of a military draft which our Constitution clearly denounces.

2) The conferees have recognized these restrictions and,

(i) Agreed that a sizable amount of military assistance is necessary for years to come not merely to create, but also to maintain even a semblance of an adequate defense force in Japan. A proposition has been made by the Japanese representatives, in this respect, describing the size of forces they believe that feasible maximum under the present circumstances. The U. S. representatives pointed out that the figures and premise involved in the proposition are on the low side but they believed the proposition could be developed and improved without causing any great hardship. The Japanese representatives are desirous to know the type and amount of military assistance to be considered under the proposed program. They also will welcome suggestions as to how the proposed program can be improved without changing the basic thesis.

(ii) The U. S. Government has recognized and agreed that the amount of Japan's share in the "mutual defense cost" should decrease as the cost of her own defense program increases.

(iii) The conferees have agreed that the most important is to develop a climate in Japan wherein the Japanese people may feel more and more responsible for their own defense. The Japanese Government is primarily responsible to see to it that by way of education and publicity this climate will develop so that the patriotism and voluntary spirit of self-defense may grow in Japan.

3) However, an external assistance is also helpful to help develop such a climate. To the people who are poverty-stricken but nevertheless proud, the most effective of such external assistance is the demonstration of generous friendship. They are a people who know how to respond to magnanimity, and how not to respond to compulsion.

(i) It was in this connection that the question of the defense support aid was taken up. There was an exchange of information as to the practicability of granting Japan such an aid. The Japanese representatives were told that their nation could be entitled to such an aid, so far as legally speaking, if the two nations entered into a bilateral agreement similar to those now present between the US and European nations. Various conditions necessary for such an agreement will be set in the MSA pact, negotiation of which is now

carried on in Tokyo. It was pointed out that the current appropriation of the U. S. Government is not predicated upon such an aid for Japan. However, it was made clear, as a matter of legal possibility, that the administration is authorized to transfer up to 10% of current appropriations, within the "economic aid" item and/or across the "military aid" within the same "area". The Japanese representatives were also told that an amount up to $20 million could be made available in accordance with section 513 (B) of the Mutual Security Act, and that the application of Section 102 of the same Act could be made even without an ECA agreement. In this connection, the Japanese representative would like to request the U. S. Government to turn this legal possibility into a reality. They request the U. S. Government to enter into a bilateral agreement with the Japanese Government so that the door may be opened for the aid of this type. These aids given to European countries are generally recognized as a great success, having contributed to a larger military strength of these nations as is envisaged today, although such aids were not by themselves of military nature. The Japanese representatives are well aware that the aid of this type is decreasing. However, the present status of Japan is exactly the same as those European nations in an earlier stage of ECA, and there is good reason to believe that the effect accomplished in Europe can be repeated in Japan to the same or even a greater extent, if such an aid, under whatever name, is given.

(ii) The conferees agreed that a greater amount of the off-shore procurement will help the Japanese economy. The U. S. representative showed their willingness to see to it that this will be done. The Japanese representatives would like to know about the magnitude of such procurement.

(iii) The conferees discussed about the Section 550 of the Mutual Security Act. The Japanese representatives believe that their Government is prepared to buy agricultural surplus products up to $50 million expecting that the Yen proceeds thereform would be used for the construction or improvement of roads of strategic importance, or to help munitions industries.

2. Trade with Southeast Asia and reparations.

The Japanese representatives have pointed out that developing markets in the Southeast Asian area is essential to the future of their economy. For that, however, an early solution of reparations is highly important. Japanese Foreign Minister Okazaki has been sent to this area to sound out the interested nations. The Foreign Office of Japan has recently informed the Japanese representative that Mr. Okazaki has met stiff attitudes in every one of the interested countries. The positions of the respective countries vis-a-vis the U. S. vary. The Japanese representatives believe that with some of them the U. S. influence would be helpful. It is the hope of the Japanese representative that by the U. S. good offices, Japan may be able to come to an agreement on the reparation with those countries so that they may ratify the Treaty they had signed. As the negotiation proceeds, Japan may find it necessary to go somewhat beyond the provisions of Article 14 of the Treaty of Peace with Japan, if and when such will help expedite the ratification and the solution of the reparation question. The U. S. assistance is designed in keeping Japan advised as to the timing and modus operandi of such a negotiation. The U. S. Assistance is also desirable in case of a project which may enable the tying of the reparation payment with development of natural resources in these countries. Although there is not a clear-cut proposition available yet, the Japanese Government will continue to explore such and any future suggestions will be appreciated. The situations in some other countries seem to be more complicated. The Japanese representatives hope that once when the case of anyone of them is taken care of the rest may follow the suit.

3. Trade with communist China.

An appreciation was expressed by the U. S. representatives as to the policy and administration of the Japanese Government in this respect.

The Japanese representatives expressed desire to be treated on a footing equal to European nations, and the U. S. agreed in principle.

4. GARIOA Settlement.

The Japanese representatives emphasized that this question can not be singled out for an early solution. To their view, this is one of those obligations and contingencies, present or foreseeable, that Japan should meet externally or domestically, including one for defence, and accordingly a solution of this question is possible only in parallel with the rest of the obligations. However, the Japanese representatives agreed to advise their government to come an agreement with the U. S. Government as to the time and place to discuss this question further with a view to arriving at a settlement, in a hope that such a step would

expedite an earlier and simultaneous solution of related question as well.

5. Foreign investment, including loans.

The Japanese representatives informed that a credit of $60,000,000 for cotton is being considered in the U. S. and they may expect to hear more about it before they leave.

The U. S. representatives suggested that some liberalization of the Japanese laws and statutes pertaining to the foreign investments will result in a greater investment.

The Japanese representatives revealed that they believe likewise and that they plan to make a trip to New York to hear directly from the business as to what they may recommend.

The U. S. disclosed that a measure to guarantee such investments is under negotiation and that their government will continue to encourage and favour such investments or loans as a matter of general policy.

6. Japanese internal measures.

The U. S. representatives expressed their anxiety as to an inflationary trend that the Japanese economy is taking or likely to take.

The Japanese representative were able to explain that this is not the case with their public finance but nevertheless admitted a danger to exist in their banking system.

They have made a specific proposition in this respect with an eye to normalizing their banking structure and credit policies.

[SOURCE: ISHINO PAPERS, MINISTRY OF FINANCE]

4-21 ASSISTANCE FOR SELF-DEFENSE FORCES

United States Memorandum — October 21, 1953
Ikeda-Robertson Consultation
Confidential

The following United States comments upon the Japanese paper of October 19 are conceived as a whole and do not stand independently of one another.

Paragraph number correspond to paragraphs of the Japanese paper.

1 1) The United States representatives recognize the existence of the four limitations upon the building of Japan's defense forces: (A) legal; (B) political (C) economic; and (D) physical. They make no comment upon the first and second, since the Japanese Government and people must deal in their own way with questions of constitutional amendment and public opinion. The third and fourth are discussed below.

2) (i) The United States contemplates assisting Japan in developing its forces by supplying major items of the military equipment for the land, sea and air forces which Japan may raise. This proposition is subject to three qualifications: Japanese willingness to raise and support the forces for which equipment is desired, necessary congressional authorization, and a defense effort on the part of Japan itself which is sufficient to justify the proposed aid. Without such justification congressional authorization could not be obtained.

The adequacy of Japan defense effort, from the standpoint of United States aid, must be examined from time to time in relation to Japan's actual economic circumstances. For the Japanese fiscal year 1954 it is the opinion of the United States conferees that United States military assistance cannot be defended to the United States Congress unless Japan's own budgetary contribution to defense is of the order of Yen 200 billion and JFY 1955, Yen 235 billion.

It is suggested that the conferees tentatively accept an objective for the ground force of approximately 325,000 to 350,000.

The exact composition and the time-phasing of the development of these forces would be carefully worked out with appropriate United States representatives in Tokyo. The aim would be to determine how Yen 200 billion and yen 235 billion can be most wisely expended for Japanese defense over the next two Japanese fiscal years.

It is noted that Mr. Ikeda's study of Japan's defense program does not provide for any increase in the NSF ground element in the current fiscal year.

It is the recommendation of the United States Conferees that Japan consider increasing the ground force by 24,000 during the current Japanese fiscal year and by 46,000 during the ensuing year, thereby increasing the ground force to 180,000.

With respect to the navy, it is suggested that in general Japan should construct at its own expense, the smaller and lighter craft such as mine-sweepers and mine-layers. The United States is willing to consider supplying on a loan basis such vessels as destroyers and

destroyer escorts. The composition and having of air force build up will have also to be considered in detail in terms of available resources. The planning to be done in Tokyo would take into account not only the composition and the time-phasing of the Japanese forces but also the most appropriate division of available Yen funds and United States military assistance among the three forces. It has already been indicated that during the current United States fiscal year, the United States would be willing, given a basic understanding on force goals for the next several years, to assist Japanese completing the equipping of Japanese ground forces in being and to assist in the training personnel, including air.

(ii) The United States would regard it as proper Japan's contribution to the support of United States forces should diminish as of justified by the development of Japan's own forces.

(iii) United States Conferees agree that it is essential to create a climate in Japan where the Japanese people may feel more responsible for their own defense, and that this is primarily the responsibility of the Japanese Government.

(iv) It is contemplated that given a Japanese program such as described above, the United States would be able to withdraw its forces as the Japanese forces develop the capability to defend Japan.

3) (i) Although Japan is eligible under United States legislation for "defence support" or economic assistance, it is emphasized that (A) economic assistance is given only on the basis of need; (B) it is the policy of the United States to encourage cooperating countries to develop only such forces as they can support; (C) no funds have been requested or appropriated for economic assistance to Japan, and funds could be made available only at the sacrifice of some other program; and (D) by reason of United States special expenditures Japan is presently in a favourable balance-of-payments position and there is no justification for economic assistance.

(ii) The actual amount of off-shore procurement in Japan under the mutual security program for the current United States fiscal year depends upon the scope and rate of the Japanese defense buildup, upon the military assistance program for Japan which may be agreed upon, and upon the ability to procure the desired end-items. The United States agencies involved have a tentative target figure of $100 million in mind.

(iii) The United States believes that $50 million is a reasonable target figure for sales of agricultural products to Japan under the criteria of Section 550 of the Mutual Security Act, including the necessity for demonstrating that such products and in addition to usual marketings. A minimum of $40 million of the local currency proceeds of such sales would be used to procure military equipment and ammunition in Japan for use by Japanese or other friendly forces in the Far East. The $100 million off-shore procurement estimate given in the proceeding paragraph includes $40 million of procurement with Yen acquired by the United States under Section 550 procedures. The possibility that the $40 million worth of local currency could be used to help develop munitions production, perhaps as an advance against deliveries, requires further study. In addition, the United States would be willing to make available up to $10 million of the local currency proceeds to help develop an adequate industrial mobilization base in Japan. It would be necessary to execute a special settlement to cover the requirements of Section 550 and the related defense support activities.

2. 1) The United States is prepared to help the reparations settlements through its diplomatic offices if it shall appear useful. The Japanese representatives understand that the assistance which the U.S. may be able to give will vary from country to country. The United States will be glad to consider any role which it can properly play in connection with relating reparations to economic development of the area.

2) The United States recognizes the important benefits which can result from increased trade between Japan and the south east Asia area. The United States is prepared to discuss any specific ideas which the Japanese government may develop with respect to the role which Japan might play in increasing the trade and economic development of the area. However, consideration of this complex subject could not delay the reaching of definite understanding on other matters we have been discussing.

3. Pending a political settlement in Korea, the United States believes that it is important to maintain a high level of control over trade with Communist China. The United States understands the desire of Japan to maintain no stricter controls than those of European countries, is now consulting with the Japanese Government on the removal from the embargo list of certain items proposed by Japan, and is reviewing other items for possible deletion. A number of such deletions have been announced, and the United States Embassy in Tokyo

is currently being instructed to a number of others. However, the United States feels strongly that it is importance to maintain economic pressures on Communist China until they can be relaxed with immunity, and we will appreciate the continued cooperation of the Japanese Government in this matter.

4. United States attaches highest importance to a public announcement before the Congress reconvenes in January 1954 of a settlement of GARIOA claims which amount to approximately $2 billion. It therefore proposes that a general agreement be reached, during the present discussions, for a settlement along the following lines:

Japan would repay $750 million with interest at 2½ percent in 35 usual annual installments with approximately $43 million of the $750 million to be settled on surplus property terms.

It is suggested that United States and Japanese representatives meet in Tokyo about November 15 to finalize sign the necessary documents.

5. It is the understanding of the United States Congress that the Japanese Government intends to permit full exchange transfer ability for foreign investment, both as to principal and earning; intends to impose no limitation of percentage of foreign ownership in private enterprises except as the matter may be negotiated between investors themselves; and that the Japanese Government intends to review all other steps which may be feasible to make productive private investment attractive to both Japanese and foreign nationals.

6. United States conferees would like to emphasize that they regard more vigorous measures on the part of Japan to resist inflation, and maintain a competitive position in world markets as essential to effective cooperation between the two countries. These measures, detailed in an earlier discussion, would include.

1) Adequate steps to resist inflation and to protect the value of the yen;

2) Adequate attention to reduction of production costs, especially costs of exports;

3) Adequate procedures to direct the flow of investment into productive enterprise, especially expert enterprise;

4) Direct and indirect measures to hold imports at levels which the Japanese economy can afford.

It is the conviction of the United States Government that unless such measures are taken: Japan's balance of payments position will deteriorate not improve; United States offshore procurement will diminish; Japan's international credit standing will be impaired; and the justification of United States military assistance will become difficult.

[SOURCE: ISHINO PAPERS, MINISTRY OF FINANCE]

4-22 JAPAN'S SELF-DEFENSE

United States Memorandum October 27, 1953
Ikeda-Robertson Consultation

Reference is made to United States Memorandum dated October 21, 1953, which reached us on October 22.

I. 1. Japanese conferees appreciate the recognition on the part of the United States representatives of the existence of the four limitations upon Japan's defense build-up. Any realistic plan must be based on careful consideration to be paid by both American and Japanese sides on these limitations.

2. (i) The United States conferees have expressed their willingness to assist Japan in developing the Japanese forces by supplying major items of the military equipment for the land, sea and air forces which Japan may raise provided that the defense effort on the part of Japan will be such as to satisfy necessary Congressional authorization.

For the Japanese fiscal year 1954 it is the opinion of the U.S. conferees that it will be difficult to defend U.S. military assistance to the U.S. Congress unless Japan's own budgetary contribution to defense substantially exceeds that of the current fiscal year, not merely in terms of actual amount but in terms of its proportion to her national income; the U.S. conferees have in mind an amount in the order of 200 billion yen for J.F.Y. 1954 and by the same taken 235 billion yen for J.F.Y. 1955.

Information available to the U.S. conferees suggests that 325,000-350 is a reasonable objective for Japan's ground force. The Japanese conferees proposed to increase their ground force by 24,000 beginning April 1954 and be completed by March 1955 at the latest; an additional increase of 46,000 is immediately to follow so that Japan may have a ground

force of 180,000 in the summer of 1956.

With respect to the Navy, the United States conferees express their willingness to supply on a loan or grant basis such vessels as destroyers and destroyer escorts, while Japan is expected to construct at its own expense, the smaller and lighter crafts such as minesweepers and mine layers.

The conferees agreed that the composition and time-phasing of air force build-up will also have to be considered in detail in terms of available resources.

The conferees also agreed that the detailed planning for the composition and time-phasing of the Japanese forces and the most appropriate division of available yen funds and U. S. military assistance among the three forces should take place in Tokyo.

It is understood that during the current U. S. fiscal year the U. S. will assist in completing the equipping of Japanese ground forces in existence and to assist in the training of personnel, including air, as already scheduled.

(ii) U. S. conferees have expressed their willingness to regard it as proper that Japan's contribution to the support of U. S. forces should diminish as Japan's own forces are developed.

(iii) The Japanese conferees agreed that the Japanese people should feel primarily responsible for the defense of their own country, but they also added that the U. S. military as well as economic assistance would greatly help create such climate in Japan that Japanese people would be more encouraged to develop their own defense forces in a shorter period.

(iv) The U.S. conferees state that the withdrawal of the U. S. forces from Japan would be effected as the Japanese forces develop the capability to defend their country.

3. (i) The U. S. conferees recognize that, legally speaking, Japan is eligible under U. S. legislation for defense support or economic assistance, but state that there are following general conditions to be taken into consideration: (a) economic assistance is given only on the basis of need; (b) it is the policy of the U. S. to encourage cooperating countries to develop only such forces as they can support with some U. S. military assistance; (c) necessary funds for economic assistance should be available; and (d) the economic conditions of the recipient country should be such as to justify the necessity of economic assistance.

(ii) The U. S. conferees state that the actual amount of offshore procurement in Japan under the Mutual Security Program for the current U. S. fiscal year depends upon the military assistance program for Japan which may be agreed upon, and upon the ability to procure the desired end-items upon proper terms and that the U. S. agencies involved have tentatively a target figure of $100 million in mind.

(iii) It is the belief of the U. S. conferees that $50 million is a reasonable target figure for sales of agricultural products to Japan under the criteria of Section 550 of the Mutual Security Act, including the necessity for demonstrating that such products are in addition to usual marketings. A minimum of $30 million of the local currency proceeds of such sales would be used to procure military equipment and ammunition in Japan for use by Japanese or other friendly forces in the Far East. The $100 million off-shore procurement estimate given in the preceding paragraph includes $30 million of procurement with yen acquired by the U. S. under section 550 procedures. The possibility that the $30 million worth of local currency could be used to help develop munitions production, perhaps as an advance against deliveries, requires further study. In addition, the U. S. would be willing to make available up to $20 million of the local currency proceeds to help develop an adequate industrial potential in Japan. It would be necessary to exercise a special agreement or agreements to cover the requirements of Section 550 and also the related defense support activities. Japanese conferees strongly desire that the United States side study the possibility of utilizing the local currency proceeds for the construction improvements of militarily important roads.

II. a. The U. S. conferees agreed that the U. S. is prepared to help the reparations settlements through the diplomatic offices if it shall appear useful, the U. S. will be glad to consider any role which it can properly play in connection with relating reparations to economic development of the area, and the assistance which the U. S. may be able to give will vary from country to country.

b. The conferees recognize the important benefits which can result from increased trade between Japan and the Southeast Asian area. The U.S. conferees state that the U. S. is prepared to discuss any specific ideas which the Japanese Government may develop with respect to the role which Japan might play in increasing the trade and economic development of the area.

III. Pending a political settlement in Korea, the U. S. conferees believe that it is important to maintain a high level of control over trade with Communist China. However, the conferees agree as a matter of principle that no stricter controls should be requested of Japan than European countries.

IV. Japanese conferees understand the importance attached by the U. S. conferees to the settlement of GARIOA problems especially in connection with the Congress to reconvene in January 1954. It is, therefore, suggested that the United States and Japanese representatives meet in Tokyo in the nearest future with a view to reaching an agreement as to the final settlement of this amount. It is stated by the U. S. conferees that the terms of settlement proposed by the U. S. is based on comparable situation that existed between Japan and West Germany. However, the Japanese conferees state that the above approach overlooks the fact that the reparation is not such a complicate problem for West Germany as in the case of Japan. The attention of the U. S. conferees is also called to the fact that West Germany has been the recipient of EC Aid, while Japan has not received economic aid since GARIOA was terminated.

V. The U. S. conferees suggested that some liberalization of the Japanese law and regulations pertaining to foreign investments will result in a greater investment. Japanese conferees answered that the Japanese Government intends to review all the steps which may be feasible to make productive private investment attractive to both Japanese and foreign nationals.

VI. The U.S. conferees emphasized that they regard more vigorous measures on the part of Japan to resist inflation, and maintain a competitive position in the world markets as essential to effective cooperation between the two countries.

[SOURCE: ISHINO PAPERS, MINISTRY OF FINANCE]

5 POLITICAL AND SOCIAL REFORM

5-1 APPREHENSION AND PUNISHMENT OF WAR CRIMINALS

SFE-106/10[1] September 12, 1945
Top Secret

Note by the Secretary

1. The enclosure, a revision of SFE 106/8 and SFE 106/9 as approved at the 40th meeting of the Subcommittee on 11 September 1945, is circulated for information. The enclosure was forwarded to the SWNCC on 12 September 1945.

2. It will be noted that the separate report on policy (SFE 106/9) has been integrated with the report on the directive (SFE 106/8).

ENCLOSURE

REPORT BY THE STATE-WAR-NAVY COORDINATING SUBCOMMITTEE FOR THE FAR EAST

THE PROBLEM

1. To determine the policy of the United States in regard to the apprehension and punishment of war criminals in the Far East.

2. To prepare a directive on the subject to the Supreme Commander for the Allied Powers.

FACTS BEARING ON THE PROBLEM

3. See Appendix "A" for "Facts Bearing on the Problem".

DISCUSSION

4. See Appendix "B" for "Discussion".

CONCLUSIONS

5. Appendix "C" should be approved as the policy of the United States in regard to the apprehension and punishment of war criminals in the Far East.

6. *Steps should be taken by the United States to secure the agreement of China, Great Britain and the Soviet Union, along with such other nations as might be agreed upon, to the principles contained in Appendix "C".*

7. *Pending agreement on Appendix "C" by the nations concerned, the directive at Appendix "D" should be approved and dispatched to the Supreme Commander for the Allied Powers.*

RECOMMENDATIONS

8. It is recommended that:

a. This report be forwarded to the Joint Chiefs of Staff with a request for their comments from the military point of view as a matter of priority;

b. Upon approval by the SWNCC of the "Conclusions" *in paragraphs 5, 6 and 7, including the policy at Appendix "C" and the directive at Appendix "D"*, this report be transmitted to the Joint Chiefs of Staff and to the State, War and Navy Departments for their guidance and, where appropriate, for implementation; *and*

c. After final approval by the SWNCC, the *United States* National War Crimes Office be requested by *the* SWNCC to furnish the appropriate lists of war criminals to General MacArthur forthwith.

APPENDIX "B"

DISCUSSION

1. In various respects the policies and to some extent, the procedures concerning the

[1] This is a revision of SFE 106/8 and 106/9. Cf. also: SWNCC 57 series, JCS 1023/10; JCS 1349.

apprehension and treatment of war criminals as set forth in the Directive to the Commander-in-Chief of the U.S. Forces of Occupation in Germany (JCS 1023/10) and in the charter for the International Military Tribunal for Europe will be suitable for the Far East also. However, the propensity of the Japanese for suicide as an honorable escape from a dishonorable or hopeless position, and the tendency of the Japanese public to martyrize perpetrators of the most atrocious crimes if the accused pleads patriotic motives for his act, indicate the need for special precautions. In order that Japanese war criminals may not escape the ignominy of punishment for their offenses, and in order that the Japanese people may be impressed with the fact that such persons are really criminals and not patriots, suicides should be kept to a minimum. To that end, suspects' names should be kept secret until the moment of their arrest. The Japanese authorities should not be charged with direct responsibility for seizing suspected war criminals, as this procedure would afford increased opportunity for suicide or escape, although they may be required to give such assistance as the occupation authorities consider necessary and advisable. No public announcement should be made of a suspect's arrest and, once in custody, he should be afforded no opportunity through the press or by other means to plead his case before the Japanese public.

2. Similarly, the procedures and policies contemplated or already being applied in Europe relating to the trial and punishment of war criminals will be generally applicable in the Far East. Military and civil courts in the colonial countries of Southeast Asia, employing the same judicial procedures and legal codes as in the metropolitan countries, should be capable of trying and punishing war criminals sent back to the scenes of their crimes in that region. The Chinese courts should also be adequate for the purpose.

3. The advantages of an international military tribunal or tribunals for the trial of major criminals charged with offenses under paragraph 1. A of the directive (Appendix "D"), and of organizations whose members are collectively charged with criminal acts, for example, the Japanese Army and Navy General Staffs of recent years and the leading ultranationalistic societies, are as apparent in the case of Japan as in the case of Germany.

4. The charter of the International Military Tribunal for Europe provides for a committee for the investigation and prosecution of major war criminals to be composed of a chief prosecutor from each of the signatory powers. This committee will, in general, determine the major war criminals to be tried by the International Tribunal, approve indictments, recommend rules of procedure, investigate and collect evidence prior to trial, secure witnesses and act as prosecutor at the trials. It is believed that a similar committee or agency should be established for Japan under the authority of the Supreme Commander for the Allied Powers. Experience in Europe has shown the desirability of a unified prosecuting agency.

APPENDIX "D"

DRAFT

JOINT CHIEFS OF STAFF

DIRECTIVE ON THE IDENTIFICATION, APPREHENSION AND TRIAL OF PERSONS SUSPECTED OF WAR CRIMES

This directive is issued to you as Supreme Commander for the Allied Powers.

1. The term "war crimes" as used herein, includes:

A. Planning, preparation initiation of waging of a war of aggression or a war in violation of international treaties, agreements or assurances, or participation in a common plan or conspiracy for the accomplishment of any of the foregoing.

B. Violations of the laws or customs of war. Such violations shall include but not be limited to murder, ill-treatment or deportation to slave labor or for any other purpose of civilian population of, or in, occupied territory, murder or ill-treatment of prisoners of war or internees or persons on the seas or elsewhere, improper treatment of hostages, plunder of public or private property, wanton destruction of cities towns or villages or devastation not justified by military necessity.

C. Murder, extermination, enslavement, deportation and other inhumane acts committed against any civilian population, before or during the war or persecutions on political, racial or religious grounds in execution of or in connection with any crime defined herein whether or not in violation of the domestic law of the country where perpetrated.

2. The offense need not have been committed after a particular date to render the responsible party or parties subject to arrest, but, in general, should have been committed since, or in the period immediately preceding the Mukden incident of September 18, 1931.

The preponderance of cases may be expected to relate to the years since the Lukouchiao incident of July 7, 1937.

3. You will, in the areas subject to your jurisdiction, take all practicable measures to identify, investigate, apprehend and detain all persons whom you suspect of having committed war crimes as defined in paragraph 1, subparagraphs B and C above, and all persons whom any one of the United Nations or Italy notifies to you as being charged with such crimes. You will similarly apprehend and detain the persons deemed to be liable under paragraph 1, A above, who are named in any list which may be sent you by the *National* War Crimes Office and such other persons against whom you have probable cause for charging under paragraph 1 A upon the basis of evidence available to you. In executing these tasks you will require from the Japanese such assistance as you deem necessary.

4. You will hold suspected war criminals in close confinement, without access to the press or other media of public information, and without distinction as to rank or position, as befits ordinary criminals.

5. As Supreme Commander for the Allied Powers, you have power (a) to appoint special international military courts (*which term shall be held to mean tribunals of any kind*) composed of military or naval officers or civilians of two or more of the United Nations, for the trial, under any applicable law, domestic or international, including the laws and customs of war, of Far Eastern war criminals where the alleged offenders are, in the Supreme Commander's opinion, appropriately to be tried by an international court; and (b) to prescribe or approve rules of procedure for such tribunals. The appointment of any such international court will be discussed by the Supreme Commander or his designated representative in advance with the appropriate local officers or representatives of each nation to be represented upon such a court and fair arrangements will be made for appropriate representation of each such nation upon the court. No such officer or civilian will be appointed to serve upon such a court without the approval of the local commander of the forces of his nation or such other official as any nation may prescribe to give such approval for its own nationals. In the appointment of any such international court and in all trials before it, the international character of the court and of the authority by which it is appointed should be properly recognized and emphasized, particularly in dealings with the Japanese people.

6. You will have (a) the responsibility for carrying out the judgments of any international courts or tribunals and (b) the power to approve, reduce or otherwise alter any sentence imposed by such a court or tribunal, but not to increase the severity thereof. Until further authorization by the Joint Chiefs of Staff, no international court for the trial of persons charged with offenses of the type described in paragraph 1 A above will be established by the Supreme Commander. *In submitting any plan for the appointment of such a court, you should specify the particular offenses and alleged offenders to be tried before the court and the nature of the coordination of the plan effected by you on a military level with representatives of the nations to be represented upon the court.*

7. You may authorize the military command of any nation participating in the occupation of Japan, including the United States, to establish special military courts to deal with war criminals not held or requested by you for trial before an international court or tribunal. Such courts should be separate from courts which may be set up to deal with current offenses against the occupation or infractions of military discipline.

8. Subject to the provisions of paragraph 16, you will promptly comply with a request by the Government of any one of the United Nations or Italy for the delivery to it of any person who is stated in such request to be charged with a war crime, subject to the following exceptions: (1) Persons who have held high political, civil or military positions in the Japanese Empire or in one of its allies, co-belligerents or satellites, will not be delivered, pending decision whether such persons should be tried before an international military court or tribunal. Suspected war criminals desired for trial before such tribunal, or persons desired as witnesses at trials before the tribunal, will not be turned over to the nation requesting them so long as their presence is desired in connection with such trials. (2) Where persons are requested by more than one of the Governments above mentioned for trial of a war crime, you will make your own determination based on all the circumstances, including the relative seriousness of the respective charges against such a person and the national interests involved, and will deliver the requested person to a particular United Nation or Italy accordingly.

9. Compliance with any request for the delivery of a suspected war criminal should not be delayed on the ground that other requests for the same person are anticipated.

10. Delivery of a suspected war criminal to a requesting government shall be subject to the condition that if such person is not brought to trial, tried and convicted within six months from the date he is so delivered, he will be returned to you if requested for trial by any of the other United Nations or Italy.

11. You will take under your control, pending decision by higher authorities as to its eventual disposition, property, real and personal, found in areas subject to your jurisdiction and owned or controlled by persons taken into custody pursuant to the provisions of paragraph 3 above.

12. You will take such measures as you deem necessary to insure that witnesses to war crimes will be available when required.

13. The execution of death sentences should be deferred when you have reason to believe that the testimony of those convicted would be of value in the trial of other war criminals.

14. You will arrest any national of a United Nation who is requested, or whom you believe may be desired, by his government as a renegade or guisling. Subject to the provisions of paragraph 16, such persons should normally be turned over as soon as practicable to their government.

15. You should (a) promptly establish an agency, acting under your command, to investigate reports on war crimes and to collect and analyze evidence, to arrange for the apprehension and prompt trial of suspects, to prepare, supervise and conduct the prosecution of individuals and organizations before appropriate international military courts or tribunals, and to recommend to you which individuals and organizations should be prosecuted, before what courts they should be tried and what persons should be secured as witnesses, and (b) should provide, after discussion with the local representatives of the nations involved and in a manner consistent with efficient administration, for equitable inclusion in the membership of such agency of suitable representatives of the United States, China, Great Britain and the Soviet Union and of other appropriate United Nations. This agency should advise the Supreme Commander and other military commanders for the Allies on matters relating to war criminals. This agency should attach importance to the investigation of the evidence that offenses of the type described in paragraph 1 A above have been committed, should collect and analyze the evidence with respect to such offenses and should recommend to you a plan for the trial of such offenses and the charges to be preferred. *Any such plan should provide for the use of rules of procedure and the application of principles in accord with those adopted for use by the International Military Tribunal for Europe established by the agreement executed 8 August 1945, except where change is necessitated by differing circumstances in the Far East. Such plan should also provide that, for the trial of persons charged with offenses of the type described in paragraph 1 A, any international appointed by the Supreme Commander should be selected by him from persons nominated by the appropriate military commanders of the several nations to be represented upon such court.* This agency should also maintain a central record and information office of Japanese war criminals and war crimes, the records and files of which should be available to any interested United Nation.

16. Military commanders having custody of alleged offenders requested for trial under the provisions of paragraphs 8 and 14 above, if in doubt as to whether such persons should be turned over to the requesting nation for trial, may consult their government and in appropriate cases leave the matter to be dealt with through diplomatic channels. Within the main islands of Japan *the Commander in Chief, U.S. Army Forces in the Pacific,* will have custody of such alleged offenders and will consult the Joint Chiefs of Staff in cases of doubt.

17. You will take no action against the Emperor as a war criminal pending receipt of a special directive concerning his treatment.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

5-2 THE JAPANESE POLICE SYSTEM UNDER ALLIED OCCUPATION

Report: R&A No. 2758 (Summary) September 28, 1945
Drafted by: Office of Strategic Services, Research and Analysis Branch
Confidential

1. Public order in Japan is maintained by the civil police (*keisatsu*) and the military police (*kempei*). The civil police system is controlled, its policies determined, and its higher officials appointed by the Bureau of Police Affairs (*Keisatsu-kyoku*) in the Home Ministry. Actual administration of police matters, however, is on the prefectural level, with the prefectural

governors and the chiefs of the prefectural Police Affairs Divisions serving as the administrative authorities. There are no municipal police systems in Japan. The Metropolitan Police Board of Tokyo (*Keishi-cho*) is under a Superintendent-General (*Keishi-sokan*) directly responsible to the Police Bureau of the Home Ministry, rather than to the Tokyo-to authorities.

2. The military police have assumed broad control over civilians, particularly in suppressing liberal or anti-militarist groups. They work closely with the civil police.

3. Police authority is based on laws and ordinances. Members of the Cabinet, the prefectural governors, and the Superintendent-General of the Tokyo Metropolitan Police Board have authority to issue police ordinances.

4. The Japanese police perform many functions which are discharged by separate government bureaus in other countries. Police functions in Japan range from the enforcement of economic regulations to arbitrary control of dissident political elements by means of censorship, suppression of labor unions, and arrest and detention for political opposition. The police by their performance of such political activities, have constituted an obstacle to the fulfillment of democratic tendencies in Japan.

5. Japanese police methods include such regular procedures as licensing and patrolling. Some modern equipment is used. Methods for the preservation of peace often involve abuse of the power of arrest and detention and the use of third degree measures.

6. Japanese communities are reported to be usually law-abiding. Regular uniformed police appear to be generally respected, though the political, or "thought" police, and the military police are apparently both feared and disliked. There is relatively little corruption among the police within Japan proper, in spite of the fact that they are not well-paid. As a result of national control, the requirements and training for the police service are fairly uniform throughout Japan. Ordinary training is given in the police schools in each prefecture, and higher training in Tokyo.

7. If the Japanese police force is allowed to operate in the future as it has in the past, the achievement of the aims of the Potsdam Declaration, specifically those expressed in Articles X and XII, would be hampered. Article X calls for the removal of "all obstacles to the revival and strengthening of democratic tendencies among the Japanese people" and the establishment of "freedom of speech, of religion, and of thought, as well as respect for the fundamental human rights." Article XII provides for the establishment of a "peacefully inclined and responsible government" set up "in accordance with the freely expressed will of the Japanese people."

The United States Initial Post-Defeat Policy Relating to Japan (SWNCC 150/4/A, publicly announced 22 September 1945) establishes specific policies with regard to Japanese public order machinery and methods. It calls for the reform of the police system as soon as practicable; the abrogation of laws which establish discriminations on grounds of race, nationality, creed, or political opinion, and the abolition or modification of agencies specifically charged with the enforcement of such laws; and the removal from office of "active exponents of militarism and militant nationalism" (Part III, Article 1). In addition, Part II, Article 2 provides that if the effectuation of democratic reforms "involves the use of force by the Japanese people or Government against persons opposed thereto, the Supreme Commander should intervene only where necessary to insure the security of his forces and the attainment of all other objectives of the occupation."

The achievement of such reforms and the maintenance of order at a level necessary for the operation and safety of the occupying forces will presumably constitute the two main purposes of the Allies with regard to public safety problems.

8. The problems involved in effecting these two ends will be determined to some extent by the degree of order which the Japanese authorities will be able to maintain. The Japanese government may be expected to seek to preserve a maximum of internal stability in order to forestall intervention by the occupying forces. They will be aided in the achievement of this task by the existence, more or less intact, of long-established machinery for the maintenance of public order and by the traditional acquiescence of the Japanese people in orders issuing from what they regard as legally constituted authorities.

9. It is not impossible, however, that economic and social dislocations beyond the control of public safety officers will cause a deterioration in public order below the level necessary for the successful operations of the occupying forces, or for the effecting of the reforms outlined above. Such a situation might arise despite the efforts of the Japanese authorities to fulfill their obligations or might even result from a conscious policy on the part of such authorities directed toward proving the impossibility or potentially dangerous effects of some reform demanded by the Allies.

10. If the Japanese government is able to maintain order at a level satisfactory to the occupying authorities, there will be open to the Allied authorities the choice of several types of supervision by which they may maintain current information on police practices, check on enforcement of reforms and anticipate the development of conditions inimical to the continued maintenance of order. Such supervision might take the form of periodic inspection by members of the occupying forces or of inspection by Japanese supervisory bodies.

11. If the Japanese authorities fail to maintain order, the occupying forces might, under extreme circumstances, substitute occupying troops for Japanese personnel, or, in less extreme cases, make detailed demands on the Japanese authorities or intervene actively on the lower as well as the higher levels of the police administration.

12. With the attainment of adequate public order conditions, the effecting of reforms called for in paragraph seven above would constitute an important step toward the development of political freedom, although reforms in the police system would not necessarily be effective or permament in the absence of a fuller degree of political freedom than Japan has known in the past.

13. Specific problems with relation to the question of police reform include: the limitation of police functions, both political and general service functions; elimination of undesirable personnel; the question of legal limitations on police methods and powers; including legal reforms and the establishment of bodies of appeal; and the efficacy of decentralization as a step toward the liberalizing of the police force.

[SOURCE: SUITLAND PAPERS, Z 703-53]

5-3 FUNCTION OF GOVERNMENT SECTION, SCAP

General Orders: No. 8 October 2, 1945
SCAP

1. The Government Section is established as a special staff section of this headquarters to advise the Supreme Commander for the Allied Powers as to the status of and the policies pertaining to Military Government in Korea and the internal structure of civil government in Japan.

2. In regard to Korea, it will be the function of the Government Section to:

a. Maintain close liaison on matters of military government with the United States Army Forces in Korea, including the arrangement of temporary duty tours in Korea for officers of the Section and for the interchange of personnel between Korea and the Section.

b. Act as an agency for:

(1) Information relative to current Military Government operations in Korea for consultation and reference by other staff sections.

(2) Expediting matters relating to Military Government in Korea which pertain to more than one staff section in the office of the Supreme Commander.

(3) Preparing, reviewing and processing reports relative to the military government operation in Korea.

c. Advise the Supreme Commander for the Allied Powers on the development and progress of Military Government in Korea and recommend action in furtherance of the occupation mission.

3. In regard to Japan, it will be the function of the Government Section to:

a. Investigate, study and advise the Supreme Commander for the Allied Powers in general with respect to the structure of civil government in Japan and in particular with respect to:

(1) Relationship of civil government to military affairs and the control of military forces.

(2) Relationship of the Imperial Japanese Government to subordinate governmental agencies or subdivisions (including regions, prefectures and municipalities), the methods and degree of centralized control, and the nature and extent of feudal and totalitarian practices.

(3) Relationship of the Imperial Japanese Government and subordinate governmental agencies or subdivisions to the people (including the degree and type of representation of the people in government).

(4) Relationship of government to business, the methods and degree of control by the Imperial Japanese Government and subordinate governmental agencies or subdivisions over business (including financial regulations, subsidies, and other devices for the control and

manipulation of industry).

b. Make recommendations for:

(1) The demilitarization of the Imperial Japanese Government and all subordinate governmental agencies and subdivisions.

(2) The decentralization of the Imperial Japanese Government and the encouragement of local responsibility.

(3) The elimination of the feudal and totalitarian practices which tend to prevent government by the people.

(4) The elimination of those relationships between government and business which tend to continue the Japanese war potential and to hamper the achievement of the objectives of the occupation.

By Command of General MacArthur:
R.K. Sutherland,
Lieutenant General, United States Army,
Chief of Staff.

[Source: *Pol. Reorientation of Japan*, II, p. 796]

5-4 EMPEROR'S POSSIBLE ABDICATION

Telegram: CA 53136 October 11, 1945
To: War Department
From: Advance Echelon, General Headquarters, Army Forces, Pacific, Tokyo
Secret

From SCAP to WARCOS pass to SECSTATE from Atcheson cite CA 53136.

A reliable Japanese source close to Marquis Kido has privately informed member of my staff that the Emperor has for some time considered abdication but would like to abdicate at time of his own choosing. This source feels that reform of the Japanese constitution should come about in manner now provided, that is, through initiative of Emperor and that it would be unfortunate if constitutional reform were imposed from outside or if Emperor were forced to abdicate by action of American authorities.

Without entering into discussion of the general question of the Emperor there would seem to be no doubt that, imperial "initiative" of and sanction for an early and suitable revision of the constitution (see our radio 31 October 10) would provide a firm basis for launching and establishment of an organic law of government.

[Source: Mod. Mil. Br., National Archives]

5-5 TREATMENT OF EMPEROR

Minutes, 27th Meeting (Excerpt) October 11, 1945
SWNCC
Top Secret

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9. TREATMENT OF THE PERSON OF HIROHITO, EMPEROR OF JAPAN (SWNCC 55/3) (Agenda Item 7)

MR. LOVETT circulated a memorandum by the War Department which took issue with the basis on which this paper was drawn up. He presented the memorandum which read as follows:

"This paper has been referred to the Joint Chiefs of Staff for consideration from the military viewpoint. Since the implications of the paper are political rather than military, it seems to me that it presents an appropriate case for consideration by the Committee before consideration by the Joint Chiefs. The Joint Chiefs will presumably wish to obtain General MacArthur's comments before acting and it would be preferable that the paper, as transmitted to General MacArthur for comment, represent a determination of policy, at the SWNCC level, subject to the comments of the Joint Chiefs of Staff and General MacArthur.

"I therefore suggest that the Secretariat request the Joint Chiefs of Staff to postpone consideration of the paper pending consideration by this Committee.

"As to the substance of the paper, I have the following comments:

"1. The conclusions go beyond the immediate needs of the situation, which seem to me to be

"a. a conclusion that there is nothing, as a matter of law, to prevent the arrest, trial and punishment of Hirohito as a war criminal, if the available evidence warrants such action.

"b. a conclusion that all available evidence of Hirohito's participation in and responsibility for Japanese violations of international law should immediately be sought, in the theater or wherever else it may be available, with strict security safeguards and then assembled and analyzed.

"c. a conclusion that the evidence so assembled in the theater should be transmitted to the Joint Chiefs of Staff by the Supreme Commander for the Allied Powers with his recommendations as to whether proceedings should be initiated against Hirohito as a war criminal, and, if such proceedings are recommended, the manner in which any such proceedings should be conducted.

"2. The tone of the discussion (Appendix B, pars. 4, 5, and 6) seem to me to be susceptible of the interpretation that Hirohito should be tried regardless of what the available evidence may be, if that is desirable as a matter of policy. I feel that the principle should be regarded as firmly settled that the trial of war criminals, so far as participated in by the United States, should be a judicial matter and that proceedings should be initiated only where the evidence warrants. In a paper which recommends collecting the evidence, it seems to me to be premature to decide what will be the action taken when the evidence is collected. Thus far, I am aware of no adequate collection of the evidence with respect to Hirohito's actions and certainly no dispassionate appraisal of any such evidence has been made.

"3. Furthermore, when the evidence is available, I believe we may want to consider whether the analysis of the evidence and the decision to try or not to try Hirohito as a war criminal should not be made in the first instance by the Allies acting together, rather than by the U.S. alone.

"4. I do not wish to be construed as opposing trial of Hirohito if the evidence warrants. I simply do not think that the time is ripe to make a decision on the issue and that, before that is done, the recommendations of the Supreme Commander and an analysis of the available evidence should be before SWNCC and JCS.

(Sgd) ROBERT A. LOVETT
Assistant Secretary of War for Air"

MR. LOVETT then made the following suggestions:

a. That the JCS should be requested to discontinue consideration of the paper in its present form.

b. That items 4 d, e and f of the conclusions, page 8, be eliminated and that items a, b, c and g be retained.

c. That the Far Eastern Subcommittee be requested to revise the paper in the light of the War Department's memorandum.

MR. GATES agreed that the JCS be requested to discontinue consideration of SWNCC 55/3. Discussion followed during which CAPTAIN DENNISON indicated that a memorandum was about to be presented by the Far East Subcommittee suggesting that a paper be prepared on the Institution of the Emperor as distinguished from the person of Hirohito. Considerable discussion followed on the subject of trying the Emperor as a war criminal. MR. LOVETT said that he felt very strongly that the whole matter should be approached from a judicial angle, and that the paper as drafted pre-judged the Emperor's guilt, which would be inadvisable for the record however guilty he may currently appear to be. He suggested that the Far Eastern Subcommittee collaborate with representatives of the Department of Justice in the preparation of the new paper.

THE COMMITTEE AGREED:

a. To withdraw SWNCC 55/3 from the Joint Chiefs of Staff.

b. To send SWNCC 55/3 back to the Far Eastern Subcommittee with the request that it resubmit SWNCC 55/3 in the light of the discussion at this meeting.

c. That a separate paper be drafted on the Institution of the Emperor, which might later be consolidated with a paper now in process relating to constitutional changes in Japan.

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[Source: Dipl. Br., National Archives]

5-6 ADMINISTRATION OF THE EDUCATIONAL SYSTEM

Memorandum October 22, 1945
SCAPIN-178 (CIE)

1. In order that the newly formed Cabinet of the Imperial Japanese Government shall be fully informed of the objectives and policies of the occupation with regard to Education, it is hereby directed that:

a. The content of all instruction will be critically examined, revised, and controlled in accordance with the following policies:

(1) Dissemination of militaristic and ultra-nationalistic ideology will be prohibited and all military education and drill will be discontinued.

(2) Inculcation of concepts and establishment of practices in harmony with representative government, international peace, the dignity of the individual, and such fundamental human rights as the freedom of assembly, speech, and religion, will be encouraged.

b. The personnel of all educational institutions will be investigated, approved or removed, reinstated, appointed, reorientated, and supervised in accordance with the following policies:

(1) Teachers and educational officials will be examined as rapidly as possible and all career military personnel, persons who have been active exponents of militarism and ultra-nationalism, and those actively antagonistic to the policies of the occupation will be removed.

(2) Teachers and educational officials who have been dismissed, suspended, or forced to resign for liberal or anti-militaristic opinions or activities, will be declared immediately eligible for and if properly qualified will be given preference in reappointment.

(3) Discrimination against any student, teacher, or educational official on grounds of race, nationality, creed, political opinion, or social position, will be prohibited, and immediate steps will be taken to correct inequities which have resulted from such discrimination.

(4) Students, teachers, and educational, officials will be encouraged to evaluate critically and intelligently the content of instruction and will be permitted to engage in free and unrestricted discussion of issues involving political, civil, and religious liberties.

(5) Students, teachers, educational officials, and public will be informed of the objectives and policies of the occupation, of the theory and practices of representative government, and of the part played by militaristic leaders, their active collaborators, and those who by passive acquiescence committed the nation to war with the inevitable result of defeat, distress, and the present deplorable state of the Japanese people.

c. The instrumentalities of educational processes will be critically examined, revised, and controlled in accordance with the following policies:

(1) Existing curricula, textbooks, teaching manuals, and instructional materials, the use of which is temporarily permitted on an emergency basis, will be examined as rapidly as possible and those portions designed to promote a militaristic or ultra-nationalistic ideology will be eliminated.

(2) New curricula, textbooks, teaching manuals, and instructional materials designed to produce an educated, peaceful, and responsible citizenry will be prepared and will be substituted for existing materials as rapidly as possible.

(3) A normally operating educational system will be reestablished as rapidly as possible, but where limited facilities exist preference will be given to elementary education and teacher training.

2. The Japanese Ministry of Education will establish and maintain adequate liaison with the appropriate staff section of the Office of the Supreme Commander for the Allied Powers, and upon request will submit reports describing in detail all action taken to comply with the provisions of this directive.

3. All officials and subordinates of the Japanese Government affected by the terms of this directive, and all teachers and school officials, both public and private, will be held personally accountable for compliance with the spirit as well as the letter of the policies enunciated in this directive.

5-7 SFE MINUTES ON POLITICAL REFORM

Minutes, 48th., Meeting[2] October 23, 1945
SFE
Top Secret

ITEM 1. SFE 142 (SWNCC) REFORM OF JAPANESE GOVERNMENTAL SYSTEM

CAPT. SABIN praised the paper but said that he felt it was of such importance that it should not be considered hurriedly. Further study would be required of the implications of several points in the paper, he said, including among others, the reference to the possibility that Japan might be permitted armed forces in the future in paragraph 4 *h* of the "Conclusions", page 2, and the reference to decentralization of the government in paragraph 5 *b* of the "Conclusions", page 2, where only one illustration was given. CAPT. DENNISON supported this view and requested an explanation of the background of the paper.

COL. McCORMACK also had questions on the paper, namely, whether the advice of the Supreme Commander should be sought prior to any assumption as to governmental reforms based on the retention of the Emperor, and whether a revision of the governmental structure along U.S. lines might not be preferable to one modelled after the British system. He also felt that the "Conclusions" of the paper should make some specific reference to implementation, that is, what should be done and how in Japan in order to effectuate the "Conclusions", whether by constitutional assembly, by public announcement, or otherwise.

With respect to the choice between the British and the U.S. democratic systems, DR. BLAKESLEE said that the Japanese would probably prefer to retain the Emperor, if, according to the Potsdam Declaration, the choice were left to them. In such an event, in order to democratize the Emperor system, he felt that the adoption of the British system would be unavoidable in view of the fact that an Imperial figurehead was incongruous with the American form of government.

CAPT. DENNISON inquired if, assuming that the "Conclusions" were adopted and put into effect by the Japanese, these measures would assure a democratic government in Japan. He felt some doubt on this score, since, in his view, a democratic government was one in which all powers were vested in the people that were not specifically delegated by the people to governmental agencies. The Emperor institution, however, assumed that all powers were vested in the Emperor which were not specifically delegated by him to governmental agencies.

DR. BLAKESLEE said that, in his view, the Japanese Government would be democratic if the "Conclusions" were adopted because the paper called for an elective House of Representatives to which the Cabinet would be responsible. Furthermore, the paper stipulated that the Emperor could act only upon the advice of the Cabinet.

CAPT. DENNISON proposed that the paper should be redrafted in order to set forth a series of principles against which the Japanese Government and constitution could be tested in order to measure its approach to democratic standards. He felt that such principles would be more effective than any set of specific provisions for a revision of the constitution. He also queried whether a decision should not first be made on the retention of the Emperor before any proposals were made as to constitutional reform.

MR. VINCENT said that the drafting of an adequate set of principles would be a difficult task. DR. BLAKESLEE, referring to CAPT. DENNISON'S question on the retention of the Emperor, said that we were not in a position to decide whether or not the Emperor should be retained, because we were committed by the Potsdam Declaration to allow the Japanese to choose their own form of government. CAPT. DENNISON replied that it was appropriate for the U.S. to have a view on the retention of the Emperor and to encourage the adoption of such a view by the Japanese.

With reference to an earlier question on the implementation in Japan of the "Conclusions", DR. BLAKESLEE said that General of the Army MacArthur should continue to follow the procedure according to which he was now operating. In other words, he should continue informal conversations with Konoye and other Japanese governmental representatives, approve any proposal they might make in the direction of the "Conclusions", suggest

[2] Cf.: SWNCC 209/D and SFE 141 series.

any points that were not being adequately considered, and only as a last resort issue an *ipse dixit.*

MR. MARTIN objected to the paper on the grounds that it proposed constitutional reforms by the same group of Japanese who had been in power before the war, with no reference to the will of the people.

THE SUBCOMMITTEE agreed to defer consideration of SFE 142 and to reconsider the same paper at a later meeting. (This decision was modified by the discussion on Item 2, which follows).

ITEM 2. SWNCC 209/D (SFE 141 SERIES) TREATMENT OF THE INSTITUTION OF THE EMPEROR OF JAPAN

MR. VINCENT said that such a paper would be superfluous if the conclusion were to abolish the institution. He added that we were not free, under the Potsdam Declaration, to do more than express our views as to the nature of a government in Japan which would satisfy democratic standards. CAPT. DENNISON said that there was an apparent unwillingness to express any view pro or con the abolition of the institution, and that if there were a U.S. view, it should be stated. He felt that such an expression would be important, for example, if the question of governmental reform should be raised in the Far Eastern Advisory Commission. In such an event the U.S. representative would have to be prepared to speak, assuming either that the Emperor institution should be retained or abolished. The proposed paper should examine the whole question of the Emperor institution in order to make a definitive conclusion, whether that conclusion was that the institution should go or should be retained, or whether the decision was that we, either didn't care or couldn't decide whether it should be abolished. It was not possible, he felt, for the other paper on governmental reform to be definitive without a decision on the institution.

MR. MARTIN added that the reorientation paper could not properly be retained without a clear stand on the subject of the institution. MR. PENFIELD suggested that the paper might be based on a sound background study of the whole institution, written by a recognized authority such as Sir George Sansom. MR. VINCENT suggested Dr. Reishauer as such an authority. Objecting to CAPT. DENNISON'S reference to the need for a definitive paper, he felt that it was impossible to arrive at a definitive conclusion at this time, and that the current need was for a useful paper for Mr. Atcheson in his discussions with the Japanese. COL. McCORMACK said that the question of the emperor institution was primarily one of long-range political significance and that the military would be satisfied if only a stable government were preserved.

Referring to SFE 142 (Item 1), CAPT. DENNISON proposed that SFE 142 be revised to list principles which could be used as a standard to measure Japan's progress towards democracy and then should cite the changes in form that would be required for either alternative: (a) if the institution were retained, or (b) if the institution were abolished. CAPT. SABIN supported this view and suggested that SFE 142 would be a better paper if SWNCC 209/D were written first.

MR. PENFIELD said that there was no need of a scholarly paper in order to conclude that we would encourage the Japanese to abolish the institution. He said that it was fairly clear that we would not force the Japanese to abolish the institution but that we would encourage any movements by the Japanese in that direction.

MR. VINCENT said he would like to avoid any delay in forwarding SFE 142 to the SWNCC by the following week in order that the paper might be approved and sent to the field for use in negotiations which were now proceeding. For this reason he felt that SFE 142 should not be delayed pending the writing of a report on the institution.

MR. MARTIN questioned the advisability of considering constitutional reforms before the Japanese themselves had decided whether or not they wanted to retain the Emperor. He felt that we should not collaborate with the group of Japanese in positions of influence now, who were the same ones that had been in influence before the war and during the war.

DR. BLAKESLEE said that the Potsdam Declaration stated that the Japanese may have any form of government they choose, provided it is democratic. Consequently, if they were to scrap their old governmental system, being wise men, they would adopt the U.S. form of government. If, on the other hand, they were to decide to retain the Emperor Institution and to democratize it, then they would follow the model of the British Government. In either event, he felt that paragraphs 4 *a*, *b*, and *c* of the "Conclusions", page 1, of SFE 142 would stand as principles of the type that CAPT. DENNISON had requested.

CAPT. DENNISON said that he supported COL. McCORMACK'S earlier proposal

that the revised paper should indicate when and how proposed governmental reforms should be effectuated. In this respect, COL. McCORMACK said that he felt that the Potsdam Declaration really called for a constitutional convention in order that the governmental reforms might reflect the will of the people.

CAPT. DENNISON proposed and the SUBCOMMITTEE agreed that paragraph 7, *b*, 2 of the "Recommendations", page 3, of SFE 142 should be deleted.

THE SUBCOMMITTEE agreed:

a. With respect to SFE 142, that the paper should be rewritten in the light of the discussion at this meeting and in the light of any additional comments forwarded by the members to the Secretary, that Dr. Borton would assume the responsibility for writing the first draft of such revision for clearance with the Working Group prior to resubmittal for Subcommittee consideration, and that the revision of SFE 142 should not be delayed pending the completion of the report on SWNCC 209/D; and

b. With respect to SWNCC 209/D, the SUBCOMMITTEE appointed a Working Group to draft a paper on this subject, with the following representation: Dr. Reishauer, Chairman. (State); Lt. Cmdrs. Hackett and Shepard (Navy); Lt. Col. Hendrick (War).

ITEM 3. SFE 145 (SWNCC) RELEASE OF SWNCC PAPERS TO FEAC

The Secretary reported that at their meeting on Monday, 22 October, the SWNCC had approved the release of Appendix "D" of SWNCC 57/3 and of SWNCC 58/9 to the FEAC.

MR. VINCENT said that GEN. McCOY was desirous of turning over to the members of the FEAC all papers that had already been sent out to the Supreme Commander, together with incoming reports as to what had been accomplished under directives issued.

CAPT. SABIN proposed and THE SUBCOMMITTEE agreed that SWNCC 58/9 should not at this time be released to the FEAC in view of the fact that the question of the disposition of Japanese naval vessels had not yet been settled.

CAPT. DENNISON proposed and THE SUBCOMMITTEE agreed that Appendix "D" of SWNCC 57/3 should not be released at this time to the FEAC because it contained references to certain groups of war criminals, the release of which would be inimical to the interests of the U.S.

THE SUBCOMMITTEE directed the Secretary to forward a memorandum to the SWNCC accordingly. [SOURCE: DIPL. BR., NATIONAL ARCHIVES]

5-8 GOVERNMENTAL REFORM IN JAPAN

Memorandum November 20, 1945
To: J.C. Vincent[3]
From: H. Borton[4]
Secret

In recent reports from Mr. George Atcheson from Tokyo on the question of Japanese constitutional reforms, and particularly in his letter of November 7th to Mr. Acheson, it is pointed out that the Supreme Commander and his advisers "wish if possible to keep the State Department out of this matter". [The question of consitutional reform]

The Supreme Commander in Japan has expressed an urgent need for twenty-five qualified research experts for an intensive research project of approximately nine months to make "non-military investigations and surveys of social and governmental conditions on basis of which recommendations will be made for modifications in Japanese governmental structure, elimination of feudalistic and totalitarian practices, and further development of occupation policies".

While it is realized that the Supreme Commander has final responsibility for all activities within his theater of command, the problems involved in the reforms of the Japanese consitution are of particular interest to the Department of State for the following reasons:

1. The problems are political in character, and hence the advice of the Department of State should be sought in connection with them;

2. Our Allies are vitally interested in the problem, and the question of governmental reform in Japan is now being referred to a sub-committee of the Far Eastern Advisory Commission for study;

[3] Director, Office of Far Eastern Affairs.
[4] Assistant Chief, Div. of Japanese Affairs.

3. Any decisions connected with the reform of the Japanese Government will affect conditions in Japan which will extend beyond the period of military government and into the time when, presumably, Japan will be controlled by civilian personnel under the supervision of the Department of State.

It is suggested that the Department should make it clear to the appropriate authorities that:

1. The Political Adviser in Tokyo and the Department of State should be kept fully informed through appropriate channels of any plans or contemplated action by the Supreme Commander on matters of political reform;

2. The paper on "Reform of Japanese Governmental System", to be submitted to SWNCC in the near future, should be transmitted immediately, in its present draft form, to the Political Adviser and to SCAP for their information;

3. No definitive action should be taken on the question of constitutional reform by SCAP prior to formal transmission by JCS of the SWNCC document mentioned above;

4. In view of the difficulty of our obtaining changes in any revised constitution which had been formally approved by the Japanese Government, including the Emperor, SCAP should request the appropriate Japanese authorities to submit a draft of their proposed changes to him for consideration of this Government prior to its formal acceptance by the Japanese and its formal transmission to SCAP.

5. Any investigations which SCAP may make on Japanese governmental structure, which result in counter-proposals or plans other than those recommended by SWNCC, should be presented to this Government for consideration prior to their implementation;

6. If the above suggestions are adopted, the publication of the statement on governmental reforms as suggested by Mr. Atcheson would appear to be unnecessary.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

5-9 DISCUSSION ON THE TREATMENT OF THE EMPEROR

Minutes, 242nd., Meeting — December 18, 1945
IDAC-FE

CONSIDERATION: TREATMENT OF THE INSTITUTION OF THE EMPEROR

The discussion of the subject under consideration was opened with Mr. Johnson's suggestion that some recognition be made of the achievements effected through the Emperor in the last few months. Mr. Dickover stressed our moral obligation to the Emperor who had acted bravely in surrendering and thus helped to save American lives. Dr. Blakeslee said that if the communications between this government and Japan relating to the surrender were subject to legal judgement, he doubted very much if such legal interpretation would subject the Emperor to treatment as a war criminal.

The committee agreed to put Mr. Johnson's and Mr. Dickover's comments into the discussion. Mr. Borton suggested that parts of Max Bishop's despatch dealing with the events preceding the surrender in June and July and the Emperor's leading role in the peace movement might be incorporated into the discussion. This was agreed to by the committee.

Mr. Sebald suggested that might not there be hidden problems in the paper such as that of the Emperor's advisers. Mr. Borton answered that SWNCC No. 228 provided that the Emperor was to act only on the advice of the cabinet which was responsible to the Diet. Dr. Blakeslee's suggestion that such a phrase might be added to 4 *b* was agreed to by the committee.

Mr. Johnson appeared to oppose the idea of the United States supporting a constitutional monarchy in Japan and suggested that a period be placed after "Republic" in 4 *b*. Mr. Borton proposed that if the Japanese people continued to show their preference for the institution of the Emperor, the Supreme Commander should in accordance with SWNCC no. 228 transform the institution into a Constitutional monarchy.

Mr. Johnson questioned the relationship of *f* to the subject matter of this paper. Mr. Reischauer explained that the attempt to deal with the treatment of the present Emperor before that of the constitution had been unsuccessful and that now the procedure had been reversed.

Mr. Johnson stated that the statement of the problem did not consider the treatment of the present emperor as a war criminal which topic was dealt with in 4 *f* and 4 *g*. The committee discussed the question of leaving *f* and *g* out. Mr. Reischauer read the *Conclusions* of the SWNCC paper on the subject of the treatment of the Emperor as a war criminal.

Mr. Johnson questioned the desirability of our advocating a "monarchical form of government". Mr. Sebald said that the Japanese could have any kind of government so long as it was peaceful and responsible. Mr. Johnson questioned the use of the term "Republic" as meaning perchance a Soviet Republic. He also objected to 4 *b*. Mr. Reischauer answered that it had been inserted to appease "hang the Emperor" people. The committee adopted Mr. Sebald's suggestion to delete all of *b*. after "such a move"; also, to break *a* and *b* into three parts; *a* to deal with a general statement of principle relating to out desire to see a government established in Japan which conforms to the will of the people and which is also peaceful and responsible; *b* with the deletion of the last three lines. The committee accepted Mr. Penfield's suggestion to leave out the adjective "extreme". The committee accepted *c* and *d* and agreed to use the term "Imperial Institution" for that of "Institution of the Emperor". In *e* the committee agreed to accept Mr. Borton's suggestion that the discussion of the technical concept of the "imperial will" be expanded.

In discussing *f* and *g* Mr. Johnson did not think it should be included in the paper; Mr. Dickover was uncertain, but thought every opportunity should be taken advantage of to stress the point that the Emperor should not be treated as a war criminal; Mr. Borton thought the inclusion of *f* and *g* might jeopardize the paper in the SWNCC meetings. Dr. Blakeslee proposed asking the advice of the Director, since the majority seemed to prefer its inclusion. Mr. Borton recalled that in discussing the group's attitude toward the SWNCC paper dealing with the problem they had not received the support of higher levels of the State Department. Consequently, Dr. Blakeslee's proposal to delete *f* and *g* was accepted by the committee. The earlier agreement to include Max Bishop's paper was reversed in accordance with the above decision.

Mr. Reischauer proposed to reword *4* of the *Discussion*. In 8 "first" was substituted for "firstly". The committee agreed to write "Republic" with a small *r*. The committee agreed that the last three lines of 4 *b* of the *Conclusions* should be retained and that 4 of the *Discussion* should stay in.

12 of the *Discussion* went out with f and g of the *Conclusions*. Dr. Blakeslee thought that some reference should be made to the remaining functions of the Emperor after he had been divested of those pertaining to religion and politics. He also suggested a closing paragraph relating to the sentimental value and strength of the institution which Mr. Reischauer thought would cause objections on the part of those opposed to the institution of the Emperor.

[SOURCE: NATIONAL ARCHIVES]

5-10 REMOVAL AND EXCLUSION OF UNDESIRABLE PERSONNEL FROM PUBLIC OFFICE (SCAPIN-550)

Memorandum — January 4, 1946
SCAPIN-550

1. The Potsdam Declaration states: "There must be eliminated for all time the authority and influence of those who have deceived and misled the people of Japan into embarking on world conquest, for we insist that a new order of peace, security, and justice will be impossible until irresponsible militarism is driven from the world."

2. In order to carry out this provision of the Potsdam Declaration, the Imperial Japanese Government is hereby ordered to remove from public office and exclude from government service all persons who have been:

a. Active exponents of militaristic nationalism and aggression.

b. Influential members of any Japanese ultra-nationalistic, terroristic, or secret patriotic society, its agencies or affiliates; or

c. Influential in the activities of the Imperial Rule Assistance Association, the Imperial Rule Assistance Political Society or the Political Association of Great Japan, as those terms are defined in Appendix A to this directive.

3. The term "public office" as used in this directive shall mean and include:

a. Any position in the government service which is customarily filled by one with the civil service rank of Chokunin or above (or equivalent rank under any reorganization of the civil service system); or

b. Any other position in the government service not customarily filled by a member of the civil service which is equivalent or superior to the civil service rank of Chokunin (in the case of government corporations the term will include at least: Chairman of the Board

of Directors, President, Vice-President, Director, Adviser and Auditor).

4. The term "government service," as used in this directive, shall mean and include all positions in the central Japanese and Prefectural Governments and all of their agencies and local branches, bureaus (including Regional Administrative Bureaus) and offices and all positions in corporations, associations and other organizations in which said Governments or any of their agencies have a financial interest representing actual or working control.

5. The term "remove from public office," as used in this directive, shall mean to discharge the person from the public office which he holds and to terminate his influence and participation therein, directly and indirectly. Persons removed from public office will not be entitled to any public or private pensions or other emoluments or benefits without the consent of this Headquarters. An official removed under this procedure will be dismissed and will not be entitled to the hearing or other procedures precedent to removal to which he may have been entitled under Japanese Law.

6. The term "exclude from government service," as used in this directive, shall mean to bar the person in question from any position in the government service. Thus, persons removed from public office will be disqualified from holding any other positions in the government service. Also, persons who may not be holding public offices from which they must be removed, may nevertheless be disqualified from taking a position in the government service. This disqualification from holding public office shall be continued until the provisions of the Potsdam Declaration quoted in paragraph 1 have been fulfilled in Japan.

7. The mere removal of officials from public office and the exclusion from government service of those persons described herein will not be sufficient to establish the new order of peace, security and justice envisaged by the Potsdam Declaration. If Japan is to achieve a peacefully inclined and responsible government, the greatest care must be taken to appoint new officials who will foster the revival and strengthening of democratic tendencies among the Japanese people and who will respect fundamental human rights and freedom of speech, religion and thought. If existing civil service qualification regulations provide obstacles to the appointment of such officials or unduly narrow the field from which appointments may be made, such regulations shall be amended or superseded.

8. The removals ordered by this directive shall be effected as expeditiously as possible, priority being given to the more important positions. Removal may be postponed in the case of individuals who are absolutely required to insure demobilization of the Japanese armed forces in the outlying theaters or to carry out the provisions of this directive. When their assistance is no longer absolutely required they will be dismissed. The names of such individuals, their positions, the reason for their disqualification, and the reasons for their temporary retention will be promptly reported to this Headquarters. The time of their final dismissed will also promptly be reported.

9. Appendix "A" contains a list of the categories of persons who must be removed from public office and excluded from government service by the Imperial Japanese Government in order to carry out the provisions of paragraph 2 of this directive. Persons included in the categories listed in Appendix "A" shall be removed from public office as provided in paragraphs 8 and 10 and shall thereafter be excluded from government service. However, if the Imperial Japanese Government represents that in order to carry on indispensable peaceful executive activities of such government, the temporary reinstatement of an individual so removed is essential and that it is impossible to obtain a suitable replacement, an application so stating, signed by a responsible official of the Imperial Japanese Government, may be filed with this Headquarters. Such applications shall contain a statement of the name, rank, position, duties, and responsibilities of the individual involved; shall state fully the reasons why such temporary reinstatement is regarded as essential, the requested period of temporary reinstatement and the efforts made to obtain a suitable replacement. Such application shall be accompanied by a copy of the questionnaire described in paragraph 10, below. No such temporary reinstatement will be effected by the Imperial Japanese Government until this Headquarters has registered its approval in writing.

10. In order to insure that the government service is cleansed of undesirable personnel the following action will be taken:

a. The Imperial Japanese Government will instruct each of its Ministries or other appropriate agencies to remove from positions described in paragraph 3 which are within its competence, any persons whom the records show or who are known to have been within the categories listed in Appendix "A." A Questionnaire (see below) will be obtained from each such individual before he is notified of his dismissal.

b. In addition, the Imperial Japanese Government will instruct each of its Ministries or other appropriate agencies to prepare and distribute to all incumbents of positions described in paragraph 3 and to future applicants for government positions which are within its competence, the Questionnaire contained in Appendix "B". Such Questionnaires will be reviewed and on the basis of them and any other knowledge in possession of the Government, individuals will be removed from office or denied employment in accordance with the provisions of this directive.

11. Each Ministry or other appropriate agency will prepare a Plan for handling the Questionnaires which will provide for:

a. Distribution.
b. Collection.
c. Review.
d. Action on basis of information in Questionnaire.
e. Classification and filing—this system should permit reference to the Questionnaire in terms of agency, rank of officials, and action taken (e.g., removal or retention).

12. Each Plan will provide for screening of positions occupied by higher rank officials first. A duplicate set of completed Questionnaires will be provided at the Headquarters of each Ministry or other agency where it will be available for inspection or removal by this Headquarters.

13. In addition to the Questionnaires each Ministry or other agency will maintain at its headquarters an alphabetical file of Questionnaire Record Cards substantially in the form indicated in Appendix "C" available for inspection or removal by this Headquarters. The cards, will be filled out in English (also in Japanese if desired). Identical numbers, with an identifying symbol for each Ministry or other agency, will be assigned to each Questionnaire and the Record Card relating thereto.

14. In order that the forthcoming elections may provide a full opportunity for democratic elements in Japan to obtain memberships in the Imperial Diet denied them during the years of Japan's militaristic nationalism and aggression and in order to eliminate from the new Diet the influence of those who have deceived and misled the people of Japan into embarking on world conquest, any person who comes within the categories described in Appendix "A" shall be disqualified as a candidate for any elective position in the Imperial Diet. Any such person shall be disqualified from standing at any time as a candidate for prefectural Governor or Mayor of a city (Shi). Also, all such persons shall be removed from and henceforth excluded from appointment to the House of Peers. The Imperial Japanese Government shall adopt measures to enforce this disqualification of candidates for elective office, including the issuance of necessary regulations, the publication of disqualification categories prepared in conformity herewith and the certification by each candidate that he is not thereby disqualified from standing for election. A comprehensive report of the measures proposed to be adopted will be furnished to this Headquarters.

15. The Imperial Japanese Government will make the following reports to this Headquarters (In English, in triplicate):

a. Reports required by paragraphs 8 and 14 hereof.

b. An initial report of the Plan of each Ministry or other agency called for by paragraph 11. This Headquarters may direct revision of any of these Plans if they are not considered adequate.

c. A weekly report, divided into sections for the fields of competence of each Ministry or other agency, showing:

(1) Total number of positions whose incumbents are to be investigated.
(2) Number and type of positions investigated previously and during the current week.
(3) Number of persons removed or denied employment during the current week.
(4) Names, ranks, positions, and Questionnaire numbers of persons removed or denied employment during the current week.

16. This Headquarters will provide for inspections and investigations necessary to check compliance with this directive, and the Imperial Japanese Government will render any assistance required for the making of such inspections and investigations. Action taken by the Japanese Government with respect to removal or denial of employment and with respect to disqualification of candidates for elective office will be reviewed and may be reversed by this Headquarters.

17. Wilful falsification of or failure to make full and complete disclosures in any Questionnaire, report or Application provided for in this directive will be punishable by the Supreme Commander for the Allied Powers as a violation of the Surrender Terms. In ad-

dition, the Imperial Japanese Government will make any provisions necessary to provide adequate punishment in Japanese courts and under Japanese law for such wilful falsification or non-disclosure and will undertake such prosecutions as may be required.

18. In addition to the general provisions of this directive covering all public offices, this Headquarters has made and may make more restrictive requirements respecting employment of certain classes of individuals at all levels in special fields.

19. All officials and subordinates of the Imperial Japanese Government affected by the terms of this order will be held personally responsible and strictly accountable for compliance with and adherence to the spirit and letter of this directive.

FOR THE SUPREME COMMANDER:
H.W. ALLEN,
Colonel, A.G.D.,
Asst. Adjutant General.

Inclosures:
Appendix A—Removal and Exclusion Categories.
Appendix B—Questionnaire.
Appendix C—Questionnaire Record Card.

Appendix "A"
REMOVAL AND EXCLUSION CATEGORIES

A. *War Criminals.*—Persons arrested as suspected war criminals unless released or acquitted.

B. *Career military and naval personnel, special police and officials of the War Ministries.*—Any person who has at any time held any of the following positions:

1. Member of:
   Board of Fleet Admirals and Field Marshals.
   Supreme Military Council.
   Imperial General Headquarters.
   Army and Navy General Staffs.
   Supreme Council for Direction of the War.
2. Commissioned officer in the Imperial Japanese Regular Army or Navy or in the Special Volunteer Reserve.
3. Commissioned or noncommissioned officers, enlisted men or civilian employees who served in or with the Military Police (Kempei-Tai) or Naval Police, the TOKUMU KIKAN, KAIGUN TOKUMU BU, or other special or secret intelligence or military or naval police organizations.
4. *Ministry of War* (unless appointed since 2 September 1945):
   Minister.
   Permanent Vice-Minister.
   Parliamentary Vice-Minister.
   Parliamentary Councillor.
   Chief Secretary.

All civilian officials of the civil service rank of Chokunin, or above, or who occupy positions normally held by persons of such rank.

5. *Ministry of the Navy* (unless appointed since 2 September 1945):
   Minister.
   Permanent Vice-Minister.
   Parliamentary Vice-Minister.
   Parliamentary Councillor.
   Chief Secretary.

All civilian officials of the civil service rank of Chokunin, or above, or who occupy positions normally held by persons of such rank.

C. *Influential Members of Ultranationalistic, Terroristic or Secret Patriotic Societies.*—Any person who has at any time:

1. Been a founder, officer, or director of; or
2. Occupied any post of authority in; or
3. Been an editor of any publication or organ of; or
4. Made substantial voluntary contributions (a sum or property the value of which is large in itself or large in proportion to the means of the individual in question) to any of the organizations or their branches, subsidiaries, agencies, or affiliates (other than the organizations referred to in paragraph D below) described in the Memorandum to the Japanese Government on "Abolition of Certain Political Parties, Associations and Societies" AG 091 (4 Jan 46) GS.

D. *Persons Influential in the Activities of IRRAIRAPS, and the Political Association of Great Japan.*—Any person who has at any time:

1. Been a founder or national officer, a national director, national committee chairman, or a leading official of a prefectural or metropolitan subdivision of; or
2. Been an editor of any publication or organ of:
   a. The Imperial Rule Assistance Association (Taisei Yokusankai) and any of its affiliates.
   b. The Imperial Rule Assistance Political Society (Taisei Seijikai) and any of its affiliates or agencies.
   c. The Political Association of Great Japan and any of its affiliates or agencies.

E. *Officers of Financial and Development Organizations involved in Japanese Expansions.*—Any person who has at any time between 7 July 1937 and 2 September 1945, occupied any of the positions listed below:

Chairman of the Board of Directors, President, Vice-President, Director, Adviser or Auditor of any of the following or, in territory occupied by the Japanese armed forces since 7 July 1937, manager of a branch of:

South Manchurian Railway Company.
Manchuria Development Company.
North China Development Company.
Central China Development Company.
Southern Development Company.
Taiwan Development Company.
Manchuria Heavy Industry Development Company.
Nanyo Development Company.
Oriental Development Company.
Wartime Finance Bank.
United Funds Bank.
Southern Development Bank.
Overseas Funds Bank.
Chosen Colonization Bank.
Deutsche Bank Fuer Ostasien.
Bank of Chosen.
Bank of Taiwan.
Bank of Manchukuo.
Manchurian Development Bank.
Korean Trust Company.

Any other bank, development company or institution whose foremost purpose has been the financing of colonization and development activities in colonial and Japanese-occupied territory, or the financing of war production by the mobilization or control of the financial resources of colonial or Japanese-occupied territories.

F. *Governors of Occupied Territories.*—Japanese officials who have held the positions listed below:

1. *Korea*:
   Governor General.
   Chief Civilian Administrator.
   Members of Privy Council.
2. *Formosa*:
   Governor General.
   Chief Civilian Administrator.
3. *Kwantung*:
   Governor General.
   Chief Administrator.
   Director of the Bureau of Pacification.
4. *South Seas*:
   Governor General.
   Director of South Seas Administration Office.
5. *Netherlands East Indies*:
   Chief Military Administrator.
   Chief Civil Administrator.
6. *Malaya*:
   Chief Military Administrator.

Chief Civil Administrator.
Mayor of Singapore.

7. *French Indo-China*:
Governor General.
Inspector General of Police.
Director of Bureau of General Affairs.
Financial Charge d'Affaires.

8. *Burma*:
Advisers to the Burmese Administration.
Chief to the Political Affairs Department of the Japanese Military Administration.
Chief of the Internal Affairs Department of the Central Administration.

9. *China*:
Advisers to the Nanking Puppet Government.
Ambassador.

10. *Manchukuo*:
Director of General Affairs Board.
Vice Director of General Affairs Board.
Officers of the Central Organization of the Concordia Society.

11. *Others*:
Responsible Japanese Officials controlling collaborationist native governments in the Mongolian Federated Autonomous Government, the Philippine Puppet Republic, the Provisional Government of Free India, and Thailand.

G. *Additional Militarists and Ultranationalists:*

1. Any person who has denounced or contributed to the seizure of opponents of the militaristic regime.

2. Any person who has instigated or perpetrated an act of violence against opponents of the militaristic regime.

3. Any person who has played an active and predominant governmental part in the Japanese program of aggression or who by speech, writing or action has shown himself to be an active exponent of militant nationalism and aggression.

[SOURCE: *Pol. Reorientation of Japan*, II, pp. 482-85]

5-11 REFORM OF JAPANESE GOVERNMENT (SWNCC-228)

Report, SWNCC-228 January 7, 1946
Drafted by: SWNCC
Top Secret

REFORM OF THE JAPANESE GOVERNMENTAL SYSTEM*

THE PROBLEM

1. To determine the constitutional reforms which the occupation authorities should insist be carried out in Japan.

FACTS BEARING ON THE PROBLEM

2. See Appendix "A".

DISCUSSION

3. See Appendix "B".**

CONCLUSIONS

4. It is concluded that:

a. The Supreme Commander should indicate to the Japanese authorities that the Japanese governmental system should be reformed to accomplish the following general objectives:

(1) A government responsible to an electorate based upon wide representative suffrage;

(2) An executive branch of government deriving its authority from and responsible to the electorate or to a fully representative legislative body;

(3) A legislative body, fully representative of the electorate, with full power to reduce, increase or reject any items in the budget or to suggest new items;

(4) No budget shall become effective without the express approval of the legislative body;

(5) Guarantee of fundamental civil rights to Japanese subjects and to all persons within Japanese jurisdiction;

(6) The popular election or local appointment of as many of the prefectural officials as practicable;

(7) The drafting and adoption of constitutional amendments or of a constitution in a manner which will express the free will of the Japanese people.

b. Though the ultimate form of government in Japan is to be established by the freely expressed will of the Japanese people, the retention of the Emperor institution in its present form is not considered consistent with the foregoing general objectives.

c. If the Japanese people decide that the Emperor Institution is not to be retained, constitutional safeguards against the institution will obviously not be required but the Supreme Commander should indicate to the Japanese that the constitution should be amended to conform to the objectives listed in *a* above and to include specific provisions:

(1) That any other bodies shall possess only a temporary veto power over legislative measures, including constitutional amendments approved by the representative legislative body, and that such body shall have sole authority over financial measures;

(2) That the Ministers of State or the members of a Cabinet should in all cases be civilians;

(3) That the legislative body may meet at will.

d. The Japanese should be encouraged to abolish the Emperor Institution or to reform it along more democratic lines. If the Japanese decide to retain the Institution of the Emperor, however, the Supreme Commander should also indicate to the Japanese authorities that the following safeguards in addition to those enumerated in *a* and *c* above would be necessary:

(1) That the Ministers of State, chosen with the advice and consent of the representative legislative body, shall form a Cabinet collectively responsible to the legislative body;

(2) That when a Cabinet loses the confidence of the representative legislative body, it must either resign or appeal to the electorate;

(3) The Emperor shall act in all important matters only on the advice of the Cabinet;

(4) The Emperor shall be deprived of all military authority such as that provided in Articles XI, XII, XIII, and XIV of Chapter I of the Constitution;

(5) The Cabinet shall advise and assist the Emperor;

(6) The entire income of the Imperial Household shall be turned into the public treasury and the expenses of the Imperial Household shall be appropriated by the legislature in the annual budget.

5. Only as a last resort should the Supreme Commander order the Japanese Government to effect the above listed reforms, as the knowledge that they had been imposed by the Allies would materially reduce the possibility of their acceptance and support by the Japanese people for the future.

6. The effectiveness of governmental reforms in preventing the resurgence of military control in Japan will depend in a large measure upon the acceptance by the Japanese people of the entire program. In the implementation of allied policy on the reform of the Japanese Government, the Supreme Commander for the Allied Powers must take into account the problems of sequence and timing, as well as measures which might be adopted to prepare the Japanese people to accept the changes, in order to insure that the reforms are lasting in strengthening representative government in Japan.

7. This paper should not be released for publication. The eventual release of a statement of allied policy on the reform of the Japanese Government should be coordinated with the Supreme Commander for the Allied Powers in order not to impede the accomplishment of such reforms in Japan itself.

RECOMMENDATIONS

8. It is recommended that:

a. Upon approval by the State-War-Navy Coordinating Committee of the Conclusions in paragraphs 4, 5, 6, and 7 above:

* As revised January 7, 1946.
** Not printed.

(1) The report, as amended, be forwarded to the State, War and Navy Departments and the Joint Chiefs of Staff for information; and

(2) The report, as amended, be forwarded to the American Representative on the Far Eastern Commission for his guidance in negotiations with other members of the Commission on the formulation of an Allied policy on the reform of the Japanese Government.

b. No part of this report be released to the press at present.

TOP SECRET

APPENDIX "A"

FACTS BEARING ON THE PROBLEM

1. The Potsdam Declaration provides that:

". . . The Japanese Government shall remove all obstacles to the revival and strengthening of democratic tendencies among the Japanese people. Freedom of speech, of religion, and of thought, as well as respect for the fundamental human rights shall be established.

. . . . . .

"The occupying forces of the Allies shall be withdrawn from Japan as soon as these objectives [as set forth in the Potsdam Declaration] have been accomplished and there has been established in accordance with the freely expressed will of the Japanese people a peacefully inclined and responsible government."

2. The Allied note of August 11 to the Japanese Government stated that:

"The ultimate form of government of Japan shall, in accordance with the Potsdam Declaration, be established by the freely expressed will of the Japanese people."

3. One of the ultimate objectives of the United States in regard to Japan is stated in SWNCC 150/4/A, "United States Initial Post-Defeat Policy Relating to Japan", to be:

"To bring about the eventual establishment of a peaceful and responsible government which will respect the rights of other states and will support the objectives of the United States as reflected in the ideals and principles of the Charter of the United Nations. The United States desires that this government should conform as closely as may be to principles of democratic self-government but it is not the responsibility of the Allied Powers to impose upon Japan any form of government not supported by the freely expressed will of the people."

[Annex 2]

Memorandum by the Joint Chiefs of Staff

SM-4499
SWNCC-228/1

WASHINGTON, 18 December 1945.

MEMORANDUM FOR THE STATE-WAR-NAVY COORDINATING COMMITTEE

Subject: Reform of the Japanese Governmental System.

The Joint Chiefs of Staff have considered a report by the State-War-Navy Coordinating Subcommittee for the Far East (SWNCC 228), on the subject of reform of the Japanese governmental system, in which it is recommended that certain policies for reform be indicated, or as a last resort, be imposed by the Allies upon the Japanese authorities.

They assume that in formulating these policies, due consideration was given to the statement in the Three Power Proclamation issued from Berlin to the Japanese people on 26 July 1945, to the effect that there is to be established in Japan "in accordance with the freely expressed will of the Japanese people, a peacefully inclined and responsible government."

From the long-range military point of view, the major concern of the Joint Chiefs of Staff with regard to the government of Japan is that no nationalistic or military clique or combination should again be able to dominate that country and lead it into a war of aggression. The effectiveness of governmental reforms in preventing the resurgence of military control in Japan will depend in a large measure upon the acceptance by the Japanese people of the entire program. The principal short-term military interest is in the possibility that the implementation of the proposed reforms may foment unrest in Japan to such a degree as to require increases in occupational forces or lengthening of the tenure of occupation by such forces. The Joint Chiefs of Staff consider it appropriate to point out that the effectiveness of the United States Army and Navy has already been reduced incident to demobilization, and that continuance of demobilization under current plans will, in the course of the next twelve months, further reduce the fighting strength of the United States armed forces to a point where it will be difficult to deal with any serious unrest in Japan.

The Joint Chiefs of Staff further consider that, as a matter of planning in connection with the successful attainment of these ends, additional studies should be made by the Supreme Commander for the Allied Powers on the details of the sequence and timing of the proposed reforms, together with measures which should be adopted to prepare the Japanese people to accept the changes in order to minimize unrest and disorder and to insure that the reforms are lasting in strengthening representative government in Japan.

Subject to the foregoing remarks, the Joint Chiefs of Staff perceive no objection from the military point of view to the objectives set forth in paragraphs 4 and 5 thereof.

For the Joint Chiefs of Staff:
A. J. MCFARLAND
Brigadier General, USA
Secretary

[SOURCE: *FRUS*, 1946, Vol. VIII, pp. 99-103]

5-12 CONSTITUTIONAL REFORM

Memorandum
To: Gen. MacArthur
From: Whitney[5]

February 1, 1946

1. The question of constitutional reform of the Japanese governmental system is rapidly approaching a climax. Several proposed revisions of the Japanese constitution have been drafted by governmental and private committees. Constitutional reform may well be a cardinal issue in the coming election campaign.

In these circumstances, I have considered the extent of your power as Supreme Commander to deal with fundamental changes in the Japanese constitutional structure, either by approving or disapproving proposals made by the Japanese government or by issuing orders or directives to that government. In my opinion, in the absence of any policy decision by the Far Eastern Commission on the subject (which would, of course, be controlling), you have the same authority with reference to constitutional reform as you have with reference to any other matter of substance in the occupation and control of Japan.

2. *You have authority from the Allied Powers to proceed with constitutional reform.* In accordance with the agreement among the governments of the US, USSR, UK and China, the President of the United States designated you as Supreme Commander for the Allied Powers to "take such steps as you deem proper to effectuate the surrender terms." (Par. 5 of Designation). By the Instrument of Surrender, the Japanese Government accepted the provisions of the Potsdam Declaration. (Par. 1 of Instrument). The Potsdam Declaration requires the Japanese government to "remove all obstacles to the revival and strengthening of democratic tendencies among the Japanese people," and the establishment "in accordance with the freely expressed will of the Japanese people of a peacefully inclined and responsible government." (Pars. 10 and 12 of Declaration.).

To achieve this alteration in the nature of Japan's governmental institutions requires fundamental changes in the Japanese constitutional structure; and such alteration is essential to the execution of the Potsdam Declaration. Therefore, your authority to effectuate constitutional reform designed to develop a form of government responsible to the people is implicit in the terms of your designation by the Allied Powers as Supreme Commander for the purpose of enforcing the surrender terms.

3. *You have authority from the Joint Chiefs of Staff to proceed with constitutional reform.* The Joint Chiefs of Staff have directed that you "exercise your authority as you deem proper to carry out your mission." (Cable No. WX 60333 dated 7 September 1945). Your mission as set forth in the basic occupation directive for Japan (JCS 1380/15) includes: (a) carrying out measures for "The strengthening of democratic tendencies and processes in governmental economic and social institutions," (b) permitting and favoring "changes in the direction of modifying the feudal and authoritarian tendencies of the government," and (c) informing the Japanese that "they will be expected to develop a nonmilitaristic and democratic Japan," (pars. 3a, 3c, and 4c of Directive).

It is clear that you cannot accomplish these aspects of your mission without effecting fundamental changes in the Japanese constitutional structure. Since the development of a democratic Japan has been explicitly made a part of your mission, you have ample auth-

[5] Chief, Government Section, SCAP.

ority from the Joint Chiefs of Staff to approve or order consitutional reform designed to achieve the desired results.

4. *Your authority to make policy decisions on constitutional reform continues substantially unimpaired until the Far Eastern Commission promulgates its own policy decisions on this subject.* The Charter of the Allied Council for Japan requires you to consult and advise "with the Council in advance of orders on matters of substance" but your "decisions upon these matters shall be controlling," (par. 5 of Charter). The sole limitation imposed upon your authority to effect constitutional reform exists in case a member of the Council disagrees with a proposed order "*regarding the implementation of policy decisions of the Far Eastern Commission* on questions concerning . . . fundamental changes in the Japanese constitutional structure" (par. 6 of Charter). In such event your order would be referred to the F.E.C. to determine whether it properly implemented the F.E.C. policy decision.

In the absence of any F.E.C. policy decision, however, there is no restriction upon your executive authority except (a) insofar as the obligation for advance consultation with the Allied Council limits the *manner* in which your authority is exercised, and (b) insofar as the F.E.C. may review any action you may take. Under its charter, the F.E.C. may, at the request of any member, review any directive issued to you or any action taken by you (par. II, A, 2 of Charter). Similarly, no directive may be issued to you by the Joint Chiefs of Staff or any other agency of the United States Government "dealing with fundamental changes in the Japanese constitutional structure" without "the attainment of agreement in the Far Eastern Commission" (par. III, 3). Neither of these provisions, however, precludes your taking action pursuant to existing directives to approve or direct constitutional reform.

5. Should the F.E.C. eventually promulgate a policy directive involving changes in the constitutional structure, *your decision in the issuance of directives (orders) thereon would not be controlling if any member of the Allied Council for Japan objected.* It is my opinion that the word "order" in the charter of the Allied Council is used in the sense of compulsion and would not embrace a mere approval by you of constitutional reform measures submitted to you by the Japanese government, although your action in approving the same would be subject to review by the F.E.C. under the general review authoriy of its charter.

6. To recapitulate, I am of the opinion (a) that you now have the unrestricted authority to take any action you deem proper in effecting changes in the Japanese constitutional structure—the only possible restriction being upon action taken by you toward removal of the Emperor, in which case you are required to consult with the Joint Chiefs of Staff; (b) should the F.E.C. issue a policy directive dealing with the matter of constitutional reform, then and in such event the issuance of any constitutional reform *directive* (order) upon the Japanese government would be subject to objection by any member of the Allied Council for Japan and your decision would not be controlling.

7. The above opinion represents the composite view of all officers of the Government Section who have examined this question.

[SOURCE: *Pol. Reorientation of Japan*, II, pp. 622-23]

5-13 PERSONAL ASSIGNMENTS: GOVERNMENT SECTION[6]

Announcement — February 4, 1946
By: Gen. Whitney

1. The following officer personnel assignments are announced:

Chief, Government Section	Brig. Gen. Courtney Whitney
Deputy Chief	Col. B. E. Clarke
Administrative Assistant	Miss S. M. Hayes
Executive Officer	Lt. Col. H. E. Robison
Administrative Officer	Lt. Col. T. Y. Horton
Liaison Officer	Maj. J. G. Marr
Librarian-Historian	Lt. C. Lloyd-Jones (WAC)
Korean Division	Lt. Col. C. D. March (Chief)
	Lt. Col. E. S. Bibb
	Lt. Comdr. H. E. Stevens
	Maj. N. W. Stalheim
	Capt. F. V. Cahill, Jr.
	Capt. W. H. Fielding
Public Administration Division	Col. C. L. Kades (Chief)
	Lt. Col. F. E. Hays
Legislative and Liaison Branch	Comdr. G. J. Swope
	Capt. J. Williams
	Lt. M. J. Esman
	Miss G. Norman
Political Parties Branch	Lt. Col. P. K. Roest
	Dr. H. E. Wildes
	Miss B. Sirota
Governmental Powers Branch	Comdr. A. R. Hussey, Jr.
	Lt. G. A. Nelson, Jr.
	Dr. C. H. Peake
	Mr. J. I. Miller
	Miss R. A. Ellerman
Local Government Branch	Maj. C. G. Tilton
	Lt. Comdr. R. L. Malcolm
	Mr. P. O. Keeney
	Miss M. Stone
Opinions Branch	Capt. F. Rizzo
	Ensign R. A. Poole
Review and Reports Branch	Lt. (j.g.) O. I. Hauge

[SOURCE: *Pol. Reorientation of Japan*, II, pp. 806]

[6] Cf: Similiar roster for Government Section, December 4, 1947, included in this volume (5-20).

5-14 SCAP AUTHORITY ON CONSTITUTIONAL AUTHORITY

Telegram: WAR 80049 — March 9, 1946
To: CINCAFPAC, Tokyo
From: War Department

It is understood that in view of Moscow communique certain members of Far Eastern Commission may question your right to approve new Japanese constitution without directive from Commission. Accordingly State Department is informally asking War Department to ascertain basis of your approval.

View in War Department had been that if Japanese Government were to proceed with constitutional reforms prior to action in FEC, you would intervene only if such reforms were inconsistent with directives already issued by you. It appears therefore that your action in personally approving of this new constitution is in consonance with War Department view since

(A) Constitution was issued, not by your headquarters but by Japanese Emperor and Government, in compliance with directives issued by you prior to Moscow conference, and

(B) Constitutional reforms appear to be consistent with directives received by you.

Request your early confirmation of views expressed in paragraph 2 above, or comments thereon.

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

5-15 U.S. EDUCATION MISSION TO JAPAN

Digest of Report — April 6, 1946[7]

The United States Education Mission, consisting of twenty-seven representatives of American education under the chairmanship of Dr. George D. Stoddard, in the process of preparing this report, spent the month of March in Japan consulting with the officers of the Education Division of the Civil Information and Education Section, General Headquarters, SCAP, with a committee of Japanese educators appointed by the Minister of Education of Japan, and with other representatives of the schools and of various walks of life in Japan. This report to the Supreme Commander for the Allied Powers is presented upon the basis of the deliberations by the members of the Mission.

[7] Submitted to SCAP on March 30, 1946.

The Mission recognizes the necessity for the original negative directives, such as those eradicating militarism and nationalistic Shintoism from the schools, but it has concentrated chiefly upon positive proposals. In so doing it has sought to aid the Japanese to set for themselves the conditions for reestablishing a sound educational system within their culture.

The Aims and Content of Japanese Education

A highly centralized educational system, even if it is not caught in the net of ultranationalism and militarism, is endangered by the evils that accompany an intrenched bureaucracy. Decentralization is necessary in order that teachers may be freed to develop professionally under guidance, without regimentation. They, in turn, may then do their part in the development of free Japanese citizens.

To this end, knowledge must be acquired that is broader than any available in a single prescribed textbook or manual, and deeper than can be tested by stereotyped examinations. A curriculum consists not merely of an accepted body of knowledge, but of the pupils' physical and mental activities; it takes into account their differing backgrounds and abilities. It should therefore be set up through cooperative action involving teachers, calling on their experience and releasing their creative talents.

Morals, which in Japanese education occupy a separate place, and have tended to promote submissiveness, should be differently construed and should interpenetrate all phases of a free people's life. Manners that encourage equality, the give-and-take of democratic government, the ideal of good workmanship in daily life—all these are morals in the wider sense. They should be developed and practiced in the varied program and activities of the democratic school.

Books in the fields of geography and history will have to be rewritten to recognize mythology for what it is, and to embody a more objective viewpoint in textbooks and reference materials. On the lower levels more use should be made of the community and local resources; at the higher levels competent scholarship and research should be encouraged in various ways.

The program in health instruction and physical education is basic to the educational program as a whole. Medical examinations, instruction in nutrition and public health, the extension of the physical education and recreation program to the university level, and the replacement of equipment as rapidly as possible are recommended.

At all levels vocational education should be emphasized. A variety of vocational experiences is needed under well-trained staff members, with an emphasis on technology and its supporting arts and sciences. The contributions of artisans and workers should find a place in the social studies program, and opportunities for originality and creativity should be provided.

Language Reform

The problem of the written language is fundamental to all modifications in educational practice. While any change in the form of a language must come from within the nation, the stimulus for such change may come from any source. Encouragement may be given to those who recognize the value of language reform, not only to the educational program, but also to the development of the Japanese people throughout future generations.

It is recommended that some form of Romaji be brought into common use. It is proposed that a language commission made up of Japanese scholars, educational leaders and statesmen be formed promptly in order that a comprehensive program may be announced within a reasonable period. In addition to deciding the form of Romaji to be chosen, this commission would have the following functions: (1) to assume the responsibility for coordinating the program of language reform during the transitional stages; (2) to formulate a plan for introducing Romaji into the schools and into the life of the community and nation through newspapers, periodicals, books, and other writings; and (3) to study the means of bringing about a more democratic form of the spoken language. The commission might, in time, grow into a national language institute.

The need for a single and efficient medium of written communication is well recognized, and the time for taking this momentous step is perhaps more favorable now than it will be for many years to come. Language should be a highway and not a barrier. Within Japan itself, and across national borders, this highway should be open for the transmission of knowledge and ideas in the interest of a better world understanding.

Administration of Education at the Primary and Secondary Levels

The principle is accepted that, for the purposes of democratic education, control of the schools should be widely dispersed rather than highly centralized as at present. The observance of ceremonies in the reading of the Imperial Rescript and obeisances to the Imperial Portrait in the schools are regarded as undesirable. The Ministry of Education, under the proposals of the Mission, would have important duties to perform in providing technical aid and professional counsel to the schools, but its direct control over local schools would be greatly curtailed.

In order to provide for greater participation by the people at local and prefectural levels, and to remove the schools from the administrative control by representatives of the Minister of Home Affairs at the local level, it is proposed to create educational agencies elected by popular vote, at both local and prefectural levels. Such agencies would be granted considerable power in the approval of schools, the licensing of teachers, the selection of textbooks—power now centralized in the Ministry of Education.

There is proposed an upward revision of compulsory education in schools to be tax-supported, coeducational and tuition-free, such education to cover nine years of schooling, or until the boy or girl reaches the age of sixteen. It is further proposed that the first six years be spent in primary school as at present, and the next three years in a "lower secondary school" to be developed through merging and modifying the many kinds of schools which those completing primary school may now enter. These schools should provide general education for all, including vocational and educational guidance, and should be flexible enough to meet individual differences in the abilities of the pupils. It is proposed further that a three-year "upper secondary school" be established, free of tuition costs, in time to be coeducational, and providing varied opportunities for all who wish to continue their education.

Together, the lower and upper secondary schools would continue the varied functions of other tax-supported schools now at this level: higher elementary schools, girls' high schools, preparatory courses, vocational schools, and youth schools. Graduation from the upper secondary schools would be made a condition of entrance to institutions of higher learning.

Private schools under the proposal would retain full freedom, except that they would be expected to conform to the minimum standards necessary to assure ready transfer by the pupil from one school to another, whether public or private.

Teaching and the Education of Teachers

In order that the newer aims of education may be achieved, teaching methods emphasizing memorization, conformity and a vertical system of duties and loyalties should be modified to encourage independent thinking, the development of personality, and the rights and responsibilities of democratic citizenship. The teaching of morals, for example, should be less by precept than by instruction deriving from experiences in concrete situations in school and community.

A program for the reeducation of teachers should be set up to further the adoption of democratic methods in the transitional period. Suggestions are made for a program which will gradually merge into one of in-service education.

Normal schools should be modified so as to provide the kinds of teachers needed. They should admit students only after completion of a course in the upper secondary school equivalent in standards to that of the present middle school, thus eliminating the normal preparatory courses. The reorganized normal schools, all more nearly at the level of the higher normal schools, should become four-year institutions; they would continue general education and provide adequate professional training for teachers in elementary and secondary schools.

Other institutions for preparing teachers for certification, whether private or tax-supported, should satisfy teacher-training standards equivalent to those of the reorganized normal schools.

School administrators and supervisors should have a professional education equivalent to that for teachers and should have, in addition, such special preparation as will fit them for their assigned duties.

Universities and other higher institutions should develop facilities for advanced study on the part of teachers and administrators; they should promote research and exert educational leadership.

Adult Education

During this period of crisis for the Japanese people, adult education is of paramount

importance, for a democratic state places much responsibility on each citizen.

The schools are but one agency for adult education, but through parent-teacher activities, evening and extension classes for adults, and the opening of buildings to a variety of community activities, adult education may be fostered.

Another important institution for adult education is the public library. It is recommended that central public libraries, with branches, be established in the larger cities, and that appropriate arrangements be made for library service in all prefectures. The appointment of a director of public library service in the Ministry of Education would facilitate this program. Museums of science, art, and industry may serve educational purposes paralleling those of the library.

In addition, organizations of all kinds, including community and professional societies, labor unions, and political groups, should be helped to use effectively the techniques of forum and discussion.

In the furtherance of these ends, the present adult education services of the Ministry of Education should be vitalized and democratized.

For a period of years following the first world war currents of liberal thought were fostered largely by men and women educated in the colleges and universities of Japan. Higher education now has the opportunity of again setting a standard of free thought, bold inquiry, and hopeful action for the people. To fulfil these purposes, higher education should become an opportunity for the many, not a privilege of the few. In order to increase the opportunities for liberal education at higher levels, it would be desirable to liberalize to a considerable extent the curricula of the preparatory schools (Koto Gakko) leading to the universities and those of the more specialized colleges (Semmon Gakko), so that a general college training would become more widely available. This would lead, on the one hand, to university study, and, on the other, to specialized training at the semi-professional level such as is provided by the Semmon Gakko, but rounded out with training of broader cultural and social significance.

In addition to providing more colleges, it is proposed that more universities be established according to a considered plan. Some governmental agency should be responsible for supervising the establishment of higher institutions and the maintenance of the requirements first set down. Except for examining the qualifications of a proposed institution of higher education before it is permitted to open its doors, and assuring that these initial requirements are met, the governmental agency should have practically no control over institutions of higher education. The institutions should be entirely free in all respects to pursue their objectives in the manner which they themselves deem best.

Establishment of economic and academic freedom for faculties in institutions of higher education is of primary importance. To this end, it is recommended that the present civil service plan be discontinued.

For the student, the freedom which should be guaranteed is freedom of aceess, on the basis of merit, to all levels of higher studies. Financial help should be given, in order that further education may be positively assured for talented men and women unable to study on their own resources. Freedom of access to higher institutions should be provided immediately for all women now prepared for advanced study; steps should be taken also to improve the earlier training of women.

The extension of libraries, research facilities, and institutes is recommended; such agencies can make invaluable contributions to the public welfare during the period of reconstruction and beyond. Attention needs to be given to the improvement of professional education in fields such as medicine, school administration, journalism, labor relations, and public administration. A special commission is recommended for the study of the whole question of medicine and public health.

[SOURCE: U.S. Department of State, *Occupation of Japan: Policy and Progress*, pp. 156-63]

5-16 REFORM OF THE JAPANESE WRITING SYSTEM AND LANGUAGE PROBLEM

Report April 30, 1946
Drafted by: Working Group[8], State Department

[8] The Working Group was chaired by Dr. E.O. Reischauer. This report was considered in conjunction with SFE 178.

MEMORANDUM FOR Dr. E. O. Reischauer, S-2586, Room 432, State Dept.
Major M. Mitchell, W-71840, Room 4B9401, Pentagon.
Comdr. Stephen Jurika, N-63068, Room 36141, Navy Bldg.
Subject: Reform of the Japanese Writing System and Language Problem.
Enclosure: Draft on Subject.

1. The enclosure, a proposed paper by the State Department regarding the reform of the Japanese writing system and language, is circulated for consideration by the Working Group at the request of Dr. E. O. Reischauer, Chairman.

2. There will be a meeting of the Working Group to consider this paper at 1500, 2 May 1946, Room 4348, Munitions Building.

For the State-War-Navy Coordinating Subcommittee For the Far East:

A. F. Richardson
Commander, USN
Acting Secretary

PROBLEM

1. To determine policy regarding the reform of the Japanese writing system and language.

FACTS BEARING ON THE PROBLEM

2. See Appendix "A".

DISCUSSION

3. See Appendix "B".

CONCLUSIONS

4. It is concluded that:

a. A thoroughgoing simplification of the Japanese writing system, preferably through the common use of the Latin alphabet in place of Chinese characters and *kana*, would be highly beneficial to Japan.

b. The reform of the Japanese writing system and the methods by which such a reform is to be achieved are problems to be decided by the Japanese Government and people.

c. The Supreme Commander for Allied Powers should encourage, but not order, the Japanese Government to form a commission of Japanese scholars, educational leaders and statesmen to study the advisability of changing the Japanese writing system and to formulate a long-range program for accomplishing whatever reforms may be deemed necessary.

d. The Supreme Commander should not demand or encourage reforms in the Japanese spoken language or any other linguistic reforms not necessitated by a change in the writing system.

RECOMMENDATIONS

5. It is recommended that this paper, upon approval by the SWNCC, be forwarded to the War and Navy Departments for guidance and implementation, where appropriate, and to the State Department for transmission to the United States representative on the Far Eastern Commission with instructions that its substance be presented to the FEC with a view to obtaining a policy decision on the subject to serve as a basis for a directive to SCAP.

APPENDIX "A"

BRIEF ON LANGUAGE REFORM TAKEN FROM THE REPORT OF THE UNITED STATES EDUCATIONAL MISSION TO JAPAN

1. The importance of language in the educative process in all areas and periods of life, both in the individual and in the nation cannot be overestimated.

2. In its written form the Japanese language constitutes a formidable obstacle to learning. The memorizing of thousands of *Kanji* places an excessive burden on young pupils and decreases the time available for acquiring essential knowledge about the world of physical nature and human society.

3. Considering the inordinate amount of time spent in learning to read and write *kanji* the results are disappointing. After six years of elementary schooling very few pupils are

able to read easily and effectively ordinary magazines and books in which many *kanji* are used. About 85% of Japanese children terminate their formal education with the elementary school.

4. The 15% who go to higher education still have to wrestle with the language.

5. Distinguished scholars, publicists, editors and other influential citizens have long recognized the need for linguistic reform.

6. Although there are certain esthetic and scholarly values residing in *kanji* the Mission believes that this system of writing should be wholly abandoned and a phonetic system adopted. Such a system would facilitate the entire learning process and simplify the use of typewriters, linotype machines, catalogues, dictionaries and other language aids.

7. The Mission is of the opinion that among phonetic systems there are more advantages to *romaji* (the Latin alphabet) than to *kana* (the Japanese syllabary), for the use of the former would lend itself well to the growth of democratic citizenship and international understanding.

8. Recommendations of the Mission:

a. That some form of *romaji* be brought into common use by all means possible.

b. That the particular form of *romaji* chosen be decided upon by a commission of Japanese scholars, educational leaders and statesmen.

c. That the commission assume the responsibility of coordinating the program of language reform during the transitional stages.

d. That the commission formulate a plan and a program for introducing *romaji* into the schools and into the life of the community and nation through newspapers, periodicals, books, and other writings.

e. That the commission study, also, the means of bringing about a more democratic form of the spoken language.

f. That in view of the steady drain on the learning time of children the commission be promptly formed. It is hoped that a thorough and a comprehensive program may be announced within a reasonable period.

9. The Japanese language commission appointed to launch this great undertaking might grow into a national language institute which would also attract scholars from other countries.

10. Now is the most favorable time for taking this step in language reform, for the Japanese people are entering into new and constructive experiences both as individuals and as a nation.

11. The adoption of *romaji* would contribute to the transmission of ideas and knowledge across national boundaries, and also break down the old spirit of national isolation and exclusiveness.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

5-17 REFORM OF LOCAL GOVERNMENT

Memorandum April 30, 1946
To: Chief, Government Section
From: C.G. Tilton, Chief, Local Government Branch

I. THE PROBLEM PRESENTED.

1. The policy of SCAP is to enforce among others the fifth term of the Potsdam Declaration, "The Japanese Government shall remove all obstacles to the revival and strengthening of democratic tendencies among the Japanese people." The fundamentals of democratic institutions and principles must be laid in the villages, towns, cities and prefectures through increased freedom of action by the populace.

2. To attain these aims profound alterations in laws, procedures and practices will of necessity be made in the whole structure of Japanese Government. Some major changes will have to be made in each of the local echelons to construct the foundations of liberalism for the people. The changes advocated should be practical in terms of the aims of the occupation and the framework of government of which they must be a functioning part; they should as well have sequence and time of introduction to insure efficient administration.

3. The following objectives comprise the heart of the problem for the reorganization of local government:

a. Greater opportunity for popular participation in political affairs at local levels, to provide the Japanese people with experience and training which is essential if they are to

establish and maintain democratic government at the national level.

b. Increased responsibility for elected and appointed officials in local government in order to develop their qualities of leadership and initiative which subsequently can be exercised in the arena of national affairs.

c. Elimination of many of the practices and procedures which now cause the local units to be dependent upon the central government, such as abolishing the requirements for the local governments to submit so many of their decisions to the Ministry of Home Affairs or other ministries for approval or final action.

d. Transfer authority in so far as possible from administrative officials to the people's representatives.

e. Opportunity for the people of a city or town to select for themselves the governmental organization of their community. The present laws prescribe a rigid structure dominated by the central government which deprive the people of the opportunity to use other democratic forms or structures. Variations from the staid required pattern would be of value in the development of greater political consciousness which also is needed in national affairs.

f. Opportunity for local representative bodies and officials to participate in the determination of national policies. At the present, local units of government, as mere administrative subdivisions of the central government, have been vehicles for the transmission of central policy, but have had no opprtunity to participate in the formulation of that policy. It is desirable that local representative bodies be elevated in responsibility and prestige so that their deliberations will be of greater influence as channels of public opinion and special group interests. From a long time point of view the populace must come to the realization that all and each of them have a part in government. Heretofore only a special few had any conviction that they were to be concerned with "their" government or with those who governed them.

II. FACTS BEARING UPON THE PROBLEM.

General Statement.

1. Local government both as to form and as to function, is determined by a series of laws and Imperial Ordinances the titles of which are self-explanatory.

a. Each of the three civil echelons has an organic law of some 150 articles which provides its basic structure: the Law concerning the Organization of Prefectures, Law No. 63, 1899 with amendments, the Law concerning the Organization of Cities, Law No. 68, 1911 with amendments, and the Law concerning the Organization of Towns and Villages, Law No. 69, 1911 with amendments.

b. Supplementary organizational elements as well as other matters for each of the echelons are provided for in Imperial Ordinances: the *Chihōkankansei* or Regulations Governing the Organization of Local Governments, the *Bunkanninyōrei* or the Regulations Concerning the Appointment of Civil Officials and the *Naimushōkansei* or Ministry of Home Affairs supervisory ordinances.

c. Budgetary and financial matters historically, have been the control mostly frequently utilized by the central government for regulation of local affairs. Fundamental to the administrations of each of the local governments therefore are national and local tax laws which provide the means for funds of operation.

2. This study is concerned with the three organic laws which both in form and substance are quite alike. There are provisions for (1) assemblies and councils with articles on their duties and powers and direct election of members, (2) duties and powers of the executive, (3) administration of personnel, (4) finances and (5) miscellaneous matters. Hence, a uniform system of local government is found throughout Japan.

3. The basic laws provide for a highly centralized national control of local affairs. The prefectural governments are administrative sub-divisions of the central government controlling and supervising cities, towns and villages. These latter, therefore, exercise only the vestiges of local autonomy. Each echelon has (1) an executive who exercises most of the local government's powers, (2) an assembly and council (the latter excepted for towns and villages) which have few legislative powers, and (3) administrative departments and sections which carry the functions of government to the people.

Home Ministry Drafts.

1. Following conferences with the Local Government Branch, the Home Ministry has submitted proposed amendments to the laws concerning the organization of local units of government. These amendments are in the right direction, but fall far short of providing for the changes which are necessary for the accomplishment of SCAP policy. The basic

pattern of centralized control is not changed, nor is there any significant increase in the authority and responsibility of local representative bodies. There is no marked curtailment in Home Ministry control of local affairs.

2. In the three divisions—executive, representative bodies and administration—below, the principal features of the organization of local government in general treatment are presented in terms of, (1) provisions in the three laws under consideration, (2) Home Ministry draft amendments, and (3) recommendations of the Local Government Branch.

Local Government Executives

1. *Method of Election*

A. *Prefectural Governor*

a. Present Law: Imperial appointment upon recommendation of the Home Minister.

b. Home Ministry Draft: Popular election of governor from among those candidates who file, with no other system of selective nomination.

Note: The Imperial Cabinet on 12 April adopted a resolution opposing direct election of the governor, proposing indirect election by group of approximately 20 electors selected by voters. ...The Home Ministry suggests, moreover, that after election within the prefecture, the governor should be confirmed in office by the national government, stressing their feeling that he should continue as a part of the national administrative structure.

c. Local Government Branch: Popular election of the governor, with nomination as follows: Popular primary election one month prior to the regular election for which candidates file according to the provisions of the Home Ministry draft; three highest candidates to qualify for the general election.

B. *City Mayor*

a. Present Law: Appointment by Home Ministry upon recommendation of city assembly.

b. Home Ministry Draft: Popular election of mayor from among candidates who file.

c. Local Government Branch: Accept Home Ministry draft.

C. *Village and Town Headman*

a. Present Law: Election by town or village assembly.

b. Home Ministry Draft: Popular election from among candidates who file, supported by 30 signatures.

c. Local Government Branch: Accept Home Ministry draft.

2. *Powers and Duties*

A. *Prefectural Governor*

a. Present Law: The present law provides for a strong executive with authority to manage and supervise prefectural affairs. Actually the governor performs his duties very largely as the agent of the national government in the exercise of his authority. Specifically, the law authorizes the governor to perform the following functions: 1. to carry into effect any matter the expenses of which are defrayed out of the prefectural funds, 2. to present a bill to the assembly, 3. to manage and supervise property and establishments of the prefecture, 4. to provide orders for the receipt and payment of accounts, 5. to take custody of prefectural instruments and papers, 6. to impose and collect rents, fees, rates, etc., 7. and to carry out any other matters prescribed in laws or ordinances. The governor is authorized to delegate authority to subordinates, to supervise these subordinates, and to take disciplinary action against them.

The powers of the governor in respect to the Assembly and to administrative matters are discussed in the next two major divisions of this study.

b. Home Ministry Draft: The draft amendments do not alter the broad powers of the governor.

c. Local Government Branch: The Branch favors in general, the retention by the governor of the powers outlined above. However, certain of his powers in relation to the popularly elected assembly should be reduced. These matters are discussed in connection with other provisions of the law relating to the Assembly.

Note: Attention is called to the fact that much of the authority of local executives, particularly that of the governor, is delegated in other national laws, ordinances and ministerial orders, or according to developed practice. Further recommendations concerning the status of local executives relating specifically to these other elements will be made separately.

B. *City Mayor*

a. Present Law: The powers of the mayor, as provided in the present law, are similar to those assigned to the prefectural governor.

b. Home Ministry Draft: No changes.

c. Local Government Branch: The position of the Branch is the same as for that concerning the prefectural governor.

C. *Town and Village Headman*

a. Present Law: The powers of the headman, within his jurisdiction, are similar to those of the governor and mayor.

b. Home Ministry Draft: No changes.

c. Local Government Branch: The position of the Branch is the same as for that concerning the governor and the mayor.

D. *Duties of Executives in Respect to Elections.*

a. Present Laws: Under the present laws, the governor, mayor and headman play an extremely important part in the administration of local and national elections. These executives are responsible for the preparation of voting lists, hearing cases relating to these lists, and rendering decisions thereon, administering the work of election inspectors, prescribing the form of the ballot papers, appointing presiding officers at polling places, and appointing responsible officers to count the vote.

b. Home Ministry Draft: The Home Ministry drafts include no change in these provisions. Moreover, additional authority in this respect is granted to the chief executive at each level, making him the responsible officer in charge of the conduct of the election of his successor in office.

c. Local Government Branch: The Local Government Branch recommends the transfer of the authority of the local executive in the conduct of elections to a special election committee. (Discussed in a separate memorandum.)

Elected Representative Bodies

1. *Prefecture*

A. *Prefectural Assembly*

a. Present Law: Under the present law the prefectural assembly, elected by direct popular vote, is a deliberative body of strictly limited powers. It may consider and decide upon a number of subjects enumerated in the law, including those "falling within the powers of the Assembly...under the Laws or Ordinances," but the number of such subjects is limited. The Assembly is convened only once a year, unless called into special session by the Governor, sessions continue for not more than thirty days, meetings may be secret at the request of the Governor or three members. Members have no right to present bills dealing with the budget, and the Assembly is not permitted to increase revenue and / or expenditures in the budget bill presented by the Governor. In the event of a tie vote, the chairman, who is a member of the Assembly, casts the deciding vote. The clerk of the Assembly is appointed by the Governor.

The present law gives the Governor considerable authority over the Assembly in the event of disagreement. He can set aside a resolution of the Assembly if he considers it *ultra vires* or contrary to public interest, in which case he applies to the Home Ministry for direction.

b. Home Ministry Draft: The Home Ministry proposes the following important changes: It broadens the base of elections, making the qualifications practically the same as in the law for the election of members of the House of Representatives. It increases the competence of the Assembly with the provision that "a prefecture may specify such matters as shall be referred to the Assembly," although it is not clear by whom. It emphasizes the right of the Assembly to examine prefectural documents and accounts. It provides that the Assembly meetings shall be public, and that the clerk of the Assembly shall be "determined" by the chairman of the Assembly with the consent of the Governor.

The Home Ministry also proposes that when the Assembly has adopted a resolution of non-confidence the Governor may request the Home Minister to dissolve the Assembly; if a resolution of non-confidence again is passed by a newly-elected assembly, the Governor shall resign. The Home Ministry also proposes a provision for dissolution by the Ministry of the Assembly upon the initiative of 1/50 of the electorate, or 10,000 persons, whichever is smaller.

c. Local Government Branch: The Local Government Branch accepts those

provisions of the draft which increase the competence of the Assembly, but favors further strengthening of Assembly's powers. The provision that the prefecture may specify such matters as shall be referred to the Assembly should be clarified, and the Assembly should have final authority in the selection of its own clerk and other staff. The Assembly should possess the right to change the budget bill presented by the Governor, increasing or decreasing revenue and expenditure measures. Meetings should be closed to the public only at the request of 2/3 of the members present, and the chairman should not possess the right to cast a second vote to break a tie. Sessions of the Assembly should be held twice a year with extraordinary sessions at the request not only of the governor but also of 1/3 of the membership. The length of the sessions should be determined by the Assembly itself and not of the Governor.

The Local Government Branch agrees that in the event of disagreement with the Assembly the Governor, at his discretion, should have the right to dissolve the Assembly; but if the newly-elected Assembly likewise passes a resolution of non-confidence he shall have the option of complying with the decision and remaining in office or of resigning. If the disagreement is due to the opinion of the governor that the Assembly acted *ultra vires*, he shall apply to the proper court, and there shall be no issue of resignation. The Branch does not accept the draft proposal authorizing the Home Ministry to dissolve the Assembly upon the motion of a certain number of voters. The authority of the Prefectural Assembly in respect to loans will be considered in connection with broader questions of fiscal autonomy.

B. *Prefectural Board of Aldermen.*

a. Present Law: The present law provides for a Board of Alderman, composed of ten members elected by the Assembly from among its own members, to represent the Assembly throughout the year. The Governor is ex-officio chairman of the Board, its meetings (usually once each month) are called by him or at the request of a majority of the members, its meetings are closed, and it considers problems delegated to it by the Assembly or the Governor.

b. Home Ministry Draft: No changes.

c. Local Government Branch: The Local Government Branch accepts the mechanics of the Board of Aldermen, but desires bi-monthly meetings as a minimum, that the Board be required to make a full report to Assembly and that it have more responsibility and voice. (Dissent by Dr. Grajdanzev and Mr. Masland.)

2. *City*

A. *City Assembly.*

a. Present Law: The law in respect to the city assembly follows closely the law of prefectures, except that the dependence upon superior government organs is even greater, ("the City Assembly may submit...", "the city assembly shall submit...", etc.).

b. Home Ministry Draft: The proposed changes closely follow the prefectural pattern.

c. Local Government Branch: The Local Government position in respect to cities follows the recommendations for prefectures. The authority of the City Assembly in respect to loans will be considered with broader questions of fiscal autonomy.

B. *Board of Aldermen*

a. Present Law: The present law provides for a city board of aldermen similar in composition and functions to the prefectural board of aldermen.

b. Home Ministry Draft: The Home Ministry proposes that the city may "under special circumstances" dispense with the Board of Aldermen by a city by-law.

c. Local Government Branch: The Branch recommends an option for a board of aldermen of assembly discretion for committee organization.

3. *Towns and Villages*

A. *Assembly*

a. Present Law: The provisions in the law for town and village assemblies are similar to those for prefectures and cities, with the following important exceptions: the headman of the town or village is ex-officio chairman of the Assembly; no specific number of sessions is prescribed.

b. Home Ministry Draft: No change.

c. Local Government Branch: The Local Government Branch recommends changes along the lines of those outlined for the prefectural and city assemblies, with the following additions: The Assembly should have ordinary sessions once a month and extraordinary sessions at the request of the headman or 1/6 of the members. The Assembly should have the authority to increase or decrease the budget estimates without approval of the Home Ministry.

ADMINISTRATION

1. *Prefecture*

A. *Prefectural Departments and Staff*

a. The Administrative staff of the prefecture is composed of members of the national civil service and prefectural employees. Of this group the law in question provides only for a treasurer appointed by the governor without confirmation by the assembly, and for committees (inquiry and supervision) composed of unpaid members.

b. The number and kinds of administrative departments and the staff of personnel are determined by the Ministry of Home Affairs by authority of Imperial Ordinance.

c. According to the present law the governor's administrative relationship with the personnel is supervisory and disciplinary; with the lower ranks, his relationship goes beyond supervision and discipline to appointment and dismissal at will.

d. Outside his own office, the governor has supervisory powers over mayors including initiation of dismissal to the Minister of Home Affairs, and supervisory and dismissal powers over headmen of towns and villages.

e. Home Ministry plan—No material change.

f. Local Government Branch desires confirmation for the more important prefectural officers by the prefectural assembly, and all supervisory and disciplinary actions to be settled within the prefecture and not have them referred to Ministry of Home Affairs.

2. *Cities*

A. *City Sections and Staff*

a. Present law provides the mayor with administrative powers to appoint (1) a deputy mayor upon approval of the governor, (2) a comptroller, treasurer, deputy treasurer, accountant on confirmation of assembly, and (3) ward heads, ward treasurers, deputy ward treasurers, city counsellors and committees on his own authority.

b. The mayor has coordinated jurisdiction or *tokatsu* over the city and hence very largely determines the city's organization as to sections and units as well as the appointment and fixation of salary of all other employees.

c. Home Ministry plan: Provides some participation by citizens but on essentials, it continues prefectural and Home Ministry consent and guidance.

d. Local Government Branch desires settlement of most administrative matters within city's area, only a few reaching the governor and none to be referred to the Ministry of Home Affairs.

3. *Towns and Villages.*

A. *Town and Villages sections and staff*

a. Present law for administrative control and organization of towns and villages is the same as the city law in essential elements.

b. Home Ministry plan similar to its recommendation in the city law.

c. Local Government Branch advocates relatively the same position on administrative matters for towns and villages as that for cities.

OTHER IMPORTANT PROVISIONS

1. *National Centralization of Local Government*

Decentralization of national control is one of the principal objectives to be sought in the reform of local government. The changes discussed above in respect to local chief executives, local assemblies, and local administration will, if put into operation, provide for certain decentralization. However, certain additional changes in the laws concerning the organization of prefectures, cities, towns and villages are needed to alter national centralization of local government.

A. *Administrative Divisions*

Local units of government should possess greater authority in respect to police, fire, education, welfare, labor and fiscal affairs. At the present time these matters are not considered in the organic laws herein under consideration.

B. *Home Rule Provision*

Local units of government should possess home rule authority, enabling them to write their own charters in respect to the structure of local government.

C. *Miscellaneous*

Local units of government should be granted greater authority in respect to their initial establishment, enlargement, change of boundaries, change of names, and so forth; at

present these matters are determined by the Home Ministry.

III. RECOMMENDATIONS

Continuous contact and discussion with the staff of the Local Affairs Bureau of the Ministry of Home Affairs since November 1945, conferences with other staff sections, as well as study and work in nine prefectures have furnished the background for following recommendations:

1. The Local Government Branch recommends the acceptance each of the changes advocated in respect to each topic discussed in subdivisions "c" of LOCAL GOVERNMENT EXECUTIVES, ELECTED REPRESENTATIVE BODIES, ADMINISTRATION and A, B, and C of OTHER IMPORTANT PROVISIONS.

2. The Local Government Branch recommends that these proposals be communicated to the Home Ministry by means of informal meetings with the officials with whom the Branch has been in conversation for the past months.

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

5-18 SUMMARY OF ACHIEVEMENTS DURING THE FIRST YEAR OF OCCUPATION

Statement — August 28, 1946
Made by: Gen. MacArthur

First and above all else, the gigantic military machine of the Japanese Empire has been completely destroyed. Its fighting power had been temporarily nullified in the war, but a tremendous military organization, manned by millions, still remained at the time of the surrender. Its liquidation required the disarming, demobilization and disposition of approximately four million organized and armed men in the home islands and two and one half million abroad. In addition, it was necessary to retrieve from overseas approximately two million civilians, and to repatriate to their homelands from Japan a further million of allied nationals. Within the early weeks of the occupation, those in the home islands were disbanded and returned to peaceful pursuits. And today, after a single year, the last remnants of the overseas forces, scattered over thousands of miles, are streaming home and the work of repatriation is drawing to a close. Nine million have been processed in this time. For magnitude, thoroughness, speed and precision, this has constituted a demobilization and repatriation which has no precedent in history.

To further insure the destruction of Japan's warmaking power, thousands of military and civil aircraft and millions of weapons of various calibers, with vast quantities of ammunition, have been seized and disposed of; remnants of the Japanese navy have been taken over and are being destroyed or held for allied division; and every element of Japanese industry utilized for, or capable of adjustments to, the making of implements of war has been either destroyed or brought under our complete control. Thus from a material standpoint also, Japan's war-making power and potential is ended.

Rapid and effective strides have been made in reshaping the Japanese Government to conform to the principles inherent in a democratic state so that the people might readjust their lives to compose a truly democratic society. A new constitution has been evolved from many months of widespread public interest and unrestricted debate which, submitted to the people by the Emperor and Government of Japan, is now in the process of democratic legislative action toward adoption or amendment. Designed effectively to curb abuse of power by individual, class or government, it places sovereignty squarely in the hands of the people upon whom it bestows the full measure of human freedom. The masses here are no longer regimented—no longer enslaved. The Japanese citizen no longer cringes in the presence of police or other public authority; his home has become his castle, free from unwarranted intrusion, observation or violence; he registers his opinion on public issues, uncontrolled except by his own conscience; he enjoys the right of assembly and petition; he worships as he chooses, in accordance with his individual religious faith; he enjoys the untrammelled right, individually or collectively with his fellow workers, to demand correction of unjust labor practices and conditions; and Japanese children, eighteen million of whom are presently enrolled, enjoy the right to liberal and free education in forty thousand public schools, now open and dedicated to the study of the arts and sciences and the historical truth and the development of enlightened thought.

Electoral discrimination has been removed, and its base expanded by reducing the age limit from twenty-five years to nineteen and enfranchizing the women of Japan. The general election held on April 10th last was a vivid demonstration of democracy on the march. A far greater number of those eligible to vote participated in this election than in any other election in Japanese history. The women of Japan took their newly gained franchise as a serious obligation, sharply broke from their traditional retirement within the family circle, and elected through this, their own revolution, thirty-nine women members of the House of Representatives—an accomplishment without precedent in political history.

Reform has been instituted in every element and echelon of the governmental structure and in every phase of governmental administrative procedure, to root out existing evils of entrenched bureaucracy which inevitably lead to totalitarian controls. Those who in past preached the doctrine of militarism, expansionism and intense nationalism, and shaped the policies responsible for Japan's collapse, have been purged and barred from governmental service to afford the people a new leadership.

To dislodge the economic hold which certain vested interests have long had over Japanese economy, the corporate and personal resources of the fourteen major families including the four big Zaibatsu groups, with the approximately 1,200 firms linked in this system, are being liquidated. All principal officers and influential members of this industrial empire are being ousted. Thus the economic strangle-hold upon the people in restriction of free enterprise, made possible by close alliance between government and concentrated wealth, is being inexorably broken.

Striking at the roots of feudalism, an agrarian reform program, now under way, will enable about two million tenant farmers of Japan to purchase the lands they now work. Shaped to break down the large land holdings into two and one half to ten acre parcels, with their disposal provided for under conditions which will permit their ready acquisition, this program will correct one of the notorious evils which has long plagued individual economy and held in serfdom the under-privileged agricultural workers of Japan.

The task is by no means complete, but a decisive advance toward the achievement of our major objectives has been made.

[SOURCE: *Pol. Reorientation of Japan*, II, pp. 754-55]

5-19 FEC DISCUSSION ON DRAFT CONSTITUTION

Minutes, 27th Meeting — September 21, 1946
Far Eastern Commission

REPRESENTATIVES PRESENT

Major General Frank R. McCoy (United States) (Chairman)
Major J. Plimsoll (Australia)
Dr. George S. Patterson (Canada)
Dr. S.H. Tan (China)
Mr. Paul Guerin (France)
Mr. Jamshed Vesugar (India)
Dr. A.D.A. de Kat Angelino (Netherlands)
His Excellency Sir Carl Berendsen (New Zealand)
Mr. Leonides S. Virata (Philippines)
Rear Admiral S.S. Ramishvili (U.S.S.R.)
Sir George Sansom (United Kingdom)

SECRETARY GENERAL

Mr. Nelson T. Johnson

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ITEM 3 DRAFT CONSTITUTION (FEC-087/1)

MR. VESUGAR said that it was the view of his Government that the responsibility for definite approval of the constitution was not that of the Far Eastern Commission. He said that such approval was the responsibility of the Japanese Government, and had been made its responsibility under Article 10 of the Potsdam Declaration. He said that under Article III, 3 of the Terms of Reference of the Commission it was apparent that only in the case of directives dealing with fundamental changes in the Japanese constitutional structure or in the Japanese Government as a whole was the attainment of agreement in the Commission

necessary. It was, therefore, the view of his Government that the proper function of the Commission was not to approve the constitution but to insure that nothing contrary to the controlling documents appeared in the constitution.

DR. TAN presented the following statement:

"In view of the fact that Item 2 of the Agenda has a time element and that it is difficult to find a constitution in the world which may be regarded as being perfect as the fundamental law of any land naturally requires years of development and actual application to practical situations before its defects or inadequacies can be revealed, my Government is inclined to accept the Draft Constitution for Japan, although it is quite apparent that it contains many provisions which warrant improvement. We therefore desire to qualify our acceptance with the following reservations and observations.

"(1) The Chinese Delegation desires to reserve its position on the matter of implementation of legislation. As it has been generally recognized by members of this Commission, the present Draft Constitution leaves many vital matters to be determined by subsequent legislation. These include such matters as the qualifications of electors and of members of both Houses (Article 44), matters pertaining to the election of members of both Houses, electoral districts, and the method of voting (Article 47), the Joint Committee of the two Houses of the Diet (Article 40), and the Imperial House Law (Article 2).

"It will be recalled that my Delegation has had occasion to bring the matter to the attention of Committee 3 and proposed that such implementing legislation should be passed upon by the Commission before they are adopted by the Diet. This proposal was adopted in a modified form by Committee 3 and further amended by the Steering Committee as contained in paragraph b of the Attached List of FEC-087/3, which paragraph in part reads as follows: 'The Committee considers, therefore, that as such matters are to be left for determination in subsequent legislation, drafts of such legislation should be made available for the Far Eastern Commission as soon as these drafts are submitted to the Diet.' This paper is still awaiting the approval of the Commission. The Chinese Delegation, however is pleased to note that the consensus of opinion of the Commission is in favor of its adoption.

"It is the understanding of the Chinese Delegation that the words 'shall be made available' as used in the Report of Committee 3 as revised by the Steering Committee, denote that implementing laws will be made available to the Far Eastern Commission in such a manner as will give it opportunities to study and scrutinize them.

"(2) The second reservation which my Delegation desires to make has to do with Article 9 of the Draft Constitution. The Chinese Delegation notes that this Article has been so revised by the House of Representatives of Japan that it is capable of an interpretation which might permit the maintenance by Japan of land, sea and air forces for purposes other than those specified in the first paragraph of that Article.

"The question therefore arises, in the first place, as to the intention underlying the revision, and in the second place, whether, as a matter of policy, Japan should be allowed to maintain land, sea and air forces for purposes other than those enumerated in the first paragraph of Article 9. These points should be clarified. I would welcome it if the Chairman or other colleagues at this table would throw some light on these points.

"The Chinese Delegation should like to request that the Chairman wire General MacArthur inquiring into the underlying cause as to why this Article has been so modified.

"As to the question of policy whether Japan should be allowed to maintain an armed force or not, we deem it appropriate that the matter should be thoroughly discussed. It is taken for granted that Japan should have a 'police force' capable of maintaining law and order, but a 'police force', as the term is generally understood, would not be called 'armed force'. If Japan should be allowed to maintain an armed force, we should be prepared that there is a probability that such armed force will some day be used for all other purposes than those mentioned in the first paragraph of Article 9. Japan, for instance, may use it for purposes 'short of war', and label its armed actions as acts of 'self defense'. This term 'self defense', has a legal connotation and should be interpreted according to generally accepted usages in international law, but the term has been abused so much in recent years, and in view of the possible implications of this Article, we cannot but feel great misgivings.

"It is my understanding that the question of Article 9 has been referred by Committee 3 to Committee 7. The Chinese Delegation reserves its right to state its views in due course in the appropriate committees and in the Commission."

GENERAL McCOY called attention to the information with respect to Article 88 on imperial property (FEC-087/7), and expressed the hope that this information from the Supreme Commander constituted all adequate answer to the reservation make by the United Kingdom representative at a previous meeting with respect to this point.

SIR GEORGE SANSOM said that on the assumption that the term "Imperial household" meant "Imperial house," the amendment, by removing any exception in respect to hereditary property and its income did much to dispose of the fear he had previously expressed that considerable sums might remain at the disposal of the Imperial house and might be used to finance activities beyond the control of the Diet. However, he continued, he was still not fully satisfied that the new clause had the desired meaning. He wondered whether it gave an assurance that the use of both the capital and the revenue of former Imperial property would be under the control of the Diet. The new clause did not say so specifically; it merely said that the property of the Imperial house would be transferred to the state. He desired assurance that, when the transfer was made, former Imperial property would be treated in the same way as all other state property, such as state-owned lands and buildings; that is, that it would come under the control of the Diet and that its administration would be subject to the usual scrutiny and audit.

SIR GEORGE SANSOM asked whether other representatives shared the doubts he had expressed with respect to Article 88. MAJOR PLIMSOLL replied that his Government entertained the same doubts raised by the United Kingdom Government.

DR. PATTERSON said that he was not prepared to state his Government's view with respect to the specific doubts, but it was his personal opinion that the matter should be clarified before any definitive action on the part of the Commission.

SIR GEORGE SANSOM said that he was prepared to remove his reservation with respect to Article 88 in view of the fact that the desired audit was probably provided under Article 90 of the draft constitution and since his doubts were not shared by a majority of other representatives, and on condition of the continuing power of review of the Constitution which was desired by a majority of its members.

THE COMMISSION unanimously agreed to postpone further consideration of FEC-087/1.

Item-4 Statement by Committee No. 3 on FEC-087/5, Soviet Proposals for the Draft Constitution (FEC-087/6)

At the request of General McCoy, MR. BORTON, speaking as the United States member of Committee No. 3, reported that the United States position on FEC-087/6 with respect to the provision that all ministers of state, including the prime minister, should be civilians, had been reserved. He said that this provision had been embodied in FEC-031/19, Basic Principles for a New Japanese Constitution, in order to prevent Japanese militarists from again exercising control of Japan. This provision now seemed unnecessary, he continued, in view of the fact that, under the draft constitution, members of the cabinet were responsible to the prime minister and the Diet. However, he added, since Article 9, as amended in the Diet, was ambiguous it was the United States view that the Supreme Commander should be asked concerning the reasons for the change and concerning the interpretation of the Article as now written.

DR. TAN presented the following formal statement:

"The proposal that all ministers should be civilians is closely related to Article 9 of the Draft Constitution. If Japan is going to have an armed force, it may be necessary to put in such a provision. If Japan is to have no armed force at all, perhaps it is not necessary; the question then becomes a question of drafting and not a question of substance. According to strict interpretation of Article 9 as it now stands, Japan may have an armed force for all purposes other than those enumerated in paragraph I of that Article. As we are aware, 'war' in the legal sense is very different from war in a material sense. History in the last two decades has revealed that there were instances where wars in a material sense existed while it was not recognized that there was war in the legal sense. In our civil society it usually takes two parties to make a quarrel, but in the field of international relations, one state alone may create a state of war.

"In the last two decades, we have seen many instances involving large-scale armed actions of an aggressive character and they were euphemistically called 'acts short of war', or 'measures of self defense', as I have just explained. If Japan is to have an armed force, it is difficult to guarantee that Japan will not resort to armed activities against her neighbors and call them acts short of war or measures of self defense as she did before. In view of the lessons given to us by modern history and particularly of our experience with Japan, I have great apprehensions about this Article. I therefore reiterate my request that the Chairman be good enough to wire SCAP inquiring into the underlying motive for the change

of this Article to its present form."

DR. PATTERSON said that it was probable that no difference existed among the representatives on the Commission as to the desirability of a provision that all cabinet ministers should be civilians. This unanimity was evidenced, he said, by the fact that the revision had been agreed in the paper on basic principles for a new Japanese constitution. It was conceivable, he said, that some military officers might have responsibility in the new Government and the provision in question would insure their non-admittance to the cabinet. He said that in the future reactionary elements in Japan might succeed in having Article 9 eliminated from the Constitution and in that event it would be valuable for the Japanese people to have to face the decision either to retain or eliminate another specific provision that cabinet members must be civilians.

MAJOR PLIMSOLL said that the principle that all cabinet members should be civilians had been unanimously accepted by the Commission in its basic principles, and pointed out that it was also contained in the directives from the United States Government to the Supreme Commander of 17 October 1945 and 7 January 1946. MAJOR PLIMSOLL added that, when he stated the views of his Government on the new Constitution on 12 September, he expressed disquiet at Article 9 because, since the Article forbade the maintenance of armed forces, it had been impossible for the Commission to insist on the inclusion of an additional provision that all Cabinet Ministers should be civilians. He had expressed at that time the view that the Japanese would never take Article 9 seriously and that they would seize the first opportunity to amend or abolish it. In that case it would once again be possible for the Japanese to lapse into their bad old ways, under which the Ministers for the Army and the Navy were always serving officers and possibly once more liable to recall at the whim of the services. The Commission was now given an opportunity to correct this position since the Japanese text had been found to be ambiguous and not to forbid the maintenance of forces.

MAJOR PLIMSOLL said the suggestion of Mr. Borton did not go quite far enough. He suggested that not only should the Supreme Commander be informed of the position in regard to the Japanese text and asked for the reasons for the change in Article 9, but he should also be informed that members of the Commission felt strongly that there should be a provision in the Constitution that all Ministers should be civilians and that the Commission would welcome a change to that effect.

ADMIRAL RAMISHVILI said that Article 9 in its present form provided an opportunity for Japanese militarists to revive an army, and to deceive the Japanese people by assuring them that such activity was permissible under the Constitution. Since the article was so ambiguous as to lead to the possible consequences he foresaw, he urged that the provision that all ministers be civilians be adopted, as well as the other provisions in FEC-087/6.

DR. de KAT said that he felt it would be sufficient at this time simply to inquire of the Supreme Commander as to the reasons for the change which had been made in Article 9.

SIR GEORGE SANSOM said he had no doubts that the Japanese text of Article 9 was ambiguous.

SIR CARL BERENDSEN said that the difficulty with respect to the interpretation of Article 9 was an example of many provisions in the constitution concerning which there was doubt as to the interpretations. In this case, he said, the ambiguity and the grave importance of interpretation were evident to all. He doubted the significance of any interpretation of the provision that might be obtained from the Supreme Commander at this time. Of greater and crucial importance was the meaning the provision would have for the Japanese in the future. The proper concern of the Commission at present was whether the constitution did in fact comply with the commission's previous policy decisions.

MAJOR PLIMSOLL moved and MR. GUERIN seconded the motion that the Commission authorize the Chairman, with the assistance of Committee No. 3, to consult with the Supreme Commander and inform him that the Japanese text of Article 9 was ambiguous, that members of the Commission felt strongly that all cabinet ministers should be civilians, and that the Commission would welcome the inclusion in the draft constitution of a provision to that effect.

ADMIRAL RAMISHVILI said that, while he did not object to an informal query on the part of the United States representative concerning an explanation from the Supreme Commander of the reasons for the change in Article 9, he could not participate in a formal decision on the part of the Commission to express doubt on a matter so obvious and factual as the absence of a certain provision from the draft Constitution.

GENERAL McCOY said that since the proposed communication to the Supreme Commander was much more than a request for information it could not appropriately be handled informally by the United States representative. He said he would support Major Plimsoll's motion.

THE COMMISSION unanimously agreed to postpone further consideration of FEC-087/6.

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[SOURCE: SUITLAND PAPERS]

5-20 ROSTER OF PERSONNEL IN GOVERNMENT SECTION

Announcement December 4, 1947

GOVERNMENT SECTION

Executive Group

Name	*Title*
Courtney Whitney, Brig. Gen	Chief
Charles L. Kades	Deputy Chief
Carl Darnell, Jr., Lt. Col	Executive Officer
Frank Rizzo	Special Assistant
Marion P. Echols, Col	Special Advisor
Frank E. Hays	Special Advisor
Makoto Matsukata	Research Analyst
Sheilah M. Hayes	Adm. Asst. to Chief of Section
Ruth Hays	Adm. Asst.

Administrative Division

Frank R. Harrison, Lt. Col	Chief, Adm. Division
Robert E. Melvin, Capt	Deputy Chief, Adm. Div.
Thomas McLendon, T/Sgt.	Adm. Asst.
Hazel L. Morris	Personnel Coord.
Shirley A. Richard	Conference Steno
Elizabeth M. Robbins	Conference Steno
Harold T. Bettencourt	Chief Clerk
Ralph Barsanti, T/5	Asst. Chief Clerk
Louise P. Perzel	Personnel Clerk
Ruth M. Grahamslaw	Clerk Steno
Anne Vennett	Clerk Steno
June E. Baker	Clerk Steno
Enid S. Peterson	Clerk (Timekeeper-receptionist)
Agnes T. Spouse	Chief File Clerk
Harry M. Scolinos	File Clerk
Richard Barta, Pfc.	File Clerk
Masako F. Sato	Clerk-Steno
Fred A. Daniel, Pfc.	Supply Sgt.
William Roach, Pfc.	Supply Clerk
Michael Urquhart, Pfc.	Supply Clerk

Interpreter Pool, Administrative Division

Raymond Y. Aka	Chief, Interpreters' Pool
Mutsuya Matsumoto	Translator A
Takao G. Shinguchi	Translator A
Yoshikiko Shigemura	Translator B
Kenji Morinaka	Translator B

Governmental Powers Division

Alfred R. Hussey, Jr.	Chief of Division
Walter E. Monagan, Jr.	Deputy Chief
Douglas P. Campbell	Chief, Civ. Lib. Br.
Annie M. Massingill	Adm. Asst.

Political Affairs Division

Name	*Title*
Guy J. Swope	Chief of Division
Clifford D. Avery	Chief, Political Parties Br.
Anna M. Kachilla	Adm. Asst.
Margaret J. Haverty	Secretary

Local Government Division

Cecil G. Tilton	Chief of Division
Robert A. Bieber, Major	Deputy Chief
Michael E. Nolan	Chief, Town and Village Br.
Kenneth E. Schnelle	Chief, Municipal Br.
Howard D. Porter	Chief, Prefectural Br.
Roy Harris, Major	Liaison Officer
Arnold W. VanBenschoten	Government Advisor
Maud McKenna	Adm. Asst. & Sec.

Public Service Qualifications Division

Jack Napier, Major	Chief
Roger W. Snow, Jr., Major	Deputy Chief
Hans H. Baerwald, 1st Lieut	Language Officer
John H. Brady, Jr.	Chief, Gov. Ser. Br.
Arvella C. Rainez	Chief, Econ. Br.
Taro Tsukahara	Govt. Analyst
Guy A. Wiggins	Govt. Analyst
Robert W. Borman, Capt.	Chief, Records & Reports Branch
Anne W. Earle	Research Analyst
Yashiteru Kawano	Chief, Screening Pool
Nan L. Grindle	Research Analyst
Martha A. McGrath	Research Analyst
Hilde K. Mueller	Research Analyst
Virginia Schwertzer, Sgt.	Research Analyst
William S. Tyson, Cpl.	Research Analyst
Kirsten E. Drivdahl	Adm. Asst.
Fumi Tajima	Special Clerk
Hatsuye I. Ogina	Gen. Clerk

Civil Service Division

Blaine Hoover	Chief of Division
Wm. Pierce MacCoy	Chief, Gen. Pers. Adm. Br.
Robert S. Hare	Chief, Class. & Com. Spec.
Harry W. Marsh	Chief, Exam. Spec.
Thomas K. Tindale	Chief, Train. Branch
MacDonald Salter	Pers. Org. Spec.
Thomas L. Eliot	Pers. Specialist
Maynard N. Shirven	Exam. Spec.
Kesse B. Bettis	Compensation Spec.
Walter P. Domanowski	Compensation Spec.
James B. Vaughn	Class. Spec.
Joseph L. Speicher	Exam. Spec.
Grace M. Pierson	Exam. Spec.
Foster B. Roser	Exam. Spec.
Helen R. Machin	Adm. Asst.
William Rusteberg, S/Sgt.	Adm. Asst.
Yoneo J. Narumi	Interpreter
Gilbert T. Suzuki	Interpreter
Yoshimari R. Aka	Interpreter
Rosemary A. Darilek	Chief File Clerk
Margaret H. McMahon	Clerk-Steno
Marcella T. Antony	Clerk-Steno

Civil Service Division (continued)

Name	*Title*
Mary A. Williams	Clerk-Steno
Ella V. Osburn	Clerk-Steno
Margaret E. Gibson	Clerk-Steno
Jane B. Coyle	File Clerk

Courts and Law Division

Alfred C. Oppler	Chief, Division
Frank C. Novotny, Capt.	Special Asst.
Arthur J. McCormick	Chief, Civil Affairs Br.
Thomas L. Blakemore	Chief, Crim. Affairs Br.
Howard Meyers	Chief, Judicial Affairs Br.
Richard B. Appleton	Chief, Lgl. Rvw. Coord. Br.
Jeanne D. Connors	Legal Research Asst.
Mary C. Morgan	Adm. Asst.
Louise E. Patterson	Secretary
Bertie W. Butler	Steno
Frank T. Yamamoto	Translator

Legislative Division

Justin Williams	Chief of Division
Helen Loeb	Chief, Diet Opr. & Anl. Br.
Richard G. Brown, Capt.	Liaison Officer
Crescenzo Guida, Capt.	Liaison Officer
Mildred E. Fischer	Adm. Asst.

Public Affairs Division

Osborne L. Hauge	Chief of Division
Marcel Grilli	Govt. Analyst
Alice G. Gordon	Chief, Public Liaison Br.
Douglas F. Scott	Deputy Chief, Pub. Liaison Br.
Moses Burg	Research Analyst
Edna Ferguson	Adm. Asst. & Ed. Clerk
Margaret V. Bodinger	Clerk-Steno

National Government Division

Carlos P. Marcum	Chief of Division
Paul J. Kent	Deputy Chief
Thomas Diamantes, Capt.	Special Asst.
John K. McLean	Asst. Analyst
Joyce M. Durner	Adm. Asst.

[SOURCE: *Pol. Reorientation of Japan*, II, pp. 809-11]

5-21 HUSSEY'S MEMO ON LOCAL AUTONOMY

Memorandum December 12, 1947
To: Chief, Government Section
From: H.R. Hussey[9]

1. Recently there has come to my attention a Memorandum for the Chief, Courts and Law Division, prepared by Mr. Blakemore under the date of 30 October 1947. With that Memorandum I heartily concur. At the same time, representatives of other Staff Sections of SCAP have expressed to me their concern over the extent to which the principles of Local Autonomy are now being carried by Government Section. That alarm I have long felt. In May of 1946, I prepared a memorandum on the subject. It is my opinion that we are now operating under a basic misconception of the meaning of local self-government in a modern democracy and that our present insistence upon complete political decentralization may well

[9] Chief, Governmental Powers Division.

result in the effective hamstringing of the national government in Japan.

2. Under the new Japanese Constitution, Article 94 provides that:

"Local public entities shall have the right to manage their property, affairs and administration and to enact their own regulations within law."

This article reiterates the sound democratic principle that the management of local affairs must rest in the hands of the citizens of the locality concerned. It follows, of course, that local communities must have the right to choose their own officials, and the constitution so provides.

3. It does not follow, however, that local officials locally elected should be charged with responsibility for the administration of national affairs in those fields where there exists a conflict or possibility of conflict of interests. In such fields, the national interest is predominant and must be administered by officials and employees directly responsible to and controlled by the national government. There can be no possibility of divided interest of divided loyalty. The local official serving his own community cannot at the same time serve the nation at large.

4. There is, perhaps, a confusion between the American principle of federation under a written constitution and the democratic principle of local autonomy. As between the United States and the several states, the federal constitution delegates to the federal government certain specific powers, reserving the balance to the states or the people thereof. When the Constitution of the United States was adopted, the federal government was looked upon as the coordinating agency, charged with responsibility for all matters of international aspect and all matters wherein conflict between states might impair the administration of the federal government. Generally speaking, all matters of domestic administration were left to the states. Since 1789, there has been a steady movement toward far greater centralization, a movement no one will decry. The old artificial state boundaries are no longer practical or acceptable lines of demarcation. In exactly the same way, the trend in the world today is toward world unity.

5. On the other hand, within each one of the United States, while the principle of local self-government has always been well recognized, the State is predominant and matters of state-wide concern are administered by state officials directly and not through delegation. It is the State which determines where the controlling interest lies. The State legislature, representing the people at large, has the deciding voice.

6. This principle, that national affairs must be administered by national officials and local affairs by local officials and that the nation at large must have the sole power of determining the extent of the national interest, must not be confused with the principle of national insistence upon uniform practices and procedures in the administration of local affairs. A national law may well require that uniform standards be applied in every local community. The remedy for failure to apply such standards lies in court action, the check in requirements for inspection and report. Thus, local public finances should be administered according to established rules subject to national audit. Discrepancies may result in criminal action brought by the attorney-general. Another enforcement device is that of grants in aid which may be withdrawn or withheld. These, however, are procedural matters. Where the objective is accomplishment of substantive result, punishment of the official or curtailment of funds is no guarantee of that accomplishment. Removal or suspension of an official, even assumption of temporary jurisdiction, when attended by the proper safeguards, is both time consuming and disruptive, and furthermore violates that basic principle of local responsibility of local elected officials to their electorate.

7. Where the national interest is in proper administration or observance of standard procedures, it is entirely proper to require local officials to observe the provisions of national laws. But where the national interest is one of substance, where the nation at large requires direct action which may effect local areas unequally, where the national interest does or may conflict with local interests, the national interest must prevail and must be administered by agents responsible to the nation at large. Furthermore, the test must be applied by the national legislature. This question is a purely political one and not open to judicial determination. It, of course, goes without saying that no executive agency of the national government should have the authority to determine this question in the absence of a statutory determination.

8. It is well recognized that the trend in Japan for the past 75 years has been toward complete centralization in the executive branch of government in Tokyo. This was not the traditional pattern, which left local communities almost complete autonomy. In a primitive community, this was entirely possible. The two great demands of the higher and central

authority were for support and military assistance. The modern trend has everywhere been toward greater centralization as well as toward greater uniformity of administration. Almost complete centralization was deliberately promoted in Japan as one method of achieving the ultra-nationalistic and imperialistic ambitions of the ruling classes. As a specific against the reassertion of those ambitions, the Occupation has undertaken to reestablish local autonomy as a fundamental principle of the new democracy in Japan. This is entirely proper. But in so doing we cannot ignore the fact that the complexities of modern life and the case of modern communications render anything near complete local autonomy, full decentralization archaic and dangerous. No modern state can long survive, no modern democracy fulfill its obligations to its citizens through reliance upon the voluntary cooperation of semi-autonomous communities loosely associated through a common heritage. The will of the people of the Japanese nation must be directly and immediately enforceable in each and every local area through the direct agents and representatives of the people at large.

9. We may and frequently must advise the Japanese people what matters are considered to be local and what of national interest. We cannot leave them in a situation wherein every national interest must be interpreted and administered in a thousand different ways by a thousand different local communities. This but substitutes anarchy for autocracy. Surely, if we have established the supremacy of the national representative legislature under a written constitution, if we have established the responsibility of public officials to the people under the law, we can trust the people of the nation as a whole to develop their new and democratic institutions quite as fully as we can trust the people of the several local entities.

10. It is recommended that the entire problem be re-examined by Government Section as a whole, that a restatement of basic principles be prepared, and that such a restatement be not only submitted to the Japanese Government but as well given the widest publicity in the Japanese press, in order that there may be no further misunderstanding on this matter. It is further recommended that in all future consultations with other Staff Sections of SCAP on problems involving local autonomy the foregoing principles be borne strictly in mind.

[SOURCE: HUSSEY PAPERS]

5-22 MODIFICATION OF PURGE

Telegram: W80453 December 2, 1948
To: CINCFE
From: CSGPO

Reference Paragraph 13 of NSC 13/2. This radio in 5 parts.

Part 1. Pursuant decision stated in reference paragraph, desire you informally advise Japanese Government that no further extension of the purge is contemplated and that the purge should be modified along the following lines:

(1) Categories of persons who have been purged or who are subject to the purge by virtue of their having held relatively harmless positions should be made re-eligible for governmental, business and public media positions;

(2) Certain others who have been barred or who are subject to being barred from public life on the basis of positions occupied should be allowed to have their cases re-examined solely on the basis of personal actions; and

(3) A minimum age limit should be fixed, under which no screening for public office would be required.

Part 2. Parts 3, 4 and 5 list modifications in purge believed desirable by State and Army in implementation of Part 1. Request comments.

Part 3.

A. Following categories of persons purged or barred by virtue of offices held should be freed of disabilities imposed by reason of Cabinet and Home Affairs Ministry Ordinance Number 1 of 1947, promulgated Jan. 4, 1947, (listed categories correspond with those in Appendix 1 to this ordinance):

Category 2, Subparagraphs 3 and 5, reserve Army and Navy officers below the rank of colonel.

Category 4, officials of IRAA, IRAPS, Dai Nippon Seijikai, and affiliated organizations.

Category 5, Subparagraph 1, directors, advisors and auditors of designated concerns.

Category 7, Subparagraph 8 of remarks, recommended candidates for 1942 elec-

tion.

B. Following categories of persons purged or barred by virtue of offices held should be permitted in every instance to have their cases examined or re-examined on basis of individual activities, on application of person concerned:

Category 5, chairman of directors, president and vice-president of financial and development organizations involved in Japanese expansion.

Category 7, Subparagraph 6 of remarks (officials in business corporations).

Part 4. In addition to above, no screening for public office should be required for persons under 30 years of age at time of Pearl Harbor.

All other categories of persons purged or barred remain unaffected by above modifications.

Modifications should not preclude further measures for relaxation of purge to be instituted as rapidly as you consider feasible.

Part 5. Japanese Government should be advised standards of examination under Paragraph B, Part 3, above, should be more liberal than under Category 7 heretofore, and that only those whose records clearly indicate they were "active exponents of militant nationalism and aggression" in positions of important responsibility should be excluded. You should ensure that appeals are acted on by Japanese Government with maximum expedition solely on basis individual's culpability under above criteria.

View here is that US should favor at peace conference elimination of purge except possibly in few highly restricted categories.

[SOURCE: MACARTHUR MEMORIAL]

5-23 THE INADEQUACY OF PUBLIC SECURITY

Letter August 6, 1949
To: Gen. MacArthur
From: Prime Minister Yoshida

The ineptitude of our police as has been demonstrated during these past uneventful months is a source of grave concern to my government, with which, after all, rests the ultimate responsibility for public security.

For one thing, the country's police power has been split up into numerous units, large and small, each of which is independent, isolated and often helpless. Moreover, the entire system is detached from the government.

To take the Mitaka runaway train case, the government must keep its hands off. We are kept in the dark as to the progress of investigations by the police, to say nothing of their plans for the future. The National Public Safety Commission takes the position that it is none of my business, although they are ready to let the final responsibility for an occurrence affecting public peace fall upon me as Prime Minister.

Clearly something ought to be done. The government is working on the revision of the Police Law, but this will take time.

Meanwhile the government must be prepared for any contingencies that may arise any day in these unsettled times.

What can be done to bring the police into closer liaison with government; to coordinate the various police branches and units, and to place them under unified control and direction, as occasion may demand, for swift, vigorous and effective action? Here is an urgent question that confronts me and my government.

I should be very grateful if you would be good enough to consider the matter and give me your advice or suggestion.

[SOURCE: SUITLAND PAPERS]

5-24 POLICE PROBLEM AND PUBLIC SECURITY

Letter[10] August 8, 1949
To: Yoshida
From: Gen. MacArthur

I am in receipt of your letter of August 6th pointing out what you believe to be existing inadequacies in the matter of police coordination. Immediately following your last discussion with me on this subject, I directed that an examination be made of the entire police problem and subsequently received the following report from the appropriate agency of my staff:

"The potential effectiveness of the Japanese police has been increased:

(1) Through the authorized loan of 125,000 United States revolvers, necessary ammunition and spare parts, 14,000 of which have been distributed with 42,000 scheduled during the balance of 1949 and the remainder during the first half of 1950. Special instructors training courses in use and care of these weapons have been completed. Delivery of approximately 150 motor vehicles has been made to police force from Japanese industry during the past year.

(2) Through the establishment of local, prefectural and national police training schools which trained 82,000 for 8 weeks or longer in 1948 and which will give in-service training to approximately 75,000 in 1949 plus recruit training for replacements required by normal attrition. Special courses in formation and riot control training for all forces have been completed.

(3) By obtaining complete cooperation of all Japanese agencies concerned with law enforcement through detailed instructions issued by, and conference between,police, procurators and officials of other concerned Japanese government agencies. No major organization, disposition, strength or high level control changes are anticipated in the police forces. With SCAP's moral support, the Japanese police are capable of handling any anticipated internal disturbance without intervention of Occupation forces.

(4) Current Japanese budget restrictions have not curtailed the police training program or personnel strength. The pay of national police is established under the National Personnel Authority Act which granted an increase to police in 1949. Municipal police are basically paid on comparable or higher wage scale. No pay reduction for police personnel is foreseen. Budget cuts materially curtailed the development and acquisition of required communication equipment and motor transportation. Full consideration was given to these essentials but budget limitations restricted acquisitions in all departments of the Japanese Government."

On September 16, 1947, in reply to an inquiry from Mr. Katayama, then Prime Minister, I gave my views in some detail concerning desirable changes in the Japanese police system then under severe criticism both inside Japan and without. I am enclosing a copy of this letter in case the same has not been brought to your personal attention.

The philosophy underlying the plan of reorganization therein outlined, and subsequently in essential features embodied in Japanese law, is drawn from the evolutionary experience of the American people but is no less applicable here than elsewhere human freedom is keystone to the arch of social organization. Its great strength, cohesion, and durability has been drawn not from centralized controls descending from the seat of Federal Government, but rather from the deep rooted concept of community responsibility both in the management of local affairs and through interrelated action in the support of the Federal Government in the conduct of national affairs.

This is a concept somewhat new to the Japanese people but one of which they are showing an increasing understanding and commendable ability fully to grasp and put into practice. It is a concept which will insure that the objectionable features of the police organization and practice in Japan's past will be completely eradicated with little or no danger of their future revival. It was, indeed, in recognition of this danger of the revival of a centralized form of police bureaucracy that the Police Reorganization Law provides that the executive control over the exercise of the police power, both on the national and local levels of government, be brought under the restraining influence of public safety commissions composed of representative and responsible citizens appointed by the executives with legislative approval for fixed terms of years. It is hoped that it will tend to develop in the Japanese people a full consciousness of individual responsibility, so essential to the erection of an edifice capable of withstanding the strains and stresses of contemporary events.

I do not believe that the failure of coordination between the national and local police units of which you speak is due to the manner of their organization or definition of their powers as provided by the law, but rather is a question of the proper education of the personalities involved. This, of course, requires time and evolution but, as pointed out in the report above quoted, progress is being made.

Needless to say, the appropriate agencies of this Headquarters remain ready at all times to advise and assist in the progressive implementation of the existing law.

[SOURCE: SUITLAND PAPERS]

[10] This is a reply to Yoshida's inquiry of August 6 (5-23).

5-25 POLITICAL AND ECONOMIC STABILIZATION

Letter
To: Gen. MacArthur
From: Prime Minister Yoshida

August 9, 1949

I desire to submit herewith my personal views on certain aspect of the current situation as well as some concrete measures which I believe are urgently needed for the political and economic stabilization of the country. Some of the latter have been discussed before, but I venture to reiterate them inasmuch as they are closely interrelated, forming parts and parcels of one comprehensive program for national reconstruction.

Our immediate task is, of course, to accelerate the industrialization of the country, which must proceed in parallel with the process of democratization. Economically, we must promote industries and expand trade. Politically, we must stem the tide of Communism now sweeping over the Asiatic Continent. The measures required for these ends are as follows:

Political

1. Elimination of Communist influence from government service and educational institutions.
2. Disposition of Korean Communists and criminal elements. (Please see the Report.)
3. Reorganization and reinforcement of the police system. A tentative plan is in preparation, which will be submitted to you soon.
4. Appropriation of an adequate Unemployment Compensation Fund.
5. Further curtailment of government spending and further reduction of government personnel. through further simplification of the administrative structure, and through abolition of economic controls as far as possible, and transfer of government monopolies and enterprises to private interests (tobacco, telephone and certain local railway lines.)

Economic

1. More freedom for our officials, traders and industrialists to travel and stay abroad.
2. Reduction of corporation and income taxes (to pave the way for induction of foreign capital).
3. Adjustment of our imports from the United States. (More raw materials and production tools and less of foodstuffs which can be purchased from nearby countries.)
4. Introduction of modern technologies and scientific methods (engineering, mining, etc.)
5. Construction of more ships (to reduce outlay on cargo charge and provide employment to seamen).
6. Extension of fishing areas.

From the geographic position of Japan and the character of her people we may safely conclude that this country can be made into a bulwark against Communism and a stabilizing force in the Far East.

True, our present social and industrial unrest is largely due to Soviet-inspired agitations and machinations of Communists. We have a crop of immature or rebellious minds, which are attracted blindly to Communism as moths are lured to the flame. But an overwhelming majority of our people, however hard up, are sober and sensible enough to distinguish between Communist promises and Communist practices. Nor need we worry too much about the developments in China and Korea. It is a matter of history that political upheavals on the Continent have never menaced directly our island nation.

More recently there have been heartening indications that the people are ready to rally to the support of the government if it pursues its policy determinedly and fearlessly against the destructive and subversive manoeuvres of the Reds. In this connection, I desire to add that my government would prefer to conduct this anti-Communist campaign on its own initiative and on its own responsibility. In the interest of Japanese-American relations I do not wish to see your Headquarters involved directly in our fight with Communists.

As a long-range program we must work out a sound and stable parliamentary government system on a two-major-party basis. In this regard, I myself hope for the growth of the Socialist Party in stature and strength so that it may play the role of an effective op-

position to the now preponderant Conservatives. On the other hand, there are not a few who disagree with me in the light of what appears to be an unhappy denouement of British experiments in Socialism.

In any case, I feel the urgent need of replenishing leadership in the political field as well as in the economic field by releasing suitable persons from purge, on the result of which will depend, I believe, to a large extent the future political alignments in Japan.

Finally, I desire to touch upon the subject of education. Thanks to the Mission of 1946 we have now a system established for liberal public instruction. But the question remains yet to be solved as to what and how to teach in order to inculcate in the youths the concepts of liberty and human dignity and to train them for citizenship in a true democratic state.

I believe it would be of a great help if we could have another mission of experts like the Dodge or Shoup Mission, to visit our country to survey anew our entire educational field, its actual conditions and needs. Needless to say, the above-mentioned Commission and all other government and private agencies concerned will be happy to cooperate toward the success of such a mission.

I shall be profoundly obliged to you for your favorable consideration of all these plans and problems.

[SOURCE: SUITLAND PAPERS]

6 ECONOMIC REFORM

6-1 THE OCCUPATION AND JAPANESE AGRICULTURE
(October 1945—April 1952)

Summary Statement undated
By Wolf I. Ladejinsky

1. It is premature to assess the full effect of the Occupation upon Japanese agriculture, but developments to date indicate it has been beneficial.

2. The basic approach of the Occupation was that technical improvements to increase agricultural production must go hand-in-hand with economic and social reforms to be effective and insure political stability in the countryside.

3. The agricultural specialists of the Occupation made no attempt to re-create Japanese agriculture in the image of American; their efforts were directed toward technical improvements which have universal application.

. . . . . .

5. In the field of economic and social reform, the completion of the land reform is a significant achievement of the Occupation. It should be noted, however, that the Japanese, not the Occupation, fathered the reform.

6. For the great majority of the farmers the economic, social, and political gains are considerable. They have the land; they participate actively in village affairs; and they are beginning to develop into a potential political force.

7. The future of the reform is promising;.....

Occupation Approach

The American specialists had no previous first-hand knowledge of Japanese agriculture. The urge to look upon the Japanese farm system from the American point of view was quite natural, but the mere physical appearance of the Japanese farm was in itself a restraining influence; the one or two-acre farm, with the land holdings scattered over the countryside in quarter-acres or less, helped rid most of the American specialists of preconceived notions which they might have had about the agricultural economy of Japan. The dangerous error of attempting to re-create the Japanese farm system in the image of the American was avoided by the knowledge and common sense displayed by the first Chief of the Agricultural Division, Dr. Warren H. Leonard, of the Colorado Agricultural and Mechanical College. In this policy he had the active support of his superior, Lieutenant Colonel Hubert G. Schenk, Chief, Natural Resources Section, SCAP. Dr. Leonard laid down the dictum that no American expert was in a position to teach Japanese farmers how to farm; that nothing must be done to upset their farm management pattern; and that measures adopted by SCAP must stimulate still further, rather than retard, the diligence, know-how, and practicality of the Japanese farmers. On some occasions his advice may have been honored in breach, but, for the greater part, the American rural policy makers in Japan concentrated their efforts along constructive lines designed to promote good farming the world over.

[SOURCE: SCHENK PAPERS, HOOVER INSTITUTION]

6-2 ESTABLISHMENT OF ECONOMIC AND SCIENTIFIC SECTION

Telegram No. 2A 6291 October 1, 1945
To: War Department
From: CINCAFPAC, Advance (Tokyo)

ZA 6291 from CINCAFPAC Adv Tokyo to Joint Chiefs of Staff, Washington.

There is transmitted herewith for your information the text of the order which established the Economic and Scientific Section. Financial matters initially assigned to this section will be withdrawn and incorporated into a separate staff section as soon as I can secure a fully qualified man to head it.

"1. The Economic and Scientific Section is established as a special staff section to advise the Supreme Commander for the Allied powers on economic, industrial, financial, mining, and scientific policies to be pursued in Japan and Korea in order to implement the Potsdam Declaration.

"2. The functions of the section are to:

a. Conduct all liaison with and coordinate the activities of all non-military missions concerned with economic, industrial, financial, mining, or scientific problems in Japan and Korea from the United States and other nations.

b. Coordinate such reports on the economic, industrial, financial, mining, and scientific activities as are required by higher authority.

c. Arrange for the preparation of inventories of the economic, industrial, financial, mining, and scientific resources of Japan, including patents and cartel agreements.

d. Recommend types and quantities of imports into, and exports out of Japan, excluding those directly imported or exported by Allied military forces.

e. Make recommendations to insure maximum production of, and equitable distribution of, essential goods among the civil population.

f. Make recommendations to insure the maximum production of supplies required by the occupying forces.

g. Make recommendations concerning the operations or non-operation of economic, industrial, financial, or scientific activities.

h. Make recommendations concerning the use of transportation and public utilities.

i. Make recommendations relative to, and to direct the conduct of, such surveys of public opinion as are essential:

(1) To keep the Supreme Commander factually informed of public reactions to the Occupation and Rehabilitation Program.

(2) To insure a dependable basis for progressive formulation and modification of policies and plans.

j. Direct the initiation and production of such plans, materials and programs as are required to implement the information and education objectives of the Supreme Commander.

k. Make recommendations to insure:

(1) The elimination of militarism and ultranationalism, in doctrine and practice, including military training, from all elements of the Japanese educational system.

(2) The inclusion of such new courses of instruction in school curricula as are necessary to accomplish the mission of proper dissemination of Democratic ideals and principles.

[SOURCE: NATIONAL ARCHIVES]

6-3 DISSOLUTION OR LIQUIDATION OF MAJOR FINANCIAL OR INDUSTRIAL ENTERPRISES

Memorandum October 20, 1945
SCAPIN-162 (ESS)

1. No approval will be given to plans or proposals submitted to you for the dissolution or liquidation of any holding company, "Zaibatsu," "Conzern," or major industrial or financial enterprise without prior submission to this headquarters.

2. When such plan or proposal is forwarded to this headquarters you will attach thereto the opinion of the Imperial Japanese Government on the plan or proposal.

FOR THE SUPREME COMMANDER:

H. W. ALLEN,
Colonel, A. G. D.,
Asst. Adjutant General.

6-4 VOLUNTARY DISSOLUTION OF THE ZAIBATSU[1]

Telegram No. CA 53860 October 26, 1945
To: War Department
From: CINCAFPAC, Advance

From CINCAFPAC Adv to WARCOS cite CA 53860 for Cutter from McCloy.

On matter of Zaibatsu strongly recommend that voluntary aspect of the dissolution be preserved first: because it is really a do it "or else" basis. Second: the whole theory and practice of this operation is to have the Japanese do the job rather than carry out the operation ourselves. Third: by having the Zaibatsu corpse preserved (after being told their dissolution was inevitable) it gives the thing a better chance of lasting effect after we leave. Fourth: the important thing is to get a good plan and then have good supervisors of the operation on hand to see they carry out the job effectively.

I have had no chance to go into the merits of the plan itself but I do think we have a good chance to move expeditiously on this matter and very effectively.

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

6-5 AGRARIAN REFORM IN JAPAN

Letter of Transmittal. No. 30 October 26, 1945
To: Secretary of State
From: George Atcheson, Jr., United States Political Adviser
Confidential

Sir:

I have the honor to enclose a copy of a paper, "Japan: Agrarian Reform", and a copy of a memorandum of October 26, 1945 transmitting the paper to General MacArthur.

It appears to us that the problem of agrarian reform is one of far-reaching importance and deserves careful attention in the current program for the democratization of Japanese economy.

Respectfully yours,
George Atcheson, Jr.

[Enclosure]

Memorandum October 26, 1945
To: Supreme Commander and Chief of Staff
From: George Atcheson, Jr.

There is attached, as of possible interest, a paper, "Japan: Agrarian Reform", prepared by a member of my staff, in consultation with Far Eastern experts of the U. S. Department of Agriculture, prior to his departure from Washington.

Perpetually depressed conditions in agriculture have enabled the military during recent decades to pose as the champions of the farming class, defending its interests against the privileged classes and arguing with considerable success that the only real solution of the farmer's plight lies in overseas expansion. Continuation of the present conditions may in future be expected to leave the farming class a fertile field for military propaganda.

The ruling and propertied classes have always strongly opposed the initiation of basic agrarian reforms and, judging by the small attention which the Higashi-kuni and Shidehara governments appear to have given the matter, will probably continue to do so. Although the Socialist and Communist Parties have announced intention to carry out agrarian reforms, the changes proposed seem ill-considered and inadequate, and occupy a subordinate position in their respective platforms.

We would suggest as a possible course of procedure that the Japanese Government be instructed to initiate studies of the problem, and to draw up, in consultation with the appropriate sections of your Headquarters, a comprehensive reform program which, after receiving your approval, would be subjected to public scrutiny before presentation to the Diet. Implementation of the reforms should not, of course, be permitted to interfere with the production of foodstuffs during the present period of acute shortages.

George Atcheson, Jr.

[1] Not enclosed in JCS 1565

[Annex]
Japan: Agrarian Reform

Data Paper
Prepared by R. A. Fearey

JAPAN: AGRARIAN REFORM
Table of Contents

I. THE AGRARIAN PROBLEM

A. "TOO MANY MEN ON TOO LITTLE LAND"
B. THE WIDE EXTENT AND UNSATISFACTORY CONDITIONS OF TENANCY
C. A LARGE VOLUME OF INDEBTEDNESS AND HIGH INTEREST RATES
D. DISCRIMINATORY FISCAL AND TARIFF POLICIES
E. WIDELY FLUCTUATING PRICES FOR RICE AND SILK
F. THE COMPETITION OF CHEAP COLONIAL RICE IN THE JAPANESE HOME MARKET
G. A DECLINING INCOME FROM SERICULTURE
H. THE HIGH PRICE OF FERTILIZERS
I. EXPLOITATION OF FARMERS BY MIDDLEMEN IN THE MARKETING OF THEIR CROPS

II. MEASURES OF AGRARIAN REFORM

I. THE JAPANESE AGRARIAN PROBLEM

Industrialization in Japan did not lead, as it did in England and certain other countries, to the withdrawal from cultivation of a large proportion of the cultivated area and the relegation of agriculture to a position of relatively minor importance in the economy. During the last 70 years the Japanese farm population has increased 25 percent, improved farming techniques have been developed, and the cultivated area has been painfully expanded, with the result that the annual farm output during recent decades, far from declining, has been from two to three times greater than during the feudal era. Japanese agriculture has continued to supply the bulk of the country's food requirements notwithstanding the more than two-fold increase in the population, and at the same time has been the source of the country's leading export item, raw silk.

The rewards to agriculture, however, have not been commensurate with its contribution. The farming population has been permitted to retain only a small proportion of its expanded output for its own consumption or to exchange for the products of industry. The greater part has been taken from it in the form of high rent, interest and tax charges and used for the benefit of industry and trade and the furtherance of the military program. As a consequence, although living standards in the farming districts have improved materially since feudal times the improvement has been much less than proportionate with the increase in the average farmer's annual product, and standards are still extremely low.

Nevertheless, until about twenty-five years ago the farming population remained reasonably content with the gains which it had made. In the inter-war period, however, not only were no further gains recorded but there was a definite deterioration in the farmer's economic status. The farm debt increased eight fold and each year additional freeholders lost their land through foreclosure and had to accept a tenant status. As it became clear that the government planned no important reforms in their behalf and that the future held forth only the prospect of still greater poverty and distress the long-suffering farming class showed signs of increasing discontent. Dissatisfaction reached its peak during the early and middle 'thirties, subsiding thereafter only because of the developing war crisis.

The unsatisfactory state of Japanese agriculture can be traced to two fundamental causes, —natural limitations and handicaps, and the government's discrimination against agriculture in favor of industry and trade. While no less than nine separate elements in the farmer's plight are listed and described in the following pages, it will be found that they all derive

from these two basic causes.

A. "*Too Many Men on Too Little Land*"

The most important single cause of the unsatisfactory conditions prevailing in Japanese agriculture is overcrowding on the land. About 5.5 million farm households till only 15 million acres, or an average of only 2.7 acres per household. This latter figure is to be compared (leaving out of account differing degrees of fertility) with an estimated 3.0 acres per farm household in China, 3.6 acres in Korea, 10 acres in the United Kingdom, 47 in the United States, and 80 in Canada. Many Japanese farm families, however, cultivate much less than 2.7 acres. In 1938, 33.8 percent tilled less than 5 tan (1.2 acres) and 66.5 percent tilled less than 1 cho (2.5 acres).

Alleviation of this condition cannot be expected through expansion of the arable land area, as a consequence of war casualties, or barring revolutionary advances in the science of fertilization, through increased yields per acre. During the last 70 years it has been possible to increase the area of cultivated land by only 25 percent, and that only with the greatest effort and expense. Moreover, all of this expansion was accomplished before 1921, when the peak of 15,101,000 acres was reached. Since that time total acreage has remained at a slightly lower level, varying between 14.4 and 15 million acres. War casualties cannot be expected to improve the situation, the total working population having risen substantially since 1940, and yields per acre are already among the highest in the world.

The only real solution to the problem would be the absorption of literally millions of farm workers in industrial occupations. For the foreseeable future, however, an expansion of Japanese industry sufficient to absorb this number of workers must be ruled out of practical consideration. The most that can possibly be hoped for is that industry will be able to provide employment for the greater part of the annual increment in the laboring force, without thought of effecting a reduction in the farming population.

B. *The Wide Extent and Unsatisfactory Conditions of Tenancy*

Next to overcrowding on the land, and a direct consequence of such overcrowding, widespread tenancy under conditions highly unfavorable to the tenant is the second most important evil plaguing the farming class.

After the abolition of feudalism in 1871 only about 20 percent of the cultivated area was tilled by the tenants, but this proportion rapidly increased. The small size of the individual peasant holdings, making profitable operation difficult if not impossible, and a heavy burden of taxation, produced a mounting indebtedness which caused many farmers to lose their land. The lack of alternative employment opportunities in industry or commerce for those thus dispossessed, and the fact that landowners with more land than they could themselves cultivate could earn a larger return by renting to tenants than by operating with hired labor, were imporatnt factors which favored the growth of tenancy. By the end of the last decade 28 percent of the farm households in Japan rented all of the land they tilled and an additional 33 percent rented part. Thus 71 percent of the total number of farm households suffered the disadvantages of tenancy in some degree. Of the total cultivated area 46 percent was rented.

The rental for a one-crop field is about 50 percent of the crop, and for a two-crop field about 60 percent. All expenses connected with the raising of the crop—seed, farmhouse, sheds and implements, and all taxes and assessments except the land tax—are normally the tenants own responsibility and must be deducted from his share of the annual product. He receives nothing from the landlord save the land, and usually is not even compensated for necessary improvements which he makes upon his holding. Moreover, contracts between landlord and tenant are so loose and for such short periods, and the demand for land is so great, that a landlord who is for any reason dissatisfied with his tenant can evict him with relative ease. While custom, and more recently the resistance of organized tenant groups, have exercised an increasing restraint on this privilege, insecurity of tenure remains a prime source of discontent among tenants.

The tenants difficulties, it should be realized, are attributable not so much to an exceptionally high rate of rent, for in fact the rate is not so very much higher than in most western countries*, as it is to the small size of his holding. An English tenant farmer with 12 acres, or an American with 47 acres, average in those countries, can deliver 40-50 percent of his crop to the landlord and still have enough for his own needs. The Japanese tenant,

*Tenant cotton and tobacco growers in the United States generally turn over half their crop to the landlord and grain farmers from 40 to 50 percent. While the landlord bears most of the cost of cotton and tobacco production,—seed, fertilizer, etc.,—grain farmers generally meet these costs themselves.

however, after turning over half the output of his tiny one-and-a-half or two acre plot often does not have enough left even for the barest subsistence. Investigations have shown that 40 percent of the tenants have to purchase rice before the year is out (with income from subsidiary occupations or with borrowed funds) and 20 percent must start their purchases withing six months after the harvest. The intense competition for the land by the excessive number of farmers and the lack of alternative employment opportunities in other fields, however, leave Japanese tenants no choice but to pay the rent demanded.

The rent which weighs so heavily on the tenant, primarily, as explained, because of the small size of his holding, affords the landlord only a moderate return on his investment. Although the absolute amount of rent and income obtained per acre is large, due chiefly to the high crop yields, the rate of return is small, about 4 percent*, because of the exceptionally high prices at which farming land sells in Japan. In 1938 an acre of good paddy field cost 2620 yen (U.S. $ 748), and upland 1680 yen (U.S. $ 479)**. (In this country an acre of good Iowa farm land cost about $ 80 in 1938, and in the more densely settled states such as New Jersey or New York, up to $ 130).*** It is not surprising that returns computed on the basis of such highly inflated land values should be low.

It should be noted that landlords who bought their land thirty or forty years ago (when population pressure was less intense and prices, accordingly, were lower) and receive the prevailing rate of rent, earn a very large return on their investment. By and large, however, the tenant's plight cannot attributed to excessive landlord profits. There has in fact been a noticeable tendency in recent years on the part of the landlords to move their capital out of cultivated land into other investment fields, notably industry, commerce and urban real estate, where the return has been higher.

C. *A Large Volume of Indebtedness and High Interest Rates*

Prior to the First World War the total farm debt in Japan was estimated at 750 million yen, or 135 yen per farming household. After that time the increasing disparity between farm income and expenditure led to a rapidly mounting indebtedness, so that in 1937 the debt totalled more than six billion yen, or over 1000 yen per household. Fifty-six percent of the debt was at that time (1937) held by money lenders, 14 percent by the Hypothec Bank and the Agricultural and Industrial Bank, 13 percent by private banks, and 17 percent by other financial institutions.

Although interest rates are high for all types of borrowers in Japan because of the chronic shortage of capital, they have been highest by an appreciable margin in agriculture, averaging between 12 and 15 percent per annum and frequently totalling as much as 20 or 30 percent. The annual charge on the farm debt consumed almost a third of the net yearly farm income during the period 1931-1935, and in later years, when farm incomes were higher, it consumed between 18 and 20 percent.

D. *Discriminatory Fiscal and Tariff Policies*

Notwithstanding the much lower per capita productivity and average level of income in agriculture than in industry a farmer's taxes, as the following table indicates, have been substantially higher than those of a merchant or an industrialist with the same income.

Relative Burden of Direct Taxes on Landowners and Business Proprietors in Japan,—1929

	Per-Capita Taxes					
Annual:	Paid by Farm Landowners:			Paid by business proprietors		
income:	Total:	National:	Local:	Total:	National:	Local:
			(*In Yen*)			
1,200	270	68	202	126	44	82
2,000	530	144	286	230	88	142
3,000	874	259	615	366	157	207
5,000	1,395	457	938	701	316	385
10,000	3,485	1,187	2,298	1,603	814	789
30,000	12,097	4,956	7,141	6,819	3,737	3,081
100,000	53,225	22,168	31,057	30,058	17,883	12,175

*The landlord's return averaged 4.4% for paddy fields and 3.7% for upland fields during the pre-war decade. (Shiroshi Nasu, *Aspects of Japanese Agriculture*, 1941, p. 130)

**The yen had an average value of 28.5 cents during 1938.

***These American figures might more properly be compared with the Japanese yen figures quoted above than with their American equivalents, because a yen had approximately the same utility value to a Japanese that a dollar has to an American.

Ouchi, Hioye, Tax Burden on Salaried Men and Farmers as Revealed by the Official Survey of their Livings, XIX Session de L'Institut International de Statistique, Tokyo, 1930, p. 9.

At the same time the farming class has received much less than its proportionate share in the expenditure of public funds, farm aid being only a fraction of the assistance afforded industry and trade. Also, farm products have been denied the tariff protection accorded many leading manufacturing industries. Imported food products have been admitted free or at very low rates of duty.

E. *Widely Fluctuating Prices for Rice and Silk*

Widely and sharply fluctuating prices for rice and raw silk, which have together comprised 65 percent of the total value of farm production, have been another factor contributing to the unhappy lot of the farmer. In the case of rice, an inelastic demand in conjunction with large variations in the size of the crop, and the difficulty of controlling rice imports from the colonies, have been the principal causes of price fluctuations. As for silk, approximately 80 percent of the raw silk output has been sold in the United States and Europe where, being a luxury product, prices have varied widely in accordance with business conditions. Government efforts to stabilize the price of rice have met with at least some success, but in the case of silk they have been almost completely unavailing.

F. *The Competition of Cheap Colonial Rice in the Japanese Home Market*

Rice adapted to Japanese taste is produced in Korea and Formosa at approximately 25 percent lower cost than in Japan. Imports of rice, duty free, from these colonies to supply the growing deficiency in Japan's domestic supplies during the last two decades have destroyed the monopolistic position formerly enjoyed by domestic producers and have exerted a depressing effect on prices. Because of the ready availability of rice from Korea and Formosa the Japanese farmer, although suffering the full effect of a price drop during years of good crops, in almost never compensated by higher prices during short years. With the exception of the rice year 1939-40, when poor crops were harvested both in Japan and in the colonies, colonial rice has always been available to fill the market.

G. *A Declining Income from Sericulture*

Japanese silk exports declined from 361 million dollars in 1929 to 79 million dollars in 1933. From 1934 to 1941 they remained in the neighborhood of 110 million dollars. In part the decline was due to depressed business conditions in foreign markets. An even more important cause, however, was the almost complete substitution after 1935 of rayon for natural silk in the manufacture of broad goods, and beginning in 1939, the rapid replacement of silk by nylon in women's full-fashioned hosiery. The burden of this loss was borne mainly by the Japanese farming class, which in former times had obtained approximately 20 percent of its income from sericulture. If, as is expected, the substitution of synthetic for natural silk continues after the war this important source of cash income will be even further reduced.

H. *The High Price of Fertilizers*

Artificial fertilizers are an essential element in farm production in a country like Japan where the soil has been depleted by centuries of intensive cultivation. Recent experiments, representing an average of results from soils all over Japan, show that in the absence of artificial fertilizers of any kind yields are 48 percent below those of plots fully fertilized. Naturally it is of great importance to farmers that they should be able to obtain fertilizers at reasonable prices. The artificial fertilizer industry, however, has set high, monopolistic prices, which it has maintained with little regard for fluctuations in the prices of farm products. Government efforts since 1936 to reduce fertilizer prices by bringing the industry under some measure of public control have not been successful.

I. *Exploitation of Farmers by Middlemen in the Marketing of Their Crops*

Middlemen, speculators and petty traders have long used their stronger bargaining position *vis-a-vis* the individual peasant to extract excessive commissions for their services. Farm cooperatives, which dispose of member's crops, provide common warehousing facilities, and furnish other joint services, have done much to overcome this evil but have not eliminated it. The poorest farmers, who need the protection afforded by membership in a cooperative most, are frequently prevented by their poverty from becoming members, and so remain at the mercy of unscrupulous dealers.

* * *

The combined effect of these difficulties, as already indicated, is a very low standard of living in the farming districts. This standard, it is true, is materially higher than in feudal times in Japan, or than in most other Oriental countries today. It must be remembered, however, that Japanese farmers lived under the worst possible conditions in the

feudal period, and over most of the Orient such conditions still prevail. Moreover, since the general plane of living in Japan is higher than in other Oriental countries, the Japanese having raised themselves to a position in many respects closer to Western than to Oriental norms, the consumption levels of the Japanese farming class are not fully comparable with those of most other Far Eastern farming populations. The more significant comparison is with the living standards of other sections of the Japanese population, which are materially better than the farmer's.

The unsatisfactory state of Japanese agriculture has been like a cancer in the economic and political life of the country. The large farming class has remained a perpetually discontented element in the population and a principal support of the military program, in which it has seen virtually the only hope of a solution of its economic ills. At the same time low farm incomes and the small total purchasing power of the farming districts have meant a restricted domestic market for Japanese manufacturing industry, contributing to dissatisfaction there. It is difficult to see how reasonably prosperous conditions and peaceful tendencies can prevail in Japan until conditions in agriculture have been markedly improved.

II. Measures of Agrarian Reform

We have seen that the principal source of the Japanese farmer's difficulties is an insufficient area of land to till. Some five-and-a-half million farm households must obtain a livelihood from only fifteen million acres. Unfortunately, however, there is not prospect that this basic handicap can be overcome, either through expansion of the farm acreage or output, as a consequence of war casualties, or, at least in the foreseeable future, through the movement of the surplus farming population into other occupations. It can only be accepted and attention directed to the solution of other evils plaguing the farming class.

These evils, however, are both numerous and important. While many are a consequence of the basic difficulty of "too many men on too little land" they are not an inevitable consequence, and, it is believed, may be overcome while that handicap still remains. The most important are (a) widespread tenancy under conditions highly unfavorable to the tenants, (b) a heavy burden of farm indebtedness combined with high rates of interest on farm loans, and (c) government fiscal policies which discriminate against agriculture in favor of industry and trade.

A. *Widespread Tenancy Under Conditions Highly Unfavorable to the Tenants*

Twenty-eight percent of the farming households in Japan rent all the land they till, and an additional 43 percent rent part. The rented area comprises 46 percent of the arable acreage. Rentals are extremely high, considering the small size of the average holding, and the tenant must bear all expenses of the farm except the land tax. Usually he is not even compensated for necessary repairs and improvements he makes on the property. Living standards, while low for all classes of Japanese farmers, are particularly low for the tenants, who in addition can be evicted by the landlord with relative ease.

a) Improvement of the Conditions of Tenancy

The tenancy problem may be approached either with the idea of improving the conditions of tenancy or of accomplishing the complete emancipation of the tenant class. Considering the former alternative first, the most important handicap under which the tenant operates, the high rent, might be alleviated by setting a ceiling on farm rents, limiting them by law to, let us say 25 percent, instead of the prevailing 50 to 60 percent. Also, the landlords' right to evict their tenants might be made subject to stricter legal provision, affording the latter greater security in their right to till the land. Regulations requiring the landlords to compensate their tenants for needed improvements and to bear a larger proportion of the costs of farm production, e.g., seeds, fertilizers, tools, and taxes other than the land tax, would be ineffective if the landlord was still able to raise rents and offset any added costs to himself. But in combination with a rent ceiling they might be of help.

This program suffers from several important disadvantages, however, Even under present conditions most landlords earn only a moderate return on their investment, and while the absolute amount of the rent per acre is quite large, due to the high yields, it is by no means exhorbitant. The suggested reforms, therefore, would so reduce the landlords' return (if they did not entirely eliminate it) that many landlords would decide either to cultivate the land themselves or to sell it. In both cases this decision would result in the eviction of the tenants already tilling the land. This would clearly follow if the landlord decided to cultivate the land himself, and would be scarcely less certain to occur if he undertook to sell it, as few tenants would possess the necessary funds to purchase their land. They might be able to buy over a long period of time, say thirty or forty years, but then during that

entire period they would be obtaining little or no benefit from the reforms; annual payments toward the purchase of the land would offset most of the gain from the reduction in rent and shifting of part of the costs of production to the landlord. Also the landlords would probably choose to sell to buyers who already had the purchase price available. Thus many tenants, far from benefiting from the reforms, would be driven from their land and forced to adopt the even less enviable status of hired farm workers. A situation would be likely to develop similar to that in Hungary, Poland and other eastern European countries; much of the land now being farmed by tenants would be purchased by large owners who would convert them into big estates farmed by hired workers under professional managers.

A further disadvantage or plans which seek merely to improve the conditions of tenancy would be that even with a rent reduction of as much as 50 percent and other significant reforms, conditions for those tenants who were not evicted would still be highly unfavorable. The average tenant's holding is so small that a rent only half as large as at present still would not leave him an adequate income. Finally, since there would have been no fundamental change in landlord-tenant relationships (i.e. for the tenants who were not evicted) the landlords, because of the continuing scarcity of land and multiplicity of farmerss seeking land to till, would still possess every advantage in dealing with their tenants, and would probably succeed in gradually restoring the former conditions of tenancy.

b) Expropriation of All Rented Farm Land for the Benefit of the Tenants, Compensation to be Provided the Landlords in an Amount Equal to the Productive Value of the Land Expropriated.

There are of course a large number of plans by which the complete emancipation of the tenant class might be effected, of which only one is considered here. Under this plan all rented farm land in Japan would be expropriated by the government and turned over to the tenants in full title. The landlords would receive in compensation government bonds in an amount equal to the productive value (capitalized value of the average net annual product) of the land expropriated. Such compensation would not be paid until stable financial conditions have been restored and bonds of enduring value could be delivered. If this should not be for some time after the transfer had been effected landlords without other means of support might have to be assisted.

Market Value Versus Productive Value—Undoubtedly the landlord class in submitting to the expropriation of their rented land would demand compensation on the basis of the inflated market value of their holdings. By the end of the last decade, however, the market price for farm land had been driven by the intense demand for such land to a point 40-50 percent higher than its productive value (capitalized earning power). The only valid measure of an earning asset's worth is its earning power. Demands for compensation in excess of the capitalized value of the annual net product of the land expropriated should not be entertained.

The Ability of Japanese Finances to Bear the Burden of Compensation—It is believed that compensation computed on this basis would not impose too heavy a burden on Japan's post war government finances. In 1939 there were 6.8 million acres of rented farm land in Japan with a total productive value of approximately 8 billion yen:

LAND TILLED BY TENANTS, 1939

	Acres	Average Market Value Per Acre (Yen)	Estimated Average Productive Value Per Acre (85% of market value)	Total Productive Value
			(yen)	(million yen)
Irrigated Fields	4,071,000	2520	1440	5,862
Dry Fields	2,745,000	1680	920	2,424
				8,387

Interest of 4 percent on 8 billion yen worth of bonds, assuming a value for the yen approximately the same as in 1939, would amount to 320 million yen a year, or only about 15 percent of the average annual budgetary expenses of Japan's national government during the period 1931-1936. At that time the tax rate in Japan was not excessive and an increase of 320 million yen in the tax load could have been borne without difficulty, as was subsequently shown. Naturally, the fact that the debt would be owed within Japan would greatly simplify the problem of its support; service on the bonds would involve no more than a transfer of wealth from one section of the population to another. It might be noted that

the United States expects to support a national debt ten times greater than in 1937 with a national income which even in the most optimistic view will not be more than twice as large as at that time.

B. *A Heavy Burden of Farm Indebtedness and High Rates of Interests on Farm Loans*

While the emancipation of the tenant class would be the principal feature of a program of agrarian reform, it would not be sufficient by itself to accomplish the desired purposes. The basic handicap of an insufficient area of land to till and many other evils would still remain, so that if this step were not accompanied by others the newly established freeholders would still not have achieved a satisfactory economic status, and would probably soon lose their land again. Also, nothing would have been done to assist those farmers who at present own their farms, many of whom, borne down by taxes and debt have been little better off than the tenants.

The farming debt totalled approximately six billion yen in 1937. During the period 1931-35 the annual charge on this debt consumed almost 30 percent of the average net yearly farm income, and in later years, when farm incomes were substantially higher, it took from 18 to 20 percent. There is reason to believe, however, that the debt has been considerably reduced since that time. Exceptionally high farm incomes, the lack of spending outlets, and currency inflation are believed to have resulted in the liquidation of a large proportion of the debt. Depending upon its size, part or all of the current debt might be assumed by the Government at such time as Japanese finances may be able to take on this comparatively small additional burden.

Reduction or elimination of the existing debt would be of only temporary benefit if steps are not taken at the same time to ensure reasonable interest rates on new loans. Rates have been high for all types of borrowers in Japan, but they have been highest by an appreciable margin in agriculture, averaging from twelve to fifteen percent per annum and frequently totalling as much as 20 or 30 percent. The principal cause of these high rates has been a large proportion of bad debts, combined with the inability of farmers to provide adequate security. The improved credit standing of the farmers as a consequence of the reforms herein proposed should do much to remove this difficulty, but would need to be supplemented by other measures to ensure adequate supplies of loan capital to farmers at reasonable rates. A government farm loan agency might be set up, and official support accorded private cooperative credit associations, which already exist in Japan in fairly large numbers. Because most farm loans are self-liquidating over a short period the chronic shortage of capital in Japan should not prevent the establishment of reasonable rates.

C. *Discriminatory Fiscal Policies*

We have seen that owners of farm land in Japan bear a disproportionately large share of the nation's tax burden. Beside the national land tax they must pay prefectural and town or village surtaxes and numerous local fees and taxes. With the elimination from the national budget of military expenditures of all kinds it will be possible to reduce taxes for all sections of the population, but in addition steps should be taken to bring about a more equitable distribution of the tax burden. This will require revision of existing prefectural and local as well as national tax laws. Also, in the expenditure of public funds the needs of agriculture should receive equal consideration with industry and trade, as they have not in the past.

D. *Other Fields for Reform*

Measures regarding tenancy, indebtedness and fiscal policy would constitute the principle features of a program of agrarian reform during the occupation period. Simply by themselves they would result in a marked improvement in the farmer's status. But even with this improvement the farmer's position, considering the large number of farmers who must obtain a livelihood from so small an arable area, is likely to be precarious. Consequently attention should be directed also to the solution of other difficulties from which the farming class has suffered.

a) Fluctuating Prices for Rice and Silk

One such difficulty has been widely and sharply fluctuating prices for rice and silk, which together comprise sixty-five percent of the value of farm production. In the past, efforts to stabilize the price of rice have suffered from a lack of funds, the difficulty of controlling rice imports from the colonies, and an insufficient determination on the part of the government to make a success of the control program. With the elimination of all military expenditures from the national budget, funds for this purpose should be more plentiful. Also imports from the colonies can probably be more easily controlled when these areas are no longer an integral part of the Japanese economic system and the interests of Japanese nationals

engaged in Korean and Formosan rice production no longer have to be protected. Rice purchases from these areas can be regulated by the government so as to offset crop variations in Japan and maintain stable prices.

In the case of silk the problem is more difficult. Silk prices vary with business conditions in overseas markets, which, of course, are beyond Japan's power to control. Also raw silk costs so much to store, because of the insurance, that plans to stabilize prices by controlling the release of stocks from storage are not practicable. Probably all that can be attempted is a system of relief payments to sericulturalists in years of low prices from funds obtained from a tax on silk in good years.

b) The Competition of Korean and Formosan Rice

Japanese farmers would benefit greatly from a tariff on Korean and Formosan rice, which in the past has entered Japan duty free. On the other hand such a tariff, through its effect on food prices in Japan, would injure the country's export industries. Higher food prices would necessitate higher wages in industry, which in turn would reduce Japan's competitive advantage in international trade. Any reduction in trade would be to the disadvantage of the entire country, agriculture included. It would therefore seem that attention should be directed to other methods of farm aid less obstructive of the interests of industry and trade and of Japanese economy as a whole.

c) A Declining Income from Sericulture

The expected further decline in the demand for natural silk after the war is bound to have a serious effect on farm incomes. In recent years the farming class has derived from twelve to sixteen percent of its income from sericulture, which, considering how close to a subsistence level this class lives, has often meant the difference between just getting by and acute privation. There has already been some adjustment to the loss of this business, chiefly through reduction of the mulberry acreage in favor of other crops. It is important, however, that the farm population find other seasonal and part-time employment in which the whole family can engage in partial replacement of the silk industry. Certain small and medium-scale industries normally found only in cities and towns have already proved adaptable to productive conditions in the rural areas. With study and investigation the number of these industries might be considerably increased, providing the farmer with the subsidiary employment he requires.

d) The High Price of Fertilizers

Japanese farmers, who must use large quantities of artificial fertilizers, have been greatly handicapped by the high prices which they have had to pay for these fertilizers. Approximately ten percent of the farmer's gross income finds its way into the pockets of the fertilizer monopoly every year. It would seem that this industry either should be taken over by the government, as an industry intimately affected with the public interest, or output, prices and sales should be strictly controlled so as to assure farmers adequate supplies of fertilizers at lowest reasonable prices. Joint purchasing arrangements have enabled some farmers to supply their fertilizer needs at lower cost, but this is not an adequate solution of the problem.

e) Exploitation of Farmers by Middlemen in the Marketing of their Crops

Finally, steps should be taken to assist and protect the farmer in the marketing of his crops. In the past, middlemen, speculators and petty traders have been able to take advantage of the farmer's urgent need for funds to extract excessive commission for their services. Farm cooperatives have been fairly successful in overcoming this evil, but their membership often does not include the poorest farmers, who need their protection most. The cooperatives should be strengthened in every way possible and their membership expended to include the less well-to-do farmers. At the same time the activities of private traders should be subjected to closer regulaton.

Of the above measures tenancy reform is of predominant importance. Also, it would appear that the second of the proposed solutions of this problem, calling for the complete emancipation of the tenant class, is much to be preferred over the first, for the reasons already stated, and because any other reforms which might be introduced would have only a limited effectiveness if the tenants had not previously been emancipated. As long as they were still tenants, the 28 percent of the total number of farming households which rent all their land, and to a lesser extent, the 43 percent who rent part, would derive little benefit from a reduction in interest rates, for example, or from a more equitable distribution of the tax burden, or lower fertilizer prices. The increase in net income obtained as a consequence of these reforms would be taken by the landlords, who would raise rents in the same proportion that incomes were increased. A rent ceiling, for the reasons earlier stated, would likely be to result in a mass eviction of tenants, the landlords tilling the land themselves or with hired labor. As long as the demand for farming land continues greatly to exceed the available supply, and the landlords, as a result, are able to establish the terms of tenancy practically at will, they will be able to transfer to themselves the greater part of the benefits of whatever reforms are instituted.

[SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

6-6 SALE OR TRANSFER OF SECURITIES OF CERTAIN BUSINESS FIRMS

Memorandum
SCAPIN-215 (ESS) October 31, 1945

1. It is directed that no sale, trade or other transfer or adjustment of the capital stocks, bonds, debentures, voting trust or other forms of capital securities of the firms listed below, nor of their subsidiary or affiliated firms, shall be made without the prior approval of this Headquarters. For the purposes of this directive a subsidiary or affiliate is defined as any corporation, partnership or stock company in which the firms hereinafter listed hold any stock or other evidences of ownership, indebtedness or control, or directly or indirectly exercise any power of management or direction.

2. It is directed further that such capital securities referred to above shall not be used as collateral for loans, bills, notes or other borrowings or credit, without prior approval of this Headquarters.

3. The firms to which this directive applies are listed as follows:

Mitsui Honsha	Shibusawa Dozoku and Co.
Mistubishi Honsha	Nippon Nitrogenous Fertilizer Mfg. Co.
Sumitomo Honsha	Furukawa and Co.
Yasuda Hozensha	Okura and Co.
Kawasaki and Co.	Nomura and Co.
Nissan and Co.	Ricken and Co.
Asano Honsha	Nisso Co.
Fuji Industrial Co.	

6-7 LIQUIDATION OF ZAIBATSU

JCS-1565 (JCAC-64/2) November 1, 1945
Report by the Joint Civil Affairs Committee[2]

THE PROBLEM

1. To make recommendations to the Joint Chiefs of Staff on two cables from the Supreme Commander for the Allied Powers (Appendices "F" and "G") regarding principles for the dissolution of Zaibatsu industrial and commercial organizations.

Appendix "F"

Telegram No. CA 53580 October 20, 1945
To: Joint Chiefs of Staff
From: CINCAFPAC, Advance

From SCAP to Joint Chiefs of Staff. Zaibatsu is subject, radio in five parts.
Part 1:

Many informal conversations have been held with influential Zaibatsu including Mitsui, Yasuda, Sumitomo and Mitsubishi and with Finance Ministry to explain the objectives of the occupation as it pertains to such organizations.

Purpose has been to have Zaibatsu take initiative in dissolution so that desired objectives can be achieved as rapidly as possible. Various plans have been proposed informally which have been rejected because they were inadequate, but which indicate that satisfactory voluntary

[2] Enclosures: telegrams between MacArthur and the War Department, October 20 to October 28, printed here in chronological order.

action will be taken by at least some of them. If such action is taken it will greatly expedite action by others who may be unwilling to initiate such action today.

Part 2:

Yasuda Hozensha controls 101 companies of which:

A. 20 owned directly (3 banks, 1 trust company, 3 insurance companies) banking group (and 2 transportations, 2 real estate, 1 warehouse, 8 manufacturing).

B. 24 owned indirectly, through above 20 companies. (1 banking; 2 stock-holding and supervising of real estate, 15 manufacturing, 5 trade and commerce, 1 machine repairing).

C. 57 companies in which it owns a substantial interest, of these the 28 most important are as follows:

banking 5,
transportation 3,
building 1,
electric 1,
mining 2,
manufacturing 15,
miscellaneous 1.

Yasuda Bank has approximately 15% of Japanese bank deposits. Yasuda officials today proposed following:

A. Yasuda family to withdraw from all positions in banking and industry.

B. Yasuda Holding Company to cease functioning as control or operating agency.

C. Yasuda Bank which controls subsidiary banks will cease exercising that control.

D. Officials in controlled companies who have been appointed by Yasuda family or hilding company will resign.

E. Officials will be appointed to succeed resigned officials who have risen from ranks to maximum extent feasible.

F. All shares in affiliated or controlled coys held by Yasuda family, holding company and bank will be sold to Control Commission.

G. Proceeds of such sales will be invested in government bonds which will be made non-negotiable for 10 years except for payment taxes, death duties and similar purposes.

H. Name of Yasuda will be eliminated from all companies.

Part 3:

If the plan in part 2 is approved this Headquarters proposes the following action:

Have a control commission appointed, supervised by this Headquarters whose functions will include:

A. Appraisal of prices of company securities.

B. Supervise marketing of securities.

C. Give employees of company involved preferential rights to purchase securities.

D. Establish principles of accounting and reporting based on United States Securities Exchange Commission standards.

E. Limit number of share purchaseable by single individual to prevent reaccumulation.

Part 4:

Plan proposed in part 2 has advantage of:

A. Liquidating Zaibatsu.

B. Freezing their capital without depriving industry of capital.

C. Absorbing public money in period when limited consumers goods available.

D. Democratizes industry and banking.

Part 5:

Request approval of the principles of plan proposed by Yasuda for liquidation of Yasuda and as basis for approval of other plans as submitted.

Because of obvious advantages of voluntary action and influence of such action in this problem on securing voluntary action in other fields request approval at earliest practicable time.

[Source: Mod. Mil. Br., National Archives]

Appendix "G"

Telegram No. CA 53699 October 22, 1945
To: Joint Chiefs of Staff
From: CINCAFPAC, Advance

From SCAP to Joint Chiefs of Staff.

Ourad CA 53580 (Appendix "F") Mitsui and Sumitomo agreed to voluntarily adopt same dissolution plan as Yasuda. Extremely difficult for this headquarters to withhold action because of the momentum this question has gained. Unless therefore, I hear from you to the contrary plan will be effectuated without delay.

Appendix "B"

Telegram No. WARX 77879 October 22, 1945
To: CINCAFPAC, Advance
From: War Department

Zaibatsu policy reference CA 53580, 20 October and CA 53699, 22 October (Appendices "F" and "G").

State Department request you take no action pending receipt further advice which will be transmitted to you urgently. State Department considers problems important and complex necessitating high level discussion this week. For your information tentative State Department views follow:

A. Dissolution of Zaibatsu should not be effected on a contractual basis but should be by direction military government without commitment to Zaibatsu in any particular.

B. Control Commission should not be staffed by Japanese but should be part your staff.

C. Plan should not limit you from taking any further action you deem appropriate. Urgency of matter fully understood and you will be promptly advised of State Department view.

Appendix "C"

Telegram No. DTG 231812Z October 23, 1945
To: War Department for Cutter from McCloy
From: CINCAFPAC, Advance

See WAR 77879 CAD dated October 23 (Appendix "B") which relates to dissolution of Zaibatsu. There is no question of a contractual relationship. The dissolution would be carried out in accordance with the direction of the Supreme Commander for the Allied Powers (SCAP). It is in the nature of a consent decree to be carried out under the supervision of SCAP but work to be done by Japanese Government officials as is the case of virtually all orders issued by SCAP.

SCAP does not have the personnel here to do the full job himself nor do we have as yet in the theater the supervisory personnel necessary but I assume that they will be here in due course. Do what you can to expedite the shipment of the Department of Justice and anti-trust people who have been requested.

Also do all you can to have the plan checked promptly through the State Department with the Department of Justice people. It would be an excellent thing if we could get a dissolution plan put into effect promptly and possibility seems to be very good at the moment. Matter needs a good Department of Justice dissolution decree man to examine plan and cable general suggestions for incorporation in plan here so that SCAP is in a position to take action promptly.

Coordinate with Hilldring and State Department.

Appendix "D"[3]

JCS 1565 (continued)
Teegram No. W 79135 (extract) October 26, 1945
To: CINCAFPAC, Advance
From: War Department

1. No obvious objection to your proceeding in accordance with plan outlined reference cable CA 53580 (Appendix "F") as preliminary steps subject to following State Department reservations, all of which have informal approval of leading Justice Department experts in this field.

2. Full freedom future action should be retained by you concerning subsequent elaboration or modification of plan. This is considered particularly vital with respect to—

(A) Subsequent addition of provisions relative to interlocking directorates and intercorporate stock ownership below top holding company. Failure of Yasuda plan expressly to deal with this subject troubles State and Justice Departments and they will desire to make further recommendations in light of discussions on the spot after arrival State-Justice advisory mission. State and Justice advise they are making urgent efforts to send mission forward and you wil be advised estimated time of departure soonest;

(B) It is understood from reference cables and Mr. McCloy's cable DTG 231812Z, 23 October (Appendix "C") that Control Commission will be staffed by Japanese Government officials under your supervision. State and Justice Departments stress importance of close scrutiny of Control Commission operations in order to assure good faith execution of plan. Hence plan should expressly provide full freedom of action on your part with respect to monitoring the activities of Control Commission.

3. Method and time of appraising prices of company securities is considered by State and Justice to be an essential factor in the dissolution process. It is felt that appraisal cannot be made in any event until decisions are reached concerning reparations removals and application of industrial disarmament programs. Hence no appraisal action should be taken now nor compensation paid until completion of reparations or disarmament programs.

4. Justice suggests that on basis other experience you prohibit transfers of Zaibatsu securities under provisions of paragraph 42 b of financial directive.

5. State Department believes desirable that permanent satisfactory solution of Zaibatsu question be initiated by Japanese, but cannot depend on them for satisfactory program or enforcement until implementation of paragraphs 5 b, 23 and 40 of basic initial directive relating to elimination from government industry and finance of active exponents of militant nationalism and aggression. This again emphasizes the importance of assuring that neither your hands nor the hands of future Japanese Governments are tied by any arrangements of a contractual or consent-decree nature with persons now in positions of leadership in government and industry. Inasmuch as basic reforms such as Zaibatsu dissolution must ultimately rest upon an informed Japanese public opinion, State urges every effort be made to place issues before Japanese people with full explanation of reasons calling for reforms.

6. State Department believes that in general imposition of basic reforms, such as this one, on Japanese by decision of present leaders of Japanese government and industry will tend to perpetuate dependence of Japanese people on the political and economic oligarchy which we are committed by the Potsdam Declaration and the Presidential Policy Statement to remove from power. It is believed that most present leaders are subject to removal under provisions of the directive cited above. In fact, many of them are believed to be subject to internment under the provisions of paragraph 7 of the political directive, subject only to temporary use as necessary to assure the demobilization of Japanese armed forces. Their removal should precede definitive reform. [SOURCE: MOD. MIL. BR., NATIONAL ARCHIVES]

[3] Appendix "A" of JCS 1565 contained revisions of Appendix "D", dated November 2. In these revisions an additional sentence at the end of paragraph 3 read: "It is assumed that the securities will not be sold to the Japanese people until appraisal of their fair values can be made." Paragraph 6 was revised to "The Department of State points out that while voluntary procedures may appear advantageous from the point of view of speedy results, there is grave danger that voluntary action on the part of many of those now in high governmental and industrial positions may serve to enhance their prestige and solidify their position in public opinion. The Department of State urges that you give full consideration to this danger in working out reforms which are to take place proir to removal of persons whose elimination is required by the directive." These revisions were dispatched to SCAP on November 3 as WARX 81022.

6-8 DISSOLUTION OF HOLDING COMPANIES[4]

Memorandum through Central Liaison Office November 4, 1945
LOF-2
To: SCAP
From: Keizo Shibusawa, Minister of Finance for the Imperial Japanese Government

The firms of Mitsui Honsha, Yasuda Hozensha, Sumitomo Honsha, and Kabushiki Kaisha Mitsubishi Honsha, hereinafter referred to as the "Holding Companies", have been holding conversations with the Minister of Finance with a view to voluntary dissolution in accordance with the desires of the Supreme Commander for the Allied Powers.

The following plan is proposed for your approval to govern the dissolution of these firms and such other firms of similar character as may volunteer for dissolution:

1. a. The Holding Companies will transfer to a Holding Company Liquidation Commission all securities owned by them and all other evidences of ownership or control of any interest in any firm, corporation or other enterprise.

b. The Holding Companies will cease to exercise direction or control, either directly or indirectly, of all financial, industrial, commercial or non-commercial enterprises whose securities they own or of which they hold any other evidences of ownership or control.

c. The directors and auditors of the Holding Companies will resign all offices held by them in such Holding Companies immediately after the transfer of the securities and other evidences of ownership referred to in paragraph "a" of this Memorandum and cease forthwith to exercise any influence, either directly or indirectly, in the management or policies of the Holding Companies affected by this dissoultion.

d. All members of the Mitsui, Yasuda, Sumitomo and Iwasaki families will immediately resign all offices held by them in any financial, commercial, non-commercial, or industrial enterprises and cease forthwith to exercise any influence, either directly or indirectly, in the management or policies of the enterprises affected by this dissolution.

2. The Imperial Japanese Government will establish a Holding Company Liquidation Commission whose functions among others shall be:

a. To proceed with the liquidation of all property transferred to it by the Holding Companies as rapidly as feasible.

b. To issue receipts to the Holding Companies in exchange for such transferred property. Such receipts will be non-negotiable, non-transferable and ineligible for use as collateral.

c. Pending the final disposition of the transferred property, exercise the voting rights incident thereto but only to the extent necessary to insure proper methods of accounting and reporting and to accomplish changes in management, corporate practices and such other changes as are specifically desired by the Supreme Commander for the Allied Powers.

d. To redeem such receipts, upon the final liquidation of the transferred property, by delivery to the holders thereof, bonds of the Imperial Japanese Government, which bonds shall mature not less than ten years from the date of delivery and shall be non-negotiable, non-transferable except by inheritance, and ineligible for use as collateral, except as the Holding Company Liquidation Commission may determine. Such exceptions will be limited to such matters as payment of taxes, death duties and comparable purposes. The Holding Company Liquidation Commission will be empowered to deliver negotiable bonds to small shareholders in the Holding Companies in redemption of their proportionate interest in such receipts in the event that such action is considered desirable by the Commission. The face value of the bonds given in redemption of the receipts shall not be in excess of the net proceeds derived in liquidation of the property transferred to it by the Holding Companies.

[4] In mid-October negotiations on Zaibatsu dissolution began among the Holding Companies, the Japanese Government, and SCAP. Though it was not received by SCAP as an official Japanese Government proposal, the "Yasuda Plan", originally rejected by the Mitsubishi concern, became the basis for these negotiations leading to LOF 2, "Dissolution of Holding Companies". In earlier drafts the term "Securities Commission" was used instead of "Holding Company Liquidation Commission". Cf: Z511-303, Finance Ministry.

e. To protect the interests of small shareholders.

f. Determination of operating questions arising in the normal course of business of the holding companies such as disposition of funds received and payment of taxes and other debts.

3. When the securities or other property transferred to the Holding Company Liquidation Commission are offered for sale, preference to purchase will be given to employees of the companies involved, and in the case of corporate shares the number of such shares that may be purchased by any single purchaser will be limited in order to insure maximum democratization of ownership.

4. Neither the Holding Companies nor any members of the Mitsui, Yasuda, Sumitomo or Iwasaki families will purchase or otherwise acquire title or ownership of, or any interest in, any of the transferred property when it is offered for sale by the Holding Company Liquidation Commission.

5. The books, records, accounts and meeting of the Holding Company Liquidation Commission will be open to the Supreme Commander for the Allied Powers at all times and all acts of such Commission will be subject to his approval or review.

6. Nominees for membership on the Holding Company Liquidation Commission will be submitted to the Supreme Commander for his approval before appointment. At any time the Supreme Commander may appoint his own nominees to membership on such Commission.

7. Immediately subsequent to the time of the transfer to the Holding Company Liquidation Commission of the securities and other evidence of ownership and control, proceedings will be commenced for the dissolution of the Holding Companies.

8. The dissolution of the Holding Companies will be under the supervision of the Holding Company Liquidation Commission and the Commission, with the consent of the Supreme Commander, will be authorized to draw upon the assets of such companies in its possession to meet the debts of the companies, in event such companies do not have sufficient other assets to pay their creditors.

9. With the permisson of the Supreme Commander for the Allied Powers, the bonds mentioned in paragraph 2. d. hereof, or any part thereof, may be delivered directly to the shareholders of the Holding Comapnies by the Holding Company Liquidation Commission in amounts proportionate to their various interest therein, in event the dissolution of such Holding Companies is completed before such bonds or any part thereof, are issued and distributed.

The foregoing plan will be declared in immediate effect upon approval of the Supreme Commander for the Allied Powers.

[SOURCE: *Documents Concerning the Allied Occupation and Control of Japan*, III. pp. 161-163]

6-9 DISSOLUTION OF HOLDING COMPANIES

Memorandum November 6, 1945
SCAPIN-244 (ESS/ADM)

1. Receipt of the proposed plan for the dissolution of Mitsui Honsha, Yasuda Hozensha, Sumitomo Honsha and Kabushiki Kaisha Mitsubishi Honsha is acknowledged.

2. The plan proposed therein is approved in general and the Imperial Japanese Government will immediately proceed to effectuate it. No disposition of any property transferred to the Holding Company Liquidation Commission will be made without the prior approval of the Supreme Commander. You will submit the legislation through which the Holding Company Liquidation Commission will be created to the Supreme Commander for approval. It should be clearly understood that full freedom of action is retained by the Supreme Commander for the Allied Powers to elaborate or modify the proposed plan at any time and to supervise and review its execution.

3. The Imperial Japanese Government will immediately take such steps as are necessary effectually to prohibit the sale, gift, assignment or transfer of any moveable or immoveable property, including securities and other evidences of ownership, indebtedness or control by Mitsui Honsha, Yasuda Hozensha, Sumitomo Honsha and Kabushiki Kaisha Mitsubishi Honsha and the members of the Mitsui, Iwasaki, Yasuda and Sumitomo families or by any person acting on their behalf.

4. The Imperial Japanese Government will deliver to the Supreme Commander for the Allied Powers, within fifteen days of the receipt of this memorandum, a report listing:

a. All moveable or immoveable property, securities and other evidences of ownership, indebtedness and control in which the members of the Mitsui, Iwasaki, Yasuda and Sumitomo families had any right, title or interest as of November 1st, 1945.

b. All transactions involving moveable or immoveable property. including securities and other evidences of ownership, indebtedness and control by any member of the Mitsui, Iwasaki, Yasuda and Sumitomo familes since January 1st, 1945.

5. It is the intention of the Supreme Commander to dissolve the private industrial, commercial, financial and agricultural combines in Japan, and to eliminate undesirable interlocking directorates and undesirable intercorporate security ownership so as to:

a. Permit a wider distribution of income and of ownership of the means of production and trade.

b. Encourage the development within Japan of economic ways and institutions of a type that will contribute to the growth of peaceful and democratic forces. The plan proposed by the Imperial Japanese Government in the memorandum referred to in paragraph 1 above will be considered only as a preliminary step toward these objectives.

6. Accordingly, the Imperial Japanese Government will promptly present for approval by the Supreme Commander for the Allied Powers:

a. Plans for the dissolution of industrial, commercial, financial and agricultural combines in addition to those mentioned in the communication acknowledged in Paragraph 1 hereof.

b. Its program to abrogate all legislative or administrative measures which create, foster or tend to strengthen private monopoly.

c. Its program for the enactment of such laws as will eliminate and prevent private monopoly and restraint of trade, undesirable interlocking directorates, undesirable intercorporate security ownership and [assure] the segregation of banking from commerce, industry and agriculture and as will provide equal opportunity to firms and individuals to compete in industry, commerce, finance and agriculture on a democratic basis.

7. The Imperial Japanese Government will immediately take such steps as are necessary effectually to terminate and prohibit Japanese participation in private international cartels or other restrictive private international contracts or arrangements.

8. Acknowledgement of the receipt of this memorandum is directed.

FOR THE SUPREME COMMANDER:

[SOURCE: *Documents Concerning the Allied Occupation and Control of Japan*, III. pp. 164-65]

6-10 REMOVAL OF ZAIBATSU PROPERTY

Letter December 5, 1945
To: General of the Army Douglas MacArthur, SCAP
From: Edwin W. Pauley[5]
Secret

Dear General:

Reference is made to the program which you announced in November 6, designed to completely break up the Mitsui, Mitsubishi, Yasuda and Sumitomo holding companies and to eliminate their control over Japanese economy.

The success of this program will depend, of course, entirely upon the way in which it is administered. Although the Imperial Japanese Government is directed to proceed with the liquidation of the properties of these companies, it is obvious that many difficult problems will be encountered—such as, for example, finding persons who have no connection with the Zaibatsu who are in a position to take over the properties. The tendency on the part of the Japanese Government will be to take the easy way out. Thus, it can be anticipated that, unless exceptionally strong action is taken, the properties will eventually find their way back, through dummies and otherwise, into the control of the same people who previously held them.

One concrete step in the direction of implementing the policy of breaking up the Zaibatsu will be our program designed to deprive the Zaibatsu, as well as others, of their holdings outside Japan. In this connection, we should see to it that any program which the Japanese Government may adopt in the future for compensating holders of external assets shall not

[5] US representative, Reparations Commission.

be designed to benefit the Zaibatsu, directly or indirectly.

In addition, I recommend for your consideration the following:

(a) In implementing any program for interim deliveries of reparations which may be adopted, immediately select a few large plants which are owned by the Zaibatsu and which constitute war potential, and order that they be dismantled and made ready for shipment.

(b) Announce that in administering any program of reparations removals from Japan, priority will be to properties owned or controlled by the Zaibatsu, in the sense that, other factors being equal, a plant owned or controlled by one of the Zaibatsu will be taken in preference to non-Zaibatsu plant.

(c) Advise the Japanese Government that they have a definite period of time in which to effectively carry out the program which you announced on November 6; require them to submit a detailed statement to you at the end of this period, describing the steps which have been taken; and advise them further that any property which we determine, at the end of this period, is directly or indirectly owned or controlled by any of the Zaibatsu will be subject to immediate removal from Japan, under the reparations program.

I believe that a program such as that outlined above would help considerably in carrying out the policies which you have already announced with respect to destroying the Zaibatsu.

Sincerely yours,
Edwin W. Pauley
[SOURCE: SUITLAND PAPERS]

6-11 RURAL LAND REFORM

Memorandum — December 9, 1945
SCAPIN-411 (CIE)

1. In order that the Imperial Japanese Government shall remove economic obstacles to the revival and strengthening of democratic tendencies, establish respect for the dignity of man, and destroy the economic bondage which has enslaved the Japanese farmer to centuries of feudal oppression, the Japanese Imperial Government is directed to take measures to insure that those who till the soil of Japan shall have a more equal opportunity to enjoy the fruits of their labor.

2. The purpose of this order is to exterminate those pernicious ills which have long blighted the agrarian structure of a land where almost half the total population is engaged in husbandry. The more malevolent of these ills include:

a. *Intense overcrowding of land.* Almost half the farm households in Japan till less than one and one half acres each.

b. *Widespread tenancy under conditions highly unfavorable to tenants.* More than three-fourths of the farmers in Japan are either partially or totally tenants, paying rentals amounting to half or more of their annual crops.

c. *A heavy burden of farm indebtedness combined with high rates of interest on farm loans.* Farm indebtedness persists so that less than half the total farm households are able to support themselves on their agriculture income.

d. *Government fiscal policies which discriminate against agriculture in favor of industry and trade.* Interest rates and direct taxes on agriculture are more oppressive than those in commerce and industry.

e. *Authoritative government control over farmers and farm organizations without regard for farmer interests.* Arbitrary crop quotas established by disinterested control associations often restrict the farmer in the cultivation of crops for his own needs or economic advancement. Emancipation of the Japanese farmer cannot begin until such basic farm evils are uprooted and destroyed.

3. The Japanese Imperial Government is therefore ordered to submit to this Headquarters on or before 15 March 1946, a program of rural land reform. This program shall contain plans for:

a. Transfer of land ownership from absentee land owners to land operators.

b. Provisions for purchase of farm lands from nonoperating owners at equitable rates.

c. Provisions for tenant purchase of land at annual installments commensurate with tenant income.

d. Provisions for reasonable protection of former tenants against reversion to tenancy status. Such necessary safeguards should include:

(1) Access to long and short term farm credit at reasonable interest rates.

(2) Measures to protect the farmer against exploitation by processors and distributors.

(3) Measures to stabilize prices of agricultural produce.

(4) Plans for the diffusion of technical and other information of assistance to the agrarian population.

(5) A program to foster and encourage an agricultural cooperative movement free of domination by non-agrarian interests and dedicated to the economic and cultural advancement of the Japanese farmer.

6-12 POLICY TOWARD THE ZAIBATSU

Summary of Recommendations — March, 1946
Report of the Misson on Japanese Combines[6]
To: The Department of State and the War Department
Top Secret

TABLE OF CONTENTS

FOREWORD
SUMMARY OF RECOMMENDATIONS
Chapter I—The Function of the Mission
Chapter II—The Structure of Zaibatsu Power
Chapter III—Financial Institutions and the Zaibatsu
Chapter IV—Control Laws and Special Companies
Chapter V—Some Possible New Owners for Zaibatsu Holdings
Chapter VI—An Outline of Recommended Policy

The recommendations of the Mission, which are set forth fully in Chapter 6, are summarized below. Certain important elaborations which appear in Chapter 6 are necessarily omitted here. The paragraphs numbered from 1 to 13 set forth a program for terminating the power of the zaibatsu. Subsequent paragraphs suggest measures to prevent the rise of new zaibatsu and to make the Japanese economy more hospitable to small competitive business.

1. The larger Japanese business enterprises should be systematically surveyed in order to make sure that all the zaibatsu have been identified and subjected to the program for ending zaibatsu power.

In this survey, the term zaibatsu should be interpreted to include any private enterprise conducted for profit, or combination of such enterprises, which, by reason of relative size in any line or the cumulative power of its position in many lines, restricts competition or impairs the opportunity for others to engage in business independently, in any important segment of business; and any individual, family, allied group, or juridical person owning or controlling such an enterprise or combination.

In applying this standard, it should be presumed, subject to refutation, that any private enterprise or combination operated for profit belongs to the zaibatsu if it is very large in total assets; if, though somewhat smaller in assets, it is engaged in business in various unrelated fields; if it controls substantial financial institutions as well as substantial industrial or commercial ones; if it controls a substantial number of other corporate enterprises; or if it produces or sells a large proportion of the total supply of the products of a major industry.[7]

[6] Usually known as the "Edwards Report". The Mission was in Japan from January 6 to March 15, 1946. Where appropriate, the summary of recommendations printed here is supplemented by footnotes from "An Outline of Recommended Policy", Chapter 6 of the Report.

[7] Specific standards were given in the Recommendations:
"as a rough indication of the scope of the contemplated program, we suggest that total assets be regarded as excessive when those of the concern and its subsidiaries and affiliates are greater in the aggregate than two billion yen; *that a concern or combine doing business in several unrelated fields be regarded as execessively large if the aggregate assets exceed half a billion yen; that a concern or combine which controls financial interests with aggregate assets in excess of a billion yen be regarded as excessively large if its industrial and commercial assets and those of its subsidiaries and affiliates exceed a quarter of a billion yen;

2. Zaibatsu corporate combines should be dissolved. Dissolution of top holding companies, though a valuable first step, is not sufficient for this purpose. It should be supplemented by the following steps:

a) Dissolution of all other concerns which are merely holding companies.

b) In the case of non-financial enterprises which are operating companies, divestiture of all securities held in other companies, including companies not believed to be part of any zaibatsu combine.

c) Prohibition of future stock acquisition by the divested concerns.

d) Prohibition of mergers of any portions of divested or dissolved concerns except when permission is granted after an affirmative showing of public interest.

e) Requirement that all officers and directors of companies included in zaibatsu combines surrender all their offices and directorships except those in the company in which they are principally engaged.

f) Dissolution of certain contractual and service arrangements among concerns included in zaibatsu combines, specifically arrangements for peformance of central office services, interchange of personnel, exclusive agency, and preferential or exclusive trading rights.

g) Requirement that enterprises which have been members of zaibatsu combines shall grant licenses on non-discriminatory terms to all applicants under patents which they now hold and under licenses which give them rights to sub-license; that such concerns shall surrender any exclusive or preferential rights which they now enjoy under patent licenses granted by others; and that during the period of transition[8] such concerns shall make available to all comers on non-discriminatory terms any technology and patent rights which they make available to other concerns which have been part of the same combine.

h) Dissolution of operating companies which, standing alone, still enjoy a monopolistic position or are so large as to retain much of the combine's power. In such dissolutions, technological unity should be preserved so far as possible, but portions of a company should be severed from one another if they are in unrelated industries, if they have had a separate corporate existence within the last five years, and if they are so separated from one another physically and technologically that they do not in fact have a common operating management. Since it is not clear how far this part of the program should be carried, the most clearly objectionable[9] companies should be attacked first and decision about the ultimate scope of the program should wait upon experience.

3. Business communities of interest based upon zaibatsu family ties should be broken. For this purpose:

a) Members of zaibatsu official families (including the individuals who exercise controlling power in certain zaibatsu combines) and persons close to them by blood, marriage, adoption, or clan loyalty should be divested of all[10] their corporate security holdings and liquid assets.

b) Such persons should also be ejected from all positions of business responsibility.

c) After ten years have elapsed (and providing the recommendations below about compensation are adopted), such persons should be permitted to make investments and hold business positions with the same freedom as any other Japanese.

4. The zaibatsu should be compensated for their property, but compensation should not give them wealth enough to buy back a place of power in the Japanese economy. To

that a concern be regarded as controlling too many companies if it has more than ten subsidiaries and affiliates; and that a concern be regarded as quasi-monopolistic if it and its subsidiaries and affiliates produce or sell more than 40% of the total sales of a major industry."

*A footnote says: "These figures are based upon the values at the end of 1945 and make no allowance for subsequent inflation. The quantity should, of course, be adjusted to the change in value of the yen to the extent that corporate book values reflect that change."

[8] Defined as "perhaps a decade".

[9] The Recommendations stated that "the first companies attacked should be those which aggregate size or in degree of monopoly power are most clearly objectionable."

[10] The Commission was not unanimous on this point: "Two courses of action appear to be practicable. One is to divest such persons of their stockholdings and offices in all companies but one, so that they may be limited to control of a single corporation. The other is to extend such divesture to cover their relations with all Japanese corporations.

All but two members of our Commission consider that, in the immediate future, the former policy would be unduly hazardous."

this end:

a) Policies which facilitate the conveyance of zaibatsu property to new owners should not be modified by any effort to obtain fuller compensation for the zaibatsu.

b) The maximum compensation for any seized property should be the net proceeds from its sale; but a tax of not less than 90 percent should be levied upon any amount by which such net sale price exceeds the August 1945 market price (in the case of securities having a market) of book value (in the case of other securities or property).

c) If possible, the level of bids for zaibatsu property should be reduced by substantial windfall tax upon the buyer wherever the purchase price is less than fair value —say 50 percent of the difference in value. If the property is resold within two years, the windfall tax should be 100 percent of the gain from the resale.

d) If sums realized by sales under these policies are so large as to make probable a revival of zaibatsu power, outright partial confiscation should be used to whittle them down.

e) Sums credited to the zaibatsu as compensation should be frozen in government bonds for ten years from the completion of the sale of zaibatsu properties. During this period, cash payments, even of interest should be limited in order that there may be no surplus for free investment, and any additional income should be invested in frozen government bonds, acceptable, however, for taxes.

f) Before the freeze is terminated, succession by the owner's heirs should be required, coupled with payment of succession taxes at steeply graduated rates.

5. Liquidation of zaibatsu securities and properties should be rapid—in a period of about two years. The plan of liquidation should allow for:

a) Pro-rata distribution of security holdings to non-zaibatsu individual stockholders of the holding concern (and in some cases to financial institutions which own the holding concern's stock).

b) Exchange and cancellation of securities between companies which hold each other's stock.

c) Negotiated sale of both securities and other properties.

d) Periodic invitation of bids upon securities, and acceptance of the highest bids in amounts sufficient to bring sales up to a minimum quota for each quarterly period.

6. Sales should be screened to exclude cloaks for the zaibatsu and to prevent excessive concentration of power in the future. Otherwise, no single pattern of new ownership should be exclusively favored. Among acceptable types of purchasers are cooperative organizations, executives and employees of zaibatsu companies, persons wishing to go into business for themselves, persons driven from ownership by government policy during the war, groups of organized workers, and, in the case of certain public utility enterprises, the state itself.

7. Certain principal officials of operating companies should be removed because of clan loyalties or exceptional personal relationships with zaibatsu families or individuals. There is no need, however, to undertake any general replacement of managerial personnel. Such new managers as are needed can be obtained by promotion and by employment of persons who have been displaced by military destruction and reparations policy.

8. Zaibatsu control over credit should be broken. To this end:

a) In dissolution and reconstitution of zaibatsu financial enterprises (other than insurance companies) which are insolvent, stock held by zaibatsu holding companies and zaibatsu individuals which are part of the same combine should be subordinated to that of other stockholders. Zaibatsu insurance companies which are insolvent should be mutualized by cutting back the face amount of outstanding policies.

b) Policy holders in zaibatsu insurance companies should be aided in buying the stock of those concerns which is now owned by the zaibatsu. Purchase should be facilitated by liberal loans on policies or payment should be permitted in the form of a reduction of the face value of policies.

c) Remaining zaibatsu holdings in financial enterprises should be liquidated like those in non-financial concerns.

9. The number of sources of credit should be increased substantially. For this purpose, former owners of independent financial institutions which have been merged with zaibatsu concerns should be permitted to re-establish their old enterprises by forced divestitures.[11] If this expedient proves insufficient, other devices should be used also—possibly a

[11] The recommendations specified that "Wherever a group of persons could make a showing that they had held at least 20% of the stock of a bank or trust company which after 1940 was absorbed by another

requirement that banks over a given size must split themselves into two or more independent units within a stated period.

10. Alliances between financial and non-financial enterprises, and alliances among financial enterprises, should be broken. To this end:

a) Banks and trust companies should be prevented from investing as much as 25 percent of their capital and reserves in the securities, loans, bills, advances and overdrafts of any one company.

b) Such concerns should not be permitted to hold in their proper, savings, and trust accounts the stock of any other company in an amount which exceeds 5 percent of the outstanding shares of that company, nor to vote any such stock which they may hold. Nor should they be permitted to own any stock in a competitor. Exemption should be made to the percentage rule for stock acquired in connection with *bona fide* underwritings or in default of loans, but any such exemption should not run longer than one year.

c) Officers and directors of any bank or trust company, and persons holding 5 percent or more of the stock thereof, should be ineligible to hold any office or directorship or a similarly large percentage of stock in any other company. Exception should be made for part-time non-policy-making employees, such as attorneys and certifying accountants.

d) No bank or trust company should be allowed to re-deposit more than 10 percent of its deposists in any one institution other than the Bank of Japan.

11. To eliminate discriminations in favor of zaibatsu banks,

a) A system of deposit insurance should be instituted to diminish the belief among depositors that accounts in zaibatsu banks are safer than elsewhere. A limit should be set to the amount of deposits which will be insured for a single bank.

b) The postal savings system should ultimately be required to redeposit its funds in ordinary banks allocating at least 90 percent of what it receives in any prefecture to banks in that prefecture.

12. To break discrimination in favor of zaibatsu banks by the government:

a) The discretion which the laws now entrust to the Minister of Finance should be greatly reduced.

b) Bank examinations should take place at least every two years.

c) The functions and powers of the special banks should be defined and limited by law and these banks should not be allowed to engage in ordinary banking.

d) All vestiges of private ownership of the Bank of Japan should be eliminated.

e) The designated bank system should be abolished, together with financial control associations, and competition among banks for customers should be restored.

f) Employees of the Ministry of Finance and of government banks should be forbidden to hold the securities of any financial institution, and should be ineligible for employment by private financial institutions for two years after they leave government employment.

13. Control legislation should be terminated except where it serves a public purpose. To this end:

a) New government monopolies should not be established during the transition period except with the explicit consent of SCAP. The petroleum and alcohol monopolies, which were instituted for war purposes, should be terminated.

b) All legislation which forbids, or requires government approval of formation of a new business or expansion of an old should be repealed immediately.

c) Laws and ordinances establishing control associations should be generally repealed, and the associations abolished. However, in particular fields in which the Japanese government determines, with SCAP's approval, that allocation and price control are necessary as emergency measures in the reconversion period, the powers now exercised under control laws should be temporarily preserved in a reconversion statute, which, however, should have a fixed time limit. This law should preserve no authority to license business, control the disposition of profits, force consolidations and suspensions, or do other acts unrelated to reconversion. Where temporary allocations and price control are to be undertaken, the old control associations or similar quasiprivate new bodies should exercise delegated authority from the government, provided that final decisions are made by the government and rights of appeal to the government against abuse of powers are provided. All bodies exercising

bank or merged with another bank to form a new insitution, and wherever such persons were willing to make the necessary minimum capital contribution required by law, they could apply to the Ministry of Finance for the reconstitution of their old enterprise."

such delegated functions during the reconversion period should be liquidated upon its expiration.

d) Laws establishing special companies should be generally repealed and the companies established thereunder should be abolished. However, those special companies which perform allocation functions needed during the reconversion period should be temporarily continued by a reconversion ordinance, in accord with the foregoing recommendation. Certain other special companies which perform governmental functions should be temporarily continued, until arrangements can be made to transfer these functions to appropriate public agencies.

e) Provisions of control laws which establish subsidies and preferences should be immediately terminated, even where other features of the control are temporarily preserved.

f) Provisions of control laws which establish governmental authority over exports and imports should be temporarily continued while policy about Japan's foreign trade is being determined, but delegations of authority in this field to private and quasi-private business groups should be terminated as rapidly as possible.

14. All forms of subsidy, legal monopoly, trade preference law, and trade barrier law should be systematically reviewed, and these should be terminated which do not have a demonstrable public purpose. Subsidies which are continued should be fully disclosed. Restrictions upon entry into an industry or market should be tolerated only for generally accepted public purposes; and in the case of natural monopolies and public utilities they should be accompanied by limitations upon prices and profits. Aggrieved persons should be given the right to attack discriminations and restrictions in the courts.

15. An antitrust law should be enacted prohibiting concerted business activity which burdens trade; activity, concerted or individual, which coerces business enterprises or is designed to drive selected enterprises out of any line of business; monopoly; excessive size;[12] and types of industrial growth or intercorporate connection which are particularly likely to lead to monopoly or excessive size.[13] This law should be enforced by a specialized agency operating at a high governmental level and exercising broad investigatory and remedial power. Exemptions should be provided for the joint activities of cooperatives, provided they are not coercive nor monopolistic; for labor activities other than the restriction of commercial competition; and for natural monopolies and public utilities in so far as they are closely regulated.

16. The patent law should be amended to require that, outside the field of activity of the inventor or his first licensee, all applicants shall receive licenses without commercial restrictions on reasonable and non-discriminatory terms; and that if any licenses are granted within the reserved field of activity, all applicants shall be licensed upon non-discriminatory terms. Assignments and licenses not publicly recorded should not be valid. Patents used illegally in violation of this policy should be voidable.

17. Control of corporations by insiders should be made more difficult by

a) Requirement for disclosure of relevant facts in selling corporate securities, and introduction of the concept of common-law fraud in the law applicable to such sales.

b) Requirement that management give the stockholders an accounting of its stewardship before company meetings.

c) Prohibition of misleading practices in corporate accounting, and minimum standards of disclosure in such accounting.

d) Provision for the disclosure of corporate insiders' transactions in the securities of their companies and for deterrents on such transactions.

e) Provision of remedies for *ultra-vires* acts.

f) Requirement that all shares in the same company be paid up to the same extent.

g) Precautions to assure the independence of auditors.

h) Adequate facilities for stockholder suits against management.

[12] The law concerning excessive size "should prohibit mergers of going concerns which are in competition with one another (possibly exempting concerns of negligible size) and should define a merger so that it includes acquisition of any substantial portion of the capital assets of an enterprise."

[13] In measuring excessive size "The standard of corporate size which should be used...should not rest upon a mechanical ceiling upon assets, volume of business done, or number of employees." Instead, "the rule of thumb to be used in appraising corporate growth should be that of technological and structural unity. A concern should not be allowed to grow larger than other enterprises by bringing together under a single control activities which are not substantially related in origin of materials, productive operations, distributive channels, or final use."

18. The opportunity to form intercorporate combinations should be reduced by

a) Prohibition of interlocking officerships and directorates.

b) Prohibition of substantial shareholdings in other companies by directors and officers.

c) Prohibition of stockholding by corporations, with exceptions for banks, insurance companies, investment trusts, and possibly other types of financial institutions.

19. Income and inheritance taxes should be steeply graduated, and property inherited by the head of a House should be subject to the rates applicable to other heirs. Diffusion of inherited wealth should be assured by provision for reasonably equal distribution among heirs, in place of the present provision which sets a minimum that must pass to the next head of the House. The discretionary power of the Minister of Finance in tax matters should be greatly reduced.

20. Cooperatives should be made a better device by

a) Terminating present legislation which makes membership compulsory for certain groups.

b) Removing legal restrictions upon the types of acitivities which cooperatives may undertake.

c) Terminating the participation of the government in the affairs of agricultural cooperatives.

21. Efforts should be made to create Japanese support for this program by the following means:

a) Provision for access to recent literature in English about problems of industrial organization.

b) Publication of SCAP's factual findings about the zaibatsu.

c) Encouragement of the organization of a Japanese commission of inquiry representative of a wide range of interests and opinions to investigate the facts about the zaibatsu and make public its findings.[14]

d) Attention to problems of industrial organization, the dangers of monopoly and excessive concentration of economic power in revision of the Japanese educational system.

e) Provision for contact between the Japanese antitrust agency and similar bodies in other countries.

[SOURCE: SUITLAND PAPERS]

6-13 ZAIBATSU POLICY RECOMMENDED BY THE UNITED STATES REPARATIONS MISSION TO JAPAN[15]

April 1, 1946

Preliminary Statement:

Shortly before the departure of the Mission from Japan, a special United States Mission, headed by Hon. Corwin Edwards, arrived with a staff to make a special study of the Zaibatsu. Limitations of personnel of the Reparations Mission obviously prevented as complete as investigation as will be permitted by the Edwards Mission. The recommendations herein contained are thus, subject to reconciliation with the final recommendations of the Edwards Mission.

While considerable material and data have been collected on the Zaibatsu by the E & S Section of SCAP, a study of the Zaibatsu, sufficient to have an understanding of the entire extent of their holdings and control would not only take months of time, but would require the services of a large staff of accountants, investigators, lawyers, bankers and experts in various fields to analyze the material already secured and to secure and analyze a vast amount of additional material. Hence the statements and conclusions herein must necessarily be considered in the light of these limitations.

From a study of the material and data thus far examined, however, the following comments and conclusions are offered.

. . . . . .

Conclusions:

[14] On SCAP's relation to the commission the Recommendations stated: "In order that its findings may command confidence, SCAP should exercise control primarily through a veto upon the composition of the committee and thereafter should refrain so far as possible from guidance or censorship."

[15] Reference 7-6, "Pauley Report", April 1, 1946.

It is recommended that such action be taken by the Supreme Commander as will supplement and modify or change both the "preliminary step" taken on November 6 with relation to Holding Companies, and the Directive of November 24, relating to taxes on war profits and payment of claims for war damage, as carry out the following plan:

1. Set up in SCAP the office of Custodian of Zaibatsu Assets.

2. Vest in the Custodian the legal title to, and require the actual transfer to him of all government bonds and the securities, (rights, shares, interests, and evidences of ownership thereof or control of or interest in all enterprises of every nature whatever their legal form may be i. e. whether partnership corporation, affilliate, direct affilliate, semi-direct affilliate, or otherwise), owned or held on September 2, 1945 by,

(a) each and every individual member of the families (including those related in-law or by law under public or private law or family rules or by custom and others who have signed the "family rules") in each of the so-called nineteen family Holding Companies theretofore designated by SCAP as Restricted concerns, and in all other concerns and enterprises, of whatsoever name, nature, or activity;

(b) by each of said 19 Holding Companies in all other concerns and enterprises, of whatsoever name, nature or activity.

3. Vest in the Custodian the power to exercise all voting rights and all powers incident thereto of the securities vested in him.

4. Authorize the Custodian to take actual possession of any and all physical properties over which any individual as concern described in 2(a) or any combination of them holds the controlling interest, and to run and operate the same when in the discretion of the Supreme Commander it is necessary so to do in order to accomplish the purpose of the Instrument of Surrender or the Purposes of Occupation, and to liquidate such properties so physically possessed as hereinafter provided.

5. Require that all Government Bonds vested in the Custodian hereunder formerly owned or held by the individuals described in 2(a) and by any of the said 19 Holding Companies, shall forthwith be surrendered to the Japanese Government for cancellation and cancelled without compensation therefor and applied to the reduction of the public debt.

6. Require that, where possible, all property taken as reparations be taken from those concerns and enterprises over which the individuals or Holding Companies or any combination of them described in 2(a) at any time since January 1, 1945 have exercised control, whether by majority stock holding or otherwise.

7. Require the Custodian, after reparations claims have been satisfied, to liquidate or sell by unit or by piece and not by group all securities vested in him, and all properties and enterprises over which the individuals or Holding Companies, or any combination of them, described in 2(a), on September 2, 1945 held the controlling interest. In such sales preference to be given to employees or groups of employees of the affected concern, on a time basis if necessary, and no sale shall be made to any of the persons or groups of persons or Holding Companies or any combination of them described in 2(a).

8. Require that the money paid for the purchase of any securities or property from the Custodian, shall be surrendered by the Custodian to the Japanese Government, which shall, apply the same to the reduction of the public debt incurred prior to September 2, 1945, by the redemption of Government Bonds and the currency note issue, subject to review by the Supreme Commander, and shall not apply the same to current Government expenditures.

9. Forbid indemnification by the Japanese Government, or the Bank of Japan, or any agency of either of them, to any of the persons or holding companies, or any combination of them described in 2(a) or to any concern or enterprise in which they or any combination of them held a controlling interest, on January 1, 1945 or subsequently, for (I) any war damage; (II) any cancelled war contracts; (III) any confiscated external assets; (IV) any bonds cancelled, public debt retired, or currency cancelled hereunder; any forbid indemnification to any of the persons or holding companies described in 2(a) for the property taken as reparations.

10. Provide for the designation by the Supreme Commander from time to time of additional persons and concerns, the securities and properties of whom or which shall there upon vest in the Custodian hereunder, and also provide for the release by the Supreme Commander from Custodianship of any securities or property theretofore vested hereunder.

11. Authorize the Custodian to take such action as may be necessary to protect the interests of small share holders other than the individuals and holding companies described in 2(a).

12. Direct the Custodian to cancel all obligations up to 5000 yen owed by any individual to any person or concern described in paragraph 2, and arising out of war production activities where the individual suffered war damage in the sum of 5000 yen or greater, or loss or damage resulted in the sum of 5000 yen or greater from the cancellation of war contracts, or sub-contracts, provided such individual is not otherwise reimbursed by the Japanese Government for such damage or loss.

13. Direct the Japanese Government to submit a plan for government long-term loans (10 years or more) at low interest rates for working capital and reconstruction of business structures sold by the custodian hereunder.

14. Authorize the custodian to void any transfer of securities or properties made by any of the individuals or concerns described in paragraph 2, at any time since January 1, 1945, if found by the Custodian to have been made for the purpose of concealing assets or property, or to defeat the terms of the Instrument of Surrender or the purposes of occupation.

Our recommendations in reference to reparations necessarily involve a concern for the effects of reparations on the internal economy of Japan. In order that the program espoused shall be in accord with the objectives of The Potsdam Declaration, and the White House Statement of September 22, 1945, which latter covers, in Part IV, the policies relating to Economic Demilitarization, Promotion of Democratic Forces, and Resumption of Peaceful Economic Activity, as well as Reparations and Restitution, we believe that the recommended plan and program will go far towards the elimination of "The authority and influence of those who have deceived and misled the people of Japan into embarking on world conquest", as required in Paragraph 6, of the Potsdam Declaration, and will help to make effective the aims of the White House Statement of September 22, 1945, particularly that portion in Part IV thereof, which declares it to be the policy;

"(A) To prohibit the retention in or selection for places of importance in the economic field of individuals who do not direct future Japanese economic effort solely toward peaceful ends; and

"(B) To favor a program for the dissolution of the large industrial and banking combinations which have exercised control of the great part of Japan's trade and industry."

[SOURCE: SUITLAND PAPERS, Z 721-4]

6-14 ESS STUDY ON CORPORATE STOCKHOLDING

Staff Study on the Edwards Report by the Anti-Trust and Cartels Division, ESS SCAP (Excerpt) — May 6, 1946
For: Chief, ESS

5. A/C DIVISION STAFF STUDY ON EDWARDS REPORT FOR CHIEF, ESS 6 MAY 1946

"8. In the opinion of the staff, the provisions of Paragraphs 2b and 2c of the Summary of Recommendations, prohibiting corporations from owning stock in other corporations and requiring existing corporations to divest themselves of such securities, are too sweeping in their nature. The effect of this recommendation would be to prevent many beneficial uses of corporate subsidiaries. The creation of subsidiary corporations is well suited to engage in speculative or risky enterprises. There are certain activities which involve a higher degree of risk than most corporate managers would wish to impose upon their principal company. For example, a hosiery manufacturer might organize a subsidiary to purchase silk in order that a sharp decline in the price of the commodity would not jeopardize the solvency of the parent concern. Another possible use for a subsidiary is the development and exploitation of a new and untried patent, where the financial outlay involved is usually quite large and the outcome conjectural. While it is true that the examples given may be classified as hazardous enterprises, they do, nevertheless, serve a legitimate function in the business process. If such operations cannot be segregated into separate subsidiaries, there is considerable doubt that they would be undertaken by established concerns. However, to leave such operations entirely in the hands of new and insubstantial concerns, having little or nothing to lose, would probably not consitute a gain from a social standpoint.

The corporate subsidiary is also frequently used by corporate management to facilitate joint operations. It is often advantageous for several companies to cooperate in undertaking a new activity. For example, a wrapping paper concern which wishes to build a new pulp factory in order to supply its raw materials might find that the smallest economical pulp unit would produce considerable more than it required for a paper operation. However, if it joined forces with a manufacturer of cleansing tissue, the two concerns together could use the entire pulp output without either manufacturer having to run the risk of being caught with an unsaleable pulp surplus. The most feasible way for the two companies to undertake this joint operation is by means of the formation of a subsidiary corporation whose stock would be owned by the two principal companies.

It is frequently possible to obtain capital on more favorable terms when a corporate subsidiary is created. Thus an unsuccessful leather company might own a successful shoe manufacturing business. There is no question but that additional capital for the shoe business could be obtained on more advantageous terms, if that branch was organized as a separate corporation and could raise the required funds on its own good credit standing, than would be possible if the investment had to be made in a consolidated enterprise which included the unprofitable leather business. The circumstance introduces a necessary element of flexibility into corporate management and has often been responsible for saving the entire enterprise.

It is indicated elsewhere in the Edwards Report that the proposed prohibition of corporate ownership of securities is intended to prevent companies from attaining too great a size and/or from expanding into too many different fields of economic activity. It is the opinion of the staff that the limitation on the ownership of securities, if adopted, would have little if any effectiveness in preventing these admittedly undesirable results. Even though a company could not own a single share in another company, it could still engage in as many activities, related or unrelated, as it desired, simply by organizing them as separate branches or divisions of a single company. Furthermore, by entering into operating agreements for the control of production, prices, markets, and so forth, with other companies, a corporation can attain widespread economic control and penetrate into many different fields of commerce and industry without the benefit of ownership in corporate securities.

There is, however, one serious evil to which the corporate ownership of securities lends itself. That is the practice of pyramiding ownership by means of a chain of intermediate holding companies, each of which may be heavily capitalized by means of senior securities. In this way, a relatively small investment at the top level can control a far greater volume of assets at the lower levels. Thus, by the use of only two strata of subsidiaries, each of which is capitalized by means of senior securities, it is possible for a holding company to control assets with a value of approximately ten times its initial investment. The staff is in agreement with the Edwards Report that this is an inequitable and dangerous practice which should be held under control. Two simple measures should be sufficient to prevent such undesirable pyramiding of assets and control:

a. A prohibition against any corporation holding shares of another corporation which itself owns any corporate securities.

b. A requirement that equity capital (common stock) must represent at least 50% of the total capitalization of any company which wishes to issue senior capital (bonds or preferred stock). Necessary exceptions to these limitations would, of course, have to be recognized in the case of financial institutions such as savings banks, trust companies, insurance companies, brokers and investment companies. It is believed that these proposed restrictions would prevent the progressive multiplication of assets and control through the use of several layers of subsidiaries and would also prevent pyramided capital structures. At the same time, it would permit the economically desirable use of a single layer of subsidiaries for the purposes which have been indicated as both necessary and proper in the field of corporate management.

. . . . . .

"10. The provision of Paragraph 10b, which limits financial enterprises to a small percentage of the shares of any one company and prohibits such enterprises from voting any such stock, seems unnecessarily restrictive. As a matter of principle, companies owning stock should be permitted to exercise their voting rights in order that their investment may be protected against possible unsound management policies or unauthorized activities. The 5 percent limitation which is imposed by this recommendation seems adequate to prevent undue investment control over industrial enterprise without also prohibiting the exercise of normal voting rights. However, the staff believes that the 5 percent restriction should include all stock and securities held by the bank either as an owner of record or as a holder of a beneficial interest, or both. If this proposal is accepted, we feel evasions of the restriction

by means of proxies or collateral holdings will be prevented."

"11. The provisions of Paragraph 10c, which prohibits officers and directors of any financial enterprise, or persons holding 5 percent of the stock of such financial enterprise, from holding an office or directorship, or a similarly large percentage of stock in any other company, also, seems unduly stringent. It is frequently desirable, if not necessary, for bank officials to have industrial connections either through stock ownership or the holding of an office. Likewise, industrial enterprise frequently benefits through banker connections on their boards of directors. If a different type of limitation can be placed on the existing unwarranted connection between investment institutions and commercial enterprise, these advantages may still be realized. It is, therefore, recommended that Paragraph 10c of the Recommendations be amended by adding to the first sentence of that paragraph the following word: "except the one in which he is principally engaged." With this modification, those occupying positions of responsibility in financial institutions would be entitled to have an interest in one industrial enterprise without completely opening the door to the type of financial and industrial tie-up which is so prominent in the Japanese economy.

"16. The provisions of Paragraph 18, relating to interlocking officerships and directorates and intercompany shareholdings, appear to be unnecessarily broad. It is believed that such prohibitions should be limited to interrelationships between competing units. Under such a limited prohibition, free enterprise could function normally and the economy would achieve the flexibility necessary under sound management practices. It is, therefore, recommended that the prohibition against interlocking directorates be applied only in the case of competing companies. Similarly, the prohibition against substantial shareholdings in other companies by officers and directors should be limited to competing companies, with an additional prohibition against shareholdings in any other company by such directors or officers, where such acquisition substantially lessens trade and competition or tends to create monopoly. Our suggestion with respect to shareholdings by corporations is covered in the paragraph which discusses the recommendations under Paragraphs 2b and 2c."

[SOURCE: SUITLAND PAPERS, Z 703-12]

6-15 TRANSMITTAL OF REPORT OF EDWARDS MISSION ON THE ZAIBATSU

Memorandum May 17, 1946
To: Joint Chieffs of Staff
From: W. F. Marquat, Chief, ESS
Secret

. . . . . .

2. War Department Message No. WX 87213, 7 December 1945, requires that the report be forwarded to Washington "through you for comment." Radio W 87071, 8 May 1946, states "US deferred action and obtained postponement action by FEC pending receipt of Edwards Report 'with your comments.'"

. . . . . .

4. It is my opinion that the Zaibatsu subject may incite debate of a controversial nature among the SWNCC and the Far Eastern Commission members. I assume that State Department will submit its final decision as to "US policy on major issues" to General MacArthur for concurrence prior to passing this policy to FEC and SWNCC. In consequence the initial comments from her on the basic report must be carefully scrutinized. The comments prepared herewith represent the considered opinions of members of the Anti-Trust and Cartels Division of ESS after wide discussion.

5. On the whole the recommendations of the Edwards Mission are fundamentally sound, particularly in connection with the objectives to be attained. The report appears to be slightly academic in its approach to some of the problems. The ideal solution, and the one that General MacArthur undoubtedly will support, is to attain the theoretical objectives of the Edwards Mission report by practical methods which will least disturb the economy of Japan. It is quite possible to dissolve monopolistic controls and to prevent their recurrence without penalizing industry or stifling big business operations offering both producer and consumer benefits. The comments suggest clarification or delimitation of the recommendations made where in disagreement with the staff opinion, and indicate the manner and scope of such modifications as are considered to be desirable.

6. I would like to discuss this report with General MacArthur. Upon obtaining his final views and instructions the papers to be transmitted to Washington will be revised in accordance with his decisions.

[SOURCE: SUITLAND PAPERS, Z 703-12]

6-16 ON THE REPORT OF THE EDWARDS MISSION[16]

Comments by SCAP undated (1946)
Secret

The objectives of this report are admirable in purpose but the practical execution of such a program, except in broad outline and along general lines, is quite beyond the size and organization of the Occupation Forces as at present constituted. The report includes in its program the most advanced refinement in the fields of finance, economics, commerce and industry—subjects which are now agitating the governments of the world and ones that are in a constant state of flux and unbalance.

To attempt in such detail the reorganization of a conquered country presents certain Utopian aspects which should be carefully considered before being attempted.

The basic question is whether the purpose of the occupation is to establish an ideal economy here or whether it is merely to provide the introduction of such democratic methods and the abolition of such menaces as to insure the disability of Japan to make future war.

If the purpose is the former, a complete reorganization approaching governmental size must be made in the Occupation Forces. This concept conflicts immediately with the budget restrictions of the American government, which have already been set forth and definitely limit the structure of the SCAP organization to a mere controlling echelon to provide and enforce broad basic principles.

The latter plan has been the one that has been followed up to the present time and it is presumed that this policy will continue. Under that assumption, this report must be regarded merely as a guiding study to which every effort will be made in compliance but which contains many details of refinement in practice that may be of great difficulty or even impracticability of accomplishment.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

6-17 FUNCTIONS OF ANTI-TRUST AND CARTELS DIVISION, ECONOMIC AND SCIENTIFIC SECTION

Administrative Memorandum No. 23 March 7, 1947
From: W. F. Marquat, Chief, ESS

1. GENERAL

The purpose of this memorandum is to assign the responsibility and outline the duties of the Antitrust and Cartels Division.

2. RESPONSIBILITY

The responsibility of the Division is to make recommendations to the Chief, Economic and Scientific Section concerning the following:

a. Dissolution of major industrial and financial combines, and legislation necessary to accomplish this objective.

b. Establishment and supervision of a public agency responsible for the reorganization of the Japanese business structure.

c. Dissolution of Control Associations and other forms of private economic control.

d. Termination and prohibition of participation by Japanese in private international controls.

e. Recommendation of new legislation and amendments to existing legislation which will:

(1) Strengthen democratic processes and tendencies in economic institutions.

(2) Prevent regrowth of monopoly in agriculture, commerce, finance and industry.

[16] Transmitted to Washington on May 17, 1946 (see preceding document) and later appended to SFE 182, "Statement of U. S. Policy with Respect to Excessive Concentrations of Economic Power in Japan", August 1, 1946. Specific paragraph references to the Summary of Recommendations are omitted here.

(3) Eliminate private economic controls.
(4) Promote the establishment of free enterprise in economic activities.

3. DUTIES

The duties and functions of the Division are to:

a. Maintain surveillance over industrial and financial combines until reorganized.

b. Maintain surveillance over dissolution of control associations and other forms of private economic control to prevent their reestablishment in some other form.

c. Maintain surveillance over the public agency established to reorganize Japanese business structure.

d. Advise Japanese in drafting and enforcement of legislation referred to in paragraph 2, above.

[SOURCE: SUITLAND PAPERS]

6-18 POLICY ON EXCESSIVE CONCENTRATIONS OF ECONOMIC POWER IN JAPAN

FEC- 230[17] May 12, 1947
Report by the United States Government (Excerpts)
To: The Far Eastern Commission

ENCLOSURE "A"
STATEMENT OF TRANSMITTAL

The United States Government desires to present herewith to the Far Eastern Commission a report of its mission on Japanese combines, and concurrently to recommend for adoption by the Commission certain policies with respect to the concentration of economic power in Japanese industry, finance, and trade.

It is the belief of this Government that the existence of the Zaibatsu, and the monopolistic controls exercised by these giant combines over Japanese economic life, have been a major factor in fostering and supporting Japanese aggression. The dissolution of excessive private concentrations of economic power is essential to the democratization of Japanese economic and political life. It therefore constitutes, in the United States view, one of the major objectives of the occupation.

This basic occupation policy with respect to the Zaibatsu is stated in *Basic Post-Surrender Policy for Japan* (FEC-014), and is reaffirmed in *Basic Initial Post-Surrender Directive to SCAP for the Occupation and Control of Japan* (FEC-015). Substantial steps to implement this policy have already been undertaken by the appropriate Japanese authorities, at the direction of or with the approval of SCAP, in the organization and operations of a Japanese Holding Company Liquidating Commission, in providing for an economic purge, and in initiating other measures with respect to combines, control associations and cartel arrangements.

To aid in formulation of comprehensive policies, standards, and procedures a mission headed by Corwin D. Edwards was dispatched to Japan in January 1946. Its report is submitted herewith.

On the basis of that report, the United States Government has prepared the following statement of broad policy with respect to the Zaibatsu question, which it desires to submit for approval by the Far Eastern Commission. In many respects, this statement incorporates measures which already have been or are being implemented by the appropriate Japanese authorities, at the direction of or with the approval of SCAP, in accordance with the directives referred to above.

ENCLOSURE "B"
POLICY ON EXCESSIVE CONCENTRATIONS OF ECONOMIC POWER IN JAPAN

1. *Objective*

The over-all objective of occupation policy in dealing with excessive concentrations of

[17] The first U.S. policy document dealing specifically with the economic concentration program was SFE 182, August 1, 1946 based on the Edwards Report and SCAP's comments. Revised as SFE 182/1 on December 19, 1946, after additional SCAP comments, it was then forwarded to SWNCC to become SWNCC 302/2, dated January 22 1947. SWNCC 302/2, as amended by SWNCC 302/3 and SWNCC 302/4.

economic power in Japan should be to destroy such concentrations as may now exist, and to prevent the future creation of new concentrations. Especial care should be taken to avoid the futile gesture of destroying one Zaibatsu class only to create another; a drastic change in the nature as well as the identity of the groups controlling Japanese industry and finance should therefore be effected. Realization of this change will require achievement of the following specific objectives:

a. Dissolution of all excessive concentrations of economic power, unless technological considerations require their continuation (paragraphs 2, 3, 4, below).

b. Elimination of the excessive economic power of persons formerly exercising control over these concentrations, and of certain individuals close to such persons (paragraphs 5, 6, below).

c. Support for varied and diffused types of private ownership of elements of these dissolved concentrations, as well as support for government ownership of such of these concentrations as cannot be dissolved and of such elements of the dissolved concentrations as do not lend themselves to competitive operation (paragraphs 7, 8, below).

d. Elimination of financial support for excessive concentrations—through the divesture of Zaibatsu holdings in banks and insurance companies, through an increase in the number of sources of credit, through the termination of alliances between financial and non-financial institutions, and through elimination of government favoritism towards certain financial institutions (paragraphs 9, 10, 11, 12, below).

e. Destruction of legal support for excessive concentrations—through the termination of control legislation, through the creation of an anti-trust law, through changes in the patent law, through amendments to corporate law, and through alterations in current tax law and practices (paragraphs 13, 14, 15, 16, 17, below).

f. Strengthening of the instruments necessary to effect the above policies—through financial and technical aid to preferred types of purchasers, through the creation of public support for anti-Zaibatsu actions of the Japanese Government, and through measures to assure the independence of government personnel form Zaibatsu influences (paragraph 18, 19, 20, below).

It is considered that the requirements of the Potsdam Declaration will not have been fulfilled until the objectives listed above have been met through the application of measures specified in succeeding paragraphs. It is also considered, however, that the means to be employed in compelling the Japanese Government to effectuate these measures, and the timing of such means, are matters for executive decision by SCAP. In general, the Japanese Government should be required to take such administrative, legislative and judicial measures as will be consistent with its structure and constitutional powers and will accomplish the policy set out herein.

2. *Definition of an Excessive Concentration*

For purposes of the policies set forth in this paper, an excessive concentration of economic power should be defined as any private enterprise conducted for profit, or combination of such enterprises, which, by reason of its relative size in any line or the cumulative power of its position in many lines, restricts competition or impairs the opportunity for others to engage in business independently, in any important segment of business.

In applying this standard, it should be presumed, subject to refutation, that any private enterprise or combination operated for profit is an excessive concentration of economic power if its asset value is very large; or if its working force (i.e., the working force required to operate its facilities at capacity as evidenced by its peak past employment figure) is very large; or if, though somewhat smaller in assets or working force, it is engaged in business in various unrelated fields, or if it controls substantial financial institutions and/or substantial industrial or commercial ones; or if it controls a substantial number of other corporate enterprises; or if it produces, sells or distributes a large proportion of the total supply of the products of a major industry.

Absolute size, as well as position within a given industry, is to be considered grounds for defining a specified concentration as excessive. It is desired to eliminate not only monopolies but also aggregations of capital under the control of a given enterprise which are so large as to constitute a material potential threat to competive enterprise.

All larger Japanese enterprises should immediately be surveyed by SCAP in the light of the above standards. Uncertainity as to whether any specified enterprise is covered by these standards should be resolved in favor of coverage since it is intended that ownership of the bulk of Japanese large-scale industry should be affected by the policies set forth in this paper. It is understood that SCAP's *Schedule of Restricted Concerns*, as amended from time

to time in accordance with the procedures provided for that purpose, comprehends the Japanese enterprises considered to be excessive concentrations within the meaning of this paper.

3. *Dissolution vs. Non-Dissolution of Excessive Concentrations*

Excessive concentrations of economic power should immediately be dissolved into as many non-related units as possible, no one of which would be covered by any of the definitions of an excessive concentration presented in paragraph 2. Such dissolution should not be affected, however, where the technological need for large scale operation is such that dissolution would clearly cause a drastic reduction in operating efficiency. It should be presumed, subject to refutation, that such a drastic reduction would not result from the dissolution of holding companies; or from the severance of ties of ownership, directorship, and officership between operating companies; or from the severance from operating companies of portions of such companies, where these portions are in unrelated industries, or where they have had a separate corporate existence within the last five years, or where they are so separated from one another physically and technologically that they do not in fact have a common operating management. Treatment of concentrations which are to be dissolved is specified in paragraph 4; treatment of concentrations which are not to be dissolved is specified in subparagraph 8 *a*. The provisions of paragraph 5 should apply equally to persons and holdings in concentrations which are, and are not, to be dissolved.

4. *Policy with Respect to Excessive Concentrations Which are to be Dissolved*

The following measures should be undertaken with respect to excessive concentrations of economic power which are to be dissolved:

a. All concerns in these excessive concentrations which are merely holding companies should be dissolved and divested of their security and property holdings.

b. The units, other than those described under *a* above, into which these excessive concentrations are broken down should, in the case of non-financial enterprises (insurance companies being considered financial enterprises), be divested of any securities which they may hold in other concerns, including concerns not a part of any excessive concentration of economic power.

c. All officers (audtitors are to be considered officers and directors of those operating units, and of operating units in the financial field as well, should surrender all offices and directorships except those in the company in which they are principally engaged, and should be forbidden to acquire any offices and directorships outside of whatever company they may be principally engaged in, at any time in the future, except as provided in paragraph 16. This policy does not apply to persons specified in paragraph 5, who will be dealt with in accordance with the provisions of that paragraph.

d. Certain contractural and service arrangements between the units into which these excessive concentrations have been dissolved should be terminated, including arrangements for performance of central office services, inter-change of personnel, executive agency, and preferential or exclusive trading rights. Resumption of similar arrangements should be prohibited for a time sufficient to ensure bona fide severance of the arrangement.

e. The operating units into which these excessive concentrations are dissolved should grant licenses on nondiscriminatory terms to all applicants under patents which they now hold and under licenses which give them rights to sub-license; should surrender any exclusive or preferential rights which they now enjoy under patent licenses granted them by others; and, during the period of transition, should make available to all comers on non-discriminatory terms any technology and patent rights which they make available to other concerns which have been a part of the same combine. Where the units in question hold license under Japanese patents owned by foreigners under terms incompatible with the sense of this paragraph, these terms should be renegotiated. Where the licensor will not agree to renegotiation, the Japanese unit should cease utilizing the license, so that the Japanese government can cancel the patent or open up the patent to licensing on non-discriminatory terms pursuant to Chapter II, Article 41 of the Patent Law.

f. Mergers of any portions of divested or dissolved concerns should be prohibited, except when permission is granted after an affirmative showing of public interest.

5. *Treatment of Personnel in Excessive Concentrations*

All individuals who have exercised controlling power in or over any excessive concentration of economic power, whether as creditors, stockholders, managers, or in any other capacity, should be:

a. Divested of all corporate security holdings, liquid assets, and business properties;

b. ejected from all positions of business or governmental responsibility;

c. forbidden from purchasing corporate security holdings or from acquiring positions of business or governmental responsibility at any time during the next ten years.

All other persons likely to act on behalf of the individuals described above should be subjected to the measures specified below. In determining who such persons may be, such factors as ties by blood, marriage, adoption or past personal relationship should be taken into account. (The phrase "past personal relationship" is used in the previous sentence chiefly in reference to persons who have been placed in positions of substantial responsibility in holding companies or their subsidiaries by the Zaibatsu families, but it should also be taken to refer to persons otherwise associated with the Zaibatsu whom SCAP may consider to be acting as "fronts" for the latter.) Such persons should be:

a. divested of liquid assets and business properties, where they possess such assets or properties in amounts of any significance; and divested of all corporate security holdings in any excessive concentration of economic power and corporate security holdings representing an interest of more than 1% in any other major private enterprise;

b. ejected from all positions in business or government which might be used to favor Zaibatsu interestes;

c. forbidden from purchasing corporate security holdings, or from acquiring positions in business or government which might be used to favor Zaibatsu interests, at any time during the next ten years.

Where doubt exists as to whether a given person should be covered by the above policies, that doubt should be resolved by SCAP in favor of coverage, since it is desired to divest a sufficient number of holdings to effect a thorough-going transformation of the ownership and control of large-scale Japanese industry.

6. *Compensation of Divested Holdings*

Individuals covered by the definitions in paragraph 5 above shall be indemnified, provided that such indemnification shall be made in such manner and degree as will prohibit their buying back a place of power in the Japanese economy. In order to bring this about, it is essential that certain measures be taken in the dissolution of excessive concentrations and in the sale of the assets of these persons. The measures set out below have been designed with a view to preventing the payment of excessive indemnification to the persons covered in paragraph 5, without affecting to the same degree and manner the compensation of others who have invested in enterprises considered to be excessive concentrations. The determination of what is an excessive indemnification shall be made on the basis of the objectives of these measures. Accordingly:

a. Policies which facilitate the conveyance of divested holdings to new owners should not be modified by an effort to obtain any specified degree of compensation for the former owners of these holdings. The over-riding objective should be to dispose of all the holdings in question as rapidly as possible to desirable purchasers; the objective should be achieved even if it requires that holdings be disposed of at a fraction of their real value. In negotiated sales of divested holdings to desirable types of purchasers, the purchaser's ability to pay, rather than the real value of the holding, should affect the fixing of prices and terms of payment.

b. A tax of not less than 90% should be levied on any amount by which the gross sales price exceeds the August 1945 market price (in the case of securities having a market), or the book value as of the same date (in the case of other securities or property). To prevent this tax from resulting in injury to non-Zaibatsu individuals, the following priority should govern the disposition of funds secured through the sale of divested assets:

First Priority: All taxes due, other than the 90% tax referred to above, and all liabilities should be paid in full.

Second Priority: All non-Zaibatsu equity holders, where such exist should be paid up to the amount of the August 1945 market price of their holdings (or the August 1945 book value in the case of securities not having a market).

Third Priority: The 90% tax described above should be paid in full.

Fourth Priority: All Zaibatsu equity holdings should be paid up to the amount of the August 1945 market price of their holdings (or the August 1945 book value in the case of securities not having a market), and remaining funds should be distributed among all equity holders in proportion to the amount of their holdings.

To prevent observance of the priorities cited above from resulting in total expropriation of Zaibatsu share-holders, proceeds of the 90% tax should be partially refunded to Zaibatsu shareholders, where necessary to provide such shareholders with a total compensation not exceeding 15% of the August 1945 market value (or book value where no market existed)

of their divested holdings.

In lieu of the 90% tax specified above, a steeply progressive tax may be specifically imposed (in addition to capital levy) on funds which are assigned to the individuals described in paragraph 5 as a result of the sale of assets divested from such individuals.

c. A 75% tax should be levied on any gain realized through re-sale of divested holdings within two years; and a 50% tax should be levied on any gain realized through re-sale within four years.

d. Sums credited to persons defined in paragraph 5 above as compensation should be invested in government bonds whose total par value will not exceed the sum thus credited and which will pay a rate of interest no higher than the lowest rate being paid by comparable government bonds. Such bonds should not be saleable, transferable, or usable as collateral, but should be acceptable for taxes, when all other sources of liquid assets have been dissipated, for ten years from the completion of the sale of such holdings. During this period, cash payments, even of interest, should be limited to sums required for accustomed living expenses, in order that there may be no surplus for investment.

e. After the process of dissolution and liquidation has been well advanced and before the end of the ten-year freeze period, the program should be reviewed to determine whether the sums credited to persons defined in paragraph 5 above will be so large as to make probable a revival of Zaibatsu power. If it is determined that the probability of such a revival still exists, added measures appropriate to the circumstances existing at the time should be applied to remove the probability.

f. Before the freeze is terminated, succession by the owner's heirs should be required, coupled with payment of steeply graduated inheritance taxes.

7. *Liquidation of Divested Holdings*

Liquidation of divested securities and properties should be effected rapidly in a period of about two years from the organization of the Holding Company Liquidation Commission. The plan of liquidation should allow for:

a. pro-rata distribution of security holdings to individual stockholders of the holding concern other than those specified in paragraph 4 (and in some cases to financial institutions which own the holding concern's stock);

b. exchange and cancellation of securities between companies which hold each other's stock;

c. negotiated sale of securities and properties;

d. if necessary to complete the liquidation within about two years, invitation of bids upon securities from eligible purchasers, and acceptance of the highest bids however low such bids may be.

Liquidation should be effected by the Holding Company Liquidation Commission, a wholly public agency of the Japanese Government operating under close supervision of SCAP. Especial care should be taken not to allow representatives of large scale business, large scale trade, or large scale finance, or of political groups, sympathetic to such business, trade, or finance, to have any place on this Commission. All nominations to the Commission should be approved by SCAP, its personnel should be removable by SCAP, and it should be required that all sales effected by the Commission be revocable by SCAP. Public announcement should be made of the terms and conditions of all sales.

8. *Sale of Divested Holdings*

In the sale of divested security and property holdings, the over-riding objective should be to transfer ownership and control of these holdings to groups and individuals in such a way as to secure, in addition to the requisite managerial skill, protection against the future creation of excessive concentrations of economic power, through a wider distribution of income and of ownership of the means of production and trade. In order to achieve this objective, the following criteria are set forth as a guide to the selection of purchasers and should be given priority, in this connection, over the purchaser's present ability to pay:

a. Divested holdings in excessive concentrations of economic power which are not to be dissolved for technological reasons, and in other enterprises such as public utilities which do not lend themselves to competitive operation, may be subjected to purchase by the national and local governments of Japan, provided, such purchases are accomplished and approved through democratic processes. Where such concentrations or enterprises are not purchased by these governments, their rates and profits should be subjected to open and effective regulation by impartial public commissions. When the National Government or a local government purchases divested equity holdings in a given concern, it should also give consideration to the comitant purchase of non-Zaibatsu equity holdings in that concern.

Every effort should be made, however, to dissolve all excessive concentrations of economic power, rather than to assign them to government ownership or regulation, until and unless the democratization of the Japanese Government has proceeded sufficiently to render it a truly trustworthy instrument for economic control.

b. In connection with non-governmenal purchases, sales to wealthy and economically powerful persons and corporations should be held to a minimum, in order not to lay the groundwork for the creation of a new Zaibatsu class. A decided purchase preference, and the technical and financial aid necessary to take advantage of what preference, should be furnished to such persons as small or medium entrepreneurs and investors, and to such groups as agricultural or consumer cooperatives and trade unions, whose ownership of these holdings would contribute to the democratization of the Japanese economy. Every encouragement should be given such persons and groups to purchase divested holdings, even if they only wish to buy a small proportion of the holdings offered for sale in a given enterprise. In the case of negotiated sales, prices should be fixed with special reference to such purchasers' ability to pay, as should the time period allowed for payment of these prices.

c. No single person, or enterprise, or group of allied persons or enterprises, should be allowed to purchase a number of divested holdings so large as to render probable the future creation of a concentration of economic power approaching in size or character those concentrations defined as excessive under paragraph 2.

d. The purchase of divested holdings in ex-Zaibatsu concerns by the employees of such concerns should be encouraged only if a vigorous effort is made to disperse ownership widely through the working force in question, rather than to concentrate it in a few top executives. To render such dispersion possible, provision should be made for financing these purchases at low prices over a long period of time, possibly through wage deductions. Especial care should be taken to prevent the use of groups of employees in ex-Zaibatsu concerns as purchasing screens for persons disqualified from making these purchases themselves.

e. All sales should be screened to exclude cloakes for Zaibatsu and for other groups who fall under any of the purge directives or purge paragraphs of the Basic Directive.

The criteria specified above should be adhered to regardless of the wishes of non-Zaibatsu stockholders in the enterprises concerned.

9. *Liquidation of Zaibatsu Financial Enterprises*

Divested holdings in Zaibatsu financial and insurance enterprises should be liquidated and disposed of in accordance with the principles laid down in paragraphs 5, 6, and 7 for the liquidation of non-financial enterprises. Policyholders in Zaibatsu insurance companies should be aided in buying stock of those concerns which are now owned by the Zaibatsu, where the condition of these concerns is sufficiently strong so that the policyholders desire to make such purchases. Purchase should be facilitated, under these circumstances, by liberal loans on policies, or payment should be permitted in the form of a reduction in the face value of policies. Zaibatsu insurance companies which are insolvent should be mutualized by cutting back the face amount of outstanding policies, where sufficient assets still exist to render this procedure practicable. In the reconstitution of insolvent financial enterprises, stock held by Zaibatsu holding companies and Zaibatsu individuals should be subordinated to that of other stockholders.

10. *Sources of Credit*

As a fundamental measure to encourage competitive operation of the Japanese economy, the number of independent sources of credit should be increased substantially, although not to the point where the individual banks would be so small as to be unable to secure the diversification of loans necessary to banking safety. The strengthening of local savings banks, and of rural and urban credit cooperatives, as well as of independent local banks, should be encouraged. To this end, the following policies, among others should be adopted:

a. Former owners of independent financial institutions which have been merged with Zaibatsu concerns should be encouraged to re-establish their old enterprises by forced divestitures. In this connection, a procedure should be set up whereby former owners of merged banks, trust companies, or insurance companies should have the opportunity, for a limited period of time, to compel the institutions into which their organizations were merged to divest themselves of assets and liabilities to the extent necessary to reconstitute the absorbed institutions in adequate size.

b. Banks over a size to be specified by SCAP should be required to split themselves into two or more independent units within a stated period, as should other banks deemed by SCAP to enjoy a monopolistic position in the field which they serve. The permissible size should be set at a level sufficiently low to force a significant number of such actions

and thus greatly increase the number of independent sources of credit, but sufficiently high to guard against the dangers or financial insecurity associated with excessively small banks.

11. *Financial Alliances*

Alliances between any financial and non-financial enterprises, and alliances among any financial enterprises, should be broken. To this end:

a. Banks and trust companies should be prevented from investing more than 10% of their capital and reserves in the securities, loans, bills, advances, and overdrafts of any one company.

b. Such concerns should not be permitted to hold, either as an owner of record or as the holder of a benefical interest, in their proper, savings, or trust accounts, the stock of any other company in an amount which exceeds 5% of the outstanding shares of that company, nor to vote any such stock which they may hold. Nor should they be permitted to own any stock in a competitor. Exemption should be made to the percentage rule for stock acquired in connection with bona-fide underwritings and to the percentage and voting rules for stock acquired in default of loans, but any such exemptions should not run longer than one year.

c. Officers and directors of any bank or trust company, and persons holding 5% or more of the stock thereof, should be ineligible to hold any office or directorship or similarly large percentage of stock in any other company. Exception should be made for part-time non-policy making employees, such as attorneys and certifying accountants, but such exceptions should be defined as narrowly as possible.

d. No bank or trust company should be allowed to redeposit more than 10% of its deposits in any one institution other than the Bank of Japan.

12. *Elimination of Financial Discrimination*

To eliminate discrimination in favor of Zaibatsu banks:

a. A system of deposit insurance should be instituted, to diminish the belief among depositors that accounts in Zaibatsu banks are safer than elsewhere. A limit (e. g., of the order of magnitude of ten billion yen) should be set to the total amont of deposits which will be insured for a single bank. A limit should also be set to the amount of deposits which will be insured for a single account.

b. The Postal Savings System should ultimately be required to deposit its funds in ordinary banks, allocating at least 90% of what it receives in any regional grouping of prefectures among the banks having head offices in that region in proportion to the assets of such banks. A bank ineligible for deposit insurance should also be ineligible to receive the redeposits of the postal savings system.

c. Legislation should be introduced to improve the standard of commercial banking and to prevent banks from undertaking business considered unwise for commercial banks. (Performance of investment banking functions by commercial banks should not be prohibited, however, until suitable alternative agents for these functions become available). Such legislation should also assign to the Bank of Japan, or to some other suitable public agency, powers of direction and inspection over other banks, whose activities would be required to conform to statutory provisions regarding capital, reserves, investment policy, and other matters. The discretion which the laws now entrust to the Minister of Finance, in this connection, should be greatly reduced, and his functions clearly defined by law and made subject to check and review by the Diet. His powers to legislate by ordinance and regulation should be strictly curtailed and limited to genuine emergencies. Bank examinations should take place at least every two years.

d. The functions and powers of special banks should be defined and limited by law, and these banks should not be allowed to engage in ordinary banking. The need for the existence of the special banks should be reviewed, in order to determine whether certain of these banks might not revert to the status of ordinary banks.

e. All vestiges of private ownership of the Bank of Japan should be eliminated. The Board of directors should be made representatives of finance, trade, industry, agriculture, and of large, medium, and smaller size business.

f. Competition among banks for customers should be restored through such measures as the abolition of the designated bank system and of the financial control associations.

g. Employees performing responsible functions in the Ministry of Finance and government banks should be forbidden to hold the securities of any financial institution, and should be ineligible for employment by private financial institutions for two years after they leave government employment.

13. *Government Support of Industrial Monopolies*

Laws and practices through which the Japanese Government has favored the growth of private monopolies should be terminated; although that Government should not be deprived of its power to regulate the Japanese economy in the public interest. To this end:

a. Laws and ordinances establishing existing control associations or special companies should be generally repealed and the associations or special companies abolished. The future assumption, by non-governmental agencies, of powers formerly exercised under these laws, should be prohibited. The future assumption, by governmental agencies, of such of these powers as have no major use other than to support monopolistic bodies and practices should also be prohibited. Necessary governmental functions formerly performed by control associations or special companies should be transferred to appropriate governmental agencies, which agencies should be created where they do not now exist. In cases where SCAP is satisfied that current conditions prevent the government from effectively performing these functions, and is further satisfied that effective performance of these functions is necessary for public purposes, he may allow temporary delegation of these functions by the government to the old control associations or special companies or to similar new quasi-private bodies, provided that final decisions are made by the government and that rights of appeal to the government against abuse of powers are provided. All quasi-private bodies exercising such delegated functions should be liquidated as soon as their functions can be transferred to appropriate government agencies, or at such sooner time as SCAP may find the exercise of their functions to be no longer necessary. (For example, where these functions relate to allocation, or price and trade control for reconversion purposes, their performance could be terminated upon the expiration of the reconversion period.)

b. All legislation which forbids, or requires governmental approval of, the entry of any new business into an industry, or the expansion of any business, should be terminated, except in so far as:

(1) the right to effect such a restriction is implicit in the anti-trust legislation suggested below;

(2) the right to effect such a restriction is necessary in order to comply with SCAP directives dealing with industrial disarmament and other subjects;

(3) non-discriminatory restrictions for generally accepted public purposes, such as protecting the public against fraud, and protecting the public health, are concerned;

(4) fields of business activity reserved to the national or local governments are concerned. In this connection, pre-war laws which set up clear-cut government monopolies should be left undisturbed; but, to prevent the use of this type of law to evade other portions of the anti-Zaibatsu program, the creation of new government monopolies during the period of the occupation should be permitted only in cases where they are in the public interest or where their creation is in accordance with the policy for sale of divested holdings to the national and local governments described in paragraph 7 *a* above. The petroleum and alcohol monopolies, which were instituted for war purposes, should be terminated as soon as possible.

c. All laws and practices under which the government has favored specific private or quasi-private enterprises, to the deteriment of potentially or actually competitive enterprises, should be systematically reviewed, and such of these laws and practices as do not have a demonstrable public purpose should be terminated. In so far as any subsidies are allowed to continue, or are granted in the future, they should be controlled by the legislative branch of the government, and provision should be made that hereafter their amount, purpose, and effect be disclosed in public reports.

Principles such as those set forth in the preceding subparagraphs should be made effective, not only by changes in substantive law, but also by provisions giving aggrieved persons the right to attack in the courts any discriminatory subsidy, preference, or other practice.

14. *Anti-Trust Law*

A Japanese anti-trust law should be enacted, prohibiting, among other things:

a. concerted business activity which burdens trade, including, but not by way of limitation to, such activities as fixing of prices, restriction of sales or output, and allocation of markets, commodities, or customers;

b. individual or concerted activity which has the purpose or effect of coercing business enterprises to conform to business policies, or participation in programs carried on by the coercing concern or group which are designed to drive selected enterprises out of any line of business, through means which include but are not limited to intimidation of a rival's customers or sale to a rival at discriminatory prices;

c. the creation of excessive concentrations of economic powers, as such concentra-

tions are defined in paragraph 2; (where considerations of structural or technological unity require the creation of large concentrations, government ownership or strict regulation of these concentrations should be provided for);

d. types of industrial growth and of intercorporate connection which are particularly likely to lead to monopoly or to excessive size, including mergers (i. e., acquisitions of any substantial portion of the capital assets) of going concerns of other than negligible size which are in competition with one another, or mergers of non-competing concerns which might lead to the creation of large scale enterprises capable of developing into an excessive concentration of economic power, where such mergers are not explicitly found to be required in the public interest.

e. types of inter-corporate relations (e.g., these described in paragraph 4 *d*) which restrain competition.

This anti-trust law should be enforced by a specialized angency operating at a high governmental level and exercising broad investigatory and remedial powers. Consideration should be given to including in this agency representatives of the groups most likely to be aggrieved by excessive corporate growth; in any event, special care should be taken not to allow representatives of large scale business, or of political groups sympathetic to large scale business to be named to this agency.

Exemption from the provisions of this law should be provided for the joint activities of cooperatives, where such activities are not coercive or monopolistic, and where they are conducted accordingly to the democratic principles characteristics of genuine cooperatives. Similar exemption should be provided for labor activities other than those involving the restriction of commercial competition, and for natural monopolies and public utilities in so far as they are owned or closely regulated by the government.

15. *Patent Law*

The provisions and the manner of enforcing Japanese patent law should be revised to ensure that patents in Japan cannot be used to support the establishment or perpetuation of concentrations of economic power.

16. *Corporate Law*

The following changes in Japanese corporate law should be effected:

a. Disclosure of relevant facts in selling corporate securities should be required, and the fraudulent practices in connection with such sales should be prohibited.

b. Before any call to a meeting of the stockholders of a corporation, the management of the corporation shall make full disclosure of all the facts necessary for the stockholders to appraise intelligently the proposals to be placed before the meeting.

c. Misleading practices in corporate accounting should be forbidden, and minimum standards of disclosure in such accounting should be required.

d. Inter-locking officerships should be prohibited, and officers of one concern should be prohibited from serving as directors of another. Interlocking directorates should be prohibited in the case of competing concerns and in the case of concerns which rent, sell, or buy goods or services to or from each other in significant amounts. In the case of other concerns, interlocking directorates should be allowed to the point where no more than one fourth of the members of any Board of Directors are at the same time directors of other corporations. No one person should, however, be allowed to serve on the Board of Directors of more than three corporations. Nothing in this paragraph should be taken as in any way modifying the provisions of paragraph 11 *c*. Officers and directors should be prevented from having holdings of shares in competing or supplying concerns, and should be prevented from having holdings of shares in any other enterprises representing more than 5% of their liquid assets or more than 5% of such other enterprises' outstanding shares. Officers, directors, and person having a beneficial interest in or control of any equity issue of a corporation in excess of one percent of the total issue should be required to report their holdings and transactions in all issues of the corporations, and such reports should be publicized. Profits of corporate insiders derived from short-term transactions in the corporation's securities should be subject to recapture by the corporation.

e. An ultra vires action by a corporation should be grounds for remedial action by a stockholder or punitive action by a public agency. Moreover, a corporation should be specifically prohibited from entering partnerships, either directly or indirectly, or in other respects avoiding the limitations on intercorporate relationships.

f. It should be required that all shares having par value should be fully paid, and that equal voting rights attach to all shares of the same issue. The use of no par value shares should be permitted; such shares to be offered for sale at any time at a value to be

decided by the company's board of directors. All corporations should be required to adopt the principle of pre-emptive rights in offering new shares.

g. Every effort should be made to assure the independence of Japanese auditors, who should be prevented from having direct or indirect affiliations with management and from having conflicting interests in other concerns.

h. With stated exemptions for banks, investment trusts, insurance companies, and possibly other types of financial institutions, the Japanese company law should be amended to forbid one corporation from holding the stock of another. The use of 100% owned subsidiaries should be permitted, however (subject to the restrictions on mergers outlined under paragraph 14 *d.*).

i. Stockholders should not be unduly hampered in bringing suits against mangement for money damages or for equitable remedies.

17. *Tax and Inheritance Laws*

In connection with current and impending revisions of Japanese tax law, every effort should be made to favor the wide distribution of income and ownership envisaged in this paper, through the following means:

a. Income and inheritance taxes should be very much more steeply graduated than they are at present.

b. Property inherited by the head of a house should be subject to the tax rates applicable to other heirs.

c. Diffusion of inherited wealth should be assured by provision for reasonably equal distribution among heirs, insofar as estates aggregating considerable wealth are concerned.

d. Members of a house should be prevented from deriving significant tax advantages from the insolvent status of other members of the house.

e. The present discretionary power of the Minister of Finance in tax matters should be greatly reduced. Tax rates should be fixed by the Diet.

18. *Policy Concerning Preferred Purchasers*

Measures specified below should be taken in order to strengthen and democratize preferred categories of purchasers of divested holdings:

a. In order to qualify Japanese cooperatives for purchase preference in connection with divested holdings, such co-operatives should be freed from governmental influence and should be relieved of public functions. They should be subject to government supervision, only insofar as such supervision is necessary to prevent fraud and to ensure compliance with the provisions of this paragraph. Membership in these cooperatives should be voluntary, and requirements for membership therein should be non-discriminatory. (In this connection, the minimum contribution or entrance fee should be reduced to the point where it will form no obstacle to the membership of low income persons.) All participating members should have equal votes and officers should be selected by majority vote. The proceeds should be divided equally among members or in proportion to the relative volume of business, without allowance, beyond a low fixed dividend, for contribution of capital. In addition to being converted into genuinely democratic instruments through these and other changes, co-operatives should be freed from all legal restrictions which prevent them from engaging in various kinds of activities. Specifically, consumers' co-operative societies should be recognized and afforded the same type of privilege as other co-operative societies. The minimum number of members qualifying for registration under the Co-operative Societies Law should be raised from the present figure of seven to levels which will vary for different types of societies but which should be sufficiently hight in each case to prevent domination by minorities. Genuine cooperative societies should receive such public financial and technical aid as may be necessary to their expansion.

b. Where the possibility exists that trade unions might purchase Zaibatsu holdings, all possible technical and financial assistance should be furnished the trade unions concerned, provided that these unions are genuine labor organizations, and are not acting as cloaks for former owners. As a means of providing for trade union ownership of divested holdings, consideration should be given to assigning ownership of divested holdings to co-operative societies organized especially for this purpose, with a membership parallel to that of trade unions.

c. Small entrepreneurs desiring to purchase divested holdings should be given all possible public assistance so that they may compete on more advantageous terms with large scale business. The Japanese Ministry of Commerce should establish a bureau specifically devoted to aiding such small business. This bureau should give special support to the performance of joint activities of an unrestrictive character by such mutual-aid organizations

of small entrepreneurs as manufactures' guilds and export guilds. Precautions should be taken, however, against domination of these guilds by the government or by the larger firms; nor should they be permitted to engage in such of their former activities as were in restraint of trade.

19. *Public Support*

Vigorous efforts should be made by SCAP to create Japanese public understanding of, and support for, the anti-Zaibatsu program through such means as:

a. provision for access to recent literature in English about the problems of industrial organization;

b. publication of SCAP's factual findings about the Zaibatsu;

c. encouragement of the organization of a Japanese commission of inquiry, representative of a wide range of interests and opinions, to investigate the facts about the Zaibatsu and make public its recommendations;

d. attention to the problems of industrial organization, and the dangers of monopoly and excessive concentration of economic power in the revision of the Japanese educational system;

e. provision for contact between the Japanese antitrust agency and similar bodies in other countries.

A special attempt should be made to furnish relevant data to, and to secure the support of, those groups whose economic interests are most acutely promoted by the dissolution of the Zaibatsu: consumers, small and medium-size businessmen, trade unions, and co-operatives.

20. *Japanese Government*

An attempt should be made to deprive the Japanese Government of its former pro-Zaibatsu character, and to prevent renewed alliances between the bureaucracy and business interests:

a. SCAP should make every effort to see that new public agencies established in order to carry out the anti-Zaibatsu program envisaged in this paper are staffed with individuals not previously associated with or sympathetic to large scale business or its political spokesmen. Economist and other intellectuals or technical experts hitherto debarred from government work because of their anti-imperialist or anti-Zaibatsu views would be desirable recruits.

b. In view, however, of the limited availability of such persons, and of the uncertain political complexion of the present Japanese bureaucracy, SCAP should reduce the discretionary policy-making authority of that bureaucracy in so far as the more important issues related to this program are concerned. In economic matters at least, the Japanese bureaucracy should not be left in a position to usurp the functions of the legislative branch of the government.

c. Existing government officials performing responsible functions relating to the control or regulation of private industrial, commercial, or financial enterprises should be discharged where, because of their past employment in Zaibatsu concerns or other previous private or public actions, they are believed sympathetic to Zaibatsu interests.

d. Government officials performing responsible functions relating to the control or regulation of private commercial, industrial, or financial enterprises should be prohibited from holding the securities of any one such private enterprise in an amount which would represent more than 5% of the official's total wealth, or more than 1% of the enterpriser's capital value. Reports of all security holdings by such government officials should be made public. Such officials should also be prohibited within a period of two years after their leaving of government employ, from accepting private positions which involve their representing, directly or indirectly, private enterprises before the government bureaus with which they were formerly associated, or from holding positions in any private enterprise which is the object of legal action as a result of its alleged violation of any of the measures specified in this paper.

e. Special procedures should be set up to make public the names of government officials holding responsible positions relating to the control or regulation of private, commercial, industrial, or financial enterprises, so that anti-Zaibatsu groups and persons may scrutinize their past records and protest publicly against appointments which they consider unsuitable.

f. The principle of private redress for injury suffered as a result of governmental action should be recognized in Japanese law.

21. *United Nations and Neutral Interests*

In the application of measures specified in this paper, SCAP should protect the interests of nationals of members of the United Nations in Japan, in so far as this can be accomplished without limiting the effectiveness of these measures. In general, his objective should be to provide adequate, prompt and effective indemnification for property taken from such interests to the extent feasible. He should also keep full records or any change in the status of such interests which may result from the application of these measures.

22. *Non-Profit Corporations*

An exception should be made to the provisions of this paper affecting interlocking officerships and directorates insofar as these provisions concern non-profit corporations which are devoted to public, charitable and cultural purposes and which do not hold securities of other corporations.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

6-19 DISSOLUTION OF TRADING COMPANIES

Memorandum July 3, 1947
SCAPIN-1741 (ESS/AC)

1. References are:

a. Memorandum to the Japanese Government from General Headquarters, Supreme Commander for the Allied Powers, AG 004 (6 Nov 45) ESS/ADM, (SCAPIN-244), dated 6 November 1945, subject: Dissolution of Holding Companies.

b. Memorandum to the Japanese Government from General Headquarters, Supreme Commander for the Allied Powers, AG 091.3 (23 Jul 46) ESS/AC, (SCAPIN-1079), dated 23 July 1946, subject: Ordinances and Regulations Affecting the Holding Company Liquidation Commission.

c. Ordinance No. 233 of 1946.

d. Letter of Designation from the Prime Minister, dated 28 December 1946, Cabinet A 449.

2. In implementation of reference Memoranda and Ordinance, the following action will be taken:

a. Immediate commencement of dissolution and liquidation of the Mitsubishi Trading Company and the Mitsui Trading Company.

b. Prohibit the conduct of any business transactions or the transfer of any assets by said companies without the permission of the Holding Company Liquidation Commission, or such other agencies as may be designated, on and after the date of this memorandum.

c. Prohibit any persons who have been officers, directors, advisors, branch managers of foreign or domestic branches, or department or section heads of said companies, during a period of ten (10) years prior to the date of this memorandum, from associating together to form a new company, or more than two (2) being employed by or advising any one (1) existing company or company hereafter formed.

d. Prohibit any group of employees in addition to those specified in paragraph c, above, exceeding one hundred (100) in number, from organizing a new company, being employed by any one (1) existing company hereafter formed, without permission of the Holding Company Liquidation Commission or such other agencies as may be designated. The Holding Company Liquidation Commission or such other agencies shall grant such permission if it shall conclusively appear that a possibility of recreation of the dissolved companies or other monopolistic combinations shall not result.

e. Prohibit any trading company in which any officers or employees of both said companies shall be employed from occupying any office now used or formerly used by either of said companies as a business office, and further prohibit any company from using the firm name Mitsubishi Trading Company or Mitsui Trading Company, or any resemblance thereof.

f. Require said companies to immediately prepare, in detail, inventories of all assets, showing location, and submit same to the Holding Company Liquidation Commission.

g. Require the maintenance of all existing books and records of said companies.

3. In carrying out the provisions of the memorandum:

a. All assets of said companies shall be disposed of in accordance with existing legislation and ordinances, by open market sale, or in such other manner as may be fair and equitable.

b. The Holding Company Liquidation Commission may remove any officers of said companies or appoint officers to act as liquidators.

c. The Holding Company Liquidation Commission may require the companies to

furnish reports and information or inspect any books or records.

4. The Japanese Government shall immediately furnish to the Supreme Commander for the Allied Powers a report of action taken in compliance with this memorandum.

6-20 ECONOMIC RECONSTRUCTION AND REORGANIZATION STANDARD LAW

Draft July 18, 1947
To: Japanese Government
Forwarded by: E. C. Welsh[18]

1. The purpose of this law shall be to insure that measures taken for Japan's reconstruction are consistent with peace time and democratic purposes and to lay the ground work for building a healthy and democratic Japanese economy.

To this end, it is desirable that the Japanese economy be reorganized and that concentrations of economic power be eliminated at the earliest possible date.

2. Concentrations of economic power designated under Article 3, which shall have existed on 1 July 1947, or which shall have been in existence at any time between 1 August 1945 and 1 July 1947, shall be eliminated as being in accordance with public welfare. It shall be the duty of HCLC to eliminate such concentrations of economic power which shall include:

a. Any enterprise of monopolistic or potential monopolistic characteristic or engaged, or having been engaged, in unrelated fields of activity or controlling. or having controlled, other enterprises engaged in related or unrelated fields of activity.

b. Cartels, combines, syndicates, trusts, combinations, associations, or other forms of understanding or concerted undertaking, between persons or devices which have or had the purpose or effect of restricting competition, eliminating competitors, consolidating competitors, or fostering monopolistic control of domestic or international trade or other economic activity, or of restricting access to domestic or international markets.

c. Concentrations of wealth in any individual or family which have been used to exercise control over enterprises or which constitute a potential threat of the exercise of such control.

3. Only such concentration of economic power which shall be designated by HCLC prior to 1 August 1948 shall be subject to this law.

4. In determining what shall constitute concentration of economic power among the factors to which consideration shall be given are the following:

a. Percentage of total production or other economic activity in the field in which the enterprise operates or operated, which is or was produced or controlled by such enterprise: comparison of present production capacity with production capacity existing prior to 1937, and comparison of percentage of present production capacity with percentage of production capacity prior to 1937: control over other enterprises operating in the same field or in unrelated fields.

b. The number and geographic location of plants operated by any enterprise: whether such plants are interrelated in productive processes and extent of such interrelation, products produced, use of raw materials or in markets for products: control of raw materials: mergers of previously existing independent enterprises or portions of enterprises: the efficiency of production of the whole unit as contrasted with the efficiency of production of its separate parts or combination of separate parts.

c. Participation of any enterprise in or the existance of any contract, agreement, other arrangement or relationship, including exclusive sales or purchasing companies, designated agents, agents association, or other similar arrangements of a restrictive or monopolistic character, or which tends or tended to create special privileges in the purchase or sale of materials, to restrict production or distribution, or to fix prices or allocate business or sales territories, or which provide for the exclusive exchange of patents or technical information.

d. Any individuals or number of families which have exercised control over substantial business activity or whole liquid wealth shall make such individual or family potentially capable of exercising control over substantial business activity.

5. HCLC shall take such action in regard to the elimination of concentrations of

[18] Chief, Anti-trust and Cartels Division, ESS, SCAP.

economic power subject to this law as it finds appropriate to accomplish the purpose thereof, including dissolution, liquidation or reorganization of enterprises or associations: prohibiting juridical persons or natural persons from engaging in such activities or performing such acts as might perpetuate concentration of economic power: cancellation of obligations of cartels, syndicates, trusts, exclusive purchase or sales agent, companies or as a organizations of a monopolistic or restrictive character, and shall, to the extent appropriate, carry out the provisions of the law and have the power to:

a. Issue such rules, regulations, orders, directives and definitions as may be deemed appropriate:

b. Determine the principles, plans and procedure for the eliminations of concentrations of economic power subject to this law:

c. Consider reports and proposed plans for elimination of concentrations of economic power and activities subject to this law and for the establishment of deconcentrated or reorganized productive units.

d. Investigate, collect and compile information concerning the properties, products, ownership, management, control, organization, business and business conduct of any person or enterprise in its relation to other persons or enterprises wherever situated.

e. Require the compilation and submission of information and keeping of records: seize or require the production of records, books or accounts, contracts, agreements, correspondence or papers: require the attendance and testimony of witnesses under oath and the production of evidence.

f. Take possession of, hold or require the conveyance of property, conversions of property of individuals or families into non-negotiable securities, direct the termination or dissolution of any contract, enterprise, arrangement or relationship, and take such other measures as it may deem appropriate and consistent with the provisions of this law: require designated enterprises or persons to submit plans for the disposal of assets or other appropriate action for the purpose of compliance with this law: approve such plans: prepare plans of reorganization for enterprises for the purpose of compliance with this law and appoint receivers with power to execute same: supervise the execution of any plan of reorganization, dissolution, liquidation, or disposal of property: and prohibit unauthorized transfers of property or other activities by such enterprise or person prior to such approval.

6. Any order of the HCLC directing or approving a plan of reorganization or dissolution of any enterprise, disposal of properties, or the prohibition of activities required by this law, shall be in writing, and, except in the case of voluntary plans of reorganization, be accompanied by written findings of fact. A proposed order, findings of fact (except in the case of voluntary plans of reorganization) and plan of reorganization, shall be transmitted to the FTC and all interested persons, and a hearing by HCLC shall be held at a date not earlier than fifteen (15) days after the date on which such order was transmitted at which all persons may make objections or recommendations to such proposed order, findings of fact and plan or reorganization. In case any conflict exists with the provisions of the Antitrust Law, FTC shall indicate such conflict. On the basis of such objections and recommendations, HCLC may make such changes in its proposed order or findings of fact as shall be deemed appropriate. Transmission of the proposed order may be by public notice.

7. A plan of reorganization shall not be approved by HCLC unless it shall accord fair and equitable treatment of creditors, security holders and shareholders. A plan of reorganization shall not require approval of shareholders, members, security holders, or creditors, and may provide for the modification of the rights of creditors, security holders or shareholders. Such persons shall have the right to raise objection at the hearing provided for in the preceding article.

8. If any findings of fact shall not be supported by substantial evidence, or if HCLC shall have refused to consider substantial evidence, an appeal may be made to the Prime Minister within six (6) days after issuance of the final order: providing however that no such appeal shall be made unless such omission shall have been specifically raised at the hearing, provided for in Article, 6, or if such facts shall have been wilfully withheld from HCLC. Within fifteen (15) days after such appeal is taken, the Prime Minister shall determine whether such omission is of such a substantial character as to render the order arbitrary, in which case the order shall be returned to HCLC for proper modification. The enforcement of the order shall be suspended during the period an appeal may be taken and until a decision shall have been made.

9. Definitions:

As used in law:

a. The term "person" shall mean any natural or juridical person existing under public, private, or special law, including associations, companies or partnerships.

b. The terms "enterprise", "activity" and "relationship" shall include every kind of economic, business or financial instrumentality or person, whether in the form of cartel, trust, combine, syndicate, stock company, partnership, association, concern, aggregate of firms or bodies, or otherwise, and whether related by agreement, combination, association or understanding.

c. The term "control" shall include every kind of economic business or financial relationship which has the effect of establishing common or concerted action among two (2) or more business units whether in the form of majority or minority stock participation, direct or indirect power to vote share, ownership of certificates or other evidence of indebtedness carrying management privileges, personal relationships, such as, common offices or directorships, contractual agreements or arrangements, or other relationships having like effect.

d. As "enterprise of monopolistic or potential monopolistic characteristics" shall include any enterprise which has or may have influence in any field of activity which shall have resulted from merger of independent enterprises or excessive expansion of activities during the period between 1937 and 1 September 1945 in relation to its previously existing position in the field of activity. "Influence" shall mean control sufficient to have an effect upon the price and or flow of capital, flow of goods or services if the activity of the enterprise were withdrawn from the market.

e. "Production capacity" shall mean degree of production obtainable by maximum normal use of production facilities.

f. "Unrelated fields of activity" shall include those fields of production which are not dependent upon each other in productive process: which are not stages of production relating to production of same final product: or which are activities which are capable of being carried on independently for productive or marketing purposes.

g. "Plant" shall mean any business unit located at one site.

h. "Independent enterprise" shall mean any enterprise having separate juridical existence. The fact that any enterprise is or was controlled by any other enterprise, or dependent upon any other enterprise in any manner whatsoever, shall not affect its status as an independent enterprise, if, in fact, it had separate juridical existence.

i. "Efficiency of production" shall include consideration of whether quantity of output or unit costs will be affected by changing the organizational structure of the enterprise.

j. "Domestic and international trade" shall include local, national, or international trade in any particular commodity or field.

k. The term "competition" and "competitor" shall include actual or potential competition or competitors.

l. "Wealth" of an individual or family shall include value of property of all enterprises owned or controlled by such individuals or families.

10. This law shall not be constructed as in any manner repealing, modifying or amending the law relating to Prohibition of Private Monopolies and Preservation of Fair Trade. Nor shall this law preclude FTC from taking any action under the Antitrust Law even though similar action might be taken by HCLC under this law.

11. The fact that any concentration of economic power shall have been authorized or permitted by law, or whether its creation shall have been voluntary or involuntary, shall not preclude its elimination if subject to this law, nor shall HCLC be precluded from taking necessary action to prohibit the perpetuation of concentrations of economic power subject to this law in any other form in the event its organization shall have ceased to exist, been liquidated or dissolved, or shall be in the process of liquidation or dissolution, or shall have been changed.

12. Enforcement of orders issued by HCLC pursuant to Article 5, subparagraph (f), shall be by FTC. Petition for modification of such order shall be made to FTC, provided, however, any such order shall not be modified without the prior approval of HCLC before 1 August 1948 and except in accordance with the provisions of separate law.

13. HCLC may delegate to FTC, in part, its functions to be performed under this law, and may use other agencies of the Japanese Government to the extent necessary in carrying out functions to be performed under this law. By separate law, on or after 1 August 1948 and on/or prior to 30 December 1948, provision shall be made for the transfer to FTC of the functions, powers, records, and such personnel as are necessary for the purpose of completing the effective carrying out of the objectives of this law.

Supplementary Provisons

HCLC law shall be amended to provide for the following:

1. HCLC shall be an agency of the Japanese Government within the office of the Prime Minister.

2. The accounts of HCLC shall be subject to examination by the Board of Audit.

3. Amend Article 5 to provide that the terms of office of the commissioners shall terminate as of the date of final transfer of functions, etc., to FTC.

4. Amend Article 6 to provide that the Commission shall have a chairman, four (4) executive commissioners, and four (4) ordinary commissioners.

5. Amend Article 9 to provide for HCLC's carrying out of the functions specified in this law.

[SOURCE: MITSUDO PAPERS, MINISTRY OF FINANCE]

6-21 HOLDING COMPANY LIQUIDATION COMMISSION BILL

Memorandum (ESS) August 6, 1947

To: Brig. General W. F. Marquat

From: Theodore Cohen, Advisor on Economic Programs, SCAP

1. The memorandum is submitted pursuant to oral instructions from you on 4 August to examine present situation of HCLC Bill and make recommendation for solution.

FACTS

2. In brief, this Bill in question authorizes the already existing Holding Company Liquidation Commission to take appropriate action to break up all concentrations of economic power. Up to now the HCLC has merely been an agency for liquidating designated holding companies.

3. The present bill had its inception in a Government Section recommendation of 19 June 1947 to assign such power to the HCLC. ESS concurred shortly thereafter. Antitrust and Cartels Division then worked out with Government Section the present draft of the bill, to which Colonel Kades gave Government Section concurrence orally. Mr. Welsh has been pressing the Japanese Government for enactment in the present Diet Session, which begins on 10 August 47. The Japanese Government, which was considering some such measure on its own, does not like the bill in its present form, but apparently with take it if pushed.

4. Coordination on the bill within GHQ has been incomplete. Other ESS divisions concerned have concurred only in the principles of the law and not the law itself. On top of this, the Government Section has changed its mind and Government Section representative now states that General Whitney believes the bill in its present form is unconstitutional and therefore should not be enacted as a law, but that if ESS insists on its present form it might be issued as a Cabinet Order pursuant to a SCAPIN.

5. The entire action is being taken as an implementation of FEC 230, dated 12 May 1947, subject: Policy on Excessive Concentrations of Economic Power in Japan, which has been submitted by the U. S. member to the FEC for approval, and is therefore U. S. Government policy.

DISCUSSION

6. The principal objection raised within both ESS and Government Section is that the HCLC is given enormous power and excessive discretion which gives it the power of life and death over Japanese business. The HCLC is guided only by a series of vague criteria for determining excessive economic concentrations, and right of appeal is provided by the bill only to the Premier. The HCLC is not required to limit its actions to those necessary to accomplish its purpose, nor even to those most appropriate or preferable. The HCLC may take any action—dissolution, separation of companies, termination of contractual arrangements etc.—which it (the HCLC) deems appropriate. As an illustration of the broad powers granted to HCLC as the bill is now written, it even has the authority and the duty to dissolve the Kodans. Finally, the HCLC is granted powers which the Fair Trade Commission has already been granted by the Antitrust Law.

7. Such a broad grant of powers to the HCLC appears inconsistent with paragraph 20b of FEC 230, which states:

"In view, however, of the limited availability of such persons, and of the uncertain political complexion of the present Japanese bureaucracy, SCAP should reduce the discretionary policy-making authority of that bureaucracy insofar as the more important issues related to this program (the deconcentration program) are concerned. In economic matters at least, the Japanese bureaucracy should not be left in a position to usurp the functions of the legislative branch of the government.

8. Such a broad grant of powers is likely to cause widespread criticism—from the "left" on the grounds that SCAP in divesting itself of its clear duty to break up economic concentration by turning it over to the Japanese who will do little or nothing, and from the "right" on the grounds that SCAP is turning Japanese business over to the mercy of a "Socialist bureaucracy" while annulling constitutional safeguards. The likelihood of criticism is made more pronounced by reports of informal conversations already held at the Press Club by ESS personnel who criticized the broad powers granted by the bill.

9. The issuance of a SCAPIN directing the Japanese to pass this bill would remove the onus of violating the Constitution from the present Japanese Government but would place the onus instead squarely on SCAP. In any event, it would not improve the bill itself. This action furthermore would appear to be a detailed implementation of general policy already communicated to the Japanese by an early SCAPIN and one which the Japanese Government appears willing to accept in substance without a directive. In effect, it would go far beyond a policy desire of the Supreme Commander and instead would formally direct the Japanese Government on the organization and operation of its own agencies to effect this policy.

10. Even though much of the Antitrust and Cartels Division action has been uncoordinated and has not received the specific approval of the Chief of ESS, it is desirable that they be supported as far as possible in their relations with the Japanese Government. In is therefore desirable not to let the action drag too long, or make excessive changes in the bill as written.

Conclusions

11. The bill as it now stands appears to grant overly broad powers to the HCLC, which makes it on the one hand unconstitutional and on the other inconsistent with FEC 230.

12. Necessary modification of the bill to make it constitutional and consistent with FEC 230 should be restricted to a minimum of new wordage and should be achieved within the next few days. However, circumstances do not appear to warrant pressuring through an undesirable bill just to save time.

13. Coordination on the bill should be achieved within ESS to insure that the missions of the various ESS divisions are not jeopardized.

14. No SCAPIN should be issued directing the Japanese Government to take the action. After the JG has taken the action by due legislative process, a SCAPIN might be issued making the HCLC in its newpowers subject to SCAP review.

Recommendations

15. The bill should be modified along the lines recommended in Tab A.

16. A conference of ESS divisions should be held in the next day or so to coordinate and achieve concurrence within the Section on the proposed modifications.

17. Formal concurrence of Government Section shall be obtained to passage of the new modified bill by the Diet.

18. Antitrust and Cartels Division should be designated to implement these recommendations.

(Enclosure: Tab A)

Proposed Modifications to HCLC Bill

1. To exempt Kodans and other agencies established with SCAP approval from compulsory dissolution by HCLC, it is proposed that the following clause be inserted at the beginning of Art. 2:

"Except for corporations, associations and enterprises established by law subsequent to 2 September 1945 and prior to 1 August 1948."

2. To prevent indefinite perpetuation of HCLC powers in duplication of Fair Trade Commission Powers, it is proposed that these powers be accorded HCLC only until 1 August 1948 by adding the following clause to Art. 3:

"and on that date the powers accorded by this law to Holding Company Liquidation Commission shall be transferred to the Fair Trade Commission."

3. To further define and specify concentration of economic power without delaying the bill, it is proposed to substitute the following for the first paragraph of Art. 4:

"Specific standards determining concentrations of economic power shall be established by Cabinet Order in accordance with the following considerations:" (there follows a list of criteria such as excessive proportion of production, unrelated corporate activities, efficiency, etc., already in the bill).

4. To avoid irresponsibility on the part of HCLC in its actions and to insure that such actions be not only appropriate but also necessary to "are necessary and appropriate" be substituted for the words "it finds appropriate" in line 2 of Art. 5.

5. In order to ensure the constitutional right of appeal, and clarify judicial proceedings, to avoid over extended litigation, it is proposed that the following sentence be added to Art. 8:

"Legal appeals and actions arising out of rulings of the Holding Company Liquidation Commission shall be taken to the High Court in the first instance."

[Source: Suitland Papers Z 703-12]

6-22 ESB'S REPORT ON ELIMINATION OF EXCESSIVE CONCENTRATION OF ECONOMIC POWER

Report — August 22, 1947
Economic Stabilization Board

Designation of Enterprises and Standard for Elimination.

1. Enterprises to be exempted.

It will be specified in the law that the following enterprises will be, as a rule, exempted from the application of the law. HCLC, however, will be in aposition to designate certain of those enterprises as an exemption to the rule when deemed specifically necessary.

a. Any concern of which the authorized capital had not amounted to ¥10,000,000 at any time between August 1 1945 and July 31 1947, will not be regarded as a concentration of economic power.

Remark: Any concern of smaller scale with less than ¥10,000,000 capital will not be made a subject worthy of discussion as the concentration of economic power irrespective of what line of business they are engaged.

b. Railroad, Electricity, Gas, Water Supply and other public utility enterprises under Government control, and financial institutions in so far as their activities in the proper field are concerned, will not be regarded as the concentration of economic power.

Remark: All public utility enterprises are by nature monopolistic and controling as long as their proper field of activities are concerned and for that reason will not be regarded as the concentration of economic power. As for financial institutions, it is believed necessary to have a certain magnitude of scale either from the nature of the business requiring creditability or from the viewpoint of protection of depositors and policy holders.

2. Standard for elimination of concentration of economic power.

a. Activities of a concern in unrelated fields will, as a rule, be dismembered. Exceptions will be made in case, judging from their nature and scale of business, there exists no evil effect. Especially when the activities are carried on as a part of a unit plant, due considerations will be given so as not to impair the entirety of the plant.

Remarks: A plant is an organic unit in which various producing processes are integrated. Examples given: Kurozaki Plant of Mitsubishi Kasei & Miike Plant of Mitsui Kagaku.

b. Business operations are regarded as related when,

(1) same equipment is in use (such as alminium and chemical fertilizer).

(2) same raw materials are used (such as rolling and casting of non-ferrous metals).

(3) prior stage and or post stage of production are involved producing raw materials, materials, semi-products, parts and processed goods, with the exception of such cases as its control on post stage is incomparably, ex-

cessive compared with its business scale in prior stage thereby causing a possible monopolistic influence upon other concerns (mining and refining in mining industry, electric steel ingot and electric steel plate, electric wire and electric machines etc.)

(4) such auxiliary operations as utilization and repairing of wastes (machine and tool repairing shop attached to the main plant).

(5) production of substitute for the primary products (artificial camphor as against natural camphor).

c. Any enterprise of monopolistic or potential monopolistic characteristic having excessively expanded its business activity by means of merger, expanding or purchasing facilities or others during the period from 1937 to July 31st, 1945, will be dismembered, in principle, its expanded parts, even if they are related activity.

Exceptions, however, will be set force in such cases as coming under any one of the following items and deemed it to be reasonable.

(1) In cases of the fair competition being secured as having powerful competitors, a large scale of enterprise or having more than two plants will not be deemed as the concentration of economic power.

Remarks: In metal mining industry, powerful enterprises such as Nihon Mining Co., Mitsui Mining Co., Mitsubishi Mining Co., or Furukawa Mining Co., are competing with one another and there are no threats of monopoly.

(2) In case of enterprises, specially in Mining industry, which are required to exploit successively new resources due to their scattered deposits and also to have considerably large amounts of capital, having more than two mines or having a large size of enterprise will not be deemed as the concentration of economic power.

In such cases that only one enterprise is allowed to be economically in existence due to the concentrated deposit of resources in a certain district, that enterprise will not be deemed as the concentration of economic power even if there exists not any other competing undertakings.

Remarks: Coal Mining Division of Mitsui Mining Co. have mines in Kyushu and Hokkaido, due to the Natural restrictions of resources deposits and also to the requirement of new exploitation of resources. It cannot be deemed that it has unreasonably expanded.

In case of concentrated location of deposit of resources as in petroleum mining of this country, enterprises will not be forcibly dismembered, even if there is not a powerful competitor. If they are dismembered, it will become impossible to carry on new exploitation.

(3) If the business management on the expanded scale can be regarded as reasonable development viewing from the business efficiency, this will not be deemed as the unfair concentration of economic power.

3. Coal Mining industry will be put aside of the objects of this law as the control and managing of coal mining will be directly carried on by the State.

4. In applying this law to the key industries of the state, dismemberment of enterprises may create various adverse effects.

In order to save such effects, it is required to make up fundamental policy of overall reorganizing industries. The execution of this law or deciding the reorganization of enterprises mentioned above is required to be postponed until the fundamental policy is established.

Remarks: Idle plants, when dismembered from the enterprise, are impossible to continue itself as a independent profitable undertaking.

It is necessary to establish beforehand overall programs on rationalization of industries as for countermeasures on idle facilities and unemployed.

[SOURCE: *Eibun Sengo Shiryo*, Vol. 3, Economic Planning Agency]

6-23 REPORT ON CONDITIONS IN JAPAN AS OF SEPTEMBER 6, 1947

Private Report[19] September 6, 1947

Prepared by: James Lee Kauffman

So long as present conditions continue in Japan I believe it inadvisable to make any

[19] Usually known as the "Kauffman Report".

investment in that country in dollars or the equivalent. The reasons on which this conclusion is based and which I believe merit no other recommendation will, I hope, become abundantly clear in this report.

That the occupation of Japan as a military accomplishment was most successful no one can gainsay. But that aspect of the occupation was completed some months ago. Certainly for the past year the emphasis should have been upon the restoration of the Japanese economy. So far this phase of the occupation has not been successful, much to the delight of several hundred Russians who are attached to the Soviet Embassy in Tokyo and who are wishing and waiting for the economy of Japan to collapse.

Heretofore the purpose of an occupation was to demilitarize the occupied country, restore order and protect and conserve property until a peace treaty was concluded. Demilitarization was deemed to have been accomplished when the conquered nation was physically disarmed and the implements of war including the plants for producing war were destroyed. In Japan, however, it was decided that demilitarization included the complete reformation of its ideology. One of the means for bringing that about is the imposition of an economic theory which has, I believe, no counterpart anywhere else in the world. It is not Communistic and certainly it is not that practiced in our country. It probably approaches more closely the socialistic ideal than anything else. Japan has now become the great economic experiment which has attracted many Americans who were formerly employed in bureaus and regulatory bodies in Washington.

This experiment is being carried on by Army officers, former Army officers, economic theorists and a few persons with some business experience. Those in the policy making level and their advisers are all very diligent and sincere, while many in the lower echelons appear to have nothing to do but to wait for closing time. Most offices look to be greatly over-staffed. Everyone appears to have lost the ability to walk even a few steps. Transportation seems to be a vital necessity and much time and effort is spent in obtaining it. A person's importance seems to be measured by the kind of transportation he is furnished just as it is by the hotel at which he is billeted. There is more face saving, it seems, among the occupational personnel than there is among the Japanese.

No one can criticize an Army officer for not being an economist or a business man. In this highly specialized world if one has some real knowledge in a single field, he is fortunate. Gen. Marquat is the head of the Economic and Scientific Section of the Occupational Government, which will be referred to as S. C. A. P. This section more than any other holds the power of life and death over the Japanese economy. The General is a very sincere and hard working man with probably no former economic training or business experience. He is just what he says he is "a good anti aircraft officer". Yet the fate of Japanese business life is largely in his hands.

Army officers found upon arrival in Japan that there were many civilian positions in S. C. A. P. more remunerative than their Majorities or Colonelcies, so a large number changed their clothes to their monetary advantage. The higher echelons are therefore either Army or former Army and are not qualified by knowledge or experience or fitted for the work they are trying to do.

The economic advisers to those in authority are for the most part either former instructors of universities who have also served some years in one of the many bureaus in Washington, or recent graduates from college. Few of these men have had any practical experience. The few business men in S. C. A. P. with real experience are not in the policy making level. They are employed to carry out policies, not to make them.

In Tokyo alone there are thousand of officers and civilians employed in the office of S. C. A. P. at salaries ranging from five to ten thousand dollars a year. The hotels where one can get good meals and a comfortable room with bath for forty dollars a month are run by the Army. All resorts—hotels have been taken over also by the Army and are either free or a nominal charge is made. Effective September 1st automobiles for recreation cost 25¢ an hour. Before that they were free. The Army sees to it that there are many amusements and plenty of recreation, so life is much easier, cheaper and pleasanter for both Army and civilian personnel than at home. Naturally under these conditions if the personnel have anything to say about it, the occupation will continue indefinitely.

All of this extravagance might be tolerated were it not for the economic theory being foisted upon the Japanese which may result in an economic collapse which will to a large extent destroy all the good will so far gained by the occupation.

S. C. A. P. proposes to create in Japan what it terms a "democratic Japanese economy" and "to this end, it is desirable that Japanese economy be reorganized and concentrations

of economic power be eliminated at the earliest possible date". There is no definition in writing so far as I have been able to learn of what is meant by a "democratic Japanese economy" but whatever that term may mean, in this instance it is proposed to distribute the wealth of Japan to the workers, farmers and small traders through the medium of taxes, sales of valuable properties at nominal values, financial assistance, regimentation and regulation.

Under date of May 12, 1947 the Far Eastern Commission at Washington issued a document directed to S. C. A. P. in Japan known as F. E. C. 230. Until quite recently this document was confidential. The letter of transmittal states that the dissemination of the information contained in the document to unauthorized persons or to the press is forbidden. Thus, the interests of American business which are obviously effected by the plan set forth in this document and the American people whose future well being may be seriously jeopardized by what was directed in it were kept in complete ignorance of its contents. This document, which was first drafted in Tokyo and sent to Washington for approval if the usual procedure was followed, is a most complete and detailed statement of how a "democratic Japanese economy" is to be effected.

In paragraph 17 it is said, "In connection with current and impending revision of Japanese tax law, every effort should be made to favor wide distribution of income and ownership envisaged in this paper, through the following means.

(a) Income and inheritance taxes should be much more steeply graduated than they are at present.

. . . . . .

(c) Diffusion of inherited wealth should be assured. * * * *"

In providing for the disposition of the property of the Zaibatsu (plutocracy) which is the term commonly employed to describe the large family holding companies subparagraph a of paragraph 6 states: "The overriding objectives should be to dispose of all the holdings in question as rapidly as possible to desirable purchasers; *the objectives should be achieved even if it requires that the holdings be disposed of at a fraction of their real value. In negotiating sales of divested holdings to desirable types of purchasers, the purchaser's ability to pay, rather than the real value of the holdings, should effect the fixing of the price and terms of payment*". Under such a directive an administrative official with a donative turn of mind could give away much of the wealth of Japan.

On the same subject the directive describes "desirable types of purchasers" in subparagraph b of paragraph 8. "A decided purchase preference, and the technical and financial aid necessary to take advantage of that preference should be furnished to such persons as small or medium entrepreneurs and investors, and to such groups as *agricultural or consumers cooperatives and trade unions*, whose ownership of these holdings would contribute to the democratization of Japanese economy.". In passing it is interesting to note to date agricultural cooperatives have been organized either by rich farmers or leftists for the purpose in both instances of taking advantage of the ignorant farmers.

While F. E. C. 230 deals with the liquidation of the holdings of the Zaibatsu it is by no means confined to that subject. Businesses in no way connected with the large family holding companies are to be split up if, by the whim of some bureaucrat in Tokyo operating behind a dummy Japanese committee as a front, they constitute an excessive concentration of economic power. This term has been variously defined in the document, one of which is "a material potential threat to competitive enterprise". To one with an imaginative turn of mind this would include most enterprises.

It is proposed to split up the banks on the theory "The permissible size should be set at a level sufficiently low to force a significant number of such actions and thus greatly increase the number of independent sources of credit, but sufficiently high to guard against the dangers of financial insecurity associated with excessively small banks." (Subparagraph b of paragraph 10.)

Not only financial institutions but all business is to under the knife of the economic quack for "any private enterprise conducted for profit, or combination of such enterprises, which, by reason of relative size in any line or the cumulative power of its position in many lines, restricts competition or impairs the opportunity for others to engage in business independently" is to be split into as many small units as some gentleman sitting in Tokyo may deem appropriate.

As one of the steps for accomplishing this, and which is of particular interest to foreign patent owners, the directive provides: "Where units in question hold license under Japanese patents owned by foreigners, under terms incompatible with the sense of this paragraph, these terms should be renegotiated. Where the licensor will not agree to renegotiation, the Japanese unit should cease utilizing the license, so that the Japanese Government can cancel the patent or open up the patent to licensing on non-discriminatory terms....."

Many more specific provisions could be cited to illustrate the economy which is being saddled on the Japanese people, but it is hoped that enough have been quoted to demonstrate conclusively that economy is not ours. It is good old socialism masquerading as "economic democracy."

This policy has been implemented by laws which Japan has already been forced to pass, such as the "Law Relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade," promulgated April 12, 1947, the Enterprise Reconstruction and Reorganization Law, promulgated October 18, 1946, the Labor Standard Law, promulgated April 5, 1947, Securities and Exchange Law, promulgated March 27, 1947, the Income Tax Law, promulgated March 31, 1947, the Law of Special Treatment for Establishing Self Cultivated Farms, promulgated October 19, 1946. SCAP also intends to have the Japanese Government enact several other laws one of which is sweeping and general in its terms and may be known as the Economic Reconstruction Standard Act. The Enterprise Reconstruction and Reorganization Law is also to be amended in several important respects. The policy has been further implemented by instructions, directions and explanations given by various members of SCAP, particularly the members of the Anti Trust and Cartel Division of the Economic and Scientific Section which is headed by H. C. Welsh. Mr. Welsh was formerly an assistant professor of economics in Ohio State and thereafter connected with O. P. A.

In "The Oriental Economist" of August 23, 1947, the provisions of the "Law Relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade" commonly called the "Anti Trust Law" are summarized as follows: "The Japanese Anti-Trust and Fair Trade Act is a good deal more specific in its provisions than its American prototype, presumably having incorporated therein some of the recommendations made by the Temporary National Economic Committee. In addition to the general provisions against private monopolies, undue restraint of trade, too substantial a desparity in bargaining powers, etc., it prohibits all holding companies, restricts the holding by financial institutions of more than five per cent of the stocks of any one company, and prohibits any company to own more than 25 per cent of the debentures of another company. It permits no person to own more than 10 percent of the stocks of any two or more companies that are in competition against one another; allows no officer of a company to hold a similar position in another company in the same kind of business or to acquire stocks therein; and makes it illegal for an individual to hold directorship in more than three companies simultaneously. Thus there is no room under the Act for such giants as the A. T. & T. or U. S. Steel, nor for "cornering" of a company's stocks by any person with sufficient financial backing, nor yet for interlocking directorates of unlimited scope and complexity as in the United States. The Japanese Act is undoubtedly many steps ahead of the present American legislation on trusts, combines and other business giantism."

This quotation does not mention what seems to be one of the most important features of the Act. For Article 10 prohibits any company other than a financial institution from acquiring shares in another company without the permission of the Fair Trade Commission created by the Act. Such permission can only be requested if the shares are to be acquired in accordance with certain specific conditions set forth in the Act. Even when these conditions have been met the Fair Trade Commission may in its discretion refuse to permit the acquisition. Under the Act a company could not acquire some of the shares of another company for anything but cash and such acquisition could not be made in the open market but must be made directly from the company of certain treasury or unissued shares.

The text of the Act in Japanese as well as the official translation uses the general term "any company" throughout the Act. According to a member of the Fair Trade Commission the term "any company" means just what it says and includes not only a corporation organized under the laws of Japan but corporations organized under foreign law whether or not registered in Japan. On the other hand, Dr. Welsh, head of the Anti-Trust and Cartels Division of SCAP, says "any company" means only a corporation organized under the laws of Japan and does not even include a foreign corporation carrying on business in Japan. Thus we have one of the many examples of the rule of men not law governing the economic existence of Japan.

It would seem that Dr. Welsh's interpretation is incorrect for it is difficult to believe a foreign corporation would be permitted to carry on business free of restrictions of the Anti-Trust Act which are applicable to a domestic one. If so, the whole purpose of the Act might be defeated. Further, if Dr. Welsh is correct the Zaibatsu, after the peace treaty is

signed, could go to a foreign country, organize a corporation, and purchase shares in Japanese corporations to their hearts content. The safe course, therefore, for any American Corporation is to consider this Act as applicable to it in dealing with a corporation organized under Japanese Law and to a foreign corporation owned by it or in which it has an interest which is carrying on business in that country.

Everyone at all familiar with Japan would agree that conditions under which agriculture lands were held and farmed needed reformation. Large tracts were in the hands of absentee landlords and farmed by tenant farmers under leases which together with usurious interest rates on loans to farmers kept the tenants in a continual state of abject poverty. The Law of Special Treatment for Establishing Self Cultivated Farms was passed to correct these conditions. It provides that agriculture lands owned by an absentee landlord may be purchased by the Government and sold to the tenants. Each tenant to receive that portion which he is farming under lease. If a resident landlord has substantial holdings he, too, must sell so much thereof as the Government designates, which in turn is sold to the tenants. Payment may be made by the purchasers in installments. The purpose of the Act as defined therein is to break up large estates and spread the ownership of agricultural lands among the real farmers. Like so many other laws enacted for lofty purposes this law in its application is being used for the purpose of distributing the wealth of Japan. Owners who paid fair market value for agriculture lands are being required to surrender them for a song. In one of several instances of which I have personal knowledge land in Hokkaido which was acquired with yen having a purchasing power equivalent to $ 15,000 must now be surrendered by the owner for yen having a purchasing power equivalent to $ 7.50. This is not an exceptional case but one illustrative of the usual way in which the law is being administered. While this is being done in the name of the Japanese Government it must always be kept in mind that SCAP allows the Japanese Government about the same freedom of choice and decision as Edgar Bergen does Charlie McCarthy.

As Athene in all her beauty came into this world via Zeus' forehead, so The Labor Standard Law sprang full blown from Mr. Cohen's brain. Mr. Cohen who until recently headed the labor division of SCAP organized Japanese labor so successfully that General MacArthur woke up one morning to find he had a general strike on his hands. This was stopped by an order forbidding it and Mr. Cohen was supposed to have had his wings clipped by being removed as head of the Labor Section. He is now one of the chief advisers to General Marquat, Chief of the Economic Section of SCAP where he will have the opportunity to do to business what he did to labor. I am told that Mr. Cohen is a fairly recent graduate of New York University and much of his previous experience was as the labor leader of the union which functions in the Carborundum Company.

The Labor Standard Law deals in considerable detail with labor contracts, wages, working hours, (including recess, rest, annual vacations with pay) safety and sanitation, women and minors, apprentices, workmen's compensation, rules of employment, dormitories, etc.

The Law provides for an eight hour day or forty-eight hour week with one day off; minimum wages to be fixed after hearings before Wage Boards composed of labor management and the public; labor contracts for not longer than one year dealing with wages, hours, and working conditions; pay for miners from "pit-mouth" to "pit-mouth;" child labor generally forbidding employment of persons under 16 years of age; medical treatment, compensation for certain illnesses, accidents and death; and various other matters. The law embodies at least all the gains which American workers have won through many years of struggle. Many of the provisions of the Labor Act are good but these benefits were thrust on Japanese labor which was unequipped by experience either to understand many of them or to know how to use them. If you have ever seen an American Indian spending his money shortly after oil has been discovered on his property you will have some idea of how the Japanese worker is using the labor law. At present the labor situation in Japan is chaotic. The country is in desperate need of coal and yet the miners, even at time and a half or double time, refuse to work overtime because they claim that working overtime is undemocratic. Giving of extra food as an inducement to work has not proven successful. Some of this food finds its way into the black market. Actual work in many mines is not over 5 hours a day and the working days each month considerably less than 25. The miners work until they have made what they consider enough for the support of their families and themselves and then take the rest of the month off. Extra food which is sold in the black market helps to supplement the income and reduce the days of work.

Throughout industry strikes of all kinds are prevalent, the workers in most industries or factories doing just about as they please. Even Dr. Welsh admits labor is "inefficient, expensive and out of hand." While workers are receiving from 3000 to 8000 yen per month they are worse off than before the war because the real wages now are less than then.

There are approximately 12,000,000 workmen union members in Japan. The largest union is that modeled on C. I. O. lines made up of workers in the same kind of industries, such as newspapers, transportation. Civil servants also belong to this union which is the most radical in Japan and in which the leaders are mostly Communists. Then there is a union, the second largest, which is modeled after the A. F. of L. composed of members of the same crafts. This union is dominated by the Socialist party and is fairly conservative. There are two other national unions, one a combination of smaller unions, the other an aggregation of company unions. Since the attempted general strike which was forbidden by order of General MacArthur the power of communism in labor seems to have declined.

Since 1937 prices for consumer goods have increased 65 times while wages are only 27 times higher than they were in that year. This differential was intended to be bridged by the Government distributing essentials but the plan has not worked very well in practice.

Practically all industries have labor contracts of which about 50% provide for a union shop, 30% for an open shop and 20% for a closed shop. Since the passage of the Taft Hartley bill Japanese labor has become more cooperative and has shown a disposition to be more reasonable in its demands.

Many of the labor contracts go far beyond such agreements in this country. The agreement between the Japanese company in which a well known American Company had a controlling interest and the company union in addition to the usual provisions for a closed shop, hours, rights of dismissal, cost of living, wages, etc. states that part of the profits (not stating what part) shall be paid to the union, and the election and removal of directors, inspectors and advisers of the company may be had only after consulting with the union.

The labor contract of another Japanese company in which an American company has a substantial share interest does not give labor the power over management that the contract just mentioned does. This contract does go pretty far, however, for it provides that a committee composed of fourteen members divided between management and labor, of which the president of the company is chairman, shall decide such questions as production, manufacturing efficiency and matters on which the labor committee cannot agree. The committee will also discuss frankly and exchange opinions regarding production and operation policies, financial statements, expenditures and income.

While Japanese labor, to use a slang expression, has gone hog wild for the present, it doesn't seem to me that the situation is hopeless. What has happened is what anyone with a knowledge of Japan would have anticipated when Mr. Cohen and his cohorts began dispersing benefits which the Japanese workers were unequipped to accept and handle. These workers are in many respects like children and have to be treated as such. You can imagine what would happen in a family of children of ten years or less if they were suddenly told all restraints were of fund that they could run the house and their own lives as they pleased. The Japanese workers are still the most law abiding, intelligent and industrious laborers in the Orient. Give a Japanese a job where he has reasonable assurance that he will make enough to feed and house his family and himself and he will work hard. As consumers goods become more available and inflation is checked Japanese laborers will again work hard and efficiently under fair contracts for reasonable wages. This present spree, however, is not benefitting the Japanese workers or the Japanese economy. The same benefits to labor could have been conferred without the present headaches had those in charge of labor policies possessed an intelligent knowledge of conditions in Japan.

SCAP has seen to it that Japan should have a Securites and Exchange Act. The Japanese are not a security minded people and purchasers of securities there are usually well informed so do not require protection to the extent of our public. The Japanese Act seems much simpler than our own and will possibly do no harm. How much good it will do is problematical. It does provide for the creation of a Securities Transaction Commission, another link in the chain of bureaucracy which is being forged by the occupational Government for Japan.

The method of taxing corporations has not been materially changed under the new tax law. Corporations, both domestic and foreign, carrying on business in Japan must pay an ordinary and an excess income tax. Formal income is taxed at the rate of 35% for domestic and 45% for foreign corporations. Excess income tax is assessed on the excess of normal income over a percentage of the capital employed. Thus the tax is 10% on the excess of normal income over 10% of the capital employed 20% over 20% of the capital employed, and 30% on the excess over and above 30% of the capital employed. In the case of foreign

corporations doing business in Japan the capital employed is determined by taking that percentage of the entire capital which corresponds to the proportion of the corporation's assets employed in Japan or on some similar basis. Under the present law with a normal tax of 35 to 45% on all income and an excess income tax of 30% on all income greater than 30% of its capital a corporation may be required to pay 65% to 75% of most of its earnings in taxes.

As with us it is the individual income tax and the inheritance tax in Japan which is employed to redistribute wealth. The income tax rate is 20% on taxable income of 10,000 yen, about $ 50 at the black market rate of exchange and increases to 75% on and above taxable incomes of 1,000,000 yen, equivalent at the same rate to $ 5,000. The law does not permit separate returns, but incomes of all members of a family living together must be added together for the purpose of determining the tax.

The laws so far discussed disclose the economic theory being imposed upon Japan, since they are intended to implement that theory. But it is largely through the medium of the Enterprise Reconstruction and Reorganization Law as it is to be enacted and the Economic Reconstruction Standard Act which the Japanese will be forced to enact that the existing economy is to be destroyed and one radically different from ours is to be substituted.

These new laws require that Japanese corporations be broken up into many small units. At first the idea of dividing companies into many small units was confined to the Zaibatsu holding companies and those in which the Zaibatsu had substantial interests. Now under the theory of an "excessive concentration of economic power" the Anti Trust and Cartel Division of the Economic and Scientific Section of SCAP has the power to destroy any single Japanese company. This is true even though the Zaibatsu has no connection with such corporation.

I first heard of the term Zaibatsu in 1944 when lecturing to the men attending the Civil Affairs Training Schools established at several of our universities. It soon became apparent that there was a well established movement on foot to destroy at any cost the vested interest in Japan of those persons popularly termed the Zaibatsu. The leaders in this movement were the same as those who advocated broad reforms for Japanese workers. They also demanded the abolition of the office of Emperor. These people advocated making over Japan according to what they thought was good for that country and they never doubted for a moment that they knew what was good for the Japanese.

Of course the family holding companies should have been dissolved and their hold on Japan's economic life broken. But the manner in which this is now being done, i. e., by a purge of a large part of the intelligent and experienced businessmen to be followed by a sale of interests in Japan's most important industrial, mining and financial enterprises at nominal prices to labor unions and cooperatives makes one wonder whether for Japan and the world the remedy may not prove worse than the disease. At any rate the cry "exterminate the Zaibatsu" has proven a most effective slogan to disguise what apparently is the real purpose, that of socializing Japan. Reformers of this kind, as we know, have insatiable appetites for power. Those in Japan are no exceptions for having conquered the Zaibatsu they are now moving into every phase of Japan's economy claiming the necessity of breaking up "excessive concentrations of economic power" as their justification.

A draft of the Economic Reconstruction Standard Act (if that is the name by which the law when enacted will be called) submitted by SCAP to the Japanese Government states "1 The purpose of this law shall be to insure that measures for Japan's reconstruction are concentrated with peacetime and democratic purposes and to lay the ground work for building a healthy and democratic economy. To this end it is desirable that Japan's economy be reorganized and the concentrations of economic power be eliminated at the earliest possible date."

The Act then goes on to define what is meant by concentrations of economic power and some of the tests which can be applied for discovering its existence. Paragraph 5 set up the procedure for eliminating it. This paragraph provides as follows: "The Holding Corporation Liquidation Committee (a committee of Japanese puppets controlled by SCAP) shall take such action in regard to the elimination of concentrations of economic power subject to this law as it finds appropriate to accomplish the purpose thereof, including dissolution, liquidation or reorganization of enterprises or associations; prohibiting juridical persons or natural persons from engaging in such activities or performing such acts as might perpetrate concentrations of economic power; cancellation of obligations of cartels, syndicates, trusts, exclusive purchase as sales agents, companies or other organizations of a monopolistic or restrictive character and shall to the extent appropriate, carry out the provisions of the

law and have power to:

(a) Issue such rules, regulations, orders, directions and definitions as may be deemed appropriate;

(b) Determine the principles, plans and procedures for elimination of concentrations of economic power subject to this law;

(c) Consider reports, etc;

(d) Investigate, collect and compile information, etc;

(e) Require the compilation and submission of information, etc;

(f) Take possession of, hold or require the conveyance of property, conversions of property of individuals or families into non-negotiable securities, direct the termination or dissolution of any contracts, enterprises, arrangements or relationships, and take such other measures as it may deem appropriate and consistent with the provisions of this law; request designated enterprises or persons to submit plans for disposal of assets or other appropriate action for the purpose of compliance with this law; approve such plans; propose plans of reorganization for enterprises for the purpose of compliance with this law, and appoint receivers with power to execute the same—"

This would seem to be bureaucracy carried to the degree. Is it strange that Japanese are beginning to question this kind of democracy which is clearly a rule of men not law.

Apparently the Japanese Government inquired of SCAP as to the manner in which it proposed to exercise these unlimited powers for a memorandum entitled "Standards of Enterprise Reorganization" was delivered to it. This document sets out the ideas of how certain individuals in SCAP propose to deal with the Japanese economy. The following are quoted from this document:

"To eliminate control company functions unless it can be shown that separate plants cannot operate with a reasonable degree of efficiency under conditions of competition.

To employ differences in geographic location as one factor in determining separation of ownership and control provided that it cannot be shown that such separation would cut off sources of raw materials or make marketing of the product extremely difficult.

To separate unrelated activities unless it can be shown that there is a very significant effect on efficiency through advantages of large scale purchase of materials or through the advantage of scientific marketing.

***No combination should own raw material supplies or raw material capacity substantially in excess of the needs for production of the final product.

***Consequently horizontal combinations will generally not be justifiable.

***In instances in which production of several products under joint cost condition is allowed to continue, the general principle should be non-ownership of the source of raw material.

***If the brand has such a history as to give it monopolistic powers, such brand name should be abolished and separate companies should take new and different brand names.

***Likewise, in separating the company into several companies, care should be taken to see that no one of the several companies has more than twice the capacity of any other of the separate companies unless its capacity is no greater than 20% of the total capacity of the industry."

Thus the great experiment, noble in purpose is reborn in Japan but still at the American taxpayers' expense.

The purge so dear to the Soviet is being used by us as lethal weapon in the socialization of Japan. It is estimated that upwards of 200,000 Japanese have already been purged and over another 100,000 will shortly be added. This includes Army and Navy personnel as well as businessmen including 56 members of the Zaibatsu families.

Far Eastern Commission directive 230 at paragraph 5 lays down the rules for determining who shall be purged. It divides such persons into two classes, "all individuals who have exercised controlling power in or over any excessive concentration of economic powers whether as creditors, stockholders, managers, or in any other capacity" and all other persons likely to set on behalf of such individuals. Note that many of those who have been and are to be purged are not members of the Zaibatsu. Thus Count Kabayama, upwards of seventy years of age, a graduate of an American college, and considered to be America's greatest friend in Japan was purged. Count Kabayama came under the purge because he was president of the Imperial Steel Company although it is reported he was made president at the insistence of the English Vickers interests when they became investors in that Company. The story goes the Vickers insisted upon someone friendly to English interests who was not allied with what is now called the Zaibatsu. Count Kabayama was chosen because

he met these requirements. He was most intimate with Mr. Grew, our last Ambassador, and his predecessors, and is reputed to have assisted them by interpreting Japanese policy and action.

The first class are to be divested of all corporate security holdings, liquid assets and business properties. The second class are permitted to retain an inconsequential amount of such property. The first group are "ejected from all positions of business or Governmental responsibility." The second group only from those positions which might be used to favor Zaibatsu interests. The first echelon are "forbidden from purchasing corporate security holdings or from acquiring positions of business or Governmental responsibility at any time during the next ten years." The next lower echelon are forbidden from doing any of these acts during the next ten years if they are done in favor of the Zaibatsu interests.

Because of the purge both the Japanese Government and businesses have been stripped of older men of ability and experience. Japanese banks are being run by former cashiers and assistant vice presidents while business concerns are being directed by former plant managers and clerks. Young men held the key positions in Government. They are hard working, sincere and intelligent but lack experience and working knowledge in Governmental affairs which is so desperately needed at this time.

The purge is tragic for those who come under it. I talked with two or three of the purgees as they are called and found that all their funds are blocked and nothing can be done by them without the consent of S. C. A. P. They are forbidden to work for their old companies and any other ones are afraid to employ them. They are required to make voluminous reports to S. C. A. P. including minute estimates of their expenditures. One man with six dependents was permitted to draw approximately 8000 yen per month from his blocked account. This at the black market rate is equivalent to $ 40. He was wondering what was going to happen to his family and himself when his blocked account was exhausted. This man, a graduate of one of our universities, said he told Tojo before the war on several occasions it would be a fatal blunder to have war with America. So long as it was possible he said he did what he could to prevent war, but once the national policy was determined he had to bow to it. His is only one of many cases in which it seems in the interest of ourselves as well as Japan the desired result could have been accomplished by following a more intelligent and less drastic course. Certainly while controlling the situation and without danger we might have utilized the knowledge and experience of some of the purgees.

The Japanese people have lost confidence in their currency. The black market rate of exchange which everyone recognizes as the true criterion of value is 200 yen to one dollar. In fact the black market is the real market in Japan for practically everything. There is price control but little if any of the controlled products can be bought except in the black market. Several weeks ago price control was taken off vegetables and Tokyo was flooded with supplies. Then for some unexplained reason control was put back and the vegetables disappeared. The farmers are beginning to show some reluctance in selling for yen, preferring to receive property instead. The Chinese, Koreans and Formosans who are reported to have made billions in black market operations together with the agriculture cooperatives and trade unions constitute the only prospective purchasers for the Zaibatsu holdings shortly to be offered for sale. Because of inflation workmen in spite of the high wages in numbers of yen per month are not as well off as they were before the war. Higher wages are being constantly demanded and in some instances food allowances are being paid in lieu of part of the monetary wage.

The only cure for inflation appears to be much larger production in the first instance of consumers' goods. In view of the many uncertainties in the Japanese economic world that would appear to be possible only in the somewhat distant future.

There are too many real imponderables in Japanese economic life to warrant other than a most pessimistic outlook. Reparations is another one of them. Until this policy is established and it is known just what form reparations are to take and what plants are to be moved, Japanese businessmen cannot plan for the future. Dissolution of the Zaibatsu companies, forced sale of their securities to unions, cooperatives and perhaps Chinese and Koreans, the purge of practically all experienced businessmen, the separation of companies into many independent ones on the theory of "excessive concentration of economic power", inflation and reparations would seem enough to give any economy an acute case of indigestion. Add to this the sustained effort to socialize Japan by a rule of men as distinguished from one of law and you have what can only be described as a mess.

There is grave danger that the entire Japanese economy may collapse resulting in a sacrifice of a substantial part if not all of the good which the occupation of Japan from a

military point of view has accomplished. The Japanese had been told by their military leaders that American troops would loot, rape and kill. When they arrived and this did not happen but instead they conducted themselves in a truly admirable manner and showed a disposition to help, there was a complete revulsion of feeling on the part of the Japanese. This fear quickly changed to enthusiasm for the occupation. As they began to realize how much better off they were in our hands than they would have been in those of Russia, they showed a real desire to cooperate and to carry out what the occupational Government directed. The restoration of law and order, the demilitarization and repatriation of troops were all most ably carried out under the most skillful, intelligent and sympathetic leadership of General MacArthur. But the military phase of the occupation was completed months ago and was succeeded by the necessity of restoring the Japanese economy. In this respect the occupation to date has not only been a failure but it has sought to impose on the Japanese an economic system which is distantly unamerican. The high command in Japan has failed to take advantage of the services of experienced businessmen which have been offered. It has accepted the advice of mediocre people and listened to the siren song of a lot of crackpots.

Some Japanese have already lost their enthusiasm for the occupation and this number is being constantly increased by those who are beginning to doubt our good will and sincerity because of our economic policy. Such persons are asking themselves whether the real reason for breaking up all large Japanese companies, for selling corporate securities to labor unions at nominal prices may not be the desire to make Japan economically impotent. As the existing chaos and confusion continues and the Japanese people enter another hard winter with practically no heat, few warm clothes and little food the number of doubters will grow and the good will recently engendered by the occupation will disappear.

Japan's real desire to be friends and do our bidding should not lightly be tossed aside. She is still the leading oriental nation in ability, respect for law and order and desire to work. She is not communistic and while communism is growing, Japan will embrace it only as a last resort. Vis a vis our relations with Russia, Japan can be either for or against us. We want her for us, because she can be the buffer against Soviet Russia on our Pacific side just as England is in the Atlantic. Because the complete success of the occupation of Japan is a matter so vital to all Americans whether or not engaged in foreign trade, it is nothing short of catastrophic that the economy of Japan is being made the guinea pig for a group of radical reformers.

Japan is costing the American taxpayers millions of dollars a year. Theoretically Japan is paying the cost. Occupation. A military operation, at least with us, is always expensive and in this instance it is particularly so on the basis that Japan is paying for it. So houses with large staffs of servants are demanded for officers and their families at rentals far below their cost to the Japanese Government. Club houses and servants are supplied without cost to the members on the supposition that it is all on the Japanese so why worry. Innumerable other extravagances of a similar nature are going on constantly. It is true that most of these are paid for directly in yen by the Japanese Government which is given a corresponding credit against future reparation payments. But in fact the American taxpayer is paying for this joy ride. We have to supply millions of dollars worth of food and other necessities to Japan for which we may never be paid. Perhaps if we did not compel Japan to use her limited resources to furnish luxury and amusement to the personnel stationed in Japan she might have more for her own needs. How long will the American taxpayers continue to stand for this or probably what is more to the point, why should the American taxpayers stand for it at all?

Are we interested in paying the freight so that some economic theorists may try an experiment there which we did not want here?

Americans in general are interested in seeing that Japan cannot carry on future wars. In accomplishing this we would like, if it can be done, to retain that country's good will. But under any conditions once Japan is completely demilitarized, we want her to get off our back and become self supporting.

General MacArthur says Japan has been so completely demilitarized she could not possibly wage war for another fifty years. By rationing vital imports such as petroleum, by stationing in Japan observers and by maintaining an effective air force within striking distance of that country, there would seem little danger of Japan being able to wage war in the forseeable future. That being so why should we tolerate the installation of a bureaucy of Americans in Japan which will make that country a dependent for years to come.

Finally, what about American business interests in Japan. So long as existing conditions

continue in that country I cannot see how an industrial enterprise owned in whole or in part by Americans can be successfully and profitably carried on. Neither can I see any reason why American capital should be attracted to that country. Were economic conditions otherwise, I am convinced Japan would be a most attractive prospect for American industry and a fertile field for American capital. Whether Japan can be made such a place depends in my opinion upon the willingness of our Government to do two things. First, put an end to the economic experiment being conducted in Japan, and second, replace the theorists now there with men of ability and experience who can if action is taken promptly still restore Japan's economy. Such a modification in policy must be followed shortly by a withdrawal of the Ministry forces and the repatriation of thousands of highly paid American bureaucrats, lawyers, former members or employees of bureaus, in Washington, clerks and secretaries.

Such a modification in policy would within a reasonable time make Japan self supporting, establish her once again as a country attractive to American industry and capital, insure the success of the occupation and over and above all give us a far eastern bastion.

James Lee Kauffman

[SOURCE: TEXT DISTRIBUTED BY THE MINISTRY OF FINANCE]

6-24 CRITICISM OF KAUFFMAN

Memorandum undated (1947)
To: The Under-Secretary of the Army
Prepared by: Charles L. Kades[20]

James Lee Kauffman first came to Japan two years after graduating from law school in 1911 to become a lecturer in English and American Law at the Imperial University in Tokyo. He held this position from 1913 until 1919 when he began to practise law in Tokyo as a partner in the firm of McIver, Kauffman, Smith and Yamamoto. It is understood that he is now the senior partner of this firm. He continued to practise in Japan until about 1927 when he returned to the United States to conduct a New York branch thereof. The Japanese office represented locally, among other U. S. companies, the Libby-Owens, -Ford Glass Company, Ford Motor Company, National Cash Register Company, Western Electric Company and General Electric Company, as well as many leading Japanese concerns.

Kauffman arrived in Tokyo August 11, 1947 as part of the first group of a mission to provide technical aid on restoration, working under the U. S. Reparation, Restitution and Restoration Delegation. While there he evidenced considerable interest in the Anti-monopoly Law (analogous to the Sherman Anti-Trust Law in the United States) and the affairs of the Japan Plate Glass Company.

The Libby-Owens-Ford Glass Company, which Kauffman represents, is the second largest stockholder (42,000 shares) in the Japan Plate Glass Company (formerly called the Japanese-American Plate Glass Company). The Japan Plate Glass Company is one of two companies which control all glass production in Japan. The largest stockholder is the Sumitomo Holding Company (about 45,000 shares). This is the holding company for the Sumitomo family, one of the largest of the Zaibatsu families which control eighty percent of Japan's industry and commerce. Kauffman's primary concern is unquestionably to prevent any reorganization of the Japan Plate Glass Company, and other companies which he represents, under the U. S. program for the deconcentration of economic power, and he expressed himself as "out to get" the head of the Anti-Trust and Cartels Division (Floyd Welsh) which is charged with breaking the control of the Zaibatsu and carrying out the anti-monopoly program.

It is interesting to note that Kauffman's services to Japan were considered to be of sufficient value to cause the Emperor to confer upon him the Order of the Sacred Treasury.

As to Kauffman's specific charges, the following comment is made:

(a) It is asserted that his report which he gave to John D. Biggers, President of Libby-Owens-Ford Glass Company, is "extremely critical of SCAP's economic administration in Japan." Kauffman is understood to have had only one conference in the Economic and Scientific Section during his entire stay here. He stated both to General Marquat, the Chief of the Section, and to Mr. Welsh, the Chief of the Anti-Trust and Cartels Division, that he would return for an additional conference, but he failed to do so. His knowledge of the economic administration must be, as a consequence, largely derived from Japanese sources.

[20] Deputy Chief, Government Section, SCAP.

(b) Kauffman's report "accuses SCAP of staffing organization with superabundance of men from former Leon Henderson's OPA." As you know, in practice all civilian personnel are recruited in Washington by the War Department in accordance with job specifications forwarded by this headquarters.

(c) Kauffman's report "is particularly critical of land reform." Here again it may be reasonably presumed that Kauffman's interest is primarily that of the clientele of his Japanese law firm. It is considered in Washington, as here, that the land reform program, together with the Zaibatsu program, are "among most important objectives of the Occupation and progress achieved to date in their implementation considered one of most notable accomplishments of Occupation." (Quotation is from WAR 86980 dated 25 September 1947).

(d) Kauffman's report that 200,000 persons have been purged from the Japanese economy and that there are 100,000 more to follow is viciously false. The economic phase of the purge program has resulted in the removal or exclusion of only 2,000 persons of which only 356 were actually removed from office and the remainder vacated their positions either before the surrender or during the occupation. This phase of the purge program is now completed. Such removals from economic positions as may be necessitated in the future will be from particular industrial combinations for the purpose of dissolving unreasonable interlocking directorates and other personnel ties among Zaibatsu-controlled industries.

(e) Kauffman's report is critical of laws which he believes are socialistic in their nature; namely, laws in implementation of Far Eastern Commission document No. 230 now under consideration by that body. This is the document presented to the Far Eastern Commission by the State, War and Navy Coordinating Committee and represents the considered American policy in the deconcentration of economic power. If Kauffman considers the anti-monopoly law and the proposed economic decentralization law, designed to implement American policy, as socialistic, he undoubtedly also views the Sherman Anti-Trust Act of 1890 and the Clayton Act of 1913 on which the Japanese laws are patterned as equally socialistic.

(f) Kauffman's report is critical of Theodore Cohen, described as General Marquat's "economic adviser". Cohen is one of several economic analysts who work on plans and programs, performing duties substantially identical with those he performed in Washington with the Foreign Economic Administration from which he was recruited by the War Department in 1945. He has been an economic analyst with the U.S. Government since 1941.

(g) Kauffman's report "says four unions have been organized and that fifty percent have achieved closed shop, says Cohen was successful in bringing about such union control and that as a result SCAP was faced with general strike." Instead of four unions, there are in Japan today seventeen thousand labor unions organized in accordance with the labor directive of the Far Eastern Commission, the U. S. policy of encouraging collective bargaining, and the recently adopted Japanese Constitution. The Trade Union Law enacted during the Occupation is silent on the question of a closed shop. Whether a closed shop is included in a collective bargaining agreement or not has been left entirely to the process of orderly negotiation between employers and employees. The attempted general strike was politically inspired as a protest against the existing Cabinet, largely influenced by that clause of the Far Eastern Commission policy decision on trade unionism specifically encouraging the engaging in political activity by trade unions.

(h) Kauffman's report states that there are ten thousand employees in the Economic and Scientific Section. In that Section there are, apart from 453 Japanese civilian technicians used to operate machines to collate statistical information, only 33 American Army officers, 2 Allied Army officers, 33 enlisted men, 568 War Department civilian employees, and 40 foreign nationals.

(i) Kauffman's report is "critical of the fact that civilians and military personnel have elaborate meals for 25 ¢ and are charged 50 ¢ per day for hotel accomodations." There are no restaurants, Allied or Japanese, operating in Japan and no private facilities for serving meals to Allied residents of hotels and billets. Furthermore, throughout the Occupation a firm policy has been maintained against the consumption of the critically short indigenous food supply. It is, therefore, necessary to feed military personnel or War Department civilians attached to the Occupation with the standard Army ration for which the regular charge of 75 ¢ per day fixed by the War Department is made. As to the hotel accomodations, Army officers not maintaining separate establishments receive no commutation of quarters whatever, the statutory amount involved being deducted from their pay. Civilians living in billets and hotels do not have normal hotel accomodation but live under more or less dormitory conditions and regulations. Shortage of available housing and apartment facilities has required

that civilians without dependents be compelled to reside in regular military billets rather than in abodes of their own choice.

(j) Kauffman's statement that transportation for recreation vehicles can be obtained for 25 ¢ per hour is partially correct. There is only a very limited supply of such vehicles, mostly jeeps, available; and the sum of 25 ¢ per hour is based upon the actual operating cost involved. His criticism in this regard runs contrary to the general belief that lack of available recreational facilities has been a material factor contributing to the difficulty of securing replacement personnel for the theater. The resort hotels of which he speaks are established as rest camps for leave purposes and to house the overflow of dependents arriving from the United States. All other Japanese inns and hotels have been declared "off limits" to military personnel and civilian personnel assigned or attached to the Occupation.

. . . . . .

It should be borne in mind, of course, that Kauffman's major grievances to the policy decisions of the United States and Far Eastern Commission, by which this headquarters is bound, rather than the executive action taken here in implementation thereof. In fact, the implementation of all basic directives received has been timed and tempered to avoid undue dislocation in the political and economic life of Japan.

The activity of Kauffman quite obviously stems from a desire to defend vested interests of his Japanese and American clientele against the application of United States and Allied policy in the administration of the occupation of Japan—possibly to lay the groundwork for a much larger Japanese clientele in the post-treaty period. Having no recourse to legal action, he apparently seeks to lobby his way to the end sought, and in so doing, judging from the statements cited in your message from the War Department, has no slightest regard for the truth. He and others who, subordinating our national interest to self-serving purposes, seek to preserve in Japan those very institutions, influences and practices which brought on the war by giving the American people a wholly distorted and false view of the occupation and creating unrest among leading elements of the Japanese people, do much to impede the orderly achievement of our basic objectives and jeopardize primary American interests.

[SOURCE: SUITLAND PAPERS, Z 721-12]

6-25 CONTINUED IMPLEMENTATION OF DECONCENTRATION PROGRAM (EXCERPTS)

Telegram No. C 56312 October 24, 1947
To: Dept. of the Army (CSCAD PL)
From: CINCFE, Tokyo (MacArthur)
Confidential

1. Reurads W 88682[21] and W 88748. I have given careful consideration to the questions raised in your W 88682, all of which go to the procedure employed in implementing the United States and Allied Policy in the deconcentration of excessive concentrations of economic power in Japan.

. . . . . .

3. The alternate procedures suggested in your message would be entirely compatible with implementation of the basic program if it were being undertaken as the voluntary act of a free people. That, however, is not the situation here where the program has long been one of the most important requirements underlying allied policy. To be effective in these circumstances implementation of the program must be under the constant supervision and absolute control of the occupying powers for otherwise, due to the tremendous influence capable of being exercised over the Japanese authorities by those adversely to be effected, implementation could not possibly be accomplished during the occupation period regardless of what special devices toward expedition might be adopted. Being fully conscious of this hazard, I considered the advisability of proceeding to the implementation of this program by direct SCAP action but finally decided on utilizing the Japanese machinery in line with policy previously in force to give the Japanese authorities, under SCAP supervision, the

[21] The War Dept. cable WAR 88682, dated October 20, 1947, stated the "General view of Army and State Depts that deconcentration program should be carried out... so as to promote economic recovery." It concluded: "Because of current review here of SWNCC 302/2 and the other questions raised this cable, it is desired that you delay adoption of the ordinance for elimination of concentration of economic power."

maximum of direct responsibility in carrying out Allied decisions.

. . . . . .

6. Although I had no part in the formulation of the original US Government policy enunciated in SWNCC 140/4/A, the starting point for all subsequent policy statements and directives, this policy has guided all actions taken by me or by the Japanese Government with my approval looking toward the dissolution of excessive concentrations of economic power in Japan. The bill now under consideration by the Diet is a measure necessary for the expeditious completion of the program in conformity with US and Allied policy which I had every reason to believe was fixed and determined.

. . . . . .

7. A radical change in pace or direction at this time would not only be extraordinarily embarrassing, but what is infinitely more important, it would introduce doubt and confusion into the program, delay and perhaps defeat its accomplishment and play into the hands of those who have been and are bitterly opposed to it. This opposition has come from 2 main sources.

8. The first group consists of those with vested interests in or sympathetic toward existing Japanese private monopoly. In modern Japan a concentration of private economic power without its equal in history prevented the equitable distribution of income and wealth and made the ordinary man as dependent upon monopoly as his forebears had been dependent upon the feudal lords of medieval Japan. Several hundred corporations belonging to 12 combines led by 10 families owned or controlled about 80 per cent of the industry, commerce and finance of Japan. Through heavy industrial, commercial and financial combinations, through strategic minority interests, the device of holding companies, family ties, the abuse of the patent system, control of credit channels and myriads of interlocking spheres of influence, private enterprise in Japan ceased to be free enterprise and became private collectivism. Such is the dismal story of the heavy hand of completely integrated financial, industrial and family control of the Japanese economy. The record is one of economic oppression and exploitation at home, aggression and spoilation abroad. As early as 1930 Japanese industrial combines veered in the direction of armaments production and geared the country for war. The alliance of the Zaibatsu with government was close and their influence on governmental policies was inordinate.

9. But besides those whose personal fortunes and positions are affected, the opposition has been joined by those who, being ideologically committed to a Socialistic or collectivistic pattern for Japan's future, sense that this program, if successful in transforming a small number of monopolistic combines into numerous competing units and in bringing about widespread ownership of the instruments of production and trade, will erect a solid bulwark against the spread of ideologies or system destructive of both free enterprise and political freedom under democratic capitalism. Business in Japan, if allowed to continue with its concentration of economic power, will lead to concentration of power in government, and from there the transition to Socialism of one form or another would be natural, easy of accomplishment, and inevitable.

10. Involved in the failure or success of this program is the choice between a system of free private competitive enterprise which goes hand in hand with political freedom and a Socialism of one kind or another under which political freedom is a myth. State Socialism, openly avowed, at least retains lip service to the good of the common man, for the instruments of production and trade are owned by the state ostensibly for the benefit of all the people, but even this fiction was not observed in Japan before the occupation for here the economy was in the grip of a system of private Socialism largely owned and operated by and for the benefit of only 10 family clans.

Before any change is made in the US policy concerning the dissolution of excessive concentrations of economic power consideration should be given to 2 serious factors:

First, Throughout the implementation of this program the Russian member of the Allied Council has repeatedly sought to introduce the concept of confiscation, but I have insisted on strict observance of the American principle of just compensation.

Second, With the possible exception of the United Kingdom, all the powers represented in Japan have been desirous of going much further in the reformation of the Japanese economy that the US policy envisages or than had been planned.

Reopening the policy for discussion at this time might well result in altering not only procedural or policy matters but in sacrificing the essential objective.

[SOURCE: STIMSON PAPERS, YALE UNIVERSITY]

6-26 GRAY'S MEMO ON JAPANESE ECONOMIC SITUATION

Memorandum November 14, 1947
To: The Secretary of the Army (Kenneth C. Royall)
From: Gordon Gray, Assistant Secretary of the Army
Confidential

1. The entire problem of the Japanese economic situation resolves itself into a single policy determination: what kind of economy does our government wish Japan to have.

2. In any consideration of policy directives and specific legislation, it is important to keep in mind the fact that the Japanese economy was an extremely peculiar one in which about ten families controlled about 75 percent of the industrial, financial and commercial activities in Japan. With this background, it must be borne in mind that there are compelling arguments that in order to bring about reforms at all, the measures taken must be drastic and might appear in the abstract to be at variance with American tradition, philosophy and law.

3. There seems to be no disagreement that the control by Zaibatsu interests should be broken up. This appears to have been largely accomplished. SCAP reported in CM IN 3386, dated 17 October 1947, that the Holding Company Liquidation Commission has designated 56 persons who controlled the 10 major Zaibatsu families; taken over their securities and established control over their other properties; designated for liquidation 67 holding companies which through their 4028 subsidiaries and affiliates control approximately 75 percent of the industrial, financial and commercial activities in Japan; has taken over securities and/or voting rights of over 250 shares with face value of 10 1/2 billion yen; has proceeded so that such holding companies as Mitsui, Mitsubishi, Yasuda and Sumitomo have been largely liquidated; has ordered closed and is liquidating Mitsui and Mitsubishi holding companies, the two largest holding companies in Japan. The cable includes a statement that "Zaibatsu control per se has in fact been abolished...."

4. The problem, therefore, is how far down the scale we wish to go in breaking up Zaibatsu operating companies, and industrial and financial enterprises which were not a part of the Zaibatsu picture, which in themselves are not necessarily evil concentrations. Specifically, there are three questions to be answered:

a. Should the leveling process be implemented to such an extreme that operating efficiency might be impaired and economic recovery and stability unduly hampered.

b. Quite apart from economic recovery, is the American Government to use the effective instrumentality of military government to impose upon the Japanese economy philosophies and procedures which have not yet been accepted by the American people for themselves, either through Congressional action or by court decision.

c. Is there a middle course that can be followed.

5. Under consideration is a policy paper, SWNCC 302/2, which has been submitted to the FEC as the American position but not yet promulagted by FEC. Without attempting to analyze it fully, the policy seems to be stated in an atmosphere of social planning. It goes into considerable detail; for example, with regard to the disposition of divested holdings, the paper directs that a preferred group of purchasers be set up: specifically, small and medium sized entrepreneurs, co-operatives and trade unions; that in determining the sales price of securities to such preferred purchasers the principal factor shall not be their value but what the purchaser is able to pay; and that the government lend all technical and financial assistance necessary to the purchasers to accomplish the transaction. The paper also, for example, deals with the patent situation, in a way inconsistent with American practices. The policy stated is taken from a report by a mission sent to Japan and headed by Professor Corwin D. Edwards, currently teaching at Northwestern University. The Edwards Mission was requested by General MacArthur, and was sent jointly by War and State and included representatives from State, War and other agencies of the Government. It was composed of seven or eight civilians and returned from Japan about sixteen months ago.

6. Under immediate consideration is an ordinance for the elimination of concentrations of economic power, which was introduced 28 September in the Diet, and which is now being held up pursuant to request from Washington. The ordinance would seek to implement certain basic policy directives, including SWNCC 302/2 previously sent to SCAP. It is felt that this ordinance if implemented to the full could reduce the economy of Japan to a "shopkeeper's economy". (Attached is a statement of features of the ordinance which may be objectionable.)

7. It should be pointed out that General MacArthur has indicated that he feels that the ordinance should be passed and that there should be no change made in basic U. S. policy. In a cable dated 24 October 1947, he made the following statement:

> "Although I had no part in the formulation of the original US Government policy enunciated in SWNCC 140/4/A, the starting point for all subsequent policy statements and directives, this policy has guided all actions taken by me or by the Japanese Government with my approval looking toward the dissolution of excessive concentrations of economic power in Japan. The bill now under consideration by the Diet is a measure necessary for the expeditious completion of the program in conformity with US and Allied policy which I had every reason to believe was fixed and determined."

8. It is difficult to say how far we should go in Japan, but from information available in Washington it seems desirable that competent consultants be sent to Japan to ascertain whether, and to what extent, further leveling of the Japanese structure is desirable in view of present United States' attitudes towards economic recovery and in view of possible Congressional interest in the type of controls and reforms which SCAP under existing policy directives is imposing on the Japanese by force.

[SOURCE: STIMSON PAPERS, YALE UNIVERSITY]

6-27 STIMSON'S COMMENT ON DECONCENTRATION OF INDUSTRY

Letter November 21, 1947
To: Kenneth C. Royall (Secretary of the Army)
From: H. L. Stimson[22]
Private and Confidential

I have read as carefully as I could the papers which Under Secretary Draper left with me last Sunday. The proposed statute or ordinance now pending before the Diet is so complicated and indefinite in its terms that it is almost impossible to foresee what it intends to do or what may be done under its terms, except that it clearly opens the possibility of extreme regulation of the industry and business of Japan. It seems to me that it endeavors to impose a system of regulation which would be difficult to realize and unnecessarily dangerous to the purpose which the United States is endeavoring to accomplish in its occupation of Japan.

Our purposes in occupying Japan were in substance to ensure our future security and the peace of the world (a) by limiting her sovereignty to her island empire; (b) by completely disarming and demilitarizing her people and her possibility of building up a new armament; (c) by developing in her people, as far as possible, a democratic desire for individual liberties and respect for fundamental human rights; and (d) by affording her opportunity to develop an economy which will permit the peacetime requirements of her population to be met. In the original papers it was suggested that for this last purpose she should be allowed to build up her foreign trade.

In the development of the first three of those steps General MacArthur has apparently made brilliant progress. In respect to her economy he has also successfully dissolved the Zaibatsu—the concentration of her industrial, financial, and commercial activities, which was supposed to tend towards her power of militarization.

The proposed statute or ordinance now under discussion proposes to carry on further these steps taken towards curtailing the concentration of industry in Japan, limiting her people and their business to an extent far greater than anything we have known in this country, and to do it in a way which is not only extremely loose and indefinite in its method of statement, but it does not provide for any judicial system whose decisions and actions hereafter may help to clarify and prevent abuse.

Although I have no present knowledge of the situation in Japan, I feel strongly that these further steps are going too far for our original purpose. Such a fundamental and drastic reorganization of the habits of a nation will undoubtedly handicap its power and speed of recuperation and postpone the time when she may become self-sustaining. It will take a very long time and much supervision to accomplish such a change, and it will therefore tend to prolong our military occupation and its expense.

[22] Former Secretary of War.

In short, some of the papers before me indicate that an attempt is being made to make the United States experiment with the economy of Japan, and I see no propriety for such a course. We are there for the primary purpose of our future self-protection against possible aggression. We are not there to create an ideal state. We are an entirely different race and government, with entirely different history and instincts. Under such circumstances, such an experiment invites trouble.

Very sincerely yours,
H. L. Stimson
[SOURCE: STIMSON PAPERS]

6-28 REQUEST FOR DECONCENTRATION REVIEW BOARD

Telegram Draft[23] November 25, 1947
Approved by W. F. Marquat
To: Washington (CSCAD)
From: SCAP

My plan for the administration of the Deconcentration Law embraces a top policy Deconcentration Review Board of five members. It is preferable that the Chairman be a former federal judge, specialist in trust cases, and that the other members be respectively specialists in corporate management, in industrial engineering and plant management, in anti-trust legislation and in the financail aspects of corporate organization. It is imperative that the personnel of the Board be qualified in these respects: none of the industrialists may be from companies with interests in Japan or with interests which compete directly with Japanese export trade; that the Board members be selected from companies which have not been defendents in antimonopoly suits in the past in the United States and which have not suffered from provisions of antimonopoly legislation. These individuals should be placed upon a reimburseable basis by the Department of Army and loaned to SCAP for an initial period of six months. Personnel selected by the standards mentioned provides SCAP with a competent professional review authority. Its selection by Washington assume that the Washington and SCAP positions are at all times coordinated and integrated. The Deconcentration Board will decide whether a company or unit is an excessive economic concentration; whether its reorganization can be accomplished without adverse effect upon industrial recovery; and what types of modifications in the reorganization may be desirable in particular instances. Since only personnel of the highest qualifications and breadth of background may be expected to discharge this responsibility adequately, it is requested that these personnel be appointed in the United States.

The review procedure envisions the submission by the AC Division, ESS, to the Review Board of a list of proposed deconcentrations. This list is then referred by Board to HCLC which considers each case jointly with the units affected. After this process, the list is returned to the Deconcentration Board together with recommendations as to proposed actions and reorganizations. The Board then coordinates the interests of all SCAP Staff Sections and other Allied interests and offers final recommendation to SCAP. SCAP decision, transmitted through the Deconcentration Board to HCLC, is final but provision exists for a single appeal in each case which repeats the review process. In each phase the deconcentration review is under the complete control of the impartial board. Through its operation American business is assured fair representation in these fundamental considerations. At the proper time, I plan to give fullest nationwide publicity to the operations of the Board and to its personnel composition.

[SOURCE: SUITLAND PAPERS, Z 703-12]

[23] SCAP's formal unclassified request for a Review Board was sent to the Department of the Army on January 26, 1948 in Radio 260433 (printed later in this volume).

6-29 ELIMINATION OF EXCESSIVE CONCENTRATIONS OF ECONOMIC POWER IN JAPAN (ZAIBATSU PROGRAM)

Memorandum December 1, 1947
To: Mr. Lovett (Under-secretary of State)
From: Frank G. Wisner
Secret

This memorandum and the attachments listed below have been prepared pursuant to your request to me on Friday to obtain for you as promptly as possible a coordinated State Department position with regard to the proposed cable to SCAP which has been submitted to you by the Secretary of the Army. It is my view that the alternative State Department draft cable is sufficient to enable SCAP to proceed, for the present, and that it goes as far as is advisable until such time as State has been given an opportunity to consider fully the fundamental changes in policy and approach which appear to be involved in certain passages of the Army draft.

1. Proposed Army Draft cable, received by State Department November 28, authorizing SCAP to permit the passage of the deconcentration Ordinance now before the Japanese Diet, provided certain amendments are made.

2. State Department's cable proposed in substitution for the above, drafted by OE and IR and concurred in by A-T, A-S, FE and NA.

3. Commentary by the State Department, prepared and cleared as above, on the proposed Army Department cable, setting forth in detail the reasons for the State Department amendments to the proposed Army cable.

State's draft includes a number of suggestions made by Army. It is agreed that only "excessive" concentrations should be affected by this legislation, that standards for deconcentration should be promulgated on an industry by industry basis rather than for the economy as a whole, and that more time should be allowed for appeals. It is also agreed that the ambiguity should be removed from those provisions of the Ordinance dealing with selection of concentrations to be dissolved and that reorganization or dissolution orders shall be accompanied by the economic and other data on which they are based.

State's draft does not include those Army proposals which would be desirable only if review of the entire program were complete and had resulted in fundamental and far-reaching changes in existing policy. It is regretted that more of the Army proposals could not be accepted but it seems fair to say that the divergencies between the two Departments in this regard do no stem from unreasonable inflexibility on the part of the officers of the State Department, but rather from the widely separate positions from which the overall problem is viewed. The basic difficulty appears to be that the wishes to prejudge the review of the program. It therefore uses, as in its first sentence, language of characterization to the effect that the policy in SWNCC 302/2 "seems to be somewhat radical and of questionable practicality". This language serves no useful purpose at this time and tends to confuse an issue not yet decided. In effect, the Army is asking us to concur on a few hours notice in a cable which prejudges important issues now under review, without any evidence being introduced in support of its judgment.

The Department of State has cooperated fully with the Army Department in the earlier request to SCAP to delay action on the Ordinance and in agreeing to review the whole program as set forth in FEC 230. The State Department is preparing its own revision and your letter to Mr. Royall of November 25 is the latest in a series of requests made by us for a statement of Army objections to the paper in order that they may be considered in this revision which may, for all we know, already have met many of the Army's criticisms.

Apart from questions of basic approach, the effect of several of the Army proposals for amendment of the Ordinances would be to weaken it to the point of unworkability. It is hard to escape the impression that this is what the Army intends by the requirement that administration of its Ordinance be permissive rather than mandatory and that provision be made for judicial review. The law could certainly have been better drafted and it is believed that the State Department's proposed amendments will improve it. In any case, it is a necessary and proper part of the deconcentration program. Its emasculation would have serious adverse effects and would indicate a reversal of basic policy.

The Army draft emphasizes the concept of "just compensation" and "fair value" in such a way as again to prejudge one of the basic issues which we have been endeavoring to

discuss concretely with Army for some six weeks. However, the question of compensation has almost no bearing on the Ordinance. The type of reorganization contemplated is similar to the dissolution of holding companies in the U. S. through distribution of portfolio securities, the sale by corporations of property unrelated to the main line of their business, etc. Just as there is no provision in the United States Holding Company Act, or Sherman Act, for "fair" compensation in connection with reorganization, so also the question of compensation is largely irrelevant with regard to the Japanese Ordinance. Army concern with the question of compensation may arise from a confusion between the purpose of the Ordinance and that other aspect of the Zaibatsu program which relates to government seizure and sale of the assets of Zaibatsu individuals. The program of government seizure and sale went into effect in August 1946 pursuant to an entirely different law and is now well advanced. The State Department is prepared to consider further the question of compensation to these individuals in the general review of the basic directive. To take up the problem out of its main context by considering it in connection with the Ordinance may not only prejudge the much larger issues but will also be misinterpreted by the Japanese Government as placing a variety of unintended and unforeseen limitations upon its power to reorganize Japanese enterprises.

The Army proposed the Agency administering the Ordinance not only to determine that an enterprise was exerting a substantial influence on prices but also to prove that the influence was "adverse". This provision would place a burden on the Agency even greater in many cases than that required by U.S. courts to be sustained under the Sherman Act. In the United States price fixing is illegal *per se* whether benign or adverse. Because of the virtual impossibility of comparing existing prices with prices which would have been existing if a monopoly had not been present, this is the only practical rule if enterprises of monopolistic characteristics are to be defined as "excessive concentrations" under the terms of the Ordinance.

The Army draft would require that standards for determining excessive concentrations be reviewed in Washington before promulgation. Even if the necessary data and staff were present in Washington for such review its effect could only be to emphasize to the Japanese responsible for administration there was considerable difference of opinion regarding the whole program between General MacArthur and Washington.

It is believed that the State Department draft goes as far as possible in accepting the Army suggestions and that it already oversteps the normal prerogatives of SCAP and the Far Eastern Commission. Not the least serious feature of the Army proposals is that they would dictate General MacArthur's action with a force and in a degree of detail which is in derogation of international agreements whereby General MacArthur is Supreme Commander for the Allied Powers and is to be instructed only by the issuance of policy directives.

For the above reasons it is recommended that you forward to Mr. Royall under the attached letter prepared for your signature, the State Department draft cable, and the memorandum of comment, both of which are also attached.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

6-30 ELIMINATION OF EXCESSIVE CONCENTRATION OF ECONOMIC POWER LAW

Law No. 207, 1947 — December 18, 1947

Article 1.

This law, by eliminating the excessive concentrations of economic power at the earliest possible date and rationally reorganizing the national economy, as a part of the series of measures taken for the reconstruction of the peace time and democratic nation, aims to lay the ground work for building a democratic and healthy national economy.

Article 2.

"Enterprise" as used in this law shall include every kind of economic business of financial instrumentality or person, whether in the form of cartel, syndicate, combine, trust, stock company, partnership, association, concern, aggregate of firms or bodies, individuals, or otherwise.

"Independent enterprise" as used in this law shall mean any enterprise having separate juridical existence.

"Relationship" as used in this law shall mean every form of relationship, including agreement, combinations, associations, or understanding.

"Fields of activity" as used in this law shall include every kind of economic, business or financial activity.

With regard to the enforcement of this law, enterprise of monopolistic characteristics shall include any enterprise which has or may have influence in any field of activity which shall have resulted from merger of independent enterprises or which shall have resulted from excessive expansion of activities during the period between 1 July 1937 and 1 September 1945 in relation to its previously existing position in the field of activity. In this case, "influence" shall mean control sufficient to have a substantial effect upon the price or flow of capital, or upon the price or flow of goods or services, if the enterprise is to be withdrawn from the market.

With regard to the enforcement of this law, unrelated field of activity shall mean any field neither corresponding to those fields of production which are dependent upon each other in productive process, which are stages of production relating to production of same final product, nor to those fields of activity which are useful for each other in production, marketing on management rationalization.

"Competition" as used in this law concerning the enforcement of this law, competitor shall mean actual or potential competition or competitor.

"Production capacity" as used in this law shall mean degree of production obtainable by maximum operation of production facilities at normal condition.

"Family" as used in this law shall mean person, his or her spouse and relatives within third degree kinship.

With regard to the enforcement of this law, wealth of an individual or family shall include property of all enterprises as well as all other property owned or controlled by such individual or members of family.

Article 3.

The HCLC shall designate excessive concentrations of economic power which exist on the effective date of this law or which shall have been in existence at any time between 1 August 1945 and the effective date of this law, and shall eliminate such excessive concentrations of economic power in interest of public welfare.

For this purpose, an excessive concentration of economic power shall be defined as any private enterprise conducted for profit, or combination of such enterprises, which by reason of its relative size in any line or the cumulative power of its position in many lines, restricts competition or impairs the opportunity for others to engage in business independently, in any important segment of business.

The HCLC shall designate excessive concentrations of economic power in accordance with the foregoing definition and in accordance with standards to be adopted under the provisions of Article 6.

Article 4.

The designation by the provisions of the preceding Article shall be made on or prior to 30 September 1948.

Article 5.

When the HCLC has made designation provided for by Article 3, it shall transmit such designation in writing to the interested persons. The cancellation of the designation of the same Article shall be transmitted in writing to the interested persons.

The transmission of designation of the preceding paragraph may be made by means of public notification.

Article 6.

The HCLC shall decide and make public the specific standards for determining what shall constitute excessive concentrations of economic power upon consideration of the following factors and other necessary matters.

1. Percentage of amount of production or other economic activity of any enterprise in Japan proper to the total amount of production or other economic activity of Japan proper in the respective field of activity.

2. Comparison of present production capacity in Japan proper with maximum production capacity in Japan proper on or prior to 30 June 1937 of any enterprise.

3. Comparison of percentage of present production capacity or amount of other economic activity in Japan proper of any enterprise to the total production capacity or total amount of other economic activity of Japan proper in the respective field of activity with such maximum percentage on or prior to 30 June 1937.

4. Relationship of control over other enterprises.

5. The number, location and other geographic conditions of plants operated by any enterprise.

6. Whether plants are inter-related in productive processes and extent of such inter-relation, use of raw materials, products produced or in markets for products.

7. Control of raw materials by any enterprise.

8. History of expansion of business activity by means of merger of independent enterprise or other means.

9. Comparison of the efficiency of production of any enterprise with the efficiency of its separated parts or combination of separate parts.

10. Participation of any enterprise in or the existence of any arrangement or relationship including exclusive sales or purchasing or other similar arrangements of a monopolistic or restrictive character, or which provides for special privileges in the purchase or sale of materials, restrictions upon production or distribution, fixing prices, restrictions upon business or sales areas, or the exclusive exchange of patents or technical information.

11. Control over substantial business activity operated by individuals or members of family.

In deciding "efficiency of production" of Clause 9 of the preceding paragraph, considerations shall be given whether quantity of output or unit costs will be affected by changing the organizational structure of the enterprise.

Article 7.

The HCLC shall take such action in regard to the elimination of excessive concentrations of economic power designated by the provisions of Article 3, as are necessary to accomplish the purpose of this law.

The HCLC shall have the power mentioned below within necessary extent in taking such action as provided in the preceding paragraph.

1. To determine the principles, plans and procedures for the elimination of excessive concentrations of economic power designated by the provisions of Article 3.

2. To collect, compile and investigate various information; to require the compilation and submission of informations; to order the keeping of records; to require production of report and views; to order persons possessing accounting books, documents and other matter to submit the same, and to detain any submitted matters.

3. To summon and question persons concerned or witnesses and to summon experts and cause them to give expert testimony.

4. To make any spot inspection of any place of business or other necessary places and examine conditions of business operation and property, accounting books and other matters.

5. To order transfer or delivery of property; to require delegation by proxy the right to execute the voting rights of stocks and other securities; or to order acquisition of securities by money received in equivalent to the transferred properties or to deliver securities in equivalent to the transferred properties and to restrict voluntary transfer of such securities, in case properties belong to individuals or members of family.

6. To order the juridical person or other organizations to dissolve and to order to terminate any arrangement of monopolistic or restrictive characteristics such as cartels, syndicates, combines, combinations, trusts, or exclusive sales or purchasing; and to prohibit such actions as to perpetuate excessive concentrations of economic power.

7. To require the submission of plans for reorganization of enterprise, the disposal of assets and other necessary measures to eliminate excessive concentrations of economic power designated by the provisions of Article 3; to approve such plans; and to prepare plans of reorganization in case plans of reorganization are not submitted or the submitted plans of reorganization are not appropriate.

8. To appoint receivers with all legal and other powers to execute plans of reorganization; and to supervise the execution of plans of reorganization, disposal of assets, dissolution or liquidation of juridical person or other organizations, or other necessary measures for eliminating excessive concentration of economic power.

9. To prohibit unauthorized transfer of property or other activities prior to the approval of the HCLC.

10. To take such other measures as it may deem necessary to eliminate excessive concentrations of economic power designated by the provisions of Article 5 and consistent with the provisions of this law.

11. To issue necessary order to carry out the matters mentioned in the preceding items, and to decide and notify to public any rules necessary to execute the same.

In case the HCLC orders any juridical person or other organization to dissolve in accordance with the provisions of Item 6 of the preceding paragraph, the respective juridical person or other organization is to be dissolved by such order notwithstanding the provisions of any other laws, ordinances or contracts.

A person who conducts spot inspection by the provisions of Item 4 of Paragraph 2, shall be required to carry with him a specific warrant.

Article 8.

In case the HCLC approves or directs any plans of reorganization, disposal of assets or such other necessary measures as eliminating excessive concentrations of economic power designated by the provisions of Article 3, directs measures provided in Item 5 or 6 of the second paragraph of the preceding Article or, if it is deemed necessary, directs any other measures, orders of such approval or direction shall be transmitted, in writing, to all interested persons and the FTC.

The proposed order by the provisions of the preceding paragraph (except in the case of voluntary plants of reorganization to be approved) shall be accompanied by written findings of fact. The written findings shall disclose in detail the economic, manufacturing and other date upon which the order is based, or such information shall be transmitted with the order in memorandum form in addition to the findings.

The provisions of Article 5, Paragraph 2 shall be applied mutatis mutandis to the transmission of order of the first paragraph.

Article 9.

The HCLC shall hold a hearing with interested persons at a date not earlier than fifteen days after the date on which proposed order was transmitted.

At the hearing of the preceding paragraph, all interested persons may make objections or recommendations to such proposed order.

The HCLC may decide and notify the public rules for procedure for hearing provided in the first paragraph.

Article 10.

In case the FTC deems there exists any conflict with the provisions of the Law No. 54 of 1947 relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade (hereinafter referred as Anti-Trust Law) in the proposed order, it shall indicate such conflict to the HCLC.

Article 11.

The HCLC may make necessary changes in its proposed order on the basis of objections or recommendations of the provisions of Article 9, Paragraph 2, or the indications by the provisions of the preceding Article.

In case the HCLC decided order, the final order shall be transmitted in writing, to all interested persons.

The provisions of Paragraph 2 of Article 5 shall be applied mutatis mutandis to the transmission of the final order of the preceding paragraph.

Article 12.

The HCLC shall not approve a plan of reorganization unless it shall accord fair and equitable treatment of creditors, security holders and shareholders (including partner; hereinafter the same).

A plan of reorganization may provide the modification of the right of creditors, security holders or shareholders without approval of the same, such persons, however, shall have the right to raise objection at the hearing.

Article 13.

If any findings of fact shall not be supported by substantial evidence, or if the HCLC

shall have neglected to consider substantial evidence, in appeal may be raised to the Prime Minister by interested persons within thirty days of the transmission or public notice of the final order, providing, however, no such appeal shall be made unless such ommission of evidence shall have been specifically raised at the hearing or if such substantial evidence shall have been wilfully withheld from the HCLC.

Article 14.

Within thirty days of such appeal as provided in the preceding Article is taken, the Prime Minister shall determine whether such ommission is such a substantial character as to render the order arbitrary.

In case the Prime Minister deems such ommission of evidence is of such a substantial character as to render the order arbitrary, the order shall be returned to the HCLC for proper modification by applying mutatis mutandis the procedures provided in Article 8-11 to the extent necessary to correct ommission.

Article 15.

The enforcement of the final order shall be suspended during the period an appeal may be taken as provided in Article 13 and until a decision shall have been made in case an appeal was made in accordance with the provisions of the same Article.

Article 16.

The excessive concentration of economic power, whether or not based upon provisions of other laws and ordinances, or whether its creation shall have been voluntary or involuntary, may be eliminated in accordance with the provisions of this law.

Article 17.

This law shall not be administered to contravene official rationing regulations.

Article 18.

With regard to the excessive concentration of the economic power designated by the provisions of Article 3, the HCLC shall not be precluded from taking necessary action to prohibit the prepetuation of such excessive concentration of economic power in any other form in the event its organization shall have ceased to exist, been dissolved or liquidated, or shall be in the process of dissolution or liquidation, or shall have been changed.

Article 19.

The matters concerning the enforcement of the final order issued by the HCLC shall be charged by the FTC.

Petition for modification of the final order of the HCLC may be made to the FTC.

The final order of the HCLC shall not be modified upon the petition for modification provided in the preceding paragraph without the prior approval of the HCLC before the date on which the functions of the HCLC shall be transferred to the FTC by the provisions of Article 26.

Article 20.

The HCLC may delegate to FTC, in part, its function to be performed by the provisions of this law.

The HCLC may assign the business concerning the carrying out of functions to be performed by the provisions of this law to other government agencies to the extent necessary in carrying out such functions.

Article 21.

Any person, coming under any one of the following items, shall be punished by a penal servitude for not more than three (3) years or by a fine not more than one hundred thousand (100,000) yen.

1. One who has violated the orders or requirements issued by the provisions of Article 7, Paragraph 2, Item 5 or who has violated the restrictions provided in the same Item.

2. One who has violated the orders to terminate any arrangement issued or the prohibition imposed by the provisions of Article 7, Paragraph 2, Item 6.

3. One who has violated the prohibition by the provisions of Article 7, Paragraph 2, Item 9.

Any person guilty of any of the offences prescribed in the preceding paragraph may, according to circumstances, be punished by both penal servitude and a fine.

Article 22.

Any person who has refused, obstructed, or evaded such inspection as provided in Article 7, Paragraph 2, Item 4 shall be punished by a penal servitude for not more than six (6) months or by a fine not more than one thousand (1,000) yen.

Article 23.

When a representative of a juridical person or an agent, an employee, or any other person in the service of a juridical person or of an individual has committed a violation as provided for by Article 21, Paragraph 1 or the preceding Article with respect to the business or property of said juridical person or individual, not only shall the offender by punished but said juridical person or said individual shall also be punished by such fine as provided for by the respective articles.

Article 24.

Any person who has refused requirements to submit such plans as provided for by Article 7, Paragraph 2, Item 7 shall be liable to a non-criminal fine for not more than ten thousand (10,000) yen.

Article 25.

Any person, coming under any one of the following items, shall be liable to a non-criminal fine for not more than one thousand (1,000) yen.

1. One who has refused requirements by the provisions of Article 7, Paragraph 2, Item 2, or who, in violation of orders issued by the same Item, has failed to compile information, to submit information, report, view, accounting books or documents etc., or to keep records, or who has submitted false information, report, or view.

2. One who has violated the order to appear by the provisions of Article 7, Paragraph 2, Item 3, who has failed to give testimony to the question made by the same clause or gave false testimony, or who has failed to give expert testimony or gave false expert testimony for the order to give expert testimony by the provisions of the same clause.

Article 26.

The functions, powers, records, and such personnel as are necessary to secure the accomplishment of the aims of this law, of the HCLC, shall be transferred to the FTC in accordance with the provisions of separate law to be issued on or after 1 September 1948 and on or prior to 31 December 1948.

Article 27.

The provisions of the Anti-Trust Law and the functions of the FTC based upon the provisions of the same law, shall not be modified by the provisions of this law and the functions of the HCLC.

Supplementary Provision

This law shall come into force as from the date of its promulgation.

The Law concerning the Temporary Measures for Dividend of Profits and others of Corporations shall partially be amended as follows.

In Article 4, after "which have submitted reorganization plan under the Enterprise Reconstruction and Reorganization Law," and companies which have been designated pursuant to the provision of Article 3 of the Elimination of Excessive concentration of Economic Power Law (hereinafter referred to as designated companies)" shall be inserted, and after "approved reorganization plan under the Enterprise Reconstruction and Reorganization Law", "or of the final order under the Elimination of Excessive Concentration of Economic Power Law" shall be inserted and the following new paragraph shall be added to the same Article.

In case where Minister of Finance is to give permission as provided for by the provise of the foregoing paragraph, with respect to dividend of profits of designated companies (excluding designated companies which are special accounting companies), he shall obtain prior recommendation of the HCLC.

In Item 1 or Paragraph 1 of Article 7, before "Article 4," "Paragraph 1 of" shall be

inserted.

[SOURCE: *NMA* #25, Reform of Business Enterprise, Part C, Deconcentration of Economic Power, Appendix 2.]

6-31 MacARTHUR'S SUPPORT FOR THE LAW FOR THE TERMINATION OF ZAIBATSU FAMILY CONTROL[24]

Telegram No. 34745 January 9, 1948
To: CSCAD PL (Under-secretary Draper)
From: CINCFE (MacArthur)

Reurads W-93502 January 7th and W-93520 January 8th, the Law for the Termination of Zaibatsu Family Control is in no sense a purge instrument nor related to the purge program which was designed to eliminate from influential positions in government and business persons who as ultranationalists and militarists could not be expected to influence the future development of Japan in the direction of peace and democracy, but is an integral part of the program for the dissolution of the powerful octopus of monopolistic financial, industrial and commercial combines whose continued existence would make the development of any semblance of free capitalistic enterprise in Japan impossible and would defeat the objective of achieving political democracy. It is a companion law to Public Law number 207 (Law for the Dissolution of Excessive Concentrations of Economic Power) passed by the Japanese National Diet on 9 December 1947 with the additions and changes stipulated in Department of the Army radio W-91710 dated 9 December 1947.

Review of the historical background to this measure and its detailed requirements is indispensable to its comprehensive understanding. It was early recognized in Washington policy studies that any program for the dissolution of excessive concentrations of economic power in order to be effective must attack not only those concentrations which exist by virtue of commercial, industrial and financial combinations, holding company devices and strategic intercorporate holdings, but also the relationships which exist by virtue of securities holdings by members of Zaibatsu families which, whether formally organized or not, have acted cohesively to perpetuate the control and influence of those families. Accordingly the Holding Company Liquidation Commission, under Imperial Ordinance No. 233 of 1946, in addition to designating for liquidation 67 holding companies which through over four thousand subsidiaries have controlled 75% to 80% of all industrial, financial and commercial business in Japan, has also designated 56 persons as heads of families which compose the ten leading Zaibatsu households or family clans, has taken over their corporate securities and prohibited them from holding or assuming positions as officials in any company. The Law for the Dissolution of Excessive Concentration aims at breaking up monopolistic combines below the holding company level. The Law for the Termination of Zaibatsu Family Control is designed to terminate the control or influence over Zaibatsu enterprises which Zaibatsu families have exercised and are still exercising by virtue of securities and officerships held by members of the immediate families of the 56 designated Zaibatsu family heads or through officials who having been appointed by and having represented the interests of Zaibatsu families, may be expected to continue such influence if permitted to remain as, or become, officials in enterprises affiliated with the Zaibatsu. Its purpose is to avoid defeat of the deconcentration program through the use of "fronts" related to the Zaibatsu by ties of blood or by feudalistic allegiance, as has been widely predicted by the press of every one of the Allied Powers not excepting that of the United States, and charged by Allied representatives seated in Tokyo and debated in the Allied Council.

Thus, the two categories of persons affected by this law are (1) the immediate family members of the 56 Zaibatsu family heads designated under Imperial Ordinance No. 233, and (2) non-family members who, as officials in Zaibatsu-controlled companies, have owed their appointment to, and have represented the interests of, such Zaibatsu in the companies with which they have been associated.

Persons in the first category, i. e. the immediate family members of the 56 designated Zaibatsu family heads, are prohibited under the law for ten years from holding or assuming any position in any Zaibatsu or restricted company or their subsidiaries and affiliates as defined under Imperial Ordinance No. 567 of 1946. They are, however, free to become

[24] This law was promulgated January 7 as Law No. 2, 1948.

officials of companies outside the restricted category, and they are not excluded from public office.

Persons who, having occupied the stated policy-making positions, are designated as appointees of the Zaibatsu, are prohibited for ten years from holding or assuming positions as officials in any of the restricted concerns identified with the Zaibatsu family of which such persons are designated as appointees. They are, however, free to hold or assume positions as officials in all companies outside the restricted list. Even within the restricted category, they may serve as officials in companies not identified as under the control of the particular Zaibatsu whom they represent. They are not divested of any of their securities and they are not excluded from any public office.

Any person falling under the definition of appointee may be exempted from such designation by showing either (1) that the company of which he was an official was not, during the period of his incumbency, under the control of the particular Zaibatsu company he represented, or (2) that the circumstances of his appointment or the nature of his activities in the exercise of his duties were such that he could not, without gross injustice, be designated as a Zaibatsu appointee. In addition, the law provides special exemptions under certain circumstances. These are (1) in the event all the officials of a company are subject to retirement under the provisions of the law, they may apply for permission for one person selected from the group to retain his position for a period of 6 months; (2) persons subject to retirement under the law, who are serving as liquidators in a company under liquidation or are chosen to serve in such capacity, may upon application be exempted for one year, renewable if necessary; (3) in the case of officials for whom replacements are unobtainable and whose services are indispensable to the management of a company which is engaged in activities essential to the reconstruction of the national economy, such persons may upon application of the company, be permitted to retain their posts for a period of up to one year.

The enforcement of the law is under the jurisdiction of the Prime Minister of Japan who is advised by an Appointees Examination Committee which examines all applications for exemption from designation and applications for or retention in or assumption of office, and reports its findings and recommendations to the Prime Minister. In addition, persons whose applications for exemption from designation or for retention in or assumption of office have been disapproved, have the right to appeal for re-examination. Such requests for re-examination will be referred to a re-examination committee which submits its reports, findings and recommendations to the Prime Minister.

The two committees provided for by the law have not as yet been appointed nor begun to function but it is expected that they will soon. Under the policy and practice which I have pursued throughout the Occupation, the administration of the law will be kept entirely in the hands of the Japanese authorities subject to my inherent power of review and intervention where necessary in the furtherance of Allied policy. The cases of the individuals named in your radio W-93502 will be considered in due course under the administrative procedure described above, which includes notification, the right of request for exceptions and the right of appeal if such request is denied. The information contained in your radio will be considered in connection with their cases if and when they come up for review. Were I to intervene in their behalf and mark them for exemption even before their cases have been considered by the Japanese Government, I would in effect be prejudging their cases, establishing a precedent which would seriously hamper if not cripple the administration of the law and undermine the spirit of self-reliance and initiative in the administration of its internal affairs which I have throughout encouraged and fostered in the Japanese Government.

Subject law was prepared by the Japanese Government in implementation of the require ments of SWNCC 302/2 which, as finally adopted by the State War and Navy Departments became the American policy, and which in pertinent part reads as follows; (Para 5):

"All individuals who have exercised controlling power in or over an excessive concentration of economic power, whether as creditors, stockholders, managers, or in any other capacity, should be:

"a. Divested of all corporate security holdings, liquid assets, and business properties;

"b. Ejected from all positions of business or governmental responsibility;

"c. Forbidden from purchasing corporate security holdings or from acquiring positions of business or governmental responsibility at any time during the next ten years.

"All other persons likely to act on behalf of the individuals described above should be subjected to the measures specified below. In determining who such persons may be, such factors as ties by blood, marriage, adoption or past personal relationship should be taken

into account. (The phrase "past personal relationship" is used in the previous sentence chiefly in reference to persons who have been placed in positions of substantial responsibility in holding companies or their subsidiaries by the Zaibatsu families, but it would also be taken to refer to persons otherwise associated with the Zaibatsu whom SCAP may consider to be acting as "fronts" for the latter.) Such persons should be:

"a. Divested of liquid assets and business properties, where they possess such assets or properties in amounts of any significance, and divested of all corporate security holdings in any excessive concentration of economic power and corporate security holdings representing an interest of more than 1% in any other major private enterprise;

"b. Ejected from all positions in business or government which might be used to favor Zaibatsu interests;

"c. Forbidden from purchasing corporate security holdings, or from acquiring positions in business or government which might be used to favor Zaibatsu interests, at any time during the next ten years.

Where doubt exists as to whether a given person should be covered by the above policies, that doubt should be resolved by SCAP in favor of coverage, since it is desired to divest a sufficient number of holdings to effect a thorough-going transformation of the ownership and control of large-scale Japanese industry."

Comparison of the above language with the provisions of the Japanese law as summarized above clearly shows that the treatment of both Zaibatsu family members and the Zaibatsu appointees contemplated under the law is substantially more moderate than that called for in the U. S. policy paper. If that policy were followed literally, all these persons would in reality be purged from all positions of governmental or business responsibility, would be divested of all securities holdings in companies with which they have been affiliated and all corporate securities holdings in excess of 1% in any major private enterprise. The law is a Japanese product and I did not insist on its being tightened to conform to the language and intent of the U. S. policy paper because the drastic treatment contemplated in that paper was considered neither necessary to attain the desired objective, nor desirable in view of the situation in Japan. Under the law, the Zaibatsu family members are not deprived of the opportunity to invest in the securities of companies not related to their own Zaibatsu enterprise, and they are left free to utilize their abilities and talents in non-Zaibatsu enterprises, in the government service or in the professions.

As for the Zaibatsu appointees, since the only purpose of their removal is to prevent the continued exercise of Zaibatsu family influence through "fronts", it has not been deemed necessary here to divest these persons of their securities, as contemplated by the American policy, as it has been considered sufficient to prevent them from holding or assuming important posts in the companies which have been controlled by the Zaibatsu which they have represented. They are entirely free to use their talents and abilities in the government service or in the service of other private concerns, even within the Zaibatsu classification.

The provisions of the law permitting exemption from designation as appointees are designed to prevent arbitrary removals by categories and to prevent individual injustices. The provision for retention upon a showing of irreplaceability and indispensability in companies which are engaged in activities essential to the reconstruction of the national economy, was included at my direction as a further safeguard against undue adverse influence on economic recovery.

Throughout the implementation of this program, I have used the American policy paper for my basic guidance as to objective, but have in my executive discretion tempered and timed the implementation thereof to meet the needs of the situation as it developed here. As a result of this, the Law for the Termination of Zaibatsu Family Control as it now stands on the books is not only considerably more moderate than the requirements under SWNCC 302/2, but is much more moderate even than the pertinent requirements of the current proposed revision of SANACC 302/2, a copy of which was brought here by General Fox within the last few weeks, which reads as follows, (para. 4c):

"Any individual who has exercised de facto controlling power in or over any excessive concentration of economic power, regardless of the titular capacity or relationship to such excessive concentration of economic power of such an individual, and any person acting for such an individual should be divested of all such power and should be prohibited and prevented from re-establishing such controlling power. Further, any such an individual or person acting therefor should be prohibited and prevented from exercising influential and significant power in business and governmental affairs prior to 1958, unless otherwise provided in international agreements hereafter provided."

It is to be noted that even under this provision, the exclusions contemplated refer to all positions of business and governmental responsibility. It is further to be noted that this represents the current thinking in Washington after the issue of the comparibility of FEC 230 (the old SWNCC 302/2) had been raised, debated in the press and been given fullest consideration.

As stated above, the purpose of the law is not to eliminate individuals from the economy or government of Japan but to establish an effective control upon the continuance of Zaibatsu influence exercised through "fronts". It is probable that, in view of the broad field for exemption provided in partial disregard of U. S. policy requirements, only a relatively few persons will be affected by removal or resignation, but the legislation will be a powerful factor in the suppression of conspiracy to circumvent Allied policy. Its implementation is now in process and completion is expected by April 1st. The suggestion which has originated largely in American minds that the lack of competent leadership is an important deterrent to the rehabilitation of the Japanese economy is wholly falacious. The basic deterrent, of course, is the lack of raw materials essential to industrial production and the food deficiency essential to sustain working energy, solution of which problems in turn is entirely dependent upon the reopening of the channels of foreign trade, the return of commerce to private controls, the establishment of a rate for foreign exchange, and the restoration of peace. The economic blockade which now restricts trade stifles, and until lifted will continue to stifle, any large-scale reconstruction of the Japanese economy. Despite these overwhelming handicaps, the recovery of the Japanese economy has been astoundingly large in a relative sense when account is taken of the much greater per capita assistance given by the United States to other foreign nations. As an example, the German economy has a per capita ratio of 11.11 dollars as compared to that of 4.23 dollars for Japan.

Presently looming as a major cause of lag in the industrial recovery on the local scene is the increasing resistance on the part of large entrenched interests to any constructive action whatsoever. Inspired by support from influential sources from without, there is increasing evidence of slow-down tactics designed to stall for time, and defeat the efforts and purposes of the Occupation authorities in the implementation of Allied policy. Many of the companies involved in such techniques assumed a major share in the exploitation of the human and material resources in the Japanese pre-war era, in gearing the country for war, and later in prosecuting war with maximum violence. Measures taken to reorient the Japanese economy away from Zaibatsu control and influence have the whole-hearted support and approval of an overwhelming majority of the Japanese people and their present government. So deeply rooted in fact is this purpose in the Japanese mind that if such control and influence were permitted to survive the allied occupation, it is probable that its subsequent elimination woud occur through the violence of revolution. Until quite recently, even the local officers and directors of affected companies have been entirely submissive to occupation direction and requirements, if not actively in cooperation. They are now becoming restive, unquestionably encourage not only by press reports of disagreement and controversy in allied circles, but probably by persuasive influence exerted by affiliates abroad, and are attempting to circumvent allied policy, purpose and direction, seeking to maintain the status quo in the period between now and an anticipated soft peace.

The answers to the present economic problems do not lie in the softening of allied policy, nor in the coddling of war guilty and their associates merely because affiliated with American interests, but in accomplishing those things essential to the inauguration here of a healthy economy based upon free competetive enterprise through adequate access to raw materials and world markets in an aftermath of peace.

MacARTHUR

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

6-32 MacARTHUR'S VIEWS ON FEC-230

Memorandum of Interview with MacArthur — January 21, 1948
Prepared by a News Reporter[25]

I paid a periodic curtesy call on Gen. MacArthur tonight and was kept an hour and a half while he defended and explained recent activities of his headquarters in Japan. I left with the impression that he now had a firm grip on the economic situation and knew what

[25] This document is a copy in the possession of the Finance Ministry. There is no indication of the reporter's name or affiliation.

was going on. He would let me use the substance of his remarks as the basic for any story. Highlights of what he said were:

1. Price control and rationing is necessary in Japan because the supply of necessities is far below minimum needs. If control is removed the poorest element of the population would starve to death, providing fine ammunition for communists. He is personally opposed to controls, and they will be removed as soon as supplies are adequate.

2. His New Year's message, he said, was a conscientious effort to explain and summarize the economic aid of the occupation. He was disappointed it was largely ignored by the American press, with the exception of the Tribune and few other papers. I needled him by mentioning that it had been praised editorially by only one paper—The N. Y. Herald Tribune—which usually opposed his policies. He said his personal policies have been dedicated to setting up a democratic capitalistic society in Japan that will be able to stand on its own feet after the occupation leaves. He fears that if Japanese monopolies aren't broken there will be revolution "that will make the French revolution look like a sewing circles here within two years after the occupation ends. The result would be a socialist state of some kind, he believes.

3. FEC-230, the confidential state department directive, was the subject of much of the conversation. He brought out some new fact of which I hadn't been aware. Mentioning that the document was based on a report by Corwin D. Edwards, professor of economics at North Western University, he added that he had rejected the first Edwards report when it was sent to him. It was a visionary plan for the break-up of Zaibatsu monopolies that would require 100,000 trained men to administrate, he said. The plan was sent to Washington and a much milder report resulted. This went to the State Department and was used by one Ed Martin and others, presumably anti-trust lawyers, as a basis of a report to the joint chiefs of staffs. Their report was passed by Gen. Hillding, Peterson, and Sullvian, representing state, war, and navy departments. Apparently these men didn't realize the dynamite the report contained, for they passed it on to the Far East Commission without change. It was then designated as FEC-230.

MacArthur said he has no intention of applying such section of FEC 230 as called for the sale of Zaibatsu securities regardless of their value to selected purchasers such as labor unions. He said the sale would be stretched over a period of time so as to realize fair value, also many of the companies were pretty well wrecked by the war. He defended the deconcentration of industry bill that forced through the diet here in December. (The bill is a mass of generalities; the administrative standards, have been reffered to Washington, also he didn't say so.)

He castigated Newsweek magazine for political motives in printing the text of FEC 230 in their December 1st, issue, declaring Vincent Astor and Harriman of the Newsweek were "the Wall Street crowd" that was anxious to get him. He said Compton Pakenham, Newsweek's former correspondent here, apparently got a hold of a copy of the document. (This is correct) He described Pakenham as a British citizen, a representative of Japanese vested interests, and a reporter who got all his news from Japanese sources. (MacArthur has personally barred Pakenham from returning to Japan. There will probably be quite a fuss kicked up about this soon. I have refrained from filing anything on it because there is some controversy about the facts. Pakenham went home last fall and his application to return was denied. When he was here, he often wrote critically of the purges and other activities engineerd by left-wingers in MacArthur's Government Section. Another correspondent barred by MacArthur was Victor Boesen of Liberty Magazine, who wrote a piece about army extravagances entitled (Goldfish for the General.)

On the whole, MacArthur said, criticism of FEC-230 was beneficial because it got a lot of newspaper space and brought the occupation of Japan into the limelight once more. He has the feeling that the American public has forgotten Japan and doesn't care what happens here any more.

My own reaction is that the criticism focused MacArthur's attention on some of the economic aspects of the Occupation for the first time. Previously, he had been giving much of his attention to smoothing out differences between the Far East nations on the peace treaty and reparations questions. Lately Brig. Gen. Bill Marquat, Chief of the E. S. S. sees MacArthur much more often than formerly, and Marquat is much more cordial to the press than he used to be.

[Source: Mitsudo Papers, Ministry of Finance]

6-33 DETERMINING DE-CONCENTRATION OF EXCESSIVE ECONOMIC POWER AND THE DE-CONCENTRATION REVIEW BOARD

Telegram No. 260433[26] January 26, 1948
Approved by: W. F. Marquat
To: Dept. of the Army
From: SCAP (MacArthur)

(Z-36542) For CSCAD Subject is enforcement of Japanese Public Law No. 207 Law for the Elimination of Excessive Concentrations of Economic Power passed by the Diet on 9 December 1947 with the additions and changes stipulated in Department of Army radio W 91710 dated 9 December 1947. Radio is in seven parts.

Part I. Designation for Examination as Excessive Concentrations.

1. Pursuant to requirements of Article 3 and Article 6 of Japanese Public Law No. 207 passed by the Diet on 9 December 1947 under title "Law for Elimination of Concentrations of Excessive Economic Power," companies will be publicly designated in four categories under classification as (a) industrial, (b) distributive and service, (c) insurance and (d) banking. Plan is for HCLC to designate companies promptly thereby assuring non-designated institutions that they will not be required to reorganize as excessive concentrations under this law. Companies and the public will be informed that designation does not constitute a reorganization order. Total designated companies are estimated at approximately 300 of which more than 70 percent are now restricted Zaibatsu concerns. This number is about one-third of one percent of total corporations in Japan but the degree of direct or indirect control extends to 80 percent of Japan's industrial, financial and commercial enterprise.

2. Standards for designation and reorganization will be issued by HCLC for each of the four categories simultaneously with announcement of designated corporations, except that standards for financial institutions will not be made public initially. Standards will be sufficiently flexible to permit realistic determination in each case upon the basis of the characteristics of the company. Standards based upon capitalization in yen, scale of production or similiar rigid specifications will be avoided. Financial soundness and productive efficiency will be strategic determinants as to the type and extent of reorganization required. Application of standards governing a reorganization where required should result in insuring freedom of enterprise while at the same time tending toward an improvement in management efficiency and tending toward decreasing yen costs of production. Complete standards being forwarded.

3. Plan is to require HCLC to designate industrial companies first, distributive and service companies second, insurance companies third and banks under a special procedure. Banking institutions of which six probably will come under the classification of excessive concentrations, will be designated separately. Banks probably to be affected by deconcentration now are reorganizing pursuant to provisions of the Financial Institution Reconstruction and Reorganization Law and major changes necessary to eliminate excessive concentration characteristics are being effected in so far as practicable. Objective is to conduct reorganization of banks to maximum degree possible before public announcement is made in order to prevent loss of public confidence in banking structure or in any banking institution.

Part II. Determination of Existence of Excessive Concentration of Economic Power.

The law provides that determination of actual existence of excessive concentrations of economic power and reorganization of companies under standards issued is a function of the Holding Company Liquidation Commission. This is to be carried on in all stages under surveillance of the Supreme Commander's Headquarters. Procedure substantially is as follows:

a. Company designated submits plan to the HCLC for reorganization under standards applicable to its category. Plan will have been worked out as evidence of the degree and type of reorganization that will be required if designated company is actually ordered to reorganize.

b. Company may file with the plan a claim that it should not be required to reorganize on the basis of the standards.

[26] Cf: The telegram draft of November 25, 1947 which requested the Review Board. (Printed in this volume.)

c. Company files statement of the effect of reorganization upon corporation stability, production capacity and financial structure, and other data requested by HCLC.

d. HCLC analyzes the reorganization plan and the company statements and consults with company officials and other interested parties.

e. HCLC holds a formal hearing at which determination is reached as to whether company is, in fact, an excessive concentration and whether company should be reorganized and, if so, the extent and form of reorganization.

f. If company claims that it is not an excessive concentration is upheld by HCLC, HCLC removes company from designated list. If HCLC determines that although company is an excessive concentration it cannot be reorganized because of technological considerations, HCLC removes company from designated list but remands it to Fair Trade Commission for surveillance.

g. If HCLC determines that the company is to be reorganized it issues the necessary orders. A copy of the reorganization order is forwarded to the Supreme Commander.

Part III. Review and Advice with Reference to the Impact of Deconcentraton Proposed upon the Operating Efficiency of the Enterprise as Reflected in the Domestic Economy.

1. It is proposed that analysis of the impact of the deconcentration action proposed by the HCLC upon the operating effeciency of the industrial, distributive insurance or banking enterprises concerned as reflected in the domestic economy, be made by an advisory group to be designated as the Deconcentration Review Board, functioning under SCAP.[26]

2. This board will receive from SCAP the HCLC reorganization order, review it together with statements of the companies concerned and make an independent assessment of the situation. Its investigations will include direct conference contacts as desired.

3. In general this board accepts the plan of reorganization for purposes of review as it is presented and appraises the effects of such plan on the operating efficiency of the enterprise as reflected in the economy. This provision simplifies the board action and makes possible the most rapid review of any claims presented.

4. The Deconcentration Review Board states its findings to the Supreme Commander for the Allied Powers as follows:

a. The company may be reorganized as per plan without drastically reducing operating efficiency with manifest impairment of the economy, or

b. The company may not be reorganized as per plan without drastically reducing operating efficiency with manifest impairment of the economy, or

c. The plan contains fundamental defects preventing its use in meeting the requirements of deconcentration without drastically reducing operating efficiency with manifest impairment of the economy.

5. Based on its findings, the Board advises the Supreme Commander when, in its opinion, he should exercise his inherent right to intervene for the purpose of staying, modifying, or setting aside any action or order of the HCLC or any other Japanese governmental agency charged with implementing the deconcentration program.

6. The Supreme Commander decides whether to intervene in the HCLC action after consideration of all facts made available to him by the HCLC and the Deconcentration Review Board.

Part IV. Action.

The HCLC takes necessary action in connection with the administration of Japanese Public Law No. 207 (Law for Elimination of Concentration of Excessive Economic Power). This is done by issuance of orders to the company concerned and subsequent surveillance of the implementation of those orders. When a company has completed reorganization or has been eliminated from designation as an excessive concentration of economic power, or has been released pursuant to instructions from the Supreme Commander, it is publicly announced as free to operate without further reorganization as an excessive concentration under this law.

Part V. Appeal

1. Provisions of Public Law No. 207 permit appeal to the Prime Minister upon neglect of the HCLC to consider substantial evidence. Appeal is filed in accordance with established Japanese procedure.

2. Judicial appeal from actions of the HCLC is provided in Japanese Law pursuant to the Japanese constitution.

3. Favorable action on the appeal by the Prime Minister will be manifested through a directive to HCLC to modify its action. Favorable decision of appeal to the courts will terminate the specific reorganization action of HCLC which then must either initiate a new reorganization action or remove the company from the designate list. Any new reorganization plan will be processed to the Supreme Commander for the Allied Powers through the same channels as the original action.

4. Appeals will be from actions of the HCLC and not from the instructions of the Supreme Commander for the Allied Powers. The Supreme Commander possesses the inherent right to annul action by the Prime Minister or the courts or to terminate appeal action.

[26] Cf.: The telegram draft of November 25, 1947 which requested the Review Board (Printed in this volume).

Part VI. Constitution of the Deconcentration Review Board.

1. Request that a group of five specially selected and outstanding individuals on policy making level be recruited in the United States for duty in Japan under the Supreme Commander for the Allied Powers as the members of the Deconcentration Review Board. Members should be prepared to serve for a period of not less than one year, extendable if required.

2. The board members should meet the following specifications:

a. Antitrust specialist from the Department of Justice Antitrust Division.

b. Securities and corporate finance specialist from the Securities and Exchange Commission.

c. Corporate management specialist.

d. Industrial engineer and plant management specialist.

e. A suitable presiding member.

3. It is desired that:

a. No appointee should be connected with a firm having interests in Japan from which position a prejudicial attitude may develop as to concentration or reorganization.

b. No appointee should be connected with a firm currently under prosecution by the U. S. Department of Justice for violation of United States Antitrust Laws.

c. Appointees should be notified in advance that they will be required to adjudicate within the framework of U. S. policy statements and upon directives from higher echelons.

d. Both business and government should be represented on the board.

e. The terms of reference furnished to the board members should include clear indication of the nature of duties to be performed. The contemplated procedure provides that they review the reorganization plans proposed by the HCLC for those companies scheduled for a change in corporate structure and that the board members submit to the Supreme Commander for the Allied Powers an expression of opinion as to how the reorganization, if effected, will be reflected in the efficiency of the operations of the enterprises concerned as to the consequent effect on the general industrial, financial or commercial economy of the country. These individuals will be available for such other appraisals as the Supreme Commander may desire to require of them, but their major have been specified in order to obviate the necessity for extensive preparation in Japanese industrial or financial history and to ensure rapid review of the main issue in each case.

It is essential that the utmost speed commensurate with adequate consideration of the problem to be attended since extended delay in implementing the program will produce undesirable reactions which should be avoided.

4. Request that names of proposed board members be submitted for clearance as soon as possible.

Part VII. General.

1. It is believed that the foregoing procedure will implement the directive contained in the proposed revision of SANACC 302/2 in a manner consonant with the intent of the United States Government, while providing proper safeguards and adequate consideration for any possible adverse effect upon industrial production, finance, price levels or general economic recovery.

2. The plan indicated herein is subject to modification as circumstances indicate the need therefor.

[Source: Suitland Papers]

6-34 RURAL LAND REFORM (SCAPIN-1885)

Memorandum February 4, 1948
SCAPIN-1885 (NR/A)

1. Reference is made to:

a. Memorandum for Japanese Government, file AG 602.6 (9 Dec. 45) CIE, (SCAPIN 411), subject as above, dated 9 December 1945.

b. Owner-Farmer Establishment and Special Measures Law, Law No. 43, 21 October 1946.

c. Agricultural Land Adjustment Law, Law No. 67, 2 April 1938, as revised by Law No. 64, 28 December 1945, and by Law No. 42, 21 October 1946.

2. The Owner-Farmer Establishment and Special Measures Law and the Agricultural Land Adjustment Law were enacted in accordance with the reference memorandum, in order to eliminate the feudal system of land tenure and remove economic obstacles to the redistribution of the land on an equitable and democratic basis. Since the enactment of these land reform laws, however, efforts have been made by certain adversely affected interests to obstruct the accomplishment of the rural land reform program.

3. The firm implementation of the Land Reform Program is essential to the creation in Japan of a society which is truly free and democratic and, as a consequence, it has become one of the foremost objectives of the Japanese people as well as of the Allied occupation. Therefore, the strict, vigorous and fearless enforcement of the above-mentioned laws is both imperative and indispensable.

4. Accordingly, it is directed that:

a. The Ministry of Agriculture and Forestry will instruct prefectural and local agricultural land commissions to purchase without delay all land subject to Land Reform Law in accordance with existing procedures and without regard to unauthorized action by pressure organizations seeking to impede the objectives of the Land Reform Program.

b. The Japanese Government will take prompt and vigorous action against any and all persons who, by bribery, intimidation or other unlawful means, obstruct the implementation of land reform measures. Reports of such action will be submitted to this headquarters.

6-35 REMOVAL OF COMPANIES FROM THE "DESIGNATION LIST"

Memo for Record April 17, 1948
Prepared by Ormond Freile, ESS, SCAP

On Saturday 17 April a meeting was convened by the Chief, ESS to review a list of designated companies submitted by Anti Trust & Cartels Division, ESS which upon approval of the Chief, ESS would be processed by HCLC and the companies exempted from further action. Under the Deconcentration Law, names deleted from the List of Designated Companies and such public announcement made as is deemed appropriate.

Present:

Major General W. F. Marquat
Mr. Welsh
Mr. Freile
Mr. Randall
Mr. Gillies
Mr. Scheier

Mr. Welsh informed Gen. Marquat that he was presenting for approval a list of companies in four categories totalling 32 companies, which could be removed from the "Deconcentration List" immediately and stated that orders to accomplish that objective were being drafted.

Gen. Marquat expressed dissatisfaction with the small number on the list presented stating that in those categories these should be at least somewhere near 200 that could be readily identified as not being excessive concentrations of power.

Mr. Welsh presented rebuttal discussion stating that under FEC 014 and FEC 015 the companies must be dissolved.

Gen. Marquat after hearing Mr. Welsh voice his opinion said that

1. There was no criticism of the operation of AC under the existing directives except the lack of practical approval and a too diligent effort to materialize an academic theory.
2. Granted that certain directives could be interpreted as mandatory it must be realized that to attempt to reorganize a large segment of industrial companies representing 75% or more of the total production in an economy already lacking stability and vulnerable to cataclysmic disruption was impractical.
3. Lack of management "know how" to operate new companies is not available.
4. Operating now at about an average of less than 40% capacity the economy cannot stand the impact of added confusion, further destruction of will to produce and further extension of uncertainty now so obvious due to lack of decision in Reparations.
5. The change in emphasis in U. S. policy to economic recovery and indication of actively accelerating industrial production through monetary and material aid decimate all thinking along the lines of reorganization except that of the very few proven excessive concentrations of economic power, of which there should be less than twenty five.

Mr. Welsh again presented statements in rebuttal indicating his thinking and supporting the contention that if HCLC did not order such reorganization as were necessary they would not be realized. Industry would not benefit by more efficient organization, Communists would be delighted with the present situation and the reorganizations planed would benefit the economy faster than anything else, etc.

Gen. Marquat stated his instructions to Mr. Welsh, as follows:

1. All companies not now proved to be Excessive Concentration of power are to be immediately removed from the list.
2. Such surveillance as is necessary by AC to insure against development of concentration of economic power will be exercised.
3. Voluntary reorganization by companies is their business and is to be examined by AC only to determine that such reorganization is not detrimental to production and economic stability.
4. Thorough examination of those companies which are established as excessive concentrations of economic power will be made by AC and its recommendation Reviewed by the Deconcentration Board.
5. No Banks will be physically reorganized. They will be designated in order to avoid a possible charge that a segment was exempted from examination under the law. But cannot be reorganized without adversely affecting the economy. They will however be controlled through new banking laws so that they cannot again exert their power to limit credit or banking facilities or to create monopolies through interlocking boards and outright ownership. No designation of Bank will be made now.

The meeting adjourned with the understanding that a new list would be prepared by AC for submission next week in accordance with the foregoing and that a definite plan for banks would be worked out.

[SOURCE: SUITLAND PAPERS, Z 703-12]

6-36 OPERATING PROCEDURE REGARDING LAW NO. 207

Memorandum June 10, 1948
To: Deconcentration Review Board
From: W. F. Marquat, Chief, ESS.

1. It is the primary function of the Deconcentration Review Board to review and make recommendations concerning reorganization orders to companies designated under Law No. 207, prior to the enforcement of such orders. Within a reasonable range of flexibility, the following is the procedure:

a. The Holding Company Liquidation Commission will transmit to the Antitrust and Cartels Division, ESS, the file on each company, which in the Holding Company Liquidation Commission's judgment requires reorganization. Such file will contain all pertinent

data and papers available to the Holding Company Liquidation Commission, including the papers filed by the company, the Holding Company Liquidation Commission's analysis and recommendations, and a proposed order to the company.

b. The Antitrust and Cartels Division, ESS, will analyze such file, as transmitted by the Holding Company Liquidation Commission, and supplement, if pertinent, such file with additional data.

c. The Antitrust and Cartels Division, ESS, will prepare a statement of evaluation of the Holding Company Liquidation Commission's proposed order, indicating non-objection or specific changes to be made.

d. The Antitrust and Cartels Division, ESS, will obtain the concurrence or non-concurrence with attendant statement of specific objections from interested staff sections and divisions.

e. Upon determination within the Economic and Scientific Section that appropriate concurrences have been obtained, the Antitrust and Cartels Division, ESS, will instruct the Holding Company Liquidation Commission to issue the proposed order, with such changes as developed from the General Headquarters' coordination, and will likewise instruct the Holding Company Liquidation Commission to establish a hearing date and hold such hearing.

f. Concurrent with issuance of such instructions to Holding Company Liquidation Commission, the file will be turned over to the Deconcentration Review Board. This file will contain, under separate tabs, each of the pertinent documents referred to above.

g. As soon as the hearing, referred to in subparagraph e., above, has been held, all documents pertaining to the hearing will be transmitted from the Holding Company Liquidation Commission, through the Antitrust and Cartels Division, ESS, to the Deconcentration Review Board, as a separate tabbed portion of the file.

h. If the hearing develops no facts, which in judgment of the Holding Company Liquidation Commission merit changing the proposed order, the Holding Company Liquidation Commission, after clearance with the Antitrust and Cartels Division, ESS, will issue the final order to the company, but before doing so the Deconcentration Review Board will be given ten (10) days written notice of the intention to issue such order.

i. If the hearing does develop facts, which in judgment of the Holding Company Liquidation Commission merit changing the proposed order, the Holding Company Liquidation Commission will re-draft the order and transmit such document, with attendant analysis and supporting date, to the Antitrust and Cartels Division, ESS, so that the procedure of General Headquarters' analysis and coordination can be carried out again on this changed order.

j. The final order to the company will be enforced thirty (30) days after issuance unless action is taken by the Holding Company Liquidation Commission to postpone the effective date of the order, or withdraw the order prior to the expiration of such period.

k. Prior to the expiration of such thirty (30) day period or extension thereof, the Deconcentration Review Board will submit to the Supreme Commander for the Allied Powers its written recommendations regarding the action.

l. The Supreme Commander for the Allied Powers will determine whether the recommendations of the Deconcentration Review Board warrant preventing the order from becoming effective and the Chief of Economic and Scientific Section will advise the Antitrust and Cartels Division, ESS, of such decision. If the order is not to be changed, the Antitrust and Cartels Division, ESS, will take no further action on the case. If the order is to be changed, the Antitrust and Cartels Division, ESS, will so instruct the Holding Company Liquidation Commission.

2. In carrying out its responsibilities regarding orders under Law No. 207 the Deconcentration Review Board may request that information from all available sources be furnished. It is recommended, however, that the Board direct all persons, petitions, etc., which concern with reorganization of companies under Law No. 207 to the Chief, Antitrust and Cartels Division, ESS, unless such persons, petitions, etc. have been requested by the Deconcentration Review Board or by any member thereof.

[SOURCE: SUITLAND PAPERS, Z 703-10]

6-37 CONCERNING YASUDA, TEIKOKU, MITSUBISHI, SANWA AND SUMITOMO BANKS

Memorandum July 2, 1948
To: SCAP
From: Deconcentration Review Board (Roy S. Campbell)

1. The Board has considered the question on which its opinion is asked in the Memorandum dated 5 June 1948, from Major General W. F. Marquat Chief Economic and Scientific Section, namely, "whether it is advisable or necessary to break up these five banks into smaller units".

2. The Board has examined all documents and data submitted by the Economic and Scientific Section dealing with the subject under review, and has taken counsel on the legal points involved.

3. Through enforcement of the "Law for the Termination of the Zaibatsu Family Control", known as Law No. 2 of 1948, "The Holding Company Liquidation Commission Ordinance", known as Imperial Ordinance No. 233, and the administrative acts under them to date, control of the above banks by the Zaibatsu and designated Holding Companies through stock ownership has been removed and is being removed.

4. The Fair Trade Commission, under the *permanent* "Law Relating to Prohibition of Private Monopolies and Methods for Preserving Fair Trade", known as Japanese Law No. 54 of 1947, has the power to prohibit or remedy any act, practice or relationship that can be prohibited or remedied by the Holding Company Liquidation Commission under the *temporary* law for the "Elimination of Excessive Concentration of Economic Power, known as Japanese Law No. 207 of 1947.

5. In the Board's opinion, it is not necessary under existing conditions and it is inadvisable to break up the Yasuda, Teikoku, Mitsubishi, Sanwa and Sumitomo banks, all of which are presently under reorganization pursuant to the "Financial Institutions Reconstruction and Reorganization Law", known as Japanese Law No. 39 of 1946. Breaking up these banks would be almost certain to cause a loss of public confidence. Division of these banks would produce a group of smaller banks, the deposits in each of which would be insufficient to serve adequately the loan requirements of large borrowers. The ratio of money on deposit to money in circulation is already low. Breaking up these banks would further aggravate this condition. Moreover, each of these banks is now under-capitalized and is faced with the necessity of raising additional equity capital. A break-up would increase the difficulties of attracting this capital.

6. The remedial actions of the Fair Trade Commission with respect to these banks would be less precipitant than proceedings under the Holding Company Liquidation Commission Ordinance, and would be of a *permanent* regulatory nature. For these reasons the Fair Trade Commission is believed to be the appropriate agency to assume jurisdiction.

7. Accordingly, the Board recommends that the Yasuda, Teikoku, Mitsubishi, Sanwa and Sumitomo banks not be broken up and that they be remanded to the Fair Trade Commission for effective application to them and enforcement of the prohibitions and remedial measures provided by, and lying within the "Law Relating to Prohibition of Private Monopolies and Methods for Preserving Fair Trade".

8. The legal opinion of the Chief, Legal Section, Supreme Commander for the Allied Powers, confirming the adequacy of the law herein relied upon, is attached.

[SOURCE: SUITLAND PAPERS, Z 703-10]

6-38 REQUEST BY WESTINGHOUSE ELECTRIC INTERNATIONAL COMPANY ON BEHALF OF MITSUBISHI ELECTRIC MANUFACTURING CO., LTD.

Summary of Letter[27] August 27, 1948
To: Deconcentration Review Board, Attention Mr. Roy S. Campbell, Chairman
From: J. P. Boyer, Special Representative, Westinghouse Electric International
CC: Mr. E. J. Burger, Deconcentration Review Board
CC: Major General Marquat, Chief E. S. S., SCAP
CC: Mr. W. S. Vaughn, Chief Industrial Division, E. S. S., SCAP
CC: Mr. E. C. Welsh, Chief Antitrust & Cartels Division, E. S. S., SCAP
CC: Mr. R. D. McManigal, Vice President, WELCO
CC: Mr. Shin-ichi Takasugi, President, Mitsubishi Denki K. K.

In the matter of: MITSUBISHI DENKI K. K.'s REORGANIZATION

This report is submitted at the request of General Marquat and is based on the personal inspection by both Mr. McManigal and myself of the MITSUBISHI DENKI factories and our lengthy discussions with both the factory and head office management as a result of our three-fold concern in the matter of the reorganization of MITSUBISHI DENKI as former and potential stockholders, creditors and former and potential licensors.

The Westinghouse Electric International Co.'s position in the matter may be stated to be the following:

I) MITSUBISHI DENKI should be retained as one unit with the exception of the Setagaya factory as it is believed that this will comply with the reorganization standards as set forth in "Standards for Excessive Concentrations in Industrial Fields" and because this will permit the company to make the maximum contribution towards the recovery of Japan and the reduction of the American taxpayers' burden resulting from the occupation.

II) The company's name, MITSUBISHI DENKI, and trade marks, particularly ⅄, should be retained as:

a) any other procedure would constitute an unjust discrimination against the company;

b) the value of the name stemmed from the quality standards of the company and not from any now-illegal "cumulative influences",

c) the dissolution of MITSUBISHI HONSHA effectively renders impossible illegal practices;

d) the name MITSUBISHI was used before the war by companies in no way connected with the HONSHA and thus said to stand for ZAIBATSU:

e) the loss of the name and especially the trade marks will seriously affect an asset of great value to the Japanese nation and will seriously handicap SCAP's efforts towards the industrial recovery of Japan as well as seriously affect export sales:

f) the retention of the trade marks and of the corporate name will in no way facilitate the rearming of Japan at any time in the future.

III) In the dissolution of the Setagaya-MITSUBISHI DENKI ties, care should be exercised that the stockholders of the latter be not injured by precipitated action and that, either the company be allowed to await satisfactory business conditions to sell the property or the shares of the new company be distributed to the old shareholders.

J. P. BOYER
Special Representative
[SOURCE: SUITLAND PAPERS, Z 703-11]

[27] Summary of a 6 page letter. Mr. Boyer's letter quoted from an October 13, 1947 letter from Mr. McManigal to Mr. Welsh, Chief of the Anti-Trust Cartels Division, which set forth "what was then and what is now" Westinghouse's opinion of Mitsubishi: "We have always found MITSUBISHI DENKI a reliable and trust worthy associate, and have felt they were large enough and sufficiently diversified in their operations to warrant us entering into the broad type of agreement such as we had with them". On December 31, 1948, the Review Board, following the advice of HCLC, recommended that the Mitsubishi Electric Company not be divided into separate companies.

6-39 FOUR POINTS OF GUIDANCE REGARDING DECONCENTRATION

Memorandum of Meeting[28] September 11, 1948
Concerning: Findings of the Deconcentration Review Board in the case of the Nippon Soda Company.

Present were:

General Marquat, Chief, ESS
ESS Antitrust & Cartels Divn.
Mr. Welsh
Mr. Bush
Mr. Scheier
Deconcentration Review Board
Mr. Campbell
Mr. Burger
Mr. Robinson
Mr. Woodside
Mr. Hutchinson
SCAP Legal Section
Mr. Carpenter
Mr. Straitiff

Holding Company Liquidation Commission
Mr. T. Sasayama, Chairman
Mr. I. Noda
Mr. G. Kashima
Mr. U. Kurumatani
Mr. Ichikawa
Mr. K. Moroi
Mr. Y. Wakimura
Mr. R. Minobe

The meeting was opened by General Marquat stating that the agencies of the U. S. and the Japanese governments present were each familiar with the responsibilities and functions of the respective agencies represented. It was agreed Mr. Noda would serve as interpreter and spokesman for the HCLC.

General Marquat continued

The Deconcentration Review Board has examined a number of cases and plans referred to it in its function as a review agency for SCAP. It has reached a finding in connection with the Nippon Soda Company. The Supreme Commander felt that since this was the first action of the Board it would be appropriate to hold a meeting with the HCLC for the purpose of familiarizing the HCLC, which is the Japanese Government agency charged with responsibility for implementation of Public Law 207, with the concepts of the deconcentration program held by the Deconcentration Review Board. A thorough understanding of these concepts should be of great assistance to the HCLC in guiding its future proceedings. The Supreme Commander and the Deconcentration Review Board have expressed great satisfaction with the efficient manner in which the HCLC has performed its duties to date.

The finding of the Deconcentration Review Board after reviewing all papers on the Nippon Soda case are as follows:

"The facts and evidence contained in the basic file submitted do not establish that the Nippon Soda restricts competition or impairs the opportunity for others to engage in business independently in any important segment of the company's field or fields of operation within the meaning of the definition of an excessive concentration of economic power set forth in Article 3 of Public Law 207. It is recommended therefore that the HCLC be instructed to stay its above order 172 unless evidence is presented that the company is an excessive concentration within the meaning of Article 3 of Public Law 207, then the company should be removed from designation under the law."

During its deliberations on those of the cases presently submitted to the Board, the Board has arrived at four general points which it offers for consideration of the HCLC as a guide to its future deliberations on the subject. The Board believes that the administrative policies and procedure under Law 207 should be required to conform to the principle that the basic proposal of the law is "to eliminate and prohibit monopoly combinations in restraint of trade and commerce and excessive concentrations which prevent or restrict competition". The Board believes that:

(1) No order should be issued under the Deconcentration Law unless there is a showing of a prima facie case that the company "restricts competition or impairs the opportunity for others to engage in business independently in any important segment of business".

[28] The copy of this document contains no indication of who recorded the discussion.

In the absence of such showing the company should be removed from designation.

(2) That the mere possession of non-related lines of business is not in itself sufficient in any case to establish that a company is an excessive concentration within the law.

(3) That the submission of a plan of reorganization as a voluntary plan is not in itself sufficient to confer upon the HCLC the authority to issue an order under Public Law 207.

(4) That the action a company is ordered to take by the HCLC under Public Law 207 should be directly related to the facts upon which that company was determined to be an excessive concentration.

These four points just given to you will influence the decisions of the Board in review of subsequent cases referred to it. These have been presented to you for your information and as a basis for further discussion in order that you may understand thoroughly the basic conception of the Review Board as to the method in which Public Law 207 should be implemented. You have the decision on the Nippon Soda case and these four points and we invite you to ask any questions that you would care to submit in further development of consonant operating procedures.

At this point I would like to emphasize that nothing that has been presented to you indicates any change in the deconcentration procedures. GHQ contemplates no change in the law, the standards or implementation procedures. This is the concept of the way it was originally intended that the deconcentration procedure be accomplished, and it is no change in policy.

Discussion follows:

Mr. Noda asked if the recommendations submitted by the Review Board and presented to HCLC for further implementation of Public Law 207 were to be taken as a final order.

General Marquat replied that these recommendations had been accepted by SCAP and that they would be taken as final unless evidence was presented to the satisfaction of the Board that Nippon Soda was an excessive concentration.

Mr. Noda stated that the procedures to be followed by HCLC were understood and if they agreed they must stay order 172. That of the number of designated companies under Public Law 207, designation of 50 had been cancelled. That no structural reorganization has been required on 175 companies. On most of them orders have been issued by HCLC stating that they are concentrations, but no structural reorganization is required and therefore these 175 companies have not been removed from that list and designation has not been cancelled. He asked if the Board intended to review these cases.

Mr. Campbell replied that the Board had not been able to fully examine these cases as they had had orders on them only since this past week when they asked for them as it was felt that the orders on the Nippon Soda case might conflict on decisions made at a later date.

Mr. Noda stated that since some action might have to be taken on the 175 companies if they were cancelled it was felt there should be some announcement from GHQ advising the Japanese public that some change in policy had occurred.

General Marquat stated: There had been no change in policy and unless a company was an excessive concentration it should not be broken up. However, the possibility of apprehension by HCLC was recognized and that was the reason why HCLC had been presented with the four basic principles on which the Board is reviewing the implemention of the law. It was suggested they utilize these principles in re-examing the 175 companies and in examining the remainder of the cases before them. It has always been the position of GHQ that efficiently operated big business was an asset to a democratic nation, and that size of plants, capitalization, volume of basic output and similar considerations are not in themselves monopolistic. It is only when a business of any size discourages free enterprise and restricts open competition that it is a monopoly. This is the concept of directives received from Washington and it must be interpreted in that light that any other position taken is faulty. In the implementation of the law by the Japanese Government, it is up to HCLC to issue, revoke or revise their orders as they see fit and that there is no Japanese agency which can control their actions if within the scope of the law. It is believed that a further review on their part of the orders in the light of the facts presented by the Deconcentration Review Board should be in no way embarrassing to them, HCLC is merely re-examining the orders and revising conclusions which it can do at any time. It was stated that there had been no change in administrative set-up and that the HCLC would continue to work with and deal with ESS through Antitrust and Cartels Division and to benefit by the advice and council of Mr. Welsh and his experts.

Mr. Noda stated that they had worked in close guidance and cooperation with ESS and had established a certain prestige in the nation not only on deconcentration law but several other important missions and therefore whatever action may have to be taken with the 175 companies they would like to be given an opportunity to study out any change occurring in their orders as if they were to announce to the Japanese public that a mistake had been made in the administration of the law and procedure not only in one company but in 175 companies it would greatly injure their prestige. They would like to present a complete method for consideration and approval if such change in order takes place.

Mr. Campbell replied that the Review Board was very sympathetic with these feelings and would be glad to cooperate in any way possible.

General Marquat suggested that HCLC permanently discard the attitude that they have made mistakes. Implementation of a law is primarily a matter of interpretation of the provisions of the legal statute and not a personal position assumed on a basis of advocacy or opposition to the purpose of the legislation. The Supreme Commander has been good enough to make available to the HCLC the basic principles upon which the Deconcentration Review Board had reached their findings. There was no intention to indicate that the HCLC had made an error. A re-examination of the 175 companies in the light of the interpretations submitted by the Board should be taken advantage of and could be referred to without any loss of prestige by the HCLC. It was suggested that they use the conference as a basis for reviewing the cases and that any consequent action taken should be clear and taken without any hesitation whatever.

Mr. Noda stated that there seemed to be some difference in the standards HCLC had followed under the law and in the 4 points set forth by the Review Board and that they would like to study that fact.

Mr. Campbell replied that he didn't think such had arisen in the Nippon Soda case, but it might in the future and that the Board would be glad to discuss it with HCLC. The Board had looked into and investigated the standards when they first arrived. They were found to be quite general and it was felt that it was possible for the Board to make their recommendations without changing the standards at that time.

Mr. Noda asked if HCLC could have copies of the 4 points, and these were furnished him by the Deconcentration Review Board.

General Marquat stated that these standards were guides for designation and were not rigidly binding upon HCLC.

Mr. Noda stated that in the event any important question arose in the future they would like to be permitted to have another conference or to get in touch with the Board.

General Marquat advised Mr. Noda that the Board will be available at any time to discuss any questions that might come up. The approach should be made through Mr. Welsh. Insofar as ESS was concerned the Board was independent of ESS. Mr. Carpenter of the Legal Section had offered his services. In addition Mr. Welsh was available for advice.

Mr. Noda expressed his thanks for the meeting and the most valuable discussion of the recommendations of the Board. He stated that the HCLC would follow the instructions and that anything important enough would be submitted informally for the advance consideration of the Deconcentration Review Board.

Mr. Noda was again assured by Mr. Campbell that the Board was willing to give them advice at any time. That they recognize that before recommendations are made a lot of ground has been covered and a lot of work and time consumed.

The meeting was closed with General Marquat stating that he would like to repeat that the Supreme Commander had expressed his admiration for the manner in which HCLC had functioned. Further on behalf of Mr. Welsh and his Division and the Deconcentration Review Board, a similar statement was in order. Lastly, that he would like to express his own personal appreciation.

[SOURCE: SUITLAND PAPERS, Z 703-10]

6-40 INITIAL REPORT OF THE DECONCENTRATION REVIEW BOARD

Telegram No. C—65098 November 3, 1948
To: Dept. of Army (Draper)
From: SCAP (MacArthur)
Approved by: W. F. Marquat

Personal for Draper. Reference your WAR 91353, following is the initial report of the Deconcentration Review Board covering the period from organization through 30 October 1948:

"1. The Board arrived in Tokyo 4 May 1948. It thereafter spent considerable time with various Sections of SCAP and Divisions of ESS, in order to obtain background material and a knowledge of the functions of the various Divisions of SCAP and agencies of the Japanese Government.

"2. On 10 May we received a Memorandum requesting that we review the Standards for Excessive Concentrations in Industrial Fields under Public Law No. 207. These Standards were studied and on 12 June the Board recommended that no change be made in the published Standards as of that time but suggested that as actual cases came before the Board, certain changes might later be recommended.

"3. On 5 June the Board was asked to make a study of the banking situation and to make recommendations as to the five large commercial banks in Japan under Law 207. The Board realized that the successful revival and operation of major business enterprises in Japan was dependent upon a sound banking system and that an early decision on deconcentration policy as it related to these banks was of the utmost importance. The Board reviewed the data submitted with reference to the five banks, and the banking situation generally and conferred at length with interested Divisions of ESS on the problem. On 2 July the Board made its recommendation that, under existing conditions, the five banks not be broken up.

"4. Throughout the period prior to receipt of the first plan of reorganization from the Holding Company Liquidation Commission on 20 July, a study of the files was made relating to companies on designation but on which orders had not been issued. In addition, considerable time was devoted to a study of the various laws and ordinances having a bearing on the deconcentration program.

"5. On 20 July the Nippon Soda Co., Ltd. plan and Order for Reorganization under Law No. 207 were formally presented to the Board. The Board's finding that this company was not an excessive concentration within the meaning of the law, and recommendation that the company be removed from designation, were submitted to SCAP 19 August 1948.

"6. On 28 August the Board summarized its conclusions to date in a general policy recommendation to the Supreme Commander. This memorandum recommended that the administrative policy and procedure under Law No. 207 should be required to conform to four stated principles as follows:

"a. That no Order should be issued under the Deconcentration Law unless there is a showing of a prima facie case that the company 'restricts competition or impairs the opportunity for others to engage in business independently in any important segment of business.' (Article 3, Law 207). In the absence of such showing the company should be removed from designation.

"b. That the mere possession of non-related lines of business is not in itself sufficient in any case to establish that a company is an excessive concentration within the Law.

"c. That the submission of a plan of reorganization as a voluntary plan is not in itself sufficient to confer upon the HCLC authority to issue an Order under Law No. 207.

"d. That the action a company is ordered to take by the HCLC under Law No. 207 should be directly related to the facts upon which that company was determined to be an excessive concentration.

"7. The Board's recommendation on the Nippon Soda Company and its general policy memorandum of 28 August were approved by the Supreme Commander for the Allied Powers in a meeting with the Board on 9 September 1948.

"8. On 11 September 1948 a meeting was held, attended by members of the Deconcentration Review Board, members of the Holding Company Liquidation Commission, representatives of the Antitrust and Cartels Division and representatives of the Legal Division. General Marquat, acting as chairman, announced that the companies remaining on designation should be re-examined in the light of the above four principles. The purpose of such re-examination was to remove from designation those companies where the evidence did not indicate that they were excessive concentrations of economic power.

"9. In response to an inquiry by Economic and Scientific Section/Antitrust and Cartels as to the Board's views with reference to the Standards for Excessive Concentrations, the Board on 18 September 1948, stated that the Standards which had been adopted pursuant to Article 6 of Law 207 cannot be employed to enlarge the definition of an excessive concentration in Article 3 of that Law. The Board further stated that it had no objection to the use of these Standards for the purpose of determining whether an enterprise falls within the statutory definition.

"10. Prior to 4 May 1948 the Holding Company Liquidation Commission had issued orders to 175 companies finding that they were excessive concentrations of economic power, but that they did not require physical break-up under the law. In addition, on 8 October 1948, Economic and Scientific Section/Antitrust and Cartels determined that an additional 41 companies were excessive concentrations but did not require physical break-up. As to these latter companies no orders have been issued by the Holding Company Liquidation Commission.

"11. On 21 October General Marquat, after conferences with the Deconcentration Review Board, issued instructions to Economic and Scientific Section/Antitrust and Cartels to advise the Holding Company Liquidation Commission to re-examine the files in these 216 cases in conformity with the Board's above recommendations of 28 August 1948 and remove from designation those companies in which no excessive concentration is evident.

"12. The Board has received from the Holding Company Liquidation Commission orders and plans of reorganization for the companies enumerated below:

NIPPON SODA COMPANY

"Received 20 July 1948. Ordered to break up into five (5) successor companies. The Board determined this company not to be an excessive concentration of economic power under Law No. 207 and recommended that it be removed from designation.

KOBE STEEL COMPANY

"Received 28 August 1948. Ordered to break up into three (3) successor companies. The Board recommends that this company not be divided and that it be removed from designation. The Board also recommends that this company be referred to the Fair Trade Commission for investigation of alleged participation in restrictive agreements.*

FUSO METAL COMPANY

"Received 28 August 1948. Ordered to break up into five (5) successor companies. The Board recommends that this company not be divided and that it be removed from designation. The Board also recommends that this company be referred to the Fair Trade Commission for further investigation of alleged participation in restrictive agreements.*

NIPPON STEEL TUBE COMPANY

"Received 9 September 1948. Ordered to break up into three (3) successor companies. The Board recommends that this company not be divided and that it be removed from designation. The Board also recommends that this company be referred to the Fair Trade Commission for further investigation of alleged participation in restrictive agreements.*

*(Final reports and recommendations on these three companies will be submitted shortly.)

JAPAN IRON AND STEEL COMPANY

"Received 2 October 1948. This company controls a major portion of the iron and steel production of Japan. The Board is now engaged in a comprehensive study of the company's business and the proposed plan of reorganization.

NISSAN CHEMICAL COMPANY

"Received 2 October 1948. Ordered to break up into six (6) successor companies. The Board determined this company not to be an excessive concentration of economic power under Law No. 207 and recommended that it be removed from designation.

OJI PAPER COMPANY

"Received 2 October 1948. No Board action taken.

MITSUBISHI ELECTRIC COMPANY

"Received 5 October 1948. No Board action taken.

RECAPITULATION

"13. RE: *Present Status of Industrial & Service Companies designated under Law No. 207*

		DESIGNATED
Originally designated		325
Removed from designation prior to 4 May 1948	50	
Companies in which it was determined no physical break-up would be required—action taken prior to 4 May	144	
Same as above—action taken after 4 May	31	
Number of additional cases now in process of being examined with a view to removal from designation as a result of the application of the principles set forth in the Board's policy memorandum 28 August 1948	41	
Cases on which action has been taken by the Board	5	
Cases on which no action has been taken by the Board	3	
Total either removed from designation or in process of being examined	274	
BALANCE REQUIRING DISPOSITION		51"

The next report of the Deconcentration Review Board will be submitted inclusive of 30 January 1949. Signed

MacARTHUR

[SOURCE: SUITLAND PAPERS, Z 703-10]

6-41 EXCESSIVE CONCENTRATION OF ECONOMIC POWER IN JAPAN

FEC- 230/3 December 9, 1948
United States Statement on FEC-230
To: The Far Eastern Commission

Note by the Secretary General

1. The enclosure, a statement on FEC-230, Excessive Concentration of Economic Power in Japan, submitted by the United States representative at the 131st Commission meeting, 9 December 1948, is circulated herewith for the consideration of the *FAR EASTERN COMMISSION.*

2. Following the reading of the enclosed statement, the United States representative announced that it was the intention of his Government to release it to the press.

NELSON T. JOHNSON
Secretary General

ENCLOSURE

Some months ago, my Government suspended its participation in discussions in the Far Eastern Commission of a United States policy proposal which was then under active consideration in the Commission. This proposal, designated as FEC-230, presented an extremely detailed plan for the implementation of a general policy which already had been stated in existing directives to the Supreme Commander. That policy, which called for the dissolution of certain Japanese combines and a widening in the distribution of the income and ownership of Japanese industry, was then and continues to be, in the view of my Government, a fundamental objective of the Occupation.

The action of the United States in suspending consideration of its proposal, however, has led to certain questions among the members of this Commission and among the Japanese people. The purpose of this statement is to clarify the position of the United States with respect to FEC-230.

Since the very first weeks of the Occupation, the Supreme Commander has devoted a considerable part of the time and resources of his staff to the problem of reorganizing the financial and industrial institutions of Japan. This program which has been based upon the Post-Surrender Directive issued December 6, 1945 and on the Far Eastern Commission's own Basic Post-Surrender Policy for Japan, was designed to make possible the early development of democratic and peacefully-inclined economic institutions in Japan. To bring about that result, plans were immediately developed and put into effect to dissolve the control of

Japanese finance and industry which rested in the hands of a few powerful Japanese families.

As a part of this program, the Supreme Commander directed the Japanese Government to adopt various laws and to create certain governmental bodies charged with the responsibility of undertaking a major reorganization of the ownership and control of Japanese industry. In the brief span of three years substantial progress has been made by these bodies. The assets of the 56 persons who comprised the heads of the 10 major zaibatsu families and the assets of the 83 holding companies controlled by these persons have been acquired by the Government and are in process of being sold to the Japanese public. A much larger number of companies have been compelled to divest themselves of holdings in and control over smaller enterprises. Such control was exercised through intercorporate stockholdings, interlocking directorates and similar devices. Contractual arrangements to which these Japanese enterprises were parties which had the effect of placing the control of production or trade in the hands of such enterprises have been declared void. The innumerable Control Associations through which Japanese enterprises exercised their collective authority are being liquidated. Action is being taken and is well advanced toward reorganization of former savings banks, trust companies and governmental banking institutions, making possible the emergence of a significant number of new commercial banks, to compete with and supplement the few large banking combines which formerly dominated Japanese credit sources. Finally, some scores of Japanese companies whose present state may constitute a threat to competitive enterprise are being scrutinized, one by one. Where necessary, these combines will be subjected to such reorganization as may be required to remove the existing threat.

To insure that the dispersion of economic control which is developing from these measures will not likely be reversed in the years to come, substantial revisions have been effected in the basic economic legislation of Japan. To begin with, an Antitrust Law has been adopted and a Fair Trade Commission set up to enforce the Law. In general, the Law seeks to restrain the development of new combines, excessively large or powerful, by outlawing agreements which restrain production or trade, by placing limitations upon intercorporate stockholdings, interlocking directorates, and similar devices for the concentration of corporate control, and by setting up procedures and penalties for the enforcement of these provisions. Other legislation now requires Japanese corporations to make considerably more information available to their stockholders and the public than heretofore has been the case and generally requires the management of corporations to adhere to much higher standards of public responsibility in the managements of their enterprise.

Moreover, many existing laws which tended to centralize the control of Japanese industry within a small group have been abrogated outright. Others have been modified drastically. The Fair Trade Commission and other Government agencies are analyzing still other Japanese laws to eliminate provisions which confer special privilege or tend to restrain or eliminate competition. Various laws relating to the conduct of Japanese banking have been placed under particularly careful scrutiny. One of the principal objectives of the revision of Japanese banking laws is to create a climate in which the undesirable prewar concentration of Japanese credit in a few hands could not recur.

In all this, the Japanese Government has demonstrated a commendable ability to comprehend Allied objectives and has cooperatively fulfilled its obligations. The Japanese Fair Trade Commission has prosecuted a significant series of cases against Japanese businessmen who were violating one provision or another of the statutes which seek to prevent new concentrations of Japanese industry. The Japanese Holding Company Liquidation Commission has made a careful study of the structure of the larger Japanese combines and, in close cooperation with the Supreme Commander, is currently developing plans for such reorganization of these combines as may be needed.

As the occupation and the economic situation have developed, there has been a corresponding evolution in the deconcentration program. For example, it has proved possible and desirable to dissolve most of the wartime control associations. As new sources of credit have been created through the conversion of other financial institutions to commercial banks, it has been possible to reconsider the need for the actual dissolution, once believed necessary, of Japan's biggest banks which under earlier circumstances had dominated the credit structures of Japan. With the daily growth of indication that the Japanese propose to enforce their fair trade laws vigorously and effectively, it has been possible to reconsider the standards to be used in the dissolution of some of the combines still existing. These changes in emphasis have been responsive to changing circumstances and have represented relatively minor alterations in a program which basically remains unchanged. That program, adhering to the broad purposes of the directive of the Far Eastern Commission, seeks to achieve in

Japan an economic climate conducive to the development of a democratic society. It seeks to prevent the resurgence of economic power in the hands of a few who recognize no responsibility to the Japanese people or the world at large.

When the United States suspended its participation in the discussion of FEC-230 in the Far Eastern Commission, that decision was based upon the growing realization that the guidance for the Supreme Commander and the Japanese envisaged therein had largely been overtaken by events. The major points of procedure set out in that document already had been implemented in Japan. Other details believed necessary to the accomplishing of the major objectives either had been faithfully adopted or had become unnecessary or inappropriate. Useful as the paper might have been at an earlier stage of the Occupation, that usefulness no longer appeared to exist.

That the paper has become outmoded in so brief a period is a singular tribute to SCAP and the Japanese Government. Procedures which it was thought would take years to carry out in many cases have been accomplished in a matter of months. Major technical obstacles have been overcome and the demonstrated determination of the Supreme Commander to carry the program through has elicited a gratifying degree of cooperation from the Japanese themselves. Accordingly, upon a careful re-survey of the deconcentration program now well advanced in Japan, the United States now believes that, as a practical matter, there is no need to lay down policies for the guidance of the Supreme Commander with respect to any remaining significant aspect of the program. Indeed, to do so in the outmoded terms in which FEC-230 is cast might well do more harm to the program than good. Hence, the United States has withdrawn its support of FEC-230 as a proposal upon which the Far Eastern Commission could act with benefit to the Occupation.

This does not mean that the deconcentration program has been completed. Considerable amounts of securities still remain in the hands of the Government and must be disposed of. Ingenuity and vigor must be brought to this task. Existing banking legislation will undoubtedly be elaborated and refined in consonance with the objectives of this program. Those remaining Japanese combines whose existence may constitute a threat to competitive enterprise will, where necessary, be reorganized as required to remove such threat. But these programs no longer call for the development of policy. They call largely for a practical application of judgment, energy and enterprise in implementing a program whose philosophy and objectives are clearly understood by the Supreme Commander and the Japanese Government, as they have already convincingly demonstrated.

[SOURCE: SUITLAND PAPERS]

6-42 REVALUATION OF CORPORATE ASSETS, AS STABILIZATION MEASURE

Memorandum January 6, 1949
To: W. F. Marquat, Chief, ESS
From: Edward C. Welsh, Chief, Antitrust and Cartels Division

1. *Question:* Would re-evaluation of corporate assets, at this time, have a net advantageous effect upon prompt stabilization of the Japanese economy?

2. *Discussion:*

a. Without regard for the concomitant effects of re-evaluation such action would in the first instance amount to a change in the yen figure at which a major portion of the fixed assets of the Japanese corporations are carried on their books. Even from such a narrow approach to the question, it becomes clear that such action is not a simple one to carry out. Either a fixed multiple or an individual re-appraisal of each asset would have to be employed. The former is patently absurd in view of the various ages and states of repair, etc., of the fixed assets insolved and the latter would constitute one of the largest jobs of asset re-appraisal ever undertaken.

b. A very large percentage of the most important manufacturing, distributing and financial companies in Japan suffered special war losses and are required to be financially reorganized under the Enterprise Reconstruction and Reorganization Law. These companies are in various stages of such reorganization, which is, in a sense, a type of orderly and compulsory bankruptcy proceeding. If at this time such reorganizations currently under way had to be halted and new plans submitted on the basis of re-appraised assets, the resultant delay in our effort to establish financially sound companies would must certainly affect adversely efforts at stablization. Likewise such delay in completing financial reorganizations

would add a speculative element to the securities market and would tend to discourage foreign investment in Japanese companies at this time. Foreign investors particularly are not interested in investing in companies until it is possible to know the financial status and condition of such companies.

c. Revaluation of assets might well be grossly unjust to creditors and stockholders which already have completed their proceedings under the ER&R Law in comparison with the effect upon creditors and stockholders of those companies whose assets would be revaluated prior to financial reorganization under such law. Revaluation of assets would not only require amendment to the ER&R Law in the "middle" of reorganizations being carried out, but would likewise require amendment to the Commercial Code since Article 285 of such Code specifies that fixed assets of companies shall be carried on the books at a value not in excess of their acquisition cost or their cost of manufacture. The historic treatment of valuation of assets in Japan has been in accordance with that principle. It is considered that the financial disturbance would be of considerable magnitude and increased uncertainty would result from the many legal suits which would develop from non-uniform treatment of creditors and stockholders.

d. Recently rehabilitated companies as well as new companies and those with new equipment would be least affected by re-evaluation of assets generally and yet in many instances these companies are the ones in the best condition to produce profitably. On the other hand those companies with the most obsolete equipment and facilities would receive the greatest "paper" change and would give the illusion of having the greatest increased asset strength for offsetting accumulated liabilities.

e. Re-evaluation of assets would give the appearance of the creation of additional assets upon which companies could borrow more funds. However, financial institutions would generally not be fooled by this action and would hence undoubtedly discount the apparently more favorable financial position of those applicants for credit whose companies' books suddenly appeared in a remarkably improved condition.

f. Revaluation of assets has been considered, even in Japan, sufficiently akin to fraud upon prospective creditors and stockholders to deserve interdiction by law. If the Commercial Code is amended to legalize such action, fairness would require notification to such prospective creditors and stockholders that the company is the "same old company" which had merely juggled its books and that such company still has the same productive assets which it had prior to re-evaluation. The illusion of solvency would then be dissolved.

g. In the financial reorganization of special accounting companies re-evaluation of assets would unquestionably call for considerable increases in the amount of new stock to be sold in reorganizing or establishing the new solvent companies. To the extent that this would retard establishment of solvent companies it would interfere with efforts to stabilize the Japanese economy and would discourage badly needed investment at this time. Re-evaluation of assets cannot in itself increase the production efficiency or the profitability of new companies. Hence, to the extent that such re-evaluation encouraged any investors it would do so only for those who were fooled by the action and had concluded that by some miraculous maneuver the company was now in a position to produce more profitably.

h. Re-evaluation of assets would not in itself contribute to the stabilization of the price level or act as a deterrent to further inflation. If the price level is not stabilized, re-evaluation at this time would act to establish a precedent and a reasonable expectation of further re-evaluations as the price level rose. If any benefits can be derived from re-evaluation of assets, such benefits would be most likely to develop from re-evaluation after stabilization has been achieved rather than before.

i. Actually re-evaluation of assets would not compel general price increases although it would increase substantially "paper" costs of production and would increase actual costs of production if appropriate depreciation reserves were established for the higher valued assets carried on the books. Likewise re-evaluation of assets would presumably require an adjustment in the method of establishing ceiling prices and particularly for adjusting such prices, unless it is determined that stabilization requires an absolute freezing upon the existing prices. A price freezing of such nature is not economically sound and would undoubtedly be administratively impractical. Likewise, re-evaluation of assets would cause an immediate psychological inflationary pressure because of the official sanction given to establishing values on a much higher plateau.

j. Re-evaluation of assets would unquestionably have some effect upon revenue received from taxation by the Government. Local government taxes would probably not be affected appreciably since property taxation is based not upon book value but upon

values assessed for taxation purposes. However, the establishment of a higher depreciation cost would result in sharply decreased net profits to companies and to the extent that such net income is subject to taxation the Government would receive less revenue from such sources, unless corporations' profit tax rates were substantially increased. In some instances re-evaluation of assets would cause sufficient increase in depreciation costs that companies showing an apparent net profit prior to re-evaluation would, after re-evaluation, reveal a net loss. Presumably this change in net profit position would have a discouraging effect upon investors who were not in a position to understand the financial manipulation or who were investing for purposes of receiving profit return on their investment.

k. Re-evaluation of assets would open the door to wide-spread attempts at stock watering, although re-evaluation per se need not result in such action. However, it is presumed that re-evaluation would encourage the placing of additional securities on a market already burdened with an unusually large supply of stocks hanging over it. It is possible that re-evaluation of assets might have a tonic effect upon some companies in light of higher equity values on the books, larger allowable yen depreciation costs, smaller net profits on the same sales volume, smaller income tax payments, write off of operating losses, and speculative fluctuation in stock prices. There is no reason to believe however that this illusion will increase production, stabilize prices, or place companies in a sounder financial position.

3. Conclusion: Revaluation of corporate assets at this time not only would not contribute to stabilization of the Japanese economy but would actually impede efforts toward such stabilization. It would act to delay necessary financial reorganizations, would impel if not absolutely necessitate increases in prices, would tend to discourage investment until after re-appraisals and financial reorganizations had been completed, would cause substantial disruption and inequity in debtor creditor relationships, would result in discriminatory treatment of creditors and shareholders of companies which have already completed financial reorganization, and would establish a basis for further revaluations by creating a sense of business irresponsibility attendant thereto. On the positive side, a definite statement should be made to the effect that there will be no general revaluation of corporate assets. Such decision and statement would contribute to stabilization by eliminating uncertainty on the part of banks and other creditors and by solidifying the general opinion that stabilization is to be achieved through hard work and austerity rather than through financial manipulations and employment of bookkeepers ink with magical results.

[SOURCE: SUITLAND PAPERS, Z 703-20]

6-43 ECONOMIC AND SCIENTIFIC SECTION TELEPHONE DIRECTORY

as of June 1, 1949

Chief of Section	Maj. Gen. W. F. Marquat	26-6458
(Forestry Bldg.)	Lt. T. P. Harada	26-8753
Deputy Chief for Operations:	Lt. Col. W. T. Ryder	26-6298
(Forestry Bldg.)	Mr. M. M. Halff (Exec)	26-6468
Deputy Chief for Administration:	Col. E. A. Johnson	26-5628
(Forestry Bldg.)	Mr. C. M. Hamm (Exec)	26-7406
Directors:	Mr. F. Baker,	
(Forestry Bldg.)	Business & Investment	26-8852
	Mr. T. Cohen, Special Asst	26-6965
	Dr. S. M. Fine, Eco. & Finance	26-6565
	Mr. P. A. McDermott	
	Trade & Commerce	26-7408
	Diplomatic Liaison (State Dept)	
	Mr. D. M. Maynard	26-8723
Far East Command Allocation Committee:	Mr. Q. Adams (Exec Chairman)	56-5630
(Hattori Bldg.)		56-1883
	Business Economist	56-6602
	Reporter	56-6683
Deconcentration Review Board:	Mr. R. S. Campbell (Chairman)	56-6130
(Hattori Bldg.)	Mr. J. Robinson	56-6136
	Mr. B. D. Woodside	56-6140

	Mr. E. J. Burger	56-6147
	Mr. W. R. Hutchinson	56-6140
	Mr. G. F. Blewett (General Counsel)	56-6140
Foreign Investment Board:	Mr. Frayne Baker (Exec Chairman)	26-8852
(Forestry Bldg.)	Mr. Clark S. Gregory	
	(Exec Secretary)	26-7413
	Miss D. V. Layne (Secretary)	26-7413
Occupied Japan Export-Import Revolving	Mr. P. Cleveland (Controller)	26-8597
Fund: (Forestry Bldg.)	Mr. F. Gerard (Deputy Controller)	26-5695
Director, Bank Operations Branch:	Mr. R. Marlow	26-6108
PIO Representative:	Mr. S. Griffin	26-8903
Administration Division:		
(Forestry Bldg.)	Lt. Col. M. F. Noyes (Chief)	26-6670
Administrative Branch:	Mr. V. J. DeSanta, Jr. (Chief)	26-6471
Personnel Branch:	Capt. L.S. Quarterman (Chief)	26-8539
Supply-Services Branch:	Capt. G. W. Saddler (Chief)	26-6625
Anti Trust and Cartels Division:	Mr. E. C. Welsh (Chief)	26-6561
(Empire House)	Mr. R. M. Gillies (Asst to Chief)	26-6626
	Mr. C. H. Smith (Exec Off)	26-6560
Controls Branch:	Mr. M. J. Rose (Chief)	26-6665
Reorganization Branch:	Mr. H. H. Scheier (Chief)	26-6597
Securities Branch:	Mr. L. A. Randoll (Chief)	26-6582
Trade Laws Branch:	Mr. L. N. Salwin (Chief)	26-6671
Finance Division:	Mr. W. K. LeCount (Chief)	57-8801
(Pacific Bldg.)	Mr. J. R. Allison (Dep Chief)	57-8800
	Miss Z. Lamb (Secretary)	57-8800
Executive Officer:	Capt. J. P. Lowe	57-8802
	Administration Mr. Carroll	57-8811
Money & Banking Branch:	Mr. H. J. Robinson (Acting Chief)	57-8810
	Mr. W. N. Rogers (Asst Chief)	57-8810
Insurance Securities:	Mr. J. P. Royston	57-8804
Financial Institutions:	Mr. H. J. Robinson	57-8809
	Mr. H. S. Lahman	57-8809
	Mr. J. J. Henry	57-8595
	Miss A. Harrington	57-8595
	Miss H. R. Sheldon	57-8595
Credit Policy:	Mr. J. R. Phillips	57-8313
	Mr. W. Goodhue	57-8313
Foreign Exchange:	Mr. G. P. Waller	57-8312
	Mr. E. Donegan	57-8805
	Mr. C. D. Yeomans	57-8803
	Mr. J. E. Jordan	57-8803
	Mr. C. S. Ishimoto	57-8805
Public Finance Branch:	Mr. E.M. Reed (Chief)	57-8806
	Mr. S. T. Baron (Asst Chief)	57-8806
	Miss M. Mabbett (Secretary)	57-8806
Financial Administration		
& Customs:	Mr. J. T. Lassiter	57-8808
	Mr. T. A. Miyakawa	57-8808
	Mr. J. W. Harrison	57-8564
	Mr. H. Jeffers	57-8564
Budgets, Local Gov't Finance,		
Fiscal Policy:	Mr. W. A. Foster	57-8813
	Mr. E. B. Hutchinson	57-8807
	Mr. N. Gregory	57-8417
	Mr. A. T. Middleton	57-8417
	Mr. A. M. McGlauflin	57-8807
	Mr. J. E. Mossler	57-8813
	Mr. Leigh	57-8417
	Miss Burns	57-8807

Liquidation Branch:		
(Bank of Taiwan Bldg.)	Mr. W. S. Brower (Chief)	26-6566
Advisor to Chief		26-6474
Assistant to Chief		26-8730
Asst to Chief (Osaka Office)		44-5106
Administration		26-6473
Asset Liquidation		26-8310
		26-8328
Audits & Accounts		26-8525
Creditors Claims		26-7646
Special Projects		26-7646
Sub. Affil. & Special Accounts		26-5597
Loans, Advances & Discounts		26-5597
Securities		26-6474
Foreign Trade & Commerce Division:	Mr. F. E. Pickelle (Chief)	26-6527
(Forestry Bldg.)	Mr. R. W. Hale (Dep Chief)	26-8416
	Mr. A. B. Kram (Special Assistant)	26-6564
	Maj. R. W. Kemp (Exec Off)	26-8417
Plans & Policies Branch:	Mr. S. J. Janow (Chief)	26-8555
	Plans (Advisor)	26-6463
	Plans (Asst)	26-6466
	Policies	26-8593
	Japanese Government	26-6202
	Fiscal & Procedural Policies	26-8679
GARIOA		26-8675
Import-Export Control Unit:	Chief	26-8563
Chemicals & Minerals Branch:	Mr. A. J. Greco (Chief)	26-5292
Foods Branch:	Mr. H. J. Zimmerman (Chief)	26-6478
Machines & Consumer Durable Goods Branch:	Mr. A. B. Snell (Chief)	26-6900
Shipping Unit:	Chief	26-6481
Funds Control Division:	Mr. Paul Cleveland (Chief)	26-8597
	Mr. F. R. J. Gerard (Dep Chief)	26-5695
	Mr. C. Wright (Economic Advisor)	26-8081
	Mr. V. L. Rich (Executive)	26-5461
	Captain W. F. Ganeau (Asst Exec)	26-5685
	Administrative Assistant (Empire House)	26-5750
	Chief, Accounting Records Br. Mr. F. R. March (Forestry Bldg.)	26-6419
	Chief, Bank Operations Br. (Mr. R. H. Marlow)	26-6108
	Chief, Current Contracts Br. (Mr. V. L. Rich)	26-5461
	Chief, Fiscal Controls Br. (Mr. Douglas F. Reeves)	26-6485
	Chief, Documents Branch	26-5724
Industry Division:		
(Forestry Bldg.)	Mr. W. S. Vaughan (Chief)	26-6631
Deputy Chief, Operations:	Mr. M. M. Class	26-6659
Administrative Unit:		
Administrative Officer		26-6633
Coal Coordinator:	Chief	26-8501
Industrial Program Committee:		26-6573
Executive Chairman		26-6662
Chemical Industries Unit:	Chief	26-6319
Machinery & Equipment Unit:	Chief	26-7842
Consumer Goods Unit:	Chief	26-8505

Construction, Shipyard & Utilities Branch:	Mr. G. E. Meyer (Chief)	26-6583
Engineering Construction Unit:	Acting Chief	26-7451
Shipyard Industries Unit:	Chief	26-8571
Public Utilities Unit:	Chief	26-6580
Raw Materials & Requirements Branch:	Mr. H. B. Overton (Chief)	26-6538
Metals & Metallic Minerals Unit:	Chief	26-6661
Non-Metallic Materials Unit:	Chief	26-8503
Requirements Unit:	Chief	26-6663
Internal Revenue Division:	Mr. L. H. Moss (Chief)	57-8812
(Pacific Bldg.)	Mr. H. Shavell (Dep Chief)	57-8613
Administration:	Lt. O. Birliner (Exec Off)	57-8613
Tax Administration Branch:	Mr. R. V. Lash (Chief)	57-8611
	Mr. R. E. Davis	57-8611
	Mr. S. Odamura	
Tax Enforcement Branch:	Mr. J. E. Monroe	57-8610
	Mr. A. Perrin	57-8611
	Mr. D. R. Moysey	57-8611
	Mr. H. O. Howat	57-8611
	Mr. T. Yoshida	
	Mr. K. Okura	
Publicity & Training:	Mr. J. E. Monroe	57-8610
	Mr. K. Kishimoto	
	Mr. H. Homma	
Research & Programs Branch:	Mr. K. P. Sanow	57-8612
	Mr. M. Bronfenbrenner	57-8612
	Mr. T. Yamane	
Local Gov't Branch:	Mr. H. C. Bradshow (Chief)	57-8609
	Mr. J. W. Allen	57-8609
Monopoly Branch:	Mr. W. Bass (Chief)	57-8612
	Mr. A. Ethridge	57-8612
Shoup Mission:		57-8692
		57-8450 (Switchboard)
	Dr. Carl. S. Shoup	(Pacific Bldg.)
	Dr. Stanley S. Surrey	26-8077
	Dr. Howard R. Bowen	(Forestry Bldg.)
	Dr. William S. Vickery	
	Dr. William G. Warren	
	Dr. Jerome B. Cohen	
	Mr. Rolland F. Hutfield	
	Mr. G. Akatani	
Labor Division:	Mr. C. W. Hepler (Chief)	57-8903
(Pacific Bldg.)	Lt. Col. S. W. Thompson (Exec Off)	57-8817
	Chief Liaison Officer	57-8815
Administrative Branch:	Administrative Officer	57-8818
	Language Officer	57-8890
Labor Relations and Education Branch:	Mr. R. T. Amis (Chief)	57-8891
	Mr. J. D. Hoover (Ch, Lab Ed Unit)	57-8819
Manpower Branch:	Mr. S.D. Collett (Chief)	57-8885
Wages & Working Conditions Branch:	Miss G. G. Stander (Chief)	57-8894
Research, Coordination & Analysis Branch:	Mr. J. I. Saks (Chief)	57-8889
Price & Distribution Division:	Mr. F. L. Whittington	

	(Acting Chief)	57-8357
	Lt. Col. C. L. Waldron (Exec Off)	57-8385
	Lt. Col. C. C. Geduldig	57-8385
	Administrative Officer	57-8388
Food Branch:	Mr. H. F. Smith (Chief)	57-8387
Price Branch:	Mr. V. L. Bankson (Chief)	57-8396
Distribution Branch:	Mr. J. R. Boner (Chief)	57-8390
Enforcement Branch:	Mr. R. Goodman (Chief)	57-8392
Research & Programs Division:		
(Empire House)		
Office of Division Chief:	Mr. Kenneth D. Morrow	26-5468
Executive Office:	Lt. Col. C.F. Knowlton (Exec Off)	26-6287
Planning Branch:	Mr. M. Sapir (Chief)	26-8038
Foreign Trade Branch:	Mr. C. S. Sheldon (Chief)	26-7329
Population & Labor Branch:	Mr. A. Buchanan (Chief)	26-7328
Price & Distribution Branch:	Mr. M. Levine (Chief)	26-7420
Foreign & Domestic Commerce Branch:	Mr. T. G. Reid (Chief)	26-7991
Production Branch:	Mr. J. S. Fitzgerald (Chief)	26-5691
Scientific & Technical Division:		
(Empire House)	Dr. H. C. Kelly (Acting Chief)	57-8683
Engineering & Research Branch:	Lt. Col. L. Cross (Chief)	57-8486
Operations Unit:	D. Reck (Chief)	57-8582
Abstracting Unit:		
Special Projects Branch:	Dr. B.W. Dees (Chief)	57-8397
Textile Division:		
(Forestry Bldg.)	Mr. F. A. William (Chief)	26-8588
Cotton Branch:	Mr. W. R. Eaton (Chief)	26-6897
Merchandising & Sales Branch:	Mr. B. W. Adams (Chief)	26-6577
Procurement & Operations Branch:	Mr. J. G. Torrens (Chief)	26-6464
Silk & Synthetic Textile Unit:	Mr. R. Crewdson (Chief)	26-8547
Wool & Misc Textile Branch:	Mr. M. B. Lauphimer (Chief)	26-8880
Trade Service Division:		
(Hotel Tokyo)	Col. C. A. Mahoney (Chief)	26-6501
Hotel Management Branch:	Mr. L. E. Tewksbury	26-6524
Liaison and Reports Branch:	Miss F. M. Foott (Chief)	26-6517
Overseas Automotive Serv Branch:	Mr. S. DaSilva	26-6596
Overseas Supply Store Branch: (Meidi-Ya Bldg.)	Mr. G. E. Klock	56-6911
Accounting Control Branch: (Hotel Tokyo)	Miss M. C. James	56-6589

6-44 PARTITION OF MITSUI AND MITSUBISHI COAL MINING COMPANIES

ESB No. 269 June 20, 1949[29]
Memorandum
To: Mr. J. Robisnon, Chairman, Deconcentration Review Board
From: T. Aoki, Director-General, Economic Stabilization Board

As regards the proposed partition of both Mitsui and Mitsubishi coal mining companies according to the Elimination of Excessive Concentrations of Economic Power Law which is at present understood to be under review by the Deconcentration Review Board, it is very much desired that careful consideration be made in view of the fact that the development of indigenous resources is essential for the rehabilitation of Japan's economy as is indicated in the Nine Point Economic Stabilization Program.

The mining enterprises in Japan have been enabled to maintain the stability of their management through handling both coal and metals and the necessity of having unified management of multiple industries of this kind is not expected to become less in future. The proposed partition if it were carried out, would make it impossible for partitioned enterprises to maintain its present scale of management, thereby adversely affecting the development of indigenous resources indicated in the Nine Point Stabilization Program to the detriment to the rehabilitation of Japan's economy.

It is cordially requested, therefore, that with due regards for the above consideration the both companies be allowed to continue as they are without partition.

[SOURCE: *Eibun Sengo Shiryo*, vol. 18, ECONOMIC PLANNING AGENCY]

[29] On June 27, 1949 the Review Board recommended that the Mitsui Mining Co., Ltd. be divided into 2 independent companies, one to be engaged in the mining of coal and the other in the mining of metals. On June 28, 1949 the same recommendation was made for Mitsubishi Mining Co., Ltd.

6-45 FINAL REPORT OF THE DECONCENTRATION REVIEW BOARD

Memorandum July 15, 1949
To: General Douglas MacArthur, SCAP
From: Joseph Robinson, Chairman, Deconcentration Review Board

1. The Board has submitted interim reports from time to time the last of which, dated 9 April 1949, related to the period from 1 January to 31 March 1949. In addition to a brief review of the work of the Board for the entire period since 4 May 1948, the date of our arrival in this Headquarters, there is included herein a resume of the activities of the Board from 31 March to date.

2. The Board was recruited by the Department of the Army in Washington during April 1948 at the request of SCAP in Radio Z-36542 of 26 January 1948. The primary function of the Board as outlined by SCAP was to review plans of reorganization prepared by the Japanese Holding Company Liquidation Commission for companies designated as excessive concentrations of economic power under Japanese Public Law No. 207 and to make advisory recommendations with respect thereto to the Supreme Commander.

3. Japanese Public Law No. 207 (Law for the Elimination of Excessive Concentrations of Economic Power) was passed by the Japanese Diet 9 December 1947. This law was one of a number of Japanese statutes sponsored by the Occupation in conformity with basic policy directives which required the adoption of a program designed to further the democratization of Japan by effecting material changes in the ownership, control and structure of Japanese industry. The basic policy directives authorizing this program are found in the Potsdam Declaration of 26 July 1945, the Basic Initial-Post Surrender Directive to the Supreme Commander for the Allied Powers for the Occupation and Control of Japan dated 1 November 1945, and in the Basic Post-Surrender Policy for Japan as contained in a Far Eastern Commission Policy Decision dated 19 June 1947.

4. The broad purpose of this deconcentration policy as interpreted by the United States Government was stated briefly by the United States member of the Far Eastern Commission on 10 December 1948, in connection with the formal withdrawal of FEC 230, as a U.S. Proposal, as follows:

"That policy, which called for the dissolution of certain Japanese combines and a widening in the distribution of the income and ownership of Japanese industry, was then and continues to be, in the view of my govt, a fundamental objective of the Occupation."

The essential purpose of Law No. 207 likewise may be described in the following language from the same statement:

"Finally, some score of Japanese companies whose present state may constitute a threat to competitive enterprise are being scrutinized, one by one. Where necessary, these combines will be subject to such reorganization as may be required to remove the existing threat.

5. Prior to the enactment of Law No. 207, various actions had been taken by the Japanese Government and by SCAP which dealt with many phases of the problem presented by the deconcentration policies authorized by the basic directives. The more important Zaibatsu holding companies had been earmarked for dissolution and their ownership and control of large portions of the Japanese economy terminated. The so-called Purge has removed many individuals from important positions in business as well as from public offices. A large number of holding companies in addition to those dominated by the leading Zaibatsu

had been designated for dissoultion or reorganization by the Holding Company Liquidation Commission pursuant to legislation enacted for this purpose. The control associations which had exercised comprehensive regulatory powers over Japanese industry prior to and during the war had been or were being dissolved. Approximately 1,200 companies which had been affiliated with Zaibatsu companies had been designated as "restricted concerns" and subjected to close supervision under Japanese ordinances granting broad powers for the control of these companies pending the sale of their securities formerly owned by the Zaibatsu affiliates to new stockholders and the severance of Zaibatsu connections. Anti-monopoly legislation had been enacted during the early part of 1947. The Zaibatsu Family Control Law was passed as a companion law to Law No. 207 in December 1947. This law was intended to terminate the control or influence over enterprises which 10 designated Zaibatsu family clans had exercised by virtue of the ownership of securities or the holding of office in these enterprises by members of such families or their appointees. A brief summary of these and other measures and actions taken under them as submitted to the Board by Antitrust and Cartels Division, ESS, is included herewith.

6. Under Law No. 207 and the rules and regulations thereunder, 325 companies were designated for investigation to determine whether as excessive concentration of economic power they should be reorganized, dissolved, or other appropriate action taken. These 325 companies had been designated prior to the Board's appointment. We were advised by the Department of the Army in Washington that SCAP had already determined that 157 of these companies should be removed from designation as not requiring reorganization under the law. Accordingly, at the time of our departure from Washington, a maximum of 168 companies remained subject to possible reorganization and therefore to review by the Board. The companies were all large operating companies and represented a substantial cross-section of Japanese industry. Many of them were also holding companies and "restricted concerns" and as such were subject to action with respect to their securities holdings under other statutes. Some of them had been affiliated with the designated Zaibatsu either as subsidiaries or by more intangible ties. Others, not identified with these Zaibatsu, were operating-holding companies which had attained a size and scope of operations comparable with some of the designated Zaibatsu sub-holding companies. These 168 companies represented a residual of Japanese industry to be scrutinized for the possible application to then, as large operating companies, of deconcentration action, pursuant to the policy outlined in the basic directives. Since the legislation referred to in paragraph 5 did not effect these companies materially as operating companies, Law No. 207 afforded a basis and procedure for requiring their break-up or reorganization if that action were deemed necessary to give effect to outlined basic policy.

7. Instructions to the Board by the Department of the Army in Washington, which were confirmed by the Supreme Commander in Tokyo, were general and accorded the Board broad responsibility to make recommendations to SCAP at any time on any phase of the deconcentration program within the framework of United States policy statements and directives. We were advised, however, that it was considered essential that decisions be reached for the companies subject to Law No. 207 as rapidly as possible; that deconcentration actions under the law should not be permitted if those actions would have a material adverse effect on production or impede the Occupation recovery program; and that in general reorganizations of companies should not be permitted or required which were not necessary, or to a degree greater than necessary, to place the industry involved in a reasonably competitive condition.

8. Of the 168 companies referred to in paragraph 6, the Board has reviewed the detailed files, which included proposed plans of reorganization, and made recommendations to SCAP for 57 companies in 21 industrial fields. In connection therewith it was necessary for the Board to study pertinent physical, economic, and financial data for many other companies in order that consideration might be given to facts and circumstances material to the different industries involved. The remaining 111 companies were removed from designation under the law without referral to the Board.

9. Under the terms of SCAP's radio of 26 January 1948, it was originally contemplated that the Proposed Orders of Reorganization would be submitted to the Board for review after their issuance to the companies by the Holding Company Liquidation Commission. Based on its findings the Board would then advise the Supreme Commander when in its opinion he should exercise his inherent right to intervene for the purpose of staying, modifying, or setting aside the Order. In connection with the Board's recommendation in the first case reviewed, it was suggested that if the recommendation (that the company not be reorganized and that it be removed from designation) were approved by the Supreme Commander the HCLC be afforded the opportunity to withdraw its order without formal action by SCAP. This suggestion was adopted and in no case has it been necessary for SCAP to intervene in any HCLC action involving removals from designation. Later the procedure was further modified in the interest of expediency and with the consent of the Headquarters to permit the Board's review of the proposed reorganization action prior to the issuance of an order by the HCLC. Under this procedure orders were actually issued by the HCLC only in those cases in which the Board had decided that it would recommend that the proposed action be taken. This arrangement was satisfactory to all interested persons and was adopted as standard procedure after the first few cases had been processed.

10. In making its recommendations it was necessary for the Board to give consideration to certain conditions and broad assumptions which deserve mention. While it is not possible of course to enumerate all of them, some of the more important ones can be stated.

11. During the war and for several years prior thereto Japanese industry in the main was operated as an adjunct to the military. The entire economy was subject to strict controls which forced sweeping changes in the basic physical and financial structure of many Japanese industries. Since 1938, and in some instances prior to that time, Japanese business can scarcely be said to have operated on a competitive basis. In addition, concentrations of management and ownership were fostered by government policies which frequently produced combined enterprises having no common financial or business background and no reasonable expectation of any future integration or related operations.

12. The period since the surrender likewise has been characterized by strict economic and financial controls made necessary by the collapse of the Japanese economy and to insure compliance with Occupation objectives.

13. For at least 11 years therefore the Japanese economy has been distinguished by the absence of competition except perhaps for the competition for contracts and for those permits and licenses from government agencies which were required to obtain necessary raw materials, power or fuel. As a consequence, there was not available to the Headquarters or to the Board recent data reflecting the operations of a competitive economy which might have been useful in appraising the probable effect of reorganization plans from a competitive point of view.

14. The relaxation and removal of government controls will undoubtedly extend over a lengthy period and will occur at different times for different industries.

15. Accordingly, in attempting to determine the degree of deconcentration which would appear to meet basic policy requirements it has been necessary to assume that at some undeterminable future date the companies being examined would be free to compete.

16. Much of Japanese industry is dependent upon imported raw materials. It has been necessary to assume that Japan will be allowed access to and be able to buy essential materials and sell her finished products in world markets.

17. Many of the companies examined were insolvent. Some time will of necessity elapse before final plans of reorganization can be prepared and made operative. It has been necessary to consider the difficulties of marketing shares in the existing unsettled securities markets and the shortage of credit in making recommendations with regard to reorganization plans.

18. As mentioned in paragraph 6, many of the companies reviewed by the Board were designated holding companies under Japanese ordinances requiring that their holdings in subsidiaries be sold. Many of the companies had been subsidiaries of or otherwise affiliated with Zaibatsu or other holding companies. Applicable legislation provided for the termination of such affiliations. The anti-monopoly law prohibits certain types or relationships and business practices. The Board considered these companies primarily as operating companies and assumed that the actions required by other legislation would be completed. The Board recommended that several companies be removed from designation under Law No. 207 where it appeared that the only action contemplated thereunder was also required by some other law.

19. The Japanese Government has become the owner of securities of Japanese enterprises amounting to many billion yen. Some of these were acquired in execution of the program which required that the Zaibatsu and the important holding companies dispose of their security holdings in other companies. Others were received in settlement of liabilities imposed by various tax laws. The Prefectural governments, as well as the Imperial Government, have owned substantial stock interests in many companies for many years. The sale of these securities to new owners is an essential feature of the deconcentration program and

substantial progress has been made toward this end. A considerable period must elapse, however, before the distribution of all these securities can be completed. In reviewing the cases the Board gave consideration to the fact that under the broad program government interests in the companies should eventually be liquidated.

20. Finally, it should be recognized that the Japanese, themselves, must assume the ultimate responsibility for the structure and ownership of their industry. Whether various deconcentration actions become fully effective and whether the resurgence of similar monopolistic combines will be permitted in the future rests mainly with them.

21. The Department of the Army expressed the hope that decisions on the companies subject to Law No. 207 would be completed by mid-1949. In having submitted recommendations to SCAP as to the degree of deconcentration which seemed appropriate on all companies which have been submitted to the Board, we believe that we have fulfilled our basic assignment. The preparation of detailed plans of reorganization and the consummation of these plans remain to be carried out by the HCLC under the supervision of the Antitrust and Cartels Division of ESS and other agencies of the Headquarters.

22. The Board is of the opinion that the recommendations made under Law No. 207 fall within permissible limits of discretion in complying with those portions of the basic policy directives which relate to the control and structure of Japanese industry and with the instructions given the Board.

23. The Board reviewed and made specific recommendations to SCAP on reorganization plans submitted to it for 57 companies. The Holding Company Liquidation Commission removed 111 companies from designation without referring them to the Board on the basis of a review of the Commission's original action in the light of the 4 principles included in Recommendations of the Board to SCAP on August 28, 1948, and announced to the HCLC by SCAP on 11 September 1948.

RECAPITULATION

1.	Originally Designated		325
2.	Removed from Designation prior to 4 May 1948	50	
3.	Removed from Designation recommended by DRB	38	
4.	Division recommended by DRB	11	
5.	Disposition of certain plants recommended by DRB	2	
6.	Disposition of securities recommended by DRB	1	
7.	Disposition of government control recommended by DRB	1	
8.	Referred to FTC for specific action recommended by DRB	2	
9.	Reorganization recommended by Headquarters divisions concurred in by DRB	2	
10.	Removed from designation and orders cancelled by HCLC as result of application of principles and recommendations stated by DRB	179	
11.	Classified by ESS/AC as requiring no physical breakup, not reviewed by DRB	37	
12.	Designated by ESS/AC as closed institutions	2	325
	Balance		000

24. The Board wishes to express its appreciation of your encouragement and support in its work, and to thank Major General W. F. Marquat, Chief, Economic And Scientific Section, for many thoughtful courtesies, and to acknowledge indebtedness to the Antitrust and Cartels Division, to the Industry Division, to the Natural Resources Section, and to other Headquarters personnel, for their helpfulness and cooperation. The Board wishes also to thank the Commissioners and staff of the Holding Company Liquidation Commission of the Japanese Government for valuable information and assistance.

APPENDIX A

Of the Final Report of the Deconcentration Review Board, 13 July 1949

CASES REVIEWED BY THE BOARD REPRESENT
Companies in 22 Industries as follows

Banking	5 Banks
Mining	5 Companies
Steel	4 〃

Flour Milling	2 〃
Oil	2 〃
Cement	2 〃
Spinning	9 〃
Cold Storage	1 Company
Chemical	8, Including Nippon Soda
Fishing	2 Companies
Express	1 Company
Paper	1 〃
Gas	2 Companies
Heavy Industries	3 〃
Theater	2 〃
Warehousing	3 〃
Beer	1 Company
Wire and Cable	1 〃
Electric Manufacturing	5, Including Tokyo Shibaura
Dairy	1 Company
Power	1, Incl Distributing Cos.
Can	1 Company

[SOURCE: SUITLAND PAPERS, Z 703-10]

6-46 JAPANESE LAND REFORM PROGRAM

Report No. 127[30] March 15, 1950
Presented by: Laurance I. Hewes, Jr.
Natural Resources Section, SCAP

TABLE OF CONTENTS

Frontispiece
Summary
Introduction
Formation and Negotiation of Land Reform Program
The Land Reform Law
Administration of Land Reform Program
Administrative Role of Land Commission System
Land Reform and Operating Problems
Law Enforcement
Future Land Problems
Conclusion

SUMMARY

1. Actual operations of the Japanese land reform program began about January 1947. As of 31 March 1949, land transferred from landlords to tenants has completely reorganized the pattern of land ownership and of landlord-tenant relations. The amount of land operated by tenants has shrunk from 46 percent to about 12 percent of the total cultivated area. Absentee landlords as a class have completely disappeared. Owners, only 36 percent of the total number of cultivators at the beginning of the program, have increased to 70 percent. Landless tenants, as a group formerly representing 27 percent of all cultivators, now represent less than 6 percent, and a number of these have acquired some land. More than 3,000,000 farmers, well over one-half of all farmers in Japan, have purchased some land during the program. Remaining tenant-landlord agreements are subject to strict government regulation. These accomplishments mark the end of the feudal land tenancy system of Japan, an economically unsound tenure arrangement which has existed since the Meiji Restoration in 1868.

2. Distress among farmers caused partly by the former system finally led to a series of reform measures in the 1920's and 1930's. In the meantime, however, Japan plunged into disastrous military adventures. Farmer discontent was exploited by militarists. Agrarian reform became the tool used to gain political support. The reforms were not completed but remained as blueprints for future implementation after their political usefulness ended.

[30] Summary and Conclusions only are included here.

Reform of the unsatisfactory tenure system became one of the principal objectives of the Allied Occupation after Japan's surrender in 1945. The Allies were convinced that successful rehabilitation of Japan's economy and introduction of democratic principles on a broad scale required a complete transformation of existing institutions of farm tenancy.

3. On 9 December 1945, the Supreme Commander for the Allied Powers, General of the Army Douglas MacArthur, issued a formal Memorandum to the Imperial Japanese Government. This document briefly reviewed the problems confronting farm tenants and instructed the government to present its plans for destroying a system of economic bondage among farm tenants. Simultaneously, and apparently quits independently of General MacArthur's Memorandum, the Japanese Government enacted legislation implementing prewar tenure legislation and broadening its scope. This legislation, presented in response to General MacArthur's Memorandum, was considered inadequate by Occupation authorities. Efforts to persuade the Japanese people of their need for a thoroughgoing land reform program were then set in motion. Widespread discussion and debate followed. Finally in October 1946, desirable legislation providing for a complete reorganization of farm tenancy was enacted in two complementary statutes, the Owner Farmer Establishment Special Measures Law and the Agricultural Land Adjustment Law. These were known collectively as the Land Reform Law.

4. These two laws required that almost all agricultural land in Japan owned by non-cultivating landlords be purchased at fixed prices by the government and sold to tenants. Terms of sale were fixed so that all tenants would be able to purchase land. Resident landlords were permitted to retain small amounts of land. This in the aggregate was expected to amount to about 10 percent of the total cultivated area. Terms of purchase and sale, methods of buying and selling, and the authorities responsible for carrying the work forward were set forth. Principal authority over land was vested in agricultural land commissions, bodies democratically elected by formers and land owners. Land commissions had final responsibility for selection of land to be purchased, price, terms of sale, selection of purchases, and supervising transfers of rights to use all agricultural land. Scope of purchase and sale authority was very broad and included power to buy other land in addition to cultivated land under tenancy, when such acquisitions were required to provide an adequate economic base for new owner cultivators. In practice these laws revealed deficiencies which were remedied by extensive amendments.

5. The execution of the Land Reform Law required an extensive administrative structure. Organization was commenced in 1946 at the central government level and gradually extended to include the 46 prefectures and nearly 11,000 cities, towns, and villages. Principal operating activities were delegated to local and prefectural land commissions and prefectural governors. Clerks of local commissions and their buraku assistants were important adjuncts in carrying forward land transfer activities. More than 400,000 persons were engaged in the work. Administration methods corresponded in the main to well known western concepts of recruiting, traning, conferences, reporting, inspection, etc.: however, in practice these had distinctive Japanese qualities. In addition, an ambitious program of public information and education was planned and partially executed. Administrative costs of the prefectural and national governments in the three fiscal years 1946, 1947, 1948 totaled more than ¥1,000,000,000. Operating costs of prefectural and local commissions in the same period totaled over ¥6,000,000,000. Most of the land transfers were completed in the calendar years 1947 and 1948. Although Japanese administrative techniques seem strange to westerners, achievements obtained are significant, particularly in view of post-surrender handicaps.

6. Justification of land commissions as a principal agency of administration rests on moral and political, as well as on practical, grounds. Scope of land reform involved almost every Japanese farmer, and a system of administration based on farmer participation furthering democratic objectives conformed to the democratic philosophy of the Occupation. Nearly 11,000 local commissions were elected in December 1946 and 46 prefectural commissions in February 1947. Election results were reasonably satisfactory: unfamiliarity with democratic techniques, and ingrained traditions resulted in biased elections in about 25 percent of the communities. These were later corrected by a simple recall procedure and new supervised elections. Ignorance of the program and the threat of political domination were early hazards to the commissions. Experience in actual operations soon provided needed education, and a number of safeguards effectively removed the danger of political domination. Commission clerks are due a large share of credit for successful performance of the commissions. This clerical assistance represented a big item in land commission expense, and local commissions themselves accounted for 80 percent of all cost. The central government assumed responsibility for commission operating expenses, first because local expenditures involved were beyond the scope of local and prefectural revenues, and second because central fiscal control was administratively desirable. Alternative methods of financing, involving extensive use of local resources or imposition of a fee system, seemed likely to impede the program and create opposition. Prefectures and local governments at their own discretion did contribute in the 1946-48 fiscal period more than ¥1,400,000,000 of a total expenditure of ¥7,200,000,000.

7. Land was transferred according to a schedule commencing with the first purchase of 129,259 cho of cultivated land on 31 March 1947. By 31 December 1948, the date originally set for completion of the transfer phase of the program, a total of 1,848,791 cho had been acquired and 1,736,951 cho sold. These amounts considerably exceed the intial estimate of 1,542,463 cho. In addition to cultivated land, 220,373 cho of pasture land was acquired as a result of amendments to the original law, 97,626 cho of which had been sold as of 31 March 1949. Poor administration and complex procedures combined to impede intra-government transfers of lands for land reform purposes, such as lands acquired by the government as payment in lieu of taxes, and former military lands. With land transfers nearing completion, emphasis was shifted to collections and disbursements of payments for land, which involved a gross turnover of ¥18,000,000,000. More than one-half of this operation was complete as of 31 March 1949. New leasing procedures for approximately 700,000 cho of land remaining in tenancy also were begun. Under this procedure written lease contracts will be required in all tenant-landlord agreements at the end of the 1949 crop year. Final official registrations of land transfers occurring in the land reform program is a lengthy, tedious process which probably will not be complete before March 1952.

8. Law enforcement problems absorbed a considerable amount of official time and energy. Landlords were astute and familiar with legal processes, while tenants were timid and fearful of legal processes. Landlords utilized several methods to defeat the land reform law—first by outright eviction, later by law suits challenging constitutionality of land reform law. With resurgence of tenant interest these methods were vigorously contested and in most instances defeated. Other legal problems grew from the intense competition between agricultural and nonagricultural land uses. This competition naturally arises out of land shortage and dense population. Legislative intent clearly favored a priority for farmer operation of cultivated land. Hence, all uses of agricultural lend for nonagricultural purposes were reviewed. Many corporate users of agricultural land reduced or transferred their holdings. These included a number of public and semi-public bodies which could not prove that cultivation of land was their principal aim. In metropolitan areas where agricultural and metropolitan uses conflicted, special procedures and standards were established to reconcile legitimate claims.

9. Japanese farm units are badly fragmented and dispersed, wasting labor and land resources. Although land reform law and policy provided for an accompanying consolidation program, results were not satisfactory. Consolidation legislation applying to all land was enacted on 6 June 1949 in the Land Improvement Law. This law, not yet in operation, should provide adequate authority to attack this basic problem. However, declining farm size and further fractionalization of farm units still threaten Japanese agriculture. The new equal inheritance rights for all family members, if applied to Japanese farmsteads, will inevitably cause a great multiplication of farms and a rapidly declining farm size. Legislation to offset potential devastating effects of unlimited succession rights is now being sought. Successul consolidation programs and a control of succession rights require a more satisfactory procedure for calculating and fixing land prices. The formula in use during land transfer operations was quite inadequate, resulting in extremely low prices to landlords and an unjustified windfall to tenants. This effect, not intended in original plants, was due to a poor price-fixing procedure and an administration too inflexible to offset the inflationary tide.

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CONCLUSION

Foregoing sections of this report have traced administrative features of the Japanese land reform program from its inception in October 1945 to 31 March 1949. A brief resume of the Occupation agrarian policy and its background introduced an outline of the steps leading to enactment of the land reform law. An analysis of the law was followed by a description of the administrative machinery for executing the program. Operating aspects of the program were outlined, commencing with the land commission system and proceeding to an

account of land transfer operations. The discussion of law enforcement emphasized the basic struggle of a land-hungry people. Some unsolved land problems subsidiary to land reform were analysed. This concluding section summarize the accomplishments, discusses the significance of the program, and closes with some suggestions of measures needed to safeguard the gains which have been achieved.

1. *Accomplishments and Immediate Effects of Land Reform*

The purchase of 1,869,063 cho of cultivated land and the sale of all but 76,492 cho to 3,000,000 eligible purchasers were accomplished in the two-year period ending on 31 March 1949. In addition 220,373 cho of pasture land was acquired, of which 97,626 cho has been sold.

At the same time land has been transferred for reclamation purposes. Although using land reform administration procedures, this is a specialized operation. A total of 335,459.2 cho has been reclaimed since 1945, and 97,500 cho had been sold as of 31 March 1949.

Substantial amounts have been collected (¥5,599,909,865) and disbursed (¥4,764,135,894) in payment for this land. These collections represent about 64 percent of all payments due the government, and the disbursements are about 51 percent of all payments owed by the government. Over-all costs of the program are reported at ¥7,267,290,164, composed of ¥1,055,357,003 spent by central and prefectural governments for administration and ¥6,211,933,161 spent for operations of local and prefectural commissions.

In a program characterized by orderly progress, almost entirely without violence, about one-third of the total cultivated land of Japan passed into the hands of more than 3,000,000 working cultivators (Figure 6). More than 50 percent of all farm households purchased land. A little over 18 percent of the total cultivated area still remains in tenancy: this amounts to about 700,000 cho. Even on this land, almost all tenants will own the larger portion of the land they cultivate, thus falling into the owner-tenant group. Tenant-landlord relations on this small area of tenant land will be strictly regulated. All lease contracts will be put in writing, and each will be subject to careful scrutiny by the local land commission.

Thus tenancy, formerly a principal characteristic of Japanese agriculture, has become a subsidiary aspect subject to public regulation. The type of tenancy which implies the exploitation of working cultivators by a petty rentier group has been abolished. Landlords as a class have disappeared; tenants have become owner cultivators. A small amount of land will continue to be rented to provide elasticity in farm operations as a convenience to cultivators.

All of this reform has been accomplished in a little more than two years of actual operations. The transition has been achieved with little disturbance to the existing farm management pattern and without interrupting farm operations or the lives of farm people.

The Japanese program is distinguished from other tenure reform programs involving

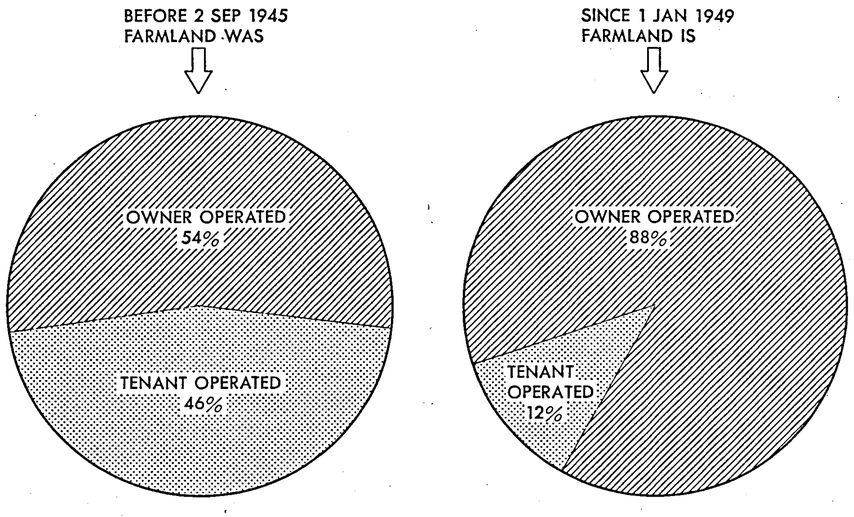

Figure 6

break-up of latifundia or the collectivization of smaller farms into single grand units or into state farms. There has been no collectivization of land in Japan whatever. Maximum effect of breaking up single operating units has been confined to units of more than three cho (12 cho in Hokkaido). In Kyushu, Shikoku, and Honshu (areas of more intensive cultivation) the total area of large holdings affected by the retention rate provision of the land reform law amounted to about 335,000 cho.* Even here, changes in cultivators probably have occurred only on units larger than three cho which formerly were cultivated by the owner. Holdings of more than three cho which were cultivated by several tenants probably have been sold to the tenants, each tenant purchasing the plots he customarily cultivated. In Hokkaido with its more extensive holdings these effects may have been greater, although retention rates were considerably higher.

The quantitative effect of the transfer of cultivated land is reflected in shifts in the distribution of owner and cultivating households, as shown in Table N:

TABLE N.—ESTIMATED CHANGES IN DISTRIBUTION OF OWNER HOUSEHOLDS OWING TO LAND REFORM (percent of owner households)

(1) By Scale of Ownership

Scale (cho)	1 Aug 47	31 Dec 48	Net Change
0.0—0.5	48.1	49.2	1.1
0.5—1.0	24.9	25.5	0.6
1.0—3.0	21.3	23.7	2.4
3.0—5.0	3.0	0.9	−2.1
Over 5.0	2.7	0.7	−2.0

(2) By Class of Owner

Class	1 Aug 47	31 Dec 48	Net Change
Absentee owner	11.2	0.00	−11.20
Resident noncultivator owner	3.3	2.97	−0.33
Resident cultivator owner	85.5	97.03	11.53

SOURCE OF DATA: Ministry of Agriculture and Forestry

Table N indicates that the following changes have occurred: (a) The number of large owners is greatly reduced. (b) The largest increase is in the group owning units between one and three cho. (c) The disappearance of non-resident owners represents abolition of the absentee landlord class. (d) Changes in proportions of resident cultivators, a group composed of owner farmers, still further increases the preponderant size of that group. (e) A further point not so clearly indicated for resident non-cultivators is the shrinkage in the amount of land owned by this group, each of whom now retains a maximum average of one cho.

Table O illustrates changes in classes of cultivators resulting from the shift in ownership:

TABLE O.—ESTIMATED CHANGES IN DISTRIBUTION OF CLASSES OF CULTIVATORS (percent)

Class	1 Aug 47	31 Dec 48	Net Change
Owner farmer	36.5	70.0	33.5
Part owner a)	20.0	22.5	2.5
Part tenant a)	16.9	2.0	−14.9
Tenant	36.6	5.5	−21.2

a) The Ministry of Agriculture and Forestry has adopted the following definitions of individuals with tenure rights: (1) owners are those who own at least 90 percent of the land they cultivate; (2) part owners own between 50 and 90 percent of the land they cultivate; (3) part tenants own less then 50 percent and more than 10 percent; (4) tenants own less than 10 percent of the land they operate.

SOURCE OF DATA: Ministry of Agriculture and Forestry Statistical Year-book for 1947, p. 5, and data supplied by Ministry of Agriculture and Forestry. November 1948.

The proportion of owner farmers has greatly increased, with tenants and part tenants making up a small minority of farm operators. Figure 7 and Table O perhaps illustrate most specifically the impact of the program on working farmers.

Certain subsidiary gains are worth noting: (a) establishment of a comprehensive body of law and regulations governing all transactions involving farm land, (b) creation of a nation-wide administrative organization of more than 400,000 persons for executing the program (the great bulk of these were working farmers), (c) development of a national educa-

* Natural Resources Section Report No 101, op cit, p 20.

tion and information program accenting themes of democracy and attacking feudalism, (d) education of large numbers of backward and timid farmers in handling instruments of democratic action and procedures for asserting their rights to land.

2. *Significance of the Reform*

The Japanese land reform program is neither an adventure in utopian idealism nor a phase of social revolution. It is a hard-headed attempt to relieve farmers of the burden of an oppressive landlord system, which fostered anti-democratic social relations and counteracted efforts to increase agricultural production. Its objective is to encourage ownership of individual farm units by working cultivators so that these "shall have more equal opportunity to enjoy the fruits of their labor".

The 3,000,000 farmers who have acquired land under the program have enhanced their stake in the institution of private property. The state's role throughout land reform operations was over-all guidance and administration of the transfer program. It did not become a landowner, nor has it obtained rights over land amounting to ownership.

Throughout all phases of the program, stress has been placed on preservation and enhancement of the indivdual family farm. This system of farm management in Japan already has proved its superiority in production. Consequently, from a management viewpoint changes in this basic pattern could not be justified. The aspirations of Japanese farmers over the centuries have been directed toward acquisition of individual units. No intervening pastoral or communal period is recorded in Japanese history and consequently no tradition of either large-scale or communal agriculture. Furthermore, a great deal of the terrain lends itself to small-scale individual cultivation.

3. *Comment on Future Policies*

In his appraisal of likely effects of land reform Dr. MacMahon Ball states quite accurately, "It would be foolish to hope for too much from these reform measures, even if they are carried out according to plan. By enabling a tenant to become an owner-farmer you improve his condition by increasing his rights, particularly his right to a larger share of what he produces. But do you not necessarily increase the volume or value of his products. It is often said that farming is very efficient in Japan. This is true in the sense that the Japanese are expert in getting the maximum product from a given area. But the meticulous exploitation of every cultivable square yard is only carried on by the reckless expenditure of human labor."*

The progress achieved by farmers through the land reform program must be reinforced by adjustments in related phases of the farm economy. In fact, the entire traditional lag of the rural behind the other segments of the national economy should be eliminated immediately. Policies favoring commerce and industry at the expense of agriculture can no

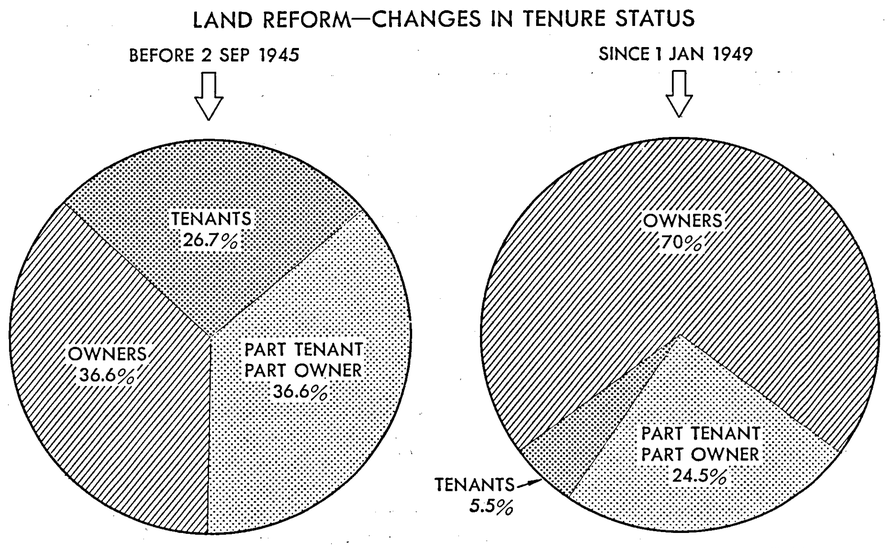

Figure 7

longer be tolerated. Such policies inevitably would result in undermining the temporary gains achieved through land reform.

Cooperatives: A farmer cooperative program is now under way. It must be vigorously supported and encouraged if the farmer's income and purchasing power are to achieve parity with the rest of the economy. Unless farmers can arrive at a position of bargaining equality with other segments of the population they are likely to slip into a condition of chronic distress with the onset of deflationary trends.

Agricultural Credit: Japanese agriculture requires and merits a carefully designed credit system. Formerly usury and landlordism went hand in hand to create exploitive tenancy. Japan cannot afford to risk the economic health of rural society through the prevailing chaotic set-up of petty money lenders. The failure to fill this policy gap constitutes a direct threat to the new land-owning group.

Taxation: Farmers should bear their fair share of the national tax burden. However, this revenue source has been dreadfully exploited in the past, and unsound taxation policy has been one of the direct causes of the spread of tenancy. Farmers have not been consulted about the manner of either assesement or collection, and tax officials have not been concerned with rural problems. A system of taxation carefully adjusted to the special circumstances of farmers should be inaugurated. Careless or antiquated fiscal policies if applied to agriculture will appreciably diminish the benefits of the land reform program and lead to a loss in farm production.

Education: The backward and unenlightened simplicity of many Japanese farmers has made them easy victims of more sophisticated groups. This deficiency can be overcome only by a long-range program of general education among both children and adults. A modification of the farm adviser system of the United States combined with the folk school system of prewar Denmark might offer a type of program well adapted to the Japanese village. Leaders in such an undertaking must be rural persons with well-established rural ties.

Development of a Farm Movement: Japan needs a sound political farm movement. At present, particularly in respect to land reform, the government has undertaken to act in behalf of farmers with no political mandate from them. Farmers must eventually be able to participate effectively in the political areas, protecting and promoting their interests on such items as land policy, farm credit, taxes, etc.

Currently, owing to their lack of organization and education, farmers are political nonentitites. Under these conditions it becomes appropriate for government to act in their behalf. But such a role is dangerously close to paternalism, which if continued will destroy all possibility of initiative and independent action by farm groups.

The existence of a large, potentially powerful but unorganised group of farmers is a challenge to national political stability. The group can and will be organized. In recent years warmongers exploited the political value of this group to gain support for a dismal military adventure. Other special interest groups may seek to make an equally undesirable alliance with farmers. Thus farmers, although not politically activated, may be regarded as politically significant.

[SOURCE: SUITLAND PAPERS]

* *Japan—Enemy or Ally*, pp. 143, 144.

7 ECONOMIC DISARMAMENT AND REPARATIONS

7-1 PRINCIPLES OF REPARATION POLICY[1]

September 4, 1944

1. Basic Assumptions

By reparation is understood the transfer of goods, services or credits from the reparation-paying government to another government without direct economic return. It is a transaction between governments and is, therefore, to be distinguished from either restitution or confiscation of private property.

Japan as an aggressor, which resorted to a war of conquest contrary to its legal and moral obligations, is legally and morally under obligation to compensate the states, victims of that aggression, in so far as material compensation is possible for such injuries, for all the damage to life, limb and property they have suffered, and all the costs of defense which have been forced upon them by that aggression.

Japan, however, does not have the economic capacity, even over an indefinite period of time, to pay such compensation, and an effort to make Japan pay the maximum of reparation would have consequences upon international political stability and economic relations more injurious to the United Nations than their gains through such payments. Consequently it would be unfortunate to create a public expectation that reparations from Japan will contribute much to relieving the United Nations of their burden of reconstruction.

The policy of the United Nations is concerned primarily with the assurance of political stability and security in the world and with the development of welfare and equality of economic opportunity for all peoples. Action toward these objectives lies primarily in fields other than reparation though a proper reparation policy may make some contribution to them.

As a consequence of these considerations, in the peace settlement, reparation policy should be regarded as of secondary importance and that policy should not be based upon a punitive conception of Japan's guilt, a legal conception of Japan's liability, an accountancy conception for calculating the amount of damage suffered by the various victims of Japan's aggression, or a retributive conception of the need to satisfy the vindictive sentiments natural to the victims. Instead the reparation policy should be based upon a careful appraisal of the political and economic consequences of alternative programs.

[Source: Dipl. Br., National Archives]

[1] This document bears no indication of its author.

7-2 JAPANESE EXTERNAL ASSETS

Summary Statement — August 1945

Prepared by: SCAP, Civil Property Custodian, External Assets Division

Japanese External Assets as of August 1945 Summary Statement, Representing Distribution by Area of Location of Property According to Possession by Right of Ownership, Custodial Control by Virtue of Occupation or Control Through Mandate, Protectorate or Colonization at Time of Japanese Surrender of Estimated Non-Military and Military Categories of Assets and Combined Totals, Expressed in United States Dollars

Value has been estimated according to reasonable prices in the Orient as of August 1945. After Adjustment, original figures for non-military and military assets have been converted to United States dollars by application of the ratios listed in the attached "Schedule of Rates of Exchange".

Geographic Area of Location of Assets According to the Possession by Right of Ownership, Custodial Control by Virtue of Occupation, or Control Through Mandate, Protectorate of Colonization.	Estimated Value Expressed in United States Dollars of: Corporate, Individual, and Government Assets Other Than Military and Naval, by Area	Military and Naval Assets by Area	Total Assets by Area and Combined
A, Belgium	$ 156,000		$ 156,000
B. British Empire			
1. British Commonwealth of Nations			
a. Australia	3,695,400		
(1) Bismarck Archipelago (Mandate)			
b. Canada	12,370,000		
c. Great Britain			
(1) Burma (Protectorate)	43,586,000		
(2) East New Guinea (Mandate)	500,000		
(3) England	18,651,350		
(4) Malay (Mandate)	103,959,900		
(5) Palestine (Mandate)	5,000		
d. India	29,346,000		
e. New Zealand	200,000		
f. Union of South Africa	2,450,000		
2. Hong Kong (Colony)[1]			
3. North Borneo (Colony)	8,601,000		
4. Sarawak (Protectorate)	—		
5. Combined Areas	—	$ 803,749,000	
Total: British Commonwealth of Nations:	$ 223,384,650	$ 803,749,000	$1,027,113,650

Geographic Area of Location of Assets According to the Possession by Right of Ownership, Custodial Control by Virtue of Corruption, or Control Through Mandate, Protectorate of Colonization	Estimated Value Expressed in United States Dollars of		
	Corporate, Individual, and Government Assets Other Than Military and Naval, by Area	Military and Naval Assets by Area	Total Assets by Area and Combined
C. China			
1. Central & South China (Including Hong Kong)[1]	$ 1,849,158,690		
2. Formosa (Occupation)	1,897,918,564		
3. Manchuria	8,629,682,939		
4. North China	2,877,277,310		
5. Combined Areas		$2,647,198,000	
Total: China	$15,254,037,503	$2,647,198,000	$17,901,235,503
D. France			
1. France	2,304,848		
2. French Indo China (Colony)	30,429,000		
3. Morocco (Protectorate)	52,000		
4. New Caledonia (Possession)	1,541,152		
5. Combined Areas		$ 120,740,000	
Total: France	$ 34,327,000	$ 120,740,000	$ 155,067,000
E. Greece	246,000		246,000
F. Italy (South of Genoa)[2]	1,179,000		1,179,000
G. Poland	78,000		78,000
H. Siam	24,613,000	144,620,000	169,233,000
I. Union of Soviet Socialist Republics			
1. Union of Soviet Socialist Republics (Including Kamchatka)	$ 50,675,077		
2. Korea North of Parallel 38 North Latitude (Occupation)	2,970,959,614		
3. Kurile Islands (Occupation)	71,196,000		
4. Sakhalin Island (Occupation)	412,598,600		
5. Combined Areas		$3,111,323,000	
Total: Union of Soviet Socialist Republics	$ 3,505,429,291	$3,111,323,000	$6,616,752,291

Geographic Area of Location of Assets According to the Possession by Right of Ownership, Custodial Control by Virtue of Occupation, or Control Through Mandate, Protectorate of Colonization	Estimated Value Expressed in United States Dollars of		
	Corporate, Individual, and Government Assets Other Than Military and Naval, by Area	Military and Naval Assets by Area	Total Assets by Area and Combined
J. United States of America			
1. Caroline Islands (Occupation)	$ 13,440,000		
2. Gilbert Islands (Occupation)			
3. Korea South of Parallel 38 North Latitude (Occupation)	2,275,535,422		
4. Mariana Islands (Occupation)	42,000,000		
5. Marshall Islands (Occupation)	560,000		
6. Ogasawara (Occupation)	10,290,000		
7. Okinawa (Occupation)	50,724,000		
8. Commonwealth of the Philippines (Protectorate 1945)	126,033,750		
9. United States of America	92,000,000		
10. Combined Areas		$1,324,890,000	
Total: United States of America	$ 2,610,583,172	$1,324,890,000	$3,935,473,172
K. Areas of Former European Axis Domination Possessing Japanese Assets which Surrendered to Military Forces of the Allied Powers as Custodial Agents Prior to August 1945			
1. Austria	$ 92,000		$ 92,000
2. Bulgaria	25,000		25,000
3. Czechoslovakia	40,000		40,000
4. Denmark	63,000		63,000
5. Germany	13,307,400		13,307,400
6. Hungary	9,000		9,000
7. Italy (North to Genoa)[3]	—		—
8. Rumania	8,000		8,000
9. Yugoslavia	15,000		15,000
10. The Netherlands			
a. Celebes & Other South Pacific Islands (Colonies)	12,718,000		
b. Java (Colony)	60,134,000		
c. Molucca Islands (Colony)	—		
d. South Borneo (Colony)	23,616,000		
e. Sumatra (Colony)	28,645,000		
f. The Netherlands	317,000		
g. Timor Archipelago (Colony)	500,000		
h. (West) New Guinea (Possession)	2,000,000		
i. Combined Areas		$ 825,291,000	
Total: Netherlands	$ 127,930,000	$ 825,291,000	$ 953,221,000
Total: Areas of Former European Axis Domination	$ 141,489,400		$ 966,780,400

Geographic Area of Location of Assets According to the Possession by Right of Ownership, Custodial Control by Virtue of Occupation, or Control Through Mandate, Protectorate of Colonization	Estimated Value Expressed in United States Dollars of Corporate, Individual, and Government Assets Other Than Military and Naval, by Area	Military and Naval Assets by Area	Total Assets by Area and Combines
L. All Other Areas Possessing Japanese Assets Combined, Exclusive of the Above	$ 85,163,260		$ 85,163,260
ESTIMATED TOTAL VALUE OF ASSETS FOR ALL AREAS COMBINED	$ 2,130,666,276	$8,977,811,000	$30,858,477,276

1) Japanese military and naval assets left in Hong Kong at time of surrender are listed under British Empire, where as assets classified under Corporate and Individual ownership are listed under Central and South China. The latter are less than 5% of the area total.
2) This estimate represents Japanese External assets in Italy as a whole—although as of August 1945 Italy South of Genoa had become a non-belligerent, whereas Italy North of Genoa had become surrendered enemy Axis territory.
3) Reference is made here to the estimate included for Italy, South of Genoa on page 33, and to the accompanying explanatory footnote.

[Source: *NMA* (#22), Reparations and Property Administration, Part C, Japanese Property Administration, Appendix 17]

7-3 U.S. REPARATION POLICY FOR JAPAN

Preliminary Statement October 31, 1945
Prepared by: United States Reparations Mission to Japan

All Eastern Asia has been damaged, and set back in its economic progress, as the result of a war started by Japan. All Eastern Asia needs to be put back on the road to political stability and peaceful progress. This requires a tolerable economic life, capable of further improvement. While Japan should have the last priority in getting back on that road, Japan is not to be barred from getting back on it.

To put it the other way around, we, as a nation, are concerned to see that Japan is not to be pauperized, but neither is Japan to be allowed to rehabilitate her economic life in a form which will allow her to gain control, or to secure an advantage, over her neighbors.

The American policy will therefore be:

(a) Industrial disarmament of Japan to insure that Japan will not again become a menace to the peace of the world;

(b) Allocation to countries entitled to reparations of Japanese industrial plants which will help them round out their own economics in accordance with a broad and consistent economic program for East Asia. In such a program Japan will not be left with any plant which represents a key phase in the processing of the raw materials of any of her neighbors;

(c) Japan will be left with industries which do provide her with a minimum of export goods, for the purpose of obtaining exchange for necessary and approved imports, such as food; and

(d) Emphasis will be given to the diversification and increase of food production and food processing in Japan.

To sum up: the problem of Japanese reparations is a problem of contributing to the economic stabilization, and thereby to the political stabilization, of East Asia as a whole. It is therefore not the main purpose to get a postwar dividend, in the form of compensation, out of a defeated Japan. For America, anything that Japan could pay in money, goods, industrial plants or services would not compensate for the lives expended in the common effort to put an end to Japanese militarism, once for all. Consequently, in the American view, we must aim at the rehabilitation of East Asia. In a rehabilitated Asia there will be a place for Japan, though no longer a place of leadership or control.

[Source: Reference 1-b, "Pauley Report", April 1, 1946]

7-4 REPORT ON THE INDUSTRIAL DISARMAMENT OF JAPAN

Undated (November, 1945?)
Submitted to: The Secretaries of State, War and Navy
By: The National Engineers Committee of the The Engineers Joint Council

The National Engineers Committee was appointed by Engineers Joint Council on February 12, 1945, to carry out the studies requested by the then Secretary of State, Edward R. Stettinius, Jr., in his "memorandum of request" attached to his letter to Engineers Joint Council of December 28, 1944. That letter requested the preparation of "studies and proposals bearing upon the industrial disarmament of aggressor states."

The National Engineers Committee's report on Industrial Disarmament of Germany was submitted to the Secretaries of State, War and Navy, through Engineers Joint Council, on September 24, 1945.

Engineers Joint Council, of which Mr. Alex D. Bailey is Chairman, includes the President, Junior past President and Secretary of: American Society of Civil Engineers, American Institute of Mining & Metallurgical Engineers, American Society of Mechanical Engineers, American Institute of Electrical Engineers, and American Institute of Chemical Engineers. Mr. Malcolm Pirnie is Chairman and Mr. Robert M. Gates, Vice-Chairman of the Executive Committee.

Under date of November 8, 1945, Assistant Secretary of State, W.L. Clayton wrote to Engineers Joint Council expressing the State Department's appreciation for the report on Germany and requesting "an examination of the question of industrial disarmament of Japan", as a result of which the National Engineers Committee was reconstituted for that purpose.

To fulfill the assigned objectives, it has been accepted by this Committee as its function, to recommend measures for the control of the industrial level of Japan, such that her war potential and the threat to future world peace and security by another Japanese aggression, will be as largely as possible eliminated. To this end it has been considered necessary to identify the critical war potential elements of Japanese industry to be eliminated or controlled, so as to permit the non-war potential section of Japanese industry to function safely on a free enterprise basis.

This report has been prepared to meet the above stated objectives and the National Engineers Committee submits it, encouraged by the fact that the recommendations of its report on Germany were substantially all included in the directive of the Allied Control Council of March 29, 1946, for the limitation and control of German industry.

Fundamental Considerations for Industrial Disarmament

The purpose of this report is to prescribe a plan for the control of the Japanese nation which will eliminate its threat or challenge to world peace for generations to come. In the formulation of any such plan, positive and continuing military and industrial disarmament must be the ultimate goal but ruthless and indiscriminate destruction of all industry and of a sustaining national economy will defeat the reestablishment of peace and the eventual admission of Japan into the councils of peaceful nations. The plan proposed must be firm but also just in the eye of the liberty loving people of the world. The complete elimination of Japanese industry, leaving the nation to eke out a living on agriculture and fishing, if possible, would create social chaos and suffering of such magnitude that enforcement would be impossible, and world opinion would repudiate the action.

The seizure, destruction or elimination of all arms, ammunitions, implements of war and combat vessels, and of facilities for their production, was directed immediately upon the occupation of Japan and was executed with order and dispatch. The surveys and studies to assemble the data necessary for an orderly control of civilian economy were begun immediately and the Committee has had the benefit of the data thus accumulated. The work of the Committee began, therefore, with a study to develop a plan which would limit the industrial economy of Japan, secure industrial disarmament, and control the war potentials until long after the occupation by the army has terminated.

The fundamental factors which have been considered are the psychology of the Japanese people, the extent and limitation of the natural resources particularly significant for war, the control of industrial facilities for processing and manufacture, the effort of controls upon national economy and standards of living, and the will of the controlling nations to perpetuate their supervision.

Japanese Psychology Must Be Adjusted

The Japanese attack upon Pearl Harbor and the war of conquest in the Pacific was the fruition not only of years of industrial preparation, but generations of psychological and religious indoctrination and perversion. It would be folly to assume that the aggressive, brutal instincts cultivated for years have been completely purged by conquest and by the judgments of the courts of justice. This perversion and fanaticism must be corrected by means other than industrial disarmament, but the plans for disarmament must be so firm and enduring as to check effectively any resurgence of militarism and of ambition for conquest. Any plan which is to be effective must be simple and direct in operation, not unbearably oppressive to the common people, and not repugnant to fair minded and liberty loving people of the world.

A Peaceful Economy in the Western Pacific Must Be Developed

For generations Japan has planned to make the whole of Asia tributary to her economy and a means of support to her military aspirations and dominance. The economic dependence of Asia upon Japan is, therefore, much greater than that of Central Europe upon Germany. In the pursuit of these ambitions, Japan has succeeded in suppressing the industrial strength of her neighbors as she has built up her own. The destruction of her aggressive power and the control of her potentials for future war will be insufficient, therefore, without the simultaneous development of industry, agriculture and trade in and among the neighbors of the Japanese Islands.

The question of setting and enforcing regulations pertaining to Japan proper, which will harmonize with policies adopted toward countries liberated from Japanese domination, should receive careful consideration. With respect to both export and import, the economies of various nations or districts have been inter-related, and each new situation will present problems involving market outlets, employment, means of obtaining necessary supplies, and preservation of invested capital in countries outside of Japan. If Japanese markets are wholly and prematurely closed before others are developed, violence may be done to the industrial economies of nations formerly dependent upon such outlets. On the other hand, during the period of readjustment and world-shortages in certain items, and until domestic industries are developed, it may be found advantageous to have Japan supply at least a part of the requirements of populations in nearby sections of the world. These considerations will affect final decisions relating to the production of commodities and capital goods in Japan and will have a bearing upon the allowable extent of imports.

The end results, however, should contemplate a balanced economy for Japan, devoid of the threat of war, and an expanding economy for her neighbors in the Western Pacific.

Policies and Procedures for Control Must Be Simple

If the controls imposed over the industry of a conquered nation are to be successful, they must be few in number, direct in application, and require a minimum of policing. Policies and procedures endorsed by the government of a victorious nation in the immediate aftermath of the horrors of war become soft and relaxing with waning memory. The re-alignments of power policies, the commercial pressures for the development of trade, the sentimental expressions of humanitarians, all tend to weaken and relax the limitations and controls for the suppression of national expansion and conquest.

The controls herein recommended have been applied, therefore, to the primary war materials and resources so as to be limited in number and direct in application. They will require a minimum of policing, which may be expected to remain long after large scale military occupation has been discontinued.

Primary Materials and Operations Should Be Controlled

In the long list of components of modern war, there are certain primary materials that have such particular properties and are required in such quantities, that war without them would be impossible. Without steel and steel alloys there would be no great fleets of ships and tanks and trucks, nor great assemblies of armament. Without aluminum there would be no great fleet of fighter, bombing and torpedo planes. Without fuels and lubricants, modern air, land and sea power would be immobilized. Without explosives to be conveyed to the targets, the instruments of war would be useless as weapons of destruction. These primary considerations immediately suggest the basic plan for the destruction of war potential.

When a nation is engaged in building a navy, or an air force, or equipping an army, hundreds of materials may become critical items. A shortage of tungston or molybdenum, or some plasticizer for synthetic rubber may represent a bottleneck in needed production. Controls may become necessary over the entire economy. When, on the other hand, it is desired to perpetuate the disarmament of a nation, this can be accomplished with the control of a few primary materials and operations.

Specific Controls for Industrial War Potential

All industrial processes, regardless of whether they are operating for peaceful or aggressive purposes, are based upon three essential factors without any one of which, production would be impossible, to wit raw materials, processing equipment and energy. The recommendations for the control of Japan's industrial war potential are, therefore, based on these essential factors as they appear in the following industries:

I. Mineral and metal industries
II. Heavy chemical industries
III. Fuel industry
IV. Electrical power industry

and they are supplemented by certain general recommendations regarding:

V. Construction industry
VI. Scientific research
VII. Nuclear energy

In certain particulars where imports must be permitted for the establishment of a balanced domestic economy they may be effectively supplemented by a system of import licenses.

. . . . . .

[Source: Suitland Papers]

7-5 REQUEST FOR DATA FROM SCAP BY THE REPARATIONS MISSION

Letter November 16, 1945
To: General MacArthur
From: Edwin W. Pauley

Dear General:

1. As I have already said to you, I deeply appreciate the efficient and constructive assistance which my staff and I have received from your whole organization since our arrival here in Tokyo. You have set a high standard of service and cooperation, and I hope that, in turn, the work of the Reparations Mission, by clarifying reparations policy as rapidly as possible, may facilitate your work as Supreme Commander. My work in developing the broad aspects of the US reparations policy for Japan consistently with our policies elsewhere is closely related to, and in many ways dependent upon, your responsibility as the Supreme Commander for the Allied Powers in Japan. I therefore doubly appreciate this opportunity of working in complete understanding with you.

2. In further development of the matters which we discussed on 14 November, and in order that we may carry out the terms of the Potsdam and Cairo declarations, I wish to ask your Headquarters to furnish me the following statements:

a. It is, as you know, the policy of the Government of the United States to eliminate or restrict the productive capacity of Japanese industry which constitutes a war potential. To guide us in developing a reparation program which will help to achieve this end, I will need as much information as can be made available concerning the industrial economy of Japan, including:

(1) A list of plants designed and devoted to the production of arms, ammunition and implements of war, including naval combat ships, aircraft, and aviation engines.

(2) Industry studies covering the following categories:

Iron and Steel
Coal
Other mining
Light Metals
Other Non-ferrous Metals
Shipbuilding
Machine Tools
Railroad Equipment and Rolling Stock
Automotive Machinery
Electric Machinery
Other machinery
Electric Power
Chemicals
Food Processing
Petroleum (natural and synthetic)
Forest Products
Cement and other building materials
Rubber and Products (including synthetic)
Textiles and Leather
Fisheries products
Ceramics
Communications and Communications Equipment
Handicraft, cultured pearls, tea, and other items of export significance

(3) In addition, it would be helpful to me and valuable for the US Government to have any specific recommendations or suggestions which you or qualified members of your staff may care to offer with reference to the methods of getting at and restricting or eliminating those Japanese industries or processing stages which serve to give Japan a position of control in East Asia. In preparing these studies, any combination or further division which meets your convenience will, of course, be acceptable.

b. My second request is for an overall Import-Export Program for Japan proper (excluding imports for Occupation Forces) for the year 1946, broken down by quarters or in such other way as you find convenient. May I also have the same material for 1947 as soon as this can be assembled? Both imports and exports should be specific, indicating the items

as well as the values involved. In preparing this program it will, of course, be necessary to make certain assumptions of a policy nature. To the extent that the statement is prepared for my use, the following guiding assumptions are to be made:

(1) There will be an immediate removal or destruction of all plants to be included in the mandatory removal list referred to in sub-paragraph a. (1) above.

(2) There is to be no production of iron or steel in Japan for export, though limited amounts will be available for fabrication in light equipment and gadgets for export, with emphasis on products absorbing a large amount of labor. An estimate of annual steel capacity of some 2,000,000 tons would seem adequate, based on the 1926-1930 average.

(3) Metal working capacity is to be restricted to a basis commensurate with allowed steel capacity.

(4) Japanese living standards in food and textiles consumed domestically are to be computed at figures no higher than those of comparable populations of neighboring Allied peoples who were overrun and pillaged by the Japanese.

(5) Imports required to meet such living standards and internal costs of occupation in Japan proper are to be chargeable against available exports ahead of reparations from current production.

(6) Japan is to be given access to raw materials required for the restricted peace-time economic activities contemplated above under rigid control by SCAP.

(7) Japan is to be permitted to export commodities and to establish credits to finance approved imports, under rigid control by SCAP.

(8) There is to be no increase of the Japanese merchant marine by Japanese construction beyond the completion of ships, not to exceed 5,000 tons, designed primarily for inter-island and short haul trade now under construction or available through repair.

(9) Agriculture is to be developed to a maximum with self-sufficiency as the objective, allowing for the manufacture of the necessary fertilizers.

(10) In both imports and exports the policy will be such as will, as far as possible, give economic aid to the Allied Countries injured by Japan and will, at the same time, involve minimum danger of Japanese control over the economies of others.

The assumptions here listed are for purposes of computation in developing the requested Import-Export Program. The nature of the balance sheet thus developed will serve to guide the final policies determined upon. I shall wish to discuss the Import-Export picture with you as soon as the approximate figures become available.

c. My staff reports that your Headquarters is already gathering and making available to my mission complete listings of Japanese foreign investments, Imperial assets, etc. These are most useful. In this area I shall need full information concerning the following:

(1) Stocks of gold, silver, precious metals and stones now on hand in Japan and an estimate of the future production of the same.

(2) Foreign currencies and foreign deposits on hand and under control of the Japanese government or its nationals.

(3) As complete and detailed data as possible concerning all property of any nature located outside Japan proper, in which the Japanese government or its nationals have an interest, direct or indirect.

(4) A complete inventory of the assets of the Imperial Household.

(5) All available data concerning the fifteen largest Zaibatsu, including, to the extent possible, a physical inventory of their holdings within Japan proper and abroad.

(6) A summary statement (estimated, if necessary) of stocks of industrial raw materials and operating supplies, including fuels, on hand in the home islands as of some recent date.

d. In order to compute the availability of resources for distribution as reparations, I shall need an estimate or summary of anticipated occupation costs, so classified as to show separately imports of occupational forces, other than munitions, and internal expenditures in Japan other than pay of troops. This material may be arranged in any way most convenient for you.

3. Would it be unreasonable to hope for the materials requested above by December 1st? We will appreciate the receipt of material as it is developed, even in tentative form.

4. Though I have made this letter comprehensive, you will recognize that it is preliminary in that it reflects my needs as I see them now. If, as I proceed further, additional information becomes necessary, I trust that I may similarly call on you for assistance. If any elements of my requests for information require further clarification, my staff and I are at your service.

[Source: Reference 3, "Pauley Report", April 1, 1946]

7-6 INTERIM REPARATIONS POLICY–PAULEY REPORT

Telegram December 6, 1945
To: President Truman
From: Edwin W. Pauley, Personal Representative of the President on Reparations

The following letter was delivered to General MacArthur, 1800, 6 December, Tokyo time:

Tokyo, Japan, 6 December, 1945.

General of the Army Douglas MacArthur
Supreme Commander for the Allied Powers

Dear General: 1. On the basis of all the material available, including the Japanese figures assembled for me by the Economic and Scientific Section of your Headquarters, I have now been able to come to some decisions of interim reparations policy and interim removals from Japan on reparations account.

2. My decisions fall within the following very simple framework:

(1) In preparation for war, in aggression in China, and in war against the United Nations, Japan built up the most diversified and over expanded industrial economy in Asia.

(2) In spite of extensive destruction, especially in the closing phases of the war, Japan retains more industrial capacity than she needs or has ever used for her civilian economy.

(3) The removal of the surplus, especially to neighboring Asiatic countries, will help to raise their industrial standards and all living standards without depressing the standards of Japan, since only excess capacities are at the moment in question.

(4) Interim removals will, in most cases, be below the total quantities that may eventually be allocated to reparations.

(5) A program of interim removals should be announced to other claimant nations immediately, and the successive actions of seizure, inventory, packing and shipment should follow in the shortest possible time, in order to make both the framework of policy and the course of action uncompromisingly clear.

3. Accordingly, I am recommending to our Government that plants and equipment be made available as soon as possible under a program of interim deliveries as follows:

(1) Half of the capacity for the manufacture of machine tools. I believe that this could most conveniently be done by seizing the 27 most important machine-tool manufacturing plants, which produce almost exactly half of Japan's total. The list of these plants, which you may wish to examine before making your own decision on plants to be seized, is attached to this letter on a separate sheet.

(2) All tools and equipment located as follows:

a. In army and navy arsenals, except for equipment useful solely for making arms, ammunition, and implements of war, which will be destroyed. It is estimated that these seizures should bring in not less than 70,000 machine tools, as well as other kinds of equipment.

b. In the entire aircraft industry of Japan. It is estimated that this should bring in 220,000 machine tools.

c. In all plants manufacturing ball and roller bearings.

d. In all plants manufacturing aircraft engines.

(3) All equipment and accessories in 20 shipyards, to the extent that it is not needed for the repair of shipping essential to the occupation. (A list of 29 leading strategic shipyards is separately attached.)

(4) All steel making capacity in excess of 2,500,000 tons per year. Japan's admitted present steel capacity is in excess of 11,000,000 tons, as compared with 1930, when Japan produced 2,300,000 tons of ingot and consumed only 1,700,000 tons of finished steel.

(5) A recommendation on pig iron will be sent to you later.

(6) All facilities for the production of magnesium, for the preparation of alumina and reduction to aluminum, other than those required for processing scrap, and all machinery and equipment used exclusively for finishing magnesium and aluminum such as strip mills, rolling mills and extrusion presses.

(7) Half of the thermal (coal[)] electric generating plants of Japan. In selecting the half of the plants of this character which are to be left, I suggest that the thermal electric generating plants left to Japan should be selected primarily for their value as standby plants to supplement hydro-electric energy in areas of high consumption.

(8) All contact process sulfuric acid plants, except those necessary to recover waste gases from zinc, lead, copper, and other heavy metal smelters.

(9) The most modern large Solvay process soda-ash plant in Japan. (According to Japanese information made available by the Economic and Scientific Section, there are four of these from which to choose.)

(10) Twenty of the most modern large plants for the production of caustic soda and chlorine, either in diaphragm or in mercury cells. (According to the Japanese information relayed to me by your Headquarters, there are 41 plants under this classification.)

4. In view of the bearing that these recommendations may have on the formulation of policy in Washington, I am passing on my conclusions to you at this stage in order to keep you fully informed, and in expectation that you may wish to take them into consideration in carrying out your responsibilities as Supreme Commander. I am aware that the steps I am recommending may bring up for reconsideration the process, which is at present rapidly going on, of conversion from war production throughout Japan, the trend of which would logically result eventually in a strong Japanese export economy. Reports from your office, confirmed by recent observations of my staff in various parts of Japan, indicate that not only conversion by the rebuilding of heavy industries is going forward with an apparent expectation of [*on*] the part of the Japanese that they will be given an opportunity to maintain a level of industrial capacity far beyond that which the Allied Governments will in fact be willing to permit.

5. I am sure that you will agree with me that, in the interest of disarming and demilitarizing Japan, as well as in order to avoid unnecessarily dislocating the Japanese economy when later removals become necessary—a situation which could easily be exploited to make Japanese workers feel that we are destroying peaceful industry—the sooner the reconversion program is geared into what may reasonably be anticipated as definitive reparations policy, the better will be our chances of successfully attaining all our objectives.

6. Under the policy now being pursued by the Japanese, I am inclined to think that the giant corporations will take over the country in spite of our program of breaking up the Zaibatsu, and that it will be next to impossible to pry loose those machine tools which should be removed as a disarmament measure. If this happens, a most important sector of the Japanese war potential will remain functioning, integrated, and in the hands of those who ran it during the war.

7. The foregoing program of interim removals is, of course, well below that [*what*] we can anticipate will eventually be removed from Japan. However, once this program gets under way we can feel that a good start has been made. Further interim deliveries and the setting of ultimate limits will thus be much easier to determine.

8. As you know already, I am planning to leave on December 10 in order to make my interim report to President Truman. Mr. H.D. Maxwell will be in charge of the mission which I am leaving in Tokyo for the time being. I need hardly assure you that he and his staff will be at your service after my departure, in case any discussion or clarification of details should be needed.

9. In departing may I thank you again, not only for the many courtesies which have been extended to me personally, but also for the assistance which has already been extended to my entire mission.

Sincerely yours, EDWIN W. PAULEY

STATEMENT BY AMBASSADOR EDWIN W. PAULEY, PERSONAL REPRESENTATIVE OF THE PRESIDENT OF THE UNITED STATED AND HEAD OF THE UNITED STATES REPARATIONS MISSION TO JAPAN

(For advance transmission to editors of A.P., U.P., I.N.S. and Reuters, for release in morning newspapers of December 7, 1945, west longitude date.)

Four years ago today Japan attacked Pearl Harbor. America will never forget the attack. Japan will never forget the consequences.

The civilized world now faces two duties with regard to Japan. First, we must make impossible a militaristic comeback. There must never be another Pearl Harbor. Second, a

way must be opened up for the development, in the future, of a self-respecting Japan, economically stable and committed politically, without reservations, to a democratic way of life. The work of the reparations mission entrusted to me by President Truman has been directed to the achievement of these two aims.

General MacArthur has thrown open to me all the material available. After study of this material, consultation with members of his staff, and extensive personal observations by myself and my staff, I have come to some firm conclusions.

First and foremost, it is necessary to recognize that the equipment built up in Japan during the past generation consisted of plants for the purpose of waging wars of aggression. It was further overexpanded during the aggression in China, and was finally turned loose against the United Nations four years ago today.

In the course of the war, we damaged these war plants sufficiently to force Japan to surrender unconditionally. Because Japan surrendered without a last ditch stand, many people have assumed that she is now helpless industrially. The superficial appearance of many bombed cities encourage[s] this easy view. The fact is that Japan's industrial equipment was overwhelmingly designed for war. Despite all the destruction, Japan still retains, in workable condition, more plant and equipment than its rulers ever allowed to be used for civilian supply and consumption even in peaceful years. That surplus must be taken out. To complete the demilitarization of Japan by taking it out will not mean the complete deindustrialization of Japan. I want to be very emphatic on that point. Figures concerning one key industry will show what I mean. In steel, and in machine tools and other machinery made from steel, Japan's own figures show that she still has, in workable condition, more than twice the facilities that she had when she invaded Manchuria in 1931.

The removal of this surplus, especially to neighboring Asiatic countries, and also to other countries whose war effort and sacrifice entitle them to reparations, will help to raise their living standards without depressing the standards of Japan, since only excess capacities are in question. Lowered standards in Japan are primarily a question of political and administrative disorganization naturally resulting from a thoroughly deserved military defeat. It is up to the Japanese to elect themselves a government which will clean up that part of the mess.

In reparations, I am recommending to President Truman an interim program of removals, to be begun as soon as apportionment and shipment can be supervised by Allied observers. These interim removals will probably be below the total sum which the Allied Governments will eventually allocate to reparations. The interim removals should remove all doubts on the subject of policy, and set the pattern for implementing action.

I am recommending that the following quantities of plant and equipment, in the following categories, be designated for interim removal:

Machine tools

1. Half the capacity for the manfuacture of machine tools.
2. All equipment in all Japanese Army and Navy arsenals (except for equipment useful solely for making arms, ammunition, and implements of war, which will be destroyed), in the entire aircraft industry, in all plants making ball bearings and roller bearings, and in all plants making aircraft engines. I estimate that the interim plan will remove from Japan between 350,000 and 400,000 machine tools.

Shipyards

3. All equipment and accessories in 20 shipyards to the extent it is not needed for the repair of shipping essential to the occupation.

Steel

4. All steel working capacity in excess of 2,500,000 tons per year. Japan's admitted present steel capacity is in excess of 11,000,000 tons, as compared with 1930 when Japan produced 2,300,000 tons of ingot and consumed only 1,700,000 tons of finished steel.

Electric power

5. Half of the coal-burning electric generating plants in Japan. This will leave enough for stand-by use to supplement hydro-electric plants.

Chemical industry

6. All contact process sulphuric acid plants, except those necessary to recover waste gases from zinc, lead, copper and other heavy metal smelters; the most modern of Japan's four large Solvay process soda-ash plants, and 20 out of 41 of the most modern large plants for the production of caustic soda.

Light metals

7. All capacity for producing magnesium and alumina, and for the reduction of alumina to aluminum, except facilities for processing scrap, and all strip mills, rolling mills, extrusion presses, etc., used in finishing magnesium and aluminum.

I have also made several other recommendations to President Truman, listed below:

External assets

8. Deprive all Japanese, including the Japanese Government, the Emperor and the Imperial Household, and the Zaibatsu, of the ownership or control of any assets located outside Japan proper, including Formosa, Korea, the Manchurian and other provinces of China, Malaya, and the Netherlands East Indies, as well as other Allies and neutral countries. All Japanese financial and economic penetration of other countries must be wiped out.

Gold and precious metals

9. The bulk of the gold and other precious metals now amassed in Japan should be shipped to the United States Mint in San Francisco, to be held in custody pending decision as to its disposal. The shipment of this treasure will not prejudice any later decision as to its use to pay for occupation costs, imports, reparations, or restitution.

10. To aid in carrying out the policies which General MacArthur has announced for destroying the big holding companies or zaibatsu, I have recommended that in reparations removals from Japan priority be given properties owned or controlled by the zaibatsu. Other factors being equal, a plant owned or controlled by one of the zaibatsu should be taken in preference to one owned by independent private enterprise. When this job has been completed, it will contribute materially to the rehabilitation and stabilization of Eastern Asia as a whole. This program will also open to the Japanese people themselves an honorable, industrious, and peaceful future. We must always remember, however, that in comparison with the people she has overrun, Japan has the last priority.

The above press release was delivered to official press representative for release December 7, Washington time.

[PAULEY]

[SOURCE: *FRUS*, 1945, vol. VI, pp. 1004-09]

7-7 REPARATIONS FROM JAPAN—IMMEDIATE PROGRAM (PAULEY INTERIM REPORT)

Report December 18, 1945
To: The President
From: Edwin W. Pauley

Dear Mr. President:

I attach a report of my preliminary recommendations on reparations in Japan. It may be considered as an interim report. In my letter of transmittal I should like to mention the following:

1. *The situation in Japan is not as bad as our papers have pictured it.* The people are not "starving." The larger cities were badly burned but there is still a tremendous amount of war-making equipment in Japan which must be removed or destroyed.
2. *MacArthur is doing a first-rate job, but he needs:*
   (a) A clear reparations policy-line now so that he can guide conversion of Japanese industry from war to peace.
   (b) Other quick action from Washington. (Much complaint that they cannot get answers on silk, vesting decree, etc., etc.) Too much "wait for further instructions" which never come!
   (c) More men of high competence from business and government. MacArthur has asked for men. He is engaged in a tremendously difficult task. Because of the lack of men, he has to rely on the Japanese Government for many things where this is dangerous. With more good staff in Tokyo, we can safely delegate authority.
3. *Under the circumstances we must have a REPARATIONS PROGRAM made up of two elements:*
   (a) An Immediate Program—which I present herewith.
   (b) A method of developing the long-range program in collaboration with our Allies. I present the method of approach herewith also.
4. *My Recommendations are summarized in one page as follows:*
   Page 15 and 16 of the Interim Report
5. *I received excellent cooperation from MacArthur's Office, from the High Commissioner in the*

Philippines, and from the State Department.

Respectfully,
Edwin W. Pauley.

After several months study of the problem of reparations from Japan, including extensive personal observations by my staff and myself in Japan, China (excluding Manchuria), Southern Korea and the Philippines, I am prepared to make certain definitive recommendations for immediate action.

1. *Basic Conclusions*

My decisions fall within the following very simple framework:

a. In preparation for war, in aggression in China, and in war against the United Nations, Japan built up the most diversified and overexpanded industrial economy in Asia.

b. In spite of extensive destruction, especially in the closing phases of the war, Japan has left within her four main islands more industrial capacity than she needs or has ever used for her civilian economy.

c. The removal of the surplus, especially to neighboring Asiatic countries and also to other countries whose war effort and sacrifice entitle them to reparations, will help to raise their industrial standards and living standards without depressing the standards of Japan, since only excess capacities are at the moment in question.

d. A program of interim removals should be announced to other claimant nations immediately, and the successive actions of seizure, inventory, packing and shipment should follow in the shortest possible time in order to make both the framework of policy and the course of action uncompromisingly clear. Interim removals will, in most cases, be below the total quantities that may eventually be allocated to reparations, but the sooner the interim removal program is made clear to the Japanese, the sooner they will see that they cannot rely definitely on certain things in order to build a peaceful, democratic Japan, and the better it will be for them as well as for us.

e. The immediate reparation program from Japan will deal only with capital goods, that is, with machinery and plants. At this stage it appears that any exportable current production will be required to meet costs of necessary imports and of occupation, which will be a first charge on exports ahead of reparations.

f. Japan should be deprived immediately of all industrial and financial interests outside her four main islands and such minor islands as may be left to Japan in accordance with the Potsdam declarations.

g. Japan's gold and precious metals should be shipped to the United States to be held in custody. It should be made clear to the Japanese as soon as possible that they cannot rely on the use of this gold for their own purposes.

h. As an aid in opening up the road for the development of democracy in Japan, the whole reparations program should be administered in the manner best designed to break up the influence of the big holding companies, known as the Zaibatsu, on the economic and political life of Japan.

2. *Program for Immediate Action*

Accordingly, I recommend the following program for immediate action:

a. *Interim Removals of Industrial Machinery from Japan Proper*

Industrial plants and equipment in the following categories should be made available as soon as possible under a program of interim deliveries:

(1) Half of the capacity for the manufacture of machine tools. I believe that this could most conveniently be done by seizing the 27 most important machine-tool manufacturing plants, which produce almost exactly half of Japan's total (a list of these plants is attached).

(2) All tools and equipment located as follows:

(a) In Army and Navy arsenals, except for equipment useful solely for making arms, ammunition and implements of war, which will be destroyed. It is estimated that these seizures should bring in not less than 70,000 machine tools, as well as other kinds of equipment.

(b) In the entire aircraft industry of Japan. It is estimated that this should bring in 220,000 machine tools.

(c) In all plants manufacturing ball and roller bearings.

(d) In all plants manufacturing aircraft engines.

(3) All equipment and accessories in 20 shipyards, to the extent that it is not needed for the repair of shipping essential to the occupation. (A list of 29 leading strategic shipyards is separately attached).

(4) All steel making capacity in excess of 2,500,000 tons per year. Japan's admitted present steel capacity is in excess of 11,000,000 tons, as compared with 1930, when Japan produced 2,300,000 tons of ingot and consumed only 1,700,000 tons of finished steel.

(5) All capacity for the production of pig iron in excess of 500,000 tons per year.

(6) All facilities for the production of magnesium, for the preparation of alumina and reduction to aluminum, other than those required for processing scrap, and all machinery and equipment used exclusively for finishing magnesium and aluminum such as strip mills, rolling mills and extrusion presses.

(7) Half of the thermal (coal) electric generating plants of Japan. In selecting the half of the plants of this character which are to be left, I suggest that the thermal electric generating plants left to Japan should be selected primarily for their value as stand-by plants to supplement hydro-electric energy in areas of high consumption.

(8) All contact process sulfuric acid plants, except those necessary to recover waste gases from zinc, lead, copper and other heavy metal smelters.

(9) The most modern large Solvay process soda-ash plant in Japan. (According to the Japanese information made available by the Economic and Scientific Section of General MacArthur's staff, there are four of these from which to choose).

(10) Twenty of the most modern large plants for the production of caustic soda and chlorine, either in diaphragm or in mercury cells. (According to the Japanese information relayed to me by General MacArthur's Headquarters, there are 41 plants under this classification).

b. *Deprive Japan of All External Assets*

All Japanese financial and economic penetration of other countries must be wiped out. All Japanese, including the Japanese Government, the Emperor and the Imperial Household, and the Zaibatsu, should be deprived of the ownership or control of any assets located outside Japan proper. I have already recommended a form of decree (attached) to be issued by General MacArthur which would completely divest the Japanese of all such assets.

c. *Ship Gold and Precious Metals to United States*

The bulk of the gold and other precious metals now under the custody of the United States forces in Japan should be shipped to the United States Mint in San Francisco, to be held in custody pending decision as to its disposal. The shipment of this gold and other precious metals will not prejudice any later decision as to its use to pay for occupation costs, imports, reparations and restitutions.

d. *Use Reparations Program to Help Destroy Zaibatsu*

One concrete step in the direction of implementing the policy of breaking up the Zaibatsu will be our program designed to deprive the Zaibatsu, as well as others, of their holdings outside Japan. In this connection, we should see to it that any program which the Japanese Government may adopt in the future for compensating holders of external assets shall not be designed to benefit the Zaibatsu, directly or indirectly.

In addition, I have recommended the following to General MacArthur:

(1) In implementing any program for interim deliveries of reparations which may be adopted, immediately select a few large plants which are owned by the Zaibatsu and which constitute war potential, and order that they be dismantled and made ready for shipment.

(2) Announce that in administering any program of reparations removals from Japan, priority will be given to properties owned or controlled by the Zaibatsu, in the sense that, other factors being equal, a plant owned or controlled by one of the Zaibatsu will be taken in preference to a non-Zaibatsu plant.

(3) Advise the Japanese Government that they have a definite period of time in which to break up the Zaibatsu; at the end of this period require them to submit a detailed statement describing the steps which have been taken, and advise them further that any property which we determine, at the end of this period, is directly or indirectly owned or controlled by any of the Zaibatsu will be subject to immediate removal from Japan under the reparations program.

3. *Activities of Mission*

My staff which accompanied me to Japan was composed of 21 men besides myself. In addition to the study of a vast amount of Japanese economic data made available through General MacArthur's staff, parts of my staff visited various places in Japan to familiarize themselves with the look of Japanese industry and agriculture as they emerged from war.

Three members of my staff visited Southern Korea and consulted with the American Military Government authorities there under General Hodge. In addition, I consulted with General MacArthur, and inspected personally a large number of industrial installations in Japan. I also visited Shanghai and North China, after which I flew to Chungking to consult with President Chiang Kai Shek. Members of my staff and I also visited the Philippine Islands, where we consulted with High Commissioner McNutt and his staff, and officials of the Commonwealth Government. My primary purpose in visiting the Philippines was to ascertain what kinds of industrial equipment and plants the Philippines might obtain from Japan as interim reparations, and the best methods of working out these deliveries.

Seven members of my staff returned with me to the United States: Dr. Luther Gulick, Col. J. R. Gilchrist, Wm, G. Johnston, Josiah E. Dubois, Stanley Joiner, Lt. John G. Reifsnider, and 1st Sgt. John Matles. Fourteen members of my staff remain in Tokyo under the supervision of H. D. Maxwell, my chief of staff: Dr. Owen Lattimore, Dr. Arthur G. Coons, Adm. S. S. Kennedy, Martin T. Bennett, Judge Peirson M. Hall, Benjamin C. Haile, John P. Hurndall, David R. Jenkins, Lt. Col. Gail S. Carter, Lt. Paul Elicker, Charles A. Karl, Benjamin C. Olsen, and Lt. George B. Oujevolk.

4. *Coordination of Reconversion and Reparations*

The industries built up in Japan during the past generation have consisted of plants primarily for the purpose of waging wars of aggression. Japan ravaged her victims in two successive stages—*first*, in preparation for war came Japanese penetration and infiltration; local industrialization was paralyzed or slowed down. Raw materials were siphoned off to Japan. The industrial use of these materials was monopolized by Japan. In the *second stage*, a few industries were fostered in Japan's outer empire, and even these industries were tributary. Key phases of the industrial processes—usually the final phase—were reserved as a Japanese monopoly. Japan, by the time the end came, was a country largely deficient in raw materials of its own—especially raw materials for war industries—but was grotesquely studded with advanced war industries. Despite all the destruction to Japan's war plants, Japan still retains in workable condition more plants and equipment than its rulers ever allowed to be used for civilian supply and consumption even in peacetime years.

Observations by my staff and myself in various parts of Japan, confirmed by reports from General MacArthur's staff, indicate that not only conversion of those war plants, but the rebuilding of heavy industries is now going forward with an apparent expectation on the part of the Japanese that they will be given an opportunity to maintain a level of industrial capacity far beyond that which we and our allies will be willing to permit.

Under a directive to the Japanese Imperial Government from General MacArthur's Headquarters, which directed the Japanese Imperial Government to "stimulate and encourage the immediate *maximum* production of all essential consumers commodities", the military authorities in the field (to whom responsibility had been delegated by General MacArthur's Headquarters) are permitting conversions of Japanese war industries to peacetime production on a large scale.

This statement of fact is not presented as a criticism of our occupation policies in Japan, but as an indication of the impossibility of proceeding consistently in harmony with a reparations policy which has not been stated. Particularly in dealing with industrial conversion authorizations, GHQ in Tokyo must know not only the broad principles of the reparation program, but also the practical implications of these principles, industry by industry.

In passing my recommendations for interim removals on to General MacArthur for his information, I accordingly said, "I am sure that you will agree with me that, in the interest of disarming and demilitarizing Japan, as well as in order to avoid unnecessarily dislocating the Japanese economy when later removals become necessary—a situation which could easily be exploited to make Japanese workers feel that we are destroying peaceful industry—the sooner the reconversion program is geared into what may reasonably be anticipated as definite reparations policy, the better will be our chances of successfully attaining all our objectives."

5. *Some Important Considerations in Long Range Program*

a. *Agricultural Situation in Japan*

The studies which we have made to date of the food situation in Japan indicate that the Japanese propaganda that "the Japanese are starving" is without foundation. The Japanese people are better fed at present than the people of any of the nations against whom Japan committed aggression. Official studies by General MacArthur's Division of Health and Welfare present positive evidence that there is no serious or unusual malnutrition in Japan. It is interesting that not less than 4% of the rice crop, and possibly as much as 8%, is still permitted to go into the manufacture of alcoholic beverages.

The evidence indicates that:

(1) The estimates of the crop yields prepared by the Japanese government underestimate the amount of food raised in the past year.

(2) Hoards of food are being held on the farms and in the local storehouses as a hedge against further decline in the purchasing power of the yen.

(3) Black market (or "open market") channels, for which no statistical data are officially available, provide the bulk of the food for the urban people.

(4) Calorific estimates, based on government collections, and the associated clamor about immediate food shortage, are intended to stampede GHQ into providing food imports and should be carefully investigated.

b. *Costs of Occupation*

It should be borne in mind that it is estimated that the occupation of Japan will cost the United States 500 million dollars for the calendar year 1946, *not including* the cost of the pay of troops. Including the pay of troops, the occupation of Japan will undoubtedly cost the United States well over one billion dollars for the year 1946.

These costs of occupation, together with what is necessary to pay for essential imports, should have prior claim on any available Japanese foreign exchange (including gold) and on the proceeds of any exports from Japan from current production.

This will, in all likelihood, mean that there will not be anything available as recurring reparations from the current output of the Japanese economy.

c. *Foreign Exchange*

Aside from the gold held in Japan, there is practically no foreign exchange presently available to pay for costs of occupation or essential imports. Unlike Germany, Japan has practically no assets in neutral countries. It is anticipated that the extensive holdings of the Japanese in territories of the United Nations will in most, if not all, cases be turned over to such United Nations.

Japan's gold holdings will probably approximate 200 million dollars.

d. *Korea*

In Southern Korea Japanese assets have been seized by U.S. military government authorities. In Northern Korea the Russians have announced that they are "holding former Japanese properties in trust" for the Korean people.

We received reliable information that the Russians are also removing selected types of industrial equipment from Northern Korea. This included hydro-electric power units from the Yalu River in Northwest Korea. Apparently actual removals were not as extensive as the rumors widely circulated in Japan would indicate.

While Korea will be treated as a friendly state, it is not entitled to any special consideration as a recipient of reparations from Japan proper because Korea made no special contribution toward organizing the victory over the Japanese. However, it would be desirable to transfer to Korea certain Japanese industrial enterprises which were engaged in finishing raw materials received from Korea, as was suggested by my public statement of 8 December 1945 issued in Tokyo. The removal of such plants and processes from Japan would eliminate Japanese control of "key industries".

If, in addition to the transfer of such industries from Japan to Korea, the Korean government, when established on a unified basis for all of Korea, were to be given control over the major Japanese-owned assets in Korea, it would seem that Korea will have received fully as much as she is entitled to.

e. *Manchuria*

It is rumored, although accurate information is unavailable, that the U.S.S.R. has removed certain machinery and equipment as "war booty". It is also reported that a number of the mines have been operating under their former Japanese managers, under orders from the Russians.

It is anticipated that it will be our policy that no plants or equipment should be moved out of Manchuria as reparations, but that such plants and equipment will be charged against the reparations claims of China.

f. *U.S.S.R. as Claimant Nation*

Although I do not believe that the U.S.S.R. should assert a substantial claim for reparations from Japan, nevertheless certain plants and machine tools may well be made available to the U.S.S.R. Preliminary observations by my staff and myself in China, Korea and the Philippines indicate that the low economic development of the Far Eastern nations generally may make it difficult for them to absorb the excess industrial capacity which we

desire to eliminate from Japan by reparations removals.

g. *Distribution Difficulties*

Distribution of reparations is a major problem in the Far East because of the backward and unsettled condition of the recipient countries. It is with this in mind that we visited both China and the Philippines and encouraged the respective governments to think and act realistically about reparations from Japan. In neither case is the government ready either in its thinking or in its organization to take and use any considerable quantity of Japanese industrial equipment.

An important factor in this situation is the capitalist, rather than socialist, nature of the two economies. Plants and machinery delivered to such a government, except possibly for power plants or naval ship-repair yards, will be sold, or leased, so that they may immediately become part of the private-enterprise economy. However, no plans have been developed to bring this about, nor do there seem to be available the technicians competent to organize or direct such enterprises or developments. In view of the importance of this matter, I plan to submit a separate report on this subject in the near future.

6. *Suggestions on International Action*

Even the interim program here presented should not be undertaken by the US Government on a unilateral basis. We need and desire the approval of the program by the nations most concerned, and we require the prompt and effective cooperation of the receiving countries.

As a means of securing this cooperation in the shortest possible time, I recommend that the interim program, as soon as it has the full endorsement of the US Government, be submitted by the Government of the US contemporaneously through diplomatic channels to the eleven countries represented in the FEAC for immediate approval by such governments.

The program submitted for approval would include or be followed by suggestions for the creation of an Allied Commission on Reparations from Japan to be the international reparation policy body, and a Reparations Agency, to be the technical and allocating body. Moreover each state expecting to receive machine tools and plants might be offered suggestions as to the creation of its own reparations-receiving set-up. Each country would be asked to draw up a list of requirements immediately. Arrangements would be made, as soon as a majority of the states approve the program, to have them send technical staffs to Japan to examine plants and equipment declared to be "removable." It would also be necessary to expand the industrial and engineering staff of the Supreme Commander for the Allied Powers in Japan for this operation.

7. *Plan of Action*

The recommendations presented above may be summarized in the following plan of action:

a. Approval by the Government of the US of the Interim Reparation Program presented above, with such amendments as prove desirable, and decision to press for immediate international concurrence in this program.

b. Submission of the Interim Reparations Program, through diplomatic channels, to each of the eleven members of the FEAC for immediate concurrence.

c. Issuance of a directive to the Supreme Commander for the Allied Powers in Tokyo by the Joint Chiefs of Staff to accomplish the following ends:

(1) Identify the specific war-potential plants and equipment which will be designated as "available for removal under the interim reparation program."

(2) Prohibit the conversion of such plants to peace-time production.

(3) Dismantle, package, and move such plants to dockside for overseas shipment.

(4) Issue a decree, vesting all Japanese foreign assets.

(5) Ship to the US all gold and precious metals in Japan.

(6) Make arrangements in Japan to receive teams of industrial experts from Allied Nations to examine and accept for shipment interim reparation deliveries.

d. Ask each of the nations entitled to reparations to prepare:

(1) A statement of their reparation claims along the lines already used in Europe; and

(2) Specific lists of types and quantities of equipment desired under the interim removal program.

e. Develop plans for the creation of an Allied Commission on Reparations from Japan which will be the agency to negotiate international agreement on long-range reparation policies including the determination of the shares to be given to each claimant.

f. Take steps to help China and the Philippines organize special technical agencies

to install and use plants and equipment received by them as reparations from Japan.

Edwin W. Pauley

[SOURCE: REFERENCE 1-A, "PAULEY REPORT" APRIL 1, 1946, SUTTLAND PAPERS, Z 721-4]

7-8 POLICY TOWARD JAPANESE ASSETS IN CHINA AND KOREA

Letter May 11, 1946
To: General MacArthur
From: Edwin W. Pauley

My dear General MacArthur:

In November and December the U.S. Reparations Mission to Japan working with your Staff investigated Japan's capacity to produce in relation to the needs of a peaceful economy and in relation to her ability and desire to wage war in the future. Many other considerations such as demilitarization, decentralization of financial control and democratization, were of great importance. However, the most extensive physical changes found to be necessary were those which are involved in moving industrial war potential capacity from Japan to those areas which heretofore have been tributaries to Japan's economy.

As an extension to the objectives and the work performed by that Mission, the objectives of this Mission can be defined as an effort to aid in the establishment of a peaceful and prosperous economic balance in Asia by the severance of the tributary ties between Japan and the areas which she conquered, and by the reintegration of the economies of those areas.

In detail, the basic objectives of the Mission are:

1. To determine the degree to which industrialization was developed by the Japanese in Korea and Manchuria and the manner in which their operations were tied to Japanese industry and to discover any assets in the form of Japanese installations in those territories available for reparations (it is the policy of the United States that all Japanese assets found in China, including Manchuria, and Korea would remain for the reparations account of those countries).

2. To ascertain the present status in Manchuria and Northern Korea in view of the reported changes since the end of the war and to evaluate the over-all effect of those changes on China's and Korea's capacity to produce.

3. To recommend, in view of the present conditions of mining and industrial capacities in Manchuria and Northern Korea, what facilities should be removed from Japan and distribution made to China and Korea. In these recommendations maximum consideration shall be given to an integration of economic development in Greater China, Korea, the Philippines and other countries which have been victimized by Japanese aggression, which will utilize the resources of those countries for their own development and will discourage being drawn again under Japanese influence.

Most sincerely,
Edwin W. Pauley.

[SOURCE: MACARTHUR MEMORIAL]

7-9 JAPANESE ASSETS IN MANCHURIA

Report July 1946
To: The President of the United States
By: Edwin W. Pauley, Ambassador of the United States and Personal Representative of the President

November 12, 1946

Dear Mr. President:

Under your instructions to me contained in your letter of April 27, 1945, and subsequent verbal orders you have issued to me, I present to you a report on Japanese assets in Manchuria.

This is a factual report based primarily on the first-hand observations and consultations with informed persons by myself and my Mission in Manchuria in June and July. In ad-

dition studies were made and appropriate personnel consulted in Washington and Tokyo prior to the arrival of our Mission in Manchuria.

It would not have been possible to carry through this assignment without the aid and assistance which was received from the Secretary of State and the Secretaries of the War and Navy Departments, and especially from General Douglas MacArthur and General George C. Marshall in the Orient. The Chinese National Government was most helpful in facilitating the activities of my Mission throughout areas under its control. In the Communist-held areas in North Manchuria, Chinese Communist and Soviet Railway officials were also of help.

EDWIN W. PAULEY

TABLE OF CONTENTS

General Staff of the United States Reparations Mission
Log of the Mission
Chapter I. General Summary
II. Development and Destruction of Manchuria's Economy
III. Electric Power
IV. Coal
V. Iron and Steel
VI. Railways
VII. Metal Working Industry
VIII. Non-Ferrous Mining and Metal Industries
IX. Liquid Fuel and Lubricant Industry
X. Chemical, Food and Allied Industries
XI. Cement Industry
XII. Textiles
XIII. Paper and Pulp
XIV. Lumber
XV. Radio, Telephone and Telegraph
XVI. Precious Metals, Currency and Securities
XVII. Records and Files
Appendices
NOTE: Appendices 1 through 14 contain Plant Inspection Reports and other pertinent data. See List of Appendices.

GENERAL STAFF OF THE UNITED STATES REPARATIONS MISSION
(MAY TO SEPTEMBER, 1946)

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CHAPTER I

General Summary

A. *SCOPE*

The objectives of the 1946 Pauley Mission in Manchuria were: to survey Japanese assets subject to reparations; to ascertain the present productive capacity of industry; to estimate what immediate reparations removals from Japan could be utilized to improve or rehabilitate that industry; and to prove or disprove reports that crippling removals had been made from that area.

The Mission was organized in Washington in April 1946 pursuant to instructions from the President. It contained well-known American engineers specializing in various fields of industry. On May 4, 1946, the Mission departed from Washington for the Far East. After a short stay in Tokyo where the Mission was augmented by a number of industrial specialists from General MacArthur's headquarters, the group departed for Seoul for a survey of Korea. A base was established in Mukden, Manchuria, on May 27, 1946 and from there inspection trips were made to the various important industrial and mining centers. Among these were Mukden, Fushun, Liaoyang, Anshan, Penchihu, Kungyuan, Chinchow, Chinhsi, Peipiao, Fouhsin, Hulutao, Kaiyuan, Ssupingchieh, Hsian, Changchun, Kirin, Harbin and Mutanchiang. Dairen, the finest seaport in Manchuria, and an important industrial center, was not reached because authority for the visit could not be secured from the Soviet Government or local authorities. Antung, another important point was not visited because Chinese Communists refused permission. The work of the Mission was greatly facilitated by the whole-hearted cooperation of the Chinese National Government and of all United States Agencies in the Far East. Chinese Communists were of assistance in the visits in territory held by them in *Northern* Manchuria. The Mission left China on 15 July 1946 and returned to Washington on 21 July 1946.

The principal sources of data upon which this report is based are the following:

a. In Washington: Conferences with and studies made by appropriate Sections of the State, War, Navy and Commerce Departments, Office of Strategic Services, Foreign Economic Administration and other governmental agencies.

b. In Tokyo: Conferences with and studies made by agencies of Supreme Allied Commander. Interviews with Japanese responsible for the management of Manchurian industry and study of Japanese records.

c. In Manchuria: Inspection of industrial plants in the centers mentioned. On-the-spot interviews with persons who were present before, during and after the Soviet occupation were most fruitful. These included Chinese, Japanese, American and European Nationals. At the time of the survey many Japanese industrial executives had not yet been repatriated, so that many documents such as diaries and production records were available in Manchuria.

It is recognized that in the interviews with individuals, the Mission was dealing with hearsay evidence and that some of the information received was biased and exaggerated. Nevertheless, by comparing data from the different sources and balancing it against observed conditions, it is believed that an accurate picture was evolved and that this report is substantially accurate.

B. *BACKGROUND*

United States policy in the postwar Far East was predicated upon the establishment of China as a strong, stable, united nation, with a basic economic self-sufficiency, so that nation could take its proper part in the development of a peaceful Asiatic economy. During the years before and after Pearl Harbor the Japanese had created in Manchuria a tremendous industrial structure which was definitely tributary to the economy of Japan. Had this structure remained as intact as it was on the date of Soviet occupancy and had China remained

peaceful, the Manchurian industrial complex could have readily been integrated with China's growing economy and so greatly accelerated the overall Chinese industrial development. The large capacities in basic industries in Manchuria would have made possible a rapid absorption by China of further processing equipment removed from Japan as reparations. At the same time this action would have lopped off from Japan one of the most important sources of strength in the Japanese war potential. It was presumed that China could fill at least partially, the economic vacuum resulting from the Japanese defeat and the consequent imposed reduction of Japan's productive capacity to a peacetime level. However, the damage which Manchurian industry has sustained since V-J Day has set back China's industrial progress for a generation and has thus materially delayed the implementation of announced U.S. policy.

Japan's interest in the Asiatic Mainland has been of long standing. The clash of Russian and Japanese interests there, resulted in the Russo-Japanese War in 1904, and the acquisition by Japan of Russian concessions in South Manchuria. With the establishment of the South Manchurian Railway in 1906, Japan's exploitation of Manchuria took definite form. The railroad expanded into many industrial enterprises which furnished a wedge for further Japanese penetration on the continent. With the seizure of Manchuria from China by the Kwantung Army in 1931 and the creation of the Puppet State of Manchukuo, the exploitation was tremendously accelerated.

Impelling motives in Japan's development of Manchuria stemmed primarily from two sources. One, the ultra patriots including the military clique, the Black Dragon Society, and all dreamers of a Pan-Asiatic hegemony under Japanese domination, found in the conquest and exploitation of Manchuria an essential step in the march to empire. The Japanese Kwantung Army played no small part in advancing the aims of the military clique. The other source, the Zaibatsu (ruling commercial combines) saw in Manchuria an opportunity for an enormous source of profit. The Japanese Government and the puppet Manchukuo Government assisted the Zaibatsu in their exploitation with preferential treatment and subsidies. There was no altruism in these actions. Japan took care that management and technical skills remained in Japanese hands, using the local population primarily as a source of cheap labor.

Manchuria is a relatively rich country. It abounds in many natural resources which exist much more sparsely in the remainder of Asia. It is one of the few areas of great size which has consistently produced agricultural surpluses. Manchuria was fortunate in that the Japanese in their industrial development there provided a far greater capacity in finished products than in any other conquered country. It was Japan's apparent intention to make Manchuria industrially an integral part of the Japanese Empire and a source of economic strength for further military conquest. This is indicated by the fact that a great deal of construction and development of industrial and power facilities were still going on at the end of the war. From 1932 to 1944 coal production was more than doubled and the output of pig iron and iron ore was more than tripled.

The best estimate of the total of Japanese investments in Manchuria as of June 1945, is ¥11,000,000,000. In arriving at this estimate, figures cited by the Chinese Northeast Economic Commission, the British Ministry of Economic Warfare, the U.S. Foreign Economic Administration, and Japanese sources were also consulted. The Chinese compilation is appended to this report as Source File 201-X-10 in Appendix 1.

The defeat of Japan caused the disruption of the production centers and trade channels built up by Japan in its empire-building and conquests, thus upsetting the entire economic structure of the Far East. U.S. policy is now directed toward the establishment of an economy that will promote a lasting peace in the Far East and to prevent the resurgence of Japanese economic domination.

U.S. policy has long held that all Japanese assets whether situated in Japan proper or in other areas, were subject to claim as allied reparations. Japanese assets in conquered areas such as the Philippines, China, including Manchuria, and Korea, were to be taken from Japanese ownership and control and were to be operated for the benefit of the countries where the physical assets exist. Under what conditions full and complete title to these assets is to be vested in the local governments and under what conditions the ex-Japanese industrial plants are to be considered as part of the overall reparation allocation, is still under discussion and awaiting allied agreement. It was considered that this primary step was necessary in order to strengthen the economies of the countries which had been victims of Japanese aggression and further to keep the facilities operating in order to prevent loss of needed production and safeguard the livelihood of the local population.

The next step needed is the realignment of production areas and trade channels in the Far East so as to secure a properly balanced regional economy that can be both productive and profitable; an economy that does not have to rely upon subsidies, confiscation, and oppression to maintain itself. The United States reparations plan is aimed at achieving these two important steps: to turn over to local non-enemy governments control of the Japanese assets situated in those countries; and, to transfer surplus capacity from Japan to regions where it can best be used to process the natural resources so as to satisfy the needs of the Far East. In the steel industry for example, where Japan has a much larger capacity than is needed for her normal peace requirements, the U.S. policy would remove this surplus capacity and place it near sources of iron ore and coking coal. Such areas can be found in Manchuria, China proper, and the Philippines.

C. *FINDINGS*

The difference in condition of the Manchurian industrial plant between Japanese surrender and the dates the Pauley Mission made its survey is appalling, as will be shown in the remainder of this report. How much of the wrecked condition is a direct result of Soviet removals, and how much may be ascribed to pillage, civil war, and other indirect consequences of the Soviet occupation cannot be accurately determined. In any case, the Soviet government must bear the major responsibility.

Soviet forces entered Manchuria on 9 August 1945. Japanese resistance was confined to Northern Manchuria and within a week this ended. Southern Manchuria, which contained over eighty percent of Manchurian industry, was taken practically unopposed and with little if any damage. There was ample opportunity for the orderly occupation of the entire area.

Japan was preparing to surrender prior to the Soviet entry into the Japanese war. The rolling up of the Southwest Pacific front, the rapid penetration of the Pacific defenses, and the powerful blows struck against the Japanese homeland forced Japan to seek means for halting the conflict. A partial chronology of important events from June 15, 1944 taken from General MacArthur's reports and other official sources shows the following:

Unopposed Soviet air landing at Mukden	August 18, 1945
Japanese delegation arrives in Manila to receive orders	August 19,
Unopposed Soviet air landings at Kirin and Changchun	August 20,
Eighth Army advance party landed at Atsugi Airdrome, Tokyo	August 28,
General MacArthur arrives at Atsugi	August 30,
Formal signing of surrender terms in Tokyo Bay	September 2,

Upon their arrival in the industrial areas of Manchuria, the Soviets began a systematic confiscation of food and other stockpiles and in early September started the selective removal of industrial machinery. It is apparent that they planned to complete these removals by 3 December 1945, the date originally set for the withdrawal of all Soviet military forces from Manchuria.

The term "stripping" as it has been used in the press in connection with removals from Manchuria may be confusing. The Soviets did not take everything. They concentrated on certain categories of supplies, machinery and equipment. In addition to taking stockpiles and certain complete industrial installations, the Soviets took by far the larger part of all functioning power generating and transforming equipment, electric motors, experimental plants, laboratories, and hospitals. In machine tools, they took only the newest and best, leaving antiquated tools behind. In the old Mukden Arsenal, for example, about one-third of the tools were taken, while in the new arsenal, virtually everything was taken or demolished.

Not only were buildings and structures damaged by the removal of the equipment, but the taking of some key equipment, such as generators and pumps from mines resulted in the loss of current production, and in irreparable damage to the mines by flooding. The removal of power facilities not only halted all current industrial production, but also made it impossible to maintain and protect the plants themselves. Water works and sewage facilities in the large cities were made inoperable because of lack of power.

After the removals, the Soviet forces permitted and even encouraged Chinese mobs to pillage, taking official movies of the process in some instances. Apparently the mobs were in search of objects of salable value and of wood for fuel to burn during the bitter Manchurian winter. The fuel problem was, of course, enormously intensified by the stoppage of a large part of coal production because of Soviet removals.

By far the greatest part of the damage to the Manchurian industrial complex occurred during the Soviet occupation and was primarily due to Soviet removals of equipment, and to Soviet failure to preserve order. After the Soviet withdrawal, Chinese Communist action

resulted in further damage to some of the installations. It is a sad commentary that the small amount of benefit received by the Soviet Government in its removals from Manchuria could have been readily supplied by reparations removals from Japan proper at a much smaller cost to the world.

The Soviet forces also confiscated approximately three million U.S. dollars worth of gold bullion stocks and over a half billion Manchurian yuan from Manchukuo banks. They also circulated nearly ten billion yuan in occupational currency, almost doubling the total Manchurian note issue. In addition to the removals, mentioned above, occupational currency was used to purchase factories and properties and some privately-owned merchandise and materials.

It is difficult to ascertain in Manchuria the real reasons behind the Soviet actions there. The excuse that the articles removed were in the nature of "war booty" and were desperately needed to replace damage caused by the German invasion at home, does not fully cover the situation. As for reparations, the Soviet military effort in Manchuria which lasted only a few days is minute when compared with the long, tremendous and costly operations in the Pacific. Therefore, the Soviet Government would not be entitled to substantial reparations from Japanese-owned assets merely on the basis of their operations in this area. Obviously Japanese assets in Manchuria did not belong solely to the Soviet Government. Other nations too are logical claimants. In the allied reparations discussions at Moscow, Potsdam and Paris in 1945, the allies expressed as a principle that the greatest economic utility would result if the industrial equipment in Manchuria were left intact there, in the locations for which these items were specifically designed. Moving this equipment has destroyed a large part of its original value and the installations from which this equipment was removed have in many cases become total losses.

It can also be pointed out that there are now in the occupied zones of Germany (other than the Soviet occupied zone) reparations items which under the terms of the Potsdam Agreement were destined to be delivered to the Soviets. The nations occupying these zones are also entitled to Japanese reparations and so have a legitimate claim on the Japanese assets removed from Manchuria by the Soviet Government. Thus Soviet claims on German reparations in occupied zones could be counterbalanced by claims by other nations on the Manchurian removals. However this would require revision of the entire global reparations program.

Soviet actions in Manchuria are high-lighted by the entirely different policy followed in Korea where there were practically no capital removals or destruction of industry. In Manchuria the confiscation and removal of food stocks, the destruction attendant upon and following the removals of machinery, the almost complete halting of productive effort with no regard for the harmful effects upon the Chinese population, all indicate that there were long range strategic reasons behind the Soviet actions. The chaos caused by the Soviets has produced a condition of instability both politically and economically which will take a long time to correct. If left a populace hungry, cold, and full of unrest.

It is generally agreed that China's first economic need is communications, principally railways, transport, and domestic shipping. Less than 10,000 miles of railway is in existence in all of China exclusive of Manchuria and less than half of that is now operable. Manchuria with its abundant natural resources and industrial plant would have been the logical point to begin the rehabilitation of China's transport. If Manchurian industry had been left intact it could also have produced the steel, machinery and consumer goods so badly needed for restoration and for new construction in China.

China's continuing internal strife is a major factor in retarding her economic recovery. But even this cannot minimize the powerful set-back which the destruction of the Manchurian industrial plant has been to Manchuria, to China, and to the Far Eastern World.

D. *CONCLUSIONS*

The situation in Manchuria today is far from promising. The internal struggle continues intermittently. Dairen, by far the best port, has been practically sealed off by the Soviets for their own exclusive use, despite the fact that under the terms of the Sino—Soviet Treaty of August 14, 1945, Dairen is to be an open port and the Soviets are entitled to use only part of the port facilities. Railway communications to the few remaining secondary ports are under constant harassment by Chinese Communists. Thus, even if Manchurian industry were working full blast, it would be most difficult if not impossible to move any large quantity of finished products to China proper. It would be just as difficult to move into Manchuria the equipment necessary to rehabilitate industry.

Little can be done in the way of rehabilitation in China in the areas where fighting is going on or where the threat of armed action is present. This, however, should not delay

the preparation of plans so that when peaceful conditions are resumed and communications restored, a rapid and orderly process of rehabilitation of the plants essential to primary needs of the inhabitants can begin. The natural resources are there. In restoring Manchuria's industrial complex, however, it must be remembered that Manchuria is practically surrounded by territory either wholly or partially under direct Soviet control. Manchuria will thus be vulnerable to further Soviet penetration.

In the meantime no effort should be spared in the industrial strengthening of the peaceful areas of other parts of China. China's urgent needs are manifold, but the prime need is for steel, for railroads, shipping, construction and consumer goods. One important steel producing area lies on the Yangtze River, near Hankow. There are others. These must be surveyed with a view to the immediate transfer to those areas as reparations from Japan, of such equipment as can be efficiently utilized. Similar recommendations have been made with respect to the Philippine Islands. The Chinese Government was urged to take action along these lines during Ambassador Pauley's conferences in Nanking on 25 May 1946. The necessity for immediate transfer of critically needed power equipment for the coal mining areas of Manchuria from Japan was also pointed out in a letter from Mr. Pauley to General MacArthur dated 20 June 1946. Training of additional Chinese personnel in engineering and management of the industrial equipment is also essential.

Manchuria's power installations are first priority in rehabilitation. This includes hydro-electric stations as well as thermal power plants at the coal mines. If sufficient power generating equipment can be quickly transferred from Japan, there is a good chance of salvaging one or two important coal mines that are now flooded or in grave danger of flooding.

Another possible and readily available but limited source of power is what remains of the hydro-electric development now in operation at Tafengmen near Kirin and which is furnishing power to Harbin and Changchun. Transmission lines to the South have been cut by Chinese Communists who will not permit repair. Until peace between the Communists and Chinese Nationalists is restored, this badly needed power is being wasted. Restoration of electric power in Manchuria will go far toward alleviating the immediate needs of the populace.

Given the best of conditions, China's rehabilitation is a matter of many years. In the meantime the stability of the entire Far East is in a large measure dependent upon satisfying the urgent needs of the populations of the various countries lying there. They all need materials and machines for reconstruction. Failure to supply these needs will result in continued unrest and instability.

7-10 DELAYS IN COMPREHENSIVE REPARATIONS PROGRAM

Letter September 18, 1946
To: Willard L. Thorp, Deputy to the Assistant Secretary of State for Economic Affairs, State Department
From: Edwin W. Pauley

Dear Mr. Thorp:

On May 2nd I sent to you a copy of my comprehensive report on Japanese reparations which had been revised as the result of discussions with members of the State Department and which I understood was acceptable to them. On August 13 I again wrote you reporting that a copy of the report had been given to the Chief of the Economic and Scientific Section of SCAP in Tokyo with a request that comments be sent to you. In the latter letter I requested that the State Department undertake responsibility for sponsoring this report in SWNCC and for expediting its approval in order that I might submit it to the President with SWNCC concurrence with the object in view of its being used as a basic statement of policy.

By letter of August 26 Clair Wilcox, Acting Deputy, reported that "...the State Department has prepared in form for presentation to SWNCC the industrial removal program contained in your report, as agreed to in May". I assumed that this meant my *entire comprehensive report* (of May 2, 1946) was being submitted to SWNCC, as was done with my Interim Reparations Program of 18 December 1945.

However, I am now informed that the Department does not intend to submit to SWNCC the comprehensive report in its entirety. Instead, I am advised the Department has drafted and proposes to sponsor in SWNCC a paper which utilizes only certain recommendations

contained in my comprehensive report and, in the case of a certain of the appendices, quotes individual sections of the report. Insofar as my understanding of our previous correspondence and discussions is concerned, this is not what I requested in my letters of 2 May and 13 August and certainly is not what I understood the Department had agreed to do.

I cannot subscribe to or endorse the apparent program of the Department as outlined in the draft paper entitled "Final Reparations Removal Program for Japan" because it fails to follow the recommendations contained in my comprehensive report. Also the Department's proposed draft refers to a *final* reparations removal program. You will note that my comprehensive report submitted on 2 May carefully avoids the use of the word "final". I do not believe, at this time, we can denominate *any reparations program* for Japan as "final".

Reparations do not begin and end with "removals". Reparations are part and parcel of a basic economic program affecting not only a defeated Japan but also a war torn East Asia. I do not believe that policy on reparations can be determined intelligently if the subject is treated in a vacuum. In order to fulfill my duties as the personal representative of the President, I believe it is essential that our reparations policy be stated in a concise form in its entirety together with a concise statement of the justification for that policy including relevant material which may—and in fact does—go beyond the mere fact of *removal* of certain industrial plant. I believe my comprehensive report of 2 May meets these basic requirements. Naturally, the Department, or any other interested branch of the Government, may differ with or object to the policy set forth in my report or with any phase of its implementation. It was the purpose of resolving any such objections that the request for presentation to and discussion in SWNCC was proposed.

If the Department, for any reason, finds itself unable now to sponsor my comprehensive report of 2 May in its entirety, I would appreciate your advising me promptly, specifying those particulars of the report to which it objects. Failing that, I shall assume that the Department will, pursuant to the understanding expressed throughout our correspondence, immediately prepare and sponsor the entirety of the comprehensive report of 2 May before SWNCC. The agreed procedure with respect to the Japanese program was different from Germany in that I filed my comprehensive report to the President prior to taking it up with the other interested governmental agencies... This time we felt it was better for us to take it up with the other agencies before giving it to the President. You can see, therefore, how extremely anxious I am to get action on this because I am delaying my report to the President pending this action. Already the President has asked, through his Legal Counsel, Mr. Clark Clifford, for certain phases of these reparations reports that I cannot give him until I hear from you.

I shall now, therefore, thank you in advance anticipation of an early reply.

Sincerely,
Edwin W. Pauley.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

7-11 ACTION ON REPARATIONS

Letter[2] undated (Oct. 1946?)
To: Edwin W. Pauley
From: Clair Wilcox, Acting Deputy to Assistant Secretary for Economic Affairs, State Dept.

My dear Mr. Pauley:

I regret the misunderstanding described in your letter of September 18 with respect to the clearance through the State-War-Navy Coordinating Committee of your Comprehensive Report on Reparations from Japan. I wish to confirm the statements made to Mr. Bennett of your staff by Mr. Gross of the Office of the Assistant Secretary for Occupied Areas Affairs and Mr. Martin of the Division of Japanese and Korean Economic Affairs that no question of substance is involved but only problems of format and procedure.

Although considered in a series of papers on various subjects rather than in one over-all document, I think you will find all your recommendations have been or are scheduled to be covered in SWNCC papers. I enclose with this letter a summary of the status of action by the State-War-Navy Coordinating Committee and the Far Eastern Commission on papers covering the various subjects concerning which policy recommendations are made in your report. Although, as you will note, final SWNCC action has not been completed on a number of these papers, I feel sure that in due course all your recommendations will have been acted on by SWNCC. Except where the contrary may have been specifically indicated in this attachment the State Daprtment has in each case supported the policies proposed in your report. Of course, since concurrence of the War and Navy Departments, of the JCS, and usually of SCAP is necessary to final SWNCC action, the State Department can give no assurances as to amendments which may be voted into these papers before final approval.

In order to insure that proper attention has been given to the interrelations among the various policy issues centering in the reparations program, the State Department has requested the SWNCC to review these papers from this standpoint, particularly in the light of the integrated viewpoint contained in your report, and make such amendments as may be suggested by this review. A copy of this document is also enclosed.

In your letter and in subsequent discussions with Mr. Bennett our attention has been called to a few points on which, in the course of negotiations in this Government and with other governments, the intent of recommendations in your report has been unintentionally obscured. I wish to assure you that insofar as the matter is within the power of the State Department, steps will be taken to make the revisions necessary to insure clarity in carrying out those policies on which we have agreed.

I hope that the information supplied with this letter will provide you the necessary basis for submitting your report to the President.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

[2] A handwritten notation adds "to Mr. Willard L. Thorp".

7-12 AMBASSADOR PAULEY'S RESPONSE TO SCAP COMMENTS ON REPARATIONS REPORT

Letter December 28, 1946
To: Secretary of State
From: Edwin W. Pauley

My dear Mr. Secretary:

I have reviewed a document by SCAP apparently under the date of September 26, 1946, entitled "Comments on Ambassador Pauley's Report to the President". Comparison of the comments in this document with my comprehensive report shows that there are only three cases of what I would call marked disagreement with my recommendations. In seven cases SCAP proposes some increases of the capacities which I recommended to remain in Japan. Most of them are not large in magnitude or are in relatively small sectors of war potential industries. Much of the discussion relates either to interpretation or repeats my own recommendations in somewhat, different language. In about ten cases SCAP either comments that may findings are premature or arbitrary or otherwise indicates that a decision should not yet be made.

In most cases where SCAP requests delaying a decision I would recommend that a decision be made subject to revision should it become necessary. In preparing my report, I anticipated that changes would be made from time to time and most scrupulously avoided referring to my program as a "final reparations program". Instead I have called it a comprehensive reparations program in order to distinguish it from my Interim Program which already has been substantially approved by SWNCC and by the FEC.

In addition to this, the second and third paragraph of my report points out that the information on which it was based came primarily from information furnished by the Japanese government and turned over to my Mission after analysis by SCAP. Where matters could not be determined with arithmetical definiteness, my recommendations have been based upon the judgements of well qualified members of my Mission. While a decision may be made more easily and surely at a later time, I believe sufficient qualified judgement is available to make decisions at this time on all matters covered by my report. A decision on a matter of policy aids in making other decisions and would remove some uncertainties about which SCAP has complained.

For example, SCAP comment on my recommendation for a Merchant Shipping limit of 1,500,000 gross tons is that any reduction below 2,000,000 is inconsistent or at least premature "under present uncertainty as to participation in world trade to be allowed Japan...". I feel no uncertainty as to Japan's proper participation in world trade and have recommended where she should participate and to what extent. My conclusion was based on

data which I understand has not been modified substantially and upon advice obtained from U.S. Navy authorities in Japan by members of my staff. The immediate effect of my program would be to make some ships larger than 5,000 gross tons (which SCAP agrees should be prohibited to Japan) available as reparations as soon as salvage and repair activities would bring the total shipping above the limit. This would allow settlement of the shipyard capacity question which SCAP also wishes to delay. Both these items are needed to reparations and the claimants are entitled to know what to expect.

SCAP's comments emphasize the necessity for exporting sufficient products to pay for required imports. In support of this plea is made on the grounds of the need for consumer goods in the remainder of Asia. I have spent considerable time both in Japan and in other parts of the Far East and realize full well both needs. However, having been both places, I realize the necessity for not allowing my concern for the export-import balance of Japan to blind me to the fact that most of the remainder of Asia is in no position to pay for imports from Japan or from anywhere else not able and willing to extend credit. The trade balance of the remainder of Asia wherein our Allies are struggling for existence without the help of a unified, powerful, and wealthy agency will also be unfavorable until industry is rehabilitated and expanded far beyond its previous levels. This is a pragmatic fact; the conviction that something should be done to correct it may be "utopian". Possibly it is also "utopian" to be as concerned about our long term security in the Far East as with our immediate material problems.

SCAP fears that the economic vacuum which might be created by removal of industry from Japan. The economic vacuum already exists and has existed since before the end of the war. We can allow filling of this vacuum by restoring the subsidized industrial economy of Japan or by the more difficult but more permanent relief obtainable by encouraging in all Asia industries able to live in a competitive world.

SCAP is concerned that "Large masses of people in Asiatic and Pacific areas will simply go without such basic needs as textiles, fuel, building materials and other similar items unless they can be produced by existing plant capacity, most of which is in Japan". Heretofore SCAP has contended that Japanese textile capacity was inadequate for home needs. As I urged early last summer, the best help that can be given the fuel situation in China is to move some electric generating equipment into the coal mining areas of Manchuria to replace that removed by the Soviets. As for building materials, most of them are bulky, cheap commodities which cannot be shipped any great distance and be sold profitably at a reasonable price. The exceptions are lumber and steel. The former is in short supply in Japan. The latter can not be made economically in large quantity in Japan because of the necessity for importing raw materials to the extent of about four tons for each ton of steel produced. Economic conditions other than the reparations program will limit the exports of these commodities.

As for delays in the reparations program, I share SCAP's concern. However, with physical and economic conditions as they are in Japan, I am far from confident that in a few years sufficient production could be secured to create a surplus greater than the production that could be obtained by moving facilities from Japan if prompt action is allowed to follow the year that has been wasted to date. Further delays, including some delays urged by SCAP, could nullify many of the objectives of our policies and could lose attainments which victory has put into our grasp.

In one other place SCAP expresses concern about the remainder of Asia. SCAP fears that the remainder of Asia will become dependent on Japan for spare parts, and for replacements was given serious consideration by my staff, but under the circumstances were considered to be not controlling. The most important category of reparations which would be concerned is machine tools. If machine tools were available to the recipient countries, they could make their own replacement parts and would not have to import them from Japan. If Japan's productive capacity for machine tools was reduced to about her own requirements, she could not export sufficient to suppress the manufacture of machine tools in the recipient countries. We should remember furthermore that many Japanese machines are copies of U.S., British and German machines. Replacement of a copy by an original should not be hard to sell.

All the other significant comments of SCAP are for a more liberal treatment of the Japanese economy. These include a number of specific recommendations for higher levels to be retained in certain industries; SCAP proposes no reductions.

I cannot argue violently with the SCAP recommendations for higher capacity levels for the production of nitric acid, sulfuric acid, caustic soda or chlorine, all of which may be

based on more recent and possibly better data on requirements than SCAP was able to give me. Nor for that matter can I argue with the proposed 11% increase in the limit on steel ingot capacity although I see little logic in it. The statement that the steel capacity remaining should be counted at 61.5% of rated capacity, I believe is extremely questionable however because it appears to be based on a misinterpretation of the recent history of the industry.

Japanese steel production failed to reach rated capacity, not so much because capacities were overrated, but because of inability to supply adequate coking coal, iron ore, scrap, transportation and labor. Much of the electric furnace capacity was installed not to supplement the open hearth furnaces but to replace them. The electric furnaces were able to make steel at times when adequate materials could not be supplied for the open hearths. Many of the blast furnaces were not operated because of undesirable location and pig iron production was concentrated in a small number of plants. All of this tended to leave a portion of capacity idle. But on a reduced scale only those steel and blast furnaces need be left which would be usable a large percentage of the time.

I cannot argue violently with SCAP's comments on woolen textiles, rayon fiber and celluloid because in the aggregate these industries do not represent an important part of Japan's war potential.

SCAP's hesitant recommendations to leave a small amount of light metals and ball-bearing production capacity similarly are not in themselves important except that the return in terms of security per dollar of import requirement is greatest in the difference in level between complete elimination and the small capacity suggested. The small nuclei of these industries would provide a training ground for rapid expansion of two industries of high war potentialities when restrictions become no longer effective.

SCAP asserts that my proposed limitation on a total machine tool installation in Japan of 175,000 units must be on a "completely arbitrary basis" and states that "there appears to be no valid reason for assigning a fixed specific limit to install machine tools in all industries until certain basic decisions which will influence the size and development of Japanese metal working industries have been made". I believe these decisions should be made now although it is advisable to leave a large margin of error as I did in arriving at the ceiling of 175,000 machine tool installations.

The industries involved in the machine tool limitation include those making a wide variety of products. Such industries can be readily converted from one product to another. Thus capacities cannot be defined in terms of output. I, therefore, stated capacity in terms of total installations for the valid reasons given in my report. If a licensing procedure is initiated (to which SCAP also objects at this time) installations allowed to remain can be assured for use in essential production.

Most of the remainder of SCAP comments relate to the relevancy of certain portions of my report to the subject of reparations. For example, my recommendations on agriculture and food are criticized as being "too far removed from reparations" and are characterized as "relatively superficial observations". As a matter of fact my Mission made a careful study utilizing the years of experience in the Far East of some of the members. I early realized the importance of a maximum food production to the reparations program because food will represent the largest category of imports. Increasing food production in Japan should do more to bring about a balance of imports and exports than any other program requiring the same amount of effort. The reparations program in turn can be made effectively complete when the trade balance is restored.

The levels of operation actually achieved by industries in Japan will not be limited by lack of capacity for some time, except, of course, in those industries which are prohibited entirely. Japan will have excess capacities under my program and reparations will not affect recovery of the economy except psychologically. Much of the psychological difficulty will be removed when a comprehensive assured retention program is adopted. While many SCAP comments can be taken as a word of caution, they doubtless reflect concern over something that if it happened at all could only happen some years hence.

In total, I cannot object to most of SCAP recommendations as seriously impairing the reparations program. I do not agree with many of them as exemplified above, but at this point I am concerned more with the delays than I am over a move to shave down the quantities of goods to be available for reparations.

Sincerely yours,
EDWIN W. PAULEY

[SOURCE: *FRUS*, 1946, vol. VIII, pp. 601-04]

7-13 COLONEL CHESELDINE'S REPORT ON REPARATIONS POLICY

Memorandum February 17, 1947
To: General MacArthur
From: R.M. Cheseldine, Deputy Chief, E & S Branch, Civil Affairs Division, War Department Special Staff

1. Pursuant to Letter Orders, The Adjutant General, War Department, dated 22 January1947, one copy attached, which read in part, "Colonel Cheseldine will ... represent the Secretary of War in Reparations policy matters in connection with Military Government and Civil Affairs activities in Japan and Korea ... and will report to the Theater Commander ... the nature and findings resulting from his visit, and the substance of any report he intends to make to the War Department ...," the attached briefed summary report of my visit to Japan with the Strike Committee on Reparations is submitted.

2. This report is confined to policy matters connected with Reparations. Such policy considerations, however, stem from a study of available industrial capacities in Japan. I have, therefore, made use of the material developed by the Strike Committee, as well as data supplied directly by the Economic and Scientific Section, the Office of the Civil Property Custodian, and the Office of the Executive for Reparations. In addition, I have had the advantage of over a year as Deputy Chief of the Economics and Supply Branch, Civil Affairs Division.

3. Policy analysis was made on the assumption that the major consideration should be the interest of the people of the United States, with due regard to the long-term international implications of such interests. This brief report was made independently of the report of the Strike Committee, although that group has made fully available its data and conclusions.

4. A more amplified and documented report will be made in Washington to the Secretary of War, with such further detail as may be requested in conference.

5. Opportunity is taken at this time to pay tribute to the Strike Committee. It was my good fortune to be associated with Mr. Strike, Mr. Perry, and Mr. Coffman on Reparations matters in Germany. These gentlemen, together with Mr. Burgess and Mr. MacKrell have assiduously devoted their time in Japan to a comprehensive review of the work already done in the several sections of General Headquarters, in the Eighth Army Offices, and in addition, have visited many plants in Tokyo, Kyoto, Osaka and Yokohama. They have been completely unbiased in their approach, sincere and thorough in their efforts to get the facts, and professionally realistic in their analysis, honest in their conclusions, and unqualifiedly patriotic and without prejudice in their recommendations. I can unreservedly commend them for the highly technical and professionally competent job they have done in such a limited time, and I should like, if permitted, to suggest that consideration be given to the award to each of the Medal for Freedom. I intend to include this suggestion in my report to the Secretary of War.

6. I am also deeply appreciative of the courtesy and cooperation shown to me and to the members of the Committee by all individuals and organizations of your command with which we have had contact. There has been an evident desire to present all the facts for our consideration. Without such candor and without their proper presentation of the facts, much less would have been accomplished in the short time available.

7. The conclusions and recommendations in my report are offered with full appreciation of the fact that no man can be profound and infallable on a subject of such magnitude and of such historic importance and implication in the time available to me. Nevertheless, they are based upon facts as presented by those who have had opportunity to secure them and upon the best analysis I can make of those facts.

8. No attempt has been made, because of time and mechanical limitations, to prepare a staff study. Only brief conclusions and general recommendations have been reduced to writing. It is believed, however, that these recommendations will give an indication of the policy structure which has been developed as a result of the picture presented to me in Japan.

[ENCLOSURE]
Report on Policy Matters in Connection With Military Government and Civil Affairs Activities for Japan

A. *The Problem*

1. The problem presented by the above mentioned orders and by personal directive from the Assistant Secretary of War, was to observe the implementation of existing policy (quantitatively and qualitatively), to secure any additional facts bearing upon reparations matters, to develop from observation and the facts presented a basis for conclusions, and to offer such recommendations as were the result of the conclusions drawn.

B. *Sources*

1. General of the Army Douglas MacArthur, Supreme Commander for the Allied Powers, at a luncheon to the Strike Committee discussed with clarity and candor the problems of the occupation of Japan and Korea. He presented the policy aspects of the economic, political, strategic and tactical problems, and facts bearing upon industrial reparations, reparations from current production and from external assets. He impressed upon the group the importance and gravity of the economic situation and the value to the United States of prompt decisions regarding reparations removals and consequent removal of restrictions upon the industry to remain in Japan. He made clear his conviction in the present friendship of the Japanese, which friendship, however, can easily be lost if the United States' policy does not offer Japan that measure of physical and economic security necessary to enable the people to rebuild their economy. His presentation of facts and their implications made certain conclusions inescapable and clearly high-light segments of United States foreign policy.

2. Interviews and conferences were held with Brig. General W.K. Harrison, Jr., Brig. General W.F. Marquat, Brig. General P.H. Tansey, Mr. R.Z. Reday, Mr. O. Friele, Mr. N. Meiklejohn, Mr. H.A. Brenn and a great number of members of the staffs at all working levels. All pertinent files, statistics, charts, cables, record memoranda and other data have been made available and have been consulted and reviewed.

3. By field trips, opportunity was afforded to secure the personal observations of Lt. General Eichelberger, Maj. General Byers, Maj. General Chase, Maj. General Woodruff, Maj. General Mullins and numerous members of their staffs.

4. A rapid but fairly comprehensive field inspection of plants in Tokyo, Yokohama, Kyoto and Osaka areas was made with the Strike Committee. This afforded an opportunity to see Japanese industry in operation, to discuss policy implications with Military Government men in the field, and to consider the effect of industrial reparations removals.

C. *Assumptions*

1. Since by directive, SCAP is charged with affecting economic disarmament and control of Japan,the further responsibility of implementing a reparations program requires integration with disarmament and control.

2. The "disease and unrest" program is to be continued.

3. Japan is friendly toward the United States and looks to the U.S. for development of her democracy along capitalistic lines.

4. Military security of the United States, as a practical matter, requires a friendly Japan. It is cheaper to retain what we now have than to be required to pay to regain it.

5. The cost of the "objectives of the Occupation" falls upon the U.S. taxpayer. The U.S. policy, therefore, requires that the interests of the U.S. come first.

6. Decisions as to steps which must be taken to carry out U.S. policy must be made unilaterally in every case where it is immediately obvious that FEC agreement either cannot be had or will be long delayed.

7. The present economy program of the Congress evidences the need for haste in reaching decision and in announcing that decision. The Congress will not permit the present heavy cost of the occupation to continue very long and failure on the part of the War and State Departments to present a workable program to reduce expense can result in a sudden decision to withdraw from Japan, thereby losing all previous investment and endangering the future.

D. *Conclusions*

1. Japan is the battleground on which is being fought the war of capitalistic democracy against Communism.

2. The United States is committed to wage this war to a successful conclusion or forever admit her loss of prestige in the East. From the economic and security points of view, Japan's friendship must be maintained.

3. The complete collapse of Japan placed the burden of her recovery to an asset position in U.S. hands. Since we have announced our intention to teach Japan democracy, our failure to assist in the recovery of her economy will cause her to lose confidence in our form of democracy. There is evidence that delay in giving Japan decision and a course of action is already causing some loss of confidence. It is difficult to explain to a people so recently

freed from feudal control that democracy moves slowly; it is far easier for them to see the swift results of totalitarian operations.

4. Restoration of a peacetime economy in Japan can be accomplished without the danger of developing a war potential. There is no evidence of any "softening" of purpose in the attitude of any person engaged in occupation duties in Japan; rather, there is a growing belief in the need for a realistic approach to the Japanese "problem" in its relation to the interests of the United States.

5. Elimination of a war potential from Japanese industry, however, should be undertaken for its own ends and not merely to provide industrial equipment for reparations. The paramount issue should not be to provide any country with reparations, but rather to reactivate a reasonable economy to make Japan self supporting and thereby not only relieve the U.S. taxpayer of his present heavy "relief" burden, but at the same time cement friendly relations with the Japanese through proof of the efficacy and strength of our capitalistic democracy.

6. Previous approaches to a reparations policy have been in error, in that they have assumed that a nation to wage war must of necessity have expanded its industrial plant far beyond peacetime requirements and, therefore, must have quantities of excess equipment. This overlooks, however, the factors of obsolescence, war damage, "wear and tear", and need of replacement because of forced use and lack of maintenance, and places an undue burden on an internal economy, thereby creating a continuing burden upon the nation which has the responsibility for the occupation.

7. While there are some industrial excesses in Japan, the generally low level of all industry and the poor condition of plants and utilities points to the necessity of great selectivity in determination of any removals.

8. Regardless of any decisions of the past, and with full regard for the international implications of any proposed change or recession, it is believed that experience (e.g.: the silk program) now proves that errors have been made in the economic and reparations policies now in effect or which are presently being considered, and that the United States must immediately admit those errors and announce such corrections as may be necessary in her own interests.

9. The studies and conclusions of the Strike Committee will show statistically and practically those industries where present excesses are obvious. Some equipment can be made available from such industries.

10. Tools and equipment taken from arsenals, and munitions plants and which are now idle in storage can safely be made available for reparations.

11. The so-called "Interim Level" should be accepted as the Final Level as already proposed by the SCAP.

12. The "obvious excesses" above the Interim Level as presently determined, however, should not be considered as immediately available for reparations and no catalogs of available plants should be offered to any nation.

13. Full consideration must be given to the impact upon the Japanese economy of the removal of large plants and heavy industrial equipment. The shortages of packing and crating material, the condition of the railroads and rolling stock, and the increasing costs of labor under the new democratic labor program, all present obstacles of large proportion, and place a grave financial burden upon an already prostrate economy. Furthermore, the value to recipient countries will be much less than is probably expected. In the face of the present financial cost of the occupation to the U.S. taxpayer, it will be extremely difficult to justify a removal program for the benefit of claimant nations which must be financed by continued advances from the United States for relief purposes, particularly when it can not be demonstrated that full economic benefit will accrue to recipient nations and so will not provide even ultimate benefit to the United States.

14. With the exception noted in paragraphs 9 and 10 above, all other industrial equipment in Japan can be permitted to operate under the system of controls proposed by SCAP in the paper "Industrial Disarmament and Economic Control of Japan," dated 22 January 1947.

15. Further study of the Interim Level should be made for refinement of excesses by industries in the light of growing experience.

16. For political purposes, decision should be reached at once regarding disposition of external assets. For all practical purposes, it would appear that the FEC nations have already received the bulk of their reparations from the Japanese external assets now located in those countries. Such assets cannot be moved.

17. The "gold pot" should be made available to SCAP for use as a revolving fund to stimulate foreign trade.

18. The possibility of using items from current production for reparations is so remote that it should be given no consideration, even for compromise purposes. History shows that it has been almost impossible for Japan to present an annual favorable trade balance. The present condition of industry and finance is such that years must pass before Japan can produce enough goods to satisfy her internal requirements and her export necessities to offset her imports. If any current production were to be taken to satisfy reparations claims, it would of necessity be at the expense of the United States taxpayers or it would require the operation at full capacity of all machinery and equipment now in Japan, without occupation controls, which would mean no industrial disarmament. If the proposed industrial disarmament plan is activated, the only conceivable reparations value which a claimant nation could obtain from current production would be the "profit" normally assessed above actual cost of manufacture on those items manufactured in Japan from raw materials supplied by the claimant nation which would also have to pay the cost of manufacture. It is not believed that such a plan would appeal to claimant nations, since in any case such manufacture could be permitted only on a very limited scale in a few industries because of the heavy drain it would impose upon indigenous industrial facilities.

19. The development of an integrated economy to make Japan self-supporting is a task of such magnitude and is so important to the future of the United States, that it is not possible for the War Department to provide enough competent personnel at authorized rates of pay to staff all of the important technical echelons. Present personnel engaged in economic activities are loyal and apparently serious and conscientious in their efforts. In too many cases, however, they are not fully qualified to make the important recommendations or decisions which are necessary. The United States cannot afford the luxury of error which can too easily arise because of this fact, and the fact must be given serious consideration in the development of the economic policy now so urgently necessary.

20. All staff studies, briefs and proposed directives on all phases of reparations now being processed by the War Department in SWNCC and FEA should be withdrawn for restudy in the light of these conclusions and the following recommendations.

E. *Recommendations.* It is recommended that:

1. The War Department immediately propose to SWNCC a comprehensive industrial disarmament and economic control policy for Japan, including percentage shares of reparations for each FEC nation and advocate its unilateral implementation. Further delay invites disaster.

2. The policy be based upon the paramount interests of the United States and the reparations phases be incidental and residual.

3. The policy be substantially as outlined in the SCAP radio 68424 and in the paper "Industrial Disarmament and Economic Control of Japan", dated 22 January 1947, subject to such refinement as may be presented in the conclusions and recommendations of the Strike Committee.

4. A directive be issued to SCAP to offer excess tools and equipment in the "pooled items" lists to all claimant countries, and at the same time SCAP be directed not to publicize the present plant and machinery catalogs.

5. The present "Interim Level" be announced as the Final Level and, subject to the policy referred to in paragraph 3 above, SCAP be directed to instruct the Japanese government to take all necessary measures to speed up the operation of all industry permitted to remain in the Japanese economy.

6. Authority be given SCAP to make use of the so-called "gold pot" by sale or as security, to provide a revolving fund to procure raw materials necessary for industrial operations; final disposition of the fund as reparations to be determined only when a favorable trade balance has been established. At the same time, arrangements be made for RFC advances for selected imports and provision be made to facilitate foreign buying of Japanese goods for export.

7. The United States publish the list of Japanese external assets, showing where located and pointing out the percentage of the whole in each location, and announce that those assets will be charged against the reparations account of each of the countries in the percentage stated.

8. United States economic policy should specify disapproval of reparations from current production.

[SOURCE: MACARTHUR MEMORIAL, RG-5]

7-14 REPORT ON JAPANESE REPARATIONS (FIRST STRIKE REPORT)

Report February 18, 1947
Submitted to: General MacArthur (SCAP)
By: Special Committee on Japanese Reparations, War Department (In Tokyo)
Secret

Dear General MacArthur:

Pursuant to instructions received form Mr. Howard C. Peterson, Assistant Secretary of War, by his letter of 8 January 1947 and as he later amplified orally in the presence of Major General John J. Hilldring, Assistant Secretary of State for Occupied Countries, the Committee has reviewed the whole reparations program for Japan, the extent to which planning has developed, and the organization on hand or needed to carry it out.

Information Supplied in Washington

Before the Committee left Wasington, it was furnished with copies of the Pauley Report on Japanese Reparations to the President of the United States dated November 1945 to April 1946, the report on the Industrial Disarmament of Japan submitted to the Secretaries of State, War and Navy by the National Engineers Committee of Engineers Joint Council, and in addition, copies of numerous cablegrams and teletype conferences between your Headquarters and the War Department in Washington. The content of each of these documents was carefully studied.

Recognition of Prior Work Done

The Committee recognizes that a tremendous amount of work was done to produce the above-mentioned reports. Notwithstanding this fact, the Committee, in view of its instructions, has not felt itself bound to any of the recommendations contained in such reports, but has attempted to carry out its instructions in the light of existing conditions in Japan, many of which have changed considerably since the earlier reports were prepared.

Principal SCAP Sections Reviewed

The Committee has reviewed the procedures in the principal divisions of the three Sections which are vitally related to the reparations problem; namely, (1) Economic and Scientific Section, (2) Office of the Executive for Reparations, and (3) the Civil Property Custodian Section which are in the charge of Brig. General W.F. Marquat, Brig. General W.K. Harrison, and Brig. General P.H. Tansey, respectively. In addition, it has consulted with pertinent branches of the Natural Resources Section.

As a part of such review, conferences were held with the officers in charge and the chiefs of the various sections, divisions and branches. In such conferences, the broad problems and policies were discussed and a review was made of the respective organizations. Interviews were held with the individuals in charge of the more important divisions and branches, including their assistants, for the purpose of surveying the personnel and reviewing their procedures and progress and the data upon which they arrived at conclusions. In all, approximately 30 such divisions, 20 of which were in the Economic and Scientific Section, were surveyed. The information and data which were gathered in the course of this work are embodied in our working papers and supporting material.

Plants Visited

As a part of the review of the overall situation, the Committee visited approximately 50 industrial plants in the Tokyo, Chiba, Yokohama, Osaka and Kyoto areas, including the Osaka Military Arsenal which had suffered severe war damage. Some of the plants had been declared tentatively available for reparations and were not in operation, others which had likewise been declared available but were in operation, at least to some extent, and still others which have not been declared available for reparations and are in operation. Such industrial plants so classified are in several different categories of industry, such as; marine engine, steel, oil refining, chemical, shipbuilding, precision instruments, textile and electric power.

In this process, opportunity was had by the Committee to meet various personnel in the Eighth Army in whose charge rests such matters as the supervision of the preparation of the inventories, the numbering of the machines, and their proper storing and maintenance. Also the Committee had occasion to meet the Japanese managements of the operating plants visited.

Discussion

Imperative Need for Prompt Action on Reparations

The uncertainty which has existed as to the exact nature of the reparations program has had a retarding effect on reconversion to peacetime production. A level of economic self-sufficiency cannot be achieved until the Japanese can be told what plants and facilities are to be removed. Until such a level is reached, the deficit remains a liability to the United States taxpayer.

Reparations as a Part of Disarmament

As a function of reparations, considerable emphasis has been placed upon industrial disarmament. The Committee believes that this function, to a large degree, has already been accomplished through the loss of the overseas empire, the military establishment, and the damage to Japanese industry due to strategic bombing. Any further disarmament of Japan should be based upon a plan which has the virtue of (1) simplicity of execution, (2) low performance costs, and (3) a single layer of control. The Committee believes that in the formation of the plan, consideration should be given to its ultimate acceptability by the United Nations.

The Committee has studied the document "Industrial Disarmament and Economic Control of Japan" dated 22 January 1947 and from the standpoint of industrial disarmament, agrees to the principles contained therein. Comments on recommended levels in some of the industries will be made later on in this report.

Reparations to Compensate for Loss

Another function of the reparations program is to repay in part the material losses of the nations which have suffered from Japanese aggression. This function is commendable and should be carried out to the extent that it is possible without leaving Japan dependent upon other nations, more particularly our own, for support. It is the opinion of the Committee that reparations of industrial equipment should not affect Japan's ability to produce sufficient goods to meet her own domestic requirements and in addition enough other commodities or goods for export to cover her requirements of food and raw material imports. The industrial products designed for export, insofar as the market will absorb them, should come from industries which cannot be converted readily to war purposes.

Level of Industry

The present Reparations Program is based on establishing a level of industry in the principal industrial categories, all of which have some degree of war potentiality. The Committee has examined the work in the several branches dealing with these industrial categories and, in addition, has reviewed similar work in other industrial categories presumably having little or no war potentiality. An unofficial tabulation dated 23 October 1946, entitled "Development of Interim Reparations Program" indicates that there are 19 industrial categories in the former classification.

In considering levels to be established in the various categories, there are many unsettled questions, including the following:

a. The advisability of retaining in Japan productive capacity for the manufacture of locomotives and rolling stock for export to China and other Asiatic countries in return for needed imports of coking coal, iron ore and other raw materials.

b. The advisability of retaining sufficient capacity in the industrial chemical plants to supply through exports the fertilizer requirements of Korea, which has normally been dependent upon Japan for this commodity.

c. Final settlement of Japanese fishing areas insofar as they affect shipbuilding, export trade, and domestic food supply.

d. Final settlement of the capacity to be left to the Japanese Merchant Marine.

e. The effect which democratization of labor will have on estimates of production as compared to historical information.

It is self-evident that the levels of industry in the various categories are interdependent, and considering this and the unsettled questions, the possibility of error in the total program are apparent.

As set forth in the document entitled "Industrial Disarmament and Economic Control of Japan" dated 22 January 1947, the basis of control is the limitation of production in the following two basic industries:

Iron and Steel——The total future annual consumption of rolled steel products and steel castings, as estimated by SCAP, is 2,750,000 metric tons which would require production of 3,500,000 metric tons of ingots. The Committee believes that a steel melting capacity at least 1/3 greater than 3,500,000 metric tons should be allowed to remain in order to provide flexibility. A further study should be made of the advisable proportion of open-hearth and electric-furnace melting capacity because under certain conditions relating to the avail-

ability of electric power, fuel supplies and scrap in particular areas, it may be economically advisable to use electric furnaces in preference to open hearths. Other reasons for a surplus of capacity are to allow for shutdowns for repairs and to provide for shifts in production from one plant to another as a result of competition. An overall surplus in rolling capacity of a similar order of magnitude should be allowed to remain to provide for diversification in finished products. Due regard should be given to the fact that rolling mill capacity is a variable quantity, depending on the size of sections rolled. Also care should be exercised in selecting equipment to be made available for reparations so that a plant's degree of integration is not unduly reduced. If steel is to be controlled at the ingot stage, it seems to be relatively unimportant to the Committee as to the amount of pig iron capacity that will be allowed to remain in Japan; except that pig iron production should not be reduced below the amount required for the production of the allowed ingot capacity until such time as other supplies of pig iron are proven to be available to Japanese industry.

Petroleum——As compared with approximate present output of 2,000,000 bbl/yr of indigenous crude from existing known reserves, there is an expected peacetime demand for approximately 18 million bbl/yr of petroleum products and a net operable capacity of about 12 million bbl/yr together with storage facilities for approximately 40 million bbls. The amount of synthetic capacity, already partly converted to fertilizer production, is insignificant. While there is only a slight price advantage to Japan in refining imported crudes because of present low Japanese plant efficiencies, every dollar so saved represents a reduction in requirements for foreign exchange which is important to her economy.

The Committee believes that the Japanese war potential in this industry can be sufficiently curbed by volume control over crude imports and it is considered less practical to resort to control of refining operations. A limitation of 12,000,000 bbl/yr on Japan's refining capacity and a similar limitation of 6,000,000 bbl on storage facilities would produce a good balance and easy control, and all excess could either be taken for reparations, if removable, or dismantled and scrapped, and all plants specializing in the production of aviation gasoline, its components, military explosive intermediates and all synthetic plants or parts thereof, not now making fertilizer could also be earmarked for reparations or scrapped.

There are other industrial categories, some of which represent a larger capital investment and also a larger value of production than the two being considered for control, but are interdependent to such an extent that they should be considered seperately.

Chemicals——Japan, under her war program, greatly enlarged her heavy chemical industry which no doubt now contains a surplus over historical peacetime needs, but these needs should be carefully examined in the light of changed postwar conditions before any plants or components are selected for reparations.

Japan has the highest population density of any nation in the Orient (over 500 per sq. mi.) and probably the lowest percentage of tillable land (about 16%) nearly all of which is under intensive cultivation, requiring fertilizers. Japan has lost Korea, Manchuria and Formosa and must now pay for all food imports with foreign exchange. Furthermore, her foreign silk markets have been very soft recently and she faces an alarming possibility of loss of this medium of acquiring foreign exchange. Therefore, she may be unable to finance raw cotton imports and may have to produce in part at least, rayon textiles in her extensive textile industries, requiring large amounts of sulfuric acid and caustic soda in production of yarns. Another suggested means of getting foreign exchange, now under consideration, is the enlargement of the paper industry requiring heavy chemicals in large amounts.

This Committee would favor the retention for the production of fertilizers all fixed nitrogen and ammonia capacity, all calcium carbide and cyanamide capacity and all chamber process sulfuric acid plants. It would also favor retaining all contact process sulfuric acid plants, all soda ash, caustic soda and chlorine plants until by the law of supply and demand it is proven that some of this production is surplus.

Shipbuilding——As estimated by SCAP peacetime requirements of the Japanese merchant marine total 2,000,000 gross tons of shipping, taking into account the traffic load around the home islands and exports and imports to and from the Asiatic mainland. No allowance is made for overseas shipping, such as requirements for importation of crude petroleum for domestic needs. In the absence of a final settlement of Japanese fishing areas, there is some doubt as to the required tonnage of the fishing fleet. On the basis of 2,000,000 gross tons of shipping, SCAP estimates that shipyard capacities should be retained sufficient for 650,000 gross tons of new construction annually and 5,900,000 gross tons for current repairs.

Japan must of necessity continue to be a trading nation. Before any level of industry can be finally established, a decision must be reached as to the tonnage of merchant marine which will be allowed Japan for the transportation of her imports and exports. It may be economically feasible to handle this foreign trade in Japanese bottoms only. In this connection, the present limitation of new ship construction to 5,000 gross tons should be reconsidered.

Machine Tools——The machine tool census indicates that there are approximately 600,000 of such units in Japan.

The Committee believes that all tools in Army and Navy Ordnance plants and arsenals should be made available for reparations. All "special machinery" used in aircraft manufacture should also be made available for reparations. A large proportion, however, of the general purpose machine tools can be converted to the manufacture of automobiles, trucks, bicycles and other such products useful in the peactime economy and, where such conversion is possible, these tools should be retained. The estimate of Japanese requirements for new machine tools is approximately 27,000 units per year, which is roughly equal to one-half of estimated capacity. In order to provide flexibility in productive capacity, to accomodate competition and to compensate for recent rapid deterioration of equipment, not more than 25 per cent of Japanese tool manufacturing facilities should be made available for reparations. The Committee believes that machine tools located in all other industries, except in the portion of the iron and steel, petroleum refining, and ship-building industries designated as available for reparations, should be declared free of control and not subject to reparations.

Electric Power——Although theoretically, except during the dry season, an excess in total installed generating capacity, including hydro- and thermal-electric plants, may exist over normal future demands, no removals for reparations account are recommended at this time since the amount or location of any such excess cannot be determined until all industrial levels are fixed and the effect of the resultant power load changes on remaining generating capacities and power transmission grids are studied. It should be noted that the net advantage to claimant nations of power equipment from this source over new equipment will be limited.

The Committee has reviewed in some detail the progress of the work in the other branches of industry for the purpose of determining the extent to which work had been coordinated between branches, particularly where there is interdependence among industries subject to reparations. These additional branches covered such items as light metals, textiles and leather, handicrafts, highway vehicles, paper and pulp, fisheries, ceramics, railroad equipment, agriculture, forestry products, rubber (including synthetic), electric machinery and coal.

The work of the Export-Import Branch was examined in detail. Any level of industry designed to make the Japanese economy self-sustaining must be designed on exports which can be sold in the world market. The figures submitted to the Committee indicate that miscalculations have been made in the past based on the amount of silk which can be sold in the United States. If similar errors were continued, and a level of industry were based on erroneous calculations, the balance between the other industries would be upset. Changing world markets and impossibility of prophesying these changes point out just one imponderable in determining a theoretical self-sustaining level of industry.

The Extent to Which Planning has Developed

Directives from the War Department to SCAP over the period 28 May 1946 to 20 September 1946 established an interim level of industry as approved by the Far Eastern Commission. Additional directives established various criteria by which Japanese industrial plants were to be classified. Based on industrial capacities as reported in each of these industrial categories, plants were selected having combined capacities equal to the total directed level and the residual plants marked for reparations. In some categories, all plants, in accordance with the directives, were marked as available for reparations. The plants so designated number approximately 1100 and in respect to the outline contained in these directives, the planning is in its final stage.

The quality of the work, however, in making these determinations is considered by this committee to be such that to continue with the present reparations program on the basis of this planning would have a disastrous effect on the Japanese economy which would in turn reflect in additional costs to the United States taxpayer.

During the field trips made by the Committee, repeated instances of defective planning were discovered which convinced the Committee that, should the program continue under present planning, the result would be a paralysis of industry such as to endanger the purpose of the occupation.

Organization on Hand or Needed

The Committee reviewed the organization within SCAP Headquarters to determine the procedure on matters regarding reparations. As it is presently constituted between Economic and Scientific Section, Office of Executive for Reparations, Civil Property Custodian Section, and Military Government within the Eighth Army, the division of authority and responsibility in connection with the various matters appears to be clear cut and workable. However, the manning of the staffs in some of these departments is considered to be wholly inadequate for carrying out a reparations program as presently planned.

A. Economic and Scientific Section

It is the function of the Industry Branch within this section to review the entire industrial production balance for a nation of approximately 80,000,000 people. This is a gargantuan task requiring the most experienced personnel which the United States could produce in order to accomplish the task in a manner which would be a credit to our country. It is necessary, however, under Government operation to accomplish this work with the men available under Civil Service or War Department limitations as to salary and other conditions, and consequently the talent required for such a task is not present. In making this observation, there is no intent to disqualify any individual from his present position but only to point out that the present established policy in regards to reparations is such as to be unworkable with the organization available for its implementation. It is not impossible that over a considerable period of time the organization on hand might arrive at a solution which would implement the reparations policy and not completely upset Japanese industry. It would, however, require many months of additional study during which time Japanese industry is deteriorating due to lack of an established United States policy on this matter, and such an inordinate delay would add to disease and unrest among the Japanese people and endanger the purpose of the occupation.

On the other hand, the present organization is extremely loyal and is competent to a relatively high level of supervision. Therefore, if a sound workable reparations program can be established, the organization on hand, with the aid of Japanese assistance, could be more than ample to carry out such a task. Assuming such a program can be established, there should be surplus personnel in this section.

B. Office of the Executive for Reparations

The function of this office in the handling of claims, making evaluations and allocations, and dismantling, packing, and shipping plants, while being of considerable importance in the whole program, is the kind of an operation which can be programmed as individual operations and except for the matter of handling claims and making allocations, the work can be done by the Japanese with a minimum of supervision. This function is infinitely less complex than the plants discussed under the Economic and Scientific Section. The Committee has reviewed the procedures in this office and it is believed that if and when a plant removal program is instituted, the proposed procedures examined will be adequate. It is the Committee's opinion that the present staff is competent to handle all these matters and that the numerical adequacy of personnel will depend upon the size of the program.

C. Civil Property Custodian Section

The subject of reparations from external assets, monetary gold, precious stones, and restitution was discussed with the staff in the Civil Property Custodian Section. The Committee believes that the procedures relating to all of these are adequate and that the staff is competent to handle the various claims that may be made.

In regard to claims for restitution, the Committee feels a date should be set after which claims of this character could no longer be filed, since some such procedure is necessary in order that a plant or item after such date could be cleared for reparations without the possibility of incurring complications as to title, as might otherwise be the case.

The Committee is advised that Japanese external assets in the form of industrial plants remain in liberated countries, with the exception of equipment which was removed from Manchuria by Russia. From data supplied by the staff, the Committee believes that the value of such assets greatly exceeds the value of the plants in Japan which may be finally declared available for reparations. If title to such external assets has been taken by the respective liberated countries in which they are located, and assuming that they will not be moved, the Committee believes that the value of such assets should be considered in settling the reparations claims of such liberated countries.

Monetary gold, precious stones, and other valuables, the value of which has been estimated to be approximately $283,000,000, has been taken into custody in Japan. There are a number of outstanding claims, particularly with respect to the precious stones, none of which to date have been proven.

D. Military Government

In order to follow the flow of reparations matters at the local Military Government level, it is essential to consider the whole Military Government operation. In the trips which the Committee made to the field offices of Military Government, it was almost universally true, except in the larger prefectures, that one officer was handling all matters pertaining to industry (which included reparations), agriculture, trade and commerce, sometimes even education, finance and labor. It is self-evident that a man chosen for such responsibilities would have little time for detailed consideration of the problems in connection with selection of plants for reparations, considering inequities which arise through selections, and then later handling dismantling, packing, and shipping. The problems which arise on such matters as the reconsideration as to whether or not a plant has been erroneously classified under criteria already established, and the further consideration that if the plant does fit the criteria and is removed, the effect that it will have on neighboring industries, transportation, and labor readjustment is complex and time consuming. The present authorized table of organization allows neither the number of men nor rating high enough to administer competently such industrial matters in connection with reparations. Here again no criticism of any of the personnel visited in the Eighth Army and Military Government is intended. In fact, the Committee feels quite the opposite as to the personnel individually. They are extremely loyal men trying to carry out the directives of an awkward policy and unsound criteria.

The work done by the Eighth Army in supervising the moving, storage, preparation and maintenance of the machine tools which the Committee saw on its field inspections, is commendable.

General

The discussion up to this point has dealt with the difficulties of policy and administration. There are other pertinent facts bearing on the entire program.

A. *Small Value of Industrial Plant for Reparations*——While no appraisal has been made of the aggregate value of plants and facilities available for reparations, based upon information obtained in the field, the Committee believes that such value is a very small fraction of the external Japanese assets, consisting of industrial installations located in former conquered terrtories and which are now in the possession of the liberated countries.

B. *Limitations on Reparations Plants Removals*——The removal of only a limited proportion of plants available for reparations is economically justifiable or physically practicable. Reinstallation and construction of necessary associated facilities, which could not be moved, and the necessity of furnishing competent operating personnel leave such partial plants of doubtful value.

C. *Dismantling, Packing and Transportation*——The dismantling, processing and packing of industrial plants will require an enormous amount of grease and oil, lumber, nails and straps, all of which are in extreme short supply in the present Japanese economy. The movement of the plants within Japan, except where they are located adjacent to deepwater ports, will require rail transportation which will consume coal for this purpose. Coal is not only in short supply, but is the present key to the economic rehabilitation and any demand such as is encompassed in this transportation requirement will seriously retard Japanese recovery to self-sufficiency.

D. *Finance*——It is not within the scope of this Committee's function to examine questions of Japanese finance, but it is doubtful if the financial structure of the country could support a large removal program.

Reparations from Current and Future Production

The Committee questions the soundness of paying reparations from current or future production, but is definitely of the opinion that if it is done prior to the time when Japan has a self-sustaining economy, the cost of such reparations would, under present policy, be a charge on the United States taxpayer. Any such program would retard or possibly make it impossible for Japan to become a self-sustaining nation which condition would prolong the occupation and the economic control of Japan by the United States. Such extension of control is considered most undesirable.

CONCLUSIONS

1. The principle of indutrial disarmament and economic control, as described in SCAP

document entitled "Industrial Disarmament and Economic Control of Japan" dated 22 January 1947, as qualified in this report in respect to levels of industry, is sound and should be the basis for a revised program for reparations.

2. Lack of progress in handling reparations matters is clearly retarding the rehabilitation of a self-sustaining Japanese economy, and as such is endangering the purpose of the occupation.

3. The reparations program, as presently constituted, is not possible of implementation with the organization on hand within the forseeable future.

4. The actual value of reparations, even under the present proposed interim program as established by the Far Eastern Commission, is inconsequential in relation to other matters concerning the occupation and should not be allowed to assume such an important aspect.

5. There are certain obvious excesses over the requirements of the future peacetime Japanese economy in the industries of steel making, oil refining, shipbuilding and in the machine tool count. There may also be additional excesses which are not so obvious and which are extremely difficult to prove, but even when ascertained would amount to little value due to the losses in dismantling and removing.

6. If a more realistic and practical reparations program can be substituted, it is probable that there will be a surplus of personnel in those departments concerned with this problem.

RECOMMENDATIONS

1. The Committee recommends that the present reparations program in respect to plant removals be abandoned.

2. The Committee recommends that a new program should be formulated, made as compatible as possible with United States present position within Far Eastern Commission, consisting of:

a. Removal for reparations purposes of all primary steel making capacity beyond 4,700,000 tons per annum, ingot capacity.

b. Removal as reparations, petroleum refining plants beyond a capacity of 12,000,000 barrels per annum, and removal of oil storage capacity in excess of 6,000,000 barrels.

c. Removal of all machine tools from Army and Navy arsenals and "special purpose" machines from aircraft plants.

d. Removal of shipbuilding plants in excess of the level to be established after further consideration of the final allowable tonnage of the Japanese merchant marine.

3. That the new reparations program be announced as soon as possible to the Japanese Government with instructions that with the industry which will be left, maximum production should be achieved, and a date set by SCAP beyond which time the United States does not propose to support Japan's economy.

4. The principle of free enterprize be encouraged, and the Japanese Government be discouraged from subsidizing industry beyond the time when economic self-sufficiency has been attained.

5. No reparations should be paid from current or future production.

6. Preferential tariffs against importation of refined petroleum products be barred for a period of 5 years as a further control on domestic refining.

7. The control measures recommended in the document entitled "Industrial Disarmament and Economic Control of Japan" dated 22 January 1947 be adopted with revisions as to levels of industry recommended elsewhere in this report.

8. The monetary gold and precious stones now in custody within Japan by borrowed to help finance imports of raw materials in order to create export of finished products; and that only after Japan is economically self-sustaining should this gold and these stones be considered for other purposes.

Compared with previous programs for reparations, the one proposed herein may appear to represent a softening of attitude toward Japan. The Committee is fully aware of the primary necessity of eliminating Japanese war potential and to insure adequate controls to prevent a recurrence of aggression by this nation.

The Committee does not believe the program recommended herein constitutes any softening of attitude but does give recognition to conditions and problems as they exist at present. This program provides both an adequate control over the level of Japanese industry and an opportunity for that level to be developed to a point of self-sufficiency. The control features of the program have been clearly set forth in the aforementioned document dated

22 January 1947.

In summarizing the findings of the foregoing report, the Committee believes that the program recommended provides the following improvements over the present situation: (1) a simplification of the work to be done by SCAP, (2) a removal of large segments of Japanese industry from the present doubtful status which is now delaying recovery, (3) an acceleration in the process of making some reparations available, (4) reduced expense to the United States Government, (5) and elimination of the threat of disaster to the Japanese economy by too drastic reparations removals.

The Committee wishes to express its pleasure in having had this opportunity to be of service to you. More particularly, it wishes to express its appreciation to all members of your staff and command with whom it came in contact for their open and frank discussions, their readiness to supply any information which was requested, their willingness to render every assistance, their efficient organization and arrangement of field trips, and the many courtesies that were extended. The Committee could not have accomplished its purpose without this excellent cooperation.

Respectfully submitted,
Special Committee on Japanese Reparations
Clifford S. Strike (Chairman)
G. V. T. Burgess
Paul B. Coffman
F. C. MacKrell
H. B. Perry

[SOURCE: SUITLAND PAPERS, Z 703-1]

7-15 REPORT ON JAPANESE REPARATIONS AND WAR DEPARTMENT VIEW

Letter of Transmittal — February 24, 1947
To: Howard C. Petersen, Assistant Secretary of War
From: Special Committee on Japanese Reparations, War Department
Secret

Dear Mr. Petersen:

Your Special Committee on Japanese Reparations, organized for the purpose requested in your letter dated 8 January 1947, has just completed a 31-day trip to Japan and has reviewed the whole reparations program in Japan, the extent to which plans are developed and the organization on hand to carry it out.

The Committee conferred in detail with many of the Sections within SCAP having to do with these matters, has made field trips and, finally, has reported its findings and recommendations to General MacArthur.

This entire subject has been discussed personally with General MacArthur and the report, conclusions and recommendations of the Committee are contained in its report to General MacArthur, dated 18 February 1947.

The Committee is in unanimous agreement in the conclusions contained in this report and General MacArthur has added the following indorsement:

"To the Secretary of WAR: This report represents an outstanding contribution to the complex problems involved. It is presented in a comprehensive and authoritative manner and should receive due consideration in the solution of a situation which brooks no further delay. Douglas MacArthur"

The Committee herewith submits this report to you and trusts that it will be helpful in the formation of a United States policy on this matter.

The Committee wishes to thank you personally for having made the travel and living conditions as comfortable as the circumstances could possibly permit.

Special Committee on Japanese Reparations

[SOURCE: SUITLAND PAPERS]

7-16 INTERIM DIRECTIVE REGARDING ADVANCE TRANSFERS OF JAPANESE REPARATIONS

Telegram No. WAR 95604 April 4, 1947.
To: Gen. MacArthur
From: Joint Chiefs of Staff
Confidential

"The following Interim Directive, Serial Number 75, received from the State, War, and Navy Departments, issued under the provisions of paragraph III, 3, of the Terms of Reference of the Far Eastern Commission, is furnished for your guidance.

PART A

"1. The Supreme Commander for the Allied Powers should effect immediate delivery of assets within Japan in accordance with the provisions of the Directive, Serial Number 69, February 19, 1947, regarding the delivery of reparations goods in Japan, as advance payment on account of ultimate reparations shares providing:

a. That such assets fall within categories of Japanese facilities and equipment which have been properly declared as available for reparations transfer by the Far Eastern Commission and designated for removal by the Supreme Commander for the Allied Powers;

b. That such assets should be declared by the Supreme Commander for the Allied Powers to China, the Philippines, the Netherlands (for Netherlands East Indies) and the United Kingdom for Malaya, Burma and its colonial possessions in the Far East;

c. That such assets should be delivered to a recipient country only after it has supplied evidence acceptable to the Supreme Commander for the Allied Powers, or to some other agent or agency hereafter designated to evaluate and pass judgement on such evidence, that the

(1) Immediate and useful employment of such assets is practicable, and
(2) Employment of rehabilitated, repaired or reconstructed facilities can contribute, directly, to immediate relief and rehabilitation requirements of the war-devastated economy of the claimant country or, indirectly, to the relief needs of other parts of Asia devastated by Japanese armed forces;

d. That no country listed in subparagraph *b* should receive delivery of more than 5%, excepting China which may receive 15%, in quantity of value of any single category of assets available as determined in subparagraph *a* above, and authorized for transfer under the provisions of subparagraph *c* above.

e. That assets specified for delivery should represent in their total quantity or value, not more than 30% of any single category of available assets as determined in subparagraph *a* above.

"2. The Supreme Commander for the Allied Powers should designate for delivery on advance transfer account such a balanced selection of plants and facilities as will not represent disproportional reduction of value or quality of over-all residual industrial capacities available for later transfer as reparations.

"3. The Supreme Commander for the Allied Powers should maintain such records as necessary to enable offset for any such advance transfers to be made against ultimate fulfillment of approved and recognized over-all national reparations shares.

[SOURCE: *FRUS*, 1947, vol. VI., pp. 376-77]

7-17 POLICY REGARDING AVAILABILITY OF JAPANESE PLANTS AND EQUIPMENT FOR REPARATIONS REMOVAL

Memorandum July 25, 1947
To: ESS, REP[3]
From: Chief of Staff[4], SCAP

1. The following policy with reference to the availability of Japanese plants and equipment for reparations removal is effective immediately:

[3] Reparations Section, SCAP
[4] Maj. Gen. P.J. Mueller

a. ESS will report to the Supreme Commander the amounts of items available for release from the Japanese economy for reparations claim under criteria established by the Far Eastern Commission or under approved SCAP policy.

b. These units will be reported within prescribed FEC categories as soon as they become eligible for release. A complete list of items now available will be furnished immediately and subsequent lists will be forwarded as the category is "cleared" either upon instructions from the FEC or upon recommendations by the Overseas Consultants, Inc.

c. ESS will be responsible for carrying out the instructions of the Supreme Commander with reference to the retention within or removal from Japanese industry of complete or partial plants now engaged in authorized production. Complete plants to be excluded from reparations lists will not be submitted to Rep Section and where plants are partially engaged in production the lists submitted will appropriately identify the equipment not to be made available for reparations claim.

d. ESS will submit recommendations on reparations retentions or disposals within the scope of its assigned responsibilities.

e. Based upon the decisions of the Supreme Commander the Reparations Section will formulate and implement all plans and procedures in connection with the allocation of reparations items to the claiming powers. Unallocated reparations items will be held in custody of the Reparations Section once they have been designated for removal.

f. If readjustments are necessary between equipment units or plants on the Japanese retention list and on the reparations removal list, they will be accomplished by coordinated action of the Reparations Section and ESS. Such readjustments require the approval of the Chief of Staff in each case.

g. Other responsibilities of the Reparations and Economic and Scientific Sections with respect to reparations matters are outlined in Staff Memorandum No. 40, 8 May 1947.

[SOURCE: SUITLAND PAPERS, Z 703-1]

7-18 REPORT ON INDUSTRIAL REPARATIONS SURVEY OF JAPAN TO THE UNITED STATES OF AMERICA (SECOND STRIKE REPORT)

Report February 26, 1948 (transmittal date)
To: The Secretary, Department of the Army
From: Overseas Consultants, Inc.[5]

SUMMARY

We present hereunder in summarized from the results of our study, which are fully discussed in Sections A and B of this report.

SECTION A

The first part of our task, covered in Section A of this report, was to designate those plants and facilities which should be retained in Japan and those which should be made available for reparations in order to leave in Japan the capacities in certain industries which had been tentatively determined by the State, War, and Navy Coordinating Committee as necessary for a self-supporting economy. This involved a study of all facilities in such industries together with estimates of their capacities and values.

The following designations as to the facilities which should be retained and those which should be made available for reparations were made by us in strict accordance with the levels of capacity established by the controlling directives.

Details of the values and capacities for individual plants with discussion of the reasons for their designation for retention and for reparations are given in the references to the several industries included under Section A.

SECTION B

The second part of our task covered in Section B of this report was to give our opinion as to productive facilities which should be retained in Japan to permit her to achieve a self-supporting economy.

It is clear that there can be no adequate compensation to the claimant nations or adequate punishment of the Japanese for the untold suffering and loss of life and property caused by Japanese aggression during the past decade. In attempting to arrive at objective

[5] The Overseas Consultants, Inc. entered into a contract with the War Department on June 30, 1947 and spent more than six months preparing this report.

Industry	Unit	Annual Productive Capacity Designated		Value of Facilities Designated for Reparations (1939 yen)
		for Retention	for Reparations	
Pig Iron	Metric tons	2,000,000	1,600,000	
Steel Ingots	Metric tons	3,500,000	2,900,000	390,314,000
Steel Rolling	Metric tons	2,650,000	1,550,000	
Sulphuric Acid	Metric tons	3,510,675	1,245,075	25,201,000
Nitric Acid	Metric tons	30,295	106,945	9,648,000
Electrolytic Caustic Soda	Metric tons	82,500	46,300	22,632,000
Soda Ash	Metric tons	493,000	—	—
Synthetic Cil	Kilolitres	—	—	—
Synthetic Rubber	Metric tons	—	900	10,236,000
Machine Tool Manufacture	Number	10,000	26,970	145,695,000
Ball and Roller Bearing	Yen	32,500,000	59,318,000	24,537,000
Thermal Power in Grid Systems	Kilowatts	1,906,000	366,860*	7,851,000
Merchant Shipping	Gross tons	1,240,500	59,500	23,700,000
Shipbuilding	Gross tons	153,000	648,100	163,120,000
Ship Repair	Gross tons	4,526,490**	2,693,350	—
Petroleum Refining	Barrels	9,807,550	—	—
Petroleum Storage	Barrels	7,293,000	—	—
Aluminum Reduction	Metric tons	25,000	68,100	86,418,000
Aluminum Fabricating	Metric tons	—	110,000	66,180,000
Magnesium	Metric tons	—	680	14,501,000
Total				990,033,000
Primary War Facilities				1,475,887,000
Total				2,465,920,000

*Mainly generators without boilers.

**This amount is sufficient to service 3,017,000 g.t. per yr.

conclusions, we were not influenced by the thought that the immeasurable damage caused by Japan could or must be paid for in full or by sympathy or pity for the Japanese people.

We realize that the first requirement for waging modern warfare is a strong industrial economy. Even the ability to produce more food increases a nation's war-making potential. An industrialized Japan, therefore, unless carefully controlled, might become a strong military power. In our opinion, however, a strong industrial Japan would be less dangerous to the peace and prosperity of the Far East than a continuance of the present state of instability and economic maladjustment in this vast and populous region. Furthermore, Japan has few of the raw materials needed for war, especially since the loss of her colonies and conquests. She has been deprived of the ability to manufacture guns, tanks, warships, airplanes, and munitions and has no military organization. As long as effective control of these activities is maintained, the possibility of her waging war is removed. We recognize, of course, that controls may be temporary and that permanent peace can be assured only if the philosophy and ideals of the Japanese people can be reoriented along peaceful lines. The chance of such a change in philosophy will be improved if the Japanese are permitted a reasonable standard of living.

Not only has Japan lost her colonies and conquests in the Far East, but her home islands have suffered enormous damage. A substantial proportion of her industrial plants has been damaged or destroyed, and most of those remaining have deteriorated greatly and are badly in need of repair. Industrial production is now far less even than during 1930 to 1934. The tonnage of her merchant fleet has been reduced to less than one fourth of its prewar size. Many industrial communities have been devastated, invaluable fishing grounds and rights have been lost, and food, clothing, and shelter are in short supply. The present population, estimated at about 79 million, is larger than ever before and, due to repatriation and a high birth rate, is growing rapidly.

Japan has large resources of low-grade coal and water power but is lacking in most raw materials needed for her industries. All her requirements of raw cotton, of low volatile

coking coal for her steel plants, and most of her petroleum and iron ore needs must be imported. Her domestic food production for many years before the war had to be supplemented by imports in increasing volume, and there is every reason to believe that this condition will continue in the years to come.

Japan has virtually no raw materials to export. The market for one of her most important prewar exports—raw silk—has been drastically reduced due to the development of nylon and the improvement of rayon yarns. She has, however, an abundant supply of labor, and it is the fruit of this labor, over and above that needed for the internal economy of Japan, which must be exported to produce a balance between imports and exports; to achieve such balance, Japanese labor must have the tools with which to work.

The question of rehabilitation is difficult. Much industrial capacity was destroyed during the war. Some essential peacetime industries were deliberately denuded of equipment to provide war materials. Necessary maintenance was almost universally neglected. The Japanese people are industrious and resourceful, but they are inefficient when judged by American standards and their plants do not have a degree of mechanization comparable to modern American plants. In addition, Japan is faced with serious internal problems apart from those inherent in the rehabilitation of her plants and the re-establishment of her trade due to the sweeping changes that have necessarily been made in her financial, industrial, and commercial structures.

For the purposes of our study, it has been postulated that by 1953 productive efficiency will have reached its prewar levels, and we have selected 1953 as a "target year" upon which to base our estimates of the volume of domestic production and imports needed to support the growing population and make Japan self-supporting. This is not to be understood as a forecast that a self-supporting economy can be reached at that time.

In looking forward to the year 1953 when it is estimated Japan will have a population of 85,800,000 people, or about 30 per cent more than in 1930-1934, it must be remembered that Japan's arable land is limited to about 15 per cent of its total area and that non-farm population is expected to be 60 per cent higher than in 1930-1934. This great growth in non-agrarian population raises new and vital problems in the provision of food which will require a large and continuous increase in the production of goods for export.

In order to permit the Japanese people to reach even the 1930-1934 standard of living, it is estimated that imports in 1953 must be at least about 275,000,000 1939 dollars more than in 1937.

Japan is faced, not only with the problem of paying for these increased imports, but with the fact that her so-called invisible income from foreign sources will be drastically curtailed as compared to any recent prewar year. During the period 1930-1937, Japan had a seemingly unfavorable balance of trade which was compensated for by invisible income consisting of interest and dividends on foreign securities, profits from undertakings abroad and remuneration for services abroad, shipping receipts for foreign goods carried, insurance, tourists, etc.

This invisible income was partially offset by invisible outgo consisting of interest and dividends on Japanese securities held abroad, profit on foreign undertakings and services in Japan, shipping costs for Japanese goods carried in foreign ships, tourist travel abroad, etc. In 1936, invisible income exceeded invisible outgo by about 233,000,000 yen.

Japan will need larger imports and larger exports in 1953 than in 1937 so that at least as large a tonnage of merchant ships would be required as was required in 1937, but, under the most favorable circumstances, it would seem to be impossible for Japan to build up her merchant fleet by 1953 to more than about 1,900,000 gross tons, or about one third of the 1937 fleet. It is apparent, therefore, that the favorable balance of income from shipping which was 194,000,000 yen in 1936, would no longer exist; instead, an unfavorable balance of perhaps 300,000,000 1939 yen might be expected. We assumed that income from Japan's investments abroad will cease and that profit from undertakings and services abroad will be reduced substantially.

The expenditures for interest and dividends to foreign holders of Japanese securities in 1936 were roughly equal to interest requirements on the presently outstanding external debt and presumably will have to be continued in some form. On the other hand, expenditures by Japanese tourists would probably largely be eliminated and government expenditures abroad be reduced. The total reduction in invisible net income in 1953 as compared to 1936 might be around 500,000,000 1939 yen or about 140,000,000 1939 dollars.

As pointed out elsewhere herein, Japan will have to import for domestic use in 1953 food and other commodities to the value of about 275,000,000 1939 dollars in excess of the

1937 level. To pay for these goods and to overcome the invisible income deficit, it would be necessary to export goods with a net export value at 1939 levels of somewhere around 415,000,000 dollars more than in 1937.

We set forth below our opinion as to which facilities should be made available for reparations, together with their estimated capacities and values. These include primary war facilities and other facilities which we do not believe can be effectively used in Japan:

Industry	Unit	Capacity	Value (1939 yen)
Nitric Acid	Metric tons	107,000	9,648,000
Synthetic Rubber	Metric tons	900	10,236,000
Shipbuilding	Gross tons	385,000	118,138,000
Aluminum and Magnesium Fabricating	Metric tons	50,000	21,688,000
Magnesium Reduction	Metric tons	480	12,559,000
Subtotal			172,269,000
Primary War Facilities			1,475,887,000
Total			1,648,156,000

From our detailed studies of the so-called war-supporting industries (those industries other than primary war industries from which reparations are to be made available) and our general studies of other industry in Japan, we can foresee grave difficulties in the way of her becoming self-supporting. Japan has not enough capacity in steel and rayon to meet her 1953 domestic requirements plus requirements for exports at the 1937 level. Silk exports in 1953 probably will amount only to a small fraction of such exports in 1937. Power requirements in 1953 will far exceed present capacity. The only industries not recommended for reparations in Section B, which appear to have capacities for producing goods in excess of 1953 domestic requirements plus exports at the 1937 level are aluminum, ball and roller bearings, and sulphuric acid (by producing ammonium sulphate for fertilizer). Such excess products available for export over the 1937 levels probably would not have a value of more than around $100,000,000 at 1937 cost levels.

The gap between foreseeable exports over the 1937 levels and required imports above that level, plus loss of invisible income since that date, is big. Not only does Japan need more, rather than less, productive capacity than she now has if she is to have any chance of becoming self-supporting, but the removal of the facilities as contemplated in Section A of this report would hurt world production and thus world recovery. We estimate that if the facilities designated for reparations in Section A were removed, the buildings and nonremovable equipment remaining in Japan, which would be difficult to adapt to other purposes, would have a value over and above the removable items of more than 1,500,000,000 1939 yen. It is not possible accurately to estimate what proportion of this value could be salvaged and utilized by Japan for other purposes, but it would not be great. Our estimates indicate that the removal cost of the removable facilities would be about 1,400,000,000 1939 yen and that Japan might permanently lose the use of facilities having a value approximating 1,500,000,000 1939 yen. It is difficult to state the equivalent of these 1939 yen in present day U.S. dollars, but it might approximate $1,350,000,000. Actually, the total cost of removal and reinstallation would be substantially greater as the claimant nations in most cases would have to pay higher costs for labor and provide buildings, utilities, and accessory equipment. The questions naturally arise: How are these costs to be paid? Who is going to pay them?

By removal of these facilities, the long-term capacity to produce goods for world markets would not be increased and, for the next few years, the facilities could not produce goods vitally needed to reduce acute world shortages. To the extent that these facilities can be utilized by Japan for the production of peacetime goods, they should be put to work promptly to relieve world shortages, particularly the shortages existing in the claimant nations.

We realize that other Far Eastern countries are in need of industrial equipment, and the ultimate decision with respect to reparations should be based on a balancing of needs to obtain optimum benefits for the region as a whole. It is our opinion that this can be achieved most surely by leaving Japan free to reconstruct and use as quickly as possible the bulk of her industrial capacity.

By retaining these plants, Japan should be able to turn out industrial products, including new capital equipment, and exchange them for the food and raw materials she requires as fast as the other countries in the Far East will be able to make effective use of the equipment and produce the food and raw materials to exchange for it.

Conclusions

The problem of restoring the economy of Japan to a self-supporting basis, even at the relatively low standards of 1930-1934, is one of enormous difficulty. Under the most favorable circumstances, it will call for intelligent direction and hard work and, above all, for opportunity to produce a sufficient quantity of civilian goods for domestic consumption and for export in order to provide food and clothing for the rapidly increasing population. The Japanese people have proved themselves to be industrious, but to be productive, they need tools with which to work.

If uncertainties as to the ultimate disposition of their industrial plants were removed and incentives to capital to invest and to labor to produce were present, much might be accomplished. The settlement of the reparations question is urgent.

Removal of productive facilities (except primary war facilities) which can be effectively used in Japan would hurt world production; would reduce the likelihood of her becoming self-supporting, and in any case increase the time required to accomplish this objective; would be expensive to the American taxpayer; and, in our opinion, would not be to the best interests of the claimant nations.

Recommendation

In view of the foregoing, we recommend against the removal of productive facilities (except primary war facilities) which can be effectively used in Japan.

EXTRACT FROM SWNCC 236/43 REPARATIONS REMOVALS OF INDUSTRIAL FACILITIES AND MERCHANT SHIPPING FROM JAPAN

The following specific actions will be taken with respect to reparations removals of industrial facilities and merchant shipping from Japan.

All facilities of the nature indicated, or in excess of the stated capacity levels in the following specified industrial categories, will be made available for claim as reparations:

(1) *Iron and Steel Industry*

(Definition: "Plants and establishments primarily engaged in the production of pig iron or steel ingots or in the production of basic steel shapes, such as rails, rods, bars, tubes, plates, strips, sheets and structural shapes by rolling, drawing or extruding steel ingots.")

That portion of Japan's blast furnace capacity that is in excess of the capacity required to produce 2,000,000 metric tons metal per year, will be made available for claim.

That portion of Japan's capacity for the production of steel ingots that is in excess of the capacity required to produce 3,500,000 metric tons per year will be made available for claim.

That portion of Japan's capacity for the production of basic steel shapes that is in excess of the capacity required to produce 2,650,000 metric tons per year of balanced type basic steel shapes will be made available for claim.

(2) *Chemical Industry*

General

No facilities will be removed which are needed to produce chemicals necessary to achieve essential production of fertilizers in Japan. In so far as the foregoing is not contravened thereby reparations removals in the chemical industry will be accomplished as hereinafter prescribed.

Nitric Acid Industry

(Definition: "Plants and establishments primarily engaged in the production of nitric acid by the oxidation of ammonia.")

That portion of Japan's capacity for the production of nitric acid by the oxidation of ammonia that is in excess of the capacity required to produce 30,000 metric tons per year (as 100 per cent acid), will be made available for claim subject to the following limitation.

No synthetic ammonia capacity shall be included in the facilities made available for claim.

Sulphuric Acid Industry

(Definition: "Plants and establishments primarily engaged in the production of sulphuric acid.")

That portion of Japan's capacity for the production of sulphuric acid that is in excess of the capacity required to produce 3,500,000 (50° Baume) metric tons annually will be made available for claim. All facilities made available for claim will be of the contact type as distinguished from the lead chamber type but should not include any contact plants when they are serving as integral and essential functional units in other manufacturing plants not made available for claim.

Soda Ash, Caustic Soda, and Chlorine Industries

(Definition: "Plants and establishments engaged in (a) the production of soda ash, including integrated facilities for the conversion of soda ash to caustic soda, or (b) in the production of caustic soda and chlorine by the electrolytic process".)

That portion of Japan's capacity for the production of soda ash which is in excess of the capacity required to produce 500,000 metric tons per year, including integrated facilities in excess of those required to produce 200,000 metric tons of caustic soda from soda ash, will be made available for claim.

That portion of Japan's capacity for the production of caustic soda and chlorine in electrolytic plants which is in excess of the capacity required to produce 82,500 metric tons of caustic soda and 75,000 metric tons of chlorine per year will be made available for claim.

(3) *Machine Tool Industry, Ball and Roller Bearing Industry and Machine Tools*

Machine Tool Industry

(Definition: "Plants and establishments engaged in the production of non-portable, power-driven machines designed to shape metal by the progressive cutting away of stock in the form of chips or shavings or by abrasive action.")

That portion of Japan's capacity for the production of machine tools that is in excess of the capacity required to produce a balanced type-size aggregate of 10,000 machine tools per year will be made available for claim.

Ball and Roller Bearings Industry

(Definition: "Plants and establishments primarily engaged in the manufacture or assembly of complete ball and roller bearings or their major component parts; namely, balls, rollers, races, and cages.")

That portion of Japan's capacity for the production of ball, roller, and similar bearings that is in excess of that required to produce bearings to the value of 32,500,000 yen annually at 1943-1944 average prices will be made available for claim.

Machine Tools

(Definition: "Available stock in Japan of non-portable, power-driven machines designed to shape metal by the progressive cutting away of stock in the form of chips or shavings, or by abrasive action.")

That portion of Japan's inventory of machine tools that is in excess of a balanced type-size aggregate of 250,000 machine tools will be made available for claim.

(4) *Thermal Electric Power Industry*

(Definition: "Plants and establishments primarily engaged in the production of electric energy through the use of fuel as the basic energy source.")

All thermal power plants in excess of those required to produce an aggregate of 2,100,000 kilowatts will be made available for claim.

(5) *Steel Merchant Shipbuilding and Ship Repair*

(Definition: "Shipyards, including all facilities, plants and establishments located within their confines, primarily engaged in the building, repair or maintenance of steel ships over 100 gross tons.")

All shipbuilding and ship repair facilities in excess of those required to build 150,000 gross tons of new shipping annually and to service a merchant fleet of 3,000,000 gross tons will be made available for claim, subject to the following limitations.

All facilities for building vessels of over 3,000 light displacement tons each will be included in the facilities made available for claim.

Immovable installations, in yards made available for claim, will be destroyed, except for buildings usable for other purposes.

Two 20,000 ton drydocks will be retained for purposes of servicing world shipping touching at Japanese ports.

(6) *Petroleum Refining and Storage Facilities*

(Definition: "Plants and establishments for processing of crude petroleum and alcohol, (but excluding synthetic crudes derived from coal), including all streight run distillation plants and natural (casing-head) gasoline plants, thermal cracking units, vacuum distillation plants for the manufacture of ordinary and high grade lubricating oils, and iso-octane plants, including any isomerization, polymerization or alkylation equipment. All tankage, whether surface or underground, connected with tank farms or refineries, used primarily for storage of petroleum and petroleum products in bulk.")

All refining capacity in excess of that required to process 40,000 barrels of crude oil per day will be made available for claim.

All storage capacity in excess of 10,000,000 barrels will be made available for claim.

(7) *Aluminum and Magnesium*

(Definition: "Plants and establishments primarily engaged in the production of alumina, primary or secondary aluminum and magnesium and their alloys.")

All facilities in excess of 25,000 metric tons per year aluminum reducing capacity will be made available for claim.

(8) *Primary War Facilities*

(Definition: Primary War Facilities are defined as Army and Navy arsenals and privately owned plants and establishments primarily engaged in the development, manufacture, assembly, testing, repair, maintenance, or storage of combat equipment and-products and civil aircraft, and plants and establishments building merchant vessels of over 3,000 light displacement tons.)

Combat Equipment End-Products are defined as military end-products which may be identified as weapons, ammunition, missiles, explosives, chemical or bacteriological warfare agents, ultra-shortwave radio equipment (radar), naval combatant vessels, armored vehicles or aircraft including air frames and aircraft engines).

All plant and equipment in this category not subject to being destroyed or scrapped under existing policy will be made available for claim subject to the following limitations:

Those facilities, attached to primary war facilities, which have been engaged in the production of military supplies essentially similar in character to such consumer goods as textiles, clothing, processed foods, fertilizers, fuels, pharmaceuticals and related and dependent industries will remain in Japan, if in the judgment of SCAP they are needed to meet the peaceful needs of the Japanese people.

(9) *Merchant Shipping*

(Definition: "Cargo vessels, passenger-cargo vessels and tankers of more than 100 gross tons each, including both wooden and steel ships.")

Merchant ships in excess of an aggregate of 2,000,000 gross tons will be made available for claim, subject to the following limitations:

All vessels of more than 3,000 light displacement tons each or with a maximum speed in excess of 15 knots will be made available for claim.

(10) *Nickel Smelters*

(Definition: "Plants and establishments primarily engaged in the smelting of nickel from its ores.")

All nickel smelters will be made available for reparations claim.

(11) *Synthetic Rubber*

(Definition: "Plants and establishments primarily engaged in the production of synthetic rubber.")

All facilities in the synthetic rubber industry will be made available for claim.

(12) *Synthetic Oil*

(Definition: "Plants and establishments engaged in the manufacture of liquid fuels from coal, whether by high-pressure hydrogenation, the Fischer-Tropsch process, or low-temperature carbonization.")

All facilities of the synthetic oil industry will be made available for claim, subject to the following limitation:

Any machinery or equipment in such plants which is suitable for use in production of synthetic ammonia, and, which, in the judgment of SCAP should be transferred for use in production of synthetic ammonia for fertilizer manufacture will be exempted from claim.

General

Industrial facilities not specified for removal above, but which are made idle because of reparations removals prescribed herein, may be made available for reparations removals unless new essential uses for them can be found in Japan. Decisions as to availability of such facilities shall be made by SCAP and their ultimate disposition will be made in accordance with directives which prescribe the implementation of reparations removals.

[SOURCE: SUITLAND PAPERS, Z 721-7 AND 8]

7-19 COMMENTS PERTAINING TO OVERSEAS CONSULTANTS RECOMMENDATIONS RELATIVE TO INDUSTRIAL REPARATIONS FROM JAPAN

Memorandum March 18, 1948
To: Chief, Industrial Division, ESS
From: H. B. Overton, Chief, Raw Materials and Requirements Branch, Industrial Division

1. Subject comments are submitted as follows:
   a. *General:*
      (1) SWNNC 236/43 is considered to represent the U. S. compromise position at the time of adoption, not necessarily reflecting the desired or true position but influenced by acceptability to the FEC, previous commitments and the political and other considerations of the moment.
      (2) In order to make Japan a self-supporting nation at the earliest practicable date the approach, bases, and reasoning of the OCI Part B recommendations are considered to be logical and sound.
   b. *Iron and Steel*
      Part A
      (1) Conforming to SWNNC 236/43 the following capacity recommendations for retention in Japan were made:

	Annual Capacity
Pig Iron	2,000,000 M. T.
Steel Ingot	3,500,000 M. T.
Rolled Steel	2,650,000 M. T.

Generally accepted methods were used to estimate annual capacity of each type and size of productive facility; accordingly there is no difference of opinion as to determination of capacity as such. OCI, however, provided for theoretical capacities of 1.25 tons for each ton of pig iron allowed, 1.25 tons for each ton of open hearth steel ingot, and 2.0 tons for each ton of rolled steel products. Production history indicates that better results have actually been obtained and with wartime neglected maintenance restored to pre-war standards and a necessary amount of rehabilitation 90% of theoretical capacity could be reached, which would make available an additional 10% of capacity above OCI recommendations for reparations.

(2) With respect to plants selected, only two differences between OCI and SCAP selections are worthy of comment.
   (a) OCI recommends retention of the Hirohata, Hyogo Prefecture, plant of the Nippon Seitetsu (Japan Iron and Steel Company). This plant was installed between 1938-41, consisting largely of imported equipment, and at a location far removed from domestic raw materials for the sole purpose of making steel plates for shipbuilding. Under criteria established by FEC Directive No. 80, which OCI was not bound by, and which states first consideration to removals will be given to Zaibatsu holdings and foreign-made equipment consistent with achievement of a fair balance in modern and efficient design and working condition between retained and reparations facilities, this plant should be made available for reparations.
   (b) OCI also recommends removal of the Nippon Kokan (Japan Steel Tube Co.) plate and sheet mills at Tsurumi Kanagawa Prefecture. Such removal would leave no conveniently located plate mill to supply the industries of the Tokyo-Yokohama district and no rolling mill to supply steel sheets, the most critical steel product, to the entire area north of Osaka.

Part B

(1) Estimates of iron and steel requirements by 1953 appear consistent with estimates based on earlier years. Preceding surveys have been centered largely around 1950, assuming the Peace Treaty signed by that time and normal industrial expansion to be permitted according to population increase and economic factors.

(2) Considering the following bases to be reasonable and logical:
   (a) An anticipated population of 85,000,000 people.
   (b) A standard of living comparable to 1930–34.
   (c) Production for Far East demand in return for imports of necessary materials.
   (d) Contributing to over-all self-support and the doubtful value of plants and equipment to claimant nations—by virtue of the relative degree of obsolescence, accumulated maintenance and rehabilitation required, impracticability and expense of removal, lack of technical experience and auxiliary facilities of the claimants, and the opinion that the facilities can best be rehabilitated and utilized to better advantage in Japan for the interests of all concerned—no serious objection is expressed to the retention of all plants. Although recognizing extreme difficulty in the attainment of recommended production capacity by 1953, it is considered that industrial recovery would be facilitated by leaving the industry in toto.

(3) As mentioned in comments under Part A, OCI recommendations of capacity to meet requirements are considered to be a good ten percent on the liberal side.

LIGHT METALS

Aluminum—Part A

(1) OCI recommendations to retain the following capacities conform to SWNNC 236/43:

	Annual Capacity
Reduction	25,000 M. T.
Fabricating	None

(2) Capacities available for removal under the above authorized levels would conform to the balance of 68,100 M. T. reduction and a total of approximately 110,000 M. T. fabricating capacity as recommended by OCI, although an appreciable amount would be inadvisable to move.

(3) In providing the levels authorized by SWNNC 236/43 the following differences in plant selections to remain exist:

OCI	Immediately Available Capacity
Nippon Light Metals Co. Shimizu Plant (alumina)	* 36,000
Sumitomo Kagaku Niihama Plant (alumina)	36,000
	72,000 M. T.
Nippon Light Metals Co. Kambara Plant (aluminum)	** 27,000 M. T.
Nissin (Sumitomo) Kagaku Co. Niihama Plant (aluminum)	25,000 〃
	52,000 〃

* Discounts 42,000 M. T. capacity temporarily being used in the fertilizer industry readily convertible back to alumina production.

** Can be readily rehabilitated to original 36,000 M. T. capacity. All major electrical equipment still installed and in use. Only cell rebuilding required.

SCAP	Immediately Available Capacity
Nissin (Sumitomo) Kagaku Niihama Plant (alumina)	* 36,000 M. T.
Nissin (Sumitomo) Kagaku Niihama Plant (aluminum)	** 25,000 M. T.

* Capacity readily expandable to required 55,000 M. T.

** Expansion of capacity extremely limited but could be expanded to a theoretical capacity of 30,000 M. T. as recommended advisable by OCI to meet the 25,000 M. T. authorized.

Do not agree with OCI recommendations to remove partial plants (264 soderberg cells from Nippon Light Metals Kambara plant and 160 from Nissin Kagaku Niihama plant) if the limitation of 25,000 M. T. is to be strictly implemented. Expansion would be relatively easy of accomplishment. Accepting a liberal approach, however, no objection is expressed in line with subsequent comments.

Under stipulations of SWNNC 236/43 all primary aluminum fabricating capacity will be removed. No differences exist in plant designation.

Part B

(1) There is no objection to retaining the entire aluminum industry minus the 50,000 M. T. fabricating capacity to be made available for reparations as recommended by OCI. This industry can contribute materially to the self-sufficiency of Japan both in meeting increasing domestic metal requirements and by providing valuable exports needed and in demand in the Far East and world market.

(2) Agree with selections of four fabricating plants to be removed. The four selected were built primarily for war purposes and represent capacity in excess of needs.

Magnesium—Part A

(1) SWNCC 236/43 provides for removal of all magnesium facilities. The rated capacity available is 6,000 M. T., but is of doubtful value as reparations due to war damage and deterioration of equipment. Limited production in Japan was inefficient and expensive. Possibly 680 M. T. capacity could be moved.

Part B

(1) No objection is expressed to retention of the one plant that is in reasonably good condition as recommended by OCI for the purpose of alloying and casting. With rehabilitation the plant could provide approximately 1,000 M. T. annual capacity. Useable equipment in the remainder of the plants should be converted to other essential uses.

NICKEL SMELTERS

(1) The definition of nickel smelters, as stated in SWNCC 236/43, is "all plants and establishments primarily engaged in the smelting of nickel from its ores."

(2) Japan has no important deposits of nickel ores and refining of these ores has been largely experimental in copper smelters; therefore agree with OCI that no nickel smelting equipment is available for reparations.

SYNTHETIC OIL

Part A and B

(1) SWNCC 236/43 provides for removal of all synthetic oil plants except as in the opinion of SCAP should be retained for use in fertilizer manufacture. Due to war damage and deterioration the remaining plants are not considered practical of moving and would be of little value to claimants or to Japan for the purpose of producing synthetic oil. The low temperature carbonization units, the first phase of producing synthetic oil and consisting largely of coke ovens (impractical to move) can be used to good advantage in the economy with a more abundant coal supply to produce coalite (semi-coke), coal tar and by-products. Certain portions of the synthesizing equipment can be and should be converted to fertilizer and other production.

(2) By virtue of the condition of the equipment, the impracticality of removal, valueless to claimants except for possible experimental or research purposes, and importance to the Japanese economy, concur in OCI recommendation to retain the plants in Japan with one exception—Toho Kagaku Kogyo (Toho Chemical Industries Co.), a combination refinery and synthetic oil plant and in good condition is considered part of the 2nd Naval Fuel Depot, Nagoya Branch, and as arsenal property. As such this plant should be made available for reparations under definition of primary war facilities.

Petroleum Refining and Storage Facilities-Parts A and B

(1) Agree with refinery capacity as stated by OCI and relative inefficiency and poor condition. Available capacity comes within SWNCC 236/43 limitation of 40,000 barrels per day and none should be removed for reparations.

(2) SWNCC 236/43 limits storage capacity to 10,000,000 barrels. Above ground storage as stated by OCI consiting of steel tankage in units of 50,000 barrels or more in condition to move and re-install amounts to 7,293,000. Best available estimates indicate an additional three to four million barrels of small size and relatively poor condition not considered by OCI. Reported underground storage (concrete construction, mostly steel lined) amounts to 11,381,650 barrels. This tankage was constructed primarily for war purposes and for the most part not conveniently located for domestic use. Agree with OCI recommendation to retain above ground storage in view of the proximity to SWNCC 236/43 position. Strategic underground tankage should probably be destroyed; OCI made no recommendation in this respect.

(3) Agree with the need for a modern geophysical survey of Japan which is presently under consideration by SCAP. Known deposits of oil offer only hopeful estimates of 2,000,000 barrels annually. Also agree that one or two modern refineries could process efficiently the indigenous production of crude oil. Question the advisability of scrapping or converting the existing plants as suggested by OCI except to a certain extent and the export of domestic crude for refining elsewhere. Recommend retention of the plants, some scrapping and conversion, and allowing economic considerations to decide the question of imported refined products vs. imported crude oil, similarly with respect to indigenous production.

[SOURCE: SUITLAND PAPERS, Z 703-1]

7-20 REPORT ON THE ECONOMIC POSITION AND PROSPECTS OF JAPAN AND KOREA: MEASURES REQUIRED TO IMPROVE THEM (JOHNSTON REPORT)

Report (Summary) April 26, 1948
To: Department of the Army
From: Committee[6] Invited by the Secretary of the Army to Inquire Into Economic Problems of Japan and Korea
Chairman: Percy H. Johnston

PERCY H. JOHNSTON, CHAIRMAN
PAUL G. HOFFMAN
ROBERT F. LOREE
SIDNEY H. SCHEUER

TABLE OF CONTENTS

Summary
General Analysis of the Situation in Japan
Raw Materials and Foreign Trade
Reparations
Position and Prospects of Foreign Investment
Budget and Foreign Trade Policy
Concluding Comments
Brief Notes on the Economic Situation in Korea

SUMMARY

In Japan General MacArthur, Supreme Commander for the Allied Powers, is administering the occupation of the four main islands which have a population of nearly 80,000,000.

The Committee has been greatly impressed with the complete demilitarization of Japan and with the progress made in developing representative government in that formerly feudalistic country. A thoroughly democratic constitution has been adopted and an elected Diet, or Parliament, is actively functioning. Unlike the situation in Germany and Korea, Japan is not cut up in separate zones of occupation, and a Japanese Government is actively dealing with the daily problems of its people. The Japanese people themselves seem to be fully cooperating with the occupation authorities. These are outstanding achievements.

Although two and one-half years have passed since the surrender, no treaty of peace has yet been signed. The United States has been paying the military costs of occupation and in addition, under its international law obligation as occupying power to prevent disease and unrest, has been furnishing food and other relief supplies to keep the Japanese people alive. These relief costs run to nearly $ 400,000,000 a year. In our opinion the United States must now face squarely the problem of assisting the Japanese people to become self-supporting.

Japan has been shorn of its empire and no longer has under its control resources of food and raw materials which formerly contributed to its prosperity. It has been expelled from China, Manchuria, Korea and Formosa, southern Sakhalin, the Kurile, Marshall and Marianna groups of islands. It grows only 80 per cent of its minimum food requirements. Its population is increasing a million a year. It must produce and export industrial products in large volume to live. It is short of natural resources and raw materials.

The Committee believes that the United States should now assist the recovery of Japan.

[6] This committee is sometimes referred to as the "Draper Mission" after Under-Secretary of the Army William Draper, who accompanied the Mission to Japan. The report was released to the public by the Department of the Army on May 19, 1948.

Japan's industrial products are needed throughout the Far East, whose countries also need Japan as a market for their potential exportable production—their tin, rubber, copra, wool, cotton, iron ore, bauxite, sugar and rice. Japanese industry is operating at a very low level—less than 45 per cent of the 1930-1934 average. Shortage of needed raw materials is a major reason. However, despite the upheaval of war and defeat and the changing social outlook, the traditional will to work of the Japanese people themselves is still in evidence. Food production and coal production have been rising, although both are still far below minimum needs. Food collections are better than at any time since the occupation—in fact rice collections reached 100 per cent of this year's quota while the Committee was in Japan.

The reparations issue has not been settled. The Japanese do not yet know which plants and which equipment will be left to them, so, within industries thought to be subject to reparations, incentive to restore and reconstruct is suppressed. Plants which are needed in bringing about the recovery of Japan should be retained and only excess capacity removed. Otherwise the United States, which is now extending relief to Japan, would in reality be paying the reparations bill. In our opinion, the capacity that can be spared without affecting Japan's useful peacetime productivity is not great. It is most important that the present uncertainty be removed and the reparation issue be finally settled.

Japanese exports have been growing and reached $173,000,000 last year. Most of these exports, however, were made possible only by a special scheme of American assistance—particularly in cotton manufacture. A beginning has been made, nothing more. Total exports will have to increase to eight to nine times present levels to provide payment for the imported food and raw materials needed to sustain a reasonable standard of life in Japan. In our opinion, it should be possible to accomplish this if tranquility is restored throughout the Far East, if present restrictions on Japanese trade and travel are lessened, and if help is given to import raw materials and get production going. An eventual shift in Japanese food and other imports from the dollar area to the sterling and Far Eastern areas, with compensation in Japanese industrial exports, is essential to any permanent Far Eastern recovery.

The Japanese merchant marine has been reduced by war losses to 20 per cent of its prewar size. Most of the larger ocean-going Japanese ships have been lost with the bulk of the remaining fleet consisting of small coastal and fishing vessels. Payment to non-Japanese shipping of present-day inflated freights on essential imports is a large factor in Japan's foreign trade deficit. We believe that Japan should be encouraged to increase its merchant shipping both by new building and by bareboat chartering of available vessels.

Principal among Japan's internal problems is the inflationary spiral resulting from the extreme scarcity of raw materials and consumer goods, the constant upward pressure of wages and other costs, and the heavy budgetary deficit. The internal cost of the occupation adds to this problem. Until this inflation problem can be solved by greater production, increased tax revenues, and more rigid control of governmental expenditures, the establishment of a stable foreign exchange rate, and even of a stable internal economy, can hardly be achieved. Here again, the importation of greater amounts of raw materials and the resulting increased production will assist in a solution.

Drastic and continuing efforts by the Japanese themselves are necessary to balance the national budget. Self-help and self-sacrifice in clarifying and controlling internal price and wage relationships, in reducing national expenditures and increasing tax revenues, in expanding domestic production of food, coal and products from other Japanese resources, are essential to proper use of any American assistance and, of course, to economic recovery itself. The Japanese people will have to work hard and long, with comparatively little recompense for many years to come, in order to survive and support their growing population.

In conclusion the Committee agrees with General MacArthur and the Department of the Army that industrial recovery of Japan on a peaceful basis is necessary to bring about a self-supporting economy: that this program has now properly become a primary objective of the occupation; and that the American Government in the national interest should support a reasonable recovery program.

In Korea the problem is complicated by the artificial division of the country into two zones of military occupation. The Koreans are eager for the independence to which our Government is committed. It has been impossible so far to hold elections throughout all Korea, but an election is soon to be held in the South Korean (American) zone, under the auspices of the United Nations. After the election and the establishment of a representative government it is proposed under the United Nations resolution to work out arrangements for the withdrawal of occupation troops.

Korean food production is improving and South Korea should eventually be able to supply its own food requirements if fertilizer requirements can be met. Other problems, however, are most acute. Lack of raw materials is greater even than in Japan. South Korea is dependent on North Korea for most of its electric power supply. The Korean railroads would stop if coal supplied by our occupation authorities in Japan were cut off. The industries which Japan developed during 40 years of Japanese control are operating at only about 20 per cent of capacity. South Korea is short of raw materials, and equally short of management and technical supervision formerly supplied by the Japanese. As in Japan, the United States has been supplying food, fertilizer, and petroleum products to keep the economy from collapse and to prevent widespread disease and unrest.

Here again the Committee believes, with General Hodge, our Military Commander, that reasonable assistance should be given to finance importation of raw materials necessary to increase production of agricultural and industrial goods. An interim aid program, not limited solely to relief, should give a new Korean Government, when it is formed under the supervision of the United Nations, the needed help to establish the stable economic conditions so necessary to encouraging the development of free democratic government.

Finally, our Committee has examined the proposed recovery program prepared by the Department of the Army and supported by the State Department. The program would provide a total of $220,000,000 for a twelve month period for raw materials and other recovery items for Japan, Korea, and the Ryukyu Islands. We believe such a recovery program essential in order to reduce and eventually eliminate spending in these areas for relief.

As an occupying power we have accepted a flag responsibility. We believe the United States can discharge this responsibility better, and end it earlier, by concentrating on economic recovery and by gradually reducing relief. Our Committee therefore recommends approval and execution by our Government of the suggested recovery program at the earliest possible date.

[SOURCE: SUITLAND PAPERS, Z 721-9]

7-21 CONCERNING THE "REPORT ON INDUSTRIAL REPARATIONS SURVEY OF JAPAN TO THE UNITED STATES OF AMERICA" BY THE OVERSEAS CONSULTANTS, INC.

Memorandum, R. B. No. 41 (GS) May 10, 1948
To: SCAP
From: K. Funada, Director-General Reparations Board, Japanese Government

The Report on Industrial Reparations Survey of Japan to the United States of America by the Overseas Consultants, Inc. (hereafter referred to as Report) has been carefully studied by the Japanese Government.

Needless to say, the Japanese Government and people are anxious to see the question of reparations settled once and for all at the earliest possible date. We appreciate the action of the General Headquarters toward that end in arranging the visit of such a distinguished group of investigators for conducting a spot survey concerning industrial reparations. The results of the labors of the Overseas Consultants, as embodied in the Report, are most gratifying in that they provide a fair and accurate appraisal of the conditions and needs of Japan. Especially the recommendation contained in Section B, which calls for reduction of reparations removals, has given us, we are glad to say, both encouragement and assurance for the future in our endeavors to achieve self-sufficiency.

However, here and there in the Report we note what appears to be misapprehension of the facts, leading to conclusions, which would impose some restrictions on Japanese economy to permit it a satisfactory operation to an early recovery. We therefore venture to submit as per enclosures[7] our observations and explanations with respect to certain aspects of our industry together with the wishes of the government for the consideration of the Allied authorities concerned.

[SOURCE: SUITLAND PAPERS, Z 703-1]

[7] Omitted. Five enclosures concerned nitric acid, petroleum refining, Aluminum and Magnesium Industry, Merchant Shipping and Shipbuilding Industry, and Primary War Facilities.

7-22 CONCERNING LETTER FROM REPARATIONS BOARD, JAPANESE GOVERNMENT, COMMENTING ON OCI REPORT

Memorandum (draft) May 26, 1948
To: Chief, ESS
From: W. S. Vaughan, Chief, Industry Division

1. Reference letter from Reparations Board, Japanese Government, to GHQ, SCAP, dated 10 May 48, subject: Concerning the "Report on Industrial Reparations Survey of Japan to the United States of America" by the Overeas Consultants, Inc., and the letter from Kobe Steel Works, Ltd., to the Chief, ESS, dated 19 May 48, subject: Strike Report Pertaining to Light Metal Alloy Fabricating Plants for Reparations, both of which letters are returned herewith.

2. These two papers are the attempt of the Japanese Government to further reduce reparation removals even beyond the obviously very liberal treatment given by Section B of the OCI report.

3. Briefs of the comments pertaining to individual categories are given below:

a. *Nitric Acid*—The OCI plan for retention of only 30,000 MT capacity in Japan is entirely inadequate. This inadequacy results in part from the OCI belief, definitely impractical, that ammonium nitrate explosives should be imported, and in part from upward revision of estimates of future nitric acid requirements made necessary by policy changes and technical developments since the time of the OCI investigation.

The OCI estimates of nitric acid production are based on a 365 working day year and this report states the actual operation of Japanese plants are approximately 280 working days. This discrepancy makes a large difference in plants available for reparations removals.

b. *Petroleum Refining*—Subject observations and explanation in reference letter from Reparations Board, Japanese Government, represent the usual plea for retention of all refinery capacity and for processing of imported crude oil as against the rather drastic recommendations of OCI to convert or scrap existing refinery equipment, export indigenous crude for refining in Netherlands East Indies and import all finished products.

An explanation is given of the inefficiency of Japanese refineries and why they should be retained in Japan. It is pointed out that indigenous crude production is expected to reach 339,000 KL by 1953 which will leave no surplus capacity in the oil producing areas. The quality of Japanese crude is very poor and therefore there would be little return for the amount exported.

The OCI proposal for scrapping of Pacific Coast refineries is countered by the argument that there is a shortage of import funds and that crude is much cheaper than finished products would be.

c. *Aluminum and Magnesium Industries*—The plea in the reference letter from the Reparations Board, Japanese Government, is for the retention of the four Aluminum Fabricating Plants designated by the OCI for removal as reparations.

The plea is based on the fact that an aluminum reduction capacity of 82,500 tons is to be retained, and for this capacity they state they will need over 200,000 tons of fabricating capacity. The estimate of fabricating capacity of all 49 plants in Japan is only 100,000 tons so that if all the plants are allowed to remain, they will still be short by 100,000 tons. They request retention of all plants now in operation.

d. *Merchant Shipping and Shipbuilding Industry*—The request is for the retention of 655,000 gross tons of new construction and 7,200,000 gross tons of repair capacity.

The request is broken down as follows:

(1) Construction Capacity	
Cargo and Passenger	480,000 GT
Construction for Export	100,000 GT
Steel Fishing Boats	60,000 GT
Msc. (Tugs, Ferries, Dredgers)	15,000 GT
Total	655,000 GT
(2) Repair Capacity	
Cargo and Passenger	6,000,000 GT
Fishing Boats and Msc.	1,200,000 GT
Total	7,200,000 GT

The total capacity of all shipyards in Japan is less than the requirements under (1) and (2) above, and it is requested that no ship repairing facilities be taken for reparations.

A further plea is based on the production by these shipyards of machinery to be used on land, such as Electrical Machinery, Chemical Machinery and Coal Mining Machinery.

e. *Primary War Facilities*—OCI list 192 aircraft plants (SCAP has 299 in custody) and 116 privately owned munitions plants (SCAP has 176 in custody) as available for reparations. The Reparations Board states that the removal of these is considered inevitable as war potential, but they request that equipment currently authorized for use (they estimate 20 to 25% of the 150,000 machines) be allowed to remain in Japan. Exemption is also requested for equipment of the Yokkaichi Naval Fuel Depot (an arsenal) making fertilizer, and arsenal equipment repairing railway cars.

[SOURCE: SUITLAND PAPERS, Z 703-1]

7-23 CONCERNING THE "REPORT ON INDUSTRIAL REPARATIONS SURVEY OF JAPAN TO THE UNITED STATES OF AMERICA", BY THE OVERSEAS CONSULTANTS, INC.

Memorandum R. S. No. 49 (GS) May 31, 1948
To: SCAP
From: H. Shimazu, Deputy Director-General, Reparations Board

1. Reference is made to the RB Note No. 41 (G S), dated 10 May 1948, subject, same as above.

2. We wish to add one more enclosure to the reference note, as attached hereto. This enclosure deals with the references made in the Report effecting a restriction to the speed and size of the future Japanese merchant shipping. As this problem is vital to the seabound Japan, it is requested that a most favourable consideration be given to the matter.

[ENCLOSURE NO. 6]

Merchant Shipping

In Section A of the Report, under the terms of SWNCC 236/43, as amended on 9 September 1947, to the effect that "all vessels of more than 6,000 gross tons each, except fishing vessels and whaling vessels, which have speed in excess of 15 knots shall be made available for claim", eight vessels total tonnage 59,552 gross tons, are recommended for reparations. However, in Section B of the Report, it is recommended that "no existing merchant ships be made available for claim" in view of the necessity that Japan should build up her merchant fleet to a minimum aggregate tonnage of 4,000,000, as a vital step in the re-establishment of a balanced economy, as "Japan is a maritime nation which depends for her existence on water transportation and foreign trade". It is also recommended that "The present fleet already is far short of immediate requirements. Where necessary, speed of ships over 6,000 gross tons can be limited to less than 15 knots in turbine-propelled ships by removing boiler units, and in diesel-propelled vessels by removing cylinder units", and that "Japan be permitted to make up as far as possible the present deficiency of her merchant fleet by charter or purchase of ships".

We are most grateful to this recommendation in that it greatly cuts down the reparations removal as stated in Section A of the Report. In this connection, however, we wonder if the Japanese merchant fleet would be able to survive economically in the international competition with its vessels of under 6,000 gross tons and under 15-knots speed.

Therefore, we are most grateful if you would be good enough to take into considerations the development of events which has been achieved for the past years as stated hereunder and modify the limitations on the speed and size of the Japanese merchant vessels.

a) As Japan has already renounced war in her new Constitution, her merchant fleet will not be a war potential in whatever sense at all.

b) In the management aspects of the Japanese shipping industry, it is entirely freed from any ZAIBATSU (financial cliques) or monopolistic domination in accordance with the SCAP memoranda, and the working conditions of Japanese mariners has been improved by the new "Mariners' Law" as far as to surpass the level assured by international conventions.

Accordingly, as Japanese merchant shipping industry has entirely been democratized as stated above, it will not menace the peace of the world.

[SOURCE: SUITLAND PAPERS, Z 703-1]

7-24 PROPOSED ACTION BY STATE DEPARTMENT ON INTERIM REPARATIONS PROGRAM

Letter (SWNCC-236/2/D) December 18, 1948
To: Dean Acheson, Acting Secretary of State
From: Edwin W. Pauley

Dear Mr. Secretary:

At the suggestion of the President I am transmitting to you my interim report to him on Japanese Reparations, and conveying to you his request that my recommendations as thus stated be referred to the State-War-Navy Coordinating Committee for consideration and whatever action is called for by the Committee and by the Departments concerned.

As my report indicates, there is, in my judgment, need for immediate action by our Government to adopt an interim reparations program for Japan. This program should then be put forward by the State Department for international agreement, and the basis laid for dealing with the long-range reparations program.

Though the bulk of my technical staff is still in Tokyo completing their analysis of the Japanese economy as a basis for my final report on Japanese Reparations, I and the members of my staff who have returned to Washington with me are, of course, at your disposal to explain or supplement the material dealt with so briefly in my report to the President.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

8 ECONOMIC CONTROLS AND PLANNING

8-1 DIRECTIVE NO. 3—BASIC INDUSTRIAL CONTROLS

Directive No. 3 September 22, 1945
SCAPIN-47

1. *General.* The Japanese Imperial Government is hereby directed to comply, or to insure the compliance as the case may be, with the requirements of the Supreme Commander for the Allied Powers stated in this directive.

2. *Economic Controls.*

a. You are responsible for initiating and maintaining a firm control over wages and prices of essential commodities.

b. You are responsible for initiating and maintaining a strict rationing program for essential commodities in short supply, to insure that such commodities are equitably distributed.

c. You will report to the Supreme Commander all details of existing economic control machinery and procedures covering the objectives outlined in paragraphs "a" and "b" above, within ten days after the receipt of this directive. You will include data on wage schedules and ration allowances of essential commodities in short supply. You will include a statement as to the manner in which such economic control measures are operating and the reasons for inadequacies, if any.

3. *Production.*

a. You will stimulate and encourage the immediate maximum production of all essential consumers commodities, including industrial, agricultural, and fisheries products, and commodities necessary to the production of such essential consumers goods. Priority in allocation of materials, fuel, equipment, and labor will be given to the production of commodities necessary to the feeding, clothing, and housing of the population.

b. Where conversion is considered necessary, of plants heretofore engaged in the production of items prohibited by paragraph 4, below, to the production of essential consumers commodities, you will submit individual application for such conversion of each plant concerned.

4. *Prohibited Items.* No production will be permitted of the following types of items:

a. Arms, ammunition, or implements of war. Applications will be presented for the use or manufacture of such industrial explosives as may be deemed necessary, accompanied by complete supporting data as to its essentiality and methods by which their distribution and use will be controlled.

b. Parts, components or ingredients especially designed or produced for incorporation into arms, ammunition, or implements of war.

c. Combat naval vessels.

d. All types of aircraft, including those designed for civilian use.

e. Parts, components, and materials especially designed or produced for incorporation into aircraft of any type.

5. You will preserve and maintain in good condition for inspection and such disposition as may be directed by this Headquarters all plants, equipment, patents, and other property, and all books, records, and documents of Japanese Imperial Government or private industrial companies and trade and research associations which have manufactured any of the items listed in paragraph 4 of this directive or any of the following items;

a. Iron and steel
b. Chemicals
c. Non-ferrous materials
d. Aluminum
e. Magnesium
f. Synthetic rubber
g. Synthetic oil

h. Machine tools
i. Radio and electrical equipment
j. Automotive vehicles
k. Merchant ships
l. Heavy machinery and important parts thereof and of any companies, associations or cartels which contributed to the Japanese war effort or were essential to the Japanese economy.

6. *Inventory and Records Required.* You will as rapidly as possible submit to this Headquarters an inventory of significant plants producing or intending to produce products in the industries listed in paragraphs 4 and 5 of this directive. This inventory will include detailed reports specifying condition and equipment and capacity of plants, and the extent of the stocks of fuel, raw materials, finished goods, and goods in process available.

7. *Imports and Exports.* No imports to, or exports from, Japan of any goods, wares or merchandise will be permitted, except with the prior approval of this Headquarters.

8. a. You will submit a report of all laboratories, research institutes, and similar scientific and technological organizations, which will include the following information:
(1) Name
(2) Location
(3) Ownership
(4) Description of facilities
(5) Number of employees
(6) Detailed list of all projects by agency that are currently being studied by these agencies and projects studied since 1940

b. You will direct such agencies to be open for inspection by duly authorized Allied representatives at all times.

c. You will direct such agencies to render a report as of the first day of each month to this Headquarters through your office stating in detail the projects on which their facilities and personnel have been engaged during the preceding month and the results of such work.

d. You will prohibit all research or development work which has as its object effecting mass separation of Uranium 235 from Uranium, or effecting mass separation of any other radio-actively unstable elements.

9. All reports required in this directive will be submitted typewritten in English, on white paper—size 8 1/2 by 11 inches, in five copies.

8-2 CONTROL OF INFLATION IN JAPAN

Report: R & A No. 2451[1] October 1, 1945
Prepared by: State Department,
Interim Research and Intelligence Service,
Research and Analysis Branch

TABLE OF CONTENTS

Summary[1]
I. Introduction: The Problem of Inflation in Occupied Areas
A. The Nature of Inflation
B. Causes of Inflation
1. Factors Causing Shortages
2. Factors Increasing Purchasing Power
3. Factors Disrupting Distribution
4. Summary: The Problem of Excess Purchasing Power
C. Results of Inflation
D. Techniques of Inflation Control
1. Price Control and Rationing
2. Control of Public Expenditures
3. Control of the Expenditures of the Occupying Forces
4. Credit Control
5. Wage Control

[1] Only the Table of Contents and Summary are printed here.

6. Taxation and Savings
II. Estimate of the Inflation Situation in Japan
A. Developments up to the Present
B. Present Situation
1. Estimate of Present Prices
2. Government Deficit
3. Bank Credit
4. Financing the Government Deficit by Savings
5. National Income Planning
6. Results of Savings Programs
7. Direct Controls
C. Inflation Problems During Military Occupation of Japan
1. Pent-up Purchasing Power
2. Current Inflation
D. Probable Effects of a Substantial Inflation in Japan
1. Possible Price Levels
2. Economic Effects
3. Effects on Particular Groups
a. Farmers
b. The Zaibatsu
c. Professional Classes
d. Industrial Labor
e. Small Business and Industry
Appendix: The Process of Inflation in Japan, 1931–1945.

Summary

Inflation is a condition in which prices rise generally and substantially as a result of demands for goods and services in excess of quantities available. The present inflation in Japan started in 1937, after Japan had made a remarkable recovery from the world depression, reaching virtually full employment of her productive capacity. During the China War Period, July 1937 to December 1941, prices in Japan rose rapidly at first, the rise being checked in the summer of 1940 when price control and rationing reached a point of considerable effectiveness.

The Japanese attack on Pearl Harbor in December 1941 found Japan's economic controls, including inflation control, incomplete but sufficiently effective to keep the rise in the price level, as indicated by published statistics, very moderate indeed during 1942 and 1943. During these two years the total increase in cost of living was 14 per cent and in Tokyo retail prices, 11 percent. During 1944 the price rise accelerated, and by November Tokyo retail prices had risen an additional 17 percent. By the end of 1944 Japan was no longer fighting the "Greater East Asia War" but was attempting to defend her home islands. As the war went progressively against Japan, control over inflation declined in effectiveness, and it is estimated that by the time of Japanese surrender in August 1945 actual prices in Japan, as contrasted with official prices, may have been as high as five times their July 1937 level.

The basic cause of inflation in Japan is the unbalanced budget of the national government. Deficits have existed during most of the years of modern government in Japan, but since 1937 these deficits have grown continuously and rapidly. Since 1941 the rate of increase of government deficits has been roughly 50 percent a year. National debt rose correspondingly, reaching a figure estimated at 125 billion yen in June 1945. Deficits have been financed mostly by means of inflationary expansions of bank credit. Bank credit has been expanded not only for the purchase of government securities but also for production and other private purposes, all largely inflationary in that the increases in bank credit outstanding have not been accompanied by increases in goods and services available for purchase.

All the inflationary pressures in Japan accelerated after the start of devastating air raids in March 1945. Government expenses leaped upward, especially because of payments such as war insurance and relief. Tax receipts and savings declined and rationing and price controls deteriorated with the disruption of normal procedures. If prices in Japan at the time of surrender were correctly estimated at some five times their July 1937 level, then inflation in Japan was still moderate. Such a level of prices is far from what would exist in a runaway inflation. With runaway inflation, prices run to hundreds, thousands, millions or more times their normal levels.

Savings campaigns have been a major instrument of inflation control in Japan and have

been so highly organized as to appear virtually compulsory. Savings are put into government bonds to a considerable extent, but the emphasis on individual purchases of war bonds has been less in Japan than in the United States. In Japan there are various forms of bank deposits which cannot normally be withdrawn on demand, and public policy has approved depositing savings in such accounts as well as purchasing bonds.

Savings goals have been set each year by the Ministry of Finance on the basis of estimated national income. The purpose of savings programs has apparently been the removal from the hands of the public of all purchasing power in excess of that necessary to maintain civilian consumption at the planned level and to pay taxes. Each year's savings goal has been set at a figure equivalent to the total of the estimated government deficit and planned private industrial investment. Goals have been met, but it appears that excess purchasing power has remained in the hands of the Japanese public. This excess purchasing power probably arises from the fact that national income was substantially larger than estimated by the Ministry of Finance at the beginning of each fiscal year. As a result of this excess purchasing power Japan has experienced growing inflation while the published savings statistics suggested that inflation control was achieving complete success.

Direct controls used by the Japanese have included controls over prices, investment, wages, production, and distribution. These direct controls worked reasonably well from the middle of 1940 until about the end of 1943. By that time the effectiveness of direct controls began to decline.

With occupation Japan faces serious inflationary forces of two types. Pent-up purchasing power is the more immediate and consists of all the money, demand deposits, and other liquid claims belonging to all Japanese individuals and organizations. The total of these claims exceeds by many fold the total current value of all goods and services available in Japan. Attempts to spend soon any considerable portion of these claims could lead only to correspondingly large further increases in prices.

The second type of inflationary force in Japan during occupation is the excess of purchasing power currently made available over the value of goods and services currently produced or imported. This inflationary force will be great for some time and corresponds to that which brought about such inflation as has already taken place in Japan. The largest of all government expenditures will disappear with disarmament. On the other hand, large expenditures, both private and public, for reconstruction, reconversion, and relief may be expected. In any case, government revenues will fall as the war boom disappears. The net effect might be an increase rather than a decrease in the size of the government deficit. Moreover, government deficits may be expected to grow as inflation progresses. Destruction has already substantially reduced the productivity and taxpaying power of the Japanese economy. In addition there will be large outlays by the occupying forces, including expenditures by individual troops. These will be wholly inflationary except as the Allies may bring supplies into Japan. These will be inflationary to the extent that outlays exceed goods and services arising therefrom, and it may be some time before such expenditures result in actual production.

The prospect, therefore, is for substantial continued inflation in Japan. The results of such inflation would be extensions of results which have probably already been felt in Japan. As prices rise, all fixed money claims decrease in value. Government salaries, public utility prices, and taxes may be expected to rise much less rapidly than other prices. On the other hand, food and clothing prices may rise more rapidly than others. Government employees will suffer as their real income shrinks. If inflation goes very far there may be a problem of corruption of the Japanese bureaucracy and a loss of whatever support this group might otherwise have given to Allied aims. Other professional classes will be hurt to the extent that their incomes lag behind prices. Industrial labor will be struggling against unemployment. The farmers, on the other hand, will probably do comparatively well in inflation. The degree of their prosperity depending upon their status as landowners or tenants. The position of small business men may be more favorable than that of the average Japanese during the occupation period. Inflation would give them inventory profits to add to whatever else might be made in a situation in which large-scale production will be limited and transportation difficult at best. Conversely, the *Zaibatsu* may suffer as a result of limitations on large-scale industry, and their losses from bombs and fires may be represented by insurance claims shrinking in value with rising prices.

8-3 CONTROL OF FOOD AND AGRICULTURE IN JAPAN (SWNCC 98/1)

Report October 11, 1945
SWNCC 98/1[2]

THE PROBLEM

1. To determine the policy of the United States with respect to food supply in Japan with particular relation to agricultural production.

FACTS BEARING ON THE PROBLEM

2. See Appendix "A". (Not Printed)

DISCUSSION

3. See Appendix "B". (Not Printed)

CONCLUSIONS

4. It is conluded that:

a. The responsibility with respect to formulating and executing food and agriculture programs should be placed on the appropriate Japanese authorities subject to the approval of the Supreme Commander.

b. Production of food crops should be maximized. However, tea and mulberry plantations should not be converted to food crops except for those areas whose trees or bushes are over age or for other reasons non-producing, and except for those areas which would be especially productive for food.

c. Supplies of fertilizers should be made available, particularly for this winter's crops. Night soil is an important source of fertilizer and its use should be continued. Surveys should be instituted of facilities and raw materials available for the production of fertilizer in Japan. The importation of fertilizer and of essential spare parts and raw materials for fertilizer plants is authorized to the extent required to meet deficiencies in local supply. Imports should be procured as far as possible from sources in proximity to Japan.

d. The production of farm tools and implements in short supply should be encouraged.

e. To the extent practicable, stock from the army remount depots should be distributed to areas most dependent on animal power.

f. Steps should be taken to insure an equitable distribution of farm produce. Such measures should include price control, rationing, control of black markets and such other measures as are directed toward full employment of resources, including labor. Attention should be given to the production and sale of such incentive goods as are in demand by food producers and can be produced locally.

g. The production of synthetic vitamins should be encouraged to supplement the probable inadequacies of diet during 1945–46, especially for the ill and for children and expectant and nursing mothers.

RECOMMENDATIONS

5. It is recommended that:

a. This report be forwarded to the Joint Chiefs of Staff for comment from the military point of view;

b. Upon the approval by the State-War-Navy Coordinating Committee of the conclusions in paragraph 4 above:

(1) this paper be transmitted to the Joint Chiefs of Staff and to the State, War and Navy Departments for their guidance, and where appropriate for implementation;

(2) the "Conclusions" in paragraph 4 above be communicated by the Department of State to the Governments of the United Kingdom, the Soviet Union, China, France, the Commonwealth of the Philippines, Australia, Canada, New Zealand and the Netherlands;

(3) after having communicated with our Allies according to subparagraph (2) above, the Department of State, at its discretion, release the "Conclusions" to the press, and

(4) this report be classified "Restricted" until such time as it is released according to paragraph 5 *b* (3) above.

[SOURCE: *FRUS*, 1945, vol. VI, pp. 748–49]

[2] Approved by SWNCC on November 5, 1945.

8-4 BOGDAN'S INSPECTION TRIP ON FINANCIAL PROBLEMS

Report: On Trip through 6th Army Area — January 6, 1946
To: W. F. Marquat, Chief ESS SCAP
From: Norbert A. Bogdan, Financial Adviser

I. Mission:

To study financial problems, with particular reference to:
a. repatriation,
b. banking conditions,
c. war profits tax and capital levy,
d. release of blocked funds for industrial reconversion
e. inflationary trends

II. Information Obtained

1. JAPANESE REACTIONS TO OCCUPATION PROGRAM.

a. The prestige of General MacARTHUR's name goes far beyond that attached to the Supreme Commander. It is one of personal trust.

b. In the area visited there was no evidence of hostility or sullenness. Such violations of directives or regulations as occur from time to time are due more to inefficiency and incomprehension than deliberate non-compliance. It is clear that in many instances the Japanese are incapable of understanding our requirements and standards. Japanese officials appear particularly sensitive lest their inability to live up to some of our standards be construed as dishonesty.

c. Public reaction to the various phases of our occupation program is one of general indifference, the vast majority of the people being of course completely absorbed in the daily struggle for food, fuel and shelter. There is as yet little visible interest in the great political issues of the day.

d. Evidence of deep religious feeling is absent. The recent SCAP directive on Shinto does not appear to have caused much reaction. Most people refer to Shinto as a ritual and a tradition rather than a religion.

e. There is general acceptance of government announcements, mainly because people realize that major policies are directed and controlled by SCAP rather than the government. Thus, the imminent change of government which everybody expects, does not seem to affect the validity of policy announcements made by the present government.

f. Educated Japanese express these specific thoughts as to the occupation:

(1) Too much emphasis is placed on the sad lot of the farmer, most of whom are in reality doing extremely well right now, particularly the tenant farmers (See Paragraph 5 of this section).

(2) Not enough has been done as yet to reorganize education. Food and education are considered to be the two key problems in Japan. Most intelligent Japanese I have met seemed keenly aware of the role education is to play in developing a sense of responsibility in the individual, so completely lacking in the past.

(3) There is little confidence in Japanese doctors as a professional group, most of the doctors being considered mercenary. Much can be done by the American occupation authorities to change conditions in the medical and public health field with wide-spread and deep social results.

(4) The average man in the street distrusts the Japanese police. Therefore the Japanese would welcome more direct participation by American troops in police duties.

(5) Thoughtful and liberal Japanese deplored the lack of action on our part in removing Japanese from top positions in government service, Zaibatsu industry and finance. (Note: The inadequacy of the top men in most of the enterprises visited, and the comparative adequacy of men in second and third line positions, was found very striking!). Many people feel that both government and private enterprises, in Tokyo as well as in the provinces, are over-staffed and that one man now holding a secondary position could easily assume a top position and at the same time permit the removal of two or three others down the line.

g. There seems to be increasing uneasiness among Japanese as to the number of reports required from subordinates regional authorities. There is obviously a limit to what these people can turn out, in view of past training and inadequate communications. One thing that should be avoided is the requirement that reports from regional authorities be made out in English. No facilities exist for such translations out in the provinces; most of this work will have to be consolidated and translated here in Tokyo.

h. Public reaction to our pension directive was one of consternation. Few directives issued by this Headquarters appear to have had a deeper effect on the average person.

2. BANKING AND CURRENCY PROBLEMS. (deleted)

[Source: Suitland Papers, Z 703-40]

8-5 DISPOSITION OF EQUIPMENT AND SUPPLIES OF THE JAPANESE ARMED FORCES (SCAPIN-582)

Memorandum — January 11, 1946
SCAPIN-582 (GD)

1. Evidence has come to the attention of this Headquarters indicating that a large scale attempt to dispose of the supplies and equipment of the Japanese Armed Forces was made between the dates of 14 August 1945 and 2 September 1945. Actions such as the above are not considered to fall within the spirit of the Potsdam Declaration.

2. You will therefore furnish this Headquarters the following information:

a. A complete list of all equipment, supplies and materials of the Japanese Armed Forces which in any way were transferred from possession of the Japanese Armed Forces between the dates of 14 August 1945 and 2 September 1945. Information will also be included to show the location of the supplies and equipment at the time of transfer, their present location if known and the persons of agencies receiving them.

b. A complete file of English translations of all orders concerning disposition of property of the Japanese Armed Forces which were issued between the dates of 14 August 1945 and 2 September 1945 inclusive.

c. A list of the names of the officials of the Imperial Japanese Government or any agencies thereof who were responsible for the promulgation of the orders mentioned in paragraph 2b above.

3. A preliminary report will be forwarded to this Headquarters within 10 days from the date of receipt of this directive. A final complete report will be submitted on or before 10 February 1946.

8-6 FOOD SITUATION IN JAPAN

Letter — February, 1946[3]
To: Mr. D. Fitzgerald, Director, Office of Requirement and Allocations, Dept. of Agriculture
From: Donald D. Kennedy, Chief, International Resources Division

My dear Mr. Fitzgerald:

Data relating to Japanese food requirements in general and the State Department's analysis of these data have been examined by representatives of the Departments of State, War, and Agriculture. There is general agreement that the food situation in Japan will be extremely serious in the spring and summer. More specifically, there is agreement that the State Department's estimate of 800 calories per day from indigenous resources for non-farm population during the crop year 1945–1946 is not unreasonable. The range of error, however, might be plus or minus 200 calories, which is somewhat greater than the error in estimates for western European countries. There is less certainty about the estimates of the rate of current consumption on the basis of which the State Department estimates, and the Army agrees that sometime in April indigenous supplies for non-farm population will be largely exhausted. However, there is complete agreement that the daily indigenous availability for urban consumers will dwindle during the coming months.

The Department of Agriculture believes that the exact date on which a drastic cut in rations will be necessary cannot be established sufficiently clearly from available data for final allocation purposes. All participants agreed that we can and should get more exact information. Conditions in the theatre, however, may postpone the receipt of such information for three

[3] The copy of this letter is undated.

weeks. Representatives of the Department of Agriculture feel that a better estimate can be made of the date of exhaustion of indigenous stocks available for rationing, and of the absolute minimum needs if the theatre furnishes up to date estimates on stocks, probably four months collections of indigenous supplies and quantities required to maintain ration levels. The State, and War Departments have agreed to expedite such a request. In the meantime, the Cabinet must consider the consequences indicated for the occupied areas if the present programming continues unchanged.

The Department of State, on the basis of its review of the data and its discussions with the Departments of War and Agriculture, feels that its analyses are sufficiently reliable to portray the seriousness of the situation and to serve as a basis for general policy determination. It recommends that of whatever amount the Cabinet tentatively decides can go to Japan in the next four months (a total which will be unavoidably small and well below the most conservatively estimated requirements), a proportionate share be scheduled for shipment in March. This would be without prejudice to adjustments agreed to on the basis of more complete data.

Donald D. Kennedy

8-7 ECONOMIC STABILIZATION BOARD

Memorandum March 26, 1946
To: Commander Hussey, GS
From: C. H. Peake, Public Administration Division, Government Section

1. On 18 March the C.L.O. submitted to the ESS and the Government Section copies of revised ordinances to establish an Economic Stabilization Board.

2. The revised provisions while an improvement over the first drafts failed to carry out all the proposals set forth in the meeting with the Japanese on 14 March. I was present at two meetings held by ESS to agree upon and draw up a version to be resubmitted to the Japanese.

3. The second meeting with the Japanese was held today. Representing the Japanese was Mr. Asakai from C.L.O. and Mr. Hashii, a Cabinet Councillor. ESS representatives were Captain Egekvist, Mr. Roberts, Mr. Liebert, Mr. Aherns and Mr. Bogdan. The revised draft was read and explained to the Japanese and a chart of the proposed set-up shown to them. These documents were not handed to them but they were permitted to make notes from them.

4. The major principles which we emphasized that the Board must observe are:

a. That it is an emergency board to be dissolved when commodities are in freer supply.

b. That it possess full policy-making powers with respect to fixing prices and relating them to wages and determining allocations of raw and semi-processed materials in short supply.

c. That the Director-General have the power to coordinate all policies and through the Prime Minister to order them to be executed by competent ministers, except in the case of price control which the Board itself will execute in order to overcome inter-ministerial conflicts which would hamper the coordination and execution of programs.

d. That the character of the Board as a public agency be established by appointing to it personnel broadly representative of the segments of the economy involved, as well as economic specialists drawn from outside the regular civil service. That this personnel hold not only advisory positions but also leading policy-making positions within the board itself.

5. The Japanese said that another revision of the ordinances would be made and submitted to us before promulgation. They appeared to understand all that was said and seemed to be in complete agreement. We are hopeful, therefore, that the next draft will be adequate.

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

8-8 FOOD CRISIS IN JAPAN

Letter, No. 337 March 28, 1946
To: The Secretary of State
From: Max W. Bishop, Office of the United States Political Adviser, GHQ, SCAP
Confidential

Sir:

I have the honor to enclose a copy[4] of a brief, informal memorandum prepared by Mr. Charles J. Shohan, Department of State member of the Special food mission from Washington, on the basis of his studies of the food situation throughout Japan. His formal report to the Department will, of course, be far more detailed and will be submitted perhaps before this despatch is received. It is believed pertinent, however, to emphasize the serious political implications of the food crisis in Japan. In full cognizance of the world-wide shortage of food and of the inappropriateness of an attempt by an officer with restricted knowledge in the field to assess relative merit of food needs, no recommendations are offered.

A famine in Japan of two or more months duration would in all probability result in widespread civil disturbance; would seriously retard achievement of the purposes of the occupation; would accelerate and expand movements to destroy capitalism and to embrace communism as a nostrum to solve political, economic, and social difficulties; and, with probable failure of Government, might do irreparable harm to the prestige of a democratic form as contrasted with totalitarian forms of control of society. Famine or threat of famine has been the one condition in Japan which has inevitably brought about disorder and flagrant disregard of authority.

In assessing the significance of the food crisis in Japan, due consideration should be given to these political factors.

Max W. Bishop
Foreign Service Officer

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

8-9 THE JAPANESE TEXTILE INDUSTRY (MISSION REPORT)

Report March 31, 1946
To: The War Department and the Department of State
By: The Textile Mission to Japan (January—March 1946)
Fred Taylor, Chairman

Contents

LETTER OF TRANSMITTAL
SUMMARY
I. JAPAN'S TEXTILE CAPACITY (deleted)
A. Cotton Textiles
B. Rayon
C. Woolens and Worsteds
D. Silk
E. Other Clothing Fibers
F. Stock Position
II. OPERATIONAL PROBLEMS OF THE JAPANESE (deleted) TEXTILE INDUSTRY
A. Machinery
B. Mill Stores and Supplies
C. Labor
D. Power and Fuel
E. Transportation and Warehousing

LETTER OF TRANSMITTAL

31 March 1946

General of the Army DOUGLAS MACARTHUR
Supreme Commander, Allied Powers Tokyo, Japan

DEAR GENERAL:

I am enclosing the report of the Textile Mission to Japan sponsored by the State and War Departments. It is my understanding that this report will be submitted to the two Departments through your office.

As you know, the Mission was established in December 1945, to conduct, as outlined in

[4] Not printed.

the Mission's directive from the Secretary of State, a complete and careful appraisal of the Japanese textile industry and of its ability to produce textile products in 1946 and 1947, with particular reference to its ability to make available cotton textile products for export over and above the requirements for domestic consumption in Japan. In view of the serious world shortage of cotton textile products as indicated by the reports of the Combined Production and Resources Board, the State Department is also concerned to know what steps might be taken by this Government, in association with the other governments engaged in dealing with Japan, to assist in maximizing the exports of cotton textiles from Japan over this short-run period of world shortage, with particular reference to her need for imports of raw materials, supplies, and repair parts, not only for the cotton textile industry, but also for other textile industries such as rayon whose production may be used to meet domestic needs, thus releasing cotton for export.

The Mission's personnel consisted of five representatives of the United States Government and four observers from China, India, and the United Kingdom, as follows:

United States

Harry L. Bailey, retired, formerly Chairman of the Board, Wellington-Sears Company
H. Wickliffe Rose, American Viscose Company
Frank E. Rowe, Riverside and Dan River Cotton Mills, Inc.
Stanley Nehmer, Acting Chief, Japanese Industrial Resources Section, Department of State (Executive Secretary)
Fred Taylor, Agricultural Commissioner, Department of State (Chairman)

China

S. Z. Yang, Counsellor, The Weaving and Spinning Company of China
Andrew Young, formerly Director, Social Affairs Bureau, Tsingtao

India

Bharat Ram, Managing Director, Delhi Cloth and General Mills, Ltd.

United Kingdom

Frank S. Winterbottom, British Member, Combined Textile Committee, Washington, D.C.

The Mission has been in Japan since 21 January 1946, during which time it has traveled extensively throughout the country, visiting approximately 85 textile plants of all types and in various conditions of operation. In addition, the Mission has had numerous conferences with members of the Japan Textile Association, with various personnel of the Japanese Government, and with officials of textile concerns. The Mission requested considerable information from the Japanese and has not found any evidence of information being deliberately withheld.

The Mission would not have been able to cover as much ground as it has without the excellent cooperation of the Economic and Scientific Section. The various members of the Section's staff who deal with Japanese textiles have worked closely with members of the Mission at all times. The members of the Mission would like particularly to extend their personal thanks to them. The Mission is impressed by the need for the development of the Research and Statistical Division of the Section as a central office for collecting and analyzing Japanese statistical data on the textile industry.

It is hoped that this report will be of value to the Supreme Commander, Allied Powers, and to the Economic and Scientific Section as well as to the State and War Departments in Washington as a survey of the capabilities of the Japanese textile industry through 1947 and as a basis for the foundation of policy beyond that date.

FOR THE TEXTILE MISSION:
FRED TAYLOR,
Chairman

SUMMARY

1. The installed spindleage of the Japanese cotton textile industry in February 1946 was 2,150,000 of which 1,115,000 were operable. It is estimated that by the return of stored equipment and repair of damaged machinery, this installed spindleage will increase by January 1947 to 3,285,000 of which an estimated 2,990,000 will be operable. Beyond this date an additional 235,000 spindles may be added through further repairs. The recent raw cotton import program of USCC-CCC-War Department is based on this current capacity. The Mission is satisfied that the maximum output in 1946 from workable spindles is sufficient to take care of the 225,000 short tons of cotton to be imported. The Mission believes it is unable to present a realistic appraisal of the 1947 position until its estimates of production in 1946 from installed and operable spindles are proven. The Mission assumes a continuation of shipments of cotton during 1947 including sufficient supplies to build up a workable stock equal to at least two months' consumption. By the end of November 144 million pounds of yarn are estimated to be produced for the export part of the USCC-CCC-War Department agreement. This should produce in 1946, in addition to 900,000 pounds of knit goods and 30 million pounds of yarn, approximately 350 million square yards of cloth.

2. Japan's current potential productive capacity of rayon is 354 million pounds annually of which 306 million pounds represents machinery in place. Of the present potential capacity 120 million pounds represents rayon yarn and 234 million pounds rayon staple. The present shortages of raw materials have reduced the output of the industry to about 13 million pounds a year. The rayon yarn capacity of 120 million pounds is about equal to Japan's average domestic consumption during the years 1933–38 and if produced and absorbed in the future could release substantial amounts of raw silk. The 234 million pounds of rayon staple would represent more than the total capacity of spindles available for processing. About 118 million pounds is the maximum which could be spun on all existing worsted, woolen, and silk spindles, together with those cotton spindles in the hands of the rayon companies. Beyond these 118 million pounds, there would be a possibility of export of rayon staple; on the basis of pre-war markets the United States, China and Mexico might offer a potential.

3. The reliability of estimates of reconversion and production in the woolen and worsted industry in 1946 is more uncertain than in the case of cotton. Woolen and worsted manufacturers have estimated that they could produce about 25 million pounds of woolen yarn and 35 million pounds of worsted yarn in the next 12 months if raw materials are made available. No import program has as yet been set up and the rate of consumption of the present stocks of raw wool and substitute fibers has yet to be determined. The mixture cloths made from the materials at present available in Japan are unlikely to be of use for export since 100 percent wool and worsted cloths form the bulk of such demand. The modern tendency in the United States and the United Kingdom is to develop wool and rayon staple mixture cloths. The Mission is of the opinion that any wool-import program be carefully considered along with that for other fibers.

4. In the Mission's survey of Japan's stocks of clothing raw materials, yarn, and cloth, incomplete reports show that as of the end of February, Japan had stocks of 575 million square yards of cloth, and raw materials and yarn sufficient to produce an additional 425 million square yards of cloth. The availability of a part of these stocks for export will depend upon an estimation of Japan's clothing requirements which the Mission suggests should be based upon a survey of the actual clothing being worn by the Japanese today. The Mission has not found direct evidence of undue clothing shortage in comparison with other countries.

5. Japan's four major textile-machinery manufacturers, who account for approximately 75–85 percent of new machinery production, have the capacity to increase Japan's spindleage and loomage in 1946 by 290,000 and 11,300 respectively. In 1947 they will be able to produce over 785,000 spindles and 16,800 looms. The peacetime reconversion of Japan's textile manufacturers is complicated by the problems of reparations and removal of Japan's war potential.

6. A problem facing the Japanese textile industry is the availability of labor. The present shortage is due directly to the shortage of the food which the mills make available to their workers under the Japanese Government's daily rice ration. Most of the mill workers, who are girls, prefer to remain in rural areas where food is plentiful. Mill owners have been forced to depend upon the black market to secure additional food for their workers.

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8-10 AN ECONOMIC PROGRAM FOR JAPAN (BOGDAN REPORT)

Report (draft) May 3, 1946
To: W. F. Marquat, Chief, ESS, SCAP
Prepared by: Norbert A. Bogdan and Frank M. Tamagna (ESS)

1. Attached is draft of a study outlining an economic program for Japan, as directed in your memorandum 20 March 1946.

2. We are keenly aware of the inadequacy of this study. The lack of reliable statistics, the complexity and variety of the issues involved, and the controversial nature of some of the problems under discussion call for far more research than it has been possible to undertake within the time and with the technical assistance at our disposal. The present study is, therefore,

nothing but a blueprint which it is hoped can be used as a basis for further research and which will stimulate sufficient interest and further thinking so as to develop into agreed policy in the near future.

3. The cooperation extended by the various Divisions of ESS has been splendid. Coordination with other Staff Sections has had to be effected on a strictly informal basis and they, too, have been most cooperative and helpful. Special tribute is due to the Mining, Forestry and Fisheries Divisions of the Natural Resources Section for their wholehearted support.

4. All chapters have been gone over by, and carefully checked with, the Divisions of ESS or Staff Sections having primary jurisdiction over the matters discussed therein, the only exception being the Chapter on Agriculture which was read by Major Leonard and his staff and approved as to general conclusions but not checked as to facts and figures owing to their pre-occupation with other problems at this time.

5. It is important to bear in mind that a general population census is being undertaken at this time the results of which will not become known until the end of May or beginning of June. In the event of such results proving substantially different from the assumptions made in this paper revision of a great many figures used therein will be necessary.

6. For this reason, and also because it is felt that the entire paper should first be coordinated through formal channels with all Staff Sections and Divisions involved, it is thought inadvisable to proceed with the preparation of charts at this time although it would have been eminently desirable to be able to illustrate the conclusions in graphic form.

7. It is hoped that you, Colonel Ryder and Dr. Fine will be able to go over the enclosed draft in the near future so as to give the undersigned the benefit of your reaction and to advise whether or not the general approach meets with your complete approval. Once you have given your reaction it is suggested that the following procedure be adopted:

a. Prepare the paper in mimeograph form.
b. Circulate it among all interested Staff Sections and Divisions with request for comments and suggestions.
c. Submit it to Mr. Edward Martin of the State Department who is expected to arrive, probably not later than the 15th of May, in order to obtain his views.
d. Request his assistant, who is expected to stay here for three months, to undertake such additional research as may be necessary, together with the Statistics and Research Division.
e. When such additional research is completed, have the Statistics and Research Division prepare charts and other graphic illustrations, to the extent desired.
f. Prepare paper in final form as an agreed SCAP proposal for submission to Washington authorities.

NORBERT A. BOGDAN
FRANK M. TAMAGNA

CONTENTS

SUMMARY		—	
CHAPTER	I	—	INTRODUCTION (deleted)
—	II	—	POPULATION (deleted)
—	III	—	AGRICULTURE (deleted)
—	IV	—	FISHERIES (deleted)
—	V	—	FORESTRY (deleted)
—	VI	—	MINING (deleted)
—	VII	—	INDUSTRY (deleted)
—	VIII	—	TRANSPORTATION (deleted)
—	IX	—	FOREIGN TRADE AND BALANCE OF PAYMENTS (deleted)
—	X	—	EMPLOYMENT (deleted)
—	XI	—	FINANCE (deleted)
—	XII	—	GOVERNMENT CONTROL OF THE ECONOMY (deleted)
—	XIII	—	CONCLUSION

SUMMARY

1. This paper proposes a blue-print for the peace-time economic structure of Japan. The view is held and expressed with increasing emphasis by responsible Japanese officials and economists that the reconstruction of Japan should rest on the maintenance of a large engineering and heavy machinery industry as the key element in the entire economy. It is furthermore contended in Japanese circles that Japan should be allowed to participate in the industrialization of China and other neighboring countries through the export of heavy machinery. Such views run counter to the basic postulate of Japan's demilitarization and the rejected in this paper. The conclusion of this study is that contemplated security limitations, as summarized in Appendix II, do not constitute a serious impediment to the development and maintenance of reasonably high levels of industrial, activity, employment and foreign trade balance and that nothing should be done to promote undue dependence by industry outside Japan on Japanese replacement, technical skill or engineering data.

2. Prohibition of production of aluminum and magnesium, and limitations on output and imports of pig iron and steel as well as on imports of salt, are the basic controlling factors to which most of the important manufacturing industries in Japan will have to adjust their capacities and production. In order to be lastingly effective, these limitations must, however, be combined with a system of strict and continuous Allied control over imports, exports and foreign exchange transactions—a control system which should be specific in restricting trade in strategic products and flexible in allowing adjustments in trading in peace-time goods. Another vital function of such over-all control is to prevent the accumulation of stocks of restricted materials in Japan.

3. There follows a summary of the basic elements in the proposed economic structure for Japan:

a. Production of essential food crops can be increased appreciably through maximum use of fertilizer, land reclamation, reform of tenancy system, and improvement of production techniques; but even optimistic estimates of such increases show that aggregate domestic production of foodstuffs will be insufficient to feed an increasing population. Consequently, food imports will continue to be necessary.

b. Production in many other lines can be expanded substantially, in some cases even above pre-war levels, without prejudice to Allied security interests, both for domestic requirements and for export.

c. While it will be difficult, and probably impossible, to have an appreciably higher percentage of the working population absorbed by agriculture, the industrial structure as contemplated should provide a reasonably high level of employment.

d. Textiles will continue to be the main export item and is the most important single factor in the industrial employment picture.

e. Given normal world demand for such products as Japan is able to produce, the deficit in the balance of trade should not be considerable and may be eliminated altogether through maximum exports of gold and encouragement of remittance and tourist traffic.

f. The pressure of inflationary trends will continue for some time to come but can be held in check, and eventually stabilized, through coordinated measures.

g. On the basis of allowed capacity in basic industries, Japan can develop an aggregate national product to a level equal to or higher than that of the mid-thirties. There will be, however, a shift in the composition of the national income, with contraction in manufacturing industries and expansion in the chemical industry and in agricultural activities.

4. To accomplish these goals the *Japanese Government* should:

a. make the new Economic Stabilization Board the top central authority for all allocation and economic planning;

b. bend every effort toward immediate and continuous increase in production, especially of foodstuffs, coal and fertilizers as well as consumers goods;

c. require the immediate reporting of all stockpiles of merchandise and raw materials throughout the country;

d. arrange for the exportation of all stockpiles for which there is world demand and which are not immediately needed for vital domestic needs. In particular, textiles, scrap, and certain special steels could be exported without delay;

e. dispose of problem of war indemnities and compensation for reparations without delay along the lines suggested in this paper and accomplish prompt dissolution of Zaibatsu combines without effecting production in operating subsidiaries;

f. dissolve industrial Control Associations and reduce government control over distribution except as necessary to:

(1) assure fair distribution of staple foods
(2) control prices of scarce and basically essential articles
(3) allocate scarce raw materials

g. proceed with a reform of the banking system with a view to mobilizing sources of credit for productive purposes and restoring financial solvency;

h. confine public expenditures to direct productive purposes and exercise strictest economy in administrative expenditures;

i. promote peaceful labor relations, through prompt and fair consideration of reasonable labor demands, encouragement of responsible unions, introduction of a modern social insurance system, etc.

5. Earliest and clearest possible definition of the extent of SCAP's responsibility toward the Japanese economy is urgently called for so as to facilitate the concentration of available SCAP manpower on the truly vital objectives and control devices of the occupation. In some fields, SCAP will have direct and positive responsibility; in others SCAP may encourage, advise or assist, provided, however, this is not interpreted by the Japanese as involving any responsibility on the part of SCAP. Finally, there are areas of the economy to which SCAP will remain completely indifferent. The delineation of these respective areas is a matter of high priority.

6. It is suggested that consistency and effectiveness of Allied occupation policy in the economic field can be assured through the adoption of the following measures by SCAP;

a. Earliest possible announcement of agreed extent, mode and type of reparations removals, demilitarization measures and other production controls as well as specific designation of those fields where production is to be encouraged.

b. Establishment of an Economic Policy Committee or Directorate within SCAP, comprising representatives of Industry, Labor, Finance, Price Control Divisions and Natural Resources Section.

c. Appointment of a SCAP observer to the Economic Stabilization Board, *not* to *direct* allocation policies but to *observe,* advise and currently *report* to SCAP.

d. Earliest possible establishment of a nation-wide statistical reporting system within the jurisdiction of the Japanese Government covering every phase of production, distribution, consumption, finance, etc.; establishment of such a reporting system to be directed by, organized with the technical assistance of, and currently supervised by, SCAP.

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XIII Conclusion

1. *Summary*

a. In the preceding chapters a blue-print for the peacetime economic structure of Japan has been indicated. Japanese officials and economists contend that the reconstruction of Japan should rest on the maintenance of a large engineering and heavy machinery industry as the key element in the entire economy. It is furthermore proposed in Japanese circles that Japan should be allowed to participate in the industrialization of China and other neighboring countries through the export of heavy machinery. Such views run counter to the basic postulate of Japan's demilitarization and are rejected. The conclusion of this study is that contemplated security limitations, as summarized in Appendix II, do not constitute a serious impediment to the development and maintenance of reasonably high levels of industrial activity, employment and foreign trade balance and that nothing should be done to promote undue dependence by industry outside Japan on Japanese replacement, technical skill or engineering data. Related to the latter consideration is the problem of whether or not Japanese technicians or labor skilled in industry, shipping or engineering should be allowed employment outside Japan. In view of its broad political and economic implications it is a decision for consideration by the joint Allied Governments.

b. Prohibition of production of aluminum and magnesium, and limitations on output and imports of pig iron and steel as well as on imports of salt, are the basic controlling factors to which most of the important manufacturing industries in Japan will have to adjust their capacity and production. In order to be lastingly effective, these limitations must, however, be combined with a system of strict and continuous Allied control over imports, exports and foreign exchange transactions—a control system which should be specific in restricting trade in strategic products and flexible in allowing adjustments in trading in peace-time goods. Another vital function of such over-all control is to prevent the accumulation of stocks of restricted materials in Japan.

c. There follows a summary of the basic elements in the proposed economic structure for Japan:

(1) Production of essential food crops can be increased appreciably through maximum use of fertilizer, land reclamation, reform of tenancy system, and improvement of production techniques; but even optimistic estimates of such increases show that aggregate domestic production of foodstuffs will be insufficient to feed an increasing population. Consequently, food imports will continue to be necessary.

(2) Production in many other lines can be expanded substantially, in some cases even above pre-war levels, without prejudice to Allied security interests, both for domestic requirements and for export.

(3) While it will be difficult, and probably impossible, to have an appreciably higher percentage of the working population absorbed by agriculture, the industrial structure as contemplated should provide a reasonably high level of employment.

(4) Textiles will continue to be the main export item and is the most important single factor in the industrial employment picture.

(5) Given normal world demand for such products as Japan is able to produce, the deficit in the balance of trade should not be considerable and may be eliminated altogether through maximum exports of gold and encouragement of remittance and tourist traffic.

(6) The pressure of inflationary trends will continue for some time to come but can be held in check, and eventually stabilized, through coordinated measures.

(7) On the basis of allowed capacity in basic industries, Japan can develop an aggregate national product to a level equal to or higher than that of the mid-thirties. There will be, however, a shift in the composition of the national income, with contraction in manufacturing industries and expansion in the chemical industry and in agricultural activities.

2. *Actions Required*

To accomplish these goals the *Japanese Government* should:

(a) make the new Economic Stabilization Board the top central authority for all allocation and economic planning;

(b) bend every effort toward immediate and continuous increase in production, especially of foodstuffs, coal and fertilizers as well as consumers goods;

(c) require the immediate reporting of all stockpiles of merchandise and raw materials throughout the country;

(d) arrange for the exportation of all stockpiles for which there is world demand and which are not immediately needed for vital domestic needs. In particular, textiles, scrap, and certain special steels could be exported without delay;

(e) dispose of problem of war indemnities and compensation for reparations without delay along the lines suggested in this paper and accomplish prompt dissolution of Zaibatsu combines without affecting production in operating subsidiaries;

(f) dissolve industrial Control Associations and reduce Government control over distribution except as necessary to:

(1) assure fair distribution of staple foods
(2) control prices of scarce and basically essential articles
(3) allocate scarce raw materials

(g) proceed with a reform of the banking system with a view to mobilizing sources of credit for productive purposes and restoring financial solvency;

(h) confine public expenditures to direct productive purposes and exercise strictest economy in administrative expenditures;

(i) promote peaceful labor relations, through prompt and fair consideration of reasonable labor demands, encouragement of responsible unions, introduction of a modern social insurance system, etc.

3. *Responsibility of SCAP*

a. Existing JCS directives are clearly designed for the so-called interim period and for that reason have not been considered in this paper. These directives have as basic principle that "SCAP . . . will permit production . . . to the minimum extent required to meet the needs of the occupation forces." Just how far SCAP's responsibility goes beyond the interim period, what the needs of the occupation forces are, etc., has not been defined. As a result, those members of SCAP and other military headquarters who by temperament or past technical experience have a tendency to "run" things their own way have begun to exercise a degree of supervision over, and interference with, industries or problems in their particular field which can easily prejudice over-all policy. Others again are prone to take an attitude that "it should all be left to the Japanese." Between the attempt to run or supervise a given industry exactly the way it is run or supervised in Cleveland or Philadelphia, and the detached approach of complete non-interference, there is a sound middle course. That course urgently requires definition so as to facilitate the concentration of available SCAP manpower on the truly vital objectives and control devices of the occupation.

b. It is believed that SCAP's relationship to the Japanese economy covers three main areas;

(1) The area for which SCAP has direct and positive responsibility, both legislative and executive;

(2) The area for which SCAP has no direct responsibility but where SCAP desires to give encouragement, advice and assistance, provided it is made clear to the Japanese that such encouragment, advice or assistance involves no responsibility or guarantee of accomplishment on the part of SCAP;

(3) The area for which SCAP not only has no responsibility but to which he is indifferent; in other words, the area which is left entirely to the responsibility, initiative and execution by the Japanese Government and people as long as nothing is done by the Japanese in violation of SCAP's orders or in conflict with SCAP policies as handed down to them.

c. (1) Area for which SCAP has direct responsibility:

This is believed to include the following:

(a) Establishment of guiding policies (equitable distribution, diffusion of ownership, prevention of disorder, etc.)

(b) Imposition of over-all limitations on industrial production, exports, shipping, etc., and continuous observation of the manner in which these limitations are being maintained.

(c) Control over the national budget

(d) Control of runaway inflation

(e) Control of foreign trade and foreign exchange

(f) Dissolution of Zaibatsu combines

(g) Democratization of distribution

(h) Provision of the direct needs of the occupation forces such as housing facilities, communication equipment, etc., and supervision of the manner in which these needs are met.

(2) Area for which SCAP has no direct responsibility but where encouragement, advice or assistance is offered:

The most important principle to be applied in this area is that the Allies do not guarantee any particular level of living or production. Consequently, it must be made clear to the Japanese, much clearer in fact than has been done in the past, that encouragement by the Allies of production in any given line, or the offer of technical advice and other assistance is in no way to be accepted as a guarantee of accomplishment or attainment by the Japanese. This area covers among other such fields as:

(a) Allocation of raw materials

(b) Production of essential commodities not subject to over-all Allied limitations;

(c) Reform of the financial system

(d) Distribution and utilization of imports

The production of automotive vehicles might serve as an example. The production of trucks for Army use naturally falls within area (1) (direct responsibility). But decision as to whether Japanese should produce passenger vehicles or trucks for their own use is definitely in area (2), subject only to Allied over-all limitations on steel, aluminum, etc.

(3) Area to which SCAP is indifferent

This area, of course, covers everything that is not covered by area (1) or (2).

d. It is realized that the above definitions represent a controversial problem. It will undoubtedly be argued that every single economic problem or phase of production presents an angle which directly or indirectly ties into some major problem for which SCAP does have direct responsibility. For this very reason it is strongly urged to arrive at the clearest possible understanding of the extent of SCAP responsibility, always bearing in mind the danger of spreading Allied manpower too thin, of killing all initiative in the Japanese themselves, and, through display of confusion and ineffectiveness, of giving the Japanese opportunities for circumvention of basic policies.

4. *Recommendations*

It is suggested that consistency and effectiveness of Allied occupation policy in the economic field can be assured through the adoption of the following measures by SCAP:

a. Earliest possible announcement of agreed extent, mode and type of reparations removals, demilitarization mesures and other production controls as well as specific designation of those fields where production is to be encouraged.

b. Establishment of an Economic Policy Committee or Directorate within SCAP, comprising representatives of Industry, Labor, Finance, Price Control Divisions and Natural Resources Section.

c. Appointment of a SCAP observer to the Economic Stabilization Board, *not* to *direct* allocation policies but to *observe,* advise and currently *report* to SCAP.

d. Earliest possible establishment of a nation-wide statistical reporting system within the jurisdiction of the Japanese Government covering every phase of production, distribution, consumption, finance, etc.; establishment of such a reporting system to be directed by, organized with the technical assistance of, and currently supervised by, SCAP.

NORBERT A. BOGDAN
FRANK M. TAMAGNA

[SOURCE: SUITLAND PAPERS, Z 721-6]

8-11 INFLATION AND ITS THREAT TO OCCUPATION OBJECTIVES

Memorandum October 23, 1946
To: The Chief, Government Section
From: T. A. Bisson (GS)

I. THE PRESENT SITUATION

1. An inflationary situation, which is steadily becoming more critical, already exists in Japan. Its more immediate expression takes the form of a huge and rapidly expanding bank note issue. On 9 March 1946, following reconversion, the Bank of Japan note issue totaled 15.2 billion yen. Present note issue, only seven months later, totals 69 billion yen. This figure exceeds the total of 61 billion yen outstanding at the end of February 1946 by 8 billion yen.

2. No diminution of this increasing note issue is anticipated. By the end of 1946 the total is expected to mount to 90 billion yen and by the end of the fiscal year (March 31, 1947) to 120 billion yen.

3. The current fiscal year's deficit is expected to be covered by the proceeds of the capital levy, amounting to some 43 billion yen. Next year's deficit, estimated at 70 billion yen, will not be covered by the proceeds of a capital levy. Either 70 billion yen will be added to the note issue or else SCAP's present directive prohibiting financing by bank borrowings will have to be rescinded. Either alternative promises intensified inflationary pressure.

4. Japan's tax system, due mainly to administrative laxity and widespread evasion, is an exceedingly poor revenue producer. The Tax system should produce at least twice the present revenues, as compared with the tax system in the United States or in other advanced Western countries. Even if this result were achieved in 1947, the doubling of revenue would not materially alter the prospective inflationary threat. The total revenue anticipated for the 1947 fiscal year is 30 billion yen. Efforts to increase this amount by stiffer and more steeply graduated tax schedules will undoubtedly meet with stubborn resistance by the present Japanese authorities. More effective collections could hardly be accomplished without a complete reformation of the present antiquated Japanese bureaucracy. It may be confidently anticipated that the spread between government income and out go will continue to widen during 1947, as it has during 1946.

5. Finally, the gravest threat in the present situation is that more than 40 billion yen of the increased note issue is reported to be hoarded. The immediate effect of this hoarding is that it deprives the banking system of deposits from which the needs of essential productive enterprises could be financed. The potential effect, which will come into play whenever, for any reason, the people lose confidence in their currency, is a rise in all prices much steeper than any so far witnessed in Japan, financial chaos, the wiping out of all savings, and widespread suffering for all except a few speculators.

II. INFLATION AND PRODUCTION

6. The Japanese authorities present the argument that, once SCAP removes existing fiscal controls and releases bank deposits, production will be stimulated to such an extent that the inflationary pressures will be overcome. However, the disturbing fact is that, on any realistic estimate, production will take at least two years to attain domestic consumption requirements. Instead of relaxation of controls, what is required is the effective enforcement of measures now available and an attack on the inflationary problem that will relate all required moves to one coordinated and comprehensive program.

7. There could easily be a runaway inflation in Japan. In the United States, the wealth of resources and productive machinery can pour goods on to the market whenever prices give the incentive to produce. In Japan materials are scarce and productive machinery is inadequate, especially to accomplish a rapid and substantial increase of output. Further, under present conditions, producers can realize larger profits by remaining idle and speculating in raw materials than by producing. Unless the present situation is brought under control, an inflation of the

Hungarian type can be expected to develop.

III. Intentions of the Japanese Authorities

8. Evidence can be adduced to show that the responsible Japanese authorities, far from seeking by every means in their power to avert inflation, are in fact pursuing a policy that invites it.

9. Whenever possible, the Japanese authorities are attempting to maximize government out go. Virtually every Section in SCAP, if not every Section, can produce examples of padded budgetary allotments for which approval has been sought.

10. These authorities are at the same time attempting to minimize income. This factor refers not only to extraordinary measures, as in the capital levy, but also to cases affecting ordinary taxation. Thus, they are permitting normal taxes to be paid from second restricted deposits, relating mainly to old financial institutions that are due to be liquidated. The deposits are relatively worthless. Government revenue takes the loss, not the taxpayer or the banks. This measure is enforced contrary to the express opposition, and the previous understanding, of ESS/FD.

11. Price rises for commodities are not only permitted by the Japanese authorities where ever possible, but are actively fostered by them. The best recent example is the case of rice, for which an arbitrary increase of from ¥300 to ¥600 per koku was announced by the Minister of Agriculture without reference to SCAP. When objection was raised by ESS/PRA, the Japanese authorities stated that since the increase had been announced and published throughout the country, adverse effects would result if the increase were not granted. Certain price increases, in fertilizers for example, are so far out of line, that ESS/PRA has had to engage in an effort to roll them back. The actions in these cases of increased prices were all vigorously supported by the Ministries involved, and their pressure along this line still continues.

12. Allocation of scarce materials to the more essential industries is an *expressed* objective of the Japanese Government, but to date this objective has been implemented only to a limited degree. The Japanese authorities have, in general, approached the allocation problem piecemeal, have followed a policy of expediency, and have, as a result, been sharing scarce materials among all users rather than channeling supplies to plants which are essential. The greatest defect in this field has been not so much in laws, ordinances or directives, but in the lack of appropriate enforcement by administrative agency—so much so that, at times, the mandates seem to be intentionally carried out with a view to permitting the maximum degree of evasion. In the absence of a comprehensive program, allocations are apprarently effected by various political and economic pressures. Effective allocation measures have not been achieved yet with regard to many critical materials, notably for the supplies required by the coal industry.

IV. The Threat to Occupation Objectives

13. The maximum degree of harm to occupation objectives would be caused by a runaway inflation. In all the respects noted below, however, a more or less serious effect on the occupation is already being caused by the existing degree of inflation.

a. For the wage and salary earner, the effects of a serious inflation are normally disastrous. The first result is likely to be labor disputes and strikes. At a later stage, these may well develop into unrest that will invite or require suppression by force.

b. Equities will be preserved by those elements in Japanese society, new Zaibatsu if not the old, whose excessive economic power SCAP is attempting to reduce. The effects of the indemnity and tax levy (for which assets are valued to a considerable extent as of March 3, 1946) have already been minimized. Holders of equities will reap an additional gain by the revaluation of their assets as inflation progresses. It is believed that as a result of the liquidation or absorption of numerous small units during the war and the channelling of post-war business to existing large companies the concentration of industrial production and economic power in the hands of a few is now relatively greater than before the war. In the aftermath of an inflationary panic the largest and strongest of those units, having gathered up the remains of their weaker fellows, will emerge stronger than ever before.

c. Production is increasingly stifled as the inflation grows more severe. The effects are already evident. Uncertainty as to the future value of the yen is leading industrialists to concentrate on the rehabilitation of plants and others measures to preserve their equity rather than to utilize the plants for production. At the same time, inventories are being withheld for speculative price rises instead of being sold or converted into finished goods.

d. As the deficit increases, Japanese credit will be so impaired that the government will be unable to carry out the basic social, economic, and other necessary reforms stipulated in occupation directives.

e. By strengthening the economic power of the old ruling elements in Japanese society and giving rise to desperate outbreaks of violence by the dispossessed populace, inflation will nullify the attempt to introduce a stable popular control of government authority directed toward the benefit of the people as a whole. Whatever hopes exist for the development of a broad middle class in Japan will vanish and the situation will be ripe for the emergence of extremist control of one color or another.

f. Ocucpation costs will be not only more difficult to meet, especially so far as transforming these costs into productive results (as in building dependency houses), but the costs themselves will be made to appear the cause of the inflation.

14. The remedy lies in a comprehensive program of price stabilization and inflation control, all parts of which are thoroughly coordinated and are adequately administered, at least to the extent that lies within the powers of the Japanese bureaucracy.

[Source: Suitland Papers, Z 703–23]

8-12 LIVING STANDARD AND THE FUTURE ECONOMY OF JAPAN

Report — December 25, 1946

Prepared by: Section III, Research Bureau, Foreign Ministry, Japanese Government

CONTENTS[5]

I. Introduction
II. Scope of Peace Economy
III. Necessary Scale of Foreign Trade
IV. Living Standard and Foreign Trade (deleted)
V. Contents of Export Trade (deleted)
VI. The Future of Japanese Economy as Viewed from Employment (deleted)
VII. The Future of Japanese Economy as Viewed from National Income (deleted)
VIII. The Importance of Shipping Industry (deleted)
IX. The Burden to be Imposed for Recovery from War Damages (deleted)
X. Economic Difficulties of Present Japan (deleted)
XI. Ambassador Pauley's Final Plan for Reparation and the Japan's National Economy (deleted)
XII. Conclusion

I. Introduction

Since the end of the war, the Government and people of Japan, in accordance with the terms of the Potsdam Declaration and at the directions of the Allied General Headquarters, have been faithfully carrying out various obligations concerning demilitarization and democratization.

Not only would the Allied Powers not permit Japan to rise again as a militaristic state and bring on disaster again to herself and the rest of the world, but also the Japanese people themselves, newly freed from the misguidance of militarists, would absolutely not allow such contingency to come about.

The long history of the Japanese race, when interpreted as a whole, also gives testimony to the innate peace-loving nature of the people.

When Japan, with the Meiji Restoration, emerged out of feudalistic conditions to become a modern state, the Western nations were already in a considerably advanced stage of development. This fact rendered it necessary for Japan to chart her course to further solidify what had been inherited from the past, rather than to settle the various internal social and economic contradictions, so that she could strengthen her immediate competitive power to keep up with other nations. Stated in other words, a rapid accumulation of capital was enforced on her agriculture, which was kept in feudalistic stage, in order to overtake other advanced capitalistic nations. As the result, there has developed internally a special type for Japan's national economy, in which semi-feudalistic agriculture based upon family system, as well as medium and minor scale commerce and industry, have extensively maintained co-existence with the highly developed modernized industries. Politically, the blind submissiveness of the popular mass to the feudalistic ruling classes and the absence of civic self-consciousness were the results.

[5] Sections I, II, III and XII are printed here.

As a consequence of such an anomalous development of capitalism itself as described above, the domestic market could not prosper. This, coupled with the presence of such factors as scarcity of domestic resources and over-population, drove Japan prematurely to the stage of imperialism to acquire colonies and overseas markets by resorting to military forces. Thus the nation's economy, as a whole, assumed a highly militaristic complexion.

The defeat in the war has put an end to this state of affairs. The era of free competition has terminated all over the world, in which the weak become the victim of the strong. A new era is now dawning, with self-conscious mankind trying to solve the world's political and economic questions by dint of his own wisdom.

Japan now finds herself in an era when, without any armaments and with but scanty natural resources, she can hope, under a world economy rationally planned, to elevate the living level of her people by dint of their diligence and intelligence.

In consideration of the greatly enlarged scale of modern warfare and the tremendous quantity of materials to be consumed therein on the one hand, and of the fact that Japan, deprived of her colonies, suffers keen shortage and unbalance in the supply of materials for her heavy industry, particularly of such key materials as iron and steel, aluminium, petroleum, etc. on the other, it is simply inconceivable that another war would be ventured upon by Japan.

Judging from the historical observations as above and the world-wide conditions, in which Japan is likely to find herself in the future, the only course left for her to take will be that of peace.

In view of the above, it may be desirable that, in settling the reparations issue, anything that has been solely assigned to military purposes in the nation's economy must be exhaustively ousted, but that at the same time industries having peaceful purposes should be restricted only to such an extent as will allow a fair standard of living for the Japanese and enable them to entertain a hope for the future promotion.

Taking the people's standard of living as the criterion, the scale of the nation's economy in the future is studied below in concrete details.

II. Scope of Peace Economy

In making a final decision upon the scope of reparations, it will be necessary, first of all, to determine the scope of the industries required for enabling Japan to maintain her peaceful economy. As a prerequisite for this it should be established that a certain rational living standard will be permitted to the Japanese. In view of this, we have made a study of future living standard of the Japanese with reference to the year 1930 when, before the Manchurian Incident, Japan was engaged in peaceful economic pursuits. Taking the actual data of that year as basis of calculation and from the following three standpoints, i.e. foreign receipts and disbursements, national income and employment researches have been made into the scope of Japan's economic requirements in the future. In the year 1930, there was a world wide depression, and, owing to its repercussions, Japan's economy also experienced a deep depression, with both the production and the consumption of various commodities in marked stagnancy. In that year, as compared with 1936–7, when the Japanese people enjoyed the most prosperous living in the past, the living standard, considered in the light of the national income, the consumption of staple commodities and other factors, was lower by about 30 per cent. But that year has been taken as the basis of study, because of the fact that in that year Japan was engaged in economic pursuits freest in the past before the Manchurian Incident form the militaristic complexion.

The results of the study as outlined above are contained in the text, as well as in the annexed data. The conclusion may be summarized as follows:

To enable a population of 80 million, which will be reached in the near future, to maintain such a level of consumption of essential materials that is equivalent to the per capita average in 1930 (when the population was 64.45 million), it would be necessary for the nation to have a foreign trade approximately equal in size to what she had in 1936, and manufacturing industry comparable to that of 1934–5.

As will be stated in the following articles, there are two problems which are of primary importance to the future economy of Japan. One is how to maintain the balance of international accounts, and the other, how to provide opportunities of employment to a numerous people. Therefore, in determining the scope of Japan's peace economy, it should be taken into consideration the industrial capacity necessary to meet the domestic consumption, as well as the industrial capacity for the production of exports requisite to render possible the importation of vital necessities. It will also be necessary to consider the kind of industries from the standpoint of giving the people as many opportunities of employment as possible.

III. Necessary Scale of Foreign Trade

In the following table, the per capita amount of food, clothing, and other consumer goods required for the Japanese in Japan Proper in 1930, is taken as the basis, (for instance: 161 kilograms of rice, 14.7 kilograms of soya beans, 13.8 kilograms of sugar, 24 kilograms of salt, 10 lbs. of textile articles) and, on this basis, the total imports required for the future population of 80 million is estimated to amount to ¥2.7 billion.

Food materials	¥822	million
Clothing materials	524	"
Others	1,371	"
Total	2,717	"

To pay for these imports, as the exports manufactured from the meagre domestic resources will not suffice, the articles manufactured from imported raw materials will have to be exported. Besides, with the anticipated disappearance of receipts derived from shipping, investments and service abroad, the invisible trade balance that nearly amounted to ¥200 million in Japan's favor in the past seems to turn to adverse balance of about ¥100 million, which also will have to be covered by export trade.

Summing up the above, exports of ¥3.5 billion (U.S. $980 million at 1936 price level) will become necessary, as the particulars shown below:

Payments		
Import of necessaries	¥2,700	million
Import of raw materials for export industry	700	"
Adverse invisible trade balance	100	"
Total	3,500	"
Receipts		
Exports manufactural from domestic raw materials	¥800	"
Exports manufactured from imported raw materials	2,700	"
Total	3,500	"

This is almost equal in value to the Japan's overseas trade in 1935 or 1936, including colonial trade. It should be particularly mentioned that the trade with Chosen, Taiwan and Karafuto, which was a mere extension of domestic trade in those years, will have to be included in foreign trade, as now they are no longer Japan's colonies. With the increased population (an increase of 24 per cent over 1930) and after the loss of invisible receipts represented by the earnings of shipping and incomes from services and investments abroad, Japan needs a foreign trade on the scale of 1936, if the standard of living in 1930 is to be maintained. Consequently she must have export industries of a corresponding scale.

The above-mentioned ¥3.5 billion represent such exports as will enable the necessary import for the maintenance of a living standard equivalent to that of 1930. But in addition to this, the damages and deterioration during the war have to be repaired. If the buildings are to be rebuilt in twenty years' time, while railways, communication equipments, factories and others are to be restored within ten years on the average, the basic materials annually required are estimated to amount to some 1 million metric tons of steel and 250 million cubic feet of lumber. If these materials are to be imported from abroad, the fund required to pay for them will amount to some ¥400 million. In case these additional imports are to be paid for in manufactured articles, further import of raw materials for the manufacture of the export articles will become necessary. The total value of necessary imports in this case will be ¥4.1 billion. (U.S. $1.2 billion at the price level of 1936.)—(See Data No. 1 "The Future of Japanese Economy as Viewed from International Trade Balance).

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XII. Conclusion

It would be evident from the above observations that even the contemplated recovery to a living standard comparable to that of 1930, which may not be called quite high, demands exertion of the most strenuous efforts.

However, if account is taken of the fact that the world's prosperity in the future can only be achieved by realization of higher standards of living for all nations, particularly for the less advanced ones, and that the postwar economic world policy as advocated by the United States also points to the removal of international trade barriers and the furtherance of trade to the

utmost, thus to bring about more employment and higher standards of living in the world, it may yet confidently be hoped that a day will come when, as the result of untiring efforts of the people and intelligent economic measures, a living standard comparable to that of 1930 or even higher may be granted to the Japanese.

[SOURCE: SUITLAND PAPERS, Z 703–46]

8-13 INDUSTRIAL DISARMAMENT AND ECONOMIC CONTROL OF JAPAN

Report January 22, 1947
Prepared by: Economic and Scientific Section
Secret

I. THE PROBLEM PRESENTED

1. Under the terms of basic directive JCS 1380/15, paragraph 17c, SCAP is charged with responsibility for developing a plan for economic control of Japan. Such control is assumed to be a permanent or semi-permanent feature of post-war treatment of Japan regardless of the duration of the military occupation.

2. Economic control of Japan must of necessity be integrated in the reparations and industrial disarmament programs which determine the economic levels to which Japan will be immediately reduced. The basic features of reparations and economic disarmament have now been sufficiently well established for such integration.

II. FACTS BEARING UPON THE PROBLEM

1. Japan is a nation of scanty resources, dependent upon imports for nearly all of her raw materials and most fuels except ordinary grade coal. Economic control should, therefore, be developed about this thesis of overseas dependence.

2. In spite of the lack of home resources and the general poverty of the country in terms of natural wealth, Japan has been able over the past ninety years to create a balanced industrial plant capable of producing all of the weapons and materials of modern warfare (with the exception of the atomic bomb). She had also, by virtue of a feudal society, been able to divert probably a greater portion of her economic strength to the preparation for and waging of war than any other nation in the world. Economic disarmament should, therefore, include decentralization of the Japanese economy, destruction of feudalism and a vigorous program for distribution of capital and financial power.

3. Experience in both military and economic control of defeated Germany after World War I and in efforts by the League of Nations to control a warlike Axis, indicate the absolute necessity for a system of economic controls capable of simple, finite application and of such continuing nature as to be an accepted part of the life of the country concerned, hence not requiring positive coercive action during times of future crisis. Economic control of Japan should be developed along such lines.

4. Experience with economic controls of any kind have clearly demonstrated that such controls if relatively indirect and unseen are more easily accepted by the persons and agencies concerned than are direct and forceful methods. This would appear particularly true in the case of control of a defeated nation, with all its ramifications in future upsurge of patriotism, political propaganda and other unpredictable national reactions. Since economic control of Japan is likely to be connected in the Japanese mind with the inevitably low economic standards which will prevail in Japan for many years in the future, the use of indirect methods wherever possible and a playing down of the fact of control would appear most desirable.

5. Modern warfare has developed along increasingly mechanical lines. The development of air warfare, technical armament and fast movement of large armies by mechanical means have made warfare utterly dependent upon certain basic commodities, principally metals and fuels. Economic control of Japan, to be feasible and to be basic rather than all embracing, should be developed, therefore, about this dependence of war potential upon a relatively few basic commodities.

III. DISCUSSION

Japan's Position as an Importing Nation

1. Any economic control of the Japanese economy for the purpose of controlling war potential must be designed with full appreciation of Japanese non-selfsufficiency. Organizing

ability, inventive genius, skilled labor, and cheap water transportation must be considered in their correct significance with relation to domestic supplies of minerals and fibers.

2. Japan, for the most part, has always been dependent on importation of iron, petroleum, cotton, wool, lead, tin, zinc, mercury, nickel, bauxite, fertilizer chemicals, rubber, and many other items. Nevertheless, in the decade directly preceding 1937 and in spite of trade restrictions abroad, she improved her economic position, obtaining adequate supplies of these raw materials in exchange for her exports in the course of international trade. Between 1926 and 1936 an increase of approximately 100 percent in industrial output and self-sufficiency in foodstuffs within the empire was accomplished. This expansion was accomplished without foreign borrowing.

3. In 1935 and 1936 Japan was an exporter of steel although still importing certain steel products and special steel. Exports of machinery, tools, and fuels climbed to a figure greater in value than that of imports. It consisted largely of the more delicate complicated types of machinery, machine tools, and instruments. It is no longer safe to state, as one well-informed writer did in 1930, that "Japan can never become a manufacturing nation of major importance because of the lack of fuel, iron, and other basic materials."

4. For a long stretch of years the textile, food preparation, pottery, and paper manufacturing industries dominated the industrial structure of Japan. By 1938 the position had changed to a point where 61 percent of the industrial production of Japan was in metal, chemical, machinery, and engineering products, which can only be interpreted as meaning that Japan no longer was dependent on the outside world for a large part of her steel, fertilizer, and machinery production, although she still had to import raw materials. Japan has been and will continue to be dependent on external sources for its supplies of oil. On purely economic grounds this is not a deterrent to economic activity; but from a military potential standpoint, it is a matter of utmost importance.

5. The Japanese policy has been to avoid importation of finished petroleum products as much as possible and to import crude petroleum—fostering the growth of the Japanese Petroleum Industry by refining in Japan. Thus, the refining industry expanded rapidly in Japan. The total supply of crude and heavy oil almost doubled between 1932 and 1936. The United States supplied almost 75 percent of the 1935–1936 total, the Netherlands Indies and British Borneo making up the remainder. Spurred on by war demands, Japan today has a sizeable modern refining establishment.

6. The amount of iron ore economically mined in Japan is relatively very small, not exceeding one million metric tons yearly up to 1940. This, plus importations from Korea, then constituted about one-fifth (1/5) of total demand. However, through government subsidy of marginal mines, output of domestic ore reached a peak of three and six-tenths (3.6) million metric tons in 1944. It is natural then that the growth of the production of pig iron brought about great increases in imports of iron ore, primarily from China and Strait Settlement. Japanese capital developed mines in Johore Province, Malaya. These supplies could be imported although traveling fairly long distances since water transportation costs were very low. Therefore, the belief that a region cannot develop heavy industries unless it possesses large deposits of iron ore, seems to have been unsound.

7. By 1936 domestic production of pig iron was nearly double the 1930 output. However, notwithstanding the increase of domestic production, importation of pig iron more than doubled during the same period. In 1929 and 1930 domestic supplies of iron and steel scrap were about three-fifths (3/5) of total consumption, but between 1930 and 1936 imports of scrap iron and steel increased over 200 percent. It is interesting to point out that in 1936 thin plates, thick plates, and tin plates were exported to foreign countries and colonies in a total that exceeded imports. Production of pipe and tube also exceeded imports in 1931. Wire and rods, after 1928, reached a level fifteen times as high as that of any earlier year. Production of other steel products consisting of forgings, steel casting, and miscellaneous assortment of other products rose steadily up to 1931, and imports fell off.

8. The foregoing paragraphs have outlined the basic important position in the Japanese economy of:

a. Import, export, and shipping.
b. Iron, steel, and petroleum production.
c. The combined ingenuity and talents of the Japanese to succeed in their heavy industries and in armament industries in spite of insufficiency of raw materials.

It is obvious that war industries are dependent upon iron and steel manufacturing, petroleum, and shipping to which must be added aluminum insofar as the airplane industry is concerned. The supply of machine tools, bearings, instruments, etc., cannot increase beyond the available supply of materials; and even though materials were diverted to that type of manu-

facture, finished tools would be useless without materials to process into end products.

Japan's Industrial War Potential

9. Though dependent as outlined above upon imported raw materials and petroleum, Japan developed in the course of the 1930s an industry capable of supplying all her needs from precision engineering to the largest and most complex heavy industrial equipment in the Orient. In steel, the backbone of war industry, she attained a yearly capacity in the home islands of better than 8 million tons of ingot. She turned out more than 50,000 machine tools a year. Her chemicals capacity included more than 5 million tons of sulphuric acid and nearly two hundred thousand tons of nitric acid a year. Her nitrogen fixation capacity was second only to the United States and Germany.

10. Although the industrial capacities noted above are small compared to those of the United States, Japan managed to siphon all or nearly all of the products of industry into the maintenance of her military establishment. In no industrial nation of the world did the civilian requirements absorb so small a share of industrial production, and probably in no nation in the world has an industrial establishment the size of Japan's been acquired with so small a total national wealth.

11. The basic reasons for Japan's ability to concentrate her national wealth in the creation of industry and to concentrate the products of industry in the preparation for war may be summarized as follows:

a. The concentration of both industrial management and the ownership of capital in the same few hands, with the consequent plowing back of capital into industrial plant.

b. The direction of industry by an all powerful central government which treated industry as an instrument of national policy and guided it accordingly through:

(1) A close alliance with the industrial powers of the country.

(2) The use of the control association device for restricting individual enterprise and competition.

(3) A liberal use of subsidies for directing industry along political lines.

12. Insofar as economic control of Japan is concerned, the above premises are recognized in current proceedings for dissolution of the Zaibatsu, elimination of the control associations, segregation of industry and banking, reorganization of the so-called national policy companies and restrictions on the use of subsidies.

13. Insofar as industrial war potential is concerned, the reparations program has to date reduced Japan's industrial plant to the following proportions:

a. Pig Iron—2 million tons per year.
b. Steel Ingot—3.5 million tons per year.
c. Steel Rolling Capacity—2.75 million tons per year.
d. Ball and Roller Bearings—about 1 million units per year.
e. Sulphuric Acid—3.5 million tons per year.
f. Shipbuilding—150,000 gross tons per year.

14. Reparations have, in addition, reduced other not so basic categories of industry and have eliminated arsenals and the aircraft industry. Suffice it to say that the levels established under either the reparations or industrial disarmament programs will, in each category, limit the Japanese industrial capacity at the time of removal to what is determined to be necessary as a minimum for Japanese peacetime needs. In no cases would the capacity be sufficient to acquire either a war potential in itself or to stockpile materials in war preparation. The problem, then, as far as industrial capacities are concerned, is the determination of what categories to permanently limit, either at the level remaining after reparations or any other level determined by the Allies to be suitable.

Methods of Economic Control

15. While acknowledging the necessity and the desirability of using economic control over a defeated and potentially warlike nation to prevent the reacquisition of a war potential, it may be observed that success in economic control depends upon the methods and types of control applied. Under modern conditions, a differentiation cannot be easily made between war industry and that necessary for peacetime living, since in the basic categories the same products are used for both. Little value would be obtained in limiting or eliminating only the industries producing and products used in war, while allowing the all important basic industries to remain unrestricted.

16. In limiting and restricting industrial and other economic activities, the limitations applied affect to a large degree the every day lives of the entire population of the nation concerned, and unless carefully camouflaged or applied indirectly through selected sources, can easily prove an onerous and visible burden upon the entire population. That visible burden is

easily translated by demagogic politicians into active resentment against the nations applying the controls. Such resentment may be further translated into future aggressive moves. While a certain amount of resentment and direct reaction to economic control is inevitable, the problem is one of so selecting and administering control as to minimize the reaction.

17. Economic controls, furthermore, if indiscriminately applied and administered without careful consideration of the effects upon economic life, can easily stifle economic activity and enterprise in the area applied. In a nation in the position of post-war Japan, an extremely delicate economic balance will likely prevail for a number of years. The most strenuous effort and the most favorable conditions will be necessary to effect any kind of import-export balance and to enable her to support her ever increasing population. The most judicious application of economic controls will be necessary, if she is to succeed. If she fails, the result will be a permanently depressed area, hence a more or less permanent charge on the U.S. Treasury.

18. Economic controls finally must be simple and easily administered and of a continuing nature, if they are to be effective. It is a well known characteristic of democratic nations, and particularly of the United States, to quickly forget the lessons of war and to tend strongly toward leaving ex-enemy nations to their own devices. It may be expected that the American public will quickly tire of any complicated and expensive system of control of Japan. Controls to survive must be simple enough to require little effort on the part of the victors.

19. By the continuing nature of controls is meant a system which is operated as a day-to-day affair and which by virtue of its application is negative in nature, i.e., it prevents the acquisition of war potential, rather than involving a complicated machinery which is designed to go into action only after an overt act has been initiated and a crisis is at hand.

Effectiveness of Control Over Basic Commodities

20. While the commodities used in modern warfare embrace probably every article known to man, the theory of control over all such items easily breaks down from its own weight. Many articles are substitutable or done without by a desperate and warlike nation, while technology is changing the nature of warfare at an ever increasing rate, making obsolete many of the end products used in classical warfare.

21. The war potential, therefore, of a national economy in terms of end products is a variable and highly complex affair. To control it on those terms would become administratively impossible, involving a maze of ever changing regulations and an army of technicians for enforcement.

22. Control over all war supporting industry would be somewhat more feasible, but again would involve complex determinations of allowable capacities in a host of industries, many of them turning out small, easily diverted products and most of them subject to rapid technological change. Such comprehensive control would furthermore exercise an unduly restrictive influence over economic development and normal business operations in the country being controlled.

23. It would appear desirable, then, to select for control a certain minimum number of industries so basic as to guarantee an automatic limitation on war potential. To be administratively effective the industries selected should be relatively uncomplex and capable of easy technical inspection. The size of plant, size of product, transportability of product, type and amount of fuel used and availability of raw materials in the area controlled should all carry important weight in selection of the industries for control.

IV. Recommendations

1. It is recommended that industrial disarmament be accomplished substantially as outlined in Washington radio WX 89837 and in our radio C 68424. Subject to the recommendations made below, rebuilding in industries not specified for control should be unrestricted except for economic reasons.

2. It is recommended that economic control of Japan be centered basically around the production and availability of steel and petroleum products. Reasons:

a. Both products are so basic to a war potential that it is impossible for a nation to wage war without them or to substitute for them.

b. Both products require large, expensive, easily visible plants. Inspection would be simple and subterfuge all but impossible.

c. Both products are bulky and most difficult to stockpile or to transport clandestinely.

d. Steel uses large quantities of coal in its manufacture, an additional easily inspected check on production.

e. In both products, Japan in the home islands is almost without raw materials resources. Of her peacetime steel requirements of perhaps three million tons a year, iron ore

is available to a maximum of less than 500,000 tons of pig iron a year. Coking grade coal is equally unavailable in the home islands. Of her peacetime petroleum requirements of perhaps 18 million barrels a year, maximum indigenous crude production is about two million barrels a year. Availability then, is subject to relatively easily applied control over imports.

f. The control of steel and petroleum can be centered on the few producers and importers of the products. It would be largely indirect and unseen by the consumer. Technical inspection would involve only a minimum of plants and the relatively invisible procedure of port control.

g. By establishing control over only two basic commodities, the war potential of the country becomes effectively limited, but the economy of the country is left free to develop an industrial pattern demanded by the post-war economic development of the Far East and the world.

h. Control over only two basic commodities would dispense with complex determinations of industrial levels necessary to Japan in a host of war supporting industries.

3. It is further recommended that secondary control be applied for whatever period is considered necessary to shipping and shipbuilding, light metals, special types of machine tools, precision bearings, instrument manufacture, the aircraft and munitions industries, and scientific research, including a complete prohibition of research in fissionable materials. Controls over these secondary products are envisaged as being in effect over the immediate post-war years of military occupation, and to be subject to extension as a military security matter for whatever period is deemed necessary by allied military authorities. In most cases it is assumed that the control would involve a flat prohibition against manufacture either of the product or a special type of the product involved. In the case of shipping and shipbuilding it is recommended that restriction be applied to type characteristics of vessels rather than to tonnage.

4. It is recommended that import-export control under a commodity licensing procedure and a system of licensing of all foreign exchange transactions be utilized as a control instrument. Commodity licensing, although initially applied to all commodities, should be gradually removed from commodities other than those basic to the permanent control procedure. It is expected that, in view of the anticipated difficulty in attaining an import-export balance in Japan, licensing of foreign exchange transactions would become a permanent procedure. Such foreign exchange licensing would further provide a check on Japanese financial activities abroad.

5. It is finally recommended that statistical reporting be also used as a control instrument. Such reporting would include the development of methods providing a maximum of cross checkability, and a maximum of interrelated reporting of raw materials availability, production, stockpiles, transport of goods, financial position, funds expended and so on.

[SOURCE: SUITLAND PAPERS, Z 703-14]

8-14 PROGRAM FOR ECONOMIC STABILIZATION (B) (SUMMARY)

Report — February 16, 1947
By: Economic and Scientific Section, SCAP

SUMMARY

The economic stabilization program is an integral part of an economic program for Japan designed to attain the objectives of rehabilitating the economy of Japan to the point where it will be self-sufficient and no longer dependent on U.S. dollar assistance and in creating the type of economic institutions through which a democratic way of life can be attained.

Both of these major objectives are endangered by the present threat of further inflation. An inadequate supply of goods along with a high volume of currency, largely caused by the government deficit, necessitates a comprehensive program of economic stabilization.

This program represents a coordinated plan to (1) increase the supply of goods, (2) reduce the amount of excess currency, (3) control prices on an objective basis, (4) distribute food and other consumer goods on a fair and equitable basis, (5) institute wage stabilization policies consistent with realistic living costs and supplies of consumer goods and (6) increase exports and imports.

In order to increase production of essential goods an effective system of allocation and distribution controls must be established. Concurrently measures must be taken to reduce blackmarkets, to redistribute idle and excess inventories, and to prohibit the use of scarce materials in the production of non-essential items. Measures to minimize business uncertainty must be promoted and include reorganization of industrial and business concerns, decisions with respect

to reparations, and channeling credit to key industries.

In order to reduce excess purchasing power a more effective tax program must be instituted, government expenditures must be more carefully screened, and payment of blackmarket prices by government and government contractors must be eliminated. Other measures include savings campaigns, restrictions upon bank credits for non-essential uses, and development of a broader base for government borrowing.

An effective price control program is dependent upon effective distribution controls and upon adequate enforcement of regulations which prohibit sales at above ceiling prices. A rational and objective price policy must be adopted and consistently employed. Such a policy should include parity pricing for agricultural products, a cost of production method for pricing those materials and commodities for which costs can be determined, and for all other commodities prices should be established in accordance with normal price relationships among standard items.

The equitable distribution of food and other consumer goods is dependent upon an effective system of collections and rations. To maximize collections of food stuffs from producers requires optimum use of the link system where scarce commodities are sold only to those who sell specified quantities of food to the government. Commodities employed in the link system must be given a high priority for materials in order to maximize their production. The system for the collection and distribution of fish and vegetables must be completely reorganized. Food refrigeration and storage facilities must be fully developed and utilized. In order to prevent mal-distribution of supplies among prefectures, more drastic measures must be instituted to increase interprefectural shipments from relatively surplus to deficit areas. For consumer goods other than food, an effective rationing system must be instituted and sales of rationed goods except in accordance with legal procedure must be prohibited.

Wage stabilization and minimum labor unrest can be achieved only after the cost of living is stabilized and distribution of scarce and essential goods is reasonably equitable. The criteria for the adjustment of wages should relate wages to the costs of purchasing an equitable share of the scarce necessities of living and although the ratio between living costs and wages cannot provide a standard of living within the immediate future as high as the pre-war standard, an improvement in the present standard is possible and is essential. Legislation to protect labor against exploitation during the period of emergency economic controls must be promulgated.

In order to obtain funds to increase imports of essential raw materials which are vital to an increase in industrial production, it is necessary to maximize exports through every available means. Export industries must receive a high priority for materials and adequate precautions must be taken to prevent dissipation of export commodities in the Japanese market. In order further to increase the funds for foreign trade purposes several measures must be accomplished and include barter and link system arrangements, borrowing on SCAP account and/or borrowing against the security of certain Japanese liquid assets, etc. Additional steps include the establishment of liaison and purchasing missions, the expansion of the Japanese government foreign trade agencies and efforts of the U.S. State Department in foreign countries to develop trade arrangements.

In varying degrees all of the above measures require the organizing and staffing of agencies within the Japanese government to plan, administer and enforce the programs. Greater efforts must be devoted to obtaining more and current information and statistics relating to the developments within the economy so that planning, administration and enforcement can be conducted with maximum intelligence. A nationwide, continuing and vigorous campaign against blackmarkets is necessary. In order to enlist public support and understanding of the program an adequate publicity campaign must be instituted and fully developed.

[SOURCE: SUITLAND PAPERS, Z 703-21]

8-15 A POSITIVE ECONOMIC PROGRAM FOR JAPAN

Memorandum[6] — March 12, 1947
To: General Hilldring, Assistant Secretary of State for Occupied Areas
From: E. M. Martin, Chief of the Division of Japanese and Korean Economic Affairs
Secret

There is attached a memorandum from me to you on the above subject, with which I enclose three documents outlining in more detail a program to accomplish the revival of the Japa-

[6] A shorter version of this memorandum appears in *FRUS*, 1947, Vol. VI, pp. 184–86.

nese economy. I should appreciate the views of A-H on these proposals.

I am at the same time circulating this program to A-T, FE, ITP, and OFD.

Since I understand Mr. Peterson is actively concerned with this question, may I suggest that it might be appropriate to provide him with a copy, with the understanding that it is an informal draft being considered in the State Department. I am particularly concerned about informing Mr. Peterson since I understand that he is thinking of moving rapidly to set up a high level mission to Japan, consisting of representatives of War, State, Commerce, Treasury, and, perhaps, RFC or Ex-Im Bank to develop a program for the revival of Japanese trade. I am told he is talking in terms of setting up the group within a week or so and planning for it to leave for Japan by May first. It seems to me necessary that we clarify our ideas as to policy on the basis of the attached memo, and that we secure SCAP's views on some of the more detailed programs involved in the opening of private trade and in the use of private financing, as these problems are raised in a radio to SCAP sent over to the War Department on March 7, before we can decide what kind of mission it is necessary to send to Japan. I think it would also be useful to await the return of Mr. Whitman, who was sent to Japan in January to discuss these same points with the SCAP staff. He is due to leave Tokyo March 23.

I. Central Problem: Japanese Recovery

1. Need for Recovery. The major objectives of this country's Japanese economic policy are:

(a) To eliminate U.S. expenditures in support of the Japanese Economy as soon as possible, and facilitate Japanese repayment of those expenditures.

(b) To create a viable Japanese economy, such as would be conducive to the emergence of a peaceful and democratic Japan.

(c) To permit a substantial Japanese contribution to the economic recovery of the Far East, which is desperately in need of the products of Japanese industry.

Realization of these objectives patently demands an increase in Japan's production, such as will bring into being a favorable Japanese balance of trade, without too harsh restrictions on Japanese domestic consumption.

This must be accomplished in cooperation with our Allies and in such a way as to avoid charges that the United States is building up Japan, either as a buffer against the Soviets or as a replacement for a currently disorganized China as our principal friend and customer in the Far East.

2. Means of Recovery. Such an increase in Japanese production cannot be achieved until the productivity of Japanese workers and factories has been restored through the import of food and raw materials substantially in excess of those required for disease and unrest purposes. It has been estimated by the Research Sub-Committee of the Japanese Reparations Policy Committee that, if certain specified and available increased food and commodity imports were provided in 1948 and 1949, Japan could be "cranked up" to the point where she might be self-supporting in 1950 and might achieve a trade surplus thereafter. Failing such increased imports, there appears to be no immediate prospect of a substantial expansion in Japanese production such as might render that country self-supporting. On the contrary, the Japanese economy will continue to deteriorate due to the cumulative effects of food shortages and to the exhaustion of domestic raw material stockpiles.

3. Cost of Recovery. It has been estimated that increased 1948 and 1949 imports would so stimulate Japanese exports during these years that the Japanese 1948–9 trade deficits would not be greater if "cranking up" imports were provided than if only disease and unrest imports were provided. Although the gross cost of the proposed imports would exceed that of "disease and unrest" imports by more than half a billion dollars during each of these two years, the increased exports made possible by these imports will be at least as large. The data attached in memorandum no. 2 gives an even more favorable picture, but it is considered wise to discount this statistical calculation to take account of unfavorable problems sure to arise such as lack of balance in the expansion of output, difficulties in controlling Japanese consumption, etc. It will be necessary, however, to have $300–500 million over and above proceeds of Japanese exports available in the first six months of calendar year 1948 to prime the pump. Something like $150 million should be available from the War Department appropriation, some $200 million from Japanese liquid resources, and $100 million from private financial sources.

4. Availability of Food and Raw Materials. The present proposal does not envisage an all-out effort to revive the Japanese economy until early in the calendar year 1948. On the basis of information currently available from SCAP the food necessary to provide efficient employees for Japanese industry on a substantially expanded basis will not be available until after the 1947 crop. It is hoped that certain other scarce materials, particularly coal, will be in more ample supply by that time. It is also necessary to do a substantial job of organization, both within Japan and internationally, and to rehabilitate certain industries such as coal mining, and certain types of facilities before greatly expanded import of raw materials can be processed. This does not mean that we delay doing what we can meanwhile with other food, other raw materials and funds on which, within the limits of our overall foreign policy, we can lay our hands.

5. Potential Opposition to Recovery. Any program for Japanese economic recovery will require the full economic cooperation of the Far Eastern nations to which Japanese exports must be sold, and from which her imports must come. It will also require their political cooperation, since it will call for major FEC policy changes. Most of these countries, however, are emotionally opposed to and fearful of attempts to revive the Japanese economy. Some substantial inducement will be necessary if their cooperation is to be secured.

II. Auxiliary Problems

6. In devising a program for Japanese recovery, consideration should be given to three auxiliary problems:

(a) The fact that the world shortage of dollars will make it difficult for even a fully recovered Japan to repay U.S. occupation costs in other than small annual amounts.

(b) The fact that a reparations settlement limited to capital removals will prove unsatisfactory from the standpoint of the claimants.

(c) The fact that, at present, neither SCAP nor the Japanese government is assuming and successfully discharging general responsibility for carrying out measures essential to Japan's economic revival.

7. U.S. Repayment. The United States wants to be repaid the full amount of its advances for the Japanese civilian supply program. Payment can only be made in goods or dollars. The amounts are large, the world shortage of dollars is and promises to continue to be acute, and the market in the U.S. for Japanese goods is narrow. Even when Japan becomes self-sufficient the payment problem will be acute.

8. Japanese Reparations. The present U.S. reparations policy does not promise to do the claimant countries much good. Most of them are in such a disorganized state economically that their ability to assimilate quantities of complicated capital equipment into their industrial structure is very limited, particularly equipment likely to be in as bad condition as most of that in Japan seems to be. In fact, it is considered unlikely that any large portion of even the interim program will be moved by the claimant countries. What these countries need most are efficient and specific types of goods such as rails, locomotives, coastal steamers, and power plants—produced to specifications, delivered soon, and without further drain on the claimants' foreign exchange resources.

9. Effective Organization of Revival. At present the economic and financial ministries of the Japanese government are weak, don't sympathize with our program, even when they understand it, and have little popular support. SCAP has been slow to take a positive stand on major economic questions. To carry out a positive program for economic revival either the Japanese Government must be reorganized into an effective and cooperative instrument with popular support, or SCAP must modify his present position vis-a-vis the Japanese Government and be prepared to step in and make decisions on economic policy questions. He must also be prepared to see that they are carried out by the issuance of directives, where necessary, and by a more vigorous use of inspection devices to prevent sabotage of economic measures. Without such a firming up of the location of power and responsibility the odds against the success of a revival program, great enough in any case, will be prohibitive. It may be necessary in order to reassure private sources of funds to set up a civilian control of economic policy in Japan, under SCAP but not under the Chief of Staff.

III. Conclusions

10. Future Japanese Imports. Food and raw material imports in excess of disease and unrest requirements should be provided in 1948, and 1949 on the scale necessary to "crank up" the Japanese economy within the limits of world food and commodity shortages. The cost of these additional imports should be met:

(a) By active promotion of barter arrangements or short-term financing of Japanese imports to be used to produce goods for export, a portion of which would be assigned to pay for the necessary imports. These arrangements should be encouraged particularly with countries which do not require repayment in dollars.

(b) To the extent that credit from private sources is not available for the purpose described above, the liquid assets available to SCAP in Japan should be converted into a revolving trust fund to finance such transactions, and if necessary, RFC and Export-Import Bank financing should be sought.

(c) Japanese liquid resources should also be considered available to pay for imports such an food, which cannot be incorporated in the self-liquidating program.

11. Future Japanese Exports. The proceeds of future Japanese exports and their contribution to the revival of the Japanese economy should be maximized by the following steps:

(a) SCAP should, with the aid of the Allied-Trade Representative in Japan, develop a detailed export-import and production plan under which Japan might use the increased imports to be made available during 1948 and 1949 to achieve self-sufficiency by 1950, assuming no reparations removals beyond Interim levels and restrictions on Japanese consumption of items other than food, especially of textiles.

(b) SCAP should implement this plan by appropriate steps, including controls over the distribution of food imports designed to maximize industrial production, and restrictions on the domestic consumption of exportable items. The goals of this plan should be made public to the Japanese people, and their responsibility for and interest in its success emphasized. They should be notified that U.S. Government import advances will cease after 1949.

(c) Sales of Japanese goods should be facilitated by resumption of controlled private trade, including travel of business men to Japan and probably travel—but not permanent residence—of Japanese business men abroad.

(d) The United States should be repaid for imports financed from War Department funds by a first charge on any liquid assets remaining in Japan on January 1, 1950, and by a lien on all proceeds of raw silk exports—silk being generally sold for dollars.

12. Inducements to Other Far Eastern Countries.

(a) The support of other Far Eastern countries for the program outlined above should be enlisted, as recommended in the report of the Japanese Reparations Policy Committee, by assigning them current reparations credits in an amount equal to twice the value of the unclaimed part of their share of the Interim Reparations Program. These credits should not be realizable while U.S. advances to Japan are continuing or out of Japanese export proceeds which are to constitute the U.S. repayments described in the previous paragraph. If, by some given date (e.g. 1955), Japan has not furnished the required amount of current reparations, the claimant countries should be authorized to remove Japanese capital equipment equal in value to one-half the Japanese default.

(b) Security fears of these countries should also be forestalled by revealing the U.S. plan for inspection and control of Japanese rearmament after the peace treaty.

[SOURCE: DIPL. BR., NATOINAL ARCHIVES]

8-16 GENERAL MacARTHUR'S LETTER ON THE FOOD SITUATION AND ECONOMIC STABILIZATION

Letter March 22, 1947
To: Prime Minister Shigeru Yoshida
From: General MacArthur

Mr. Prime Minister:

Last year at this time the Japanese people were confronted with a serious food crisis which disrupted the entire economy and brought severe hardships to the people. In this emergency, the United States shipped substantial quantities of food to Japan which enabled the Japanese people to escape widespread starvation. Food imports have been scheduled for Japan again this year in order to supplement indigenous supplies and to meet the essential minimum requirements of the Japanese people. However, I must advise you that these food imports are calculated on a minimum basis and presuppose the maximum utilization of indigenous foods and the equitable distribution of these supplies. To maximize collections of food into official channels and to bring about a proper transfer of food from surplus to deficit prefectures so as to achieve continuation of food rationing are clear responsibilities of the Japanese Government.

At this time I wish to call to your attention Directive No. 3, which I issued to the Imperial Japanese Government on 22 September 1945. This directive made it the responsibility of the Japanese Government to maintain a firm control over wages and prices and to initiate and maintain a strict rationing program for essential commodities in short supply as well as to insure that such commodities are equitably distributed. It is imperative that the Japanese Government carry out this responsibility to the Japanese people. The Allied Powers, of course, are under no obligation to maintain or to have maintained any particular standard of living in Japan, nor is there any responsibility to import foodstuffs to meet deficits arising from the failure of Japan to assure the just and efficient distribution of its own food supplies.

The food problem, though basic to the peaceful reconstruction of Japan, is not an isolated phenomenon, but is on the contrary only one part of the overall problem of economic stabilization which includes the additional factors of increased production of raw materials and industrial products, stabilized wages and prices, maximum exports, and sound public finance. By the same token, black marketing of food and failure to realize full collections are only two manifestations of general maldistribution. These problems are so inextricably inter-woven that is not practical to think in terms of a solution for one independent of the others. What is required is an integrated approach across the entire economic front. Accordingly, it is essential that the Japanese Government, through the Economic Stabilization Board which was created for this purpose, take early and vigorous steps to develop and implement the integrated series of economic and financial controls which the current situation demands. These economic objectives are national in scope, transcending the special interests of any group, and therefore should be non-partisan. Unless determined measures are undertaken at once by the Japanese Government, the inflationary condition of the economy, together with its attendant maldistribution of food and other necessities, will become increasingly serious, industrial recovery will be further retarded, and the achievement of the social and political objectives toward which the Japanese people have made such an encouraging start will be endangered.

The social and economic welfare of Japan will depend largely on Japan's own efforts in the redirection of its human and natural resources to peaceful living and upon competent public administration of democratic and effective economic controls. Aid to Japan cannot be expected upon a scale sufficiently great to overcome maldistribution and inflation within Japan. Outside assistance is contingent upon full utilization of indigenous resources, which is entirely a responsibility of the Japanese Government.

Sincerely yours,
DOUGLAS MacARTHUR

[SOURCE: SUITLAND PAPERS, Z 703–44]

8-17 A POSSIBLE PROGRAM FOR A BALANCED JAPANESE ECONOMY

Report[7] March 27, 1947
Prepared by: Research and Statistics Division, ESS, SCAP
Restricted

FOREWORD

The 1950 program for Japanese industry, set forth in the accompanying tables and text discussion, is intended as a point of departure for intensive discussion within SCAP. It is not intended or expected that the material will be released without basic general agreement on the estimates and analysis.

The requirement program is based on a few simple but fundamental tenets. The first is that the Japanese economy, to be stable and balanced, must provide its growing population with a minimum acceptable standard of living. The norm selected as reasonable is the average per capita level of living in the years 1930–34. The second major premise is that Japan, as an essentially industrial nation, must rely upon imports of a substantial portion of her foodstuffs and still more of her necessary industrial raw materials. It is therefore crucial for Japan that she be able to develop her industrial production to levels and along lines which will provide sufficient profitable exports to balance her international accounts. Both the standard of living and the foreign balance criteria take for granted the paramount objective of the Allies, that Japan shall not have the specific industry potential or the will to wage war again.

A significant shift in the structure of Japanese industry and trade is involved in the program. Machinery production and exports are proposed at levels considerably higher than in the base period—though not nearly so high as Japan achieved at the height of her military power. On the other hand textiles would assume a relatively less important role in Japanese economy. There was a strong power trend in this direction in Japan even apart from military preparations. It is in keeping with natural lines of development from lower to higher stages of industrialization. Japan has acquired industrial capacities, skills, "know how," in the

[7] Accompanying tables omitted.

machinery, metals and chemicals industries which are urgently needed in the development of Far Eastern economic life. There is natural complementarity between the economies of Japan—exporting chiefly higher fabricated goods—and other less industrialized areas which can supply Japan with food and raw materials while themselves developing a manufacturing base in textiles and other light industries.

The heart of this study is the levels of industrial production that Japan must attain to achieve both internal and external balance within the setting of Far Eastern and world economy. By comparing these target levels with the estimated present restorable capacities of major industries it is possible to judge where there are surplus capacities or deficits requiring capital expansion to attain production goals. In the case of industries specified in the Interim Reparations Levels program the present restorable capacity figures used are *after* the effects of proposed reparations.

It is believed that there is inherent logic and necessity in the over-all character of the program here proposed. Nevertheless specific details may be open to question. The important point is that agreement now on the kind of economy Japan requires for a stable and peaceful future is absolutely essential to remove present doubts and confusion and to raise Japanese production and trade from their current low levels.

Major Conclusions

1. In order for Japan to have a balanced economy—defined below—in 1950, it will be necessary for her to be able to produce in over-all terms 36 percent more industrial goods than in the 1930–34 base period. On the other hand, her present restorable capacity for industrial output is only 23 percent above the base period, after account is taken of the effects of the Interim Reparations program. (See Table 3)

2. If the currently proposed Interim Reparations program were to be executed, it would leave Japan deficient in a number of strategic basic industries, e.g. ball and roller bearings, shipbuilding, electrolytic caustic soda, chlorine, thermal electric power and in crude steel. On the other hand the program appears to be liberal in terms of retained capacity for machine tool production. (See Table 1)

3. Further analysis of Japanese requirements as against present restorable capacities reveals that there will still be excess capacities in some industries but deficiencies of capacity in others. Additional important instances of the former are railroad rolling stock, non-ferrous metal refining, several chemical industries; chief instances of the latter are most branches of the textile industry, salt, ship-building and coal. In these and other industries there is need for considerable amounts of capital investment and expansion in the form of plant and equipment. (See Table 4)

4. In view of the above, it appears that the Interim Reparations program is in need of revision, with more attention paid to Japan's peacetime requirements for a tolerable standard of living and a balance in her international accounts. There is a point beyond which complete destruction of all war-making potential also means serious impairment of a country's capacity for peace.

5. Under the requirements program set forth in this report (see Table 5), Japan could achieve a reasonable balanced economy. This is defined to mean a real per capita standard of living equal to that in the base period (average 1930–34); and a sufficient volume of exports to pay for the necessary imports, with due account taken of service and invisible items in the balance of payments. (See Table 6)

6. Attainment of this desired balance in Japan's international account requires not only a sufficient level of physical productive capacity and exports, but also a sufficiently favorable relationship between the prices received for exports as compared with prices paid for imports. If this relationship of export to import price levels (terms of trade) is as favorable as in the base period, it appears that the accounts would balance. If price levels and relationships were roughly the current ones—adjusted for obviously extreme cases—there would be a deficit in Japan's international balance of payments amounting perhaps to over $100 million. Such an amount—less than $1½ per person—could easily be met by an equivalent reduction in the standard of living, either through reduced imports, increased exports, or some combination of both. (See Tables 6 and 6A)

7. The character of Japanese industrial production and foreign trade will need to be drastically different from pre-war days. Silk production and exports will be lower. Exports of textiles and textile products as a whole will have to be less than in the base period. Machinery production and exports must become relatively far more important. Imports of foodstuffs can be sharply reduced, and domestic production greatly expanded. However Japan's imports will still continue to be chiefly foodstuffs and industrial raw materials; and her exports chiefly

textiles, machinery products, and other highly fabricated goods. (See Tables 5, 7 and 8)

8. One of the most acute problems will be the lack of an adequate merchant fleet. In the pre-war period Japan had a merchant fleet of over 4,000,000 tons and derived considerable income from the carrying trade. She will, under the present Interim Reparations program, be permitted a usable tonnage of 2,000,000 tons; at present she has only half this tonnage. If allowed only 150,000 tons of new construction per year it would take Japan ten years to achieve the permitted level, twenty years to achieve the estimated minimum required level of 3,000,000 tons. The rate of construction shown as required in the tables is 350,000 tons a year, calculated to allow reaching a merchant fleet of 3,000,000 tons in seven years. In any event Japan will remain a net debtor in terms of shipping rather than a creditor, which in effect means that a considerable amount of her exports must pay for the additional cost of imports carried in foreign bottoms. (Tables 1 and 6)

[The intervening paragraphs are missing in the original.]

industrial capacity before reparations. There is clearly considerable excess capacity in pig iron, basic steel, aluminum, machine tools, ball and roller bearings, ship-building, etc. (Table 1) However the levels of capacity to be retained in these industries under the proposed Interim Reparations plan, except in the case of machine tools, fall considerably short of requirements.

When it comes to non-reparations industries (see Table 4) there are many cases in which present restorable capacity is well below stated requirements. This is most notably the case in textiles. Here the problem is one of serious deficiency of capital equipment, spindles, looms, and other machinery. A few examples are shown here. The amount of equipment shown as presently available (as of December 1946) counts units whether actually operating, operable, or inoperable, and is therefore an overestimate. In the case of coal mining too, considerable capital outlay and expansion is required. Other instances of necessary capital expansion are superphosphate and salt. (Table 4)

Industry	Unit of equipment	Average Number 1930–34	Peak Number		Total number now available	Number required to obtain required production*	% of number available to number required
			Year	Number			
Cotton yarn	Spindles (000)	8,190	1937	12,165	3,800	6,000	63
Cotton woven	Loom	289,800	1941	393,300	153,200	180,000	85
Raw silk	Basin	287,300	1929	327,000	36,600	40,000	91
Silk woven	Wide loom						
Rayon woven	" "	253,300	1937–38	356,100	60,700	61,825	98
Woolen yarn	Card	500	1940–41	730	568	1,060	54
Woolen and worsted woven	Loom	24,100	1939	30,900	13,200	27,500	40

* On two shift basis throughout. If operations were on a one shift basis twice as much equipment would be required.

If Interim Reparations levels were to become effective in the industries listed, there would of course be further capacity deficiencies in many of them—for example basic steel, ball and roller bearings, electrolytic caustic soda, ship-building and thermal electric power.

It was stated earlier that in over-all terms Japan's present restorable industrial capacity (after Interim Reparations) is about 23 percent above base period production. (Table 3) Over-all requirements however call for a 36 percent expansion over 1930–34, so that the Reparations program would leave Japan deficient in industrial capacity by 10% over-all. Furthermore, there is considerable room for difference of opinion as to what constitutes present restorable capacity in various Japanese industries. There are some inclined currently, for whatever reason, to put rated restorable capacities in many industries at levels considerably lower than these suggested in this report. Such differences in appraising Japan's present industrial potential need to be threshed out if reparations decisions are to be realistically arrived at and executed.

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[Source: Suitland Papers, Z 703–21]

8-18 ACJ'S VIEW ON STABILIZATION OF WAGE-PRICE RELATIONSHIPS

Statement April 14, 1947
By: Allied Council for Japan: Office of the Member

representing jointly the United Kingdom, Australia, India and New Zealand.

Summary of Conclusions and Recommendations.

1. The destruction and wastage of war and the dislocations of defeat present the Japanese Government with a series of major economic problems.
2. Japan today is faced with a two fold task. First, to restore capital equipment for the production of peace time goods and, second, to ensure that the goods produced are justly distributed. Efficiency and social justice must be the keynotes of economic policy.
3. Inflation must be stopped. It has produced inefficiency, since available resources have been wasted in non-essential uses. It has caused injustice by throwing the main burden of sacrifice on wage and salary earners while other sections of the community have profited.
4. While the immediate cause of inflation is the unbalanced budget, a more fundamental cause is the failure to make price control effective by strict control over the distribution of raw materials and consumer goods.
5. The control of raw materials must be enforced to make price control effective and to ensure that materials are reserved for essential uses. It should be based on a permit system. Permits should be necessary for both the purchase and transport of controlled materials. Records for Government inspection of movements of controlled materials should be kept by suppliers, merchants, carriers and users.
6. Rationing of essential consumer goods is necessary to ensure just distribution and should be controlled by a coupon system.
7. Prices should be fixed to restrict profits to a minimum. Control of prices to prevent profiteering is more important than fixing a particular level of money wages since, in the present circumstances of Japan's economy, increases in wages simply raise costs and prices, and do not increase real wages.
8. Provided profiteering is eliminated by price control, wages should be pegged as an additional safeguard against excessive increases in costs and prices. These pegged rates should, however, be periodically reviewed and raised as production efficiency increases.
9. Every effort must be made to ensure that Government revenue keeps pace with expenditure. Taxes should be based on current income. Returns of business and professional incomes should be made at intervals of less than one year, if possible each quarter, so that taxes may be adjusted to current earnings.
10. Government expenditure should be pruned to eliminate all but the most essential items. Accounts submitted by Government contractors should be carefully audited prevent excessive charges.

[SOURCE: SUITLAND PAPERS, Z 703–23]

8-19 ESSENTIALS OF THE ESS ECONOMIC STABILIZATION PROGRAM

Report May 20, 1947
Prepared by: Economic and Scientific Section, SCAP

SUMMARY

1. *Industrial materials distribution.* Critical industrial materials will be allocated to essential industries at official prices.
2. *Food distribution.* Food officially distributed will be increased through progressive closing of blackmarket outlets and expanding linked distribution of consumer goods to food producers in exchange for deliveries.
3. *Consumer goods distribution.* The most essential consumer goods will be rationed generally, but other controllable consumer items will be delivered to special productive groups as incentive.
4. *Price control.* Effective prices will be reduced through progressive diminution of blackmarket purchases; price ceilings will be realigned and enforced in accordance with a cost of production formula for industrial commodities and a parity formula for agricultural commodities.
5. *Wage control.* Wages will be stabilized at a proper ratio to cost of living through direct budgetary control of government workers and wage adjustment standards to be used in mediating labor disputes.
6. *Government expenditures.* Government expenditures will be restricted and legal prices and prevailing wages observed in public contracts.
7. *Taxation.* The new 1947 income tax laws will be strictly enforced to siphon off excessive purchasing power, particularly of the "new yen" class.
8. *Industrial credits.* Credits will be furnished to essential industries and withheld from non-essential industries through a priority system.
9. *Business reorganization.* The reorganization of business on a peace-time non-monopolistic basis will be completed rapidly to remove uncertainties obstructing industrial production.
10. *Exports.* Exports and export industries will be maximized by all practicable measures.
11. *Foreign trade financing.* Liquid funds sufficient to provide initial raw material imports and permit flexibility and ingenuity in promoting sound foreign trade ventures will be made available.
12. *Expediting critical industries' production.* Special intensive programs will be used to break bottlenecks in selected critical industries, as coal and fertilizer.
13. *Administrative reform.* Government agencies dealing with economic stabilization will be reorganized to place persons thoroughly competent and sympathetic with the program in control.
14. *Enforcement.* An energetic program will be prosecuted with emphasis upon apprehending and punishing major malefactors.
15. *Publicity.* The above program will be thoroughly explained to the Japanese people.

ESSENTIALS OF THE ESS ECONOMIC STABILIZATION PROGRAM

INTRODUCTION

Economic stabilization in the indispensable prerequisite to Japan's economic recovery which must be attained if faith in democratic ways is to be affirmed and totalitarian alternatives rejected by the Japanese people.

The constantly developing inflation which has come to characterize the Japanese economy has resulted primarily from the failure to utilize most effectively through rational controls the inadequate resources of a country impoverished by a disastrous war.

The inflation has impeded the distribution of materials, goods and services to essential industries and has created great and obvious inequities in purchasing power among the various groups of the population. If this situation continues, the consequent social unrest among the lowest real income groups is likely to endanger the basic aims of the Occupation.

The Economic and Scientific Section has, over the past twenty months developed a comprehensive, integrated, corrective program. It has been communicated to and urged on the Japanese Government. Many of its principles have been adopted in legislation and ordinances. However, it has never been enforced in the degree or spirit demanded by the existing situation. Herein lies the basic explanation for the continuing failure to realize any marked degree of stabilization.

The essentials of this program are submitted herewith. They deal only with key measures, fifteen in all, which will decide the issue. However, they will not achieve stabilization if applied singly. They must be applied in a coordinated fashion with careful attention to timing and interrelationships, and under the unified control of the Japanese Economic Stabilization Board.

Given integrated and vigorous action by the Japanese, this program can speed the achievement of economic stabilization immeasurably; if it remains incomplete or ineffective, stabilization will become progressively more difficult to attain.

PROGRAM

1. *Industrial materials distribution.* Essential industries must be assured adequate supplies of key raw and semi-finished materials at official prices. In return for this assurance they will be required to produce only essential products to sell at official prices. This will be carried out through the planned allocation of selected critical materials. The allocations list, which at present consists of 17 critical materials including coal, steel, lumber, salt, cotton, glass, lead and petroleum products, will be enlarged or reduced as needed. The completed plans have already been put into effect. Controls will be progressively tightened to eliminate the movement of materials outside the allocation system.

2. *Food distribution.* Food collected and distributed through official channels must be

increased considerably over the 1946–47 level. The reluctance of farmers and fishermen to deliver food above the low quotas assigned, stemming from the much greater returns offered by blackmarket prices, and their inability to procure desired goods at official prices, will be combatted by: (a) the progressive closing down of blackmarket outlets and confiscation of and punishment for non-delivered staple foods, and (b) the expansion of the link system to assure consumer goods at official prices in exchange for food deliveries.

3. *Consumer good distribution.* A controlled supply of specified consumer goods must be available in quantities adequate to provide incentives, other than excessive monetary outlays, for increased food collections and for workers in especially hazardous and essential occupations. Consumer goods produced through special material or credit allocations will be earmarked for this purpose. Although the most essential consumer goods will be rationed to the general population to keep their prices down, emphasis will be placed on diverting other controllable consumer goods to special productive groups on a link basis.

4. *Price control.* The rapid rise in key commodity prices must be drastically slowed down and ultimately stopped. At the same time effective commodity prices must be lowered by progressive elimination of purchases at blackmarket prices. Official prices must be low enough to avoid the recurring need for inflationary wage increases on the one hand and to eliminate inordinate profiteering on the other, while simultaneously providing sufficient incentive for essential production. This will be accomplished by realistically realigning key price ceilings in accordance with a cost of production formula for industrial commodities and a parity formula for agricultural commodities. The Economic and Scientific Section and the Japanese Price Board have already worked out proper pricing formulas and the most important ceilings have been set in accordance with them, subject to readjustments as required by changing circumstances.

5. *Wage control.* Wage levels must be stabilized at a proper relation to price and cost-of-living levels. In many industries and occupations, wages and workers' income have fallen far behind increased living costs. Where they have fallen so far behind as to directly threaten health, worker productivity or family stability, for the time being, wages must be allowed to increase. Otherwise, however, wage increases will be permitted only to the extent necessary to maintain an equitable relationship between wage levels and cost-of-living. Where wage increases for the latter groups would threaten key price ceilings, such increases will be held in check by: (a) providing incentive consumer goods rather than increased money wages to workers in essential and hazardous industries, (b) application of existing budgetary controls on wage increases for the large number of workers in government service and on public contracts (nearly 1/3 of all employed wage earners) and (c) establishment of wage adjustment standards to be used by the Labor Relations Committees in major disputes involving wages.

6. *Government expenditures.* Government expenditures must be restricted to the amounts necessary to carry out appropriate and authorized government functions. This will be accomplished by careful screening of budgetary allotments and control of public contracts to eliminate payment of blackmarket prices, excessive wages and inordinate profits. To avoid paying exorbitant prices the Japanese government will be instructed to make greater use of its power to requisition stocks of goods where they cannot be procured at legal prices.

7. *Taxation.* Revenues adequate to support government functions must be assured and excessive concentration of purchasing power among relatively small groups of the population must be siphoned off. This will be done through effective application of the new 1947 income tax laws, which are designed to hit hardest at the "new yen" class which has profitted most from the inflation.

8. *Industrial credits.* Credits must be prevented from financing non-essential enterprises which drain commodities from the available supply. A credit priority system, requiring financial institutions to withhold funds from non-essential enterprises and channelling credits to essential industries needing assistance has been instituted by law and will be enforced. Criteria governing essentiality for credit purposes have been coordinated with criteria governing the materials allocation plan. This system will be supported by the refusal of the Bank of Japan to rediscount non-essential credits.

9. *Business reorganization.* Business reorganization on the basis of peacetime industry and genuine competition must be rapidly completed and unnecessary uncertainties obstructing resumption of production removed. This will be accomplished by: (a) final designation of plants to be removed for reparations as soon as the final reparations plan is received, (b) immediate issuance of reorganization standards for Zaibatsu and other corporations undergoing reorganization, (c) elimination of control associations which are hampering free expansion of private business, cornering scarce goods and increasing commodity prices unnecessarily.

10. *Exports.* Export and production for export must be maximized by all practicable means to obtain foreign exchange for the import of food, fertilizer and raw materials for essential industries. Priority in allocations of materials and industrial credits, and rigorous limitation in domestic use of exportable commodities will be utilized to this end.

11. *Foreign trade financing.* Liquid funds sufficient to provide initial raw material imports for reviving export industries and to permit flexibility and ingenuity in initiating and promoting sound foreign trade ventures must be available. Such funds will be acquired by borrowing from foreign sources with guaranteed exports, impounded Japanese liquid assets and other resources as revolving credits and as security.

12. *Expediting critical industries production.* In addition to utilizing general measures outlined above to promote production in key industries, special intensive programs must be undertaken by the Japanese Government to remove bottlenecks in a few selected industries. Such programs have already been carried on in the coal and fertilizer industries with success. They will be continued and extended to other critical industries.

13. *Administrative reform.* The above program must be supported by administrative reorganization and the appointment of new personnel thoroughly committed to a consistent program of economic stabilization. Any number of constructive economic stabilization measures have been officially adopted by the Japanese Government in the past, but these have not been applied in the spirit or on a scale necessary to make them effective. Effectuation of economic stabilization will require rapid organization and staffing of government agencies to replace the still operating semi-private control associations, expansion of the Economic Stabilization Board under inspiring and determined leadership, establishment of ESB authority over the ministries, and prompt removal of Japanese officials obstructing the economic stabilization program.

14. *Enforcement.* The above program must be supported by comprehensive and fearless enforcement. This will apply not only to extra-legal prices, but to tax evasion, transportation and sale of commodities outside of ration channels, misuse of allocated materials, failure to carry out industrial credit policy, and all other control violations. Enforcement must be characterized by a willingness to apply criminal penalties where necessary and emphasis on detection and punishment of the few large, rather than the numerous small, malefactors.

15. *Publicity.* The above program must be explained thoroughly to the Japanese public to enlist popular support in a democratic society and to forestall selfish pressure groups who may attempt to undermine economic stabilization by misuse of the democratic institutions established under the new constitution.

[SOURCE: SUITLAND PAPERS, Z 703–20]

8-20 ECONOMIC CONDITIONS IN JAPAN[8]

Report — August 1, 1947
Prepared by: Research and Statistics Division, ESS

INDEX

Summary
Industrial Production
Foreign Trade
Prices and Wages
Finance

SUMMARY

It is becoming increasingly clear that the Japanese economy cannot attain a degree of recovery which even at a minimum level will place the nation on a self-supporting basis unless (a) foreign exchange to finance the essential imports is secured, both through credits from foreign sources and through substantially increased exports, and (b) adequate imports of essential raw materials are obtained. It is also clear that such a degree of recovery is not an immediate prospect; and for this reason, the Japanese Government is confronted with the dire necessity of taking steps to obtain maximum economies and optimum utilization from the national viewpoint of available resources.

Among the more significant current features of the economy are the following:

[8] Only the Summary is printed here.

I. The level of industrial production is approximately 40 per cent of the 1930–34 average. Although there has been an increase above the level of one year ago, the rate of increase has been slow, and the prospects for substantial improvement within the next 12 months are beset with difficulties. Many of the conditions which have retarded industrial recovery are assuming a chronic character.

II. Imports of raw materials have not approached the amounts necessary to invigorate Japanese industry. Imports of all commodities other than food and fertilizer materials in the first 6 months of 1947 were at a rate approximately 5 per cent of average 1930–34 imports of such commodities. Food and fertilizer imports are at a relatively higher level. Although sufficient food has been imported to prevent starvation or violence, a large segment of the population is poorly nourished, and total supplies of food are so low that inflation has been retarded only to a limited extent.

III. Inflation continues unchecked. The Tokyo effective price level for all foods, for example, in July 1947 was approximately 100 per cent higher than a year ago. Advances in official prices and in wage rates were even greater. Government expenditures and deficits continue to increase, the cash deficit for the fiscal year ending March 31, 1947, amounting to ¥65 billion.

IV. Real wages, in spite of substantial increases in nominal wages, are still seriously low, and maldistribution of scarce essential goods remains pronounced. Although in May 1947 money wages had advanced almost 26 times above the levels of the early years of the 1930 decade, effective prices were from 60 to 90 times as high as in the same period. Although the distribution of grains (rice, wheat, barley, flour, and corn), which are the most important foods in terms of calories, is reasonably equitable, maldistribution of all other foods continues to be acute.

V. The industrial cost structure is not only seriously distorted from any reasonable or normal pattern but the cost level continues to advance primarily under the impact of rising wage rates and procurement of materials in the black market. The consequent impact upon the level of official prices is obvious.

VI. The situation however is not completely discouraging. Increasing understanding of the specific nature of the basic problems will inevitably lead to a degree of successful solution. The importance of the fact that grains and cereals are distributed by means of relatively effective governmental controls in a fairly equitable fashion must not be underestimated. Should these controls weaken, the consequences might well be violent. The worst period of food shortage during the year has passed; with increased arrivals of food imports and the harvest of summer wheat and barley, the next 3 months promise some improvement in the food supply. Preliminary estimates of a normal rice crop in November are encouraging. The present Government is approaching the economic situation in an intelligent and farsighted fashion even though the vigor of its approach and its political strength are still in doubt. Recently inaugurated measures, such as the financing of coal mine rehabilitation, will doubtless have salutary effects in the coming months. The Government is undertaking a stabilization program which includes a revised wage-price policy, improved distribution controls, and a drive to exterminate large-scale blackmarketing.

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

8-21 REGARDING THE ESTABLISHMENT OF KODANS[9]

Informal Memorandum — September 3, 1947
To: Mr. Hiroo Wada, Director-General, Economic Stabilization Board
From: W. F. Marquat, Chief, ESS

1. Your proposals for the establishment of kodans in the following fields have been carefully considered:
   a. Iron and steel.
   b. Basic industrial chemicals.
   c. Rubber.
   d. Hides and leather.
   e. Consumer daily necessities.
   f. Coal mining.
2. These proposals cannot be considered favorably at this time for the following reasons:

[9] Public Corporations.

a. The proposed additional kodans go beyond the scope of the original understanding concerning the extent to which kodans would be used. Particularly, in connection with the coal mining kodan the contemplated scope of activities far transcends the original conception of the role of kodans as distribution mechanisms. In the case of chemicals and consumer daily necessities, an enormous number of commodities, many of them unimportant in character, are recommended for distribution control by kodans. It is deemed that an excessive inspection force would be needed to ensure sole distribution by the kodans of such a variety of items. Implicit in any such enforcement activity is the danger of unreasonable petty investigations and searches.

b. In many instances where new kodans are being requested, such as rubber, hides and leather, and iron and steel, it can be demonstrated that existing allocation and rationing controls affecting the commodities included are not being effectively implemented. Allocation certificates are regularly being granted in excess of commodities available for distribution. This difficulty cannot be met by creating kodans. It can be met only by adjusting the allocation to equal the supply. In every instance it is my view that substantial tightening of existing controls can be effected with far fewer personnel than that required by the proposed new kodans. It is believed that the need for additional kodans of the type proposed could largely be eliminated by a tightening of outstanding control ordinances.

c. The widespread growth of kodans, using as they do personnel and officials of former Zaibatsu companies as well as control unions and associations, creates the clear threat of the perpetuation of these objectionable institutions under a different guise and under the protection of the Government. While the kodans are designed to be of temporary character, it is quite possible that they may be renewed regularly for some time and in the absence of persistent vigilance become so ingrained in the application of essential controls that their dissolution would be most difficult. Under these conditions there is a genuine danger that the functions which the Government intends the kodans to perform may in effect be perverted by selfish special interests.

d. The considerable complexity and broad scope of the proposed kodans would require an enormous administrative and enforcement staff not amenable to the same controls prevailing for the regular government civil service. The establishment of rates of remuneration far in excess of that prevailing in the regular civil service would create various difficulties. Finally, the requirement for substantial funds from government sources to finance the working capital of the kodans would constitute a genuine inflationary hazard.

[SOURCE: *Eibun Sengo Shiryō*, vol. 3. ECONOMIC PLANNING AGENCY]

8-22 THE POSSIBILITY OF A BALANCED JAPANESE ECONOMY[10] (GREEN BOOK)

Report — October 1947
Prepared by: Economic and Scientific Section, SCAP

SECTION III
APPENDIX TABLES

A. Table: Forecast of Major Industrial and Consumption Levels and Foreign Trade 1948–53 with Comparisons
B. Food: Table B1 — Estimated production utilization and import requirements of staple foodstuffs, 1948–53
   B2 — Estimated production of staple foods for the crops of 1947–53
C. Textiles: Production, Export, Domestic Consumption Forecast 1948–53 Compared with 1930–34 Average, 195X Requirements and Actual 1946–47.
   Table C1 — Cotton textiles
   C2 — Raw silk
   C3 — Silk fabrics
   C4 — Rayon filament and staple fiber
   C5 — Wool textiles
   C6 — Domestic textile consumption

[10] Usually known as the "Green Book". This document is Section III of the "Report on the Occupation of Japan" (October 1947) and Section I is entitled "Progress Toward Broad Political and Economic Objectives".

D. Basic reference data:
Table: Japanese production, imports, exports and net supply, 1930–34 averages and year of peak supply.

I. Summary

Introduction

The economic recovery of Japan depends primarily on the importation of such basic raw materials as coking coal, high-grade iron ore, salt, rayon pulp, petroleum, fertilizers, cotton, and wool. For many of these materials, the former sources of supply are not now available. Formerly, the raw material sources for Japan were in large part its colonies and other parts of the Far East now torn by political strife and economic disorganization. To obtain materials from other parts of the world involves long shipping hauls, high costs, currency problems, and other difficulties. In addition, many of these materials are in world short supply.

This dependence of Japan on raw materials from Far Eastern countries makes it necessary to evaluate the prospects of Japanese economic recovery on separate fundamental bases—the first basis, designated as Condition "A", rests on the assumption that there will be little improvement in the political unrest and economic disorganization in the Far East—the second basis, designated as Condition "B", assumes a resonably favorable rate of improvement in the Far Eastern political and economic situation.

Objectives

Three basic objectives have been kept in mind in making these estimates for the rehabilitation of the Japanese economy: first, to stimulate the rehabilitation of the economies of all the Far Eastern nations; second, to assure permanent establishment of democratic institutions in Japan; and third, to eliminate the necessity for financial assistance from the American Government.

Japan's Capacity

Japan is producing currently about 85 per cent of the present low food consumption of its population. When food consumption reaches a more adequate level, Japan will be able to produce only about 75 per cent of its food requirements. The loss of colonies as a result of the war has made it imperative to seek elsewhere for food imports. In raw material resources, Japan is outstandingly deficient; and technological changes have reduced the market for raw silk, once Japan's most important source of foreign exchange.

In order to attain the objectives of a self-supporting economy and to contribute to the well-being of neighboring economies, Japan must import approximately 25 per cent of food requirements in addition to the industrial raw materials mentioned above.

Japan still retains a large industrial plant capable of being utilized to produce goods for foreign sale to secure exchange for the purchase of food and the essential raw materials which Japan lacks and to produce the commodities so vitally needed in the rehabilitation of the other Far Eastern economies.

Conditions for a Balanced Economy

Because of the limited availability in foreign sources of many commodities, international financial difficulties, and certain industrial bottlenecks in Japan such as textile capacity, transportation capacity, and low rate of coal production, the rehabilitation of the Japanese economy to a balanced position will require several years to achieve. The rate of recovery will depend primarily upon conditions in foreign markets, both with respect to the availability of materials for export and of their ability to purchase imports. Under both Condition "A" and Condition "B" it is assumed that Japanese consumption will be restricted to the practicable minimum consistent with rehabilitation of the economy. A gradual rise in the Japanese standard of living to normal levels, however, is allowed; but the balance in international payments nevertheless will be achieved one or two years earlier than the achievement of the level of production necessary to provide the prewar living standard.

Foreign Trade and Production Levels in the Future Economy

When reasonably acceptable levels of production are attained, under the assumptions of Condition "B" in 1953, the level of industrial production will approximate 135 per cent of the 1930–34 average; and per capita consumption will be approximately equal to that of the base period. The principal differences between foreign trade in the future balanced economy and in the base period will be in greater imports of foodstuffs, greater exports of machinery and metal products, and smaller exports of raw silk.

The altered character of the export-import trade of the economy, when reasonably acceptable levels will have been obtained, is shown in the following table:

	1930–34 (average)	1947 (estimate)	1953 Forecast Condition "B"
	(in million dollars at present price levels)		
Total Exports	1827	260	1640
Textiles	1200	208	900
Machinery and Metal Products	140	10	325
All Other	487	42	415
Total Imports	1840	423	1540
Textile Fibers	612	91	462
Ores, Metals, and Minerals	242	41	214
Foodstuffs	498	229	530
All Other	488	62	334

Industrial production in the future economy will substantially exceed base-period production in machinery, rayon textiles, and commercial fertilizers and will be greatly reduced in silk. Per capita domestic consumption of textiles and of food will approximate the levels obtaining in the 1930–34 period. The supply of coal and of steel will be about 5 per cent higher on a per capita basis than in the base period.

Under Condition "A", Japanese industry even by 1953 will achieve a production level only approximately equal to that of the 1930–34 period but only 76 per cent of the 1930–34 level on a per capita basis.

Need for Appropriate Funds

In calendar year 1948, imports under Condition "A" are estimated at $620 million. Of this amount, approximately $400 million represents food, petroleum, fertilizer, medical supplies and other essential commodities for which United States appropriated funds are required. Raw cotton and other raw materials of a self-liquidating nature will be financed by the Revolving Fund. The bulk of export proceeds must go initially to repay the Revolving Fund and to build it up in order that it can finance the raw material imports for an expanding Japanese economy. Thus, for calendar year 1948, with the need for appropriations estimated at $400 million and the net trade deficit estimated at $240 million, the balance of $160 million would build up the capital in the Revolving Fund and in commercial accounts.

The rapidity with which the need for appropriated funds for supplies will diminish from this level depends primarily on the ability to attain currency conversions between other currencies and dollars. This is so because the greater part of Japan's exports will be to other Far Eastern areas whereas, for at least several years to come, the basic essentials for Japan's life must come from the United States. If this currency problem is solved, then Japan will no longer be dependent on United States appropriated funds—under Condition "B" by 1951—under Condition "A" by 1953.

Subject to the above very important qualifications, the order of magnitude of future appropriations needed to put Japan on a self-supporting basis would be approximately $1200 million under Condition "A" and $950 million under Condition "B".

The need for future appropriations would be in a diminishing scale from 1948 to the time when a balanced economy is attained—under Condition "A", starting with $400 million in 1948 and ending in 1953—under Condition "B", starting with $400 million in 1948 and ending in 1951. These estimates are for supplies for Japan. They do not include administrative expenses of the occupation or the needs of the Ryukyus.

Balance of Payments and Problem of Foreign Exchange

The net balance of international payments for Japan, i.e., the net trade position in all

Year	Condition "A"	Condition "B"
	(millions—dollar equivalents)	
1948	−240	−200
1949	−145	−175
1950	−160	−100
1951	− 65	0
1952	− 55	+ 75
1953	0	+100

currencies expressed in dollars for convenience, will approximate the following amounts:

Under Condition "B" a trade balance is forecast in 1951 but under Condition "A" not until 1953.

If Japan were a going concern, and if all currencies were freely convertible to dollars, the above amounts would represent the amount of outside assistance needed by Japan. Neither of these conditions exists at the present time. Japan is in a highly disorganized condition economically with foreign trade at a very low ebb and consequently needs funds to revive its economy. Other currencies are not now convertible into dollars, and the dollar shortage is becoming more acute among Japan's customers.

In considering the need for United States appropriated funds in relation to these trade estimates, the following additional factors must be kept in mind.

(1) At present practically all food, fertilizer, petroleum, medical supplies, and many other essential supplies are available only in the United States and for which dollars must be available.

(2) The proceeds of exports made possible by imports financed by the revolving fund must be used to repay the fund and to build it up for future enlarged imports.

(3) The estimates in this study are trade estimates and do not make allowance for such financial aspects as (a) payment for goods exported from Japan is frequently not made until after the goods have been exported, and (b) appropriated funds must be available before imports are ordered and considerably in advance of the time they are actually imported.

(4) These estimates represent a realistic appraisal of trade prospects and procurement possibilities. Funds should be available in case unanticipated opportunities should develop to purchase basic raw materials that could be used to speed up Japanese recovery and to shorten the period of dependence on United States appropriations at a faster rate than shown by these estimates.

(5) With a rapidly changing price level, adjustments would be necessary in accordance with these changes.

(6) Administrative expenses of the occupation are, of course, not included in the trade estimates.

In connection with any particular period, the above factors must be analyzed carefully at the time in order to determine the amount of the appropriation needed.

Need for Controls

During the several years of economic recovery, consumption in Japan will be restricted to relatively low levels. Goods and materials will be in short supply relative to demand; and for this reason, a series of economic control measures designed to achieve efficient utilization of materials and to minimize maldistribution of goods is mandatory. These measures include allocation of critical materials, rationing of food and other key consumer goods, price and credit controls, export-import and exchange controls, and various supplementary measures essential to the effective administration of the economic controls. Otherwise, it will not be possible to channel materials to their most essential uses, and the repayment of loans from the Revolving Fund and the advances made by the United States would be jeopardized.

Conclusion

A production level high enough to meet the goal of attaining a degree of economic activity sufficient to meet the objectives of providing substantial essistance to the other Far Eastern nations and for providing the economic basis for flourishing democratic institutions—in other words, a balanced economy—will be reached under Condition "B" by 1953.

Under Condition "A", these objectives will not be attained.

A balance of international payments which, if arrangements are made to meet the problem of currency conversion, would eliminate the need for United States appropriated funds will be achieved in 1951 under Condition "B" and in 1953 under Condition "A".

[SOURCE: SUITLAND PAPERS, Z 703–40]

8-23 SANACC MINUTES ON THE REVIVAL OF THE JAPANESE ECONOMY

Minutes — October 23, 1947
SANACC[11], 61st Meeting
Top Secret

[11] State-Army-Navy-Air Coordinating Committee, redesignation of SWNCC.

1. REVIVAL OF THE JAPANESE ECONOMY (SANACC 381/1)

The STATE MEMBER said that the State Department was of the opinion that SANACC 381/1 covered the substantive points in SWNCC 384 and suggested that SANACC 381/1 be tentatively approved and that the Army withdraw SWNCC 384 from consideration by the Committee.[12]

The ARMY MEMBER pointed out that of Potsdam three basic principles had been approved for the control of Japan, namely, demilitarization, democratization and economic self-sufficiency. He said that the first of these had, in the opinion of the Department of the Army, been substantially completed and that the second was well on its way toward realization but that he had been unable to find any definite indication in directives to SCAP that the U.S. Government considered economic reconstruction as a primary objective in its handling of Japan. He went on to say that it would be extremely difficult to revive Japanese economy and that it probably would be even more difficult to continue to secure substantial funds from Congress for purposes of the occupation. Should SANACC come up with a paper which indicated that the economic recovery of Japan was a primary objective of this Government and if SCAP would be so notified, he felt that it would be much easier to get funds from Congress.

MR. CLAXTON suggested that the Conclusions of SANACC 381/1 could be modified to indicate State's acceptance of the principle of economic recovery being a primary objective of this Government, and asked if it would be satisfactory to the Army Member if SANACC 381/1, as so modified, could be tentatively approved and dispatched to SCAP, and that the Army withdraw SWNCC 384 from consideration by the Committee. The ARMY MEMBER stated that certain aspects of the Army paper (SWNCC 384) were covered by SANACC 381/1; that he would like to have a slightly modified SWNCC 384 acted upon now by the Committee, sent to SCAP for information and released to the press, leaving SANACC 381/1 for later discussion by the Committee as a more detailed program.

The ARMY MEMBER said that he could not agree to the Army's withdrawing SWNCC 384 from consideration by the Committee. He stated that SCAP had seen and agreed with the substance of SWNCC 384, and that the latter was of the opinion that SWNCC 384 might be construed by the other countries represented on the FEC as a unilateral directive. The ARMY MEMBER agreed that certain changes would have to be made as he had indicated previously. He said that he was extremely anxious to settle this problem and said that he would meet at any time with the other members of SANACC to work it out.

THE COMMITTEE agreed to defer consideration of SANACC 381/1 and SWNCC 384 pending further discussions between Departments of Army and State.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

8-24 THE ECONOMIC RECOVERY OF JAPAN (SANACC 384/1)

Report — December 22, 1947
SANACC 384/1[13]
Secret

Memorandum by the Army Member of SANACC

A review of the accomplishments of the first two years of United States occupation of Japan reveals that the first phase of the occupation has been completed. It is becoming increasingly apparent, however, that further progress toward the reestablishment of Japan as a productive and respected member of the community of nations will be difficult, if not impossible, without the creation of a self-sustaining Japanese economy. Until such time as these conditions are created, the economy of the Far East will remain disrupted and Japan will continue to be an increasingly onerous burden on the resources of the United States.

It appears, therefore, that immediate steps must be taken to hasten the economic recovery

[12] Portions of SWNCC 384/1 and SANACC 381/2 are printed later in this volume. For further statements on these policy papers see *FRUS*, 1947, Vol. VI, pp. 302–04; and 313–17.

[13] Most of Appendix "A" is printed in *FRUS*, vol. VI, 1947, pp. 316–17, where it appears as a proposed statement to the Far Eastern Commission. An additional concluding paragraph in Appendix "A" of SANACC 384/1 reads: "SCAP should therefore recognize an appropriate shift of emphasis to facilitate the early revival of the Japanese economy on a peaceful, self-supporting and democratic basis, and should take all possible and necessary steps to increase the ability of Japan to attain that goal, consistent with the basic objectives of the occupation."

of Japan. Not only is it necessary to bring about the earliest possible determination of the reparations which Japan will be required to pay, but it will be necessary to issue, within the framework of existing Far Eastern Commission policy decisions, an appropriate directive to SCAP.

To this end it is recommended that:

a. Appendix "A"* be approved by the State-Army-Navy-Air Force Coordinating Committee as a policy statement to be introduced into the Far Eastern Commission, and

b. Appendix "B" be approved by the State-Army-Navy-Air Force Coordinating Committee as a statement of United States policy to be dispatched by the United States Government to General MacArthur, to be transmitted to the Far Eastern Commission for its information, and simultaneously to be released to the press for publication.

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APPENDIX "B"
U.S. POSITION REGARDING ECONOMIC RECOVERY OF JAPAN

Part I—Ultimate Objectives—of the Basic Post-Surrender Policy for Japan, as approved by the Far Eastern Commission, is as follows:

"1. The ultimate objectives in relation to Japan, to which policies for the post-surrender period for Japan should conform are:

a. To insure that Japan will not again become a menace to the peace and security of the world.

b. To bring about the earliest possible establishment of a democratic and peaceful government which will carry out its international responsibilities, respect the rights of other states, and support the objectives of the United Nations. Such government in Japan should be established in accordance with the freely expressed will of the Japanese people."

"2. These objectives will be achieved by the following principal means:

a. Japan's sovereignty will be limited to the islands of Honshu, Hokkaido, Kyushu, Shikoku and such minor outlying islands as may be determined.

b. Japan will be completely disarmed and demilitarized. The authority of the militarists and the influence of militarism will be totally eliminated. All institutions expressive of the spirit of militarism and aggressions will be vigorously suppressed.

c. The Japanese people shall be encouraged to develop a desire for individual liberties and respect for fundamental human rights, particularly the freedoms of religion, assembly and association, speech and the press. They shall be encouraged to form democratic and representative organizations.

d. Japan shall be permitted to maintain such industries as will sustain her economy and permit the exaction of just reparations in kind, but not those which would enable her to rearm for war. To this end, access to, as distinguished from, control of, raw materials should be permitted. Eventual Japanese participation in world trade relations will be permitted."

The U.S. Government has reviewed the accomplishments of the first two years of the occupation of Japan in the light of the ultimate allied objectives as listed in the Basic Post-Surrender Policy for Japan.

This review has revealed that the Supreme Commander for the Allied Powers has taken the steps necessary to assure the accomplishment of the objective that Japan shall not again menace the peace and security of the world. In implementation of the basic policy SCAP has destroyed Japan's ability to make war on the land, on the sea, and in the air, and has eliminated the exponents of Japanese militarism and ultra-nationalism from positions of power in Japan. Under the present surveillance of the Allied Powers, and later surveillance of the United Nations, Japan should not again menace the peace and security of the world.

Great strides have also been made toward bringing about conditions whereby a democratic and peaceful Japan can assume the responsibilities of a respected member of the community of nations in accordance with the second ultimate objective of the Basic Post-Surrender Policy. A peaceful and democratic Japanese Government has been established in accordance with the provisions of an enlightened constitution adopted by the freely expressed will of the Japanese people. The ravages of the war and the penalties which the Japanese people are still paying for blindly following their leaders in a war of aggression are such, however, that Japan does not yet have the economic strength and stability to maintain a self-sufficient economy and to carry out all of its international responsibilities. At present economic stability in Japan is maintained at the expense of the American people through the importation of vital food and other materials required to prevent widespread disease and unrest.

The first three of the four principal means for achieving the ultimate allied objectives regarding Japan, as listed in the Basic Post-Surrender policy, have been fully utilized. The authority of the Japanese Government is now limited to the four main islands and a few minor outlying islands. Japan has been completely disarmed and demilitarized. The authority of the militarists has been eliminated and the Japanese people have been encouraged to develop a desire for individual liberties and respect for fundamental rights.

With regard to the fourth of these principal means, Japanese industry and commerce are not yet sufficient to sustain the Japanese economy, there is not yet final Allied determination of the reparations Japan will be required to pay, and Japan is not yet in a position to participate fully in world trade and to contribute her indispensable part to the economic rehabilitation of the Far East.

It is now apparent that the first phase of the occupation has been completed. In order to fulfill completely the fundamental objectives of the Basic Post-Surrender Policy and to establish the conditions requisite for a peace treaty that will enable Japan to take her rightful place in the community of nations, the economic recovery of Japan for her benefit and that of the entire Far Eastern area must hereafter be stressed.

It is realized that this is not fully attainable by SCAP until there is Allied determination of (1) the capital plant and equipment to be retained for the Japanese economy and (2) the capital plant and equipment to be delivered by Japan as reparations.

Meanwhile, all possible efforts must be made to reduce, as soon as possible, the drain on U.S. resources resulting from the cost of sustaining the Japanese economy. Pending determination of a Japanese level of industry and Japanese reparations SCAP should, therefore, take all possible and necessary steps, within the limits of this authority, to increase by all appropriate means and to the maximum extent possible consistent with the basic objectives of the occupation, the ability of Japan to support herself.

SCAP should, therefore, direct the Japanese Government to devise and develop plans under his supervision for the economic recovery of Japan to the end that the Japanese economy will be balanced at the earliest possible time. Greater efforts by the Japanese people, coupled with such assistance as the American Government may be able to provide for a temporary period, should eliminate the burden on the U.S. taxpayer of supporting the Japanese economy. Elimination of this burden must be one of SOAP's principal objectives. The U.S. people will not continue indefinitely to subsidize the economy of Japan.

It is therefore the view of the U.S. Government that SCAP should recognize, in implementing economic policy, an appropriate shift of emphasis to facilitate the early revival of the Japanese economy on a peaceful, self-supporting and democratic basis. Since this objective is fully in accord and consistent with the ultimate Allied objectives regarding Japan, as already approved by the Far Eastern Commission, the U.S. Government is submitting to the Far Eastern Commission a proposed statement of Allied policy which endorses the required shift of emphasis.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

* Not Printed.

8-25 MAINTENANCE OF PRESENT PRICE LEVELS

Memorandum January 21, 1948

To: Dr. S. M. Fine (ESS)

From: H. F. Alber, Chief, Price Control & Rationing Division, ESS

1. Japanese Government is considering increase in rates for Government communications and railways in the near future ranging from 120 to 200%.

2. Although the inflation can be expected to continue for some time, the Japanese economy is temporarily in a period of relative stability and the rate of inflation has been markedly reduced in the last several months. The general economic outlook is more favorable now than at this time last year or during the period of April to June 1947 immediately preceding the new wage-rice policy. In many respects, the improved economic situation is a result of the stabilization programs developed and supervised by ESS over the past year.

3. Favorable factors contributing to the present stabilization include:

a. *Excellent Collection of the 1947 Rice Crop*—79% of quota collected as of 10 January 1948 compared with 60% at the same time last year.

b. *Improved Fish and Vegetable distribution*—Consumers currently receiving 2 to 3 times more fish and vegetable at official prices than last year.

c. *Staple food ration being met in full*—At this time last year ration delays had already occurred in the major cities.

d. *Cost of living relatively stable*—Beginning in August, the overall, effective cost of living has shown increase of only about 3% per month, (with decreases in certain key areas, such as staple food) in sharp contrast to the approximately 20% increases per month which began with the food crisis of May through July 1947.

e. *Effective control of year-end inflationary splurge*—In the period from 1 December 1947 through 10 January 1948 blackmarket prices in Tokyo increased only 6% compared with an increase of 23% over the same period last year, indicating that inflationary pressure of year-end bonus payments has been more effectively contained.

f. *Improved labor situation*—The expected October labor offensive has been met without serious disturbance and for the time being all major labor problems are under control.

g. *Transportation controls*—The new transportation certificate system has begun to make itself felt and improvement is being secured in the control of the movement of blackmarket goods. The planned extension of this system to warehouses will provide another effective device to combat blackmarketing.

h. *Coal production*—Impressive increase in coal output is having a pronounced stabilizing effect.

4. Economic prospects for the next 6 or 9 months contain several important favorable factors including:

a. *Electrical power*—Improved electric power supply, within the next 30 to 60 days, will relieve an impediment to industrial production.

b. *Increased coal allocations*—Continuing high coal production will soon begin to show up in substantially increased allocations to industrial users.

c. *Improved food supply*—There is every prospect that indigenous and imported food stocks will permit the ration to be met in full during this food year thereby avoiding a summer food crisis (with all of its inflationary effects) for the first time since the Occupation began.

d. *Consumer goods supplies*—Arrival of surplus Army stocks of scarce clothing and other consumer goods from the United States will substantially increase supplies available for rationing to farmers and essential industrial workers thereby relieving in part, the pressure of blackmarket purchases on cost of living.

e. *Imported industrial materials*—Significant quantities of key materials will arrive in the near future relieving a serious "bottle-neck" in industrial production.

f. *Tax collections*—The new tax collection program developed by the Finance Division is already showing increases in revenue receipts and can be expected to substantially modify the inflationary effect of the previous failure to collect taxes.

g. *Improved transportation*—Increased supplies of coal and improved weather conditions will substantially relieve crippling transportation shortage.

h. *Increased industrial production*—The above favorable factors combined with seasonal improvement will show a substantial increase in industrial production beginning in March or April.

5. These favorable conditions are temporary and there are, of course, serious negative factors still prevailing which are tending to upset the present economic stability, these include:

a. *Government revenue*—The failure to collect taxes over the past 9 months has placed government revenues in an unfavorable position.

b. *Shortages of materials, consumer goods and food*—Serious shortages are continuing and they will encourage continuation of the inflation.

c. *Increasing volume of currency*—The note issue has reached serious proportions (over two hundred billion yen), but since the first of January the total issue has been contracting slightly and the note issue is in itself not immediately threatening.

d. *Wage increases*—Unless the present period of stability can be maintained, labor will demand drastically increased wages which will precipitate another sharp movement in the wage-rice spiral.

e. *Price increases*—Further price inflation will take place until basic causes of inflation are corrected.

6. Interviews with businessmen and the absence of general demands for increased prices, suggest that the present official prices are still generally satisfactory.

7. The above factors lead to the conclusion that the existing price framework can be held for the next 60 to 90 days providing no action is taken to destroy the present period of stability. The proposed increase in communication and transportation rates would upset the present delicate balance and precipitate a general price movement. The magnitude of the increases being discussed (100 to 200%) is extremely and unnecessarily inflationary, and would set a pattern for across-the-board price increases of comparable degree. It is believed that the general price movement, when it comes, can be held down to increases of 50 to 60% unless extremely high increases in government charges cause an abnormally rapid rate of price inflation. The railway and communication increases are being proposed in order to reduce the deficit in the current fiscal year budget so as to contribute to economic stabilization. However, the actual effect of a forced budget balance at this time will be to accelerate inflation in direct contravention of its intended purpose.

8. Price Control and Rationing Division strongly recommends that the present price line be held as long as practicable (probably until April or May). Specifically, no change in rail or communication rates or other important prices should be permitted now but should be deferred until a general price movement becomes unavoidable. The budget should be allowed to continue to be temporarily unbalanced, if necessary, to avoid an unreasonable acceleration of the inflation. If ESS forces an immediate balancing of the budget, we will be responsible for unnecessarily stimulating inflation.

[SOURCE: SUITLAND PAPERS, Z 703-56]

8-26 ECONOMIC CONDITIONS IN JAPAN

Report February 4, 1948
Prepared by: Research and Statistics Division, ESS

SUMMARY

During 1947 the level of industrial production in Japan improved substantially over the 1946 level and, in December, reached a new postwar peak of approximately 45 per cent of the 1930–34 average level. Currently the Japanese economy is characterized by two major sets of problems. On the one hand, it cannot expand production substantially above current levels unless raw material imports can be secured in much larger volume. On the other hand, it is still beset by severe inflationary pressures arising from the shortages of foods and other commodities, the failure to date of the Government revenue system to siphon off effectively excess purchasing power, and the consequent necessity to operate the Government at a large financial deficit.

Although the monthly rate of increase in industrial activity in 1947 was very low, the average production level in 1947 was 26 per cent higher than the 1946 average. The increase in 1947 was made possible by greater and more effective utilization of indigenous resources and to a lesser extent by imported materials. Coal mining and iron and steel were the principal industries whose expansion resulted from factors of production within the economy. Cotton textiles was the main industry to expand primarily under the influence of imported materials.

The foreign trade of Japan has been marked by a large deficit balance, shortages of dollar exchange, and unavailability of adequate quantities of essential industrial raw materials in foreign markets, particularly in Japan's normal sources of supply. The trade deficit has been covered by advances from the United States Government for financing food and other vital imports for "prevention of disease and unrest." Exports have been limited by the low levels of production in Japan and have been dominated by textiles—principally cotton textiles. Substantial further increases in exports are contingent largely upon prior imports of raw materials and to a lesser extent upon developing markets and concluding satisfactory financial arrangements.

The price level, after a rapid rate of advance during the summer months of most severe food shortages and ration delays, settled back to a slower rate of increase in subsequent months. An all-time peak level however in effective consumer prices was reached at the end of 1947. Money wage rates have also continued upward, but real wages have remained considerably below normal levels. Inasmuch as production has not kept pace with rising money wages and labor costs, unit industrial costs in monetary terms have continued to rise. This has been reflected in a continuing increase in the level of official wholesale prices. In spite of the severe inflationary pressures, however, a considerable degree of success has rewarded the efforts of the Government to minimize maldistribution of food and other goods and to retard the rate of inflation otherwise inherent in the situation.

In addition to the inflationary pressures imposed by absolute shortages of commodities, continued increases in the levels of purchasing power and the large amount of Government deficit financing have been important contributing factors to inflation. The budget deficit has

resulted principally from the large degree of failure to collect personal income taxes from the self-assessment group. This failure has had the additional effect of making the revenue system as it is actually operated even more regressive, the tax burden falling with a heavy hand upon wage and salary earners and other low-income groups.

Many developments indicate that in 1948 the economic picture will show decided improvement. Chief among these are brighter prospects for financing foreign trade, in particular the procurement of raw materials imports; enhanced prospects for exports; much higher production of coal, and of steel and industrial output generally as a result of better coal use and more abundant raw materials; smoother delivery of food rations throughout the year; and further improvement in distribution controls. Prices and economic stabilization generally depend very largely on more effective administration of the tax system and setting of tax goals more in accordance with levels of purchasing power.

Industrial Production

Level of Production

The level of industrial production in 1947 averaged 41 per cent of the 1930–34 annual average and was 26 per cent higher than the 1946 average. In December 1947, the level of industrial production reached 44.5 per cent, which was the highest point attained since the end of the war.

Since the end of 1945, when production was at a minimum level, recovery has taken place in two stages. The first stage occurred between January and September 1946 when the production index rose from 18.2 to 38.0—a monthly rate of increase of 2.5 points. The second stage occurred between October 1946 and December 1947, when production increased at a much slower rate of approximately 0.4 points per month. In other words, during the first nine months of 1946, production increased at a rate of approximately 13 per cent per month; but thereafter the rate of increase declined to approximately one per cent per month. In the first stage, the rapid increase was made possible by the existence of a considerable margin in the supply of indigenous materials. However, as the limits of these were approached, a lower rate of expansion was imposed chiefly by the lack of imported raw materials, with coal the main indigenous material the shortage of which was a restraint on industrial recovery.

The increased activity in 1947 as compared with 1946 was fairly general among the various industries. The outstanding increases were shown by coal mining, iron and steel, and cotton textiles. Several industries registered lower production in 1947 than in 1946, and among this group were motor trucks and salt. In the following table are shown the changes in each of several principal industries and their contributions to the overall advance in industrial production in 1947 above the 1946 level.

Index of Industrial Production 1947 Compared With 1946

	Index (1930–34=100)		Points Contribute to Change in Total Index
	1946	1947	
Industrial Production	32.46	41.05	+8.59
Major Increases			
Coal mining	65.34	87.37	+2.24
Machinery, n.e.c.	22.00	34.00	+1.49
Cotton yarn	11.16	23.25	+1.07
Cotton woven goods	7.45	20.41	+0.98
Raw silk	12.37	16.75	+0.90
Lumber	101.21	117.81	+0.66
Crude steel	20.53	34.62	+0.65
Chemical group	36.88	44.68	+0.52
Major Decreases			
Motor trucks	1896.44	1252.43	−0.65
Salt	59.25	23.13	−0.51

[Source: Hussey Papers, University of Michigan]

8-27 SELF-SUPPORT OF THE JAPANESE ECONOMY (SANACC 381/2)

Report
SANACC 381/2[14]
Confidential

February 12, 1948

The Problem

1. To determine United States policy with respect to the restoration of the Japanese economy to a self-supporting status.*

Facts Bearing on the Problem

2. See Appendix "A".[15]

Discussion

3. See Appendix "B".

Conclusions

4. It is a major objective of the U.S. Government to promote the achievement by Japan of a self-supporting status at the earliest possible time. To this end, the following steps should be taken:

(a) It should once more be made clear to the Japanese Government and people that ultimate responsibility for economic recovery rests in their hands, and it should be announced that U.S. appropriated funds for the procurement of Japanese imports cannot continue indefinitely and must follow a definite declining schedule to terminate at a fixed date. SCAP and the U.S. Government should undertake all measures consistent with the preceding statement and with existing occupation policies that will facilitate the achievement of a self-supporting status by Japan.

(b) To maximize the effectiveness of Japanese self-help, and the minimize the need for U.S. appropriated funds, a production, consumption, export, and import plan should be prepared by the Japanese Government under which Japan can become self-supporting before the beginning of U.S. fiscal year 1953, with a specified declining annual amount of U.S. appropriated assistance. The Plan should be submitted to SCAP for review and approval, and should be transmitted by him to the U.S. Government for its approval of the Plan's requirement for U.S. funds and commodities. The Japanese Government should reconsider, and if necessary revise, this Plan periodically in the light of new developments. Any extensive revisions of the Plan should be reviewed and approved by SCAP and the U.S. Government, in the manner provided above.

(c) The Japanese Government should assume responsibility for the execution in Japan of this Plan, and for the adoption and implementation of such measures to improve Japanese economic performance as may be required for this purpose. As may be necessary to this end, SCAP and the U.S. Government should take steps to increase Japanese responsibility and authority in regard to the day-to-day operation of the Japanese economic system, and especially in regard to the conduct of foreign trade.

(d) SCAP should inspect Japanese execution of the approved Economic Recovery Plan, especially with a view to determining the extent to which the Japanese are minimizing dependence on U.S. appropriations by expanding exports and by securing credits from private sources. He should take such steps as he deems necessary to ensure that, in so far as success is within the power of the Japanese, this Japanese execution does not fall short of its goals in a way which would increase the amount of U.S. financial assistance required for Japan's attainment of self-support. He should make clear to the Japanese that continued financial assistance from the United States cannot be expected unless they put forward their best energies to carry out the approved program.

[14] See SWNCC 381, July 22, 1947; and SWNCC 381/1, October 16, 1947, "Revival of the Japanese Economy."
[15] Not printed.
* For purposes of this paper, a self-supporting status is defined as one in which Japan will be able to pay for essential imports each year from the proceeds of exports, from credits obtained from commercial sources, and from governmental loans made on a sound reimbursable basis. Essential imports are those necessary to maintain a level of consumption in Japan not to exceed that prescribed in FEC 186/1, "Determination of Japan's Peaceful Needs".

(e) This Japanese plan for becoming self-supporting, as approved by SCAP and the U.S. Government, should be made the basis for requesting funds from the Congress for procuring necessary Japanese imports as long as the Japanese are carrying out the plan satisfactorily. Although these funds should be sought on an annual basis, the Congress should be furnished information concerning this approved Plan's estimated overall cost.

(f) Before this economic recovery program is terminated, convertible assets of known Japanese ownership should be made available to the Japanese Government for expenditure in promotion of Japanese self-support, if such action would reduce the amount of U.S. appropriated funds required to meet the cost of this program and if such action is consistent with all relevant obligations or commitments of SCAP and the U.S. Government.

(g) The importance to Japanese recovery of the cooperation of other countries, and especially of those Far Eastern countries with which Japan's trade must be primarily conducted, should be fully recognized in the execution of the economic recovery program described in this paper. To this end, such steps should be taken as may serve to convince these Far Eastern and other countries that this program is designed to be, and is in fact, a contribution to the economic revival of the Far East as a whole, and hence in their own economic interest, rather than merely an attempt to end the burden of the occupation on the United States.

(h) Both in the interest of general recovery in the Far East, and in order to reduce Japan's need for U.S. appropriated funds and for certain commodities which are short in dollar areas, every effort should be made to obtain Japanese imports from non-dollar areas, and to encourage Japanese exports to those areas in payment for such imports. Active encouragement should also be given to the securing of non-dollar credits for the financing of such imports.

(i) In the event that a peace treaty is negotiated with Japan prior to completion of the program for making Japan self-supporting, the general arrangements contemplated in this policy statement should be continued under an agreement between the U.S. and Japanese governments.

RECOMMENDATIONS

5. It is recommended that:

(a) SANACC give tentative approval to the above Conclusions, and take steps to secure SCAP's comments with respect thereto;

(b) SANACC, upon obtaining SCAP's comments, give final approval to the Conclusions as they may be amended in the light of those comments;

(c) The paper then be implemented in accordance with decisions concerning that implementation to be taken by SANACC. Such implementation should include the submission by the State Department to the Far Eastern Commission, for action individually at the appropriate time, of any portions of this paper, and of policy papers prescribing any steps which may be taken in accordance with it, which are proper subjects for FEC policy decision.

APPENDIX "B"

DISCUSSION
TABLE OF CONTENTS

I. General Policy
1. U.S. Objective (Refers to paragraph 4 of the Conclusions)*
2. Japanese Responsibility (Paragraph 4a of the Conclusions)
3. U.S. Funds (4a)
4. Action by SCAP and the U.S. Government (4a)
II. Economic Recovery Plan
A. Preparation, Review, and Revision
5. Preparation (4b)[16]
6. Review (4b)
7. Revision (4b)
B. Execution of the Plan
8. Japanese Responsibility (4c)
9. SCAP Supervision (4d)
10. U.S. Appropriations (4e)
C. Policies Related to Execution of the Plan

[16] This section only included.

* Note: The parenthetical numbers following each of the headings in the above Table of Contents indicates the sub-paragraph in the Conclusions to which the designated paragraph in the Discussion refers.

11. Expenditure of Convertible Assets (4f)
12. Far Eastern Cooperation (4g)
13. Import Procurement and Financing (4h)
14. Effect of a Peace Treaty (4i)
III. Procedural Implementation
15. SANACC Action (5a)
16. FEC Action (5b)
17. SCAP and U.S. Government Action (5b)

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II. ECONOMIC RECOVERY PLAN

A. Preparation, Review, and Revision

5. *Preparation.* Over-all, long range planning will be required if Japan is to achieve self-support with a minimum of U.S. expenditure. A state of self-support can only be achieved by Japan after a number of years, and Japanese investment, production, and consumption cannot be intelligently planned for the early years except on the basis of planning for the later years. The long range Economic Recovery Plan prepared by the Japanese Government should state the Japanese import*, production, consumption, and export goals to be achieved during each of the years between its beginning and its termination date, and should specify the economic policies to be followed by the Japanese Government in attaining these goals. This Plan cannot, of course, be prepared realistically without some assumption as to the U.S. appropriated funds that will be available for its implementation. The Plan should therefore assume that U.S. appropriations will be available in the amount being requested of Congress by the Army Department for fiscal 1949, and that subsequent appropriations will be available in specified declining amounts until the Plan's termination date. Press reports indicate that some phases of a plan such as described above have already been developed by the Japanese Government. If so, they should be useful as a basis for the more extensive and formalized Japanese Plan suggested in this paper. It seems reasonable to assume that, in the development of this latter Plan, the Japanese Government will take into account whatever decision may ultimately be reached by the Congress concerning the 1949 appropriation for Japanese import procurement.

[SOURCE: SUITLAND PAPERS]

8-28 UNWARRANTED EXTENSION OF OCCUPATION OPERATIONS

Memorandum March 9, 1948

To: The Chief, Government Section

From: Alfred Hussey, Jr., Chief, Governmental Powers Division

1. JCS 1380/15 sets forth in specific language the basic pattern of this occupation. Pertinent excerpts are attached as Tab "A".[17] The Supreme Commander has on frequent occcasions declared that primary responsibility for carrying out his directives and instructions rests upon the Japanese Government, that he looks to them to exercise the initiative and energy necessary to establish a responsible government, a free economy and a peacefully inclined Japan. (Tab "B")

2. It has never been considered part of the work of this Headquarters actively to interfere with the operations or functioning of the Japanese Government unless and until failure to comply with SCAP's orders has been established. It is well established that the Supreme Commander is not responsible for efficiency of performance, honesty of operation or particular selection of methods, operating policies or even goals of accomplishment beyond that necessary to secure conformity to basic policy.

3. The very noticeable trend toward active interference in such operations is serious cause for alarm. Particularly in the economic, welfare and agricultural fields have SCAP staff sections been engaging in actual operations, directing lesser Japanese agencies and officials in the discharge of their responsibilities. So widespread has this practice become that the Japanese bureaucrats have quite openly become accustomed both to shifting responsibility for all decisions to SCAP and blaming SCAP for preventing successful accomplishment of projects through interference.

[17] Tabs not printed.

* In this respect, the Plan will be of particular value to the U.S. Government in facilitating its overall export programming for the next several years.

4. There is a wide chasm between defining the goals and laying down the general principles which should govern the methods to be adopted for the achievement of those goals, on the one hand, and actively directing the adoption of specific measures and personally controlling the implementation of those measures. SCAP is adequately equipped to declare the principles, determine the measure of accomplishment and to impose the necessary sanctions. It is not equipped to assume the responsibility for operating the actual machinery.

5. A few specific examples will suffice by way of evidence of the present state of affairs. In the field of Price Control and Rationing, this Headquarters has undertaken to supervise and control the present project, which was adopted at its direction. The Supreme Commander has declared that the Japanese people will be aided only when and to the extent that they aid themselves. Food must be fairly and adequately distributed, prices must be kept down, inflation must be checked. Upon the basis of this declaration, this Headquarters has proceeded to tell the agencies involved of the Japanese Government exactly what they should do to accomplish this result. Furthermore, they have undertaken to supervise and support the activities of those agencies along the directed lines. The obvious result of this is to bring any blame for failure home to SCAP. If the Japanese do what we tell them to do in minute detail and if we attempt to hold them to it, is it at all surprising that they say: "We are not to blame. We only did what you told us to do"?

6. Notwithstanding, it should be the entire responsibility of the Japanese Government to satisfy SCAP as to its food and other basic requirements and that the Japanese people should be given every opportunity of knowing why they are suffering from a lack of food and fuel and clothing, certain agencies of SCAP and 8th Army have undertaken to engage in the actual operation of food collection and distribution, exhorting the people to cooperate, directing prosecutions, aiding in tabulations. Admitting that the recent rice collection drive achieved a large measure of success, it is reasonable to ask does not this indicate that the Japanese Government failed to discharge its legitimate responsibilities and yet escaped all liability for such failure? In truth, it received instead congratulations. Suppose the drive had failed? The Japanese could well have argued that Occupation interference had caused the failure.

7. Economic recovery is not a responsibility of the Supreme Commander. The Allied Powers wisely decided at the outset that the major job of the Occupation in the economic field should be no more than the establishment of those basic conditions of freedom from restriction, freedom of participation, equal access to materials, equal opportunity, and dissolution of monopolies to provide the optimum conditions for such recovery. The fields must be cleared of stumps and weeds and must be nourished and enriched. The general nature of the crops must be determined. Beyond this, however, it must be left to the Japanese to determine when and how to plant, how to cultivate, what tools to use. Unless they are permitted to decide these questions for themselves and are required to assume full responsibility for their decisions, they will never become independent.

8. Recently, members of the Diet informed this Section that instruction by a representative of ESS that immediate provision of revenue to pay the 0.8 wage bonus must be made through the increase of railway and postal rates was the proximate cause of the cabinet crisis that brought about the fall of the Katayama Cabinet (reference is made to Memorandum for the Chief, CS, from the Chief, Legislative Division, dated 7 February 1948, Tab "C"). It is precisely this sort of thing that is not only directly contrary to SCAP policy but highly dangerous as well.

9. Tab "D" represents a survey directed by 8th Army in response to CI&E instructions. The minuteness of the information sought, the scope of the questions asked indicate all too clearly the extent to which the Occupation is becoming operational. The information sought might well be useful as part of a research project for the modernization and improvement of Japanese schools but goes far beyond anything required for the purposes of the Occupation. This operational directive is duplicated in the fields such as labor, public health, etc. The work involved thereunder on the MG teams is tremendous. To what end? Were Japan a clinical study—an experiment in social organization—to be watched, taken apart, rearranged to suit the moods or interest of the research group, such operations might be justified. But such is not the case.

10. There is another risk involved in engaging in actual operations. Such operations must of necessity and do in fact result in frequent, close and direct contact between Occupation personnel at all levels and officials of the Japanese Government at all levels. As one specialist becomes intimately concerned with a particular phase of governmental activity, he sees new discrepancies and unforeseen defects and instinctively directs that remedial measures be adopted. No satisfactory check on such operations can be maintained. The vital coordination of SCAP policies is lost. The Japanese are faced with a multiplicity of conflicting instructions and are

helpless to take action. The damage to SCAP prestige is irreparable in the chances of full accomplishment of SCAP objectives greatly reduced.

11. The wisdom of the decision to make use of and govern through the existing machinery of government is not to be questioned. The Supreme Commander has with great skill encouraged the Japanese to undertake full responsibility for carrying toward successful accomplishment Occupation objectives. He has, from the very outset insisted that the Japanese should assume the responsibility for the failures and for the successes. He knew well that only by this means would they be made fully aware of the price to be paid for aggression, and only by this means would they gain experience with and faith in the new era and system. He also knew well that Allied interference could only produce confusion, delay, excuse, in the absence of a gigantic and complex military government force prepared actually to govern the entire country. Paternalism, however benevolent, saps vitality. Interference in actual operations—as opposed to complete control—dislocates the administrative controls of the Japanese Government and prevents any fair or just assessment of responsibility.

12. The sooner SCAP withdraws from actual interference and operation, the sooner can be determined the extent to which Occupation objectives have been accomplished. Such a withdrawal would permit a substantial reduction in the size of Occupation forces and a consequent reduction in appropriations therefor. Withdrawal and future abstention would then show the American people just what the true situation was in Japan and permit a far more accurate method of ascertaining the real requirements for future assistance.

13. It is recommended that there be undertaken a complete and detailed survey of all SCAP activities and operations, and that an assessment be made in the light of established policies for the purpose of developing a program of gradual withdrawal from all relations with the Japanese Government save on the highest level or for observation or supervision only.

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

8-29 MARQUAT'S MEMO ON WAGE STABILIZATION PROGRAM

Memorandum[18] May 6, 1948
By: W. F. Marquat, Chief, ESS

1. The experience thus far in attempts to effectuate genuine economic stabilization in Japan have been only partially successful. While the preponderant explanation lies in the area of continuing deficiencies of essential industrial raw materials, food and other products along with remaining imperfections in control of legal distributive channels, another significant explanation must be attributed to the inflationary pressures deriving from continued increases in all wage rates. It is anticipated that substantial increases will be realized in the coming year in the availability of strategic materials and continued improvement is being realized in the effectiveness of distribution controls over all essential raw materials and manufactured products. Thus, it becomes imperative that realistic attention be directed to the formulation of appropriate plans to correct the inflationary stimulus derived from unwarranted and uncontrolled increases in wages. Without the adoption and implementation of a forceful wage stabilization program, current and contemplated plans for realizing economic stability will face insurmountable difficulties.

2. Stabilization of wages in the present situation is an indispensible prerequisite to the reestablishment of the Japanese nation on a sound self-supporting basis and creation of world confidence and, therefore, is a necessary condition for the establishment of a foreign exchange rate and inducement to foreign investment participation in Japan. Further, a plan designed to secure stabilization and protection of real wages from the inflationary spiral should be eminently acceptable to organized labor. Because of the foregoing considerations it is believed that the Japanese Government, labor and management should voluntarily embrace such a program and cooperatively work for its successful implementation. It is therefore proposed that a wage stabilization program be adopted by the Japanese Government after due deliberation and discussion which possesses the following major outlines:

a. Provision for a wage stabilization commission composed of management, labor and public representatives to formulate overall policy, set up necessary administrative organization and review effectiveness of operation of the program.

b. Concomitant with holding the price line, wages will be stabilized at a level reflect-

[18] Cf: The memorandum of the Economic Stabilization Board, "Measures for Wage Stabilization," May 6, 1948. *Eibun Sengo Shiryo*, vol. 8, Economic Planning Agency.

ing the current wage-price relationship.

c. A new wage frame will be announced with appropriate upward adjustment to accomodate for the new revised price level. Wages exceeding this figure will be frozen (coal miners, electric workers, etc.). For other wages the conventional differentials will prevail. Within this wage structure collective bargaining will be permitted with permissive narrowing of conventional differentials upon demonstration of adequate cause. Collective bargaining on issues other than wages will not be impaired.

d. To the extent that practicable schemes can be formulated, incentive wage payments will be permitted for increased productive effort over a realistic base period. Such payments would allow for exceeding the established wage frame but would not be inflationary per se since additional output would accompany increased wage payments.

3. Unless Japan succeeds in stabilizing her economy through the combined contribution of increased imports, increased indigenous production, improvements in the effectiveness of official distributive channels, the attainment of a balanced budget and severe limitation of yen note issue, and stabilization of wages, Japan cannot count upon continuing American aid and financial support.

[SOURCE: SUITLAND PAPERS, Z 703-23]

8-30 ESSENTIALS OF ECONOMIC STABILIZATION PROGRAM

Memorandum July 15, 1948
By: W. F. Marquat, Chief, ESS
Confidential

In order to fulfill the requirements incidental to insuring the continuation of American aid and to hasten the realization of a self-supporting Japanese economy, the following basic elements for an effective economic stabilization program in Japan are indicated as imperative of immediate adoption and full implementation:

1. Increased production of all essential indigenous raw materials and manufactured products.
2. Improvement of effectiveness of present allocation and rationing system through rigorous enforcement and programming. Complete elimination of the blackmarket.
3. Further improvement in the efficiency of the food collection program with more realistic determination of collection quotas.
4. Rigorous adherence to official price schedule with prompt punishment of all violators.
5. Prompt introduction of firm but flexible wage stabilization program.
6. Acceleration and strengthening of program to achieve substantially increased tax collection and vigorous criminal prosecution of tax evaders.
7. Introduction of new tax measures for raising additional revenue as well as effecting a redistribution of the tax load in the direction of greater equity.
8. Systematic reduction of deficits in the Special Account of the Budget.
9. Improvement in operation of foreign trade controls and administration and establishment of a foreign exchange control under appropriate agency of the Japanese Government.
10. Strengthening and effective enforcement of existing selective credit control program.

[SOURCE: SUITLAND PAPERS, Z 703-20]

8-31 JOINT RECOMMENDATIONS AS TO STABILIZATION POLICY

Memorandum October 26, 1948
To: General Marquat
From: Floyd L. Whittington, E. M. Reed, and Chester W. Hepler (ESS)

1. The existence in the Japanese economy of continuing forces of instability is a serious threat to the program of rehabilitation of Japan and is of grave concern to ESS. The stubborn persistance of such forces has led to a series of informal discussions by concerned ESS divisions over the past two or three months. The conclusions and recommendations outlined below are the product of these discussions and represent a position concurred in by the Price and Distribution, Labor, Industry, Foreign Trade and Finance Divisions, the Coal Coordinator, and the Directors of Production and Utilities and Economics and Finance.

2. Past proposals for controlling the inflationary forces have invariably hinged upon the institution of some method of formalized wage control or wage stabilization. However, SCAP has always expressed reluctance to direct the institution of any such program. During the discussions mentioned above, the conclusion has been reached that SCAP's reluctance is well-founded and that a program of formalized, administered wage control based on the use of statistical formulae and implying the ultimate prohibition of strikes and use of force, if necessary, should not be adopted.

3. Controls are normally justified only to protect the economy against unreasonably high charges for scarce items of production and consumption. Labor is the one item of production in the Japanese economy of which there is adequate supply. Further, the successful application of a plan of formalized wage controls requires a situation in which the basis for wage payments and the methods for calculating wages are standardized, or at least capable of being easily determined and understood, in which there is a high degree of development of administrative techniques, and in which there is available a large amount of reliable statistical data. None of these conditions exist in Japan. The lack and the unreliability of statistical information and the low level of development of administrative techniques are well known. Insofar as the basis of and the methods used in determining wage payments are concerned, members of ESS, representatives of the Japanese Government, management, and most workers are unable to give any clear and definite explanation of total wage payments made. Total income received by workers in Japan is so confused as between wages, bonuses, repercussion allowances, winter allowances, family allowances, age and sex differentials, overtime payments, welfare allowances and many less common forms of reimbursement that control of the basic wages could be circumvented within the "conventional" wage pattern. The effective application of a plan of formalized wage control in Japan thus would be exceedingly difficult, if not impossible. In fact upon further reflection it appears that what is needed in the current economic situation existing in Japan is not formalized wage control but stability in labor-management relationships and a stabilization level in which labor costs can be kept in proper relationship with prices.

4. It is therefore recommended that any plans for instituting a system of formalized, administered wage control be abandoned, at least for the time being, and that instead SCAP advise the Japanese Government to adopt a policy under which:

a. A price level will be established which will be supported by a determined amount of subsidies and which will be held until unforeseen factors may make a change necessary;

b. No additional subsidy payments, no increases in prices, and no loans from the RFB or other government sources will be made to cover deficits resulting from wage increases or inefficient operation will be made;

c. The fixing of wages will be left to the processes of collective bargaining and other free social and economic forces, operating with the framework of the price and subsidy level established;

d. The government will not interfere in the process of collective bargaining and labor will be permitted to strike if agreement cannot be reached with management and management will be permitted to cease operations and go through bankruptcy in the event of inability to continue to operate at a wage level it has agreed to pay.

It is believed that if such a policy is adopted the price level adopted can be held and that the presently never ending round of wage and price increases and accelerating inflation can be brought under much more effective control. This conclusion is buttressed by the now generally recognized fact that in terms of basic standard of living the Japanese economy is in not too bad a position by relative, historical Japanese standards.

5. It is recognized in making such a recommendation that there may be losses in production resulting from strikes and from shut-downs of some plants as a result of their allowing their costs to go higher than they can meet. However, it is our considered opinion that such stoppages will be temporary and that the total loss to production over the year will be much less than might be supposed if, in fact, it occurs at all. In the first place, as a result of the lack of accumulated savings, the loss of pay and supplemental rations, and the relative immobility of labor, it does not appear that any group of labor will be able to carry out any protracted strike. In the second place the present instability in labor-management relations resulting from uncertainty as to wage and price levels is discouraging expansion in production and leading to long drawn out wage negotiations, slow-downs, sporadic strikes, absenteeism, and the like. The basic causes for such uncertainties will be eliminated under the policy of labor-management relations recommended. Manufacturers are presently holding back on production and shipments because of uncertainty as to future price levels. Finally, Japanese industry is operating at present at substantially less than capacity. This low level of operation results in large part from shortage of raw materials rather than from shortage of labor. Under such circumstances temporary production losses resulting from strike can be in large measure offset by later operations at a

higher percent of capacity. It is also believed that over the period of the year no disasterously adverse effect will be exercised upon the export program as a result of the adoption of the policy recommended. Harmful effects of the export program resulting from the adoption of this policy can come only from adverse efforts in production and deliveries. As pointed out above, existing uncertainties in the wage and price structure are hampering production and delaying deliveries. To the extent that the adoption of the policy recommended eliminates such uncertainties, the export program should be aided. Certainly the establishment of a stable price and cost relationship and level is essential to the operation of a sound program of foreign trade.

6. The results of the adoption of the policy recommended insofar as labor-management relationships are concerned will undoubtedly be healthy. Under present circumstances in which the government assumes responsibility, in the form of price increases, increases in subsidies, or deficit financing, for industrial deficits resulting from wage increases, free collective bargaining cannot exist. As long as such circumstances exist labor disputes will continue to be resolved by ESS through the Japanese Government with management sitting on the sidelines as a disinterested party and with labor having no responsibility for its actions. Such conditions will ill-prepare Japanese workers and management for the exercise of the rights and the assumptions of the responsibilities inherent in free collective bargaining, the full exercise and assumption of which is essential to the development of democratic free enterprise.

7. It is, therefore, recommended that the policy recommended in paragraph 4 above be presented to SCAP and considered for adoption. Upon approval by SCAP, the concerned divisions of ESS will immediately begin the detailed work necessary to putting the policy into effect at the earliest possible date which it is anticipated will be 1 February 1949. In the interim, temporary expedients will be adopted in the light of their relation to the general policy to be put into effect.

[SOURCE: SUITLAND PAPERS, Z 703–20]

8-32 PROGRAM FOR A SELF-SUPPORTING JAPANESE ECONOMY[19]

Report November 1948
Prepared by: ESS, SCAP

TABLE OF CONTENTS

Summary Introduction[20]
Chapter I Highlights and Conclusions
II The Balance of Payments and Appropriated Funds
III The Foreign Trade Program
IV Merchant Shipping and Shipbuilding
V Industrial Production Prospects
VI Fuel and Power Potentials
VII The Steel and Machinery Program
VIII The Textiles Program
IX The Food Problem
X Economic Stabilization Controls
XI The Nature of Japan's Prewar Economy
Appendix A Population Data

SUMMARY

The paramount economic objective of the United States with respect to Japan is to aid the Japanese in attaining at the earliest possible date a condition of self-support. The program presented herewith indicates the ways and means to be employed to achieve this goal by fiscal year 1953. Fundamental to the overall consideration is the fact that the program must be implemented in its entirety and according to the time phasing proposed if the ultimate goal is to be met.

Appropriations

Although a balance in Japan's international accounts can, it is predicted by secured by fiscal year 1953, trade deficits are inescapable prior to that time. Not only will the total trade

[19] Commonly known as the "Blue Book", this report was reprinted with slight change by the Dept. of the Army, under the same title in January, 1949.

[20] This section only printed.

deficits be substantial though decreasing—but the problem of dollars will continue to be especially acute, owing to the inevitable deficit in trade with the United States and other dollar areas. Consequently, United States appropriations aggregating 1.3 billion dollars will be required between fiscal years 1949 and 1952 if Japan is to be self-supporting thereafter. The maximum need for funds is in the fiscal years 1949 and 1950; this is the critical period in which industrial production must experience its most rapid rise. During this time the pipelines of the economy must be filled with the necessary raw materials while exports and the proceeds from exports despite efforts to maximize them will inevitably lag. After 1950 a rapid reduction in appropriations should be possible if foreign trade has gained the momentum and the levels projected.

Foreign Trade

The urgency for the most rapid possible re-entrance of Japan into world markets, particularly in the Far East, on a much larger scale cannot be over-emphasized. Already key markets and indispensable sources of materials are being lost. Japan must re-establish close relations with the natural market areas in Asia, providing them with the capital equipment and consumer goods which they actively demand and drawing from them to the limits of available supplies the industrial raw materials and foodstuffs which they can offer. There must be a more dynamic utilization of all available funds in this connection. Maximum expenditures of usable foreign exchange must be made in Far Eastern markets to provide working capital which will generate the necessary permanent flow of goods to and from Japan. This will have the practical result of effecting a true reduction in financial costs to the American taxpayer while protecting for the United States the long run markets and sources favorable to it.

The present program projects the volume of trade to fiscal year 1953, eventuating in a level of exports of over 1.3 billion dollars and of imports of 1.5 billion dollars in the latter year. The expected savings and receipts from the development of potentially sizable invisible exports are estimated to make up the apparent trade deficit. Halt of the exports must consist of cotton and other textile manufactures. Nevertheless, textiles can never regain the position of domination in Japan's foreign trade which they held before the war. The new pattern of demand emerging in the Far East is based on the need of the countries of this region for transportation equipment, electric power equipment and industrial machinery of all types. These and kindred products must become a major factor in Japan's exports from now on.

Unlike the prewar period, Japan cannot draw upon an empire for its food and raw materials. Though this program assumes Japan will obtain the maximum amounts of these from Asia, Australia and Malaya, it will still be necessary to obtain large amounts of food, raw cotton, and other goods from the United States. Notwithstanding the fullest utilization of sterling assets, the inevitable trade pattern creates a continuing dollar problem for Japan. The realities of this situation compel Japan to restrict its domestic consumption to minimum levels compatible with productive efficiency and health in order to create from exports the financial ability required to pay for imports now procured through available appropriated funds.

Basic Assumptions

The proposed program can be achieved only if a number of assumptions and conditions are fulfilled, and the necessary policies modified and effectively implemented. Prominent among the basic assumptions are: (1) there will be an integrated and expanding program of American aid for Asia, (2) political and economic conditions in the Far East will permit the necessary expansion of trade, (3) Japan will be increasingly free to conduct its own foreign commerce and engage in merchant shipping, (4) the Japanese government and people will take the necessary steps in internal policy to accelerate production and maximize exports, (5) Japan's internal economy will be effectively stabilized, (6) there will be a speedy and acceptable solution of the reparations problem, (7) there will be no international trade discrimination against Japan or opposition to her freedom to engage in world trade.

Considerations of Japan's Internal Economy

Inevitable difficulties and problems face Japan because of a rapidly growing population which, by 1953, will attain almost 87 million. This is 31 percent above the 1930–34 average, and represents a growth rate of 1½ million persons a year. Economic and social policy must reckon with this fact in many ways. Japan's people must be satisfied to share as equitably as possible the hardship imposed. A food consumption level of 1,950 calories a day in 1953 for the average consumer is only 87 percent of the prewar level. The people must be prepared to approach this level through acceptance of an austerity program in the interim period. Textile consumption will also be restricted and the housing shortage will still be severe.

The program presented demonstrates clearly that to attain even the modest standard of living proposed for 1953 the industrial production index for Japan must be 35 percent greater than in the 1930–34 base period. Solution to the grave and very real problem presented may

be found only in the most effective utilization of all available resources. These include the development and employment of all of the potentialities of Japan as they can be reinforced by contributions from external sources. The Japanese domestic resources must of necessity include not only the products yielded by the earth and the sea but also the will to work, the acceptance of sacrifice and the willingness to contribute to the overall good.

The Japanese must provide their full contribution to this program. They must realize that only if they do so will further American aid, already so generous, supplemented by private foreign investment in sound enterprise, be forthcoming. It is confidently expected that the Japanese people will demonstrate their sincere interest in the vital problem of their economic rehabilitation and will make the sacrifices required. Assuming this, the program presented indicates the required scope of Unites aid needed to make their efforts effective.

Only through this combination of domestic and foreign effort can the way be cleared for the development of a stable, democratic, self-supporting Japan.

[SOURCE: SUITLAND PAPERS, Z 703–31]

8-33 ESS MEMO ON ECONOMIC STABILIZATION

Memorandum[21] November 8, 1948

To: W. F. Marquat, Chief, ESS

From: Eugene M. Reed (for W. K. LeCount, Chief, Finance Division, ESS), C. W. Hepler, Chief, Labor Division, ESS, F. Whittington, Acting Chief, Price and Distribution Division, ESS.

1. Within the general policy for stabilization of the Japanese economy ESS has adopted four supporting policies; first to maintain the price level; second to maintain a balanced budget; third to prevent the government from financing the deficits of industry by means other than subsidy from the budget; and fourth to refuse to permit work stoppages in basic industries such as coal, at least to the extent necessary to maintain production to meet the needs of the occupation and the export program. We are now faced with major wage demands both from the government workers and from workers in private industry, the two most critical of which are from the electrical workers and the coal miners. It is imperative that ESS and SCAP review these demands and the policies adopted in the light of their interrelated implications.

2. Both the electrical workers and the coal miners in wage agreements entered into in March and April 1948 included in their contracts a sliding scale of wages based upon changes in cost of living. These sliding scale provisions have stood since their adoption as a major threat to the stabilization effort. In the adoption of the price level which was made effective from 23 June, no provision for further increases in wages to the workers in these industries was made. However, at that time workers in these industries, together with other workers, were granted substantial reductions in the earned income tax, which, to a considerable extent, offset increases in the cost of living resulting from the increase in the price level. The statistical indices of the cost of living have moved approximately 32⅓% since the effective date of the sliding scale contracts. Offsetting the tax reduction against the increase in the cost of living there is apparent justification for an increase of approximately 15% in wages of coal miners and electric workers. The electric workers wage dispute was, however, referred to the CLRB for compulsory mediation in order to avoid a strike of the electric workers in late September. The Central Labor Relations Board has now made a finding that the electrical workers are entitled to a wage increase of 41.94% over the April wage effective from 1 October forward as well as a retroactive adjustment of 32½% over the April wage for the months July to September, inclusive. The coal miners wage dispute has not been referred to the Central Labor Relations Board, but protracted negotiations have been carried on between the miners and the operators with the operators unable, under the present price structure, to offer any substantial advance in coal miners' wages without some form of relief provided by the government. It has now been proposed by the Japanese Government that the CLRB award for the electric workers be approved and that the coal miners be granted the same percentage wage increase, both to be financed by the combination of increased government subsidies and increased prices to consumers. Since the government has no revenue available from which the subsidy (see Appendix 1) could be paid such a proposal violates both the principle of a balanced budget and the policy of holding the present price level.

3. The proposed CLRB award in the electric workers dispute is estimated by the CLRB to cost 3,468,000,000 yen in additional wage payments by the electric industry within the current fiscal year. To absorb 3,468,000,000 yen in the rate structure of the electric industry within this fiscal year would necessitate a rate increase effective 15 November of 25%. Such an increase, if applied to power users in other basic industries, would necessitate an upward revision of prices particularly of such basic commodities as fertilizer, cement, textiles, caustic soda. This would inevitably be reflected in the farm parity index necessitating a revision of food prices. The result would be particularly exaggerated because of the high degree of dependence of many plants on electricity as the prime source of power. Some consideration has been given by the government to the possibility of absorbing all or part of the increased cost through rate increases applying only to charges for lighting (frequently referred to as domestic consumers). The imposition of the full cost of the CLRB proposal on the electricity consumed for lighting would result in a rate increase to such consumers of approximately 60%. The proposal actually embodies in the Ministry of Finance's tentative budget is to impose one-half of the increased cost upon lighting consumers and to absorb the other half through government subsidy. It is readily apparent that none of those courses of action can be implemented within present ESS policy.

4. The proposal of ESB to apply to coal miners' wages the same percentage increase granted the electric workers under the CLRB award would establish basic wage rates of 5,680 yen a month for surface workers, 6,400 yen a month for underground workers, and 7,769 yen for office workers, and if made effective from 1 October would impose a cost on the coal industry for such increased wages of 6,158,000,000 yen within the current fiscal year. This increase is said by ESB to be equivalent to 360.72 yen per ton on a monthly production of 3,070,000 tons. It must be pointed out, however, that based on an expansion of the labor cost factor used in the present price of coal the 42% increase would cause an increase in the price of coal to 579 yen a ton, and further, that the 3,070,000 tons have not yet been produced in any month since the inception of the Occupation. Therefore, if our fondest hopes of obtaining a production of 3 million tons a month in the period from 18 November to the end of the fiscal year on 31 March are met it would necessitate a price increase of 456 yen per ton to return the 6,155,000,000 yen cost within the fiscal year. This would amount to approximately 20% increase over the present producer price of 2,388 yen per ton. A price increase of 456 yen per ton would cost the government railways, which is the largest non-special consumer of coal, 273 million yen a month or well over 1 billion yen in this fiscal year. Similarly, all other heavy users of coal would be placed in a serious deficit position by a 20% increase in the cost of coal. Included among the heavy users are such vital industries as iron and steel, gas, fertilizer, chemicals and items of significance to the export program. Coal presently supplied to many of the key industries is furnished at a price subsidized by the government. For such special users to whom coal is presently furnished at a reduced price the 45% yen increase in price would constitute an increase of more than 45% in coal costs and would necessitate the revision of the prices of all commodities produced by them. The Ministry of Finance's tentative budget proposal includes subsidizing the coal used by so-called special users (key industries) down to its present consumer price, but allowing the increase in producer price to be passed on to all so-called general users including the government railways. While this proposal would avoid the worst repercussions on basic industries, it would still have a serious effect upon the government deficit and also upon virtually all secondary industry in Japan, which is fundamentally the export producing industry, and the consumption goods industries, and would therefore have a serious effect upon export prices to be paid by Boeki Cho and upon the consumer price index. It therefore appears that in the case of coal there are no identifiable users upon whom an increase in the cost of coal can be said to have little effect upon the rest of the price structure.

5. In the foregoing paragraphs we have discussed the magnitude and implications of a 42% wage increase for electric workers and coal miners. It was pointed out in paragraph 2 that the proper application of statistical data would probably result in approximately a 15% wage increase for coal miners and electric workers. Such an increase would probably be unacceptable to the workers and at the same time would have the ill effects in lesser magnitude that have been pointed out as to the 42% proposal. Without ruling out the possibility of an increase of less than 42%, it is now proposed to give attention to the effects of failing to grant any wage increase.

6. In the event that no wage increase is granted in these two industries we face a strong probability that strike action will be taken in the immediate future by the unions. In all probability strike action will not result in any complete and continuous shutdown of production in either industry, but would more likely take the form of sporadic stoppage resulting in a curtailed output rather than a complete stoppage of supply. It is almost impossible to measure the degree of acceleration that might take place in these sporadic strikes over those existing

[21] Appendices and tabs omitted.

now due to wage negotiations. However, a continuation over any extended period of sporadic work stoppages will cause as much or more loss of production than would be occasioned by an immediate and complete work stoppage, since it is likely that with a complete work stoppage labor could not subsist without receiving wages, supplementary rations, and incentive goods. It is the consensus of opinion of interested Divisions that facing a complete work stoppage in connection with forcing both management and labor to take a more responsible attitude toward wage-price relation will in the future be advisable.

7. While the threats of work stoppages outlined in the preceding paragraph do not appear to justify the dire economic consequences of granting wage increases at this time, the lack of any agreed-upon stabilization program within SCAP, including the determination of integrated wage, price, cost, and budget relationships, leads us to the conclusion that it is not advisable to so apply the policies set forth in paragraph 1 as to prevent wage increases in the electric and coal industries.

8. It is therefore recommended:

a. That the basic stabilization program outlined in Tab 8 which has been developed jointly by Price and Distribution, Labor, and Finance Divisions and which has received the concurrence of the Industry Division and the Director for Production and Utilities be adopted. Adoption and necessary action for its complete implementation should be taken at the earliest possible date, and in any event prior to a major revision of the price and budget structure. The proposal basically involves the assumption of no imposed administrative wage control, but rather the fixing of a reasonable wage-price budget relation within which the ordinary economic forces will be allowed to determine the wage level and under which SCAP and the Japanese Government will assume the calculated risk of production stoppages arising either from labor unrest or from bankruptcy of the management but with the full enforcement of the first three policies mentioned in paragraph 1 of this memorandum.

b. That in the interim period pending the implementation of the basic stabilization program estimated to be possible by 1 February, action be taken in the form of:

(1) Attempting to hold the settlement in the cases of the electrical workers and coal miners to a wage increase more consistent with the factual increase in cost of living and in any case to not more than 42% and, to any extent possible, limiting the government's liability in connection with such a settlement to amounts more closely related to such cost of living increases.

(2) Increasing such selected prices to consumers as will produce revenue for the government without seriously impairing the general price level.

(3) Eliminating all new appropriations for any purpose other than the support of the government workers' wage increase, the support of the present price level and such existing known obligations of the government for payments as are inescapable. This involves the elimination of any one-time payment to government workers, the postponement of the enforcement of existing legislation for the reform of the judicial and legal system, the absorption within the present public works appropriation of any necessary expenditures for flood and earthquake damage, and the curtailment of all existing government programs by amounts sufficient to absorb current shortages of funds resulting from failure to increase sufficiently appropriations for materials and supplies when the budget was originally adopted.

(4) Maintaining the appearance of a balance in the general account budget by deferring such obligations as may be postponed for inclusion in the budgetary requirements for the following fiscal year.

9. The foregoing recommendation for interim action is made completely contingent upon the full acceptance by the Supreme Commander and ESS of the proposed basic stabilization program recommended in paragraph 8a above. In the event that such a stabilization program cannot be fully accepted, it is strongly recommended that the present issues be faced at this time in the form of a full maintenance of the present policies with a result that no action to permit increase for the electric workers or the coal miners be taken.

10. In conclusion it is pointed out that this entire discussion and the recommendations made above have been predicated upon an increase in government employees wages to a level of 5,300 yen a month. An increase in such wages to any amount substantially above this level will make it impossible to put into effect the recommendations made and will require either establishing a new general price level or unbalancing the budget.

11. Tabs 3–5, attached for information, are copies of previous memoranda which have been submitted to your office or discussed with the Director for Economics and Finance.

[SOURCE: SUITLAND PAPERS, Z 703–20]

8-34 ESB'S BASIC IDEAS UNDERLYING ECONOMIC SELF-SUPPORT PROGRAM

Report October 4, 1950

Prepared by: Economic Stabilization Board

1. Nature of program.

Efforts will be made to make the program as practicable as possible. The program will be formulated placing weight on basic ideas and measures implementing them.

2. Period of program.

The program will cover the three years FY 1951–53.

3. Basic assumptions.

(1) Population

It is assumed that Japan's population will increase at the following tempo:

(Unit: 1,000 persons)

FY 1950	84,174
FY 1951	85,549
FY 1952	86,865
FY 1953	88,156

Note: The above estimate on population is in the process of revision. It is likely that the figures for FYs 1951 and 1952 will increase to some extent and that for FY 1953 will remain almost unchanged.

(2) Changes in international situation.

It is assumed that the international situation will change as follows:

a. Outlook of Korean conflict.

The Korean conflict will be localized without expanding into armed crashes between the U.S.A. and U.S.S.R. or Communist China.

b. Possibility of World War III.

World War III will not breakout during the period covered by the program. On the other hand, the present tension between the American and Soviet blocs will not be eased.

c. Rearmament of powers.

The U.S. and Western Europe will continue rearmament on the scale now being planned.

d. Communist China.

Communist China will not attack Formosa for some time to come. The trade between Japan and Communist China will be maintained on the present scale.

e. U.S. aid to foreign countries.

The U.S. aid to foreign countries will be made more for military requirements. But the U.S. will continue to give purely economic aid to countries in Far East and Europe from political standpoint to ward off the encroachment of Communist influence.

f. Peace with Japan.

The peace with Japan will be realized in one form or another in the near future, thereby greatly expanding the freedom of Japan in here external economic activities.

(3) U.S. aid to Japan.

It is assumed that the U.S. aid to Japan will be continued as follows:

(Unit: million dollars)

USFY 1950–51	232
USFY 1951–52	150
USFY 1952–53	100
USFY 1953–54	0

(4) Price.

Economic factors such as production, foreign trade, etc. will be measured in full consideration of price changes. But national income will be calculated, temporarily, on the basis of the price level in 1950.

4. Goal of program.

The fundamental goal of the program lies in attaining Japan's economic self-support as early as possible. The economic self-support mentioned above, however, means an economy wherein international payments are balanced, a reasonable standard of living is secured and higher economic self-supply is attained through the development of indigenous resources.

The above-mentioned goal consists generally of the following:

(1) Scale of exports and imports.

The targets of exports and imports and the balance of international payments are estimated as follows:

(Unit: million dollars)

	FY 1950	FY 1951	FY 1952	FY 1953
Imports	1,220	1,358	1,477	1,575–1,600
Exports	810	1,050	1,250	1,250–1,450

(2) Development of electric power resources.

The target of electric power resource development program is set forth temporarily as below:

(As for a detailed program, see 1st tentative plan of electric power program attached hereto)

(Unit: 1,000 KW)

	FY 1949 (actual result)	FY 1950	FY 1951	FY 1952	FY 1953
Hydro-power					
Existing plant	5,908.1	5,939.5	6,169.5	6,308.5	6,336.4
New construction	—	31.4	261.4	400.4	428.3
Thermal-power (average of maximum generation)	1,820	2,029	2,162	2,162	2,162
Existing plant	1,775	1,934	1,901	1,941	1,941
New construction	45	95	221	221	221

Note: The above figures cover only those plants which are expected to have effects within the period under the program, and those which will have effects after FY 1953 will also be incorporated into the program.

The amount of electric power supply estimated from the above equipment is as below (Unit: 1 million KWH):

(a) Ordinary rainfall

	Supply at generating end	*% of loss*	*Supply at consuming end*
FY 1951	35,283	28.5	25,227
FY 1952	36,917	27.0	26,949
FY 1953	37,500	25.5	27,927

(b) High and low water seasons (FY 1953)

	Supply at generating end	*% of loss*	*Supply at consuming end*	*Ratio to A*
Ordinary condition of water—A	37,500	25.5	27,927	100
High water season-B	39,783	26.5	29,241	B/A106
Low water season-C	35,131	24.5	26,524	C/A 94

(3) Construction of ships.

The target of ship building program was set forth temporarily as below:

Construction program of ships per annum (including ships to be exported): 300–400 thousand gross tons.

Thus the gross tonnage of ocean-going ships will become by the end of FY 1953;

Cargo-vessels; 1,480–1,680 thousand gross tons

Tankers: 210–240 thousand gross tons

Total 1,690–1,920 thousand gross tons

(4) Production increase of iron and steel.

The target of production increase in steel is set forth temporarily as below:

FY 1951 3,500–4,000 thousand tons,

FY 1953 3,700–4,200 thousand tons,

Investigation will be made concerning the purchase conditions of materials.

(5) Production increase of textiles.

The targets of production increase in textiles are under investigation.

(6) Production increase in foodstuff.

The target of production increase in foodstuffs will be set up at about 12 million koku in the total of rice and wheat for coming three years.

(7) Improvement in living standard.

The target of improvement in living standard is as below:

1934–1936	100
1950	80
1951	83 (increase against preceding year 4%)
1952	86 (increase against preceding year 3.5%)
1953	89 (increase against preceding year 3.0%)

5. Basic principles of fiscal and banking policy.

(1) Supply of necessary fund for the attainment of the program will be planned within the framework of the accumulated real capital and the expected supply of foreign capital. Inflation through the creation of ficticious capital will be avoided.

(2) The program will be worked out on the assumption that the present exchange rate be kept unchanged and on the basis of domestic prices as will be affected by international prices.

(3) Legal control of banking will be avoided, while positive enforcement of effective fiscal and banking policies will be made including the utilization of government funds.

(4) In full recognition of the necessity of self-support in business concerns, Government subsidies and other aids will be granted only in exceptional cases.

[SOURCE: *Eibun Sengo Shiryō*, vol. 25, ECONOMIC PLANNING AGENCY]

8-35 ESB'S ECONOMIC SELF-SUPPORTING PROGRAM OF JAPAN

Report January 20, 1951

Prepared by: Economic Stabilization Board

Contents[22]

I. Necessity of Formulating Economic Self-supporting Program.
II. Basic Ideas of Self-supporting Economic Program.[23]
III. Scale and Composition of Self-supporting Economy Program.
  1. Summary of Program.
  2. Foreign Trade.
  3. Mining and Manufacturing Production.
  4. Agriculture, Forestry, and Fisheries Production.
  5. Transportation.
  6. Construction.
  7. Employment.
  8. Capital Accumulation and Consumption Level.
IV. Problems in and Measures for Attaining Economic Self-support.
  1. Securance of Imports.
  2. Increase of Ships.
  3. Increase of Self-sufficiency.
  4. Securing of Electric Power.

I. NECESSITY OF FORMULATING ECONOMIC SELF-SUPPORTING PROGRAM.

1. It is already 5 and half years since the termination of hostilities, but Japan's economy is still being supported by U.S. aid amounting to hundreds of millions of dollars per year and is far from being self-supporting. Therefore the highest objective of our economic policies should be the attainment of a self-supporting economy and we should do our utmost so that we may quickly be able to get along without foreign aid.

It is now expected that the peace treaty will be signed in the near future and our national sovereignty or political independence will be regained. The fact however that political independence cannot be complete without economic self-support adds to the necessity of attaining the latter. The Self-Supporting Economy Council was set up for these considerations and with the collaboration of many men of knowledge and experience in various walks of life has drafted a basic program for attaining Japan's economic self-support and measures required for its accomplishment.

2. Since the outbreak of the Korean conflict, international tension has steadily been intensified and the Japanese economy is in a position to be seriously affected should the situation get worse. Under such circumstance, our attempt to give the topmost priority to the attainment of economic self-support in our economic policy might be exposed to criticisms from various standpoints. But the road to economic self-support is a right one for Japan to tread. For the reason especially that the recovery of independence is fervently desired as a basis for promoting

[22] Section I and II printed only.

[23] Subsequent sections omitted.

economic policies, the objective of economic self-support should not be distorted.

3. It goes without saying that the operation of our economic policies should always be flexible enough to cope with the changing situation. It is not at all an easy task to formulate a long-term economic program at a time when internal and external conditions are changing so swiftly as at present. Nevertheless, economic policies must be established on a long-run and overall basis and be operated most rationally and efficiently. In this sense it is at such important time as now that a long-term and overall economic program is really needed. In order to solve this contradiction attempts have been made to base this program on what appear to be the most appropriate premises at present and to strike out a basic line for the Japanese economy to go along.

4. How the premises adopted here may change in future admits of no prediction. Should these premises be changed, contents of the program will also have to be modified accordingly. But such modifications should be made as an adjustment of established program to the changed situation. Individual economic policies without being rooted in a basic program will be incoherent after all, however quickly they may be able to adapt themselves to the changing situation and the result will be that the circulation of national economy will be disturbed and the rationality and effectiveness of economic policies will have to be lost.

5. In formulating this basic program, aiming at striking out a basic line for the Japanese economy, we attempted to set up targets which may be attainable if we made efforts, avoiding impossible targets however sublime they may appear. The level of the self-supporting economy embodied in this program is such that it will not be realized unless necessary measures are properly implemented.

We must endeavor to modify the contents of the program in keeping with the changing situation so as to make possible the most rational development of our economy. We feel confident that this program will serve as a basic road sign in the implementation of future economic policies.

II. Basic Ideas of Self-Supporting Economy Program.

1. Objective: It is intended in this program that our economic self-support will be attained in JFY 1953, and economic programs have been formulated for JFY 1951, 1952 and 1953 for attaining the above objective.

2. Meaning of Self-Supporting Economy.

The self-supporting economy as used in this program is of such nature as will enable not only balancing of international payments but also simultaneous improvement in living standard. It is intended also that, in consideration of future possible changes in situation, improvement will be made in self-sufficiency of our economy.

3. Premises: This program is based on the following premises.

(a) A World War III will not break out in the period under this program.

(b) But the tension between USA and USSR will continue and the world-wide rearmament tendency will be stepped up.

(c) Domestic inflationary policy will be avoided and the present exchange rate ($1: ¥360) will be maintained.

(d) Living standard will be raised as follows (1934–36=100):

JFY 1951	83
1952	86
1953	89

(e) Population will increase as follows:

JFY 1951	85,571	(Unit: 1,000)
1952	86,882	
1953	88,204	

[Source: *Eibun Sengo Shiryō*, vol. 26, Economic Planning Agency]

8-36 JAPAN'S INDUSTRIAL POTENTIAL

Report on Japan's Immediately Available Production Resources — February 20, 1951

Prepared by: ESS, SCAP

INTRODUCTION

Studies by the US War Production Board during World War II credited Japan and its

empire with producing 18 percent as much war material as the United States. It is estimated that more than three-fourths of this production came from the four main islands now constituting Japan.

While much of this war production potential was destroyed immediately following World War II, Japan still has a very considerable capacity to produce and an intelligent, able labor force capable of substantial contributions.

The World War II production by Japan was possible only through sacrifice such as no other peoples engaged in the War were required to make. Fertilizer output was seriously curtailed, limiting food production, and the cotton textile industry—the pride of Japan—was reduced from twelve to less than three million spindles.

With adequate access to raw materials, Japan can produce in much greater volume than current experience. It is the purpose of this study to provide an estimate of Japan's industrial potential together with such related data as might be required to evaluate that potential. The principal value of Japan's industrial capacity is that much of it is available now and awaits only orders, raw materials, and a plan for utilization.

TABLE OF CONTENTS

BASIC ASSUMPTIONS
JAPAN'S INDUSTRIAL POTENTIAL[24]
IMPORT REQUIREMENTS
TRANSPORTATION
POPULATION AND LABOR FORCE
FINANCE
APPENDIX TABLES:
I. Industrial Activity and Estimated Current Capacity
II. Industrial Production and Capacity, Selected Commodities
III. Raw Material Requirements: Programmed for 1952, and for Capacity Operations
IV. Import Requirements Classified by Ultimate Disposition: Programmed for 1952 and at Capacity Operations
V. Number of Minor Political Divisions, by Size Group and Total Population in Each Group
VI. Key Statistics, June—December 1950

Basic Assumptions

This study envisages the practical implementation of a plan for the mobilization of the Japanese industrial potential for the United States military procurement within Japan. Consideration of this multi-faceted problem is predicated upon an appreciation of the mutual advantages to accrue to both the United States and Japan with due reference to vital factors of the world shortage of strategic materials, the individual national rearmament programs of the Western Powers and the international Military Defense Assistance Program sponsored by the United States.

The fundamental approach of necessity must be that determining the currently available and immediately expandable capacities in Japan; the employment of these capabilities to meet first the real domestic and normal commercial demands and finally the determination of the residual productive effort which is susceptible of employment elsewhere. There is no intention at this distance from the Washington planning sources to attempt assessment of the actual value of Japan's contribution to the United States program of industrial mobilization but the extent to which the domestic industry here may or may not be made complementary to the American industry is a matter of extreme significance.

Under the careful guidance of the Supreme Commander for the Allied Powers, the prostrated economy of Japan at the end of World War II has been revived at unprecedented rates toward the state of achievement of complete self-support. Disregarding for the moment the impact of the global military situation, the signing of a peace treaty for Japan this year would find the Japanese nation emerging upon a postwar autonomous career capable of meeting domestic economic requirements and of accumulating modest future earnings from which to meet any post-peace treaty commitments or to improve the satisfactory but meager standards of living. This is an Occupation accomplishment of historic precedent and a tribute to the adequacy of the initial policies of their realization.

[24] Portions of this section are deleted. Subsequent sections are omitted.

With the interjection of the inflammatory global war complex into the overall situation the post-peace treaty relationships between the United States and Japan must include, among other considerations, an evaluation of the extent to which the United States will be called upon to furnish economic aid or military aid or both. It is axiomatic that any excessive immediate demand upon Japan for assuming a total military defense would emasculate its economic stability to the point of requiring outside support but it is equally factual that unless provided with markets and sources of materials to continue satisfactory industrial and commercial progress both economic and military aid will be a necessity. The obvious solution lies in having Japan contribute to the international military effort by utilizing the surplus economic potential to the fullest extent possible, thereby providing for its continued economic sufficiency and for increasing its contribution to its own military defense.

Whether the United States has or has not the industrial capacity to meet the total requirement of American and European and Asiatic defense through a realignment of its productive plant, finances and man-power, is for determination in the United States. There is no question that this could be done provided the repercussions on national levels of existence are acceptable. It is germane to the issue, however, that the United States is vitally concerned with the international Military Defense Aid in which the efforts of the British Commonwealth, the Benelux countries, Germany, France Italy, and other nations are utilized. This problem for the Far East is a matter of increasing importance and within this military and economic orbit Japan best is capable of contributing to, as well as participating in, the overall program. It is considered a prime essential that this nation be integrated in this global multilateral effort to the full extent that its resources may be considered an asset and this has been the main basis for the instructions by General MacArthur to explore the possibilities of such participation even before the Munitions Board request was received. More especially it is difficult to comprehend why Japan, with its attractive potential, should be specifically and discriminately eliminated from such a program on the eve of reacceptance into the family of democratic non-Communist nations. It cannot be completely discounted that this unemployed latent capacity, once ignored by the Western Powers may be made a means of ingress of subversive influences should Japan be faced with economic deterioration following attainment of independent national existence.

The problem of materials shortage as applied to the United States pertains mainly to strategic commodities since there is a high degree of self-sufficiency in basic raw materials. On the other hand, the ability of Japan to meet its domestic and export targets when the rest of the world attains top speed in its military production program will depend largely upon the availability of basic raw materials, practically all of which must be imported. Without allocations of such commodities there will eventuate inevitably a precipitous decline in industrial activity with a consequent demand for outside aid if the nation is to be kept vital to perpetuate its own existence and psychologically adjusted to anti-Communist doctrines.

The matter of justification for the immediate participation of Japan in military construction programs is a paramount consideration in view of the provisions of the Potsdam Declaration, FEC directives and specific statutory stipulations of the Japanese constitution. Of no less significance is the need for initiating these programs under conditions which will pertain after ratification of the peace treaty. It is appreciated that salutary efforts have been exerted to define the right of Supreme Commander to authorize the production of war materials for the Korean effort on the basis that the interests of the Occupation are threatened by aggressive military action on the nearby peninsula. The problem is broader than this as there must exist a basis for continued production of such end products should the Korean war be terminated in the near future and for participation in non-Communist Asian military aid. To use the foregoing hypothesis as the only justification would invite a reexamination of the problem by the FEC powers fearful of the creation of a Japanese military potential immediately upon the imminent termination of the Occupation by acceptance of the peace treaty and may result in the imposition of sanctions definitely contrary to the best interests of Japan and possibly of America. Practically, complete and sole reliance upon such a shortage justification adversely will affect the all-important domestic financing and will discourage foreign investment, both essential to the full development of Japanese production resources.

It is the opinion accepted here that a more adequate initial basis for engaging in production of military items by Japan is that of insuring economic survival as described heretofore. The production of military equipment as a marketable export commodity without directly associating such production with the creation of a Japanese military establishment which could threaten the former World War II victorious nations, would permit continuity of contractual obligations into the peace treaty period and the acceptance of medium and long-range programs. Japan rearmament aspects would be analyzed subsequent to the acceptance of the military defense

pact now under discussion. It is contemplated here that safeguards be introduced to insure against the actual possibility of regeneration of Japanese military power beyond that desired by the non-Communist bloc and especially in provide refutation to allegations of violation of pact agreements by the United States in the pre-peace treaty period. Briefly it is suggested that special tools employed in this production be controlled by the United States through some means of retaining title and authority finally to dispose of this equipment in the best interest of the Western Powers as they appear at the termination of the program.

The fact that Japan, once again a free nation, should be provided with limited facilities for producing its own defense weapons over a period of time is an obvious assumption. Since the development of a war potential is dependent principally upon the stockpiling of steel and petroleum products, raw materials for which must be imported into Japan under international allocations, there is provided a sufficient safeguard to satisfy those powers who may be inclined to challenge such assumption.

Domestic financing problems are complex since Japan operates under foreign exchange controls and will do so for some time in the future. The budgetary requirements may be established satisfactorily only if some reasonably definite prospect of the type and volume of future production can be determined. The inflationary impact of the present extensive military procurement is a matter of extreme concern to the maintainence of future economic stability.

Overseas transportation introduces another important segment of overall consideration. Without marine transportation available in quantity adequate to move imports of needed raw materials and exports of manufactured products any program of this nature will fail.

Contributing factors of specialized and general labor have been analyzed and found not to be seriously limiting.

In order satisfactorily to conduct such a program of contribution to the United States military production program it is considered essential that a procurement agency be created initially under the Occupation but so constituted that it may function after the peace treaty. In addition to a general administrative headquarters this body should contain subdivisions of the United States Army Ordnance, Medical, Quartermaster and Signal Departments, the United States Air Force and the United States Navy. These installations provide specifications, valuable technical inspection, information on contractual procedures and authorized financial information necessary to the accomplishment of the proposed program.

It is contemplated that capital financing will be accomplished within Japan but it will be essential to provide for prompt payment and for such prepayment advantages as may be consistent with United States policy. Cancellation provisions mutually acceptable will be a definite requirement. In general, long range programs will prove most attractive. The viewpoint here is that the utilization of Japan's excess capacity to produce a limited number of military items which can be made economically and satisfactorily while at the same time permitting manufacture for curtailed domestic consumption and non-military export will provide assurance of continued economic stability for Japan and make maximum contribution to the U.S. military program. It is emphasized that this plan does not contemplate a super-controlled economy but envisages a progressive expansion to the extent ultimately required. It must be apparent that since Japan is now engaged in depleting its industrial stockpiles for military procurement without adequate replacement for normal needs it will be necessary to gear the production programs in the future to the availability of materials. Unless programmed imports of raw materials can be related to military output it may become necessary actually to restrict military production in order to make the limited raw materials available for normal economic utilization.

In summation the basic assumptions for the economic mobilization program contemplated are:

The continued economic stability of Japan, acquired during the Occupation, is a matter of concern to the Western Powers.

The United States is vitally interested in the amount of economic and or military aid it will be morally committed to consider for Japan after the peace treaty.

Given access to the necessary raw materials, Japan can retain an acceptable economic level without United States economic aid.

Without the required access to raw materials, basic as well as strategic, Japan will be faced with the grave possibility of an economic dilemma probably terminating in a requirement for outside assistance.

Unless Japan can participate in appropriate armament production programs, neither strategic nor basic raw materials will be made available in quantites required to maintain the present equilibrium.

Considerable idle capacity now exists in Japan in production categories reputed to

be in short supply in the United States. Basic equipment and materiel items can be made in Japan under U.S. standards at satisfactory costs for supply to the non-Communist military aid countries in the Far East area such as French Indo-China, Thailand, Formosa, the Philippines, Malaya and Burma.

Except in certain specialist categories, manpower for increasing industrial production is in ample supply.

Japan is particularly well situated to fulfill supply functions as a Zone of the Interior area for the United States and the Western Powers in the Asiatic region.

Psychologically, Japan's participation in the uniform production effort of the free world will serve to align her more closely with the democracies and make her ultimate full armed participation more assured.

Participation in a military production program will serve to educate Japan in the manufacture of items to be required for her future independent defense. Proper controls will be instituted to prevent the regeneration of any undesirable war potential.

Specific exclusion from future MDAP production participation in view of the latent ability to contribute, could be construed as discriminatory and unjustifiable. It could result in serious disruption of international good will.

A collapsed economy precipitated by failure to be accorded the right to participate in allocations of basic and strategic materials will open an avenue of approach to Communist appeal in Japan. With sizeable idle industrial capacity, unemployed by reason of exclusion from available military exports markets, the probability of attractive offers by the Communist area after the peace treaty is not entirely remote. Under the capitalistic system the profit motive is difficult to control.

The program as prepared indicates Japan's total industrial capacity, that portion of capacity required for domestic and normal export needs and the residual suitable for integration into the United States effort. The amount of this capacity that will fit into the overall United States requirement is for determination after joint analysis by the Munitions Board and the Occupation and Japanese representations later to be convened.

The political justification for military item production by Japan is a matter of concern. The efforts to support the position that the present Korean War is a threat to the Occupation, in consequence of which the Supreme Commander is authorized to take such precautionary measures as he deems appropriate to include the production of munitions, is concurred in and appreciated. However, complete dependence upon this premise may invite re-opening of the issue when the peace treaty is ratified and the Occupation interest is terminated. Financing and long range contracts are inhibited by the Korean War-Occupation concept as sole basis for this action.

Placing the manufacture of military export items on a basis of economic necessity is supportable from every angle, is not open to political challenge since the items are not actually used by Japan and will not be discouraging to financing or entrepreneuring efforts.

Safeguards, such as foreign title to special purpose tools, will furnish adequate refutation to arguments by certain FEC nations of pre-peace treaty violation of the Potsdam Declaration and FEC directives.

The study includes analysis of the inherent problems of domestic financing, labor and overseas transportation.

Corollary studies of the dependence of Japan upon vanishing Asiatic sources and markets and of domestic controls required are included. It is emphasized that the headquarter's proposal does not contemplate a supercontrolled economy for Japan nor an extensive bureaucratic regimentation of industry. The nature and extent of certain domestic controls inevitably required by world conditions are directly influenced by the acceptance or rejection of the proposed long range participation by Japan in military production programs.

In order promptly to consider the problem it is recommended that a procurement agency under aegis of the Munitions Board or other United States authority be created. This body initially will function under the Occupation but should be so organized as to be capable of continuing after the peace treaty. This would not interfere with present Korean procurement but could assimilate all or part of the latter to the extent determined practicable after it starts functioning. Its technical and inspection components would have immediate extreme value.

As a result of comprehensive analysis of the situation it is felt that the program indicated herewith will have profound influence upon the future economic and military relations between Japan and the United States and that it will return financial, military, commercial, industrial and political mutual benefits to both nations.

JAPAN'S INDUSTRIAL POTENTIAL

JAPAN'S INDUSTRIAL POTENTIAL. In December 1950 Japan's Industrial production index (1932–1936=100) rose to a new post-war high of 115.0. This new level was roughly 53 percent of production in the peak war year of 1944 and 56 percent of the industrial capacity available at the end of December 1950. Table 1 A compares industrial production in the year 1950 and in December 1950 with the industrial capacity currently available, and compares both with the wartime peak of 1944.

TABLE 1A. INDUSTRIAL ACTIVITY AND PRODUCTION INDICES AT SELECTED DATES
(1932–1936=100)

Industry Group	Calendar Year			Dec 1950 Production	Dec. 1950 Percent of Capacity
	1944 Production	1950 Cpacity	1950 Production		
Industrial Activity	209	204	111	132	65
Utilities	162	207	186	211	102
Industrial Production	219	204	95	115	56
Mining	151	140	110	121	86
Manufacturing	227	211	93	114	54
Durables	432	304	148	148	49
Non-Durables	48	139	76	89	64

It will be noted that while December production was 56 percent of capacity, that mining production was at 86 percent of capacity and manufacturing was 54 percent of capacity. In durable goods, December production was only 49 percent of capacity as compared with 64 percent for non-durables. It is important to note also that the output of durable goods was far greater, 128 index points, in 1944 than was capacity as of December 31, 1950. Nonetheless, with present facilities in Japan the production of durables can be doubled and the production of non-durables can be increased by more than one-half over the December 1950 production rates.

Table 1 of the appendix provides the detail by major industry and industrial group. Table 1B and Charts A and B provide significant comparisons between recent production and capacity.

PRODUCTIVE CAPACITY DEFINED. "Capacity" means potential output with present facilities assuming adequate supplies of raw materials, fuel, and labor. The specified limiting factors, i.e., lack of raw materials, fuel, labor, and also capital and markets for finished products are not considered at this point. The capacity figures therefore represent only a measure of operable physical manufacturing facilities.

It should be also noted that the overall measure of industrial capacity is a combination of the capacity to produce 69 representative, or controlling, products. These products and their respective capacities are shown in Table 1 of the appendix. They are the industrial series used in the official SCAP Industrial Activity Index published regularly in "Japanese Economic Statistics. Section 1". For purposes of this study, capacity to produce is related to *actual* production in the base years (1932–1936=100). Thus, as defined above, overall capacity of 204, as shown in Appendix Table 1 means simply that at the end of 1950, Japan's capacity to produce was more than double *actual* output in the 1932–1936 period, and 72 index points above the level of production in December 1950.

Capacity to produce at the end of 1950 was nearly double actual output in the full year 1950, and about the same as production in the peak year 1944. In general, it is assumed that the capacity to produce products not covered is similar to the capacity in the series listed, either in the related group or to the whole series. Specifically, this may not be true in every case; generally, however, it is. It should be recognized that a definition of capacity, such as that given above, inevitably results in some differences in interpretation as it is applied to different products. For products of the mines, particularly, the indicated capacity figures contain a large element of individual judgement. Then too, mining capacity is more flexible than most other types of industrial capacity in that the submarginal mines of one era may be satisfactory producers in another.

For electric power production, the definition given above is so unrealistic, because of stream flow variations, that an entirely different method of calculation has been used. Capacity, therefore, has been calculated as follows: For hydro-electric power, capacity represents actual

TABLE 1B. PRODUCTION AND CAPACITY—SELECTED ITEMS

Production Item	Unit	Production		Annual Capacity End of 1950
		Actual 1950	Annual Rate Dec. 1950	
Electricity	Billion KWH	45	52	50
Coal	Million MT	39	43	50
Crude Petroleum	Thousand KL	300	353	380
Refined Petroleum	Thousand KL	1,665	2,310	3,285[1]
Iron Ore (Metal Content)	Thousand MT	446	466	550
Pyrite Sinter	Thousand MT	348	423	1,680
Copper Ore (Metal Content)	Thousand MT	40	43	50
Limestone	Million MT	11	12	15
Pyrite	Thousand MT	1,911	2,134	2,280
Pig Iron	Thousand MT	2,227	2,579	5,600
Ferro Alloys	Thousand MT	66	69	214
Crude Steel	Thousand MT	4,848	5,960	9,900
Finished Steel				
Primary Products	Thousand MT	3,184	4,509	10,473
Secondary Products	Thousand MT	1,152	1,627	4,596
Cast Iron Products	Thousand MT	103	120	432
Copper Products	Thousand MT	78	106	160
Aluminum, Primary	Thousand MT	25	31	114
Ship Construction	Thousand GT	234	262	802
Railroad Locomotives	Units	118	156	744
Freight and Passenger, Cars	Thousand Units	4	2	16
Industrial Locomotives	Units	417	540	1,308
Industrial Cars	Thousand Units	29	32	76
Trucks, Passenger Cars and Buses	Thousand Units	32	43	53
Three-wheel Vehicles	Thousand Units	35	44	48
Industrial Machinery	Thousand MT	473	602	1,346
Bearings	Thousand MT	4	3	7
Internal Combustion Engines	Thousand MT	40	43	82
Machine Tools	Thousand MT	3	6	14
Electric Motors	Thousand Units	277	239	320
Storage Batteries	Thousand MT	12	11	18
Vacuum Tubes	Million Units	11	13	18
Sheet Glass	Million Cases[2]	4	5	5
Cement	Million MT	5	6	7
Lumber	Billion Bd Ft	4	6	7
Plywood	Million Sq Ft	391	477	900
Raw Silk	Thousand Bales (132 lbs.)	151	188	170
Cotton and Rayon Yarn	Million Pounds	614	801	870
Wool Yarn	Million Pounds	72	99	127
Sulphuric Acid	Million MT	3	4	4
Nitric Acid	Thousand MT	38	61	135
Chemical Fertilizers	Million MT	3	4	5
Coke	Million MT	4	5	6
Dyestuffs	Thousand MT	9	15	21
Oil and Fat Products	Thousand MT	170	132	1,126
Industrial Explosives	Thousand MT	19	20	35
Pulp	Thousand MT	748	866	996
Paper	Million MT	1	1	1
Crude Rubber Consumption	Thousand MT	87	90	131
Leather	Thousand MT	7	8	60

[1] Capacity depends upon type of products produced.
[2] 100 sq. ft. 2 mm. thick.

output in the calendar year 1950 plus an allowance for power spilled over dams in peak periods of rain fall. For thermal-electric power, capacity represents the output of the authorized generators operating at 32 percent of full time operations. This is the highest rate ever attained in Japan, and somewhat above the current rate of operations. The "index" of electric power capacity (appendix Table 1) was computed from the public utility portions of this capacity to provide comparability with the production index.

Machinery capacity, measured in number of tons, is subject to wide variations in actuality, depending of course, on the type of machinery manufactured. Another limitation on the indicated method of determining capacity us inadequate correction for seasonal factors. In the sake industry, temperature and humidity requirements are such that processing operations are concentrated into a period of three or four months, the equipment standing idle the balance of the time. In the beer industry, seasonality of demand affects operations to a considerable extent. Seasonally idle capacity in both of these industries might conceivably be used for other purposes. No consideration is given to that possibility in these calculations.

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Iron Ore. Japan has three sources of indigenous iron ore. First, there is some homatite of fair quality. Secondly, some iron is obtained from sintering iron pyrites, and finally, some iron is obtained from low grade iron sands. Heavy supplementation is required, however, from foreign sources.

Nonferrous Metals. For normal operations Japan has sufficient copper, lead, zinc and pyrites. Refining facilities, however, exceed the capacity of the mines so that Japan can successfully import and refine these items or can process scrap profitably. Japan has no significant domestic sources of tin, nickel, tungsten, vanadium and molybedenum.

Iron and Steel. More than 900 plants in Japan produce ferrous metals. Perhaps 50 of them are worth mentioning, and 20 are truly important; but if these 20, six are outstanding. These six (Yawata, Fuji. Kokan, Kawasaki, Kobe and Shin Fuso) account for 89 percent of Japan's pig iron capacity, 54 percent of its steel ingot capacity, and 66 percent of its capacity for finished steels. The industry as a whole is capable of large expansion over present operations. This, however, will require more iron ore, far more, in fact, than is provided for in present plans. Orders for this ore must be placed at once, if operations are to approach capacity in 1952. This is because the "lead-time" on ore deliveries from foreign sources is 12–15 months.

Pig iron output by December 1950 reached an annual rate of 2.6 million metric tons, or 46 percent of capacity; crude steel production in December was at an annual rate of 6.0 million, or 60 percent of capacity. Additional furnaces to be blown in during 1951 will lift the pig iron rate to 3.3 million tons by the beginning of 1952, according to industry estimates. Coordinately, steel ingot operations will be lifted to an annual rate of 6.3 million tons. This compares with the maximum output of 7.6 million tons, which was attained in 1943.

Operations could be stepped up more rapidly than indicated above. As shown in Appendix Table 111 programmed ore receipts, both foreign and domestic, will have to be increased to 10.3 million tons if full operations are to be attained in 1952. Also, relining and blowning in of additional furances will have to be rescheduled to step up steel production, and upward revision of present plans will only be made if the presence of adequate ore supplies at the mills can be assured. The industry goal of 6.3 million tons of steel ingots and castings has been set to reflect current appraisal of scrap availability at favorable prices. More scrap, of course, would permit a higher level of steel output.

Japan's iron and steel capacity can be described as follows:

Type	*Number*	*Annual Capacity* (1,000 MT)
Pig Iron		
Large blast furnaces	37	5,594
Small blast furnaces	11	84
Charcoal furnaces	6	35
Electric furnaces	150	213
Total	204	5,926
Steel Ingots and Castings		
Open hearth furnaces	198	7,147
Thomas converters	6	325
Electric furnaces	700	4,119
Total	904	11,591

For purposes of this report, the above figures have been somewhat modified, in an effort to determine *firm* capacity at the present time. Only the equipment actually operating or ready

to operate has been included. Equipment not included is generally regarded as obsolete or beyond repair. Depending on the circumstances, some of this equipment may, of course, be brought back into operation. For pig iron, most of the blast furnaces and charcoal furnaces are included, and a few of the electric furnaces. For crude steel, all of the open hearth furnaces and Thomas converters are included, together with 292 electric furnaces having a capacity of 2.4 million tons. These electric furnaces were actually in operation in December 1950. Aggregate annual capacity in these terms, and as used in this report, is therefore as follows: pig iron, 5.6 million tons; steel ingots and castings, 9.9 million tons. Additional electric furnaces might be placed in operation, although this is not desirable in view of the electric power situation. In a serious power shortage, it might be necessary to shut down some of the presently operating electric furnaces; some, however, would have to be retained in operation for the manufacture of certain types of special steels.

While steel finishing capacity, aggregating more than 15 million tons per year, is considerably in excess of crude steel capacity, the pattern of potential output may not be in accordance with actual requirements. Solution to this problem, as well as determining the composition of the facilities required for the production of finished steel products, will depend upon policy decisions yet to be made.

Machine Capacity. Japan's ability to process steel into finished products is perhaps greater than its capacity to produce steel. As of 31 December 1950, the metals and machinery industries of Japan had between 550 and 600 thousand machine tools and other metal-working tools. About 80 percent of these are metal cutting and grinding tools; the balance comprises metal shaping tools, testing and measuring devices, and welding and heat treating equipment. A minimum of 279 thousand tools are "held" by the Civil Property Custodian, these comprising 235 thousand cutting and grinding tools, and 44 thousand of the other categories listed above.

Of the 235 thousand cutting and grinding tools held by the C.P.C., about 133 thousand were idle on 1 December 1950, the balance being largely in the hands of Army contractors, military establishments, and private industry. Twenty percent of the idle tools are in operable condition, the remainder being reported as having "one or more parts missing". Of the latter category, perhaps one-fourth could be restored to operable condition with only minor repairs, and an additional 50 percent could be made operable with minimum requirements for materials and capital. Similar information regarding the active-idle status and physical condition of the 44 thousand other cools mentioned in the preceding paragraph is not available.

The balance of the overall supply comprises 246 thousand tools in all categories which are not under reparations custody, and about 25 thousand tools which have been manufactured since the war.

The real total of machine tools may be well in excess of the 550 thousand units mentioned above. Firm figures are available only for custody tools (279 thousand units) and new production (25 thousand units). The balance of 246 thousand tools is an estimate by the Japanese Ministry of International Trade and Industry, and for obvious reasons, it may be regarded as conservative. Moreover, it should be recalled that reparations seizures were limited to plants in certain industries[1] with many important tool using industries remaining untouched.

The present supply of 550 thousand tools appears to be only about 64 thousand units below the supply early in 1946. Thus:

	Units
Reductions since 1946:	
Reparations shipments to claimant countries	57,000
Special purpose tools destroyed under SCAP direction	12,500
Other tools released from custody as scrap	20,000
Total reductions	89,500
	Units
Increase since 1946:	
New manufacture	25,000
Net reduction	64,500

The indicated 1946 supply is 614.5 thousand units, i.e., 550 thousand units *plus* 64.5 thousand units. This is somewhat in excess of the only available inventory figure for 1946, which indicated a total of 560 thousand units early in that year (before reparations seizures). The latter figure, however, is probably an understatement. The inventory was conducted under the adverse circumstances existing at the time.

The extent of tool destruction prior to 1946 cannot be determined. There are no adequate inventory figures prior to 1946, and no records of bomb damage (in terms of machine tools) or of unsupervised destruction immediately after the war. It may be worth noting that the capacity of the machinery industry at the end of 1950 has been estimated at 349 (1932–36=100). Actual output in 1944, the peak year, was 718. Both output and capacity, however, are on a tonnage basis, and no inferences should be drawn as to the extent of the change in the machine tool inventory since 1944. That is, assuming operations were at capacity in 1944, the indicated reduction in capacity from 1944 to 1950 is almost 50 percent. It must not be inferred, however, that the *number* of tools has been reduced to this degree. Bomb damage, and unsupervised destruction could not have reasonably accounted for such a large reduction. More realistically, the decline in capacity can be credited to the removal of key tools and high performance tools, with the aggregate number of tools being reduced much less than 50 percent.

Recent Japanese Economic Stabilization Board estimates place the number of tools in 1942 at 670 thousand and at 565 thousand at the end of 1949 indicating a slightly larger number than the minimum figure of 550 thousand noted above.

Currently Japanese machine tool manufacturers can produce about 12.5 thousand machine tools per year. Some additional tools can be produced in other plants, but 15 thousand tools per year is about the total overall current capacity.

The following table shows the minimum number of machine tools believed to be in Japan:

Machine Tools in Japan (S.L.)
1946–1950

Machine tools on hand 1946	614,000
Reparations shipments	57,000
Destroyed Special Purpose	12,500
Others Destroyed or Scrapped	20,000
New Tools—1946–1950	25,000
Machine tools on hand 31 Dec 50	549,500

The Japanese government under SCAP direction is preparing to conduct a machine tool survey in the near future.

[1] Arsenals, aircraft and munitions plants; machine tool and ball and roller bearing factories; shipyards, and chemical, iron and steel plants.

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MILITARY ARTICLES. At this time, it is impossible to determine what may be required of Japan in the way of end products to support the United States, United Nations, and other military assistance pact nations in the Far East. To date, Japan has supplied a wide variety of items in support of the Korean operation. Table 1E provides a tabulation of the supplies contracted for to 28 January 1951 by the US for the UN Korean effort. For the most part, these items have been primarily civilian in character and not those specifically required for purely military operations.

Quartermaster Corps. It is clearly evident that with currently available surplus capacity Japan can furnish all of the uniforms, canteens, webbing, mess kits, tents, shoes, blankets and other quartermaster items required as basic equipment for a large military force.

Measured by sewing capacity, and disregarding the very modest domestic requirements, equipment is available for processing 1.08 billion square yards of light fabric. In terms of men's two-piece suits (5 square yards of fabric per suit) this equates to 216 million suits per year. Alternately, this capacity is available for such items as men's and women's uniforms, both summer and winter, work suits, coats, raincoats, jackets, nurses uniforms, and related products. Similarly, knitting and finishing capacity is available for processing 1.1 billion pounds of yarn per year in the manufacture of such items as undershirts, sweaters, socks, stockings, mufflers, mittens, gloves, drawers, etc. Also, capacity is at hand for processing 23.3 million square yards of heavy fabrics. In terms of tents of average-size (89.5 square yards), this provides for an output of 260 thousand units; alternately, this capacity can be used to produce sheets, waterproof bed rolls, tarpaulins, jungle hammocks, rifle covers, water buckets, sleeping bags, duffle bags, web belts, etc. Finally, processing equipment is available for processing 37.8 million square yards of fabric into jute bags.

Facilities are also available for the manufacture of portable mess gear, portable refrigeration units, gasoline driven pumps and electric generators, mobile laundries, and a long list of housekeeping supplies such as soap, mops, brooms, and insecticides. Such specialized items as large fork-lift trucks, which are required in relatively limited quantities, are not suitable for production in Japan.

Ordnance. In the peak year 1944, production of military explosives amounted to 126 thousand metric tons. The fixed nitrogen content of this amount of explosives is about 25 thousand tons.

By mid-1951, it is estimated that the ammonium sulphate and calcium cyanamide companies will be producing fixed nitrogen at an annual rate of about 525 thousand tons, which is

TABLE IE. SUPPLY CONTRACT AWARDS BY ARMED FORCES AND ECONOMIC COOPERATION ADMINISTRATION 25 June 1950–28 January 1951

(Values in Thousands of US Dollars)

Commodity	Value	Commodity	Value
Grand Total	$145,491	Chemicals and Drugs	6,310
Food and Beverages	3,864	DDT	956
Biscuits and Rations	3,697	Dressings	623
Other	167	Fuel	1,022
Textiles and Products	33,295	Drugs and Biologicals	3,709
Yarn and Thread, Cotton	2,468	Non-Metallic Min. and Prod.	6,506
Cotton Fabric	4,534	Glass	589
Blankets	4,853	Cement	684
Sleeping Bags	2,274	Coal	4,609
Wool and Rayon Yarns	1,504	Other Non-Metallic Mineral	624
Clothing	4,062	Metal Products	36,931
Sandbags	6,720	Barbed Wire	4,455
Rope and Net	655	Barbed Wire Posts	6,209
Other	6,225	Drumps and Containers	6,739
Wood and Paper	18,147	Buildings	3,685
Lumber	4,620	Rail and Track Materials	2,454
Ties and Poles	2,364	Structural Steel and Sheet	2,758
Plywood	770	Pipe and Fittings	1,846
Bom Wood	2,164	Other Iron and Steel	1,750
Pallets	1,044	Wire and Cable	1,630
Tent Floors and Frames	1,062	Tools and Kits	1,973
Prefab Bldg Parts	3,816	Other	3,432
Charcoal	600	Machinery and Equipment	37,346
Other (Incl Paper)	1,707	Rail Equipment	9,287
Rubber Products	2,432	Trucks and Parts	17,101
Tires	565	Electrical Equipment	2,319
Camelback	979	Batteries	4,429
Rubber Footwear	344	Other	4,210
Misc Rubber Products	544	All Other	660

enough for both present domestic agricultural needs and military explosive output at the 1944 rate. Other explosive components appear to be available in adequate supply. Cotton for gun cotton is available. Methyl alcohol production in 1950 was higher than in the peak year 1943. Benzene and toluene, while below war year levels, could be raised without difficulty. It is understood that coal tar crude recovery in manufactured gas plants is being actively encouraged by government engineers; the techniques are well known, and have been applied successfully and profitably in the Japanese steel industry. Glycerine also appears to be in adequate supply. These are the essential ingredients of a wide range of military explosives.

Japan also can produce ammunition of almost any type. Special purpose equipment will be required in limited amounts. There follows a brief list of ordnance items which have been studied rather intensively with a view toward their possible production in Japan: .30 cal. light machine gun, .50 cal. light machine gun, .45 cal. sub-machine gun, M1 rifle, .30 cal. carbine, .30 cal. PAR rifle, 60 and 81 mm mortars, 2.36, 3.5 and 4.2 mortars, 2.36 and 3.5 Bazookas, 57 and 75 mm recoiless rifles, 105 and 155 mm Howitzers, quarter ton trucks, 2½ ton trucks, and light tanks. In general Japan can produce these items either at slightly higher or at slightly lower cost than the United States.

It is most important to again note that Japan does not have a large, convertible automotive industry. At best, Japan's annual capacity to produce vehicles is in the neighborhood of 125 thousand vehicles of all types, with specialization in heavy and very light "ends of the line."

Signal Corps. Japan's vacuum tube capacity is far in excess of current requirements for the domestic economy and for normal export trade. Japan, with but minor technical assistance, can provide virtually any of the requirements of the Signal Corps. In fact, the majority of the Signal Corps items are particularly adaptable to Japanese production techniques. While adequate inspection of end products would have to be provided, there is sufficient evidence that Japan could produce these articles most satisfactorily.

Chemical Warfare. Japan's chemical industry is outstanding in that it can produce virtually any type of material required in chemical warfare. Ample capacity and technical knowledge are available for such production.

Medical Corps. Under the direction of SCAP's Public Health and Welfare Section, both the quality and volume of Japanese drugs, biologicals, etc., have been improved. Facilities are being expanded rapidly, and standards are high.

Table 1F contains a list of medicines and medical equipment, together with the amounts produced during the years 1946–1949.

Engineer Corps. Japan can produce bridges, structural steel, cement, lumber and a number of other engineer items, but it is particularly deficient in its ability to produce heavy construction equipment.

Ships. If necessary, Japan can produce any kind of merchant ship. Also, there are facilities for producing war-ship hulls and engines.

Aircraft. No aircraft factories operate in Japan today, and none has operated since 1945. Production during the war, however, was as follows:

Year	*Units*	*Aluminum Production* LT
1940	4,764	26,460
1941	5,088	50,400
1942	8,856	75,360
1943	16,692	108,012
1944	28,176	109,464
1945	10,064	16,452

In 1944, 2 million of 8 million persons engaged in manufacturing in Japan were engaged in the production of aircraft and aircraft parts. This compares with 488 thousand in arms and ammunition, and 682 thousand in ships. The production performance record in returns of completed aircraft is very creditable. In addition, Japan can produce aircraft parts and accessory equipment. Further, it should be possible for Japan to produce air frames suitable for the installation of American engines. Finally, if required, Japan could produce scouting and liaison planes in considerable volume.

While the cost of aluminum ingots is high because of the high cost of electric power and imported bauxite, this initial cost can be partly offset by the lower cost of further processing. The great bulk of tools utilized in aircraft production in World War II is currently held in custody by SCAP's Civil Property Custodian.

Transportation Corps. Th ability of Japanese industry to produce goods for the transportation Corps is discussed in other sections of this report.

SPECIAL CONSIDERATIONS RELATING TO INDUSTRIAL CAPACITY. In considering the industrial potential of Japan, there are both scarcities and abundances peculiar to Japan, which can be evaluated in qualitative terms only. Outstanding examples are discussed here.

Mineral Resources—While it is generally believed that Japan is poor in mineral resources, it is increasingly evident that the true potentialities of Japan have not been fully examined. Exploration, with modern equipment, is needed. Modern, highly specialized tools required for such work are not available in Japan.

Lumber—Nearly 70 percent of the area of Japan is in so called "inaccessible" forests. Cutting in accessible forests, which account for about 15 percent of the land area, is proceeding at about double the replacement rate. Until the necessary access roads are built, Japan must be regarded as "poor" in terms of lumber, with industrial capacity in many directions thereby adversely affected.

Cement—While mineral resources are generally deficient, there is an abundance of lime, clay, and low grade coal. The cement industry is approaching capacity operations, with considerable quantities of cement being exported. Here, available raw materials can be used only if capacity is expanded.

Synthetic Chemicals—Sufficient low grade coal and lignite is available to resume operations in the several synthetic gasoline plants, which have been idle since the surrender. In 1945, synthetic oil capacity was estimated at 86 thousand kl per year, and it reached a somewhat higher level during the war. The plants would require major repairs.

INTERMEDIATE PRODUCTS. In several areas, by-products could be obtained by the application of modern techniques. The four soda-ash manufacturers, for example, now have pilot plants in operation for utilizing excess chlorine in the production of ammonium chloride. Used as a fertilizer material, ammonium chloride would relieve some of the pressure on sulphuric acid production facilities. The use of ammonia and urea as fertilizer is beginning. This, too,

TABLE 1F. PRODUCTION OF MEDICINES AND MEDICAL EQUIPMENT SELECTED ITEMS 1946–1949

Item	Unit	Monthly Average Production			
		1946	1947	1948	1949
PHARMACEUTICALS					
Mapharsen	kg	—	—	149	47
Bi. Subsal. Inj.	liter	—	—	445	51
Sulfathiazole	kg	—	—	6,017	7,651
Sulfadiazine	kg	—	—	11	252
Penicillin	1,000,000 I.U.	—	1,152	24,752	149,859
Hexylresorcinol:					
Crystal	kg	—	—	301	1,228
Capsule	1,000 0.1 gm	—	—	499	5,077
BIOLOGICS					
Cholera Vaccine	1,000 cc	1,911	531	67	23
Diphtheria Antitoxin	1,000 cc	112	61	92	29
Diphtheria Toxoid	1,000 cc	175	472	1,991	152
Smallpox Vaccine	1,000 dose	2,596	2,174	1,149	6,713
Typhoid Vaccine	1,000 cc	1,164	11,495	2,955	738
Typhos Vaccine	1,000 cc	0	221	100	141
TEXTILE SANITARY MATERIALS					
Absorbent Cotton	1,000 lb	29	214	321	396
Gauze	1,000 lb	38	58	105	142
Bandage	1,000 lb	46	40	100	63
Rubber Medical Goods	kg	—	49,999	69,871	71,950
Surgical Instruments	1,000 pcs	—	1,392	2,121	3,168
Dental Instruments	1,000 pcs	—	326	477	541
Glass Syringes	1,000 pcs	—	399	382	396
X-RAY & ELECTROTHERAPY EQUIPMENT					
X-ray Machine	each	163	175	312	341
Ultra Shortwave	each	47	48	89	39
Ultra Violet-ray	each	15	35	92	93
Infra-red Ray	each	21	29	14	37
Luminous Screens	each	—	56	140	161
Intensifying Screens	each	—	146	266	450
Electro Surgical Instruments	each	—	12	10	10
X-RAY FILM					
$2\frac{1}{2} \times 3\frac{1}{2}$	doz	—	—	987	247
$4\frac{3}{4} \times 6\frac{1}{2}$	doz	—	—	1,048	140
5×7	doz	—	—	892	396
$6\frac{1}{2} \times 8\frac{1}{2}$	doz	—	—	2,016	2,016
8×10	doz	—	—	3,696	2,057
10×12	doz	—	—	22,698	27,094
11×14	doz	—	—	1,176	2,325
Dental	doz	—	—	734	1,427
120	roll	—	—	4,144	7,561
35 mm	roll	—	—	—	10,023
X-RAY TUBES					
Coolidge	each	—	—	771	754
Kenotron	each	—	—	225	509

would release sulphuric acid for other uses. Among the mineral resources not fully utilized might be mentioned the growing titanium bearing ferrous slag piles. With the proper facilities, titanium dioxide might be recovered, thus reducing the need for imported ilmenite. Titanium dioxide is important as a pigment and is used in the manufacture of titanium for high temperature, high strength alloys.

FINISHED GOODS. There is considerable excess capacity in certain lines, including flour milling, leather tanning, leather shoes, soap. and paint. To some extent, at least, these facilities should be regarded as part of the Japanese industrial potential. Such idle equipment will be available when U.S. operations are overloaded.

FLEXIBILITY OF INDUSTRIAL FACILITIES. The flexibility, or convertability of the Japanese industrial economy can be viewed only in relative terms. For example, the Japanese apparel industry is probably as readily convertable to a war footing as the American industry, although of course at a much lower rate of output. The same can be said for the food processing industry and for all other industries where products for war are of the same general nature as products for peace.

In the organic chemical industries one type of versatility is inherent. There are three basic crude raw materials, coal, petroleum and plants. Theoretically and, in an increasing degree, actually, any intermediate can be processed from any of the three basic raw materials. Where, in one situation, it may be most economical to produce ethyl alcohol from plants, in another situation petroleum or coal might be the most economical source. Then, too, the various end products may be obtained by differing processes from any one of several intermediates. In many cases, specialized plants may be the most economical for the manufacture of various products such as plastics, synthetic rubber, textiles, gasoline and pharmaceuticals, but it is nevertheless possible to produce them with existing facilities. In some phases, the degree of flexibility is not greatly different in America and in Japan. In military explosives, for example, Japanese ammonia plants can produce fixed nitrogen, either for fertilizer or for explosives. Pharmaceutical and dyestuff manufacturers can convert to the manufacture of each other's products; and electric furnaces now used in the manufacture of calcium cyanamide and calcium carbide are equally suitable for the manufacture of electro-chemicals and alloying materials. In these cases, and in many others, the characteristic of versatility is in the choice of process to be used in the synthesis of a desired end product. Much new equipment is needed however, before Japanese convertability approaches that of the U.S., even in respect to degree and variety.

In the machinery industries, a considerable degree of flexibility obtains. Here, relatively high flexibility is accompanied by and partly accounts for the low productivity of the industries. This is explained by the lack of special machine tools, which by their nature are not versatile, but are highly productive. Relatively high convertability in the machinery industries is characterized by another serious limitation, in that they are typically equipped to produce only light products such as watches and sewing machines, or heavy products, such as locomotives and ships. This is probably due in part to policies which kept consumption of consumer durable goods at a low level and emphasized capital formation. Facilities for producing such items as refrigerators, electric stoves, vacuum cleaners and washing machines are almost entirely lacking. Thus, Japan, with the necessary adaptation of existing tools, can produce a wide variety of products including office machines, optical and other instruments, electric motors, household electrical appliances, marine engines, boilers, conveyers and cranes, and large generators. Facilities for producing such items as automobiles and trucks, tractors, construction equipment, etc., however are very limited.

[SOURCE: SUITLAND PAPERS, Z 703–34]

8-37 NOTES REGARDING UTILIZATION OF THE JAPANESE ECONOMIC POTENTIAL

Memorandum April 17, 1951

To: General Marquat, Chief, ESS

From: E. A. Tupper, Visiting Expert

In accordance with your recent request I am glad to give you a memorandum on this subject. You will appreciate, I am sure, that in the brief time available to me it has been impossible to locate and analyze all aspects of this problem. This memorandum therefore represents only a partial and interim report.

The following points impress me as being among the more important ones which should be considered by SCAP.

But first I want you to know I am impressed with the great progress made toward rehabilitating the Japanese economy and very conscious of the impossibly difficult circumstances under which it has been achieved.

You will therefore understand, I hope, that such points as I may make below, which may appear to be critical, are not intended to be so. Instead they are merely "notes on unfinished business" of which you undoubtedly are well aware. They are included only to give a rounded picture.

Need for Programming

1. It is my strong impression that government officials in Washington misjudge some aspects of the situation here. Otherwise I am confident they would be pushing very much more vigorously for a program of US-Japanese economic cooperation.

2. On paper Japan is a democracy. That does not mean, however, that she is in fact. From various sources the picture I get is that about two percent of the people are Communists, about ten percent support the principles of Democracy while the other 88 percent could be pushed either way. Living standards are still only 75 percent of prewar—and those were of course low.

The people are accustomed to regimentation, they do not fear violence, they have no great fundamental urge to fight and suffer to win or preserve liberty and they have seen Russia grow strong enough under Communism to put the United States on the defensive.

Under these circumstances the only real hope of counteracting the greater efforts to Communize Japan which can be expected to follow the end of the Occupation is a program which promises an increasing standard of living. And the *program* must of course give prompt evidence of its effectiveness.

3. Inevitably there is serious danger that the recent change in Command will be followed by considerable confusion and uncertainty regarding existing and prospective US policies. Unless some positive steps are taken promptly, this will tend to slow down and delay the development and implementation of a program of US-Japanese economic cooperation.

4. The approach of the peace treaty together with the end of the Occupation arouses the latent instincts of SCAP personnel to begin to plan on more permanent employment. It will be difficult if not impossible to replace individuals as they resign. To the extent that US-Japanese cooperation is to be handled on behalf of the US by SCAP it will become increasingly difficult to do a satisfactory job.

5. Immediate and aggressive action toward developing a program of cooperation therefore appears to be imperative. This is so for three reasons:

a. In the absence of a sound and carefully thought out *program,* uncoordinated action on the part of military procurement officers and lack of action on the part of civilian allocation officials in the US could undo much of the progress made here since the end of the war.

b. Failure to develop such a program would be a serious blunder in that substantial resources exist in the Far East which could be used to great advantage in fighting the battle against Communism.

c. The balance between Democracy and Communism is a delicate one which could be very easily upset.

6. In the event of all-out war the economic potential of Japan and of other friendly nations in the Far East should be used as effectively and as fully as possible. This can be done only if there is sound and imaginative planning *before the fact.*

7. So long as full-scale war can be avoided and until the Communists can be forced to modify their international aspirations the Far East will continue to be vulnerable. Accordingly, until the economic strength of friendly nations in this area can be increased, there will be need for substantial United States commitments in this area. The economic strength of this area cannot be increased under present circumstances without substantial United States assistance. If this help is to be forthcoming it must be based on a well-developed, integrated program.

8. While considerable basic work has been completed which would aid in the formulation of a sound program there is much which remains to be done before a fuller utilization of the economic potential of Japan and other areas of Asia can proceed very far. For example I have been unable to locate any source of information either in SCAP or the Japanese Government which shows the size and character of undeveloped resources in this area, what it would take in the way of capital goods exports from Japan to bring them into production or to increase their output, nor what it would take in the way of Japanese imports to make this possible. Similarly some of the information essential to laying out a balanced program for the maximum and most effective internal use of Japan's resources is also lacking.

9. Although time has not been available for me to discuss the planning problem sufficiently with ESS officials to get a proper understanding of their thinking I have, at the moment, the following impressions which may or may not be correct.

a. Judgments of what can be done appear to be somewhat too ambitious. While there is surplus industrial capacity and manpower available, and while raw materials could be obtained with United States assistance, the availability of power is a decidedly limiting factor. If Japan were to operate her industry on a wartime basis as she did in 1944 there is, of course, no question of the possibility of substantially increasing the value added by manufacture. Such a shift necessarily would involve a radically different pattern of power use. That, however, does not appear to be called for in the present circumstances and, as I have indicated in my memorandum to you of 9 April 1951, would be a tragic mistake.

Estimates furnished to me of current power generation and a projection to 1 January 1953 indicate that if the present pattern of power use were continued the output of the industrial segment of the economy could be increased only 10 percent by that time. In the absence of a further increase in generating capacity it seems probable that the pattern of power use could with advantage be changed sufficiently to increase industrial output by perhaps 20 to 25 percent by 1 January 1953. However it appears impossible to contemplate an increase in output of 50 percent without a substantial increase in power generating capacity or otherwise taking the heavy risk of wrecking everything SCAP has worked so hard to create.

b. As I have previously indicated, too much emphasis in current thinking appears to be placed on "special procurements" as such. Japan could and should provide substantial quantities of goods required by the military forces in this area. Nevertheless there are definite limits to the amounts which could and should be provided—and the amounts are not great in terms of figures we customarily think of in the US. Moreover the procurement should, so far as possible, be spread across the board with emphasis on products which have civilian counterparts.

c. More attention should be devoted to the longer range aspects of the problem of preparing, economically, for the defense of the Far East. I refer to course to the problem of resource development.

d. More attention must also be given to the mechanics of effecting economic cooperation. For example: how should we proceed to develop a realistic program of cooperation which is in the interest of both Japan and the United States; how should both Japan and the United States go about the implementation of such a program; what kind of procurement policies and joint procurement organization is needed to prevent the several US procurement services now buying here from competing against one another and, more importantly (because of procurement officers' lack of understanding of all the details of Japan's precarious economic situation), upsetting the economic "applecart".

10. *My personal opinion is that a top level mission of great competence and prestige is needed here to work the problem through, directly with a comparable group of Japanese people.*

11. In summary, I have the impression that such thinking as has been done within SCAP and the Japanese Government cuts a great many corners. The SCAP program, such as it is (in sales department terminology), appears to be in the nature of "sales quotas" established with perhaps too little attention to past performance, to market needs, and to the long hard road between the designers' dream of a new product and public acceptance of the finished article.

12. Because of the absence of concrete programs showing the character, size and timing of Japanese production over the next several years it is virtually impossible to visualize the kinds of controls which will be both necessary and feasible.

13. In my memorandum of 4 April 1951 addressed to Mr. D. George Deihl, copy of which I have handed to you, I outlined briefly the steps which must be taken if a program of production is to be established for Japan. I should be happy to go into this subject in detail for you if you should care to have me do so.

Economic Controls

14. I am informed that at the moment supply and demand is in relatively good balance. If so the actions taken by the Japanese Government to eliminate as many controls as possible has been wise.

15. Obviously, however, there are strong prospects that world shortages of critical materials will continue to grow. Thus, even in the absence of programs to utilize more fully the Japanese economic potential, Japan will encounter increasing difficulty in securing adequate raw material supplies. And, of course, to the extent that Japanese production targets are set at higher levels the problem will be accentuated.

16. It therefore appears certain that Japan's economy will have to look forward again to more controls if inflation is to be minimized and her production capacity is to be devoted more

largely toward furthering her long range interests.

This is especially true since so large a share of her imports must come from the United States or be obtained with US assistance. It would be politically infeasible and economically impractical to deny raw materials to United States industry in order to make them available to Japan unless:

a. Japan had a program of production which was clearly not only in her interests but in ours, and

b. Japan were to demonstrate she not only had the willingness to direct such materials to their most essential use but also the ability to do so.

17. Such controls as may be established should be as few as possible in number, relatively simple to operate and rigidly enforced. A variety of factors call for the use of such concepts, important among which are the following:

a. The foundation of any control system must be comprehensive and accurate statistics plus intelligent analysis. Japanese statistics have lagged far behind the development of our own and are therefore far from adequate for control purposes.

b. There is no single common purpose which unites the Japanese people in a desire to move toward a particular national objective such as we had in World War II and now have again to a more limited extent. Accordingly there can be no general acceptance of nor sympathy with the reimposition of controls. (A big selling job is needed here to assist in educating the people to the value to them of a long range program of building economic strength.)

c. There appears to be no practicable way, at least for the time being, to get the cooperation of government and business in developing a system of controls and making it work effectively. We have learned in the United States that neither business nor government can alone do a satisfactory job of developing and operating controls. The only reason we have any success with our control machinery is because business and government have learned how, in an emergency, to work together. Accordingly every effort should be made to find ways and means of effecting business-government participation in the laying out of programs and implementing them. This would of course involve amending the National Personnel Act.

d. Standards of performance and personal integrity appear to be vastly higher in the United States government service than in the Japanese government service. Accordingly any control system used in Japan (which of course must be operated by government) starts out with two strikes against it.

18. My tentative opinion (subject to revision as I work over the considerable amount of material I have accumulated but have not yet had an opportunity to study) is that so far as allocations are concerned the control of power and coal plus a few strategic materials would be adequate under most circumstances if

a. The nature of the control was clearly spelled on;
b. The administration was simple;
c. Careful checks were made on performance;
d. Penalties for violations were heavy;
e. Violators were sought out and punished;
f. Such controls were implemented by an effective anti-speculation and inventory control order as well as by appropriate conservation orders limiting or prohibiting the production of certain types of end products and the use of critical materials in the manufacture of others, and
g. Appropriate import and export restrictions.

19. I have some specific ideas as to how to proceed to agree upon and set down in specific terms (a) the size and character of economic development in Japan and the Far East which would most closely approach our common interests and objectives, (b) a time schedule for doing so, (c) methods for bringing it about, (d) determining the costs involved in terms of money and the use of resources, and (e) implementing such program as might be adopted.

I should be glad to give them to you if you should care of have them.

E. A. Tupper
Visting Expert

[SOURCE: SUITLAND PAPERS, Z 703-51]

8-38 UNITED STATES-JAPAN ECONOMIC COOPERATION

Statement May 10, 1951
By: General Marquat (ESS Chief)
Released by Public Information Office, SCAP

Major General William F. Marquat, Chief of SCAP Economic and Scientific Section, accompanied by Peter A. McDermott, Chief of the Trades and Services Division of ESS, arrived at Haneda Air Base at 11:25 a.m. today after conferences in Washington on United States and Japanese economic cooperation in the immediate future.

Upon arrival in Tokyo, General Marquat released the following statement regarding the activities of the SCAP mission of which he was chief delegate:

The SCAP mission to the United States held conferences within an extremely wide coverage of government and private departments and agencies in the interrest of determining the potentialities for US-Japan economic cooperation in the immediate future and the prospects for continuing economic relationships after the Peace treaty. The results were significantly gratifying since they indicate a sincere interest on the part of the United States in Japan's future and wholehearted desire for mutual cooperation. A detailed statement will be issued later after submission of a report to Lt. Gen. Matthew B. Ridgway, Supreme Commander for the Allied Powers.

It can be stated at this time that Mr. Joseph M. Dodge, President of the Detroit Bank and financial consultant to the United States government and the Supreme Commander on Occupation financial policy, continues his prodigious efforts on behalf of Japan's international interests in spite of extremely heavy demands upon his time. This also is true of various United States government individuals such as J. Foster Dulles, Ambassador, and departments such as State, Army, Treasury, and Commerce, whose activities in support of Japan's world position are accelerated as a Peace settlement becomes imminent.

Contacts made by the SCAP mission in Washington and New York included Mr. Averill Harriman, special assistant to the President; J. M. Dodge, Financial advisor on Japan; Frank Pace, Jr., Secretary of the Army; Earl Johnson, assistant Secretary of the Army, the Munitions Board; John D. Small, chairman and the International programs Division of the Munitions Board under William Van Affen; Willard Thorpe, Assistant Secretary of State for Economic Affairs; V. Alexis Johnson, Chief of Division of Northeast Asian Affairs, State Department; Mr. Walsh, Deputy for E.P.S.; John W. Snyder, Secretary of Treasury and George H. Willis, Chief Office International Finance, U.S. Treasury, Governor Szynczak, Federal Reserve System; William McChesney Marfin, Chairman of Board of Governors, Federal Reserve System, Mr. Taggart, Committee Foreign Supplies and Requirements (Foster Committee); Sidney Weinberg, Deputy Chief, Office of Defense Mobilization; William Foster, Head of Economic Cooperative Administration; Board of Directors Export Import Bank (Chairman Herbert E. Groton); Office of Overseas Affairs, Department of Army, Brig. Gen. A. L. Hamblin; G-4 Department of Army, Maj. Generals Carter Magruder and John Christmas, and Brig. Gen. Olmsted, and a long list of other government agencies and commercial and industrial firms.

Other members of the mission besides General Marquat and Mr. McDermott included, Brig. Gen. Urban Niblo, Colonel Maylon Scott, Colonel Calvin M. Bryan, Lt. Col. Leslie L. Motz, Lt. Col. Marcus S. Griffin, Lt. Col. Robert N. Bond, Capt. William P. Fetzer, USN, Captain Raymond O. Bruzynski, USN and Mr. Terrance O. Kennedy, Mr. Kenneth D. Morrow and Dr. Sherwood M. Fine.

[SOURCE: *Eibun Sengo Shiryō*, Vol. 27, Economic Planning Agency]

8-39 MARQUAT'S STATEMENT ON U.S.-JAPAN ECONOMIC COOPERATION

Press Release May 16, 1951
By: W. F. Marquat
From: Public Information Office, SCAP

The following is a detailed press release prepared by Maj. Gen William F. Marquat, Chief of the Economic and Scientific Section, SCAP head of the SCAP mission on U.S.—Japan economic cooperation recently returned from the United States:

General Matthew B. Ridgway today authorized the release of the report on accomplish-

ments of the SCAP Mission on U.S.-Japan economic cooperation recently returned from the United States. The Occupation Headquarters group under the leadership of Major General W. F. Marquat, Chief of the Economic and Scientific Section, spent three weeks in Washington with high officials of the United States Government to include the Departments of State, Defense and Treasury; Office of Defense Mobilization; the Defense Production Administration; Munitions Board; Emergency Procurement Services; Export-Import Bank; Economic Cooperation Administration; Federal Reserve Board; Committee on Supplies and Requirements and others. Japan's future economic relationships with America were discussed with W. Averill Harriman, Special Assistant to the President; Ambassador John Foster Dulles, Presidential emissary on the Japanese peace treaty negotiations; Minister Joseph M. Dodge, consultant and adviser on Japanese economic and financial matters, and other prominent authorities.

The Supreme Commander for the Allied Powers received the context of the report from General Marquat and directed that the facts be transmitted to Prime Minister Shigeru Yoshida and then released for publication. Salient features are:

Japan's recovery under the Allied Occupation is respected and admired in official and unofficial circles in the U.S.

The U.S. is deeply concerned that Japan be accorded world markets and sources of raw materials supply on a non-discriminatory basis and to the extent that Japan can continue to justify such treatment.

The U.S. is fully cognizant of the advantages entailed in including Japan in its emergency procurement program along with Europe and other Western Hemisphere powers on a basis of quality of manufacture and of competitive pricing. The U.S. industry has made sacrifices and has engaged in capital financing to increase its production capacity in consequence of which it will demand priority in U.S. emergency procurement. However, there will be ample early demand, increasing rapidly in the future, available to Japan on a basis of presently existing excess industrial capacity and of favorable geographic location. Expension of the U.S. procurement program is progressive as funds are made available and purchases are made on an order to order basis. There is no single overall program contemplated wherein long-range assignment of procurement orders can be made. Because of many intangibles inherent in international industrial development it is essential that the placement of orders be made on the basis of successive contracts predicated upon competitive bidding.

Available foreign exchange and the accessibility to the world short supply of both basis and strategic raw materials are the major controlling factors. The raw materials situation is the more vital at the moment and stringent allocations procedures are being instituted. The development of new sources of these scarce supplies will demand priority attention in terms of allocations and financing. The opportunity for Japan to seek out and develop such new sources of supplies can be exploited to considerable advantage.

Production and stockpiling activities in the United States presently are largely in the planning and programming stages although available capacity is being fully employed. Agencies have been constituted for directing the national effort through essential channels by means of allocations controls and other recognized methods. It is obvious that if the other countries in the world are adopting measures to adjust domestic prices of manufactured items to international levels Japan must consider similar action of she will not be able to compete. If, for any reason, Japan is not able to contribute to the international program her claim for raw materials and food to maintain a suitable standard of home consumption will be affected. Japan should effectuate proper surveillance through existing agencies to the fullest extent possible.

International, United States and private financing can be made available to Japan upon the basis of the credit risk involved. For membership in international financial organizations Japan must qualify before making application. General Ridgway already has assured the Japanese of the Occupation's full assistance in this respect. Some of the prerequisites for membership in international financial bodies are:

1. Adoption and announcement of future International Payments Policy. Consideration of this problem already is under way.

2. Announcement of permanent measures of national inflation control. Since a fundamental purpose of international financial agencies is to assist in the stabilization of national currencies, the acceptance of a member nation which has no program for protecting its domestic currency from devaluation because of uncontrolled inflation is extremely doubtful. Emergency demand production is by nature inflationary and all nations today find it necessary to adopt measures to compensate for the expension of individual purchasing power through the production of goods that cannot be consumed in the domestic markets. At the same time it is essential that domestic standards of living be improved to the fullest extent possible.

3. Collateral deposit matters are of importance. The source of the base deposits for membership must be established definitely before membership can be considered.

4. National budgetary policy is important. Unless domestic stability can be maintained there exists the danger of uncontrolled inflation resulting in devaluation of currency and consequent inordinate advancement of prices. The extension of international credit under conditions where a nation prices itself out of world markets is infeasible.

United States national financial institutions are willing to consider loans to Japan within the purview of their existing policies. Since these institutions are capitalized by United States treasury funds in many instances there are provisions of law limiting the types of financing that may be undertaken. Normally this type of financing may be considered only when United States interests are included in the mutual benefits of the transaction contemplated.

Private investment institutions in the United States are interested in Japan on a loan by loan basis. The Primary concern in this type of financing is assurance on the part of Japan that any investments made in Japan at this time will be accorded recognition and reasonable protection against expropriation after the peace treaty. The announcement of foreign investment policy to endure beyond the Occupation period is an essential factor in the encouragement of foreign investment. In a period of industrial expansion with the United States, when special amortization privileges and similar incentives are accorded the entrepreneur, there are ample opportunities for local profitable investment and capital is not too interested in foreign investments elsewhere if the risk to be taken is disproportionately high.

Japan's future commercial policy is a matter of considerable interest to government and private circles in the United States. The U.S. Government position as to trade with Japan has long been exemplified in Occupation policy. It is substantially that of permitting Japan non-discriminatory treatment with other foreign nations in trading with the U.S. with due recognition of the responsibility of the United States Government to protect the national interests against unfair practices. There will exist always in all countries certain special interests which oppose competition from any course whatever. However, these countries and firms will want to sell to as well as buy from Japan and any protection for domestic business or industry, in Japan or elsewhere, is a matter for reciprocal agreement at the national level.

While the SCAP-FEC Mission was not an agency for order placement in the United States, as a result of discussions there were developed several areas in which immediate business relationships might be established between the two countries concerned. Specifically there may be limited opportunities to increase sales of consumer goods of proper quality and price; however, these should be considered temporary only until production of such items is resumed by United States firms. Further, Japanese industry may assume some of the international markets for special demand goods which would assist U.S. industry to a limited degree to retain capacity for consumer production in addition to that required for the manufacture of military items.

There is general acknowledgment in the United States of the serious nature of Japan's current shipping position. There is no inclination to discriminate against Japan with respect to the relationships between U.S. and international merchant marine operations. The opposition is not to Japanese shipping per se but to the re-creation of the undercutting type of prewar ocean transport formerly supported by Japan. In this area of activity also it would be of infinite value if Japan should indicate a definite merchant marine policy. With respect to the leasing or chartering vessels from the U.S. "mothball" fleet there are existing tight legal restrictions against making available these ships to any foreign nation and the policy is not discriminatory against Japan. Although strenuous and positive efforts have been made by U.S. authorities to extend favorable special consideration to Japan, it is extremely doubtful whether a change in legislation could be effected and even if such were possible it is improbable that it could be accomplished in time to meet the urgency of the problem. It would appear to be more practicable for Japan to seek out some other solution rather than to depend further upon this "wind-fall" prospect.

For Japan's future industrial progress, United States private concerns already have indicated hearty approval of contributing "know how" on a commercial basis. With proper incentive in terms of declaration of permanent general policy and protection of investment there would be considerable interest in equity ownership. Japan can undertake broad technological advancement on a premise of direct purchase with guarantees of protection of patent rights. Although the demand for special purpose machine tools from the United States is extremely great at present, Japan may obtain consideration of its needs for such items to increase its industrial capacity to be applied to the economic-cooperation program.

Actual procurement under the U.S.-Japanese Economic Cooperation plan will be accom-

plished through existing service and civilian purchasing agencies. Since these groups have individual appropriations to expend and to account for, central procurement is not possible. An overall coordinating agency for all U.S. procurement in Japan is under consideration mainly for the purpose of consolidating American demands and dealing with the Japanese Government on industrial planning and mobilization problems.

The United States believes that Japan's industrial potential may be utilized advantageously to a maximum extent to increase raw materials production and industrial potentials in Southeast Asia. An attractive opportunity exists for Japan to supply Southeast Asia and other areas with capital and consumer goods not now available from normal sources in countries engaged in war production. To these ends efforts should be exerted to enlist the support of the various U.S. economic aid and technical missions in Southeast Asia to develop programs linked to the overall U.S.-Japan economic cooperation plans.

In summation there is a definite desire in America to witness an early peace settlement granting Japan full autonomy providing for an expanding viable economy. There is a sincere willingness to accept Japan as a mature member of the family of Free Nations and to accord her access to markets and sources of supply so long as Japan uses both for sound domestic development and for contribution to the tranquility and development of the free world. There is every manifestation that there will be a continuing interest after the peace treaty in Japan's welfare and continued progress. Having contributed with historic munificence to Japan's rehabilitation under the Occupation, the United States does not feel committed to "bail out" Japan after the peace treaty if she should permit a recession in the salutary economic progress already achieved. Inordinate inflation will price Japan's products out of the markets of the world and would preclude access to reasonable amounts of raw materials imports.

In consequence of the investigations of the Headquarters Mission it is indicated clearly that great opportunity exists for Japan to continue her economic advancement at a rate that would be eminently satisfactory. There is a positive requirement, however, for the immediate formulation and announcement to the world of her long term economic policies—not necessarily those used in the United States or advocated by the Occupation so long as they are sound in principle. This long has been the SCAP position. Japan's future will be established upon the adequacy of her own actions in adopting sound future economic measures and in extending Free World industrial cooperation. The potential for success appears to be substantial.

General Ridgway has indicated that during the remainder of the Occupation period the economic agencies of the SCAP Headquarters will contribute their fullest efforts toward the further development of U.S.-Japan economic cooperation as a matter of long term mutually beneficial relationhsips.

Members of the SCAP-FEC Mission, in addition to General Marquat were: Mr. Terrance O. Kennedy, Dr. Sherwood M. Fine, Mr. Kenneth D. Morrow, Brig. Gen. Urban Niblo, Colonel Maylon Scott, Colonel Calvin M. Bryan, Capt. William P. Fetzer, USN, Capt. Raymond O. Bruzynaki, USN, Lt. Col. Marcus S. Griffin, Lt. Col. Robert N. Bond and Lt. Col. Leslie L. Motz.

[SOURCE: MORINAGA PAPERS, MINISTRY OF FINANCE]

8-40 JAPAN'S INDUSTRIAL POTENTIAL

Report (Vol. III) February 20, 1952
Prepared by: Programs and Statistics Division, ESS, SCAP

Table of Contents

Introduction
1. Capacity, 31 December 1951[25]
2. Military End-Item Potential[25]
3. Trade Patterns and Raw Materials
   General Patterns
   Imports
      Korea and Formosa
      China
      North America
      Southeast Asia, Sterling

[25] These sections only printed. Table 4 in section 2 is deleted.

      Southeast Asia, Non-Sterling
      Non-Southeast Asia, Sterling
      Other Areas
      Commodity Distributions
      1935–1951 Comparison
   Exports
      Destination
      Commodity
      Foods
      Textiles
      Metals and Metal Products
      Other Selected Manufactures
4. Southeast Asian Development and Problems Related Thereto
   Introduction
   Iron Ore
      Goa
      India
      Malaya
      The Philippines
      Use of Laterite Ore, The Philippines
      New Caledonia
      Ma-On-Shan, Hongkong
      Summary
   Manganese
   Coking Coal
      Formosa
      Japan
   Copper, Lead, Zinc and Nickel
      Formosa
      The Philippines
      Burma
      Celebes
      New Caledonia
      Japan
   Bauxite
   Salt
5. The United States Program[25]

INTRODUCTION

U.S. policies in the Far East have now come to embrace a series of related objectives calculated to be of optimum benefit to the free world.

These objectives are

1. Develop sources of essential materials in short supply in the free world such as chrome, zinc, tungsten, copper, lead, nickel, manganese, iron ore, rice; increase production in context of furthering general economic development of free Asian countries.

2. Facilitate Japan's procurement of essential commodities such as iron ore, salt, coal, etc., without resorting to Communist China and other Soviet-bloc countries, by encouraging trading relationships and expanding trade among the free nations of the area.

3. Encourage Japanese contributions toward the sound economic development of the free nations of the area. Japan can provide capital equipment, construction materials and technical know-how, and some funds. Japan can also provide Southeast Asia with equipment and materials now presenting the U.S. and West Europe with serious export problems.

4. Mobilize Japan's industrial potential for the manufacture of military end items with a view to ultimately making it possible for Japan to produce those things essential to Japan's own defense. Also to produce items in Japan to supply countries in Southeast Asia under the Mutual Defense Assistance Pact program and otherwise relieve the burden upon the U.S.

5. Obtain maximum cooperation of Japan and other free nations in the Far East and in Europe in enforcing effective security trade controls by providing adequate free world markets on the one hand and by denying supplies to the Communist-bloc nations on the other.

These objectives can be obtained only if Japan can be supplied with an adequate incentive by means of U.S. end-product orders so that the Japanese can see the opportunity to realize

on their investments and only if Japan's potential factory output is properly divided over time among the several prospective claimants. This division of product has been set forth in detail in "Japan's Industrial Potential," Volume II. It should be noted that Chart A and Table 6 of the above publication indicate that additional U.S. procurement of "hard goods" of $200 million in 1952 and of $400 million in 1953 could provide the basis for substantial subsequent expansion of production.

While Japan's economic strength has recovered from the crushing defeat of World War II to a position in which it probably could sustain itself in a peaceful world, it does not have the strength it exhibited in World War II and it is not presently in a peaceful world. Japan's capital has not yet been fully restored. SCAP policy from 1945 to the advent of the Korean War was directed primarily at assisting the non-war industries, such as textiles, paper, fertilizer, general purpose machinery, etc. War and war-supporting industries are not in good financial condition.

Much of Japan's normal trading area is still involved in war or is in Communist hands. In view of Japan's exclusion from normal pre-war trade with the Asiatic Mainland, Japan's current level of recovery (industrial production index of 143 for December 1951) is all the more encouraging. The most important aspect of this is that Japan has already found sources of supply to substitute for those of the adjacent mainland. This substitution of supply sources has, of course, resulted in long and costly supply lines. The length and cost of these supply lines can be reduced now only through developmental work in Southeast Asia.

It must be recognized that Japan's temporarily satisfactory balance of payments position rests essentially upon earnings from emergency procurement in support of the United Nations in Korea and upon other factors associated with the Occupation—partial pay-as-you-go, construction, sales of yen, etc. Korean procurement has been but a market substitute for normal trade with Korea and China.

The publications, "Japan's Industrial Potential," Volumes I and II, dated 20 February and 20 October, 1951, respectively, outlined Japan's overall potential. Volume II presented a suggested distribution of Japan's potential factory output calculated to obtain therefrom the optimum benefits for the free world.

The purpose of this paper, Volume III of "Japan's Industrial Potential," is to

1. Describe Japan's capacity as of 31 December 1951.
2. Further describe Japan's industrial potential in terms of its ability to produce military end-items.
3. Analyze Japan's trade patterns.
4. Evaluate Southeast Asian resources and note problems related thereto.
5. Suggest what the United States should do in order to attain the desired results.

1. CAPACITY, 31 DECEMBER 1951

"Japan's Industrial Potential," Volume I, pointed out that Japan's productive capacity as of 31 December 1950 was computed at 204 in terms of the 1932–1936 based index of industrial production. It also pointed out that there were several major "friction points" limiting the attainment of that goal. These were shipping, power, rail cars, and coke ovens. One year later, 31 December 1951, the computed capacity index was 243. A part of the increase in the revised index is due to better basic data, to recomputation of capacities in the steel industry, and to new estimates on mining.

However, real additions in the steel industry as well as in a number of other industries have taken place. The most startling increases in capacity from December 1950 to December 1951 were sheet glass, from 4.7 million cases to 8 million cases; cement, 6.8 million metric tons to 8.8 million; cotton yarn, 720 million pounds to 972 million pounds; calcium carbide, 569 thousand metric tons to 753 thousand; standard trucks, 33,000 to 40,200; rayon, 479 million pounds to 574 million; and sulphuric acid, 4 million metric tons to 4.4 million. In nonferrous metals there have been some declines in capacity due to old equipment being junked to make way for new equipment not yet installed. Some conversion has also taken place as one of the alumina processors began conversion to nickel lupe processing. Restoration of pig iron production facilities has progressed rapidly, and there is now a temporary excess of such production.

In December 1950, when capacity was 206 (note: this is a revision of the figure, 204, used in Japan's Industrial Potential, Volume I), actual production was 117. In December 1951, with capacity computed at 243, actual production was 143. Thus there has been an increase in capacity utilization over the year; in December 1950 capacity utilization was 57 percent, while in December 1951 the figure had increased to 59. Capacity increases virtually paralleled those in actual production, industry by industry. Appendix Table 1 provides data on production and capacity.

The rapid rate of capital formation in 1951 and the tempo of construction and plant rehabilitation have made necessary a recomputation and upward revision of expanded (or 1956) capacity shown in "Japan's Industrial Potential," Volume II, 20 October 1951. This is also shown in Appendix Table I. The revised figure is 285.

Japan entered 1951 with 1679 ships with a gross tonnage of 2,037,637. By 31 December 1951, through construction and purchase, the total Japanese fleet had increased to 1,795 ships with a gross tonnage of 2,620,000. These figures include all types of ships. The merchant fleet as of 31 December 1950 had 944 ships of 1,711,443 gross tons. By 31 December 1951, this had been increased to 1,017 ships of 2,283,000 gross tons. Expansion will continue as rapidly as funds permit. Table 1 shows how the fleet fared during the year.

Table 1 *Number and Gross Tonnage of Japanese Vessels*
(Steel Vessels 100 Gross Tons and Over)[1]

(Tonnage in Thousands)

	In Service As of 31 Dec. 1950	New Construction	Purchases and Conversions	Scrapped or Converted	In Service As of 31 Dec. 1951
Total number	1,679	124	52	60	1,795
Total tonnage	2,037	419	291	127	2,620
Merchant fleet					
Number	944	70	52	49	1,017
Tonnage	1,711	387	291	106	2,283
Cargo					
Number	650	55	50	31	724
Tonnage	1,240	317	270	84	1,743
Semi-cargo					
Number	60	0	0	8	52
Tonnage	112	0	0	18	94
Passenger					
Number	118	0	0	10	108
Tonnage	78	0	0	5	73
Tanker					
Number	116	15	2	0	133
Tonnage	281	70	21	0	372
Fishing fleet					
Number	403	12	0	11	404
Tonnage	163	20	0	20	163
Special type fleet[2]					
Number	332	42	0	0	374
Tonnage	163	11	0	0	174

[1] One gross ton=100 cubic feet of internal capacity, except for certain spaces such as water ballast tanks, passenger cabins, etc.

[2] Special ships such as fishery patrol, fishery research, cable layers, weather ships, training ships, tugs, salvage ships, dredgers, police patrol, floating cranes, train ferries, hopper barger, ex-naval vessels, etc.

Progress in solving the rail car shortage in 1951 was not as satisfactory as that in marine shipping. The number of serviceable freight cars in the hands of the railways was 106,199 on 31 December 1950 and 110,376 on 31 December 1951. However, total freight train kilometers in the last half of 1950 was roughly equal to that of the war year 1942. Only in the years 1943 and 1944 did total freight train kilometers equal the rates of the last six months of 1951. Table 2 shows progress in providing rolling stock this year.

Coke oven restoration has proceeded satisfactorily although the rehabilitation program is not yet actually completed. Capacity as of 31 December 1950 was 5.7 million metric tons. The December 1951 production of 540,000 metric tons of coke gives an annual rate of almost 6.5 million tons. Operable capacity at the end of 1951 was 10.2 million metric tons; installed capacity was 10.9 million metric tons. Thus 0.7 million tons of capacity still must be rehabilitated. To be sure, some of the operable ovens are not in prime condition and certain others require

Table 2 *Railway Rolling Stock (Government and Private)*

(In Units)

	In Service 31 Dec. 1950	New Construction and Repair	Added by Conversion	Retired or Converted	In Service 31 Dec. 1951
Total locomotives	5,391	50	0	14	5,427
Steam, including diesel	4,862	21	0	2	4,881
Electric	529	29	0	12	546
Passenger cars	11,329	360	42	1,666	10,065
Freight cars	106,199	5,191	35	1,049	110,376
Electric cars (suburban & municipal)	11,261	478	66	329	11,476

more than normal repair for such facilities. Appendix Table II provides the data on coke oven facilities.

Total electric energy generation increased from 44,890 millions of KWH in 1950 to 47,576 in 1951. However, due to an abnormal shortage of rainfall at certain seasons of 1951 and to a very limited amount of reservoir storage capacity, the hydro-electric energy generated was less in 1951 than 1950; a substantial increase in thermal plant output was required to meet the total energy demands in 1951.

The scheduled increases in 1952 and 1953 electric energy production quantities are calculated on increased generating capacity under construction and scheduled for completion and operation during those years. The electric power companies' current program for the modernization and expansion of thermal plants will greatly improve the output of these plants and provide more efficient and economical operations and reduced maintenance costs. Concurrent with this effort is a development program for the construction of new hydro power plants and the modernization of high tension transmission systems and distribution nets.

Table 3 shows actual and estimated capacity and energy generation for the years 1950–1953.

Table 3 *Power Plant Capacity and Energy Generation*

Capacity

(Thousands of KW)

Year	Total	Hydro	Thermal
1950	10,542	6,559	3,983
1951	10,884	6,773	4,111
1952[1]	11,310	6,958	4,352
1953[1]	12,361	7,661	4,700

Energy Generation

(Millions of KWH)

Year	Total	Hydro	Thermal
1950	44,890	38,258	6,632
1951	47,576	37,386	10,190
1952[1]	50,010	37,120	12,890
1953[1]	53,140	39,050	14,090

[1] Estimated

Source: Public Utilities Commission

2. MILITARY END-ITEM POTENTIAL

Japan's ability to produce military end-items may be appraised initially in terms of the volume of crude materials which can be made available for such production. During 1951 Japan operated an essentially free economy, the only real restriction being the cessation of trade with Korea and China resulting from the war in Korea. Japan was able to reorganize its supply

sources and increase its volume of production by 22 percent, from an index of 117 in December 1950 to 143 in December 1951. Real restrictions were not placed on the use of iron or steel, copper, aluminum, or on many other war-important items. Japan's non-residential construction has been virtually at capacity since the advent of the Korean War. This construction boom has had its impact upon the cement, glass, and structural steel industries, all of which expanded rapidly to meet demands.

In terms of raw material availabilities, Japan can produce substantial and progressively larger quantities of military end-products. Japanese steel producers only recently indicated that in calendar year 1952 they could produce almost 1.3 million metric tons in excess of the levels required for the domestic economy, Korean procurement, and normal export. Simply stated, restrictions on the wasteful excesses of the domestic economy could enable Japan to make at least 2.0 million tons of steel available for military end-products this year. Similar actions with respect to copper and aluminum could produce like results, although the quantities would be relatively smaller. Computing military end-products at a very low rule-of-thumb value figure of $1,000 per ton, Japan could, if advance orders had been placed, produce $2.0 billion in military end-products this year from crude materials normally available to it by imposing moderate restrictions upon the Japanese domestic economy. To be sure developmental programs in Southeast Asia must proceed as rapidly as possible to insure that levels once attained can be sustained and more economical sources of raw materials found. As time progresses there will have to be a shift from scrap to pig iron for steel makihg, thus necessitating an increased ratio of iron ore to steel output.

In terms of raw materials, nickel appears to be the one item most critical for Japan. In terms of end-products cost, the most serious deficiency for Japan in high grade heavy coking coal.

Japan's ability to deliver can also be measured to some degree by Korean contract delivery experience to date. Table 4 and Chart A show contracts, deliveries and payments cumulatively. Deliveries have been roughly 45–60 days after contract placement, and payments within 30 days after deliveries.

Contracts for supplies have been placed with more than 2700 Japanese firms, a surprisingly "broad base" considering American experience. It is important to note, too, that the bulk of the contracts have not been concentrated in the hands of a few large companies as is the case in the U.S. Quite the contrary is true, with the hundred largest contractors accounting for but 57 percent of the value of all contracts for supplies. Moreover, new suppliers are being added to the list daily. In ten months ending 6 January 1952, initial contracts were signed with about 1000 Japanese firms.

This relatively wide dispersion of orders is also surprising in that it is not consistent with the pattern of Japanese industry organization. In Japan, as in the U.S., there is a strong tendency toward the concentration of economic power, with a few large companies accounting for the bulk of the business in each industry. The contrary pattern in contract awards is a most satisfactory situation in terms of the U.S. procurement program in Japan, particularly so if that program is to be expanded.

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A general review of contracts reveals that very few have had to be amended because the contractor could not deliver as scheduled: The most serious difficulties have arisen from the unusual power shortage in September, October and November 1951. Spot problems have developed. Almost every jute bag available from production and stocks from Hokkaido to Singapore has become a sandbag in Korea, causing serious disturbance to the rice trade and making it imperative for the Japanese Export Bank to aid in financing a bag plant in Thailand.

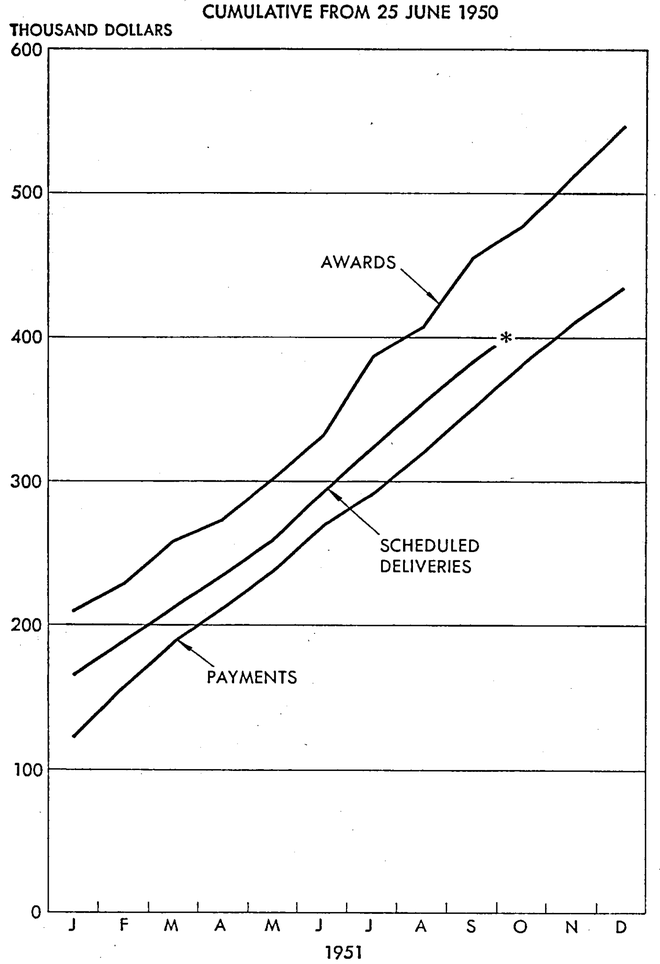
The Japanese Special Steel Association reports that Japan can produce virtually any type of special steel to SAE specifications. Planned production for calendar 1952 is 250,000 metric tons, for which electric power will be allocated. Output, however, could be stepped up to 564,000 tons (see Appendix Table III) if additional electric power, to the amount of 600 million KWH, were made available. A considerable amount of additional electric power is in sight for 1952, as indicated earlier. The full needs of the special steel industry could be met, conceivably, if stepped up armament production generates a heavy demand for such steels. A sustained demand from armaments producers would solve some other problems that have plagued the industry since the end of the war. The volume of output has been low with short runs on small orders, and production costs have been high. Also the shortage of working capital has forced the companies to finance raw material purchases at exorbitant rates.

The major difficulty remaining is that of alloying agents. Japan is almost entirely dependent upon outside sources for these materials. As explained later the situation regarding manganese and nickel has shown some improvement, but prospects for cobalt are not promising.

CHART A

CONTRACT AWARDS, DELIVERIES, AND PAYMENTS

CUMULATIVE FROM 25 JUNE 1950



* DATA NOT COMPLETE AFTER SEPTEMBER 1951

Recent interest has been expressed by Japanese manufacturers in zircon, selenium and boron special steels. Nothing is known here regarding the metallurgy of these steels, but the possibility of drawing on ample U.S. supplies of borax for boron steel will be investigated. This might provide some of the additional flexibility needed by the special steel industry to meet varying specifications for special requirements.

Another approach can be made to Japan's ability to produce military end-products, that is, individual plant determinations. Shortly after the Japanese National Police Reserve was created, the Machinery Bureau of the Japanese Ministry of International Trade and Industry contacted 70 major World War II private producers of munitions (metals) to see what production rate those companies could achieve within a maximum of one year after the placement of firm orders and the installation of necessary tools and equipment, if it became necessary for Japan to produce munitions for self-defense. Two conditions were presented: under the first condition civilian production was to be retained, while under the second civilian production would be stopped in these particular plants. It was assumed that:

1. Selected former Government establishments would be operated in part to perform specialized production functions; actual operation would be by private firms.
2. Any facilities and tools now in use by the Occupation Forces or the contemplated Security Forces would be returned to the Japanese if required. This could include certain

facilities and equipment now contemplated for post-treaty use by the U.S. under the Administrative Agreement.
3. Selected general and special purpose tools from former Government plants in reparations custody would be made available to the private manufacturers.
4. Some special purpose tools would be supplied to Japan by the U.S.; others would be built in Japan.
5. Materials, power, operating funds, et cetera, would be made available.
6. Drawings and specifications would be provided, or the item would be equal to the best produced in World War II.

The subject data from the Japanese Government Ministry of International Trade and Industry have been available to Economic and Scientific Section only since 18 January 1951 and have had to be translated from Japanese to English subsequent to that date. While it has not yet been possible to analyze them in detail, it is possible to evaluate them generally. In the main, the companies concerned represent important producers of civilian products and have very satisfactory production records, good engineering staffs, and trained technicians. The 70 selected private plants claim they require about $70 million in facilities to be producing munitions at a rate of $630 million annually at the end of one year (assuming installation of tools and equipment) if they retain their civilian production and about $100 million in facilities if they are to produce at a rate of $1 billion at the end of one year and are to drop civilian production.

Raw material requirements for the production plan indicated for either level of production are well within Japan's abilities with the support in sight in Southeast Asia. Nickel is again indicated as the most seriously difficult item.

The summary data from this study of metals fabricators are shown in Appendix Tables IV through VII. A separate table on explosives is provided, appendix Table VIII. About $13.0 million in facilities is required by explosive makers to match the production estimated by the metals fabricators.

Japan's ability to produce machine tools is shown in Appendix Table IX.

Separate physical surveys of some of the plants of Japan have been made by Economic and Scientific Section, by Ordnance and by representatives of the Japan Logistical Command. These determinations indicate that the Japanese can produce a significant volume of munitions if such are desired.

The individual plant plans summarized in Appendix Tables IV through VII are available for examination.

It must be borne in mind that most of Japan's publicly owned arsenals were heavily damaged during the war. They were also singled out for special purpose tool destruction and had substantial quantities of general purpose tools and general industrial equipment removed. They have not been maintained in the post-war period and were victims of poor wartime maintenance. Private plants (except those involved in aircraft manufacture) were not so badly damaged by bombs and were not subjected to the same level of reparations removals or special purpose tool destruction. General industrial equipment removed for reparations purposes has in some instances been replaced.

It should be noted that the 70 selected munitions makers include aircraft manufacturers and naval ordnance producers. If the Japanese were to concentrate on ground arms and munitions up to and including 105 mm, it is believed that Japan could produce virtually all items needed by Japan and by MDAP countries in Asia. In order to avoid criticism by other Asiatic countries, it is believed that some production should be undertaken in other countries, e.g., the Philippines, Thailand, etc.

SCAP-ESS has a roster of more than 9,600 companies with 17,011 individual plants or locations (see Table 5). This roster shows the name of plant, location, product, capacity, capital and a number of other important details regarding each plant.

Ordnance, GHQ, has made plant studies, has reviewed JLC and ESS data and has determined that the production of the following is practicable: Mortar, 60 mm; mortar, 81 mm; mortar, 4.2"; bayonet, M1 with scabbard; launcher, grenade; projector, pyrohand; rifles cal 30 and pistols cal 45; howitzer, 105 mm; rifle, 57 mm; rifle, 75 mm; board, plotting M10; circle, aiming; telescope, BC; telescope, OBS; table, graphic, firing; ordnance, tools for field use; watches; binoculars; sighting equipment; truck mounts (M.G.); and ammunition for: mortars 60 mm, 81 mm, 4.2"; rifles and carbines cal .30; pistols and submachine guns cal .45; howitzer 105 mm; rifles 57 and 75 mm; grenades, hand and rifle; flares, trip; mines, personnel and antitank.

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5. THE UNITED STATES PROGRAM

The President in his message of 9 January 1951 to the Congress of the United States directed several of his remarks to the problems of the Far East and Southeast Asia. There has been created in Washington an Interdepartmental Committee on Far East Mobilization. Again in Washington there has been created the International Materials Conference working cooperatively to distribute critical materials equitably among free world nations. The Mutual Security Agency and the U.S. State Department recently issued a joint policy statement covering relationships between Japan and the countries of Southeast and South Asia. All the above indicate that U.S. policies have now become clear. There is, nonetheless, a question as to how we are to attain the desired objectives.

Only since the advent of the Korean War has Japan attained a per capita level of industrial production equal to or greater than that in the 1932–36 base period. The other nations of the Far East have not fared so well and have not recovered so adequately. The most significant economic force in Southeast Asia since the end of World War II has been Japan's ability to produce and deliver goods to the area and Japan's ability to absorb food and raw materials from the area. This is a most important element in all South and Southeast Asian considerations.

Currently, Japan is the only industrial nation with a substantial idle industrial capacity. It is the only nation which can produce the industrial goods, both producer and consumer, required by the South and Southeast Asian area. Japan is the only nation so situated geographically as to be able to utilize large quantities of many types of raw materials from the area. As mobilization efforts of the U.S., Canada and West Europe increase, only Japan's potential can be relied upon to fill the requirements of the Asiatic free world countries. The success of Mutual Security, Technical Cooperation and Colombo Plans all rest to a marked degree upon Japan's ability to produce and consume.

In the free world the objective at this time is to obtain sufficient military and economic power to deter and/or defeat Communist aggression wherever it appears. If World War III should come to pass, the objective will be to defeat Communism as rapidly and as economically as possible. The optimum level of arms production, then, is the most important single goal of the free world. There is an important distinction between optimum and maximum levels of production. Within two years in an all-out effort, Japan could probably produce at a rate of almost $10 billion in war goods annually, but such an effort would result in lower standards of living and a failure to meet capital and consumer goods needs of South and Southeast Asia.

What is desired is an overall program which will raise production, productivity, living standards throughout the free world, and which will gradually mobilize the effort of the whole area. The question is essentially one of determining how optimum results are to be attained.

It is believed that there are a number of related actions which the U.S. can take which will lead the way to the results desired. Japan's role is implicit in the objectives initially stated in this study—it is that of an industrial base. The role of the U.S. follows.

The productive capacity of Japan can be directed to the ends desired if the U.S. will place planned, properly phased military end-item procurement orders in Japan. This will make it possible for the Japanese to organize their munitions industries and will make it possible for Japan to consume ever-increasing quantities of raw materials from Southeast and South Asia. This then provides a base for expanding the economies and developing the raw materials resources in the free nations of Southeast and South Asia. The placing of orders in Japan for goods financed with MSA funds will also help materially.

Ultimately the armament industry of Japan should be able to support the free world armies of the Far East. The initial problem is one of placing orders in such a manner as to provide the base upon which ever increasing production can be based. Japanese manufacturers must have the kind of orders which will make possible sufficient profits to warrant the investments and other efforts required. The Japanese manufacturer cannot tool, reorganize assembly lines and parts fabrication, arrange for subcontracts, purchase raw materials, and assemble labor forces unless he can be assured of a sufficient volume of business to warrant the effort. Further, he needs access to low-cost credit if costs are to be kept as low as possible. Such is not now available in Japanese financial institutions, private or public.

The placing of a sufficient volume and variety of end-product orders, however, will make such efforts worthwhile. It will attract new capital, provide a sound base for financing, interest the Japanese in efforts to obtain added raw materials in Southeast Asia, etc. In short, the placing of orders in adequate volume and variety is the first step in real mobilization for Japan.

A long-range U.S. off-shore procurement program for Japan is essential so that the Japanese

can plan their industrial expansion and plan the expansion of their sources of raw material supplies. This should be a balanced, gradually expanding program based upon a sound distribution of Japan's potential factory output. The program should be designed so the Japanese at a later date can provide for their own defense. American-made equipment initially supplied to the Japanese could ultimately be returned to the U.S. and Japanese-made equipment substituted therefor. Such an approach would provide an adequate production base for some items required only in small numbers when supplementing American-made equipment.

The second U.S. step should be to advance credits wisely to selected Japanese industries. It must be remembered that from 1945 to the beginning of the Korean War the U.S. favored the development of the non-war and non-war-supporting industries of Japan. The textile, paper, fertilizer, and a number of other general industrial categories of a non-war nature are in favorable financial condition as related to the war-supporting industries of Japan. Japan is beset with problems of economic stabilization, and selected loans to Japanese industries could be made without upsetting budget and other fiscal policies calculated to continue economic stabilization in Japan. The establishment of a Tokyo branch of the Export-Import Bank of Washington would be the best means of accomplishing this purpose.

U.S. credits are also needed in Southeast Asia. The U.S. can help stem the flight of capital from Southeast Asia by the wise use of credits in that area. These credits should be made available to enterprisers providing materials to Japan, the U.S., or the free world in general. All appropriate U.S. agencies—Mutual Security Agency, Technical Cooperation Administration, Export-Import Bank of Washington, and Defense Materials Procurement Agency, etc., through coordinated planning, programming and operation in Southeast Asia—can aid materially in development there.

The U.S. needs an agency in Japan which will undertake the mobilization work begun by SCAP under the Occupation. Such an agency under the aegis of the Department of Defense, the Mutual Security Agency, or the Department of State, should continue mobilization planning in Japan in conjunction with the Japanese.

Presently, the Japanese interests are occasionally in conflict with direct American interests in certain materials. In every instance in which there is no International Materials Conference Committee in which Japan is a participant and in which there is a conflict or potential conflict between Japan and the U.S., there should be created a joint U.S.-Japanese Materials Conference.

The Japanese should be provided reasonable access to areas from which they are now excluded or virtually excluded. The initial area of greatest importance is Palau in the Trust Territories, where bauxite is available. This one-time Japanese "property" provides the best-protected and shortest-haul bauxite source for Japan. The U.S. can hardly argue in favor of Japanese access to sterling area countries if the U.S. is to refuse the Japanese access to territories under U.S. control.

All of the basic groundwork essential to launching Japan into armament production has now been accomplished. Orders for end-products accompanied by accelerated action in Southeast and South Asian development with some credits there and in Japan will make it possible for Japan to be the anchor of the free world in the Far East.

[SOURCE: SUITLAND PAPERS, Z 703–35]

9 AID AND TRADE

9-1 POLICY WITH RESPECT TO RELIEF IN JAPAN (SWNCC 107/1)

Report
SWNCC 107/1[1]

October 1, 1945

THE PROBLEM

1. To determine the policies with respect to relief which should be followed by the Supreme Commander in Japan.

FACTS BEARING ON THE PROBLEM

2. See Appendix "A".

DISCUSSION

3. See Appendix "B".

CONCLUSIONS

4. It is concluded that:

a. The objectives of the relief policy of the United States are to prevent such starvation and widespread disease and civil unrest as would (1) clearly interfere with military operations or endanger the occupying forces, and (2) permanently obstruct the ultimate objectives of the occupation.

The problem of relief, in the sense of imports to supplement Japanese resources, is an integral part of the general problem of supervising or directing the economy of Japan. Relief should be accomplished with a maximum of Japanese responsibility and a minimum of imports.

b. Widespread publicity should be given to the general policy that, the Supreme Commander should assume no obligations to maintain, or have maintained, any particular standard of living in Japan; and that the standard of living will depend upon the thoroughness with which Japan redirects the use of its human and natural resources wholly and solely for purposes of peaceful living, administers adequate economic and financial controls, and cooperates with the occupying forces and the governments they represent.

c. Initially imported supplies may be provided only when it is clear that maximum Japanese efforts cannot produce or have not produced materials essential to a standard of physical well-being below which there would be such starvation, widespread disease or civil unrest as would clearly endanger the occupying forces, or interfere with military operations. Imported supplies may also have to be provided to prevent such widespread starvation or disease as would permanently obstruct the ultimate objectives of the occupation. The burden of proof rests on those who present a plea for imports.

d. Disease rates may be used as an indication of the adequacy of living conditions in terms of danger to the occupying forces and the objectives of the occupation; but in such case should be independently verified by the Supreme Commander. In the absence of a pronounced increase in disease rates, a state of physical hardship should not for the present be construed as endangering the occupying forces or the objectives of the occupation.

e. Distribution of supplies should be made through Japanese public supply agencies or such other consignees as are acceptable to the Supreme Commander and under his direct supervision or control. In the event that, as a matter of military necessity, relief supplies are issued by the occupying forces, the cost of such issues should be paid for by the Japanese Government.

f. The Supreme Commander should immediately undertake a survey to determine the average caloric content required for two basic standards of diet, (1) that adequate to prevent, under present conditions in Japan, such widespread disease or civil unrest as would endanger the occupying forces; and (2) that adequate to prevent interference with attainment of the general objectives of the occupation. The results of such survey should be promptly reported

[1] Approved by SWNCC on November 5 and forwarded to the Secretary of State on November 8.

to the Joint Chiefs of Staff as a basis for further planning. In the determination of such average caloric content it should be considered that variations in diet may be made according to age and work required, and that it is preferable to begin low and to increase as circumstances clearly permit rather than risk failure to maintain a standard once established. Meanwhile, the Supreme Commander should not provide relief supplies unless it can be shown that a balanced diet of 1500 calories of rationed and non-rationed items is not available for urban consumption.

g. The existing dispersion of persons from food deficit areas to food surplus areas should be prolonged, exceptions being made for people of needed special skills. In the discretion of the Supreme Commander voluntary movement of persons from food deficit areas to food surplus areas may be encouraged.

h. Special attention should be given to encouraging production and sale of incentive goods to induce farmers and other food producers to move their produce to market.

5. The Japanese authorities should be required immediately to restore such public health services as water and sewage disposal systems, particularly in congested urban areas. Imports requested for this purpose must be justified as necessary relief measures before being approved. This is not to be construed as an authority to import supplies for housing, communications or other facilities necessary to restore the economy of Japan. Economic rehabilitation is a responsibility of the Japanese Government.

RECOMMENDATIONS

6. It is recommended that:

a. This report be referred to the Joint Chiefs of Staff with a request for their comments from a military point of view; and

b. Upon approval by the SWNCC of the "Conclusions":

(1) this report be transmitted to the Joint Chiefs of Staff, and to the State, War and Navy Departments for their guidance and, where appropriate, for proper implementation, and

(2) no part of this paper be either communicated to our Allies or released to the press at present.

[SOURCE: *FRUS*, 1945, Vol. VI, pp. 731–33]

9-2 REQUEST FOR ESSENTIAL IMPORTS

Telegram No. CA 52910
To: Joint Chiefs of Staff
From: SCAP

October 7, 1945

Reourad ZA 5510 and CA 52579, the Japanese Government has submitted request for importation 100,000 tons salt, 100,000 tons rice, 100,000 tons wheat or small grain, 120,000 kiloliters petroleum for last quarter, 1945. Based on previous imports of basic commodities and present shortages such imports considered urgently necessary for minimum essential needs. Requirements first quarter 1946 will be at least equal to above probably greater. Your directive WX 68524, 25 September 1945, provides for importation only where payment can be made by exports. Pending your decision on export import policy and financial procedures queries have been forwarded to U.S. forces this theater regarding available surpluses those areas. To pay for imports total of 46,000 bales silk available for export plus other export commodities now being inventoried. Commercial details on commodities available for export will follow. Urgently request designation of U.S. Commercial Company or other agency for service re: Sale of Japanese exports in areas needing them and procurement of supplies for importation to Japan. Reply soonest requested.

9-3 JAPANESE CUSTOMS ORGANIZATION (SCAPIN 941-A)

Memorandum
SCAPIN 941-A (ESS/IE)

April 8, 1946

1. The Imperial Japanese Government is directed to transfer to and centralize in the Ministry of Finance the control of all customs functions and the administration of all matters connected therewith including customs houses and personnel.

2. The Ministry of Finance shall be responsible for the implementation and enforcement

of all Japanese customs regulations including any new regulations which may be issued in the future and for carrying out all Directives from the Supreme Commander for the Allied Powers regarding customs control or requiring action by customs officials. The Ministry of Finance may delegate such authority and responsibility in connection with the customs control as may be necessary provided prior authorization and approval are given by the Supreme Commander.

3. The Imperial Japanese Government will submit to General Headquarters, Supreme Commander for the Allied Powers, a statement of the action taken to comply with provisions of this Directive.

[SOURCE : *History of Non-Military Activities of the Occupation of Japan,* Vol. XVII Appendix 36]

9-4 A FOREIGN EXCHANGE RATE FOR JAPAN

Draft for Discussion June 25, 1947
To: Chief of Staff, SCAP
From: W. F. Marquat, Chief, ESS

I. THE PROBLEM PRESENTED

1. What are the prerequisites for the establishment of a foreign exchange rate for Japan?

II. FACTS BEARING ON THE PROBLEM

2. Foreign trade between Japan and other countries is now channelled on a government-to-government basis. The Japanese concerns deal with the Japanese Boeki-Cho (Board of Trade). Foreign firms and governments deal with SCAP. Boeki-Cho turns exports over to SCAP. SCAP turns imports over to Boeki-Cho.

3. Under this arrangement separate accounts are maintained. The Boeki-Cho account with Japanese buyers and sellers is maintained in yen, while the SCAP accounts with foreign buyers and sellers are maintained in dollars, sterling or other acceptable hard currencies. Very often SCAP transactions with countries other than the U.S. have been purely barter arrangements with no prices set at all for the time being.

4. Present plans anticipate admittance into Japan of a limited number of foreign commercial representatives to deal directly with Japanese manufacturers. It is not believed that this arrangement will have any pronounced favorable impact upon export volume in the immediate future but it should develop trade as time goes on. The plans for these direct contacts provide that private arrangements will not include price determination, but that prices will continue to be set as at present, namely (a) the Japanese seller will be paid in yen by Boeki-Cho in accordance with yen cost of production plus a fair profit, and (b) the foreign buyer will pay in dollars, sterling or other acceptable currencies to SCAP's export account in accordance with the fair value of the goods in the world market as set by SCAP at the time of purchase. Except for restricted commodities sold on a world price basis prices will be negotiated between the foreign trade representative and the SCAP agents. The present procedure for setting prices has been operating relatively satisfactorily for 15 months.

5. Japan's foreign credits are very low at present. It may be anticipated that Japan's supply of foreign exchange for years to come will be scarce.

6. The domestic economy in Japan is unstable. Prices have been rising steadily and rapidly for the past two years. Concomitantly, the value of the yen in terms of commodities has been falling. While there is no official exchange rate with other currencies, the U.S. military exchange rate has been raised from 15–1 to 50–1. The blackmarket yen-dollar rate has gone from about 60–1 in March 1946 to a present estimate of from 120 less to 1.

III. DISCUSSION

7. *Desirability of an official exchange rate.* When an official exchange rate is established it will eliminate the present indirect price setting procedure now in use, and enable prices to be set directly by the parties themselves. The parties to the transaction, being permitted greater flexibility and freedom in their arrangements, will be afforded broader opportunities for negotiating. Furthermore, efficiency will be promoted since when a manufacturer is underbid consistently in this system he will either have to improve his production or merchandizing methods or retire from business.

8. *Impracticability of an exchange rate at present.* If, however, an official rate of exchange were established prematurely it would seriously handicap Japanese foreign trade and have disastrous effects on the Japanese internal economy. This is because Japanese price levels are

constantly rising, because domestic prices are out of line with each other and world prices and because Japan's present balance of international payments is strongly unfavorable.

9. *Effect of the establishment of an exchange rate in face of rising prices.*

a. Japanese exports would be discouraged because as yen prices continue to rise, tied-in dollar prices of Japanese export items generally would also rise and become less attractive to foreign purchasers.

b. Imports of industrial raw materials would be curtailed, as the reduction in exports concomitantly reduced the acquisition of foreign exchange.

c. Conversely, any supply of foreign exchange acquired by Japan would be quickly drained by whatever imports were brought in, since foreign sellers would decline yen credits and demand payment in other currencies as the yen came to be over-valued in terms of those other currencies.

d. Wide speculation would be invited. At present, speculation in Japanese commodities, which has been encouraged by the inflation, is limited to yen users. Tying other currencies to the yen would extend speculative opportunities in Japanese commodities to users of those currencies all over the world.

e. Until price stabilization is effected, therefore, the exchange rate would have to be changed periodically thereby discouraging foreign traders who would have no reliable base upon which to estimate costs and future return except as gambling operations demanding a very large return for chances taken.

10. *Effect of the establishment of an exchange rate in view of the distorted internal price structure.* As a result of Japan's long commercial isolation, Japanese commodity prices have lost customary or any reasonable coherent relationship to world prices. This has been aggravated by the instability of the Japanese economy, temporary war time circumstances and fragmentary government controls of varying extent and effectiveness. Temporarily, therefore, certain Japanese export items which can successfully compete in the long run in world markets have an unreasonably high cost of production at present because they require special capital outlays, because they are produced with relatively uncontrolled materials, or because plant and labor force are out of proportion to the limited scale of operations now restricted by the small quantities of materials and fuel available. Conversely other Japanese commodities would fortuitously have extremely low prices as equated at any proper exchange rate. As a result the high cost items presently sold would not be salable on the world market unless they were directly subsidized. Furthermore, foreign traders would probably buy up future production of the low cost items before the Japanese sellers became properly oriented as to world prices. This might tie up Japanese export production for up to eighteen months at unreasonably low prices, and seriously curtail the future acquisition of needed foreign exchange by Japan.

11. *Effect of the establishment of a foreign exchange rate in the face of a strongly unfavorable balance of payments.* Japan's exports since the war's end amount to US $150,000,000 while imports amount to US $395,000,000. If a foreign exchange rate were established with such an unfavorable balance of trade, international payment settlements could not be made. There would be a flight from the yen unless foreign credits adequate to make up the unbalance were avaialble.

12. *Prospects for stabilization.* Stabilization of the yen in Japan to the degree required to permit the establishment of a foreign exchange rate cannot be accomplished immediately. On a long-term basis, stabilization of the yen must be based on stabilization of the economy and halting the constant rise in Japanese domestic prices. This in turn would require a considerable increase in raw material imports and in production, both of which would take time before effecting the requisite degree of stabilization, especially since increased imports are largely contingent on foreign credits. In the meantime effective controls can succeed in slowing up the inflation and encouraging production. Emphasis on such controls will hasten the establishment of a realistic international exchange rate.

On a temporary basis, a decline in the yen value could be materially slowed down by foreign credits which could be used to support its price in the money market. Adequate amounts would be difficult to obtain. Since sums needed would be large it is doubtful whether private sources would be unwilling to furnish them. The World Bank has the authority to make such loans only to members and Japan is not a member; the funds of the World Bank thus far are not large enough to take care of prior requests for United Nations countries. Even if such funds were obtained, a temporary respite only would result, permanent relief being possible only through general economic stabilization.

13. *Prospects for realignment of domestic prices.* As the distortion in the domestic price structure results largely from Japan's commercial isolation and from temporary maladjustments in the post-war economy, so prices of goods for exports will tend to fall into line as Japanese business-

men become acquainted with world prices and as economic stabilization progresses. As an aid to the former development, it would be helpful to have Japanese personnel review SCAP dollar price determinations on an advisory basis. Equalization subsidies for export goods which are temporarily high cost but which can compete in the long run in the world markets would help to bring them in line with world prices. In this case, the subsidy method would need to be designed for progressive elimination lest production of economic exports be furthered, and where possible the subsidy should be financed by the export goods whose costs are temporarily far below comparable world prices. It is estimated that with proper measures of assistance Japanese export prices can be brought into reasonable alignment within six months after the opening of private foreign trade.

14. *Prospects for balanced payments.* For a considerable period of time, perhaps several years, Japanese imports will out-value exports. This will continue at least until (a) raw materials are being imported at a rate sufficient to maintain Japanese industry at a high level of activity and (b) invisible export items, such as the tourist trade, expand. In the interim, a balance in international payments can be achieved only by expensive loans in dollars or other hard currencies for the purchase of raw materials in dollar or sterling areas.

15. *Necessity for continued trade and exchange controls.* A corollary of the establishment of a foreign exchange rate would be the substitution of alternate exchange and trade controls. Channelling of payments through government agencies serves as a simple but effective device for controlling Japan's foreign trade. The scarcity of domestic goods and the necessity to maximize exports and export industry will make such controls unavoidable in Japan for years to come if scarce foreign exchange is to be conserved and critical materials are to be channelled to essential domestic and export industry. When a foreign exchange rate is established and direct trading permitted, therefore, other controls such as licensing of exports and imports and foreign exchange controls will have to be substituted.

IV. Conclusions

16. If a foreign exchange rate were established immediately Japanese exports would be handicapped, imports curtailed, supplies of foreign exchange exhausted, foreign speculation in Japanese goods invited, and Japanese production tied down to abnormally low-prices for an extended period.

17. To avoid these effects, the following would be prerequisite for the establishment of a foreign exchange rate.

a. Stabilization of the Japanese economy, including Japanese prices and currency.
b. Realignment of Japanese domestic prices with world prices.
c. Achievement of an equilibrium in Japan's balance of international payments.

18. Prospects for the achievement of these prerequisites within six months do not appear bright.

19. To assist in the rapid attainment of these prerequisites, the following measures would be desirable:

a. Effectuation of the ESS Economic Stabilization Program.
b. Use of Japanese official personnel to advise SCAP in fixing of dollar prices.
c. Devising of interim pricing formulae which will permit equalization subsidies of temporarily high cost export items, preferably supported by temporarily low cost export items.
d. Provision of extensive foreign credits to Japan, to be earmarked largely for raw material purchases.

20. As a corollary, it would be necessary to develop in the Japanese Government the trade and foreign exchange control mechanisms which could operate under SCAP direction immediately upon the establishment of a foreign exchange rate.

V. Recommendations

21. It is recommended that no foreign exchange rate be set for the present.
22. It is recommended that the interim measures noted in paragraphs 18 and 19 be taken.
23. It is recommended that the appended statement (Inclosure 1) on establishment of a foreign exchange rate be released to the private traders as soon as possible.

[ENCLOSURE]
Statement of Foreign Exchange Rate

Although SCAP considers that the establishment of a foreign exchange rate at the earliest practicable moment would be very helpful to the expansion of Japan's foreign trade, conditions at present do not permit it.

In the interim SCAP will receive and pay out dollars and other acceptable foreign currencies incident to private transactions, while the Japanese Government through Boeki-Cho (Board of Trade) will handle yen payment for Japanese businessmen engaged in foreign trade.

The Japanese Government is at present engaged in an intensive effort to stabilize the domestic economy, restore balance among domestic commodity prices, and terminate currency inflation.

When these conditions have been largely brought about and when Japan's balance of international payments has been brought more closely into equilibrium, it will then become possible to establish a sound foreign exchange rate. At that time it will be done.

Pending this establishment, SCAP will bend every effort to perfect interim currency and pricing arrangements so as to assist foreign trade to the maximum.

[Source: Suitland Papers, Z 703-7]

9-5 RESTORATION OF PRIVATE TRADE WITH JAPAN (SFE 194/2)

Report
SFE 194/2[2]
Confidential

July 16, 1947

REPORT BY THE STATE-WAR-NAVY COORDINATING SUBCOMMITTEE FOR THE FAR EAST

The Problem

1. To determine the policy of the United States with respect to the restoration of private trade with Japan.

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Conclusions
I. Long-Range Policy Objectives

4. To foster the development of conditions in Japan which will contribute to the expansion and balanced growth of international private trade.

5. To promote the reduction of trade barriers and the progressive elimination of all forms of discriminatory treatment in international commerce.

6. To encourage an increase in Japanese exports, compatible with occupational objectives, in order that these exports may, as soon as possible, pay for the imports required for the prevention of disease and unrest within Japan, and the reestablishment of a self-sustaining Japanese economy; and, in order that Japan may provide goods required throughout the world particularly in areas which have suffered deprivation as a result of Japanese aggression.

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III. Entry of Private Businessmen

9. On and after August 15, 1947, the following categories of businessmen should be permitted entry into Japan:

a. Merchants and other traders who are prepared to purchase or to make arrangements for future purchases of potential exports, or to provide raw materials or other commodities which Japan must import.

b. Representatives of banks, insurance companies, airlines, and shipping companies who are prepared to render necessary services in connection with Japan's foreign trade either to private non-Japanese businessmen, to the Supreme Commander for the Allied Powers or to Japanese persons or agencies approved by him.

c. Representatives of companies or individuals with substantial prewar property interests in Japan, particularly representatives of property owners who cannot make satisfactory provision through the use of powers-of-attorney to relieve SCAP of custodial responsibility.

10. In the initial stages permission to enter Japan should be granted only to those whose business activities can be expected to contribute to the fulfillment of Japan's export and import programs and to the achievement of the objectives of the occupation sufficiently to justify the burden which their presence will impose on Japan's domestic economy and on the occupying forces.

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[2] Section 2, 3, 7, 8, 11 and 17 are omitted.

12. There should be no discrimination on grounds of nationality against any foreign businessman admitted to Japan, and all should be accorded equality of opportunity to transact business and obtain available accommodations.

IV. Methods of Conducting Business in Japan

13. Occupation policy should oppose excessive concentration of economic power in Japan. To this end, businessmen admitted to Japan should be encouraged to operate so as to enlarge the number of Japanese firms engaged in foreign trade. Any limitations or controls on the participation of Japanese firms in foreign trade should be based upon criteria established by or under the supervision of SCAP and should operate only to the extent required to meet the objectives of the occupation. The fostering of monopoly by any agency of the Japanese Government participating in foreign trade should be prevented. Contracts between Japanese and foreign businessmen should not result in undue restrictions on the flow of international trade. The distribution of export and import licenses should be on a fair and equitable basis.

V. General

14. Trading should be continued—during the transitional period, as may be necessary in the interest of maximizing export proceeds—by the Japanese Government and through the medium of governmental agencies with some areas and in some commodities. In so far as possible, Japanese governmental trading through the medium of governmental agencies and private trading should not overlap for the same commodity in the same market.

15. The Japanese Government should be encouraged to take an increasing responsibility and initiative for planning of foreign trade, subject to necessary SCAP controls.

16. A commercial exchange rate for the yen should be established as soon as practicable.

[Source: Dipl. Br., National Archives]

9-6 ESTABLISHMENT OF OCCUPIED JAPAN EXPORT-IMPORT REVOLVING FUND

Circular No. 9 (Extract) August 15, 1947
Issued by: SCAP

1. There is hereby created an Occupied Japan Export-Import Revolving Fund (hereinafter referred to as "The Fund"). The Fund is established as a means of financing, primarily on a self-liquidating basis, Japanese imports and exports of commodities and services which are required for the achievement of the objectives and policies of the Occupation and for the mutual benefit of the United Nations and Japan.

2. The Fund shall be managed and operated by a Controller designated by the Supreme Commander for the Allied Powers. The Controller shall have such deputy or deputies as may be similarly designated.

3. The Controller shall be responsible and accountable to the Supreme Commander for the Allied Powers for the safe custody, management, operation and control of The Fund. He shall have authority to make all collections of moneys due The Fund, to make disbursements from The Fund, to make any commitments, allotments, allocations or incur obligations involving The Fund, to borrow monies on the credit of The Fund, and to perform all other acts which he shall determine to be necessary, appropriate or convenient to accomplish the purposes for which The Fund is created.

4. The Fund shall consist of the following:

a. Gold and its equivalent in the approximate value of one hundred thirty-seven million ($137,000,000) dollars, made available to the Supreme Commander for the Allied Powers for the purpose stated herein.

b. The export proceeds of all products, including textiles, manufactured from materials the import of which was financed by The Fund, or by credits based thereon.

c. The export proceeds (in excess of the amount necessary to liquidate CCC_1 and CCC_2 accounts) derived from the sale of textiles manufactured from cotton imported under CCC_1 and CCC_2 contracts.

d. Any monies otherwise accruing from any operation of The Fund.

e. That proportion of the total export proceeds as the respective value of the material purchased through the use of The Fund bears to the total value of all materials uesd, when any material, the import of which into Japan is financed through the use of The Fund, is mixed with any other material not acquired through the use of The Fund.

f. Other assets as may be designated by the Supreme Commander for the Allied Powers.

g. Any monies borrowed on the credit of the foregoing assets.

5. The Fund shall be used for the payment of the following only:

a. Fidelity and surety bond premiums of the Controller, any deputy Controller and such other employees as may be deemed necessary.

b. Materials imported for the purpose of directly deriving goods for export therefrom, which will, in the judgment of the Controller, have an anticipated value in excess of the cost of such materials realizable within one year after the date of arrival in Japan of such materials.

c. Raw materials, processing materials or operating supplies needed for the production of such exports.

d. Services and general imports of machinery or machine parts, supplies, or other materials deemed necessary by the Supreme Commander for the Allied Powers for the general Japanese economy; provided that any funds advanced for these purposes shall not exceed fifteen percent (15%) of the value of the assets of The Fund specified in Paragraphs 4 *a*, 4 *c*, and 4 *f*, above.

e. Monies borrowed and interest and other charges in connection therewith.

f. Fees, service or other charges arising out of any transaction specified in Paragraphs 5 *b*, 5 *c*, and 5 *d*, above.

6. The Fund shall be subject to the following special restrictions:

a. No obligation arising out of the operation of The Fund shall be secured by a special lien on any of the assets thereof; but those to whom The Fund is so obligated shall have a first claim against the assets thereof, prior to any other claim against such assets.

b. The Fund shall not be expended or obligated unless after such expenditure is made or obligation is incurred, a cash reserve consisting of gold and its equivalent, dollars, and freely convertible currency is equal to 30 percent (30%) of the initial value of the assets specified in Paragraphs 4 *a*, 4 *c*, and 4 *f*, above, or of the outstanding liabilities, whichever is greater; provided, however, that the foregoing restriction shall not apply to expenditures made to discharge obligations previously incurred within such limitations.

c. In the event he deems it necessary to export and sell any of the assets referred to in 4 *a* to obtain currencies to pay obligations of The Fund, the Controller shall, prior to making the sale, first offer to sell such assets to member nations of the Far Eastern Commission for currencies required to discharge such obligations of The Fund.

7. Subject to the terms and provisions of Paragraphs 5 and 6, above, at such times as the net worth of The Fund exceeds forty percent (40%) of the total liabilities as reflected by the last current statement of the status of The Fund then, and in that event, and in that event only, the Supreme Commander for the Allied Powers may, at his discretion, withdraw from The Fund any amount so long as such withdrawals do not reduce the net worth of The Fund to less than forty (40%) percent of the total liabilities. For the purposes of this Paragraph 7:

a. In addition to assets described in Paragraph 4, above, assets shall include, but shall not be limited to, all of the following resulting from the operation of The Fund,

(1) Receivables arising from firm forward export sales,
(2) The value of raw materials at cost or market (whichever is lower),
(3) Goods in process at the value of the raw materials, and,
(4) Finished goods at their export market value or forward sales value.

b. Liabilities shall include, but shall not be limited to, the initial value of Paragraphs 4 *a*, 4 *c* and 4 *f*, above, plus all accounts payable and commitments made.

8. The Controller shall render a monthly statement of the status of The Fund to the Supreme Commander for the Allied Powers within thirty (30) days after the last business day of the month for which such statement is rendered. Copies of such statement will be made available to such parties as the Supreme Commander for the Allied Powers may direct, or as may be entitled thereto pursuant to the terms of any contract approved by him.

9. In the event of a transfer of authority prior to a peace treaty or upon the proclamation of a peace treaty to which the United States Government and the Japanese Government are signatories, the Controller upon the occurrence of either of the stipulated contingencies shall liquidate, as soon as may be practicable, all proper claims (including commitments) arising out of the operations of The Fund against the assets of The Fund. The balance of The Fund shall be retained for appropriate ultimate disposition in accordance with controlling directives.

[Source: *FRUS*, 1947, Vol. VI, pp. 276–79]

9-7 ESS'S REPORT ON YEN EXCHANGE RATE

Report January 10, 1948

Submitted by: Yen Exchange Committee (ESS)
Mr. T. Beplat, Chairman—Finance Division
Mr. S. Janow—Foreign Trade Division
Mr. C. Wright—Foreign Trade Division
Mr. F. Ritchie—Price Control and Rationing Division
Mr. M. Rosenfelt, Executive Secretary—Research and Statistics Division

Contents:

Part I —Summary and Explanation of Recommendations
Part II —Proposed Modified Single Rate Exchange System[3]
Part III—Statistical Appendix[3]

Part I
Summary and Explanation of Recommendations

1. In accordance with its instructions, the Yen Exchange Committee herewith submits its report and recommendations concerning the general policies and the specific actions it considers should be adopted in reestablishing a system of international exchange for Japan.

2. The committee recommends that when the decision is made to establish a commercial exchange rate for Japan, the plan which is presented in detail in Part II of this report be instituted.

3. The committee recommends that the rate of exchange should be established for the present at 150 yen per U.S. dollar.

4. Up to the present time, it would not have been economically feasible to establish any kind of exchange rate system. To establish an exchange system under the inflationary conditions prevailing here would have merely served to accelerate this inflation, since frequent readjustments in the rate would have been required and since every such readjustment would have been public notice of the inflationary advance. For example, the following table indicates the monthly increase in the exchange rate over the past year that would have been indicated by the economic indices shown in Table VII:

Nov. 1946	100%	
Dec. "	117	
Jan. 1947	120	
Feb. "	131	
Mar. "	148	
Apr. "	150	
May "	176	
June "	194	
July "	235	
Aug. "	236	
Sep. "	250	(estimated)
Oct. "	265	(estimated)

5. If, however OJEIRF can be effectively implemented, if other funds now being sought can be used to bring in necessary raw materials, and if long run capital investment can be encouraged, then the conditions will be present by which through the establishment of an exchange rate system, Japan's foreign trade and domestic economy can be started toward rehabilitation and eventual stabilization. The committee considers that an exchange system can be safely introduced only when these and similar measures have begun to achieve significant results.

6. Because of the primary importance of foreign trade to the Japanese economy, the particular level set for the overall exchange rate will exert a fundamental influence over the level of employment, national income, standard of living, prices, the movement of foreign capital and investment, invisible exports such as tourist trade and remittances, and will have a direct impact upon the international allocation of resources as between different industries.

If the rate is set too high (i.e. a large number of yen per dollar) the effect is to make exports unnecessarily cheap in terms of other currencies. This means also that the cost of

[3] These sections omitted.

imports are increased and hence the country's ability to purchase sufficient quantities of essential imports is seriously impaired. Such an unduly high exchange level also would tend to discourage certain industries which depend upon imports to a large extent, a very important class of industry in Japan.

On the other hand, if the rate is set too low the nation's exports will be too highly priced to permit effective competition in world markets and the resulting lack of foreign exchange will prove an insurmountable obstacle to the purchase of the desired volume of imports. Although such a rate would reduce the price of imports, shortages of foreign exchange would circumscribe ability to make such purchases.

Because of the critical importance of the determination of an exchange rate, the most careful examination of all relevant factors must precede such an action. An error in this field could do much to destroy or to invalidate many of the other measures which SCAP has taken to restore the foreign commerce of Japan and to re-establish the economy on a sound and self-sustaining basis.

7. The reasoning by which the committee agreed to recommend the adoption of a rate of 150 yen per dollar at the present time may be summarized as follows:

a. According to the data contained in Tables 1 and 4, the relation of various alternative rates to the groupings of commodity exports are as follows:

Yen per Dollar	Percentage of Commodity Exports within ±20 Yen	Percentage of Commodity Exports within ±40 Yen
80	25.32	45.04
100	37.76	59.72
120	34.14	62.92
140	25.14	45.25
160	12.04	28.34
180	5.51	30.59

In accordance with this table, it was considered that the feasible range for a central rate lies between 120 and 150 yen per dollar. That is, the rate of 150 yen to the dollar is about the highest and 120 yen per dollar is about the lowest rate that can be adopted and still have these rates fall within the principal group of commodity exports at current yen/dollar prices.

b. The reasons that a rate of 120 yen per dollar seemed preferable in the opinion of the committee, were:

(1) So far as projected imports are concerned the data presented in Tables 5 and 6 indicate that virtually all imports will fall under 100 yen to the dollar at current yen/dollar prices, except for small amounts of petroleum and certain other commodities. There are strong administrative reasons to have the central rate as near as possible to the going rate of imports as well as exports, in order to maximize the number of commodities that can be shifted from the current method of pricing to a foreign exchange system.

(2) The major purpose of establishing a rate of exchange apart from its use for commodity imports and exports is to provide a means by which foreign investors can purchase yen with which to invest under the currency control regulations in, among other things, real property such as factories and labor such as may be involved in invisible exports. The price level of real property in Japan at the present time is remarkably low in comparison with the price level of such daily necessities as food and fuel; for example, the price level of the stock market is no higher than the prewar level, and general information indicates that real estate is priced very much below comparative prewar levels. Similarly, labor is, in terms of exchange standards, a very cheap commodity in Japan today, since a highly skilled laborer still earns no more than a maximum of, perhaps, 300 yen a day, which at a rate of 150 yen is only $2.00 a day, and a rate of 120 yen is $2.50 a day. For these specific purposes a rate of 120 yen therefore appears attractive enough to encourage the importation of foreign capital for such investments.

(3) A major problem of Japan today is the control of inflation. It is obvious that the higher the rate of exchange, the greater the inflationary effect, and thus for purposes of stabilization a lower rate would be desirable.

(4) Admittedly it is difficult at the beginning to establish a proper rate with complete accuracy. Assuming for the moment that it is as likely that error will be made on the side of allowing too high a rate as allowing too low a rate, it is evident that the establishment initially of the lower rate would, on these grounds alone, be preferable, since clearly under

present conditions it would be relatively easy to raise a rate if it is established too low, but it would be virtually impossible to lower a rate.

(5) The rate of exchange as proposed here will be introduced simultaneously with a set of foreign investment and currency controls designed to prevent the ravishment of the Japanese economy by foreign speculators purchasing property and commodities at far below their true value because of disturbed conditions in Japan; in other words, carpet-bagging. The establishment and enforcement of such controls is under the best conditions a difficult matter. At the beginning of this program it will be of decided assistance to the proper enforcement of such regulations if a lower rather than higher rate is established, since a lower rate will tend to keep out undesirable and merely speculative investment.

c. On the other hand, the considerations urging the adoption of a rate of ¥150, as they appeared to the committee, were:

(1) A rate of ¥150 to the dollar is undoubtedly nearer the ratio between the daily cost of living in Japan and the United States. According to Table VII the average rise in retail prices since the period 1934–36 has been about fifty three (53) times as great in Japan as in the U.S. If the average rate of exchange of approximately 3.5 yen per U.S. dollar prevailing in the period 1934–36 is multiplied by fifty three (53) the resulting figure of 185 might be taken as a reasonable standard if the rate of exchange were to be established only on the basis of relative costs of living.

(2) Initially, if the recommended plan of action presented in this report is followed, the principal users of this rate will be SCAP licensed concerns, missionaries, and personnel of the Occupation and licensed concerns. Their yen needs are primarily for living expenses, office operating expenses and the purchase of souvenir items. As indicated above a rate based on comparable purchasing power would be 185. As a practical matter, therefore, in order that the rate will be more in line with current conditions and therefore would be utilized by those concerned, a rate of ¥150 would be much more acceptable.

(3) The higher the rate of exchange, the greater the amount of capital imports and remittances such a rate would attract. It is considered highly desirable that within the limitations of the regulations governing foreign investment, the maximum amount of the inflow of foreign capital should be encouraged.

(4) The inflationary trend in Japan has still not run its course; consequently a higher rate is likely to be more stable than a lower one, simply because the lower one would probably have to be adjusted sooner than a higher one, and stability is a highly desirable characteristic in an exchange rate.

d. After a thorough consideration of the above factors, the committee concluded that:

(1) So far as current conditions are concerned, the reasons urging a rate of ¥120 per dollar are stronger than those which justify a higher rate.

(2) There will, however, be a necessary delay of several months before this rate can be made applicable to commodity imports and exports. It would be most desirable as an aid in effectively instituting the exchange system, if the same rate which is initiated now can be carried over as the rate under the new system.

(3) It therefore seemed that a rate of ¥150 per dollar could more probably be continued in this way than could a lower rate.

(4) At the same time, the committee is of the emphatic opinion that under present conditions, ¥150 per dollar is the highest feasible rate, and that a rate higher than this would have most serious administrative and economic repercussions.

8. The specific system which the committee recommends for establishment of a single rate of exchange under present conditions is presented in detail in Part II. This proposed system contemplates that a single rate of exchange will be established, but that for the time being it will be desirable to allow exceptional rates for certain commodity imports and exports where an explicit and documented justification indicates that there is need to allow such exceptional rates. The reasons the committee considers that at this time it is necessary to allow for a limited number of exceptional rates deviating from the central rate, may be summarized as follows:

a. The Japanese economy has been insulated from free economic contact with the world economy for over ten years. During that time the allocation of resources within the Japanese economy has been dictated largely by non-economic demands, first, those originating in wartime needs, and second, since the end of the war those determined by the extreme inflationary conditions prevailing. If this distorted and very much weakened economy were to be placed in unprotected contact with the world economy abruptly and without safeguards, the result could not be other than highly injurious to the foreign trade program upon which the stabilization and eventual recovery of the economy depends.

b. If a single rate were adopted without possibility of exceptional rates, the inflationary consequences of this move would be very great. In specific terms, if an unmodified single rate of ¥150 per dollar were adopted, the effects of this can be estimated quantitatively as follows:

(1) *Exports below single rate.*

According to Table IV, 56% of all exports for 1948 at current dollar and yen prices, are projected as selling at rates below ¥140 per dollar. For this approximately $217,000,000 in exports (56% of $387,000,000 total projected 1948 exports as shown in table I) there would be either an increase in yen prices or a decrease in dollar prices or some combination of these two movements as readjustments to the single rate of ¥150 per dollar occurred. If the adjustment took place by an increase in yen prices, the effect of this can be calculated, using the data in table IV, to involve an increase in the price of these commodities (disregarding here the effect on related prices throughout the economy) of approximately 14.3 billion yen; if the adjustment occurred in the form of a decrease in dollar prices, the net loss in foreign exchange would be about $95.6 million for the year 1948.

(2) *Exports above the single rate.*

According to table IV, 34% of all exports or $131 million are projected as being priced above ¥160 per dollar. Even if the rather extreme assumption is made that all producers of exports which are now priced up to ¥180 per dollar can lower their prices up to the extent required in order to continue exporting at the new rate of ¥150, there would still be over 30% of all Japanese exporters priced over ¥180 per dollar. This amount of $116 million in exports (30% × $387,000,000 projected value of total exports) could not reasonably be expected to be realized unless subsidies which would compensate at least for the major portion of the difference between their present rates and ¥150 per dollar were forthcoming. The amount of subsidies in yen required to compensate for the difference between these present rates and ¥180 per dollar (assuming that all such exporters could then absorb the price reduction from ¥180 to ¥150 per dollar) would be approximately ¥5 billion.

(3) *Imports under the single rate.*

As can be seen in table VI and Chart #3, less than 4% of all imports are expected to be priced at a rate over ¥150 per dollar, the weighted average for all imports being ¥52.73 per dollar (excluding imports financed by GARIOA). Thus, the use of an unmodified single rate would mean that imports would have to be increased by an average of about 97 yen per dollar of import or an aggregate of about ¥26 billion. Alternatively, if these price increases were to be avoided, subsidies of an equal amount would have to be paid.

In summary then, the inflationary effects of an unmodified single exchange rate system can be quantitatively estimated, at the rate of ¥150 per dollar, as:

¥14.3 billion direct increase in prices, or else loss of $95.6 million in foreign exchange, as prices below the single rate rise

plus ¥5 billion subsidy to allow exports above the single rate to continue, or else loss of $116 million in exports

plus ¥26 billion subsidy to maintain the present level of import prices, or else allow a price rise in imports of this same aggregate amount.

c. The committee has carefully considered the possibility of a single rate system under which all imports and exports now *under* the single rate would be permitted or required to come up to this single rate, but which would provide for maintaining exports above the rate by allowing explicit subsidy payments. This alternative, however, was rejected since the inflationary effects of the necessary subsidy payments or alternative price rises described in (b) above would not be avoided by this propsal.

d. The primary economic justification for a single rate at this time, is that it would tend to bring down the prices of many export goods, some of which are undoubtedly priced too high. Under present conditions, however, the committee is of the opinion that an unmodified single rate, by raising the prices at which imported materials would have to be sold as explained in paragraph (b) above, would not on the whole tend to reduce export prices. Instead, by increasing the prices of imported materials and so increasing costs of production for a large portion of Japanese industry, it is considered that the net effect would be in the direction of price increases throughout the economy.

e. Therefore it is concluded that as long as the present conditions under Japanese economy continue, namely, strong inflationary movements, the lack of sufficient food and raw materials, the extreme unbalance of international payments, the lack of foreign credits to finance

the imports of raw materials for re-export, and a still distorted price and wage structure, the adoption of an over-all single exchange rate without providing for exceptions to this single rate would not be either beneficial or practical.

9. The committee recognizes, however, the great value of an unmodified single rate system so far as administrative simplicity and so far as reducing unnecessarily high export prices is concerned. The plan submitted in Part II has been carefully developed with the advice on technical aspects of experienced Japanese bankers and technicians, so that it is considered administratively entirely feasible and as simple as possible. This plan also contemplates that increasing pressure will be brought to bring down such exceptional rates above the central rate as may be allowed, so that in operation the plan will tend more and more toward identity with an unmodified single rate system.

10. It will unavoidably take at least two to three months to set up the administrative and operating mechanism for the system outlined in Part II. In view of this necessary time lapse and of the pressing need for immediate purposes of a rate of exchange to apply at least to non-commodity transactions, it is recommended that the rate of exchange of ¥150 per dollar be established by 1 February 1948 for all invisible imports and exports.

Specifically it is recommended that initially the rate of exchange cover the following:

a. Imports of foreign capital.
b. Imports of working capital for foreign concerns in Japan.
c. Remittances to all persons, including Japanese, from abroad.
d. Payment to Japanese for services or goods in the performance of licensed activities by foreign concerns.
e. Conversion of acceptable foreign currencies by occupation personnel.
f. Conversion of acceptable foreign currencies by private foreign businesses and attached personnel.
g. Pricing of all services, such as shipbuilding repairs, which are classed as invisible exports.
h. Payment of invisible imports.

There is an immediate need for a financial rate of exchange that will facilitate the flow of capital into Japan for investment purposes and also for all other invisible exports from Japan, such as remittances and conversion of acceptable foreign currencies by occupation personnel and private foreign business personnel. Without such a rate SCAP and the Japanese Government are forced into elaborate substitute administrative devices for an economically feasible exchange rate, which are both complicated and inefficient.

11. It is to be noted that adoption of this rate of exchange would mean that the present military rate of conversion of 50 yen to 1 U.S. dollar would have to be adjusted upward. There is no objection to this change as the present military conversion rate is not in accordance with present conditions; and if foreign capital, remittances and other invisible exports are to be permitted at the financial rate of exchange, it is considered that the same advantages should be made available to occupation personnel.

Concerns licensed by SCAP, missionaries, occupation personnel and remittances to Japanese nationals are all unable to receive a reasonable amount of yen in return for U.S. dollars. Consequently the volume of transactions at the military conversion rate of ¥50 to 1 U.S. dollar is very small. It is considered that there is a pressing need for an immediate change in the rate to provide an adequate return in order that those needing yen funds will obtain them legitimately, rather than through other sources. In addition, in the immediate future foreign investments will be encouraged in Japan and it is therefore necessary to have a rate in order to effectively convert such funds to yen.

12. It is further recommended that until the establishment of the modified single exchange rate system can be instituted, the following policies should be followed:

a. The present method of pricing exported and imported commodities should be continued as at present until the modified single rate system is put into operation.

b. Existing yen/dollar conversion rates for export commodities moving in foreign trade should not be formalized, since these ratios represent in many cases distorted economic conditions.

c. All private trade contracts submitted by Boeki-Cho to the Foreign Trade Division for validation should also show the yen prices of the items, and beginning 1 February, 1948 contracts involving a ratio in excess of ¥300 per U.S. dollar should not be approved without special consideration by the Foreign Trade Division. Boeki-Cho will be instructed to establish a reviewing procedure for all contracts that indicate a yen/dollar relationship in excess of 300 to 1, and to forward only those to SCAP for approval which Boeki-Cho recommends be permitted because of exceptional circumstances. Exceptions made to this cut-off point should be reviewed in terms of general standards by this committee.

The reasons that such unusually high yen/dollar ratios of exports are undesirable and should be eliminated if possible are evident:

(1) A high yen/dollar ratio for a particular commodity basically means that the Japanese economy is utilizing a larger amount of resources (which is reflected in the higher yen price) in order to obtain less foreign currency credits than is the case with other commodities. In other words, a high yen/dollar ratio for a commodity export is prima facie evidence of an inefficient utilization of economic resources.

(2) The higher the yen/dollar ratios that are allowed, the higher the yen price itself tends to rise (since for a given dollar value, a higher yen price can be obtained if a higher yen/dollar ratio is permitted). This tendency for yen prices to rise is, of course, an additional factor in causing inflationary movements.

(3) If yen/dollar ratios higher than absolutely required by cost conditions are permitted, the higher ratios tend to result in larger profits and in a diversion of economic resources to the production of these commodities for export. Allowing such higher ratios is, however, only a temporary condition and provides certain segments of Japanese industry with an artificial insulation against world competition. Sooner or later, however, these in industries will in fact have to compete in the world market. At that time, if unnecessarily high ratios have been allowed, the capital investment in those industries may be suddenly and drastically reduced in value and labor unemployment will rapidly increase. To guard against such undesirable future results, great caution needs to be exercised now in allowing unusually high yen/dollar ratios.

[SOURCE: SUITLAND PAPERS]

9-8 APPOINTMENT OF EXCHANGE RATE MISSION

Letter — May 14, 1948

To: Ralph A. Young, Associate Director, Division of Research and Statistics, Board of Governors, Federal Reserve System

From: William H. Draper, Jr., Under Secretary of the Army

Dear Mr. Young:

This letter will serve to confirm your appointment as the head of a special technical mission which will shortly visit Japan under invitational orders of the Department of the Army for the purpose of studying exchange rates with respect to the Japanese yen.

The other members of the technical mission, in addition to yourself are as follows:

Orville John McDiarmid	Department of State
Arthur Waters Stuart	Treasury Department
Lt. Col, Paul Alfred Feyereison	Department of the Army
Henry K. Heuser	Department of the Army
Michael Lee	Department of Commerce
Arthur Baird Hersey	Federal Reserve System

Interested U.S. governmental agencies and the Supreme Commander Allied Powers are of the agreed opinion that a commercial exchange rate for the Japanese yen should be established at the earliest possible date. Although conditions during the two and one-half years of the occupation have not been considered such as to allow the establishment of a commercial rate, the absence of such an exchange rate has undoubtedly retarded efforts to achieve the prime economic objectives of the occupation of Japan. General MacArthur has recently recommended a change in the military conversion rate of the yen in terms of the dollar as an interim and necessary action in the interests of the occupation. This rate would be used as well for certain financial transactions and, in effect, would become a remittance rate for authorized conversion of dollars to yen rather than either a purely military conversion rate or a commercial rate involving two-way transactions.

Since the interested departments of the Government are vitally concerned in the establishment of a commercial exchange rate for Japan as soon as practicable, and in view of SCAP's recommendation, a full and detailed study of the exchange rate and interrelated problems by all interested parties appears most appropriate at this time.

The terms of reference of your mission as agreed among the Departments of State, the

Treasury and the Army are outlined below, upon which you are expected to report the findings and recommendations of your mission for consideration of interested Washington agencies, including the National Advisory Council:

(1) To give immediate consideration, in collaboration with the Supreme Commander Allied Power, to the practicability of establishing a commercial rate and supplementary measures to accompany the operation of such a rate.

(2) To give immediate attention, in collaboration with the Supreme Commander Allied Powers, to the establishment of a new conversion rate for the Japanese yen for military and nontrade international financial transactions, in case action regarding the establishment of the commercial rate is found by the mission to be premature.

(3) To endeavor to reach an agreed position with the Supreme Commander Allied Powers with respect to the above.

(4) To submit to Washington the final report and recommendations of your mission not later than *16 June 1948* in order that the United States Government may reach a position in this matter by 1 July 1948.

I am deeply appreciative of your having been made available by the Chairman, Board of Governors of the Federal Reserve System, for this million and of your willingness to undertake this responsibility.

9-9 YEN-DOLLAR PRICE RELATIONS AND THE PROBLEM OF AN EXCHANGE RATE

Memorandum June 6, 1948

By: W. V. Turnage, Research and Programs Division, ESS

The problem is whether it is now advisable to institute a uniform rate of exchange between the yen and other currencies for all commodities entering into Japan's foreign trade.

At present there is a wide range of yen-dollar price ratio among commodities in Japan. In general import ratios are lower than export ratios, and the products of heavy industry are at the high end of the range.

It is the object of a uniform rate to compress these ratios into a single exchange rate by changing the yen prices of commodities to conform to dollar (or relevant world) prices at an appropriate rate of exchange between the yen and dollar. Dollar prices are related among themselves in a sharply different fashion from pre-war relations, and this in part brings about some of the current spread in yen-dollar ratios. However, mainly these spreads result from the fact that commodities are currently priced in yen consistent with the "cost-of-production pricing principle." In part these spreads also result from the fact that imported raw materials are generally priced relatively low. The relatively abnormal cost pattern in the Japanese economy is mainly, however, a consequence of the low level (and high unit cost) of production in the large scale industries. (It must be noted that the present range of yen-dollar ratios would be even more exaggerated if subsidies were withdrawn.)

The problem is not one of inflation except in a secondary manner. The primary objective of a uniform rate is not to halt inflation, but to "rationalize" the price and cost pattern, to compress the various yen-dollar ratios into a uniform ratio. While there is some argument that the effect of a uniform rate would in its later stages tend to stabilize prices, it is agreed by all that the initial effects would be to raise prices. The position that the establishment of a uniform rate would become a deflationary influence is not only debatable, but rests upon such tenuous grounds that it becomes of small consequences as an argument for the immediate establishment of a uniform rate. In fact, the argument that such a rate would have sharp initial inflationary effects is a persuasive reason for not adopting a uniform rate at this time.

The central problem is whether the establishment of a uniform rate would effect a rationalization of costs. Now the problem of rationalization of costs, centers about the operation of industrial plant capacities at high and efficient levels. This can only be achieved in one of two ways:

(1) Through slow process of recovery of trade and production to normal or "target" levels, or

(2) Through the squeezing out of excess capacity and the concentration of scarce supplies of materials into a few plants which can thereby operate at efficient levels by a drastically rigorous allocation system. (The latter alternative, of course, would create vast problems of a political and social nature.)

The argument for a uniform rate claims that such a rate, while not bringing about an early or immediate rationalization of costs, would tend to promote such rationalization. In view of the fact that the advocates of a single rate do not ask for immediate rationalization (through the allocation mechanism), it is not clear just how soon they do propose to achieve rationalization or the squeezing out of excess capacity. In view of the facts that (a) domestic demand is of enormous potential, and (b) that the principal bottlenecks to the expansion of production rest in factors and conditions external to Japan, it is not clear how a "rationalization" of yen prices can contribute to the removal of external bottlenecks and thereby to the expansion of production.

There are essentially only two positions which can be taken with respect to this great problem. Although the advocates of a uniform rate, while not proposing a drastic rationalization through the elimination of excess capacity, compromise at some intermediate point, they essentially propose the position of forced rationalization.

The advocates of a price ratio system on the other hand rely essentially upon the natural development of recovery to bring about a rationalization of costs and prices through the attainment of normal operating levels of industrial capacity which will remain in Japan for ultimate full utilization. They do compromise, however, in the direction of some degree of forced rationalization through the medium of administration of the price-ratio system and through the allocation mechanism.

The latter position has the following arguments:

(1) That wise management at critical points can more effectively encourage rationalization than can the "single shot method."

(2) That the price ratio system is less inflationary:

(a) It does not have the initial price raising effect of the uniform ratio.

(b) It exercises more effective control of excess purchasing power by direct restriction than would the uniform rate which involves diffusion through increased reliance upon the tax mechanism to drain off excess purchasing power from those who would otherwise benefit from the increased yen prices consequent to a uniform rate.

(c) It assures maximum exports with a minimum reliance upon government subsidies.

(d) It gives some assurance of maintenance of the parity pricing system for indigenous food in contrast with the jeopardy to this system which would result from the single rate. (This is of enormous importance in the direct and indirect efforts to restrain the advance of nominal wages.)

(Note: In a subsequent memo I shall take up the issues raised by the point 2b above (concerning the excess purchasing power of abnormal profits) and their consequences upon the completion of the future Japanese economy and upon the problem of U.S. aid.)

9-10 REPORT OF THE SPECIAL MISSION ON YEN FOREIGN EXCHANGE POLICY (YOUNG REPORT)

June 12, 1948

TABLE OF CONTENTS

Preface and Major Conclusions[4]
I. BASIS OF THE MISSION'S WORK
A. Terms of Reference
B. Exchange Rate Policy
C. Recent Developments in United States Government Policy with Respect to Economic Assistance to Japan
D. Fundamental Problems
II. PRESENT ECONOMIC SITUATION IN JAPAN
A. Achievements of the Occupation
B. Employment and Industrial Production
C. Price Pooling and Allocations Principles
D. Cost and Price Distortions
E. Inflation

[4] These sections only included.

F. Supply of Money
G. Present Credit Controls
H. Proposed Realignment of Costs and Prices
I. Foreign Trade
J. Trade Procedures
III. A SINGLE GENERAL RATE OF EXCHANGE
A. Adjustment of Japanese Prices to World Prices
B. Drawbacks of Multiple Exchange Rates
C. Impact of a Single General Rate on the Balance of Payments
D. Timing the Alignment to World Prices
IV. THE PRICE LEVEL AND RATE STABILITY
A. Effects Upon the Price Level
B. Prospects for Rate Stability
V. FEATURES OF OUR FOREIGN EXCHANGE PROPOSALS
A. A Practicable Commercial Exchange Rate
B. Characteristics of the Proposed Administered or Controlled Type Single General Yen Exchange Rate
C. The Rate Level
D. Necessary Future Changes in the General Rate Level
E. Timing the Establishment of a General Rate
F. Military Conversion Rate Problem
VI. MEASURES TO IMPLEMENT AND ACCOMPANY ESTABLISHMENT OF RATE
A. Pricing of Exports
B. Other Adjustments of Official Prices
C. Management of Foreign Trade Fund
D. Administration and Control of Foreign Trade and Foreign Exchange
VII. MEASURES FOR PROMOTING EXCHANGE STABILITY
A. Monetary and Credit Policy
B. Budget
C. Taxation
D. Allocation of Raw Materials and Semi Finished Products
E. Stabilization of Wages
F. Administration and Control of Foreign Exchange
G. Food Collection Program
VIII. OUTLINE SUMMARY OF PROPOSED EXCHANGE RATE PROGRAM[4]

Preface and Major Conclusions

Our on-the-spot studies of Japanese economic and financial conditions were facilitated in every possible way by General MacArthur, Supreme Commander for the Allied Powers, and his staff. Comprehensive factual and analytical materials were furnished by Major General W. F. Marquat, Chief of the Economic and Scientific Section of SCAP, and Colonel H. S. Ruth, Fiscal Director of CINCP Every opportunity was provided for individual and Mission discussions of the technical aspects of our assignment with these officers and their staffs. We also talked with many members of the Japanese Government and benefited from an insight into their point of view on Japanese foreign trade and international financial problems.

In conducting our studies, we have adhered closely to our terms of reference, as stated in Under Secretary of the Army's letter of 14 May 1948. The general conclusions which we have reached in accordance with those terms are stated below:

1. The time is not yet ripe for the establishment of a definitive type yen foreign exchange rate.

2. Recovery in basic Japanese production and trade, however, has reached a sufficiently advanced stage to permit establishment of a practicable commercial exchange rate for operating purposes. In our report we describe such a rate as an administered or controlled type, single general rate.

3. Taking full account of existing obstacles to further rapid Japanese economic recovery, we regard establishment of a general exchange rate as essential to continuing progress towards the recovery goals of the Occupation.

4. An additional consideration weighing heavily in our thinking is that inflationary

developments in Japan have now attained a force that makes establishment of a practicable commercial exchange rate imperative as a central measure of an urgently needed financial stabilization program. An early downward adjustment of Japanese official thinking with regard to a realistic level of domestic consumption under present supply conditions is also imperative.

5. We strongly suggest introduction of a commercial exchange rate of the type we propose at the earliest possible date. We would feel that such a rate could be established not later than 1 October 1948. Earlier introduction might be feasible.

6. It is our opinion that extended delay in the inauguration of a single general exchange rate will jeopardize the effectiveness of our recommended foreign exchange policy for Japan, and in addition, put serious obstacles in the way of working out any subsequent stabilization program.

7. The single, general exchange rate, which we recommend, would be integrated into existing economic controls, and certain of these controls would need definite strengthening in order to make the exchange rate and financial stabilization program effective. Our specific recommendations with respect to these controls are discussed in sections of our report dealing with implementing measures and measures to promote exchange stability.

8. In addition to serving as a key instrument in Japanese financial stabilization policy, we strongly believe that an exchange rate of the type we propose will: (a) greatly simplify foreign trade procedures; (b) increase the dollar proceeds obtained from export trade; (c) accelerate the return of Japanese foreign trade to private channels; (d) stimulate foreign investment in Japan; and (e) generally facilitate the further expansion of Japanese economic recovery.

9. If prompt action can be taken to implement our proposal for a new Japanese foreign exchange policy, we believe that SCAP may wish to reconsider his recommendation for action to set a new and higher conversion rate for military and other authorized purposes in advance of setting a general rate. However, if SCAP prefers an earlier change in this conversion rate, we recommend that such preference be given full weight.

10. If preparatory steps to inaugurate a single general rate will require several months to complete, the Mission would favor immediate establishment of a new interim conversion rate for military purposes, including necessary remittance and other financial transfers.

11. Our studies lead us to recommend that a proper level for a general exchange rate be determined by the application of the following principles: (a) a level that will provide sufficient yen per dollar to sustain, and later expand, Japanese exports; and (b) a level that will encourage more efficient production in "high-cost" industries.

12. On the basis of current and projected information supplied at our request by SCAP's staff, we believe that an appropriate level for the proposed single, general exchange rate, if introduced at a very early date, would be in the neighborhood of 300 yen per dollar. Changes in the Japanese economic situation between now and the date when a general rate is introduced, together with such special considerations bearing on the rate level as may subsequently arise, may indicate a finally determined level either somewhat lower or somewhat higher than 300 yen per dollar. To provide for this contingency, we recommend that SCAP be authorized to fix a level at the appropriate time within a range of 270 yen to 330 yen per dollar.

13. With establishment of the general rate, SCAP should be given authority to make subsequent adjustments in the rate within specified limits, without Washington approval, in accordance with the principles of the International Monetary Fund, as applied to member countries.

14. If it is decided to institute promptly a new military rate for interim uses we would regard any level up to 270 yen per dollar, as determined by SCAP, to be consistent with previously stated principles regarding this rate and also with our recommended program for establishing a single, general rate at a later date. The new military rate, if introduced, would be absorbed into the proposed general yen exchange rate when the latter rate is inaugurated.

The full discussion of our major findings, together with our specific recommendations, is set forth in the following pages. An outline summary of the program of policy that we propose for dealing with the Japanese foreign exchange problem appears at the end of the report.

The Mission arrived in Tokyo on 20 May 1948, and completed the preparation of its report on 12 June 1948.

Paul A. Feyereisen, Lt. Col. — Michael Lee
Arthur B. Hersey — Orville J. McDiarmid
Henry K. Heuser — Arthur W. Stuart
Ralph A. Young, Chairman

. . . . . .

VIII. Outline Summary of Proposed Yen Exchange Program

I. *Type and Scope of Rate*
Administered or controlled single general rate to apply to all transactions.
Military conversion rate merged with the general rate when such rate is established.
Not a "definitive" rate.

II. *Objectives*
Adjustment of Japanese Foreign Trade prices to world prices.
Simplification of foreign trade procedures.
Attainment of monetary and exchange stability.
Increase of trade, production, and flow of foreign investment.

III. *Relation to Other Programs*
Requires support of existing economic controls, together with essential simplification and strengthening of certain controls.

IV. *Main Principles for Establishing Rate Level*
A level high enough to sustain at the outset, and later expand, the volume of Japanese exports.
A level low enough to encourage more efficient production in the "high-cost" industries.

V. *Rate Level*
On basis of above principles, SCAP authority to establish general rate within range of 270 and 330 yen per dollar.

VI. *Implementing Measures*
Resale of food imports at prices consistent with prevailing price maintenance programs.
Cost of price equalization to be met from the general account budget.
Appropriate, but not necessarily full, alignment of other Japanese prices with world prices through the established exchange rate level.
Retention of present SCAP controls over foreign trade. Increased controls over yen foreign trade account.

VII. *Accompanying Stabilization Measures*
Strengthening and enforcement of existing selective credit control program.
Systematic reduction of deficits in general and special accounts budgets.
Acceleration and strengthening of program to step up tax collections and enforcement with increased tax revenue the goal.
Introduction of some new taxes to raise additional revenue and to redistribute the tax load.
Revision of methods of allocating raw materials and semi-finished products.
Introduction of flexible but firm wage stabilization program.
Adjustment in foreign trade control and administration.
Introduction of a foreign exchange control under appropriate agency of Japanese Government, e.g., Bank of Japan.
Continued improvement in the food collection program.

VIII. *Change in Rate*
Application of International Monetary Fund principle as applied to member countries or authorizing on-the-spot changes in the initial exchange rate within specified limits at the discretion of SCAP.

IX. *Timing*
Immediate start on administrative arrangements.
Target date set for establishing the rate on or before 1 October 1948.

X. *New Conversion Rate for Military and Other Authorized Purposes*
Other than military uses, to include such charitable, financial, and other remittances as SCAP may authorize.
In event of early introduction of single, general rate, SCAP review of recommendation for institution of new military rate will be desirable.
If essential preparatory steps for establishment of single, general rate require a period of several months, a new military rate to be instituted no later than 1 July 1948.
A conversion rate level up to 270 yen per dollar at the discretion of SCAP, would be consistent with previous stated principles for the military rate, and with the recommended Mission program for a single, general rate.

[Source : Ministry of Finance, Z 721-11]

9-11 JAPANESE EXCHANGE RATE[5]

Memorandum June 25, 1948
To: National Advisory Council
From: The Staff Committee
Top Secret

1. *The Problem*

The Report of the Special Mission on Yen Foreign Exchange Policy, 12 June 1948, has been given limited and controlled circulation among the members of the National Advisory Council. The analysis and recommendations in the report of the special mission require consideration by the National Advisory Council, and an action on present exchange rate alternatives and the problem of promoting exchange rate stability in Japan.

The Mission's terms of reference and its report included a discussion of the military rate problem in the absence of a general exchange rate. This problem is not being presented for consideration by the Council.

2. *Economic Situation in Japan*

The occupation of Japan has been marked by the inauguration of an extraordinary program of institutional reform and by economic recovery which, at this time, is being retarded by: (a) the limited availability of imports; (b) a complex of factors which have inhibited the more rapid development of export trade; and (c) by the secondary and tertiary impacts of past economic policies, which were generally effective in initiating and promoting the recovery that has been achieved to date.

A partial listing of the more impressive institutional reforms include: (a) a land tenure program which, in a comparatively short period, is removing in Japan by legal process, those feudalistic characteristics of Asiatic agriculture which are at the root of the widespread social and political unrest in other countries of East-Asia; (b) the establishment of a democratic, constitutional form of government; (c) the establishment of a free trade-union movement within the framework of collective bargaining; and (d) measures directed to the development of competitive private enterprise, including a highly effective official program.

In the field of productive activity, the level of agricultural production has been substantially increased. Electric power and coal production have made significant gains, and manufacturing output in general has more than doubled over the last two years.

The financial and monetary situation in Japan is characterized by acute inflation, the basic causes of which are the large budgetary deficit, the sharp post-war decline in industrial production, and efforts to maintain monetary incomes at levels which cannot be translated into corresponding real incomes under present supply conditions.

The budgetary deficit has been occasioned by a lack of effective controls over governmental expenditures and by failure to increase tax revenues sufficiently. The absence of effective credit controls has added to the expansion in the money supply. The absence of effective commodity controls has resulted in the growth of black and gray markets in consumers' goods, industrial raw materials and semi-finished products. The inflation has been accentuated by systems of price pooling, export-pricing, subsidy, raw materials allocation and credit administration which have been accommodated to the high and steadily rising unit costs resulting from the maintenance of capacity level industrial payrolls in the face of sharply curtailed industrial output, and from the operation of industrial plants excess to the requirements of present and prospective output levels.

The consolidated general accounts and special accounts budget for fiscal 1949 (April through March), which is still in process of consideration by the legislature, is seriously out of balance. An over-all deficit on the order of 180 billion yen is indicated. The forecast has been made that a rise in the outstanding note issue on the order of 100 percent may result over the year, if the deficit is increased by later supplemental budgets.

Official domestic ceiling prices for producers' goods and finished manufactures which were established in July 1947 have become obsolete because of the advance of wage rates and prices not subject to control during the past year. An upward revision of official prices by about 80 percent is now under study and reportedly will be announced soon. It is anticipated that these adjustments will reduce present disparities between official and black market or free prices, as well as between legal selling prices and costs, and that they will result temporarily

[5] National Advisory Council Document No. 714.

in more tenable relationships between prices, wages and production costs upon which to base a stabilization program.

Manufacturing output in general has more than doubled over the last two years, but is still only 41 percent of 1930–34 levels and some 20 percent of peak wartime levels. Economic recovery is being retarded by a complex of factors which inhibit the development of export trade, as well as by the limited availability of raw materials imports and the disruption of normal production incentives by inflation. Among the factors limiting exports, in addition to shortages of raw materials, are the absence of a vigorous and purposive policy and program for allocation of materials and the procedural complexities of the foreign trade mechanism both for traders and administrators.

In the absence of a rate of exchange applicable to export and import trade, export products have been priced in yen at official domestic prices, or at special prices approved by the Japanese Board of Trade, and in dollars or other currencies at what are considered approximations to world market prices. The resulting yen-dollar price ratios have exhibited wide dispersion, owing partly to the operation of industrial plants at varying levels of output in relation to capacity, partly to the pricing policies referred to above, and partly to the inflation of yen costs and prices for domestic factors of production as compared with the low and relatively inflexible yen costs assigned to imported materials. There has been a wide area for administrative decision with regard to prices both in foreign currencies and in yen; a condition which makes possible favoritism, pressure methods and corruption on the part of the Japanese.

Imports have generally been priced into the domestic economy at yen-dollar price ratios considerably lower than for exports. The net result has been that, despite the large import surplus in terms of dollar values, the foreign trade fund's yen disbursements for exports have tended to balance or exceed its yen receipts on imports.

The present system for the yen pricing of exports implicitly involves a "cost-plus" principle and places a premium on waste and on cost and profit excesses, and provides opportunities for malfeasance and pressures from special interests among both Japanese and non-Japanese foreign traders. Since yen prices and dollar prices are unrelated, the bargaining between exporters and the Japanese Board of Trade on yen prices provides no check on the suitability of the dollar prices which must be approved by SCAP. In the opinion of the Mission, the formalization of existing yen-dollar ratios and their consolidation into several dozen ratios, a program to which the Board of Trade and the SCAP staff have given considerable attention in recent months, would perpetuate many disadvantages of the present procedure. The administrative problems connected with reviewing cost data to set appropriate exchange ratios appear nearly as great as under the present pricing system. Moreover, a multiple rate system would be a barrier to the curbing of inflationary tendencies, in that it would allow excessive outpayments of yen to inefficient exporters and would tend to preclude the use as a deflationary device of larger inpayments to the foreign trade fund for imports. Any attempt to compress the range between high and low ratios, through administrative repricing over a period of months, would be subject to increasing resistance.

3. *Summary of Recommendations of the Special Mission With Regard to a General Exchange Rate*

The Special Mission recommended an administered or controlled type single, general exchange rate, applicable to all transactions including those to which the present military rate applies, to be established as soon as administratively possible, with target date on or before October 1, 1948. The level of the rate recommended, on the basis of allowing 80 percent of Japanese exports to move at their pre-existing yen prices or better, is within the range of 270 to 330 yen per United States dollar, to be determined by SCAP. It is recommended that SCAP be authorized to change the level of the rate initially set, within a margin of 10 percent above or below such level, without consultation with Washington agencies.

Foreign exchange proceeds of Japanese exports would remain under the control of SCAP. The yen foreign exchange fund would become a strictly "banking" fund from which the yen countervalue of export proceeds would be paid, and into which would be paid the yen countervalue of import costs. In order to maintain controlled domestic prices for food and fertilizer, subsidies would be provided from the general account of the budget.

The Mission recommended certain other necessary implementing measures to accompany the introduction of the single rate, and a comprehensive program of economic stabilization, the component measures of which should be introduced as soon as administratively feasible, and without reference to the timing of the establishment of the single exchange rate.

4. *Views of the Supreme Commander and GHQ Staff*

In a SCAP staff memorandum transmitted to Washington by General MacArthur, the view was taken, with respect to the price structure in Japan, that the economic isolation and

low level of output have produced such price distortions as compared with the world economy that the establishment of a single exchange rate would produce an excessive impact at the present time. The use of the single rate as a basis for pricing import and export goods would involve an upward adjustment of the domestic price level by 200 percent. This is due to the low yen-dollar ratios now applying to imports and the fact that the largest volume of exports are now moving at rates lower than the single rate proposed by the Mission. On the other hand, it was argued that extensive recourse would have to be made to subsidies to prevent the elimination of high-cost exports as well as to check "unsupportable inflation."

After reviewing the Mission's report. General MacArthur indicated that there was complete agreement in principle that an effectively administered single overall exchange rate between the yen and the dollar would contribute significantly to Japanese financial stabilization, simplify foreign trade procedures and otherwise aid in economic rehabilitation. He emphasized that he differed with the views of the Mission only as to the appropriate time for instituting the rate.

He cited the existing low levels of production and foreign trade in Japan as indicating the difficulty of imposing, concurrently with establishment of the rate, all necessary control and stabilization actions required to achieve rate stability. He indicated that reduction of consumption levels, concentration of industrial output, and increased unemployment and reduced payrolls might produce serious, "even collapsing" short-run economic and social consequences upon the national welfare. He expressed concern that the impact of the program might be to reduce the productivity of the economy and increase Japanese reliance on foreign aid. He pointed to the weakness of the Japanese governmental structure and referred to the possible need, in enforcing a drastic stabilization program, for more stringent external controls on Japan than have been invoked during the more recent period of the occupation.

General MacArthur urged that one of the prime determinants in setting the date for establishment of a controlled rate of exchange should be "the adjustment of the foreign trade index, based upon the 1930–34 base, into coincidence with the production index." Other determinants, in his view, would be the strengthening and establishment of stabilization measures which are "prerequisites to the establishment and maintenance of the controlled rate of exchange."

5. *Review of the Arguments*

SCAP's position that establishment of a single, general rate of exchange should wait on a substantial recovery in export trade would seem to imply postponement of this action for as much as two or three years. Recovery in export trade will continue to be seriously hampered by complexities in export procedures if a single rate is not adopted. The reactions of other countries trading with Japan are likely to be unfavorable if the present system of implicit multiple rates is continued or formalized as a system of explicit multiple rates. Earlier projections of the rate of expansion of Japanese exports have proven ill-founded and the present outlook cannot be considered optimistic.

SCAP's reference to reduction of consumption levels appears to apply only to reduction of the *expectations* of wage-earners, farmers, and others as to the real income they should be able to obtain with their money incomes. There is little likelihood that the real level of consumption as determined by domestic production and imports will be adversely affected by a stabilization program embracing strong fiscal measures and other measures recommended by the Mission. Moreover, the unemployment which may be occasioned either by temporary cutting off of high-cost exports or by rationalization in these and other industries is hardly likely to constitute an insuperable problem in view of the present extremely low figures of absolute unemployment. The statement that extensive recourse to subsidies for exports would be required by a single exchange rate is unsupported.

It is recognized that the establishment of a single exchange rate at a level substantially above the present implicit rates for many imports and exports will require substantial revisions in domestic prices of foreign trade goods. However, present official ceiling prices established a year age are already seriously out of adjustment with wages and with black market prices and the general revision of official prices which is being planned at the present time will have an effect of narrowing the present gaps between implicit yen-dollar rates and the proposed rate of 300 yen to the dollar. When the present very low ratios for imported raw materials are eliminated by introduction of a single rate, concurrently with a raising of the yen prices on corresponding exports, a considerable part of the distortions in the Japanese price-cost structure will be straightened out automatically without creating new difficulties. Higher prices for imported goods or for domestic products of imported materials would have relatively slight direct effects upon the ordinary consumers' budget, except in the case of food. Provided food imports are subsidized to the consumer and provided wages are controlled in line with a further

gradual increase in the cost of living, the upward pressures on industrial costs should not exceed what can be absorbed at the higher level of selling prices which will be occasioned initially by introduction of a single exchange rate at the level proposed. Minimization of further inflation of the general level of prices and costs will require, of course, early implementation of a fiscal and financial stabilization program.

An urgent need exists for a stabilization program in Japan entirely without reference to its helpfulness in supporting a single exchange rate system. The present trend of sharp inflation, if not controlled, threatens a complete breakdown of normal economic incentives. Moreover, it postpones indefinitely the stage at which price controls and wage controls can be relaxed. Not least in importance, it builds up a psychology of exaggerated dependence upon the United States for economic aid.

Maintenance of a general exchange rate at the level initially established depends, of course, upon the early effectiveness of supporting measures. Whether the introduction of a single rate should properly be postponed until after the supporting measures have become fully effective depends on a proper weighing of the following considerations:

a. The effect of establishment of a single rate upon the attitude of the Japanese Government toward fiscal and financial stabilization and toward the promotion of Japanese exports to reduce dependence upon the United States.

b. The effect of establishment of a single rate in eliminating administrative barriers to direct dealing between Japanese exporters and foreign traders on a realistic basis of cost, quality and price, and in exerting pressure for more efficient operations in high cost export industries.

6. *Conclusions*

It is the Staff Committee's opinion, after considering the positions taken by the Special Mission and by SCAP, and after review of the present economic situation and probable future developments in Japan, that the exchange rate and other measures recommended by the Special Mission are essential to bringing the present Japanese inflationary situation under control; to ending the administrative difficulties and the potentialities for abuse by the Japanese inherent in the existing foreign exchange system as well as in the modification of this system recently under consideration; to increasing Japanese production and exports; and in laying a foundation for a lasting development of Japanese foreign trade. The Staff Committee regards the introduction of a single rate as an important force in bringing about a rationalization of Japanese export production, and further as a necessary guide and compulsion to the adoption of urgently needed economic stabilization measures. The Staff Committee, therefore, views the establishment of such a rate as an important stabilizing factor in itself. The Staff Committee agrees that the accompanying measures to achieve economic stabilization, as recommended by the Special Mission, would be essential under any exchange rate arrangement.

7. *Recommendation*

The Staff Committee submits the following action for the consideration of the Council:

The National Advisory Council advises the Departments of State and the Army that:

(1) A single general exchange rate for the yen, applicable to all types of transactions including those for which a military conversion rate would be used, should be established and become operative as soon as administratively possible. The Council perceives no reason to object to a level between 270 yen and 330 yen per dollar if established within the time limit envisaged in the Report of the Special Mission on Yen Foreign Exchange Policy.

(b) An energetic program for financial stabilization in Japan is essential to the promotion of exchange stability under any general exchange rate arrangement; the various component measures in such a program should be initiated or strengthened without delay. In order to carry out this program, the measures recommended in the report of the Special Mission are commended to the attention of the Departments of State and the Army.

(c) The alternatives to the early establishment of a single, general exchange rate, namely, the continued use or the possible formalization of a wide range of export and import conversion factors, appear unsatisfactory in the light of the objectives of United States foreign financial policy.

[SOURCE: U.S. TREASURY DEPT., Z 732-1]

9-12 NAC MINUTES ON INTERNATIONAL MONETARY AND FINANCIAL PROBLEMS

Draft of the Minutes June 28, 1948

NAC, Meeting No. 98
Confidential
Present:
Secretary John W. Snyder (Chairman), Treasury Department
Secretary Kenneth C. Royall, Department of the Army, Visitor
Major General Daniel Noce, Department of the Army, Visitor
Mr. Francis Walker, Department of the Army, Visitor
Mr. Ralph A. Young (Chairman), Special Mission of Yen Foreign Exchange Policy, Visitor
Lt. Col. Paul A. Feyereisen, Special Mission of Yen Foreign Exchange Policy, Visitor
Mr. Arthur B. Hersey, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. Henry K. Heuser, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. Michael Lee, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. Orville J. McDiarmid, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. Arthur W. Stuart, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. Willard L. Thorp, State Department
Mr. J. Burke Knapp, State Department
Mr. J. J. Stenger, State Department
Secretary Charles Sawyer, Commerce Department
Mr. Clarence I. Blau, Commerce Department
Mr. Thomas B. McCabe, Board of Governors, Federal Reserve System
Mr. Lewis Dembitz, Board of Governors, Federal Reserve System
Mr. William McC. Martin, Jr., Export-Import Bank
Mr. Herbert E. Gaston, Export-Import Bank
Mr. Paul G. Hoffman, Economic Cooperation Administration
Mr. Wayne C. Taylor, Economic Cooperation Administration
Mr. August Maffry, Economic Cooperation Administration
Mr. George F. Luthringer, International Monetary Fund
Mr. John S. Hooker, International Bank
Mr. Walter C. Louchheim, Jr., Securities and Exchange Commission
Mr. Frank A. Southard, Jr., Treasury Department
Mr. James J. Saxon, Treasury Department
Mr. William W. Parsons, Treasury Department
Mr. Elting Arnold, Treasury Department
Mr. Robert A. Dillon, Treasury Department
Mr. John O. Hally, Treasury Department
Mr. John W. Gunter (Secretary)
Mr. Allan J. Fisher (NAC Secretariat)

1. *Japanese Exchange Rate*

Mr. Gunter pointed out that NAC Document No. 714 dealt with the Report of the Special Mission on Yen Foreign Exchange Policy and that the general effect of the paper was to approve in broad terms the findings of the Mission. At the present time, there is no single exchange rate in Japan. Exports have been priced in yen at official domestic prices, or at special prices established by the Japanese Board of Trade, and in dollars or other currencies at what are considered approximations to world market prices. The dollar-yen price ratios computed on these bases show wide disparities. The Mission recommended a single general rate be established by October 1, 1948 in the range of 270–330 yen to the dollar. This action would be accompanied by exchange control plus a realistic program of economic stabilization. SCAP had expressed views in which he dissented on some points, particularly on the matter of timing. He felt that an action at this time would have an undesirable impact on the Japanese economy and there should be substantial recovery of Japanese trade before the exchange rate was established. The view of the Special Mission was that establishment of the rate would facilitate exports and would be an important element of stabilization. The Staff Committee recommended an action to the effect that a single general exchange rate for the yen should be instituted as soon as possible and that there would be no objection to the establishment of an exchange rate within the limits recommended by the Mission. The action also would commend to the attention of the Departments of State and the Army the program for financial stabilization recommended by the Special Mission. The action further stated that a multiple rate system was in general unsatisfactory in view of the objectives of United States foreign financial policy.

Secretary Royall said that the Department of the Army was in accord with the recommendation. The expression "as soon as practicable" left open the question of timing. The Department of the Army thought that that question, for the present, must be left open. General

MacArthur had strong views, which were substantiated by some of the people who had recently been in Japan, to the effect that a substantial change in the exchange rate might cause unemployment, dissatisfaction and uncertainty and affect the political as well as the economic situation. General MacArthur also felt that the real solution of the monetary problem was adequate imports and an active foreign trade. More specific views and recommendations had been requested of General MacArthur by cable. The matter had been discussed with leading bankers in this country and the latter did not think the exact timing could be fixed now. The Mission had recommended a date of October 1, 1948. The Department of the Army hoped there could be agreement on a specific date which would be somewhat later. The recommendation would leave open to the Army, after receiving General MacArthur's recommendations, the putting of this policy into effect at such time as the Army elected. The Army would interpret "as soon as practicable" to mean as soon as these other conditions might be attained which might be three months, six months or a year hence. It had been suggested that the period might be two years. The Army in making the decision would do so after conversation and coordination between the State and Treasury Departments. Secretary Royall added that the Army was planning to put into effect a military rate on July 1, 1948, which would merely fix the rate of exchange for dollars which are sent in for military and diplomatic use and to a limited extent for other civilian use. The amount would not be a large factor in the currency situation since it would be about $1 million a year. The contemplated rate was up to 270 yen to the dollar as compared with the existing rate of 50 yen to the dollar.

The Chairman inquired whether the rate was strictly confidential at this time. Secretary Royall confirmed this and said the rate should not be given publicity.

Mr. Thorp said that the State Department felt that there should be a sense of urgency with respect to establishing a single exchange rate for the yen. They thought it was one of the key steps toward improving the situation. The Department felt that the relationship of the United States with other countries was made more difficult and our pressure on them not to adopt multiple rates and to go to the International Monetary Fund less persuasive if we condoned multiple rates in areas in which we have responsibility. The State Department did not believe that anything like a 2-year period would be a reasonable time. They hoped it would be a matter of a few months. The Department recognized that the exchange rate was not something that could be acted upon by itself but that it must be part of a broad program.

The Chairman observed that the views of the Treasury Department coincided with those just expressed. The Treasury would not push the October 1 date but did not like to talk in terms of one or two year periods. It would be necessary to be guided by circumstances but both State and Treasury would like to urge on the Army that further discussions be held as early as possible and that the aim should be the institution of a single exchange rate at the earliest possible date.

Secretary Royall said that the Army felt the same way about the matter but they did not know yet what specific information would be received from General MacArthur. They desired to hasten action but recognized that changing the exchange rate was not going to be effective unless other things were done simultaneously. One of the bankers who had been consulted said that the other measures should be taken before the establishment of the exchange rate but the Army did not agree and thought that the several measures could take place at the same time.

Mr. Southard commented that Secretary Royall had used the expression "as soon as practicable" whereas the expression in the action was "as soon as administratively possible" which might be stronger. The latter term might mean as soon as proper steps could be taken to put the program into effect.

Secretary Royall said that the Army did not accept the interpretation that the expression meant as soon as the Army could get the mechanics into operation. There were other considerations than purely mechanical steps. The Army assumed that "as soon as administratively possible" took into account the other economic factors that had to be solved at the same time.

The Chairman commented that the sense was that action should be taken "as soon as practicable and possible" and that putting the two words together showed the urgency of the recommendation.

Mr. Hoffman said that the action had an important bearing on ECA operations because there was nothing more embarrassing than talking to foreign countries about putting their fiscal houses in order when in Germany, Japan and Greece, countries where we had responsibility, multiple rates were condoned. He thought that the sooner the United States faced the problem and solved it, the better it would be. Mr. Hoffman added that he would not value his own

opinion on the position in Japan but unless something closer to a balance were achieved the benefits of a currency reform would be of short duration. However, there was urgency about the whole matter of currency reform and related problems.

Secretary Sawyer commented that everyone was in agreement on the recommendation and that the question under discussion was the interpretation of the term "administratively possible". The Chairman said that it was the timing of completion of action that was under discussion and that he assumed that the Army, having heard from General MacArthur, would bring the matter up again. Secretary Royall said that the Army would take the matter up with the State and Treasury Departments and that the latter could clear it with the Council if they desired.

Mr. McCabe said that the Federal Reserve Board was convinced from the facts presented by Mr. Young that the situation was very urgent. Their opinion was that "as soon as practicable" should mean a matter of months.

Without further discussion the recommended action was unanimously approved:

Action. The following action was taken:

The National Advisory Council advises the Departments of State and the Army that:

(a) A single general exchange rate for the yen, applicable to all types of transactions including those for which a military conversion rate would be used, should be established and become operative as soon as administratively possible. The Council perceives no reason to object to a level between 270 yen and 330 yen per dollar if established within the time limit envisaged in the Report of the Special Mission on Yen Foreign Exchange Policy.

(b) An energetic program for financial stabilization in Japan is essential to the promotion of exchange stability under any general exchange rate arrangement; the various component measures in such a program should be initiated or strengthened without delay. In order to carry out this program, the measures recommended in the report of the Special Mission as commended to the attention of the Departments of State and the Army.

(c) The alternatives to the early establishment of a single, general exchange rate, namely, the continued use or the possible formalization of a wide range of export and import conversion factors, appear unsatisfactory in the light of the objectives of United States foreign financial policy.

[SOURCE: U.S. TREASURY DEPT., Z 732–1]

9-13 THE ECONOMIC REHABILITATION OF JAPAN

Report[6] October 15, 1948

Prepared by: Reports and Analysis Branch, Civil Affairs Division, Department of the Army

Prewar Japan's principal economic assets were a large and industrious population, excellent fishery, forestry and hydroelectric resources, considerable deposits of low-grade coal, copper and sulphur and a geographic location favorable to the development of foreign trade and shipping. Such basic industrial materials as petroleum, high-grade coal, iron ore, pig iron, crude rubber, lead, zinc, tin, aluminum ore, nickel, raw cotton, and wool had to be imported. Japanese food production was never equal to consumption requirements—approximately 20% of the total food supply came from abroad.

Although deficient in many basic materials, Japan had established herself as a strong competitor among the major industrial nations. The economies of Korea, North China, Manchuria and Formosa were closely tied into the Japanese economy, while those of the Netherlands Indies, French Indo-China, The Philippines, Burma and India were dependent to a lesser degree. These countries were, and are, the natural sources of a large part of the raw materials required by Japan, as well as the normal outlet for many Japanese manufactured items. But the political tensions and economic instability existing throughout a large part of this area preclude, for the present, the resumption of normal pre-war trade. In consequence, the postwar period has found Japan dependent upon the United States as a source of supply for most of the food and many of the raw materials formerly imported from adjacent areas.

Upon their entry into Japan three years ago, the forces under General MacArthur's command found a shattered nation. The colonial empire with all its riches was lost, the merchant

[6] A note under the title of this report states: "The following summary of United States policy with regard to the economic recovery of Japan, and of progress made to date in the implementation of this program was prepared from official sources by the Reports and Analysis Branch, Civil Affairs Division, Department of the Army. Information contained therein is current as of 15 October 1948 except where otherwise indicated.

fleet all but destroyed, many of the cities, factories and houses had been devastated, food and coal production, and stocks of vital raw materials were inadequate, and industry practically at a standstill. The ruinous effects of defeat and war were re-enforced by the prewar sacrifice of Japan's normal economic development to the military adventures of her rulers.

The Congress of the United States has appropriated funds "For expenses necessary to meet the responsibilities and obligations of the United States in connection with the government or occupation of certain foreign areas, including . . . such minimum supplies for the civilian populations of such areas as may be essential to prevent starvation, disease, or unrest, prejudicial to the objectives sought to be accomplished . . ."* Until June, 1948, the program known as Government and Relief in Occupied Areas (GARIOA) was limited to providing only those commodities essential to the survival of the civilian population, including food (much the largest category), fertilizer and other vital agricultural supplies and medical supplies. In the GARIOA appropriation for the Fiscal Year 1948–49 (Public Law 793, 80th Congress), Congress authorized the expenditure of funds for the economic rehabilitation of Japan.

At the same time, the food situation was materially improved by SCAP-initiated programs for land reclamation, improved agricultural methods, increased production of fertilizers, rehabilitation of the fishing industry, and the equitable distribution of food resources. Japan is, however, still dependent on outside sources for approximately 15% of her food requirements, and, in view of the high birthrate and severe limitations to further expansion of arable land, there is no hope that she can be independent of outside food sources even to maintain a bare subsistence level.

The cost of the GARIOA program for Japan and the Ryukyus totalled $310,911,424 during the fiscal year 1 July 1946–30 June 1947, and, as of 12 August 1948, an estimated $374,054,401 of the GARIOA appropriation for the fiscal year 1947–48 had been obligated. It is estimated that approximately 5% of those figures was assigned to the Ryukyus, and the remainder to Japan.

Under present conditions this burden on the American taxpayer can be relieved only by rehabilitating the Japanese economy to the extent that Japanese exports can pay for essential imports.

United States Objectives

United States policy for the economic rehabilitation of Japan is based upon the following objectives:

1. To assure a firm economic base for the permanent establishment of democratic institutions.
2. To stimulate the economies of all Far Eastern nations and to stimulate trade throughout the area.
3. To eliminate the necessity for continued financial assistance from the United States Government by enabling Japan's economy to become self-supporting.

Foreign Trade: Programs and Progress

Early Developments. The prewar Japanese economy was more closely geared to foreign trade than that of any other country, with the possible exception of Great Britain. The ultimate goal of the Occupation with regard to foreign trade has been the creation of a balanced trade position for Japan and a volume of foreign trade sufficient to bring the Japanese economy to the average 1930–34 level. SCAP early directed the establishment of the Japanese Board of Trade, (*Boeki Cho*), responsible for handling foreign trade activities from the Japanese side, and with a revolving fund to pay Japanese producers for their supplies. SCAP then established a foreign trade account (known also as the "SCAP Trust Fund") to pay for American and foreign goods from the proceeds of the sale of Japanese commodities. Until August, 1947, Japanese trade was conducted on a government-to-government basis.

Private Trade: Exports

On 15 August 1947, Japan was opened to limited private trade. Effective 15 August 1948, private export trade with Japan was liberalized to the extent that Japanese concerns and foreign buyers are permitted to make export contracts directly, without negotiating through the Japanese Board of Trade (Boeki Cho), or any other agency. Such contracts must, however, be approved by Boeki Cho and validated by SCAP.

There follows a summary account of the new export procedures. Persons desiring more detailed information are referred to the Office of International Trade, U.S. Department of

* Public Law 793—80th Congress, Chapter 685-2d Session, National Military Establishment, Department of the Army-Civil Functions.

Commerce, Washington 25, D.C., or to the nearest Department of Commerce Field Office.

1. The buyer and seller make a direct contract for the sale of the export product, which contract is subject to approval by Boeki Cho and validation by SCAP. The price of the commodity must be at least the established minimum price and the contract must be written in terms of acceptable foreign exchange.
2. Critical materials are allocated to the producer on the basis of his approved and validated contract, and under certain circumstances, he may also obtain a loan from a Japanese commercial bank.
3. Contracts require the buyer to establish a letter of credit in favor of the Japanese seller. When the letter of credit is established through a foreign bank in Japan, that bank will advise the seller.
4. Inspection is to be carried out in accordance with the terms of the appropriate contract. Under the standard contract form (JX 10), inspection is the responsibility of the buyer. The Export Commodity Law, now pending, provides for grading and labelling certain export commodities and for minimum standards for other commodities. When this Law goes into effect, the government may make "spot" inspections of export goods in order to enforce compliance with the Export Commodity Law. Prior to the effective date of the Export Commodity Law, the Board of Trade may indicate in its approval of the contract that the commodity to be exported is subject to inspection by the Board of Trade or its designated inspection agency.
5. Under the standard form of contract (JX 10), the buyer or his agent is responsible for making shipping arrangements. If he fails to do so within the time specified in the contract, the seller may make such arrangements at the buyer's expense.
6. After shipment is complete, the Japanese seller draws a foreign exchange bill and presents it, with the shipping documents, to his Japanese bank, which then forwards them to a foreign bank in Japan. The Japanese bank will pay the yen value of the export to the seller when the foreign exchange bill has been negotiated by the foreign bank. The foreign bank then credits the proceeds in foreign exchange to the SCAP commercial account.
7. Settlement of claims is negotiated directly between the Japanese seller and the foreign buyer but the agreement is subject to the approval of Boeki Cho and validation by SCAP.

The prices of Japanese commodities usually are determined on the basis of world market prices. The same U.S. import duties and other regulations apply as apply to commodities imported from other countries, and distribution of Japanese goods within the United States takes place through customary trade channels.

Private Trade: Imports

Due to Japan's economic situation, and lack of foreign exchange, imports into Japan are restricted to items essential to the Japanese economy. Individual producers selling commodities to Japan may be reimbursed from funds originating in the SCAP Foreign Trade Account, or from funds appropriated by Congress for GARIOA. Details follow:

1. *Transactions Involving the Foreign Trade Account:* Reference has been made to the SCAP Foreign Trade Account, or "Trust Fund," based on the proceeds of Japanese exports. Transactions utilizing this account may take place under any one of the three following types of procedures:

a. *Direct Negotiation with SCAP:* SCAP solicits bids for needed commodities on a competitive basis, or negotiates contracts with individual producers directly.

b. *Sale to SCAP Through Department of the Army Procurement Agencies:* When SCAP is unable to procure commodities directly or where prices, the time element, and other factors make it more desirable for the Army to perform this function, Army Procurement Agencies solicit bids or negotiate individual contracts.

c. *Sale by Preliminary Negotiation with Individual Japanese:* U.S. and foreign producers may enter into *preliminary* negotiations with Japanese, but such contracts are subject to approval by Boeki Cho and SCAP validation.

In all three cases, reimbursement is made in appropriate currency (dollars, sterling, etc.) from the SCAP Foreign Trade Account, and commodities are allocated to Japanese industry by agencies of the Japanese Government, under SCAP supervision.

2. *Transactions Involving Appropriated Funds (GARIOA):* By Public Law 793, 80th Congress, funds were appropriated to finance the procurement of such minimum supplies for the civilian population of Occupied Areas as might be essential to prevent starvation, disease, and unrest prejudicial to occupation objectives and such supplies, commodities, equipment and services as might be essential to carry out the purpose of the appropriation. Public Law 793 provided further that expenditures might be made thereunder for economic rehabilitation in

Japan, Korea and the Ryukyus, in such manner as to be consistent with the general objectives of the Economic Cooperation Act of 1948. The procurement of commodities purchased in the United States which are financed by this appropriation is usually effected by Government procurement agencies. Procurements which are made outside the continental limits of the U.S. and financed by this appropriation may be effected by either the Department of the Army or by SCAP on a competitive bid basis or by negotiation. SCAP finances such procurements when the desired commodity is available only in the Far East. The Department of the Army must approve the transfer of funds to SCAP for procurement under these conditions.

Private Trade: Statistical Data: Data concerning private trade contracts executed during the period 1 January through 31 May 1948 are presented below (value figures include the dollar equivalent of contracts executed in sterling):

Private Trade Contracts
1 January—31 May 1948

Type	Number	Value (in dollars)
Import	264	$ 45, 612, 000
Export	2, 655	45, 738, 000

Occupied Japan Export-Import Revolving Fund (OJEIRF).

On the basis of a Far Eastern Commission policy decision in July 1947, SCAP established on Occupied Japan Export-Import Revolving Fund, based upon Japanese-owned precious metals valued at $137,000,000. OJEIRF is used as a means of financing, primarily on a self-liquidating basis, imports of basic raw materials for processing by Japanese export industries. On 14 May 1948, the Department of the Army announced that an agreement providing for a $60,000,000 revolving credit to finance the import into Japan of U.S. cotton had been executed by the Import-Export Bank, the Chase National Bank of the City of New York, the National City Bank of New York and the J. Henry Schroder Banking Corporation. The Bank of America National Trust and Savings Association was also a party to the agreement.

Congressional Appropriations

In addition to the GARIOA appropriation for the fiscal year 1948–49, (Public Law 793) which included the authorization to expend appropriated funds for economic rehabilitation, the 80th Congress, in Public Law 820, approved 29 June 1948, authorized the Secretary of the Army to issue interest-bearing notes from time to time for purchase by the Secretary of the Treasury, not to exceed in the aggregate outstanding at any time $150,000,000. Proceeds of these borrowings are to be used as a revolving fund for purchasing natural fibers produced in the United States, purchasing processing materials, transporting to occupied areas, insuring, processing in occupied areas, selling the resulting product of textiles and yarns, repayment to the Treasury, and disposition of commodities, products and proceeds, in excess of amounts necessary to repay the Treasury, for the benefit of the economies of the interested occupied areas.

It is expected that operations under this Act will begin in the near future.

Commodity Credit Corporation

Over a period of time, surplus American cotton valued at approximately $200,000,000 has been supplied to SCAP by the Commodity Credit Corporation. This cotton was processed and approximately 80% of it exported, largely to those countries in the Far East which were dependent on pre-war Japanese cotton textile exports. Indebtedness to the Commodity Credit Corporation had been reduced to about $37,000,000 at 30 June 1948 and it is expected that this debt will be fully paid, from the proceeds of export sales, by 31 December 1948.

Agreement with Sterling Areas

On 31 May 1948, an over-all sterling payment agreement was executed between Japan and sterling area countries, placing private and government trade on a cash basis in sterling currency subject to periodic settlement of balances.

Statistical Data

The following tables present an over-all picture of Japanese foreign trade during the period 1 January through 31 May 1948:

ESTIMATED VALUE OF JAPANESE FOREIGN TRADE
BY AREAS OF ORIGIN AND DESTINATION
1 January through 31 May 1948
(In U.S. Dollars)

Area of Origin	Value of Imports[1] (CIF Japanese Port)	Value of Exports (FOB Japanese Port)
Total, All Areas	$ 282,648,792	$ 62,911,716
North America—Total	208,609,508	13,722,330
U. S.	*205,044,036*	*13,512,792*
Others	*3,565,472*	*209,538*
Asia—total	35,202,785	40,628,362
Europe—total	6,938,622	6,416,297
South America—total	2,289,473	34,192
Africa—total	1,448,567	1,550,236
Oceania—total	301,087[2]	560,299[2]
Others—total	27,858,750[3]	

ESTIMATED VALUE OF MERCHANDISE IMPORTS[4]
TO JAPAN, BY COMMODITY GROUPS
1 January through 31 May 1948
(In Dollars; CIF JAPANESE PORT)

Commodity Group	Value
Total	$ 282,648,792
Animals and Animal Products	4,968,136
Vegetable Food Products	120,547,016
Grains and Preparations	*51,738,920*
Sugar and Related Products	*33,557,969*
Others	*35,250,127*
Vegetable Products, Inedible[5]	18,888,299
Textile Fibers and Manufactures	87,933,611
Cotton, Unmanufactured	*67,276,384*
Cotton, Other	*1,282,104*
Other Textile Products	*19,375,123*
Nonmetallic Minerals	27,837,423
Metals and Manufactures[6]	4,511,040
Machinery and Vehicles	182,531
Chemicals and Related Products	17,707,237
Miscellaneous Commodities	73,499

[1] Includes estimated value of goods procured with U. S. Government appropriated funds and estimated value of surplus military stocks transferred to Japanese Government.
[2] Imports from Australia and Guam; Exports to Australia.
[3] Imports from Cuba.
[4] Includes estimated value of goods procured with U. S. Government appropriated funds and estimated value of surplus military stocks transferred to Japanese Government.
[5] Includes wood and paper.
[6] Excludes machinery and vehicles.

ESTIMATED VALUE OF MERCHANDISING EXPORTS
FROM JAPAN, BY COMMODITY GROUP
1 January through 31 May 1948
(In Dollars, FOB Japanese Port)

Commodity Group	Value
Total	$ 62,911,716
Animals and Animal Products	5,528,653
Vegetable Products	2,719,760
Textile Fibers and Manufactures	37,332,300
Cotton Manufactures	*21,249,861*
Others	*16,082,439*
Wood and Paper	1,755,595
Nonmetallic Minerals	6,200,242
Metals and Manufactures[1]	3,127,806
Machinery and Vehicles	2,555,903
Chemicals and Related Products	1,647,634
Miscellaneous Commodities	2,043,823

[1] Excludes machinery and vehicles.

[SOURCE: SUITLAND PAPERS, Z 703–45]

9-14 YEN EXCHANGE RATE AND ECONOMIC REHABILITATION PROGRAM

Letter January 5, 1949
To: General William F. Marquat, Chief, ESS
From: Kumakichi Nakashima, President,
Japan Foreign Trade Council, Inc.
Dear General Marquat:

I beg to acknowledge the receipt of your two letters, dated 22, November, 1948, and 11, December, 1948 respectively, of which I am exceedingly appreciative and grateful.

Now we are confronted with a new problem. The latest directive of the Washington Government to implement the nine-point economic rehabilitation program ought to be regarded as intimately related with the recent FEC's decision for a speedy establishment of a single exchange rate. To translate into action the new nine-point economic directive needs considerable courage and determination on the part of the Japanese business, labor and politics, and how the setting of a single exchange rate will be effected is yet to be seen.

What to do about "Yen" should be treated with extreme caution and can be decided only after more general economic policies in preparation are formulated. With the adoption of the single exchange rate, provision will be made for State action to bridge over the economic distress by

(1) Subsidizing, for a certain fixed time, export industries or import traders by making good the losses they are liable to suffer by transitional currents and processes.

(2) Subsidizing those inefficient producers who can hardly stand out a strain of monetary reform, but whose existence is deemed socially and economically indispensable, by means of affording facilities for the supply of such essentials as coal, electricity and transportation at specially reduced charges.

(3) Enforcing exchange control to a reasonable extent.

(4) Making preparation for the State-planned relief of the unemployed and taking positive measures to guard against the danger of the spread of Communism.

But the above would suffice only for pro tem measures, not for a rounded rehabilitation program. First of all, we must understand that inflation in present-day Japan is not inflation in the common sense of the word; it may rightly be termed "an underproduction inflation". Our current economic ills are mainly ascribed to the imponderability of the means of production for the population of the country. Whereas the population sharply rose from 66 million of 1930–34 level to 80 million by May, 1938, the production of both consumers' and producers' goods fell off to only 30.9 and 37 percent of 1936–37 level respectively, by June, 1938.

To meet the steady increase in prices due to the shortage of production versus population, the authorities see no other way but to resort to such fiduciary measures as could very well touch

off the disastrous round of inflationary momentum. It demands our utmost exertion to see that our production means as a whole should be increased and get production going at full blast, the quantitative unevenness of available commodities should be restored, and an efficient interrelation between commodities should be established.

It will take more than just exchange stabilization to change this situation. If the single exchange rate is established for the conduct of a relatively free trade, before some sort of adequate means is taken to prepare the way for the administration of production tonic to our body economic, I fear lest it should drive Japan into a "low-exchange-rate inflation" as had been experienced in Italy and Shanghai. No matter what effort the Government might exert to uphold the official exchange rate thus fixed, the yen's blackmarket value could develop a limitless slowing-down and Japan would be swept by another round of full-fledged inflation. The new system would be difficult to hold, let alone operate.

What, then, do these all add up to? With the humility of a defeated nation, we venture to ask the United States Government that, with a dollar-yen exchange rate fixed and adopted, Japan be granted a minimum "currency stabilization fund" necessary for maintaining the said exchange rate, plus a certain amount of currency credit to be put down to Japan's account against the importation of various essential goods she may need for the modernization of industry and the development of scientific working methods. Five years under this arrangement would see Japan sufficiently independent economically.

When the late Mr. Junnosuke Inouye, then Minister of Finance in the Hamaguchi Cabinet, embarked on the policy of restoring the gold standard, he was reminded by some of his friends that the program can hardly realize its objective, unless care by taken to see that a certain amount of credit be obtained from the United States to cover the inevitable out-flow of gold. To this Mr. Inouye replied in an angry tone that Japan can acquit herself creditably by her own financial strength. But it was not to be so, it was to be otherwise. The gold standard ended in being little more than a name, and its failure could lead us into another disastrous round of industrial chaos which rendered null and void the much hoped-for benefits of the new monetary order.

The implementation of the nine-point economic rehabilitation program is a great venture. It is the building from the bottom up and the only way to lead us out of the wilderness of our political and economic difficulties. The setting of a single exchange rate would help knock our national economy off the dead center upon which it has become stalled, and would confront Japanese industry with the challenge to cut production costs to a point at which profits would be possible at low prices. We should be reconciled ourselves to getting along with very little, and having barely enough to do all that we must do.

I beg to avail myself of this opportunity to submit to you my highest esteem and courtesy, and remain.

Most respectfully yours,
Kumakichi Nakashima,
President, Japan Foreign Trade Council, Inc.
[SOURCE: SUITLAND PAPERS, Z 703–7]

9-15 COMMENTS ON THE EXCHANGE RATE PAPER OF JANUARY 11[7], 1949

Memorandum January (?), 1949
By: Seimour J. Janow, Foreign Trade and Commerce Div. ESS, SCAP

The exchange rate paper, the subject of these comments, is an imaginative and useful report. As the authors are well aware, the conclusions and recommendations of the paper are conditional, contingent upon numerous assumptions as to past data, as to future Japanese governmental action and anticipated international reactions to proposed subsidy methods. It is felt that before the recommendations in the paper can be accepted, there must be re-examination in the following fields:

a. Whether the specific data of prevailing exchange ratios is accurate.

b. Whether data about specific exchange ratios which is subject to time lags and "weighting" problems can be used without supporting general data that will relate Japan's price structure to world price structure.

[7] Exchange Rate Paper of Jan. 11, 1949 is not printed. Janow's after-remark regarding this memorandum can be found in the file written above this document. His remark reads: "Just a 'personal' sounding off—of official status, not the views of FTCD".

c. Whether the method of subsidies proposed can, in fact, be efficiently administered and will be, as is hoped, free of international difficulties.

d. Whether the assumptions about future rationalization of industry to a rate in the 300's and the inflationary aspects of a rate in the 400's are sufficiently supported by data or acceptable arguments.

e. Whether the rigidities that will be associated with the fixing of an exchange rate have been made clear.

f. Whether the necessary position of the Japanese Government in the exchange rate problem has been respected.

a. *Specific data used in this paper.* It is believed that the ratios shown in Table 2 are subject to a substantial lag in time, and are not representative of existing export exchange rates. There are two difficulties in accepting the ratios shown in Table 2; one of which involves what appears to be use of old data (November 1948) in finding existing rates; and the other concerns the matter of the "weights" which have been assigned to achieve the general ratios for individual categories, such as machinery and metals, rubber products, cotton specialties, et cetera.

Compilation of most recent data on this subject is relatively easy and straight-forward. The question of assigning proper "weights" to commodities within the general categories used is far from simple, and it is not believed that this aspect has been accomplished in a satisfactory manner. For example, the categories of machinery and metals appear in this table at 350 yen to the dollar. This is not demonstrated as a properly weighted average figure. For example, within this category are such things as ocean-going ships now being constructed at 550 to one; aluminum sheets, now being manufactured at an approved ratio of 580 to one; iron galvanized steel sheets at a ratio of 410 to one; steel ingots at 350 to one; electric fans at 520; automobiles at 430; electric apparatus at 600; and communication equipment at 310.

A forecast we have made for sales of iron and steel products in the calendar year 1949 would indicate that total value may exceed $250,000,000, assuming that 500,000 tons of steel were allocated for export in 1949. This figure is for sales and not for deliveries. However, it is the sales figure that should be used in this study. Steel products fall into the following major categories: Primary products, secondary products, ships, rolling stock, textile machinery, communication equipment, light machinery, light metal manufacture, enamel ware, miscellaneous machinery, plants, electric machinery, locomotives, industrial machinery, hardware. The category carried on Table 2 of your report consolidates all of the fields we have mentioned, and indicates a single ratio for the entire machinery and metals output. Moreover, it assumes a weight in terms of dollars of $125,000,000; whereas the *sales* anticipated may reach $250,000,000. There is no indication of what weights in yen have been used in arriving at your total average figure. In short, it is not believed that 350 to one is the proper ratio of this total group, or that the $125,000,000 carried for the program is sufficient indication of the value of this category.

It is appreciated that a great deal of uncertainty must surround general summaries of this kind. These comments are made only to establish the degree of uncertainty inherent in a study dealing with a period in the future by using past data which is perhaps now lagging behind current rates, and projecting future effects based on estimates of future sales. At least this study should be corrected to include more recent data, and more recent projections of future sales.

b. *General Data.* It is observed that this study omits all general economic analysis of Japan's price structure relative to world price levels. There is no reference in this paper to Consumer's Price Indices for Japan and the United States and other countries equally related to a common base. There is no reference to Japan's general price indices and wholesale price indices to world or other country indices of the same type; and there is no reference except by implication to the movement in the past three years of Japan's effective Consumer's Price Indices. The absence of these data makes it impossible to estimate whether the rates suggested in the paper would be supported by the general indices mentioned. You are well aware of the inadequacies of the commodity ratios available. General data of this kind here indicated is essential when specific export ratios remain so uncertain.

It is worth reminding the various persons concerned that in January of 1948 an exchange rate of 230 yen to one dollar would have covered all but 11% of the anticipated exports of 1948. There is no reason to believe that the inflation we have known in the past has run its course, and that future price changes will be of a negligible character. The analysis presented in your paper is entirely static, not allowing for lags in the data used or in changes in price levels in the future. It is static also in that it does not relate the rate of change of effective prices in Japan with the rate of world price changes. It is proposed that these general price data be presented as relevant to the decision as to whether the single rate proposed is justified initially

or whether, if established, it can be sustained.

c. *Method of Subsidies.* A subsidy program is obviously going to be necessary but the double study system proposed is certain to be an extremely difficult one to administer, and one which is apt to cause international adverse action. There is good reason to argue that Japanese Government imports of food, iron, coal, salt, or petroleum and other bulk material should be released at prices in consonance with domestic yen costs of production, rather than world price. The Japanese iron and steel industry was, in the past, based on Chinese iron ore and coal carried to Japan in Japanese ships. Similarly, food imports in the past were largely from Asia and Near Sea areas, and also largely carried in Japanese ships.

Rationalization of the Japanese steel industry from 330 to 1, to current world price levels determined by the cost of east coast United States coking coal shipped in American flag vessels to Japan cannot be described as a "necessary" price adjustment. It may be expected that in the future only a few years ahead, raw material supplies and perhaps food will again be largely available in Asia. Rationalization should come after not before this happens. The bulk raw materials may be continued as a Japanese Government import, and the government may release them at prices comparable to domestic production without involving a complicated administrative arrangement, or running risks that this practice can be criticized by foreign governments as an unfair subsidy program.

In the case of raw silk, subsidy payments for mulberry acreage or for cocoons is likewise a practice that will not be subject to criticism. A "support price" device can be used which is not unknown to American agricultural practices.

However, the explicit subsidies for export commodities to cover the difference between the cost of production, existing yen ratios and 330 to 1 is an extremely dangerous device. In the first place, such subsidy payments, to be effective, must be paid at the time of the export takes place; otherwise the payment will lose effectiveness. Japanese governmental payments are invariably slow and delayed. We have improved the situation by having governmental payments made against documents at the time of export, using the Japanese commercial banks for this operation. An effective direct export subsidy program would require this device to be used. In other words, it would be generally known both in Japan and abroad what the export subsidy amounted to. Internally, industries which were not given subsidies such as the ceramics and paper industries would justifiably protest. Chinaware, glassware, leather and rubber products industries were receiving an excess of 350 to 1 more than a year ago; and it can be expected that their cost structure reflects these ratios in a well established and perhaps rigid way. They are certain to resist "rationalization".

It is believed over optimistic to suppose that industry associations in the United States, United Kingdom Philippines, Australia, South Africa, Egypt and others would not object to a specific export subsidy.

An elaborate system of export subsidies will substantially destroy the psychological effects of a single exchange rate. It is suggested that a subsidy system that will be acceptable internationally and most usable internally will be confined to reductions in the cost of production. Far preferable to a system of direct subsidy in price is the fixing of an export rate at a level sufficiently high to cover the major commodities that Japan must export to achieve self support.

d. *The Rejection of a Higher Rate.* Summary of the position taken in these comments is that the data used in the paper does not demonstrate that 83 percent of the dollar value of exports in 1949 can take place at the yen rate of 330 to one. The proper proportion, considering the metals and machinery exports properly weighted and including silk products adjusted to more recent exchange ratios will reduce this figure substantially. The most important commodity which is said can be exported at or below 330 is cotton textiles. It seems inappropriate to allow cotton textiles to have the importance assumed in your paper for the following reasons:

1. The cotton textile industry is already largely "rationalized". This rationalization is the result of the destruction of spindles during the war to a low level. The cotton industry has been revived to a high level of operation *relative to present existing capacity* through the impetous of three specific cotton loan programs; two CCC Loans and the OJERIF Loans. All together more than $250,000,000 has been loaned to Japan specifically for the cotton industry. Such international support has not been given to any other industry in Japan. It is to be expected that the cost structure in cotton textile should be better than average. All projections of balance of payments show a diminishing relative importance of the cotton textile industry and a greater reliance in the future upon machinery, metals and highly fabricated products. Almost all of the exports on which increasing reliance must be placed are in the yen ratios higher than 330 to 1.

2. It has not been conclusively demonstrated that the cotton textile industry can

be profitably conducted over the next year at 330 to 1. The secondary and tertiary effects of price changes caused by the new import exchange rate, and further inflation have not been allowed for as upward influences on costs. Further, the dollar return per unit of textile exports has been assumed as stable while from every indication it appears that world prices of cotton textiles are softening.

For example, if the average return per yard of cotton fabric is 21c now, it is not impossible that a decline of 3 to 4c may be experienced in this year. Such reduction of the order of 20 percent or perhaps larger might mean, taken together with rising cost, that even in the cotton textile industry 330 will not cover costs in 1949. And this is an industry where large capital formation is planned for this year, the repair and replacement of more than 300,000 spindles is the minimal expansion program.

What has been said of the cotton industry applies with greater force to other industries, particularly to machinery and metals. Japan's steel products of the primary and secondary types are now selling at two to three times the prices of similar and perhaps superior products in the United States and the United Kingdom. During the next year it may be necessary to lower dollar and sterling prices of metals and machinery exports. Such reduction in export prices are very likely to be greater than savings resulting from lowered costs of production. The subsidy payments in your paper may have a double insufficiency: They may be low because sales of machinery and metals are underestimated; also, stability in export prices is assumed whereas substantial reductions may in fact take place.

Rationalization as a concept requires demonstration that costs can be reduced, that world market prices, internal costs of labor, materials, financing, have been considered and that stability or deflationary influences can be assumed. It has not been proved that ceramics, silk, rubber manufactures, glassware, optical goods, piece goods, steel products, machinery exports, ships can in time be forced to reduce their costs to the 330 level. There may be no end in sight for subsidy payments at 330.

A higher rate of exchange, say 400 or 430 is rejected as inflationary. This attitude seems somewhat arbitrary. If a higher rate is fixed, a good deal of the profits resulting to lower cost of industries can be recaptured by taxes, particularly in the cotton textile industry where cost figures are well established. It seems desirable to fix a higher rate around which rationalization can take place, and to take measures against inflation by methods of taxes. This higher rate, if properly placed, may permit an exchange rate system *which is without specific export subsidies.*

e. *Rigidities of an Exchange Rate.* The paper proposes to follow the principles of the International Monetary Fund allowing for devaluation of the yen by 10 percent without seeking permission from Washington. This aspect by itself suggests that the rate to be fixed should anticipate the future rather than be based on past and possibly already outmoded data. A year ago an exchange rate of 200 to one might very well have been fixed on the principles proposed in this paper. If the rate fixed is not adequate to meet requirements it will be difficult and perhaps not possible to alter it without long delay.

Most of the people working on this problem are familiar with the losses, inefficiencies and depressions that accompany an overvalued exchange. Once an exchange rate is fixed for Japan it will assume the same rigidity as any rate registered with the International Monetary Fund. This is an argument that a rate should be fixed *at a level which anticipates future circumstances.* All of these factors argue for a rate at 400–450 level.

f. *The Position of the Japanese Government.* The Japanese will regard the fixing of an exchange rate to which they can attribute their economic difficulties as "a permanent occupation". In a subject so intimately connected with the welfare of the economy, it is suggested that the Japanese Government should be requested to make recommendations without prior instruction from the SCAP as to what they should report. A free and undirected expression of opinion should be required from the Japanese as to the exchange rate level and the methods to apply it. The impression is given by the paper that the General Headquarters has already instructed the Japanese Government what it shall report and at what levels the rate may be set. Such procedure is culpable; it will demoralize the Japanese and provide them with a ready excuse for future failures; such instruction denies the Headquarters the benefit of the economic and political reasonings of the nation that must live with the exchange rate. Without a *"free"* expression of Japanese opinion the fixing of a proper exchange rate is not thought desirable.

Note: All of the above is based on the assumption that an exchange rate must be fixed in the near future because of "political reasons." If so, the exchange will be fixed in a condition of relative economic darkness. A far better procedure would be to fix a single import rate at 330 to 1 and then establish a series of firm and very limited export ratios not to exceed eight in number into which all commodities must fit. Then one by one investigate thoroughly the cost structure of the industries in the categories above 330. After six months of such program we would know something about existing yen-dollar ratios, and something about costs of production. At that time it might be possible to find a single exchange rate and establish and administer it with confidence and knowledge.

[SOURCE : SUITLAND PAPERS]

9-16 APPLICATION OF EXCHANGE RATE PROPOSALS

Memorandum (Draft) February 19, 1949
By: W. F. Marquat, Chief, ESS

1. Reference is ESS memorandum, subject: Exchange Rate, dated 15 January 1949. The paragraphs which follow elaborate certain aspects of the application of the recommendations made therein.

2. *Exports.*

a. On the basis of export prices, and with temporary selective subsidies to silk and iron and steel products industries which are recommended herein, it is estimated that 83 percent by dollar value of the export items projected for JFY 1949–50 can move at or below 330–1. Of the remaining 17 percent, it is believed that a considerable portion can reduce yen prices sufficiently under pressure by means of rationalization, elimination of marginal export manufacturers or reduction in profits or handling charges, to move at 330–1.

b. A decline in export volume immediately after the establishment of the rate, therefore, may be expected. However, as necessary adjustment measures are effected, a substantial portion of this decline should be wiped out.

c. No special tax on windfall profits of manufacturers who could export successfully at a lower rate is recommended because:

(1) Considerable administrative difficulties would be involved,
(2) The regular corporate profits taxes should be collected at a comparatively high level of efficiency in view of the relatively public nature of export manufacturers' accounts, and
(3) Such temporary profits can serve a useful purpose in stimulating production and export of low yen cost products.

d. The subsidies of selected products recommended herein are considered essential because otherwise iron and steel products and machinery could sell only at a median rate of about 400–1 and raw silk at a median rate of about 420–1. Without subsidies a major portion of iron and steel and silk export products could not be exported at 330–1. In the case of iron and steel products and machinery temporary subsidies for high yen prices are justified because this is Japan's most important new potential export field, because rationalization will not yet have reached its normal post-war point in most of 1949–50 and because certain facilities, such as shipyards, may have to be reactivated or restored. In the case of raw silk, a temporary subsidy is essential during the period of adjustment of present high cocoon prices to world competitive prices to avoid sharp curtailment of cocoon production. To effect this it is recommended that cocoon prices immediately be removed from the list of prices determined by the agricultural parity index, and instead be allowed to sink to the proper level to sustain raw silk sales in the world market over a 9–12 month period, during which time a gradually decreasing subsidy would be applied to sericulturalists. No silk subsidy is recommended beyond JFY 1949–50.

e. It is estimated that total yen costs of the above two subsidies would amount to about 7.2 billion yen.

f. The export recommendations differ from these of the Young Report in that the Young Report recommended no export subsidies and a rate high enough to move 80 percent of the exports. At current prices, this would lead to a rate of about 420–1 which would be highly inflationary, give great windfall profits to most export manufacturers and probably would eliminate steel ship and certain other machinery exports. Although the Young Report estimated in June 1948 that a 300–1 rate would move 80 percent of the exports, this estimate apparently did not take into account either the official Japanese price revision of July 1948 or the greatly expanded steel and steel products and machinery program for 1949–50.

3. *Imports.*

a. It is recommended that during JFY 1949–50 the only imports whose prices are to

be subsidized down to prevailing domestic levels are those which otherwise would have a drastic upward impact on the cost of living or on the general industrial price structure.

b. Imports recommended for subsidy for cost of living purposes consist of food, fertilizer, raw cotton for domestic consumption, textile materials for the fishing industry and rubber and leather for footwear, with a total subsidy cost of 102.4 billion yen.

c. Imports recommended for subsidy for industrial price purposes are iron and steel raw materials, leather and rubber for industrial and transportation purposes, and asbestos, with a total subsidy cost of 21.1 billion yen.

d. It is recommended that import items with a total value of about $331.5 million in JFY 1949–50 be allowed to move without subsidy. Of this total, import items totalling $291 million in JFY 1949–50 have heretofore been subsidized in concealed fashion by selling them at lower rates than 330–1 in the Japanese domestic market. It is believed that the general economy could absorb the upward yen price adjustments necessitated thereby without major impact.

e. Import subsidies recommended herein are believed justified at this time because a great proportion of these imports:

(1) Are coming from abnormal sources, e.g., food, coking coal, and iron ore, and therefore have abnormally high prices temporarily, and

(2) Are being transported on non-Japanese vessels with relatively high dollar charges. Transportation costs represent two-thirds the cost of coking coal imports, and three-fourths the cost of iron ore imports. With an eventual Japanese merchant marine, these charges should be greatly reduced.

f. The import recommendations herein differ from the Young Report in that the latter proposed subsidizing only food and fertilizer. Each additional import subsidy recommended herein has been considered carefully and it is believed that in each case the advantage gained in price stability far outweighs the burden on the public treasury. Conversely, the the drastic inflationary impact which would result from abrupt termination of these subsidies renders them unavoidable. If, for example, raw cotton for domestic consumption was not subsidized, its price would be raised by 300 percent, thereby requiring a 100 percent increase in domestic textiles and a 15 percent increase in the agricultural parity index and the price of food. If the iron and steel raw materials, i.e., coking coal, iron ore, pig iron, magnesite, magnesium clinker and graphite, were not subsidized, the price of steel ingot would have to be raised by 6,000 yen per ton or 60 percent, with resultant impacts on almost all industrial costs and the general price structure. Similar adverse impacts could be expected if the other subsidized prices were allowed to reach their international levels. Under these conditions the rate could not be maintained. The import subsidies recommended herein are therefore minimal.

4. *Domestic Price Adjustment Funds.*

a. It is recommended that expenditures from the national budget general account for domestic price or rate adjustment purposes in the following categories be eliminated:

(1) Lead, zinc and aluminum should be eliminated from the stabilization band and the prices thereof be permitted to rise to world market levels, thereby eliminating one billion yen requirements.

(2) Industrial wage adjustment subsidies, amounting to 4 billion yen in JFY 1948–49 should be eliminated. These can be compensated for in the coal and metal mining industries by increased production and increased prices of lead and zinc; in the civilian merchant marine by absorption in the general price adjustment appropriation; in electric power by rationalization and improved collection of excess rate fees; and in textiles by the margin afforded by a higher exchange rate than necessary for that industry.

(3) Operating deficits in the rail and communication special accounts which amounted to 33 and 9 billion yen respectively in JFY 1948–49 and would otherwise amount to 56 billion and 14 billion yen respectively in JFY 1949–50, would be eliminated by a 120 percent passanger fare increase and a 25 percent overall communications rate increase, or equivalent adjustments.

b. It is recommended that the price adjustment funds for commodities remaining in the price stabilization band be increased from 69.5 billion yen in JFY 1948–49 to 100 billion yen in JFY 1949–50. This 43 percent increase in total funds is believed necessary to cover a 200 percent programmed increase in the iron and steel program, a 16 percent increase in copper production, and a 35 percent increase in the production of indigenous coal for special industries, (e.g., iron and steel, artificial fertilizer, and soda ash) as well as slight increases in fertilizer and soda ash production. This recommendation entails a substantial reduction in per unit subsidies, which reduction is believed to be made possible by greater utilization of plant capacity and reduction of overhead costs resulting from expanding production.

c. It is recommended that the civil merchant marine and miscellaneous subsidies be tentatively retained at present levels, (11 billion yen and 5 billion yen respectively) pending detailed analyses in those fields.

d. It is recommended that export subsidies be paid out of the domestic price subsidy fund to the amount of 7.2 billion yen. To compensate for this it is recommended that special economic rehabilitation public work projects totalling 7.2 billion yen in JFY 1949–50 be paid for out of the yen counterpart fund established through yen sale of GARIOA and EROA imports.

5. *Budget Position JFY 1949–50.*

a. It is believed that the JFY 1949–50 budget can be balanced in the general account within the existing price structure at a level approximating 600 billion yen (or 775 billion yen if the yen counterpart fund estimated at about 179.5 billion yen is included) as compared with the total 490 billion yen general account budget for JFY 1948–49.

b. On the expenditure side, this budget presumes a program increase in reparations removals and a program decrease in Termination of the War Activities, together with a net decrease in the domestic price adjustment expenditure as indicated in paragraph 4 above. Other major programs are presumed to remain the same, with increases in yen expenditures resulting from the official price increases and wage raises which occurred during JFY 1948–49. The allocation of funds from the national to the local governments is reduced from a projected requirement of 65.4 to 55.4 billion yen and the local governments made financially autonomous to a slightly greater extent by revisions in the real property tax assessments as described below. Stringent governmental economies or a reduction in force in government employees early in the fiscal year may bring about a reduction in expenditures, the magnitude of which cannot be computed at this time.

c. On the revenue side, two new tax measures or their equivalent in revenue yield are recommended: a national gasoline tax yielding 5 billion yen and a substantial increase in local taxes on real properties used for commercial and industrial purposes, yielding about 10 billion yen. No drastic changes in residential rents or taxes are recommended at present because of the drastic adverse effect on consumer living costs and wage rates. In estimating revenue yields throughout, a conservative view has been taken of net increase in tax collection efficiency.

d. It is recommended that additional net government borrowings amounting to 60 billion yen for capital investment purposes be permitted for JFY 1949–50 compared to 179.5 billion yen in JFY 1948–49 and that no requirement that such funds be secured from current revenues be instituted. These funds would be devoted almost entirely to the railway and communications construction accounts and to increased capitalization of the Reconstruction Finance Bank for long range industrial development loans only. No net additional RFB credit should be made available for working capital and no new deficit loans will be permitted. Although net additional special account borrowings would increase note issue, this is not considered inflationary because several times the equivalent amount of goods and services would be produced for the Japanese domestic economy beyond that available in JFY 1948–49, and this excess should almost entirely be channelled into industrial rehabilitation projects of the type to be supported by the government borrowings recommended herein.

6. *Wages and Unemployment JFY 1949–50.*

a. The present recommendations presume that throughout JFY 1949–50 there will be no wage increases of sufficient magnitude to require upsetting official price levels in any significant industry. It is believed that if the three principles of wage stabilization can be rigidly enforced wages can be stabilized to the necessary extent. If this cannot be accomplished, more direct and formal wage controls will probably be necessary. In any event, it is noted that assuming an entirely congealed price-wage structure after its establishment, a 300–1 exchange rate probably could be maintained. A 330–1 rate has been recommended, however, in order to provide a "cushion" and safety factor. This cushion should be able to accommodate moderate wage increases beyond the stabilized level and unjustified by increased production and efficiency, if even formal wage controls do not prove to be completely effective.

b. The requirements for increased rationalization generally and in export industries particularly will probably lead to limited discharges but there appears no reason to anticipate a great wave of mass unemployment from private industry. The industries whose export segments will be forced to reduce costs because of the establishment of a 330–1 rate, namely leather and furs, canned fish and fruits, paper and wood products, chemicals, dyes and drugs, optical goods, handicraft toys, clothing and pottery and glassware, either do not employ large numbers

of workers or are devoted in only minor degree to export production. In many of these cases, rationalization should not take the form of discharge of surplus workers but of conservation of materials and fuels and operating economies. In other cases, particularly in iron and steel, any potential separation of surplus workers should be offset by greatly expanded production. Nevertheless, it will be necessary to absorb numbers of the unemployed produced by progressing industrial rationalization and government economies in FY 1949–50, which would not be directly influenced by the establishment of an exchange rate. For this purpose, the public works program as computed in the first draft budget for JFY 1949–50 has not been reduced from JFY 1948–49. Concomitantly, it will be necessary to revise the nature of the public works program to function more effectively as unemployment relief than heretofore.

7. *Subsidies and International reaction to them.*

a. The present recommendations propose a total of 230 billion yen during JFY 1949–50 as necessary to maintain the exchange rate. This amount consists of 123.5 billion yen in import subsidies, 7.2 billion yen in export subsidies and 100 billion yen in domestic price adjustment funds.

b. Both export and import subsidies can be supported entirely by foreign trade profits, i.e., excess of imports over exports made possible through U.S. financial assistance. It is recommended that this be accomplished through establishment and use of the counterpart fund outlined below. The domestic price adjustment funds can be supported entirely by the national general account budget revenues.

c. Subsidies to make up the losses incurred in sales of GARIOA relief imports at prevailing domestic prices at a cost of 90 billion yen and support of the Japanese iron and steel industry at a cost of about 86 billion yen account for 76 percent of the total subsidy amount. No international criticism is anticipated because of the subsidy involved in holding the price of relief goods to domestic levels inasmuch as UNRRA goods and other U.S. relief supplies have always been disposed of at extremely low prices and Japan's international competitive position is not directly assisted thereby.

d. The subsidy for the iron and steel industry, which is typical of the non-relief subsidies, is recommended herein despite possible criticism because:

(1) Without such subsidies the cost of steel ingot in Japan would be raised by 300 percent. An increase of this magnitude in such a basic material would completely disrupt the stabilization effort and render impossible the maintenance of an exchange rate for months to come while stabilization at far higher price levels is being attempted.

(2) The Japanese iron and steel industry at the present time has to surmount great obstacles which it is presumed will be eventually eliminated. They include: unduly long hauls of iron ore and coking coal from abnormal supply sources, very high dollar transportation charges on both raw material imports and finished product exports because of the absence of a Japanese merchant marine, and low efficiency of production because of low degree of plant capacity utilization.

(3) Japan cannot revive without a going iron and steel industry. Regardless of price considerations, no steel ingot is available for purchase in quantity on the world market, nor is it likely that it will be easily available for years to come. Japan has no choice but to manufacture steel ingot regardless of cost to rehabilitate its industrial plant and transport facilities.

(4) It is not likely that reprisals, such as countervailing duties will be applied against Japan by countries which are importing Japanese iron and steel products, because in almost every case the product is greatly needed in and desired by the importing country, and does not undercut local manufacturers by unduly low prices.

e. The International Trade Organization charter, with which Japan should make every effort to comply permits limited subsidies for both imports and exports where the member nation is temporarily in distressed economic circumstances. As in the case of iron and steel, it is not believed that countries importing desperately needed Japanese products will avail themselves of their ability to apply countervailing duties under the charter and thereby penalize themselves. In the case of cotton textiles, which historically was the prime offender in Japan's overseas dumping policy and thereby primarily responsible for quota restrictions against Japanese exports, no subsidy of any kind is proposed.

f. The subsidies recommended in this JFY 1949–50 program are temporary and represent a considerable net decrease from present partly concealed subsidies as follows:

(1) Import subsidies. Items totalling about $291 million of imports in the JFY 1949–50 program are recommended for removal from subsidy with the establishment of the exchange rate.

(2) Exports. Only silk and selected iron and steel products are recommended for subsidy in JFY 1949–50 through the domestic price adjustment fund. Items totalling 17 percent or $34 million of programmed exports for JFY 1949–50 are recommended for removal from present indirect subsidy with the establishment of an exchange rate.

(3) Domestic price adjustment funds, except those used for export production subsidy indicated in (2) above, are recommended for reduction from 131 billion yen in JFY 1948–49 to 116 billion yen in JFY 1949–50.

8. *Counterpart Fund.* It is recommended that with the establishment of the exchange rate, simultaneously a yen Counterpart Fund be established into which would be deposited the yen proceeds of the sale of imports purchased with U.S. appropriated funds, both GARIOA and EROA. On the basis of estimated sales during JFY 1949–50 of $400 million of GARIOA imports and $130 million EROA imports, the Counterpart Fund revenues would amount to about 175 billion yen. It is recommended that this fund be used as follows:

a. 42.9 billion yen to make up the deficit in the foreign trade commercial yen accounts which would ensue from the segregation of GARIOA and EROA import proceeds. The yen proceeds of the sale of $420 million of commercial imports (imports purchased with export proceeds) would amount to 138.6 billion yen compared to 181.5 billion yen needed for purchase of imports.

b. 102.4 billion yen for subsidizing import prices to stabilize the cost-of-living. (See par 3b above)

c. 21.1 billion yen for subsidizing import prices to stabilize the general industrial price level. (See para 3c above)

d. 7.2 billion yen for selected public works which contribute directly to economic rehabilitation. The equivalent amount saved from the general revenue would be applied to the domestic price adjustment fund for subsidizing the production of selected exports. (See para 2d above)

e. 1.3 billion yen to make a start on reduction of the national debt.

[SOURCE: SUITLAND PAPERS, Z 703–55]

9-17 PRINCIPLES OF COUNTERPART ADMINISTRATION

Memorandum March 21, 1949

By: O. J. McDiarmid, Office of the Financial Adviser, SCAP

It has now been agreed that a counterpart fund will be established by an explicit charge to the General Account of the Budget and that payments will be made by the Japanese Government into the counterpart fund as EROA and GARIOA imports are received in Japan. Such payments should be equivalent to the landed dollar cost of the aid supplies converted at an agreed rate of exchange. Pending the establishment of a general commercial exchange rate, the military-financial rate of 270 yen to the dollar will be used for this purpose. It will be the responsibility of SCAP to notify the Japanese Government regarding the timing and amount of such payments to the counterpart fund.

Regarding releases from this account the following procedure is recommended:

a. Releases should be programmed on a three months' basis. For the first three months of Japanese year 1949–50 an early decision should be made as between use for investment and debt retirement or retention in the fund. In respect to the amount allocated for investment a general breakdown by categories such as railways, communications, shipbuilding, etc., should be made after screening by SCAP of a program submitted by the Japanese Government. If possible, an outline of the counterpart release program in this degree of detail should be submitted to Washington when recommendations are made regarding the exchange rate. A general outline of the Budget should also accompany the exchange rate recommendation. It is not desirable, however, that consideration by Washington of the exchange rate be deferred. If the above-mentioned counterpart program cannot be quickly formulated, the exchange rate recommendation, together with a breakdown of the counterpart program between investment and debt retirement, together with an outline of the budget, should be sufficient information on which to secure approval of the exchange rate recommendation.

b. SCAP should, at all times, retain control over specific releases from the counter-

part fund and release for investment purposes during the first and subsequent periods should be made conditional upon the attainment by the Japanese Government and the Bank of Japan of prior agreed upon performance in the fields of budget and monetary and credit control. Such procedure is entirely in accord with ECA counterpart release policy in France and other ERP countries. A general objective might be to make counterpart releases for debt retirement roughly equivalent to net currency and credit expansion with appropriate adjustments for increases in the level of production. By such a policy maximum stabilization effects could be achieved. In respect to debt retirement choice should be made between the debt held by the Bank of Japan and by the commercial banks according to the loanable funds position of the banks in relation to the legitimate credit needs of the economy.

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY]

9-18 MARQUAT'S RECOMMENDATION ON FOREIGN EXCHANGE RATE

Telegram (Draft) March 22, 1949
To: Dept. of the Army
From: SCAP, approved by W. F. Marquat, Chief, ESS
Secret

1. Recommend approval general foreign exchange rate for Japanese yen of 330 yen to the dollar to be established April 1 or as soon thereafter as deemed practicable here. Rate will apply on permitted foreign trade and exchange transactions including transactions for which military conversion rate now applicable, as basis accounting Occupation Forces official expenditures, payment personal expenditures' occupation personnel and others.

2. Request approval include authorization SCAP adjust initial rate 10% up or down without further consultation.

3. Principal bases this recommendation are:

a. Considered over 80% current value Japanese exports can move at 330 or higher. Remainder would require extensive rationalization or stop exporting. Do not (repeat not) contemplate export subsidies.

b. Rate together with import subsidies which budget can absorb (see Dodge to Voorhees[8] Serial 16) can be introduced without basic disturbance existing price and wage structure that higher yen dollar ratio would require if subsidies not increased beyond budget's capacity to meet.

c. Domestic subsidies (about 100 billion yen) included in present budget provide cushion assist in absorbing effective rate on price and cost structure including exports.

d. Balance achieved consolidated budget including provision for Counterpart Fund (Dodge to Voorhees 15) premised upon 330 to one exchange rate.

4. Since Japanese fiscal year begins 1 April and necessity adjust certain prices conform reduced subsidies included in budget in light of exchange rate consider desirable announce exchange rate that or earliest date thereafter. Early termination general uncertainty prevailing in foreign trade circles also considered essential and introduction exchange rate at time of budget discussion in Diet calculated achieve desirable political results. Information already furnished Washington re outline of budget and Counterpart Fund, ESB white paper and other information originally obtained by Washington agencies will provide basis your consideration this recommendation. If Telecon deemed necessary expedite matter please request.

[SOURCE: SUITLAND PAPERS, Z 703–55]

9-19 PROPOSED SINGLE RATE FOR JAPANESE YEN AND RELATED MEASURES[9]

Memorandum March 25, 1949
To: National Advisory Council
From: National Advisory Council Staff Committee
Top Secret

1. *The Problem*

SCAP has requested authorization to establish a general commercial exchange rate for

[8] Tracy S. Voorhees, Undersecretary of the Army.
[9] National Advisory Council Document No. 807.

the Japanese yen on April 1, 1949, or as soon thereafter as practicable at 330 Japanese yen to 1 U.S. dollar. Discretionary authority is also requested to adjust this rate within a range of 10 percent above or below this rate without further consultation. The request indicates that the rate would apply to permitted foreign trade and exchange transactions including transactions for which the military conversion rate is now applicable, as a basis for accounting for official expenditures of the occupation forces, and for payment of personal expenditures of occupation personnel and others. The request has the concurrence of Mr. Joseph Dodge, Financial Adviser to SCAP.

In connection with the introduction of the proposed rate of exchange, SCAP indicates that no export subsidies are to be applied, but that to maintain domestic price stability and support the proposed rate, it is considered necessary to continue import subsidies, at a reduced rate, on about half the programmed imports for the Japanese fiscal year 1950 (commencing April 1, 1949). 63 percent of the expenditures on subsidies would be on food and fertilizer imports, and the remainder mainly on coking coal, pig iron and iron ore imports.

It is indicated that a yen counterpart fund, based on the dollar cost of United States aid supplied and converted at the general exchange rate will be established.

2. *Background*

On June 28, 1948 the National Advisory Council adopted an action favoring the establishment as soon as administratively possible of a single general exchange rate for the yen applicable to all types of transactions including those for which a military conversion rate would be used. The Council perceived no reason to object to a level between 270 yen and 330 yen per dollar if established within a time limit envisaged in the report of the special mission on yen foreign exchange policy.

The proposal of SCAP to establish a general commercial exchange rate on April 1, 1949 is not accompanied by statistical or other data which would provide an adequate basis for appraisal of the appropriateness of the level now proposed. Such information as is available to constituent agencies of the National Advisory Council concerning economic and budget trends through 1948 would strongly suggest, however, that the rate level proposed for establishment on April 1 overvalues the yen as compared with the range of rates proposed in June 1948 by the special mission on yen foreign exchange policy for introduction as early as August 15 and not later than October 1. There has been a substantial further inflationary development since October 1; although black market prices appear to have become stabilized at a high level, currency inflation continued and wage rates rose by about 20 percent to the end of the year.

The special mission on yen foreign exchange policy recommended that the final rate selected within its suggested range should provide for some cushion to allow for future increases in the domestic price level in Japan. The rate now proposed for introduction on April 1, 1949 would not appear to provide any significant margin against further domestic price increases.

SCAP estimates that on the basis of December prices, roughly 80 percent by value of the Japanese exports programmed for the fiscal year commencing April 1, 1949 can move at the proposed rate provided specified adjustments are made. Producers of the remaining 20 percent of programmed exports would be required to reduce costs and profits to enable them to export at this level. Very considerable and rapid adjustments in unit production costs of export commodities would appear to be required if Japanese exports are to be sustained and increased in accordance with present plans.

SCAP argues that an exchange rate for the yen higher than 330 to the dollar either will disturb the existing price and wage structure or, if offset by increased subsidies, will unbalance the Government's budget which is now expected to be held in balance during the coming fiscal year. However, the degree of subsidization proposed for imported food (in order to equalize its price with domestic food prices) is such that a 10 percent depreciation of the exchange rate, if not offset by increased subsidies, would raise the yen sale price of imported food only by 62/3 percent. In view of the wide differences which now exist between black market and official prices, there would appear to be no serious difficulty in allowing official prices for imported food to rise slightly above official prices for the domestically produced equivalents.

3. *Local Current Counterpart Fund*

While the SCAP proposal indicates that it is planned to establish a local currency counterpart fund equivalent to the value of United States aid based on the dollar cost of such aid converted at the exchange rate to be established, information now available in Washington does not adequately show how the fund would be administered. Accordingly, this aspect of SCAP's proposal is not presented for Council consideration at this time.

4. *Discussion*

The establishment of a single general rate of exchange for the yen applicable to permitted

foreign trade and exchange transactions including transactions for which the military conversion rate is now applicable, as a basis for accounting for official expenditures of the occupation forces, and for payment of personal expenditures of occupation personnel and others is a stated objective of United States Government foreign financial policy. While the available evidence may suggest that the level of the single rate proposed may overvalue the yen to a degree which would require subsequent modification in the interest of achieving SCAP's foreign trade objectives, it appears that this rate may permit the achievement of planned export volume for the Japanese fiscal year 1950 if present plans to achieve economic and financial stabilization in Japan are successful. However, on the basis of available information, there would appear to be no grounds for objection if, upon review, SCAP were to determine that the rate initially to be set should be on the order of 10 percent higher than that proposed. Such a review by SCAP might well include consideration of the desirability, in case a higher rate were adopted, of holding import subsidies at the figures now proposed.

SCAP has requested that approval of the proposed rate level include discretionary authorization to adjust the initial rate 10 percent up or down without further consultation. In view of the great importance of Japanese exchange rates in world trade, the Department of State is strongly of the opinion that provision should be made for review by the National Advisory Council of the circumstances giving rise to any future changes in the rate.

5. *Action*

The Staff Committee submits the following action for the consideration of the Council:

The National Advisory Council advises the Departments of State and the Army that:

(a) Establishment of a single general exchange rate for the yen applicable to permitted foreign trade and exchange transactions including transactions for which the military conversion rate is now applicable, as a basis for accounting for official expenditures of the occupation forces, and for payment of personal expenditures of occupation personnel and others, is appropriate and consistent with the foreign financial policy of the United States.

(b) The Council perceives no reason to object to the establishment of a rate between 330 yen and 360 yen inclusive per dollar on April 1, 1949 or as soon thereafter as may be practicable. The establishment of this rate should be undertaken on April 1, 1949 or as soon thereafter as may be practicable. The Council is prepared to accept SCAP's recommendation that the rate be fixed at 330 yen per dollar; however, it strongly recommends that consideration be given to fixing a rate up to 360 yen per dollar.

(c) Any proposed changes in the rate subsequent to its initial establishment [exceeding 10 percent above or below the rate initially established] should be referred to the Council for consideration.

[SOURCE: U.S. TREASURY DEPT. Z 732-1]

9-20 PROPOSED SINGLE RATE OF EXCHANGE FOR JAPANESE YEN AND RELATED MEASURES[10]

Meeting No. 122 March 29, 1949
Top Secret
Action: The following action was taken:

The National Advisory Council advises the Departments of State and the Army that:

(a) Establishment of a single general exchange rate for the yen applicable to permitted foreign trade and exchange transactions for which the military conversion rate is now applicable, as a basis for accounting for official expenditures of the occupation forces, and payment of personal expenditures of occupation personnel and others, is appropriate and consistent with the foreign financial policy of the United States.

(b) The establishment of this rate should be undertaken on April 1, 1949 or as soon thereafter as may be practicable. The Council is prepared to accept SCAP's recommendation that the rate be fixed at 330 yen per dollar; however, it strongly recommends that consideration be given to fixing a rate up to 360 yen per dollar.

(c) Any proposed changes in the rate subsequent to its initial establishment should be referred to the Council for consideration. However, the Council would give prompt consideration to any changes in the rate proposed by SCAP.

[SOURCE: U.S. TREASURY DEPT. Z 732-1]

[10] National Advisory Council Document No. 88 (Action No. 321).

9-21 DODGE'S TELEGRAM ON FOREIGN EXCHANGE RATE

Memorandum (Telegram—W846348) March 30, 1949
By: J. M. Dodge, Financial Advisor, SCAP

In discussing the exchange rate problem and the Washington cable with respect to it our group considered the following:

1. It was assumed that the pressure for the 360 rate instead of the 330 rate was largely predicated on the need to provide real incentives for maintaining and increasing exports from indigenous resources and in so doing create greater pressure on internal consumption. This principle is subject to the following qualifying problems.

2. The analyses available indicate that the 330 rate does provide some additional incentives for between 60 and 70% of export items as present world prices. Notable exceptions are certain finished steel products, ships, silk and ceramics. At the 330 rate substantial additional incentives are provided for some exports now able to move at a much lower rate though this will be partially offset by higher raw material costs resulting from the new single import rate. A high rate does not add incentives for rationalization in industries now exporting at a rate much lower than 330. To provide suitable incentives for exports requiring a range above 330 would mean the establishment of a much higher rate. However the statistical data underlying these conclusions are neither current nor reliable. Calculations are based on costs which included both direct and hidden subsidies which it has been agreed can be removed.

3. Most exports are predicated on contracts with considerable time to run which prohibits the new rate affecting exports immediately.

4. In establishing the present budget we have pressed for every possible modification of views from every section of ESS which has a direct responsibility relating to the economic and financial program. We have accepted the finally obtained views beyond which they are unwilling to go and agree the general price level (and the necessary subsidies relating thereto) could be maintained.

5. All of the accounting computations in the present budget new before the Diet were predicated on the maximum concessions obtainable in view of an anticipated approximate 330 rate. These accounting computations are extensive and require weeks of time. The creation, passage by the Diet, and control of the new Budget is a prerequisite of a stable and effective exchange rate. The actual passage and implementation of the Budget is not yet assured.

6. It should also be realized that the new budget, its terms and composition is in itself a major change in the approach to existing financial and economic problems and the full effects of the changes in the budget will not be apparent until sometime in the future.

7. In predicating the budget on these revisions and adjustments of views pertaining to individual elements affected by the budget our conclusions were based on a program which included an immediate elimination of export subsidies, an immediate reduction in import subsidies and a further progressive and actual reduction of import subsidies accompanied by a highly intensified production and export allocation and control program.

8. It is believed that because of the present large gap between many of the actual rates used in figuring imports and many of the actual rates used in figuring exports that the elimination of export subsidies and the pressure created by a progressive reduction of import subsidies would effectively force these rates closer together.

9. Rationalization can be forced by progressive reduction of import subsidies under a 330 rate but at the same time there can be a loss of possible exports resulting from the possible stimulation of indigenous exports by a higher rate.

However, if at this time we were to take a higher export rate it would make the reduction of import subsidies much more difficult. It probably would load to a demand for greater import subsidies to avoid marked increased in the price level and the wage and labor problems possibly resulting from this.

10. The issue was between accepting a higher rate primarily to stimulate exports and at the same time accepting increases in the price level (or import subsidies) with the possibility of some serious internal repercussions resulting from a higher price level or to stablize at approximately the present price level, rationalize by de-subsidization, and program increased exports by improved methods of raw materials allocation which will result in export and products.

11. We concluded that unless the SCAP organization could agree to and work out a progressive and substantial reduction in import and other subsidies which will effectively eliminate

them over the period of the next 12 or 24 months and an effective program which will achieve greater exports by allocation of raw materials which will produce export and products which in turn can be profitably exported at the 330 rate either a higher rate must be established at once or later.

Little real progress has been made on this. There has been some agreement in principle but implementation to the end of effective results is not either easily or quickly accomplished.

12. It is possible that there should be a period of demonstration of adequate administration of the budget and measurement of the effects of the new budget plus the establishment and implementation of an effective program of subsidy reduction and allocations to measure the extent of stabilization before the establishment of a much higher exchange rate. There is no way to tell now the repercussions of the stabilization moves already instituted.

13. Domestic price band subsidies on such items as coal and primary iron and steel products enter directly or indirectly into the cost of production of practically all Japanese exports. These subsidies now amount to from 100% to 300% of consumer prices for these materials. To remove these subsidies without increases in costs of end item export products assumes a degree of rationalization which is very optimistic for the near-term future. This together with the fact that world prices are declining for many of these exports makes it extremely doubtful that these price band subsidies can be substantially eliminated at the 330 level without reduction of export volume and diversion into the domestic market of products that would otherwise be exported. A 360 rate would make it easier to reduce price band subsidies. As for import subsidies these on food and fertiliser might have to be increased at the 360 level to maintain present official consumer prices. Since the import subsidies on iron and steel and the industrial raw materials are in a class with the price band subsidies discussed above, no reason is seen why they should be increased but might rather be decreased if a rate of 360 were adopted.

14. The assumption that 330 is an 80% bulk line rate for Japanese exports is based on the following premises:

(a) Raw material imports continue on a highly subsidized basis.
(b) Continuance of price band subsidies of 115 billion yen.
(c) Maintenance of world prices relative to Japanese prices.
(d) Export subsidies are paid on raw silk and shipbuilding.

Assumption (a) will be at least partly invalidated when a 330 import rate is introduced. Assumption (c) seems to be invalidated by recent export experience of Japan and (d) by the elimination of export subsidies. If a program for rapid progressive reduction of price band subsidies is to be carried out, particularly within such industries as coal and pig iron where the opportunities for rationalization are limited, some increases in export prices appear inevitable and 330 will not continue to move 80% of Japanese exports.

15. It is contended that domestic band subsidies can not be substantially eliminated without resulting in some rather large price increases and this suggests that the prospect of holding the wage line is not at all certain. It is also not certain that the 330 rate would move 80 per cent of the exports after the 330 import rate has actually been introduced. The Textile Division has indicated that silk and woolens would find great difficulty in adjusting to the 330 rate over any near future period. Falling world prices and possibly devaluation of other currencies suggest a higher rate as also the need for invisible exports and foreign investment. A too low exchange rate would lead to a diversion of export goods into the domestic market when the objective is a diversion of domestic market goods to export. Obviously exports can be stimulated more effectively and more rapidly by the natural force created by the establishment of a rate which will promote this effect than by mere program.

16. Inasmuch as all the accounting computations in preparing present Budget now before Diet have been predicated on 330 rate it has been considered advisable to defer announcement of actual rate until after passage of Budget.

Any immediate change in rate would mean recomputation of budget before passage and consequent delay. Any later change will also require recomputation but the budget adjustment for this purpose can be predicated solely on accounting requirements and avoid the political complications of moment connected with passage of budget.

The Japanese Government has instituted internal price adjustment on imports to 330 rate effective 1 April thus making any further rate change a relatively minor adjustment and protecting the counterpart fund from serious loss because of failure to institute rate 1 April.

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY]

9-22 YEN COUNTERPART OF GARIOA[11] AND EROA[12] IMPORTS (SCAPIN-1988)

Memorandum April 1, 1949
SCAPIN 1988 (ESS/EX)

1. The Japanese Government will establish as of 1 April 1949 a special account in the Bank of Japan in the name of the Japanese Government to be designated the U.S. Aid Counterpart Fund for Japanese Stabilization (hereinafter called the Fund) and will make deposits in Japanese yen in this account in amounts commensurate with the dollar cost to the Government of the United States of America aid (including any cost of processing, storing, transporting or other services incident thereto) furnished Japan by the United States.

2. The Supreme Commander for the Allied Powers will from time to time notify the Japanese Government of the dollar cost of the United States aid and the Japanese Government will thereupon deposit in the Fund a commensurate amount of yen computed at a rate or exchange which will be indicated to the Japanese Government by the Supreme Commander.

3. The Japanese Goverment will be permitted to draw from the Fund only such amounts and only for such purposes as may be approved by the Supreme Commander.

4. The Japanese Government will be required to submit to the Supreme Commander separate and specific proposals for any desired use of the Fund. In preparing these proposals the Japanese Government will take into account the imperative need for promoting and maintaining internal monetary and financial stability, for stimulating exports and for carrying out the other objectives set forth in the letter of 19 December 1948 from the Supreme Commander to the Prime Minister. To these ends the above mentioned proposals will take due cognizance of the need for effective retirement of the national debt, especially debt held by the Bank of Japan and other banking institutions and will coordinate such action with the legitimate needs of private and public enterprise for capital and credit. Such expenditures as the Japanese Government may be permitted to make from the Fund will not, in general, replace funds otherwise available from the normal revenues of the Government, savings of the Japanese people or from existing sources of credit. Whenever practicable, releases from the Fund will be repayable to the Fund in accordance with clearly defined interests and amortization schedules. However, this principle will not preclude approval of other categories of releases which will better contribute to the stabilization and export capacity of Japan.

5. In authorizing limiting or disallowing applications for releases from the Fund, cognizance will be taken of the attainment by the Japanese Government, the Bank of Japan, and other financial institutions of prior established goals in the fields of budget, monetary and credit control. Furthermore, proposals by the Japanese Government to advance counterpart funds for private and public investment programs will be considered in the light of achievement by the proposed recipients of specific programs of rationalization and economic stabilization.

6. Direct communication between Economic and Scientific Section, General Headquarters, Supreme Commander for the Allied Powers and appropriate agencies of the Japanese Government within the scope of this memorandum is authorized.

9-23 ECA'S REPORT ON LOCAL CURRENCY COUNTERPART FUNDS

Report May 31, 1949
Prepared by: Division of Statistics and Reports and Fiscal and Trade Policy Division, Economic Cooperation Administration

TABLE OF CONTENTS

FOREWORD
SUMMARY—CURRENT ACTIVITY
COUNTERPART FUNDS—P.L. 472
PROGRAM APPROVALS AND WITHDRAWALS
STATUS OF 5% FUNDS

[11] Government and Relief in Occupied Areas.
[12] Economic Rehabilitation in Occupied Areas.

COUNTRY SUMMARIES

France
Italy
Greece
United Kingdom
Norway
Austria
Bizone
Trieste
Denmark

FOREWORD

Under the Economic Cooperation Act of 1948, and pursuant to the provisions of the agreements entered into between the United States and certain European countries participating in the European Recovery Program, each participant receiving assistance in the form of grants has assumed an obligation to deposit in a Special Account amounts of its local currency commensurate with the amount of the basic dollar grants. In addition, participating countries deposit local currency in the Special Account to match the amount of drawing rights on other participating countries which they exercise under the Agreement for Intra-European Payments and Compensation of October 16, 1948. There is no requirement for the deposit of local currency against assistance rendered in the form of loans or conditional aid.

These local currency counterpart funds are divided into two portions: not less than 5% is allocated to the uses of the United States within the country, and the remaining 95% is to be utilized within the country as agreed between the government of the country and the Administrator.

The general purposes for which the 95% portion is to be used include the monetary and financial stabilization of the participating country, the stimulation of productive activity within the country, and the exploration for and development of new sources of wealth. In addition, expenditures of this portion may be made for other purposes consistent with the Economic Cooperation Act.

In general, proposals for the expenditure of the 95% portion of the counterpart deposits are first formulated by the participating government and discussed with the special ECA mission in the country. The recommendations of the mission are reviewed by the Office of the Special Representative and by ECA in Washington. The latter office formulates a final recommendation after discussion with other appropriate agencies of the U.S. Government, usually including the State Department, Treasury Department and the Commerce Department, and on policy matters requests the advice of the National Advisory Council on International Monetary and Financial Problems and the ECA Public Advisory Board.

With respect to broad programs of utilization extending over a considerable period of time, approval is usually given in principle only. As various segments of the program are finalized, they are presented with a request for approval of the actual withdrawal of funds. Where broad programs covering a considerable period of time are approved in principle, the amount so approved will generally exceed the amount actually deposited to date. Future deposits will be made in amounts necessary to meet the withdrawals under the program.

The internal monetary and financial situation in a participating country is a basic factor in the determination of the purposes for which counterpart funds should be expended, or the extent to which they should be withheld from expenditure. Appropriate management of the local currency funds can help to establish the internal financial stability which is a prerequisite to the accomplishment of the aims of the ERP.

Subject to this basic factor, utilization of local currency counterpart funds is directed toward the stimulation of productive activity and the exploration for, and development of, new sources of wealth in order to achieve the maximum recovery in the participating country. In some countries the lack of private capital available through investment channels for increasing the productive capacity of industry and agriculture makes especially desirable the use of counterpart funds for that purpose.

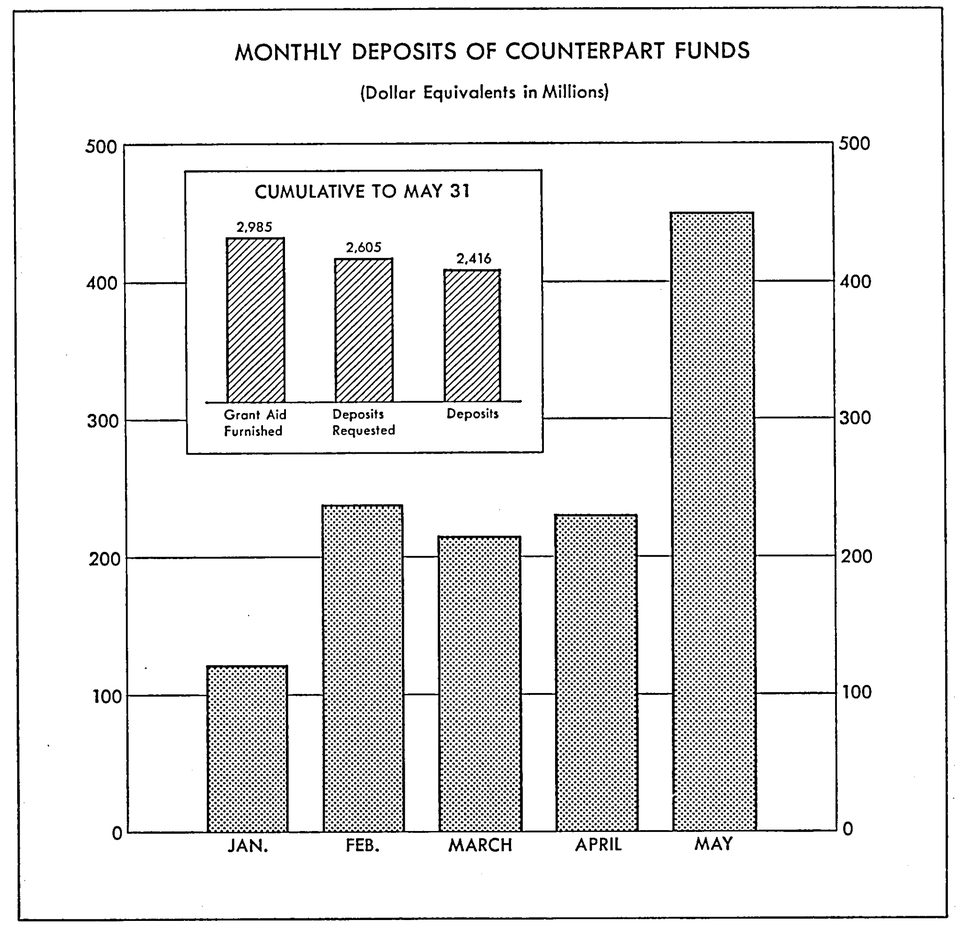
Under the Economic Cooperation Act (PL 472, 80th Congress) ECA is also responsible for approving the utilization of the unencumbered portions of any deposits of local currencies made by participating countries pursuant to the provisions of the Foreign Relief Program of 1947 (PL 84, 80th Congress) and the provisions of the Foreign Aid Act of 1947 (PL 389, 80th Congress). The procedure used in approving releases of these funds is the same as that used for the release of funds deposited under the provisions of the Economic Cooperation Act.

It is the policy of ECA that the five percent share of counterpart deposits allotted to the uses of the U.S. Government shall be withdrawn promptly as it accumulates and placed in a separate account. These funds are to be used to pay the administrative and other operating expenses of ECA within the participating country and to purchase, or develop the production of, scarce materials. Insofar as it may be determined that the funds in this 5 percent portion are not required for these purposes, ECA will arrange to release the surplus to the U.S. Treasury; no such releases had been made up to May 31, 1949.

SUMMARY—CURRENT ACTIVITY

Deposits—P.L.—472

Counterpart fund activity in May was highlighted by a sharp increase in participating country deposits in the special counterpart accounts. As shown in Chart 1, the equivalent of $452 million was deposited in May, more than the combined total for the two previous months.



For the fourteen month period ended May 31, grant aid furnished, requiring local currency deposits, amounted to $2,985 million. The participating country governments had been formally requested to deposit the local currency equivalents of $2,605 million, with actual deposits through the end of May totaling the equivalent of $2,416 million, or 93 percent of the amounts requested.

May deposits were substantially higher than those of the previous month largely because of the deposit of £30,700,000 ($124 million) by the United Kingdom, which had made no deposits in April. France contributed to the rise with franc deposits of the equivalent of $124 million, as contrasted to $94 million in the previous month. Deposits by Italy and the Bizone

were also substantially above the level of previous months.

The monthly deposits by four of the larger recipients of ECA assistance are shown in the following table.

(*dollar equivalents in millions*)

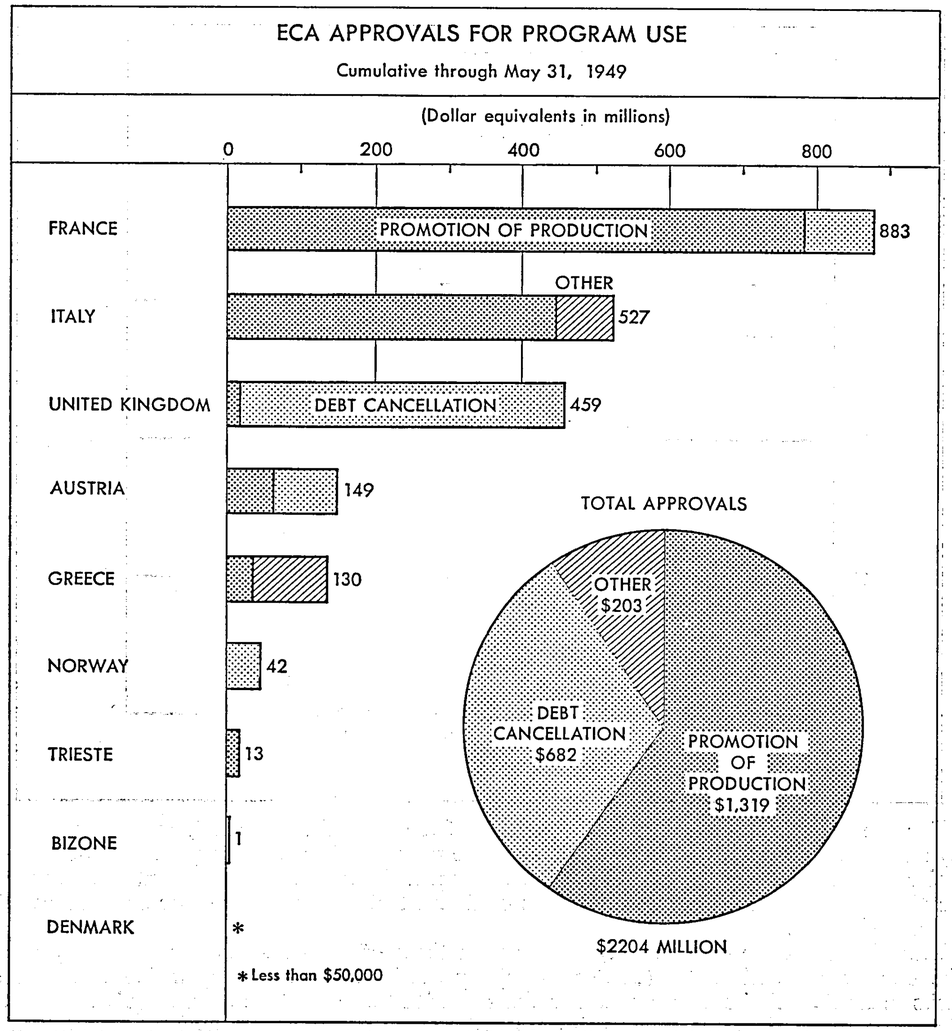
	Total	*France*	*U.K.*	*Italy*	*Bizone*	*Other*
Jan.	120	42	22	—	23	33
Feb.	239	53	75	8	27	76
Mar.	215	79	26	47	—	63
Apr.	232	94	—	15	33	90
May	452	124	124	56	53	95

Three countries, for which no counterpart has yet been released, had made deposits through May 31 as follows:

Belgium — 131,482,500 francs
French Zone — 108,000,000 Deutsche Marks
Netherlands — 345,609,058 guilders

Approvals for Program Use

The amount of counterpart funds which ECA approved for program use totaled the equivalent of $122 million in May, substantially below the April figure of $257 million.



France was authorized to withdraw another 25 billion francs ($92 million at the present rate) in May under the program submitted by the French Government in March, and discussed in the preceeding issue of this report. Of the 238 billion franc program, ECA had approved the withdrawal of 75 billion francs through the end of May.

Apart from the French release, the only May approval for program use was 300 million schillings ($30 million) for Austria. The Austrian Government submitted to ECA a program for the use of 361 million schillings, utilizing 300 million schillings of ECA counterpart funds and 61 million schillings of non-ECA counterpart. Half of the funds will be used to meet extraordinary expenses of the Austrian Government, covering the following items:

	Millions of Schillings
Federal railways	145
Postal and telegraph systems	29
Federal forests	4
Federal printing office	2
	180

The remaining 181 million schillings will be used to provide Government loans to industry, primarily to the electric power and coal mining industries.

Through the end of May, the participating countries and ECA had agreed on the proposed use of $2.2 billion of local currency counterpart funds. About 60 percent of the total is being used to promote industrial and agricultural production, particularly through expenditures on transportation and power facilities, and through expansion of raw material output.

Retirement and cancellation of government debt accounted for another 30 percent of the total funds approved for country use. The remaining 10 percent was allocated mainly to Greece and Italy for public housing construction and care of refugees.

Withdrawals

The equivalent of $165 million was withdrawn from the counterpart accounts by the participating countries in May, as compared to $227 million in the previous month. France and Austria withdrew the full amounts authorized during the month, with Norway and Greece each withdrawing the equivalent of $20 million under previous authorizations. Through the end of May, the equivalent of $1,683 million bad been withdrawn for country use.

U.S. Portion

As a result of the large deposits during the month, the 5 percent portion available for use by the U.S. increased by the equivalent of $23 million in May. The U.S. portion of counterpart deposits amounted to $121 million equivalent through May 31. ECA had made commitments against this amount equivalent to $56 million, primarily for purchases of strategic materials.

Counterpart Funds P.L. 472

STATUS OF EUROPEAN LOCAL CURRENCY COUNTERPART ACCOUNTS UNDER THE FOREIGN ASSISTANCE ACT OF 1948—PUBLIC LAW 472 AS OF MAY 31, 1949

(Dollar equivalents of the local currency, in millions of dollars)

COUNTRIES RECEIVING GRANTS	GRANT AID FURNISHED	DEPOSITS REQUESTED	TOTAL AMOUNT DEPOSITED	95% OF DEPOSITS FOR USE BY RECIPIENT COUNTRIES				5% FOR USE BY U.S.			TOTAL BALANCES ON DEPOSIT
				95% OF DEPOSITS	APPROVED FOR PROGRAM USE	WITHDRAWALS	BALANCES ON DEPOSIT	5% OF DEPOSITS	TRANSFERRED TO U.S. ACCOUNT	BALANCES ON DEPOSIT	
TOTAL	$ 2,985.0	$ 2,604.8	$ 2,416.3	$ 2,295.5	$ 1,690.8	$ 1,213.3	$ 1,082.2	$ 120.8	$ 39.0	$ 81.8	$ 1,164.0
France[a]	900.5	826.7	758.5	720.6	570.5	570.5	150.1	37.9	4.1	33.8	183.9
United Kingdom	722.4	608.1	608.1	577.7	459.2	457.5	120.2	30.4	18.1	12.3	132.5
Italy	298.9	257.5	234.5	222.8	434.8	—	222.8	11.7	11.7	—	222.8
Austria	252.1	218.5	207.5	197.1	40.0	40.0	157.1	10.4	1.2	9.2	166.3
Bizone[b]	244.9	237.1	188.7	179.3	1.1	1.1	178.2	9.4	.4	9.0	187.2
Netherlands	206.0	159.5	130.3	123.8	—	—	123.8	6.5	.9	5.6	129.4
Greece[a]	147.9	121.9	116.9	111.0	130.0	92.9	18.1	5.9	2.0	3.9	22.0
French Zone[b]	71.9	58.9	54.0	51.3	—	—	51.3	2.7	.1	2.6	53.9
Norway	70.1	57.0	57.0	54.1	42.3	42.3	11.8	2.9	.1	2.8	14.6
Denmark	58.7	48.2	48.2	45.8	*	*	45.8	2.4	.2	2.2	48.0
Trieste[c]	8.6	8.4	9.6	9.1	12.9	9.0	.1	.5	.1	.4	.5
Belgium	3.0	3.0	3.0	2.9	—	—	2.9	.1	.1	—	2.9

NOTE: "Dollar equivalents" are computed at the actual rates which were used by the respective Governments in agreement with the Administrator in making commensurate deposits of local currency.

* Less than $50,000.

[a] Exclusive of P.L. 84 and P.L. 389 deposits.

[b] Exclusive of temporary deposits required to match conditional aid.

[c] Inclusive of $1.2 million advance deposit.

Program Approvals and Withdrawals

ECA APPROVALS FOR USE OF EUROPEAN COUNTERPART FUNDS AND ACTUAL WITHDRAWALS CUMULATIVE THRU MAY 31, 1949

(Dollar equivalents of the local currency, in millions of dollars)

PURPOSE	TOTAL		PUBLIC LAW 472		PUBLIC LAWS 84 AND 389	
	APPROVED FOR PROGRAM USE	WITHDRAWALS	APPROVED FOR PROGRAM USE	WITHDRAWALS	APPROVED FOR PROGRAM USE	WITHDRAWALS
TOTAL	$ 2,203.9	$ 1,682.9	$ 1,690.8	$ 1,213.3	$ 513.1	$ 469.6
MONETARY AND FINANCIAL STABILIZATION	682.1	682.1	609.6	609.6	72.5	72.5
Debt Cancellation	*682.1*	*682.1*	*609.6*	*609.6*	*72.5*	*72.5*
PROMOTION OF PRODUCTION	1,319.1	929.4	884.6	536.7	434.5	392.7
Raw Materials Extraction	289.3	132.5	218.2	96.2	71.1	36.3
Agriculture, incl. land reclamation and irrigation	*171.9*	*15.3*	*135.0*	*13.2*	*36.9*	*2.1*
Forestry	*1.3*	*1.1*	*1.2*	*1.0*	*.1*	*.1*
Coal Mining	*116.0*	*116.0*	*82.0*	*82.0*	*34.0*	*34.0*
Other Mining and Quarrying	*.1*	*.1*	..	..	*.1*	*.1*
Manufacturing	24.8	24.8	3.4	3.4	21.4	21.4
Primary Metals	*4.9*	*4.9*	..	..	*4.9*	*4.9*
Stone, Clay and Glass Products	*.9*	*.9*	..	..	*.9*	*.9*
Fertilizer	*1.4*	*1.4*	..	..	*1.4*	*1.4*
Chemicals and Allied Products	*.7*	*.7*	..	..	*.7*	*.7*
Petroleum and Coal Products	*10.4*	*10.4*	*2.7*	*2.7*	*7.7*	*7.7*
Machinery	*5.0*	*5.0*	..	..	*5.0*	*5.0*
Miscellaneous Manufactures	*1.5*	*1.5*	*.7*	*.7*	*.8*	*.8*
Transportation, Communication and Utilities	750.0	579.1	413.9	250.0	336.1	329.1
Railroads	*339.5*	*217.8*	*210.2*	*88.5*	*129.3*	*129.3*
Waterways and Harbors	*14.0*	*5.1*	*9.6*	*.7*	*4.4*	*4.4*
Merchant and Fishing Fleet	*70.5*	*37.4*	*40.8*	*14.7*	*29.7*	*22.7*
Roads and Misc. Transporation Facilities	*10.3*	*3.1*	*9.7*	*2.5*	*.6*	*.6*
Communication Facilities	*8.1*	*8.1*	*2.9*	*2.9*	*5.2*	*5.2*
Electric, Gas Light and Power Facilities	*304.2*	*304.2*	*137.3*	*137.3*	*166.9*	*166.9*
Water Systems	*3.4*	*3.4*	*3.4*	*3.4*	..	..
Exploration and Development of New Sources of Wealth Strategic Materials	39.1	39.0	39.1	39.0	..	..
Technical Assistance	2.7	.2	2.7	.2	..	..
Loans to Industry (not elsewhere classified)	14.7	14.7	14.7	14.7	..	..
Undistributed Promotion of Production	198.5	139.1	192.6	133.2	5.9	5.9

OTHER PURPOSES	202.7	71.4	196.6	67.0	6.1	4.4
Construction of Public Buildings & Housing Facilities	34.1	25.0	29.7	20.6	4.4	4.4
Housing	*27.0*	*18.3*	*27.0*	*18.3*	..	..
Public Buildings	*7.1*	*6.7*	*2.7*	*2.3*	*4.4*	*4.4*
Special Relief Projects	66.3	44.3	64.6	44.3	1.7	..
Health and Sanitation	*14.5*	*1.4*	*14.5*	*1.4*	..	..
Care of Refugees	*46.7*	*39.5*	*46.7*	*39.5*	..	..
Miscellaneous Social Services	*3.7*	*2.0*	*2.0*	*2.0*	*1.7*	..
Transportation of Relief Packages	*1.4*	*1.4*	*1.4*	*1.4*	..	..
Tourism	14.3	.3	14.3	.3	..	..
Loan Capital (act elsewhere classified)	20.0	..	20.0	..	..	..
Undistributed Other Purposes	68.0	1.8	68.0	1.8[1]	..	..

NOTE: Dollar equivalents are computed at the actual rates which were used by the respective Governments in agreement with the Administrator in making commensurate deposits of local currency.

[1] Including temporary advance accounts in Greece of $1.8 million in dollar equivalents (not reflected in approvals for program use).

STATUS OF 5 PERCENT FUNDS

STATUS OF U.S. PORTION (5%) OF EUROPEAN COUNTERPART DEPOSITS
UNDER THE FOREIGN ASSISTANCE ACT OF 1948—PUBLIC LAW 472
AS OF MAY 31, 1949
(Dollar equivalents of the local currency, in thousands of dollars)

COUNTRY MISSION	5% OF TOTAL GRANT AID FURNISHED	5% OF TOTAL COUNTERPART DEPOSITS	TRANSFERRED TO U.S. ACCOUNTS	U.S. OBLIGATIONS				TOTAL U.S. EXPENSES
				TOTAL	ADMINISTRATION	STATEGIC MATERIALS	OTHER	
TOTAL	$ 149,252	$ 120,822	$ 38,936	$ 55,814	$ 6,587	$ 43,790	$ 5,437	$ 37,080
France	45,025	37,927	4,097	14,029	3,106[1]	10,417	506	3,788
United Kingdom	36,121	30,404	18,078	24,727	443	24,267	17	24,727
Italy	14,946	11,726	11,726	10,348	923	5,600	3,825	4,748
Austria	12,604	10,377	1,200	982	165	—	817	982
Bizone	12,245	9,437	385	182	55	—	127	182
Netherlands	10,298	6,514	868	3,637	130	3,506	1	744
Greece	7,398	5,847	2,000	1,477	1,362	—	115	1,477
French Zone	3,594	2,700	52	17	17	—	—	17
Norway	3,506	2,850	130	125	110	—	15	125
Denmark	2,936	2,410	172	150	141	—	9	150
Trieste[2]	429	480	78	26	21	—	5	26
Belgium	150	150	150	114	114	—	—	114

NOTE: Dollar equivalents are computed at the actual rates which were used by the respective Governments in agreement with the Administrator in making commensurate deposits of local currency.

[1] Includes $2.713 thousand expenses of office of Special Representative.

[2] Includes 5% of $1.217 thousand advance deposits.

COUNTRY SUMMARIES

STATUS OF FRENCH COUNTERPART FUNDS
MAY 31, 1949

PUBLIC LAW 472[1]	LOCAL CURRENCY	DOLLAR EQUIVALENT
	(Billions of francs)	(Millions)
Deposits In Special Account	194.4	$ 758.5
5% Reserved for United States	9.7	37.9
Balance of 95% for France	184.7	720.6
ECA Approvals for Program Use of 95%	146.2	570.5
Withdrawals	146.2	570.5
Purpose of Withdrawals:		
Debt Cancellation	25.0	97.6
Promotion of Production	121.2	472.9
Agriculture	*2.4*	*9.4*
Coal Mining	*21.0*	*82.0*
Petroleum and Coal Products	*.7*	*2.7*
Railroads	*19.2*	*74.9*
Merchant and Fishing Fleet	*1.6*	*6.2*
Electric, Gas Light and Power Facilities	*35.2*	*137.3*
Strategic Materials	*10.0*	*39.0*
Loans to Industry, n.e.c.	*.7*	*2.7*
Undistributed	*30.4*	*118.7*
PUBLIC LAW 389[2]		
ECA Approvals for Program Use	68.8	312.1
Withdrawals	68.8	312.1
Purpose of Withdrawals:		
Promotion of Production	68.8	312.1
Coal Mining	*7.5*	*34.0*
Primary Metals	*1.1*	*4.9*
Stone, Clay, and Glass Products	*.2*	*.9*
Fertilizer	*.3*	*1.4*
Chemicals and Allied Products	*.1*	*.7*
Petroleum and Coal Products	*1.7*	*7.7*
Misc. Machinery	*1.1*	*5.0*
Misc. Manufactures	*.2*	*.8*
Railroads	*12.4*	*56.2*
Waterways and Harbors	*1.0*	*4.4*
Merchant and Fishing Fleet	*5.0*	*22.7*
Roads & Misc. Transp. Facilities	*.1*	*.6*
Electric, Gas Light and Power Facilities	*36.8*	*166.9*
Undistributed	*1.3*	*5.9*

[1] Rate: 256.3 francs to U.S. dollar.

[2] Rate: 220.5 francs to U.S. dollar.

STATUS OF ITALIAN COUNTERPART FUNDS
MAY 31, 1949

PUBLIC LAW 472	LOCAL CURRENCY	DOLLAR EQUIVALENT[1]
	(Billions of lire)	(Millions)
Deposits in Special Account	134.9	$ 234.5
5% Reserved for United States	6.7	11.7
Balance of 95% for Italy	128.2	222.8
ECA Approvals for Program Use of 95%	250.0	434.8
Withdrawals	0	0
Approved for Program Use but not yet Withdrawn	250.0	434.8
Promotion of Production	196.6	342.0
Agriculture	*70.0*	*121.7*
Railroads	*70.0*	*121.7*
Waterways and Harbors	*5.1*	*8.9*
Merchant and Fishing Fleet	*15.0*	*26.1*
Roads and Misc. Transportation Facilities	*4.1*	*7.2*
Technical Assistance	*.5*	*.9*
Undistributed	*31.9*	*55.5*
Other Purposes	53.4	92.8
Housing	*3.8*	*6.7*
Health and Sanitation	*7.6*	*13.1*
Tourism	*8.0*	*13.9*
Undistributed	*34.0*	59.1
PUBLIC LAWS 84 AND 389		
ECA Approvals for Program Use	53.0	92.2
Withdrawals	28.0	48.7
Purpose of Withdrawals:		
Promotion of Production:		
Railroads	*28.0*	*48.7*
To be Withdrawn	25.0	43.5
Promotion of Production	24.0	41.8
Agriculture	*20.0*	*34.8*
Merchant and Fishing Fleet	*4.0*	*7.0*
Other Purposes:		
Misc. Social Services	*1.0*	*1.7*

[1] Rate: 575 lire to U.S. dollar.

NOTE: Dollar equivalents are computed at the actual rates which were used by respective Governments in agreement with the Administrator in making commensurate deposits of local currency.

STATUS OF GREEK COUNTERPART FUNDS
MAY 31, 1949

PUBLIC LAW 472	LOCAL CURRENCY	DOLLAR EQUIVALENT[1]
	(Billions of drachmae)	(Millions)
Deposits in Special Account[2]	1,169.4	$ 116.9
5% Reserved for United States	58.5	5.8
Balance of 95% for Greece	1,110.9	111.1
ECA Approvals for Program Use of 95%	1,300.0	130.0
Withdrawals—Total	928.5	92.9
Tenporary Advances[2]	*18.2*	*1.8*
For Country Use	*910.3*	*91.1*
Purpose of Withdrawals:		
Promotion of Production	272.4	27.2
Agriculture	*38.0*	*3.8*
Forestry	*5.7*	*.6*
Railroads	*16.2*	*1.6*
Waterways and Harbors	*6.8*	*.7*
Road and Misc. Trans. Facilities	*25.1*	*2.5*
Water Systems	*34.4*	*3.4*
Technical Assistance	*1.4*	*.1*
Undistributed	*144.8*	*14.5*
Other Purposes:	637.9	63.9
Housing	*183.0*	*18.3*
Public Buildings	*23.2*	*2.3*
Health and Sanitation	*13.9*	*1.4*
Care of Refugees	*394.6*	*39.5*
Misc. Social Services	*19.6*	*2.0*
Transportation of Relief Packages	*1.0*	*.1*
Tourism	*2.6*	*.3*
To be Withdrawn:	389.7	38.9
Promotion of Production	3.6	.3
Agriculture	*1.3*	*.1*
Forestry	*1.5*	*.2*
Misc. Manufactures	*.3*	..
Waterways and Harbors	*.4*	..
Technical Assistance	*.1*	..
Other Purposes	386.1	38.6
Housing	*20.0*	*2.0*
Public Buildings	*4.0*	*.4*
Care of Refugees	*71.9*	*7.2*
Tourism	*.6*	*.1*
Loan Capital (n.e.c.)	*200.0*	*20.0*
Undistributed	*89.6*	*8.9*

[1] Rate: 9,999.4 drachmae to U.S. dollar.
[2] Exclusive of .3 billion drachmae transferred from PL 84 and applied to withdrawals (less than $50,000).

STATUS OF U.K. COUNTERPART FUNDS
MAY 31, 1949

PUBLIC LAW 472	LOCAL CURRENCY (Thousands of pounds)	DOLLAR EQUIVALENT[1] (Millions)
Deposits in Special Account	150,890	$ 608.1
5% Reserved for United States	7,544	30.4
Balance of 95% for United Kingdom	143,346	577.7
ECA Approvals for Program Use of 95%	113,953	459.2
Withdrawals	113,515	457.5
Purpose of Withdrawals:		
Debt Cancellation	113,450	457.2
Promotion of Production:		
Technical Assistance	*17*	*.1*
Other Purposes:		
Transportation of Relief Packages	*48*	*.2*
To be Withdrawn:		
Promotion of Production	438	1.7
Strategic Materials	*18*	*.1*
Technical Assistance	*420*	*1.6*

[1] Rate: $4.03 per £1.

STATUS OF NORWEGIAN COUNTERPART FUNDS
May 31, 1949

PUBLIC LAW 472	LOCAL CURRENCY (Millions of Kroner)	DOLLAR EQUIVALENT[1] (Millions)
Deposits in Special Account	282.9	$ 57.0
5% Reserved for United States	14.1	2.8
Balance of 95% for Norway	268.8	54.2
ECA Approvals for Program Use of 95%	210.0	42.3
Withdrawals	210.0	42.3
Purpose of Withdrawals:		
Debt Cancellation	210.0	42.3

[1] Rate: 4.96278 Kroner to U.S. dollar

NOTE: Dollar equivalents are computed at the actual rates which were used by the respective Governments in agreement with the administrator in making commensurate deposits of local currency.

STATUS OF AUSTRIAN COUNTERPART FUNDS
MAY 31, 1949

PUBLIC LAW 472	LOCAL CURRENCY (Millions of Schillings)	DOLLAR EQUIVALENT[1] (Millions)
Deposits in Special Account[2]	2,075.3	$ 207.5
5% Reserved for United States	103.8	10.3
Balance of 95% for Austria	1,971.5	197.2
ECA Approvals for Program Use of 95%	400.0	40.0
Withdrawals	400.0	40.0
Purpose of Withdrawals:		
Debt Cancellation	125.0	12.5
Promotion of Production	275.0	27.5
Forestry	*4.3*	*.4*
Misc. Manufactures	*2.0*	*.2*
Railroads	*119.8*	*12.0*
Communication Facilities	*28.6*	*2.9*
Loans to Industry (n.e.c.)	*120.3*	*12.0*
PUBLIC LAWS 84 AND 389		
ECA Approvals for Program Use	1,088.3	108.8
Withdrawals	1,088.3	108.8
Purpose of Withdrawals:		
Debt Cancellation	725.0	72.5
Promotion of Production	318.6	31.9
Agriculture	*21.2*	*2.1*
Forestry	*1.3*	*.1*
Miscellaneous Mining & Quarrying	*1.4*	*.1*
Miscellaneous Manufactures	*.3*	*..*
Railroads	*243.9*	*24.4*
Communication Facilities	*51.5*	*5.2*
Other Purposes:		
Public Buildings	*43.7*	*4.4*

[1] Rate: 10 schillings to U.S. dollar.
[2] 90-day Certificates of Indebtedness, gradually converted into currency from proceeds of sales.

NOTE: Dollar equivalents are computed at the actual rates which were used by the respective Governments in agreement with the Administrator in making commensurate deposits of local currency.

STATUS OF BIZONE COUNTERPART FUNDS
MAY 31, 1949

PUBLIC LAW 472	LOCAL CURRENCY	DOLLAR EQUIVALENT[1]
	(Millions of DM)	(Millions)
Deposits in Special Account[2]	377.5	$ 188.7
5% Reserved for United States	18.9	9.4
Balance of 85% for Bizone	258.6	179.3
ECA Approvals of Program Use of 95%	2.1	1.1
Withdrawals	2.1	1.1
Purpose of Withdrawals:		
Other Purposes: *Transp. of Relief Packages*	*2.1*	*1.1*

[1] Temporary rate: 2 Deutsche Marks (DM) to U.S. dollar.
[2] Total deposits were 443.0 including 65.5 conditional aid.

STATUS OF TRIESTE COUNTERPART FUNDS
MAY 31, 1949

PUBLIC LAW 472	LOCAL CURRENCY	DOLLAR EQUIVALENT[1]
	(Billions of lire)	(Millions)
Deposits in Special Account[2]	5.5	$ 9.6
5% Reserved for United States	.1	.4
Balance of 95% for Trieste	5.4	9.2
ECA Approvals for Program Use of 95%	7.4	12.9
Withdrawals	5.2	9.0
Purpose of Withdrawals:		
Promotion of Production	5.2	9.0
Misc. Manufactures	*.3*	*.5*
Merchant & Fishing Fleet	*4.9*	*8.5*
Undistributed (General Engineering Proj.)	*3*[3]	
Other Purposes: *Transp. of Relief Packages*	*3*[3]	
To be Withdrawn:		
Promotion of Production: *Undistributed*	*2.2*	*3.9*

[1] Rate: 575 lire to U.S. dollar.
[2] Inclusive of 700 million lire advance deposit.
[3] Less than 0.05 billion lire.

STATUS OF DANISH COUNTERPART FUNDS
MAY 31, 1949

PUBLIC LAW 472	LOCAL CURRENCY	DOLLAR EQUIVALENT[1]
	(Millions of Kroner)	(Millions)
Deposits in Special Account	231.2	$ 48.2
5% Reserved for United States	11.6	2.4
Balance of 95% for Denmark	219.7	45.8
ECA Approvals for Program Use of 95%	.1	*
Withdrawals	.1	*
Purpose of Withdrawals:		
Promotion of Production: *Technical Assistance*	*.1*	*

[1] Rate: 4.79901 Kroner to U.S. dollar.
* Less than $50,000.

[SOURCE: SUITLAND PAPERS, Z 703-2]

9-24 PROGRAM FOR THE USE OF COUNTERPART FUNDS

Memorandum July 13, 1949
To: General Marquat
From: Walter K. LeCount, Chief, Finance Division, ESS

1. The Dodge Mission policy for the use of the Counterpart Fund is that it is a stabilization fund to be used (1) to relieve the stringency of private credit by releasing funds to banks by purchasing government obligations held by or normally taken by them, (2) for investment in government enterprises critical to the stabilization program, (3) for such investment in key private industries to relieve "bottlenecks" in the production program as may be required to be made by the government, and (4) for holding as a reserve to be used for expansion of private or governmental credit and production in the event of the development of serious deflationary forces in the economy. The use of the fund for private investment was agreed to with considerable reluctance as it was felt that the Japanese economy is not characterized by a general shortage of capacity and that any needs for private financing should be met from private sources rather than by the government. As a result the policy of the Mission was that the use of Counterpart Funds for private investment would be exceedingly limited and restricted to essential financing which because of some peculiar circumstance could not be met privately.

2. The Japanese Government policy for use of the fund differs basically from that of the Dodge Mission in that it considers that there is a serious shortage of productive capacity in Japan which must be overcome as quickly as possible, that the freeing of funds to the banks will do almost nothing toward easing the credit stringency and making funds available to industry and that as a result the government must provide such funds directly, and finally that basic conditions in the economy have so changed since the time of the Dodge Mission recommendations that, instead of its being appropriate to use the Counterpart Fund as a device for controlling inflation, conditions are now such that such grave danger of a serious and immediate deflation exists and the fund must be used immediately as a counter-deflationary weapon. As a result of this policy, the Japanese Government proposal for use of the fund involves the immediate commitment of the entire fund for: (1) redemption of debentures of the RFB hold by banks as provided in the budget, (2) investment in the government railway and communication enterprises as provided in the budget, (3) investment in private enterprises to an extent sufficient to provide for a considerable expansion in production capacity, and (4) government projects under the public works, railway and other programs which were considered and deliberately rejected at the time of the formulation of the budget and the expenditure of funds for which would require a revision of the present budget, but which the Japanese Government considers necessary as a counter-deflationary measure and as being politically desirable. Attached is a summary of the use of funds proposed by the Japanese Government.

3. From discussions with the Research and Programs, Price and Distributies and Labor Division, it appears that it is the concensus that the present economic situation in Japan is characterized by a transition from severe inflation to a period of leveling off and even turning down. The almost complete stopping of government financing through the RFB and the delay in filling the resulting gap by the banks and the counterpart fund has led to a temporary intensification of disinflationary factors. In such a situation there are deflationary forces operating which must be closely watched in order to be prepared to make changes in policy and action if and when changed conditions require. However, it does not appear that there is anything in the present situation which was not hoped for when present policies were adopted, except that perhaps the results have been obtained a little more quickly than was expected, or which require as yet any change in policy other than to place more emphasis on the necessity for holding in reserve in the Counterpart Fund an amount sufficient to give the fund sufficient flexibility to be used as a counter-deflationary weapon should serious deflationary tendencies develop. Agreement has been reached with Research and Programs and Price and Distribution that such a situation exists. Mr. Morrow feels that in addition the use of the fund for investment in private capital expansion should be even more restricted than has been heretofore contemplated and that instead emphasis should be placed on providing the flexibility mentioned above, increasing the freeing of funds to the banks, and the use of the fund to finance exports under a program under which exports would be stimulated by permitting long delays in payment by the importing country. This recommendation is based on the position that there is plenty of capacity already in existence in Japan and that current international circumstances will require long terms in payment for exports.

4. In view of this situation the Finance Division has prepared and recommended for issuance a statement of policy for the use of the fund in accordance, with the general policy recommended by Mr. Dodge and has prepared a general outline of amounts necessary for particular purposes. That outline is as follows:

a. Purchase of government obligations from banks as part of program for freeing funds for private financing requirements. 63 billion

b. Investment in government railway and communication enterprises. 27 billion

c. Reserve for further freeing of bank funds or for private investment as conditions in the economy may require and for financing exports under any program of delayed payments for exports. 25 billion

d. Investment in critical private enterprise. 25 billion

(1)	Electric power	10 billion
(2)	Shipping	4 billion
(3)	Iron and steel	2 billion
(4)	Coal	4 billion
(5)	Miscellaneous	5 billion

In connection with Mr. Morrow's recommendation for use of funds for financing exports it is pointed out that 40 billion of capital subscription to the Foreign Trade Fund is included in this year's budget which will be used in part for the purpose recommended. In addition should the situation require additional financing for such purposes, the Foreign Trade Fund could continue to carry a part of the 25 billion borrowing now outstanding instead of repaying it in full as is now planned. Should both sources prove inadequate some part of the reserve as indicated above can be used. In so far as his recommendation for reduction in private capital investment is concerned, the amounts shown above for coal and iron and steel represent drastic reductions over original Japanese proposals and are included only to cover specific "bottlenecks" to production and not to provide for general increases in capacity but much less than desired by the Japanese Government and will not permit undertaking anything like the full 33 plant program approved by the Industry Division. Amounts for electric power are included only because it seems clear that in the long run a considerable increase in electric power capacity will be of great benefit.

5. Protracted discussions have been held with representatives of the Japanese Government but it has not been possible to reach agreement with them as to the general outline of a program for use of the fund. It is recommended, however, that, rather than hold up approval of all disbursements from the fund pending Japanese acquiescence in the program and especially in view of the necessity of getting the fund into operation and immediately, approval of individual applications for use of funds within the general outline prepared by the Finance Division be given on a specific case basis. It is further recommended that, as soon as final concurrence of other divisions is obtained to the internal distribution of funds within the 25 billion total for industrial investment, the program be announced as SCAP policy to relieve the uncertainties in the minds of Japanese business men as to the part the fund will play in their own or competing enterprises.

[SOURCE: SUITLAND PAPERS, Z 703–2]

9-25 GOVERNMENT AND RELIEF IN OCCUPIED AREAS ECONOMIC REHABILITATION IN OCCUPIED AREAS FISCAL YEAR 1950

Report[13] n.d.[14]

Submitted herewith are separate justifications in support of the Army Department request for funds for Government and Relief in Occupied Areas (GARIOA Section I) and Economic Rehabilitation in Occupied Areas (EROA Section II). These funds are required to discharge the obligations of the United States as an occupying power in Germany, Japan, and the Ryukyus Islands and to support our objectives in these areas and in Austria.

ECONOMIC OBJECTIVES OF THE OCCUPATION

Until one year ago, the authority of the Army Department to furnish economic aid to the

[13] Charts and other portions omitted.

[14] The exact date could not be ascertained. However, this document is thought to have been written during the summer of 1949.

occupied areas was limited to the provision of the minimum quantities of supplies required to prevent disease and unrest. The obligation of the United States, as an occupying power, to furnish such minimum supplies stems directly from the rules of Land Warfare and the Hague Convention and has been reaffirmed by the Congress in the annual GARIOA Appropriation Acts.

The promotion of economic recovery, at least to the extent required to assure internal economic and political stability, has always been a major objective in the occupied areas. In the first three years of the occupation, however, the only funds available for that specific purpose were those derived from the sale of such exports as could be produced by economies devastated by war, with no world trade contracts, and with extremely limited means of financing necessary raw material imports. The painfully slow rate of recovery that occurred under these conditions made it increasingly evident that the dependence of these areas on our relief would be indefinitely prolonged if their resources were not supplemented by sufficient aid to speed up the rate of their industrial recovery and thereby to achieve eventual self-support.

The need of additional funds designed specifically to promote economic recovery in the occupied areas was recognized by the Congress in legislation passed last year. Bizonal Germany became eligible for additional funds to quicken the pace of industrial recovery under the authority of the Economic Cooperation Act of 1948. PL 793, 80th Congress, which appropriated the funds required for foreign aid further provided that funds appropriated to the Department of the Army for Government and Relief in Occupied Areas might be expended "for the purposes of economic rehabilitation in Japan, Korea, and the Ryukyus in such manner as to be consistent with the general objectives of the Economic Cooperation Act of 1948."

It has accordingly been possible during the past year to inaugurate programs of economic recovery in all occupied areas. Progress under these programs, which will be described in more detail in the testimony to follow, has been almost directly proportional to the amount of additional aid made available. Continuation of such aid is essential if the occupied areas are eventually to become self-sustaining economics independent of extraordinary outside aid.

RELATION BETWEEN RELIEF AND RECOVERY FUNDS

Since the emphasis between the relief and recovery objectives in the occupied areas has been changed by Congressional action, all funds expended should be considered in terms of their contribution to recovery objectives. For that reason appropriations for economic aid must be viewed and must be administered as single funds for a single purpose. It is useful, however, to maintain, for administrative purposes, a separation of funds as between the older GARIOA and the newer recovery expenditures. The former represent the expenditures that the United States would be called upon to make in support of its obligations as an occupying power. The latter represent costs which could be avoided without prejudice to United States obligations and must be justified in terms of the longer range economies to the United States. The Department of the Army submits that these expenditures represent the only honest alternative to the continuation for an indefinite period of a vast relief program financed by the United States taxpayer.

The administrative separation of Funds in the case of Japan and the Ryukyus Islands presents no particular difficulty since they are parts of one appropriation and are intended to be used by one agency. In the case of Bizonal Germany, however, the funds for relief and the funds for recovery have been parts of separate appropriations to different administrative agencies. Proper use of the funds to assure that each would make its contribution to the common objective has required extremely close coordination between the Department of the Army and the Economic Cooperation Administration.

While the desirability of a single appropriation for Germany to be administered by a single agency has been fully recognized, it has seemed essential, so long as no responsible German government existed in Western Germany and so long as the economic welfare of the Bizone remained a direct responsibility of the military governors, to guarantee to the military governors administrative control over at least that portion of the funds for Germany which would be required to support the minimum obligations of the occupying powers. It is intended that the funds will be transferred to a single agency of government as soon as a responsible government is set up in Western Germany and the direction of economic and political affairs, to the extent that such direction is reserved to the occupying powers, is placed in civilian hands.

Despite the separation of the German funds during the past year, it has been possible to so administer them as to have the effect of a single program. Estimates of total aid required to achieve recovery objectives are made in the first instances by German agencies. This total aid figure is screened and revised by military government. The portion to be furnished by

the Army is deducted and ECA aid is requested, through OEEC, to cover the balance. The OEEC recommendation as to the aid to be assigned to Germany takes into consideration all American funds, whether furnished under the GARIOA budget or through allotments from ECA funds. Finally the ECA program is developed in cooperation with the Army Department to review both the total aid figure and the portions to be assigned to GARIOA and to ECA.

Close coordination to assure that all funds will be used for a single recovery purpose is maintained throughout the year in the administration of the program. Requests originating in Germany for ECA aid are received by the Army Department, examined in relation to the aid being received from GARIOA funds, and transmitted to the ECA along with information as to the current status of GARIOA programs. Funds allotted by the ECA for German aid are either transferred to the military government of Germany through the Army Department for commercial procurement by German agencies or, in the case of food items, are transferred directly to the Army Department which then purchases and ships the commodities authorized by the ECA as part of the total supply program for Germany.

REVIEW OF PROGRESS DURING FISCAL YEAR 1949

Germany

One year ago, when the Department of the Army submitted its Fiscal Year 1949 request for funds for the occupied areas, the economic outlook of Bizonal Germany was perhaps bleaker than it had been at any time since the beginning of the occupation. The index of industrial production in May of 1948 was only 47 percent of the prewar (1936) level, 4 points lower than in March of the same year and only 2 points above the level achieved 6 months earlier (Chart 1). During the first 3 months of calendar year 1948 the food ration for the normal consumer fell below 1200 calories per day in some large industrial areas and averaged little more than 1300 calories per day for the whole Bizone area. Other essential consumer goods were virtually unobtainable through legal channels. An almost worthless currency furnished little incentive to produce or exchange commodities at legal prices. The black market, in which primitive barter arrangements took the place of the normal methods of exchange, flourished. The prospect of good domestic crops and a sizable accumulation of coal stocks due to an unusually mild winter were the only bright spots in an otherwise discouraging economic outlook.

An almost unbelievable change in the economic prospects of the Bizone has occurred since May of 1948. This change has been due for the most part to a fortunate combination of favorable events that restored the will to work of the German population and furnished them at least the minimum materials with which to work.

When the Congress approved substantially the entire sums requested by the Army Department in a supplemental appropriation for Fiscal Year 1948 and the full appropriation for Fiscal Year 1949, a supply of foods sufficient to meet minimum ration requirements for a full year was assured for the first time since the beginning of the occupation. By early summer it was evident that an excellent crop would also guarantee an increased domestic food supply.

The passage of the Economic Cooperation Act made available funds for additional foods and for industrial materials required to promote economic recovery. While supplies purchased under the authority of this act did not reach Germany in large volume until several months later, the assurance that such supplies would be received made possible a more rapid obligation of GARIOA and JEIA funds than would otherwise have been prudent. Consequently the benefits of the ECA program were felt in Germany before the first ECA financed cargo left ports in the United States.

A drastic currency reform was announced in June 1948. The new currency unit, the Deutsche Mark, substituted for the old Reichs Mark at an average ratio of 16 to 1, had a high scarcity value and served to reestablish normal economic incentives to production and exchange. The immediate success of the currency reform, coupled with increased supplies of food and other consumer goods, paved the way for a relaxation of price and ration controls on all but the most essential goods, thus giving a further incentive to productive activity.

The nearly simultaneous occurrence of the above mentioned favorable events had an electric effect on the German economy. The index of industrial production rose from 47 percent of the 1936 average in May to 61 percent in July and further gains have been registered in each succeeding month. Hidden inventories of goods moved through the channels of distribution into consumption. Absenteeism in industry declined sharply. The black market for most commodities was virtually wiped out. An impressive revival of activity in all sectors of the economy gave consumers their first real promise of some relief from the drab austerity of the postwar years.

The internal economic revival of the Bizone has been reflected in a substantially increased quantity and variety of German exports. The $800 million commodity export goal for Fiscal Year 1949, which appeared practically unattainable one year ago, will almost certainly be exceeded. Major relative gains have been registered in exports of manufactured articles.

The above described improvements in the Bizonal economy have already been reflected in lower requirements for dollar aid. In May of 1948 it was estimated that the Bizonal area would require $675 million from the GARIOA appropriation (exclusive of administrative costs) plus approximately $430 million in ECA aid to accomplish the Fiscal Year 1949 objectives set for the Bizone in the European recovery program. The total U.S. dollar aid figure of approximately $1.1 billion was a minimum estimate made in the light of the economic status of the Bizone last spring. Even as late as July of 1948 when some reduction in food import prices could be taken into account, it was possible to reduce the GARIOA figures only to $637 million. Subsequent revisions in both the GARIOA and ECA programs in September and December of 1948 could take into account the impressive revival of Bizone industrial production and exports and the unusually good harvest so that the GARIOA figure was reduced further, to $574 million. Assuming an ECA aid figure of $411 million this will mean total aid of approximately $985 million during Fiscal Year 1949, $115 million lower than the original estimate and $63 million below the estimate made last July.

Japan

The economic prospects of Japan one year ago were little if any better than those of the Bizone. Industrial production then had reached approximately 50 percent of the 1930–34 average. Exports were still below $200 million a year, insufficient to finance even minimum imports of raw materials, leaving no balance available to reduce United States relief expenditures. A mission appointed by the Secretary of the Army, under the chairmanship of Mr. Percy H. Johnston, had surveyed the Japanese economy and returned with a strong recommendation that a recovery program for Japan be undertaken at the earliest possible date. In the words of that mission, "The United States has been paying the military costs of occupation and in addition, under its international obligation to prevent disease and unrest, has been furnishing food and other relief supplies to keep the Japanese people alive. These relief costs run to nearly $400,000,000 a year. In our opinion the United States must now face squarely the problem of assisting the Japanese people to become self-supporting. Otherwise we will be called on to continue relief shipments indefinitely, so long as our occupation responsibilities continue."

As noted previously the Congress subsequently approved the use of part of the total funds ($1.3 billion) appropriated to the Department of the Army for relief and recovery in the occupied areas to inaugurate a recovery program in Japan, Korea, and the Ryukyus Islands. Early estimates indicated that not more than $100 million would be available for this purpose after taking care of minimum relief requirements. Japan's share of this total was approximately $74 million. Later in the year when the effects of the industrial recovery in Germany could be more fully appraised, it became possible to increase the recovery funds for the Pacific area by an additional $50 million and Japan's share of such funds was raised to approximately $108 million.

The effects on the Japanese economy of the rehabilitation expenditures being made from Fiscal Year 1949 funds are not yet fully evident. In the first place, time has been required to set up and fill supply pipelines. Secondly, a substantial portion of the total funds were not made available until late in the Fiscal Year. An impressive improvement in Japanese production and exports has nevertheless occurred during the year, much of which may be attributed to United States aid.

There has been a noticeable acceleration in the rate of increase in industrial production in Japan since the inception of the EROA program. The index averaged 62.4 percent of the 1930/34 level during the last quarter of calendar 1948, an increase of 36 percent over the average for the first quarter of the year. Preliminary estimates indicate that the increases have been maintained (Chart 2) in recent months. Not all of this increase can be attributed to EROA aid received or a more rapid use of domestic supplies in anticipation of such aid. It is significant, however, that the index gained only 21 percent between the first and final quarters of calendar year 1947, when no EROA aid was available.

Merchandise exports from Japan have shown even more striking gains than those recorded for industrial production. Exports during the last quarter of calendar year 1948 were approximately three times those reported for the first quarter of the year (a monthly average of approximately $36 million in the final quarter as compared with an average of $12 million in the first). Current estimates indicate that exports during FY 1949 may exceed $400 million, an increase of 140 percent over exports during Fiscal Year 1948 ($166 million).

The progress achieved in Japan in the past year, limited as it was by inadequate total funds

and the late availability of the large portion of these funds, has been encouraging. It is the best evidence available in support of our contention that if recovery aid is continued further substantial gains can be made during Fiscal Year 1950 and will result in long range economies for the United States.

The GARIOA Program

As noted previously, all funds appropriated for economic aid to the occupied areas must be used to further the recovery objectives approved by the Congress. The administrative distribution of these funds as between relief and recovery items follows, in the case of Germany, the division of responsibility between the Army Department and ECA. While both relief and recovery funds for Japan and the Ryukyus Islands are included in one appropriation request, it is believed useful and desirable to show the respective requirements separately.

The GARIOA request includes funds for the purchase of certain relief supplies (food, agricultural supplies, medical supplies and petroleum products), for the transportation thereof, for administrative costs connected with the supply program and with military government activities, and for reorientation programs directed toward the strengthening of democratic ideals and institutions in the occupied areas. Expenditures for these purposes represent the minimum amounts of aid that the United States must provide to meet its obligations as an occupying power.

As may be seen from the accompanying charts, (No. 3, 4 and 5) the major portion (66 percent) of all GARIOA expenditures in FY 1950 will be for food, as compared with 64 percent in FY 1949. Agricultural supplies and POL will account for 8 and 6 percent, respectively, of total expenditures. Transportation will account for approximately 13 percent of the total program, as compared with 12 percent in FY 1949, largely due to the fact that there has been a smaller decline in transportation rates than in procurement costs. Administrative and reorientation expenditures will account for approximately 5 and 2 percent, respectively, of the total budget.

Expenditures for food will absorb 80 percent of the total budget for Germany in FY 1950, as compared with 70 percent this year. Expenditures for POL will take 4 percent of total funds, as opposed to 4.5 percent in FY 1949. Since all fertilizers and two-thirds of the seeds required for the Bizone will be paid for from nonappropriated funds, expenditures for agricultural supplies will decline from 10 percent of the total budget in FY 1949 to less than 2 percent in FY 1950. The foods requested for Japan will be spent approximately as follows: food 50 percent; transportation—18 percent; agricultural and fishing fleet supplies and fertilizers—16 percent; POL—8 percent; with the balance going to reorientation projects, medical supplies, and administrative costs.

The sections immediately following will describe in detail the main GARIOA supply projects for each area. Administrative and reorientation projects will be discussed for all areas in a later section.

• • • • • • •

SECTION II. EROA
ECONOMIC REHABILITATION
Japan and Ryukyu Islands

As previously noted, the proposed expenditure of $123 million for the economic rehabilitation of Japan and the Ryukyus Islands during FY 1950 is an addition to funds required for minimum relief needs. It is an expenditure that could be avoided without prejudice to our obligations as an occupying power but is justified on the ground of long-range economy to the United States. It is based squarely on the principle that the promotion of industrial recovery is the only alternative to the indefinite continuation of relief aid at a much greater ultimate cost to our taxpayers than the cost of the program proposed here. The measure of success already achieved with funds provided for recovery purposes from the FY 1949 appropriation ($108 million for Japan and $7 million for the Ryukyus), and the achievements noted in Germany from substantially greater recovery expenditures, furnish ample basis for the conclusion that such long-range economies can be effected.

Japan

The Problem:

Japan, like Great Britain and Germany, has always been dependent on foreign trade to support her economy. A population more than half that of the United States lives on a total land area smaller than the State of California. Japan has very limited raw material resources, other than an inferior grade of coal, required to keep her industries running. Consequently, the only route to self-support is through exporting the products of Japanese industries to earn the means of payment for the imports of food and raw materials which she must have to survive.

Japan was able, before World War II, not only to satisfy, through trade, the minimum requirements of her population, but also to accumulate sufficient reserve to build a modern army and navy and to launch an aggressive war. As the "workshop of Asia", she became a major supplier of textiles, machinery and equipment, and a great variety of manufactured consumer goods to other Asiatic countries and even managed to penetrate some of the protected markets of the Western Hemisphere. Earnings from these exports, supplemented by those from her merchant fleet, more than sufficed to pay for her minimum food and raw material import needs.

The war and its aftermath have radically altered the Japanese economy both internally and in its relation to the world economy. Her population has been swollen by the return of repatriates and a high rate of reproduction. Her soil has been depleted by efforts to maximize crop production without adequate fertilization. Her industrial plant has not only suffered serious bomb damage but was also disarranged by wartime conversion to the production of military supplies. She was largely cut off from traditional sources of food and raw material by the loss of her colonies and the continuation of civil war on the Asiatic mainland. Her major markets were lost. Some of these are being regained as the ability of former customers to pay for Japanese goods increases and as their hostility toward Japan subsides. Others may, in large part, be permanently lost. This is especially true of silk and cotton textiles, because of the competition of synthetic substitutes and of the development of domestic textile industries in former importing countries.

Despite the major difficulties described above, Japan—given adequate assistance to purchase the raw materials initially required to start the import-export cycle—can achieve a greater degree of self-support in 1950 and may become fully self-supporting at a tolerable scale of living in subsequent years. She has the industrial capacity and a numerous and technically skilled labor force—assets which most Asiatic countries lack. The reduction in market outlets for her textiles and consumer goods can be made up through expansion of the output of her heavy industries. Such expansion must, of course, be subject to the limitations on prohibited and restricted industries which have been imposed to curb her war potential.

Progress Achieved During FY 1949:

Last year the Congress approved the inauguration of a recovery program in Japan, Korea, and the Ryukyus Islands, when it granted the Army Department permission to use funds appropriated in the GARIOA budget. Our first estimates indicated that only $100 million would be available for this program in all three countries, of which $74 million would be used for Japan. Later in the year, when the improved economic position of the Bizone could be fully appraised, an additional $50 million was transferred to the recovery programs of the Pacific areas, and Japan's share was raised to $108 million.

Despite the limited total funds and the late transfer of a substantial part of them, Japan has made progress. Notwithstanding the convulsions on the Asiatic mainland, the internal situation has been calm and well ordered. Economic improvement during the past year has been marked. Coal production has steadily increased since the occupation. Beginning in 1945 with a total monthly production of less than 500,000 tons, it has been consistently over 3,000,000 tons monthly, during the last months of the calendar year 1948, and the first quarter of 1949. Great improvement has been made in the operating condition of the coal mines. With this amount of coal production, it has been possible to repair electric generating facilities and to increase the output of power. Industry has consistently gained momentum and (excluding the textile industry) has reached approximately 78% of the 1930–1934 level. Experts during FY 1949 should be about $400 million in value, more than double the amount in the pre-fiscal year. The economy is, however, and will continue to be, characterized by lack of raw materials and other consumer goods. Further industrial progress will be limited unless critical materials can be made avaiable—not only for export production but for repairs and rehabilitation.

The inauguration of an internal stabilization program is perhaps one of the most notable achievements during FY 1949. The nine point program calls for a balanced consolidated budget, improved tax collections, limitation of credit, wage stabilization, strengthening of price controls, improvement and tightening foreign exchange controls, improvement of the allocation and rationing system, an increase in domestic raw material production, and an improvement in the domestic food collection program. SCAP has insisted throughout the occupation that the Japanese government institute measures such as these to cope with the internal problems to the extent that such measures are economically and politically feasible. The Stabilization

Program is one of the most far-reaching of such measures. Two important steps have already been taken under that program. The consolidated budget has been balanced and a general exchange rate has been established. It must be understood, however, that the success of such measures depends to a very large extent on the assurance of a flow of goods in foreign and domestic trade sufficient to dull the edge of inflation and restore normal incentives to productive effort. Such assurance cannot be given without external aid. The Stabilization Program may, therefore, be regarded as one of the first and possibly one of the most significant results of the aid furnished during Fiscal Year 1949. Such aid must be continued if that Program is not to become a paper reform without visible economic results.

Program for FY 1950

The Army's justification for the requested $116 million for economic recovery in Japan is based upon the assurance that materials purchased therewith will be used effectively for the production of exports which can be sold or traded abroad for essential raw materials or foodstuffs.

We have made careful study of the seven industries in Japan which produce the major portion of exports. These are iron and steel, textiles, ship construction and repairs, chemicals, ceramics, machinery, and rubber. The amount of production which is feasible and the amount of usable productive capacity under the most efficient allocation and utilization of the available coal and power supply were ascertained. Having estimated on this basis the expected production in FY 1950, the requirements of raw materials necessary to support that production level were determined. Finally, a careful estimate of the potential market for exportable items was made, together with a realistic estimate of expected exports for FY 1950 from these industries.

No attempt has been made to deal in like manner with the hundreds of handicraft and other small industries which contribute to the total export market and consume the minor part of imports.

Careful consideration in determining the feasibility of export sales has been given (1) to Japan's normal trading area in the Far East; (2), the impact of the loss of the silk market; (3), the reluctance of competitor nations in the field of world trade to assist in the building up of a strong competitor, and (4) the fact that in more recent months some of the fear and enmity towards Japan and Japanese products has been dissipated and more cordial trade arrangements are now becoming effective.

The seven key industries mentioned above, given the required supply of raw materials, can provide for the essential needs of the domestic economy and produce for export goods valued at close to $500 million during Fiscal Year 1950. Other industries are expected to earn about $140 million from exports while consuming only a minor portion of total industrial imports. To produce these exports, raw materials to a total delivered value of $500 million will be required. Non-appropriated funds (short term loans and credits, the Export-Import Revolving Fund, PL 820 funds, and proceeds of exports) total $389 million.

Based on the premise of this presentation it is submitted that $116 million requested in the FY 1950 EROA Budget, plus funds from SCAP's commercial account and other credits can reasonably be expected to support in FY 1950 the production of more consumer goods, to provide for repair and rehabilitation of the transportation system, and power transmission facilities, industrial plants, and to make possible considerable replacement of the fishing fleet and inter-island cargo ships. At the same time it can reasonably be expected to produce (a) an export return sufficient to more than pay for the original outlay in raw materials, and (b) the initiation of a regular cycle of import-export activity.

The objectives here set up for FY 1950 are attainable. Their achievement would mean more stable political and economic conditions within Japan and a substantially increased measure of self-support in the Japanese economy. This request for funds to make that achievement possible is not another request for relief assistance; it is the outline of an opportunity for a wise investment.

The Ryukyu Islands

The Department of the Army's request for economic rehabilitation funds for the FY 1950 includes $7 million for the Ryukyu Islands. This request is based upon a plan to increase the efficiency and output of the agriculture and fishing industries and to expand the export sales of certain manufacturing industries.

Located between the 29th and 24th degree parallels north latitude, the Ryukyu Islands stretch for approximately 775 miles in a northeast southwest direction between Formosa and Japan proper. This archipelago comprises some 150 islands of which only 30 are significant. Okinawa, the largest of these islands, contains approximately 60 percent of the estimated 900,000 native population. Most of the population is employed in agriculture and fishing. Manufacturing is, for the most part, of the domestic handicraft type. There are, however, a number of small industrial plants capable of producing goods for the domestic economy and for export but which require repairs, equipment and raw materials before they can be reactivated. The Islands possess some coal and rock phosphate deposits which are available for export.

Prewar statistics on Ryukyuan export trade and other external receipts cannot be completely separated from those for Japan proper. It appears, however, that the Ryukyus normally incurred a substantial deficit on commodity trade.

The economic rehabilitation plan for FY 1950 does not forecast that the area can become wholly self-supporting. It is anticipated, however, that the external deficit of the economy can be reduced to manageable proportions by the measures here proposed. No funds were allocated for economic rehabilitation purposes prior to the current fiscal year. During Fiscal Year 1949, $7.3 million were made available for economic rehabilitation.

The following summary of measures, either underway or soon to be initiated, are necessary for economic rehabilitation:

1. Continued expansion of the fishing industry to include greater emphasis on freezing and canning fish and seafoods for export, in addition to meeting domestic food needs.
2. Increased use of indigenous raw materials and expansion of industrial output of manufactures for domestic use and for export.
3. Re-establishment of communication and transportation facilities, including harbor development.
4. Effective recruitment, training, utilization and compensation of Ryukyuan labor in direct and indirect support of the occupation.
5. Economic stabilization, including a unitary exchange rate and effective wage and price control.

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY]

9-26 ESS MEMO ON USE OF COUNTERPART FUND

Memorandum September 2, 1949

By: ESS[15]

The ESS program for use of the Counterpart Fund is based on the general policy developed during the time of the Dodge Mission and the policy statements concerning use of the Fund transmitted to the Department of Army by Mr. Dodge. Excerpts from such statements follow:

Radio C-68539, Dodge to Voorhees, 14 March 1949:

> "United States aid. U.S. Aid should be included in national budget and should fully reveal maximum yen value such aid and purposes for which counterpart funds utilized. Latter funds should be used only for capital investment, debt reduction, and possibly minimum import subsidy program."

Radio C-68699, Dodge to Voorhees, 22 March 1949:

> "e. Believe ECA principles, and procedures should apply to review and releases from counterpart fund including consultation on program with interested Washington agencies. SCAP would retain complete control over specific releases and release for investment purposes would remain conditional upon (a) attainment by Japanese Government and banking institutions of prior agreed upon goals in field of budget monetary and credit control and (b) achievement by recipients of funds for specific programs of rationalization. Believe fund with above conditions will provide highly desirable method of controlling eventual utilization of local funds accruing from U.S. aid programs."

Radio C-69080, Dodge to Voorhees, 7 April 1949:

> "2. Consolidated budget balanced with slight surplus. In addition covering all Government expenditures budget provides approximately 75 billion yen for retirement portion outstanding Government debt approximately 17 billion yen for direct Government investments and establishes U.S. Aid Counterpart Fund for 175 billion yen which will be used under SCAP control for retirement additional Government debentures and for approved capital investments."
>
> "11. Counterpart Fund is included in budget in sum of 175,000 million yen of which 27,000 million yen is recommended for public investment (railroads 15,000 million yen and communications, 12,000 million yen). Of the balance of 148,000

[15] The author is not indicated.

million yen it will be recommended that 62,467 million yen be used to retire R.F.B. debentures leaving 85,533 million yen available for debt retirement or further public or private investment."

Radio C-69511, SCAP to DA, 25 April 1949:

"Part V. The Counterpart Fund will be a yen fund supervised by the Ministry of Finance and will be used under strict SCAP supervision for investment in government enterprises, such as railways and communications, key private industries, and debt retirement. Application for approval of each expenditure will have to be made by the Japanese Government to SCAP."

Radio C-69859, SCAP to DA, 7 May 1949:

"1. The yen counterpart of EROA and GARIOA assistance expected to be provided during the Japanese Fiscal Year 1949–50 has been included as an explicit charge in the Japanese budget. The Japanese Government was directed in SCAPIN 1988 (1 April) to establish a U.S. Aid Counterpart Fund for Japanese Stabilization which would be administered under strict SCAP control for the general purposes of debt retirement, investment in government enterprises and key critical private enterprises or such other uses as might be consonant with current stabilization efforts. The employment of the fund will be closely integrated with concomitant actions being undertaken in connection with the Nine Point Economic Stabilization Program. In general releases from fund will be conditional upon:

"a. Attainment by Japanese Government and banking institutions of prior agreed upon goals in the field of budget, monetary and credit control.

"b. Achievement by recipients of funds of scheduled production goals and improved efficiency levels.

"Although present intent is to utilize the fund potential to achieve a disinflationary impact its main purpose will be to provide the SCAP with an instrumentality of control of the general economic situation as the situation may dictate advisable.

"2. Preliminary estimates indicate the total value of the Counterpart Fund during the Japanese fiscal year 1949–50 will approximate 175 billion yen. Although no firm or final programs for and uses of the fund have been developed it is tentatively planned that approximately:

"a. 62 billion yen will be used to retire RFB debentures.

"b. 27 billion yen will be used for self-liquidating investments in government enterprises (15 billion yen for railroads and 12 billion yen for communications).

"c. 86 billion yen will be apportioned between further debt retirement and investment in key critical private industries. Key critical private industries are construed to include electric power, coal, steel and shipping."

[SOURCE: SUITLAND PAPERS]

9-27 BOJ'S VIEWS CONCERNING FOREIGN EXCHANGE RATE

Letter of Opinion — October 8, 1949
Submitted to: W. J. Logan and General Marquat
By: Bank of Japan[16]

With reference to Japan's foreign exchange rate, I believe that it is inadvisable to alter the ¥360 rate against the dollar in haste at least under the present conditions, and that efforts should instead be made to attack diverse factors which should be solved prior to such an alteration, and then consideration be given on the issue of alteration. Reasons are listed as follows:

1. Industries of Japan should have made a new start on a new basis after the war, but they, under cover of the inflationary developments, have failed to effect the rationalization. It was only after the early part of the present year that the Japanese industries at last set foot on a new path leading to the rationalization, by virtue of the stoppage of inflation that followed the formulation of the equibalanced budget based upon the Dodge Plan and the establishment of the single foreign exchange rate. The rationalization was, therefore, just commenced with the elimination of surplus personnel, leaving many things to be done hereafter in regard to attainment of the greater efficiency of productive equipment and rationalization of management. Since considerable determination and efforts are required for carrying out the rationalization, industrialists are inclined to evade it whenever they find their pretexts in the external factors, and therefore, persons in the administrative as well as economic responsibilities should refrain from entertaining any easy-go-luck idea at this juncture. A reduction of the yen rate, if effectuated under the prevailing conditions, will be liable to place enterprises under loose management, instead of promoting export trade, and eventually to give rise to such a situation wherein a further reduction of the rate will be required. Especially such a country as Japan, which is poor in natural resources and is obliged to depend on foreign trade, should acquire maximum amount of foreign currencies with minimum volume of exports. It is thus necessary for this country to export merchandise of excellent quality at appropriate prices. To attain this end, it is urgent and indispensable condition that industries of this country devote their efforts to accelerate the rationalization so as to enable this country to participate in fair international competition.

2. In my opinion, the pound sterling has hitherto been overvalued as viewed from the developments down to date and it has been placed in a proper position by virtue of the recent reduction. Japan's export trade with the sterling areas are hinged around textile products, particularly cotton goods. Exports of cotton goods had more or less profit margin at the rate of ¥360 prior to the reduction of the sterling-dollar rate, even under the condition where the official sales prices of raw cotton to the manufacturers of cotton goods for export to the sterling areas were fixed at levels 34.5% higher than those for cotton goods exported to the dollar areas. It is thus believed that cotton goods will have an export ability even after the reduction of the sterling-dollar rate, if the above-mentioned official sales prices for raw cotton are restored to the normal level. Sundry goods will be greatly affected, but it would not be necessary to place much weight thereon, because their exports are not so large in value. Heretofore, Japan has enjoyed a favorable balance in its trade with the sterling areas, and countries within the sterling areas had rather been inclined to restrain imports of the Japanese goods due to a shortage of settlement funds and other reasons. It will be fortunate if the recent reduction of the sterling rate works to modify this tendency to restrain importation of the Japanese goods. It may also be feasible to increase imports from the sterling areas in a way to cover the probable effects of the sterling reduction upon the Japanese export trade. It is inconceivable that the situation is so acute as to require an immediate step in regard to the exchange rate, when due considerations are given to the actual conditions of the trade between Japan and the sterling areas and further to the fact that commodity prices in the United States are now free from a downward tendency as was the case sometime ago, and so Japan is not obliged to lower the yen rate in relation with the United States.

3. For an expansion of Japan's export business, it is necessary to rectify the existing "blind trade." Unless such a point is readjusted, it is impossible to clarify the true position of Japan's export business. In order to correct the "blind trade," it is highly necessary to shift foreign trade to private transactions as far as possible, but it is further hoped that arrangements may be made for making it easier for the Japanese traders and surveyors to travel and to establish their offices in foreign countries. Through these measures, the prices of the Japanese export goods will be more rationalized and their yen value receivable to exporters will be further increased. It is further believed that a treatment similar to the most-favored nation clause in regard to the customs tariffs, acceleration of the foreign trade agreements and amendment of the floor price system, if materialized, would greatly strengthen Japan in maintaining its exchange rate.

4. If Japan is to cut the exchange rate, it may be regarded appropriate to do so when all the countries within the sterling areas reduced their rates, so that such a cut may not be open to foreign censure. However, it is impossible at present to judge as to what extent the yen should be lowered, in view of the above stated inadequate industrial rationalization and trade relations with the sterling areas. It is believed that a proper and stabilizing rate of reduction can be determined through careful studies only after thoroughgoing realization of the industrial rationalization, clarification of trends of the Japanese trade with the sterling areas following the reduction of the sterling rate and ascertaining results of the Anglo-Japanese trade conference. Moreover, it is forecast that the rate of reduction then may perhaps be narrower than as thought reasonable today. And, Japan's export trade will have been depressed and its international trade balance aggravated when Japan is required to cut the yen exchange rate, and it is believed that such a fact will win nations of the world to consent, as in the case of Great Britain.

5. On the strength of the foregoing reasons, it may be said that if attitude of persons assuming the administrative as well as economic responsibilities is such as to invite the least suspicion either at home or abroad, Japan's export business would suffer a further setback and

[16] The document in our possession is a copy, and the "Bank of Japan" appears in handwritten form on the title page.

this country would be driven into a position where it will have to cut the yen rate under extremely adverse conditions. Japan's attitude at this moment should, therefore, be clarified with firm resolution as speedily as possible.

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY]

9-28 RECOMMENDATIONS AND FINDINGS OF THE ADVISORY MISSION FOR INTERNATIONAL TRADE (FREILE REPORT)

Report[17] October 24, 1949
Submitted to: General MacArthur
Prepared by: Advisory Mission for International Trade
Confidential

Dear General MacArthur:

The Advisory Mission for International Trade, which consists of selected representatives of the Departments of Commerce, State and Treasury, the Federal Reserve System, the Tariff Commission and the Department of the Army, officially convened in Tokyo at your invitation on 19 September. Since that date, the Mission has engaged actively in the study of a wide diversity of subjects specifically inter-related with foreign trade promotion. During the period, the Mission and its members have discussed these problems with most of the important business organizations. Innumerable representatives of private business, manufacturers, exporters and importers and an impressive coterie of financial, legal and other professionals interested in this subject have provided information and data.

The Advisory Mission for International Trade respectfully submits for your consideration its recommendations and findings resultant from the work during the period 19 September to 24 October.

In the accompanying document, the agenda of study, the assignments to the various specialists of the Mission and the 'modus operandi' are defined in the "Foreword". By virtue of the diversity and special nature of the subjects, and the fact that each member of the Mission was selected as a specialist in a specific field, it was deemed appropriate that the format of this document be a series of individual papers covering each principal agenda topic.

The members of the Mission desire personally to express their thanks for this opportunity of participating intimately in the considerations respecting the foreign trade future of Japan. The Mission has enjoyed excellent cooperation from the entire headquarters and from the business community, both national and non-national. It is not feasible to acknowledge each of the individuals and organizations who have aided materially in the accomplishment. The assistance rendered by the American, United Kingdom, Dutch, French and Japanese Chambers of Commerce was of material value.

The members of the Mission personally desire to acknowledge special indebtedness to Major General W. F. Marquat and his staff for wholehearted support, friendly cooperation and assistance.

It is the hope of the Mission that the attached document, "Recommendations and Findings of the Advisory Mission for International Trade", will constitute a useful contribution to continued progress and expansion of the foreign trade of Japan and be of assistance to you in the accomplishment of your objectives.

Sincerely yours,
ORMOND FREILE, Chairman
Advisory Mission for
International Trade

FOREWORD

The Advisory Mission for International Trade was activated at the invitation of SCAP to visit Japan; there to work with SCAP personnel, Japanese Government personnel, trade groups and businessmen concerned with foreign trade to formulate positive recommendations in regard to trade promotion for submission to SCAP.

SCAP request for the Mission is contained in radio *C-69921* dated *10 May 1949.*

The personnel of the Mission was planned to include specialists in major aspects of foreign trade promotion and representatives of the principal Federal agencies with primary interest in the problems of the promotion of Japanese foreign trade.

[17] Various portions of these papers are deleted.

Accordingly, the following personnel was designated to constitute the Mission:

Michael Lee	Department of Commerce
Norman P. Davis	Federal Reserve Bank of N.Y.
Edward W. Doherty	State Department
John F. Shaw	State Department
Arthur W. Stuart	Treasury Department
Patrick Henry	Tariff Commission
Derek Brooks	Department of Commerce
John Judge	Department of Commerce
Mabel Eads	Department of Commerce
Eleanor Crosby	Department of Commerce

Mr. Ormond Freile, Office of the Undersecretary of the Army, and Chief of Industry and Commerce Section—Far Eastern Group, was appointed to be the Chairman of the Mission.

During the first week of the activity of the Mission, the Chairman requested of Major General W. F. Marquat, Chief, Economic and Scientific Section, an agenda of topics which he and his advisory staff felt should be studied by the Mission. The agenda embraced the following six points:

1. Elimination of Government trading in favor of private foreign trade (export and import).
2. Adjustment of procedures to minimize Government restriction on trade growth due to burdensome documentation.
3. Maximization of foreign exchange earnings, with due regard to flight of capital and problems of dumping.
4. Stabilization of export prices.
5. Japanese export trade promotion problems.
6. Reduction of restrictions on financing of Japanese exports.

In order to delineate clearly the areas of study to be undertaken by the individual Mission members, the Chairman promulgated this list of responsibilities.

a. Items 1, 2, 4 and 5 are the principal responsibilities of the Department of Commerce Group and Mr. Henry.

b. Items 3 and 6 which would, of course, include the Foreign Exchange Control Exchange Media, and other financial aspects related to Foreign Trade, are the principal responsibilities of Mr. Norman Davis, Mr. Arthur Stuart and Mr. Edward Doherty.

c. The accumulation of full data on barter deals, procedures and impacts on U.S. Commercial policy are designated to Mr. Shaw.

In discharging their responsibilities and preparing data for final recommendations and findings, the members of the Mission worked closely with the American, United Kingdom, Dutch, French and Japanese Chambers of Commerce as groups, and with their members as individuals. All members were also in continuous touch with SCAP units and personnel with interests in the areas under study and with the counterpart units and individuals of the Japanese Government. As a result, each paper, in reporting findings, and in leading up to conclusions and recommendations, reflects existing practices and operating structures as well as the opinions, both of these concerned as administrators, and of those concerned as operating businessmen.

The members of the Mission are in unanimous agreement on the following major recommendations:

a. That the present system of floor prices be abandoned.

b. That foreign trade, other than imports financed with U.S. appropriated funds be transferred to private channels.

c. That procedures applicable to the conduct of foreign trade be simplified to the maximum practicable extent.

d. That banking functions now being performed by SCAP be transferred to the Japanese banking system to the full extent consistent with statutory or other requirements governing the management or disposition of foreign exchange funds.

The conclusions reached, and the detailed implementing procedures recommended by the individual specialists are set forth in the basic papers which constitute the bulk of this document. The order of presentation of the basic papers is shown in the Index, next following.

INDEX

The papers which comprise this document, "Recommendations and Findings of the Advisory Mission for International Trade", are presented in the order in which the assignments are shown in the FOREWORD.[17]

Papers prepared by Mr. Michael Lee, Mr. Derek Brooks, Mr. John Judge, Miss Mabel Eads and Miss Eleanor Crosby of the Department of Commerce and Mr. Patrick Henry of the Tariff Commission—

Recommendations and Procedures for Transferring Japanese Foreign Trade to Private Channels	TAB A
Diagram of Proposed Export Procedure	TAB B
Diagram of Proposed Import Procedure	TAB C
Abolition of Floor Prices and Surveillance of Export Prices	TAB D

*Papers prepared by Mr. Norman Davis, Federal Reserve Bank of New York, Mr. Arthur W. Stuart, Treasury Department and Mr. Edward W. Doherty, Department of State—

Replacement of Foreign Trade Payment Certificates With Yen	TAB E
Private Financing of Japanese Trade	TAB F

Papers prepared by Mr. John F. Shaw, Department of State—

Commercial Arrangements for Conducting the Foreign Trade of Occupied Japan	TAB G
Consideration With Respect to Certain Transportation Matters Relating to Foreign Trade	TAB H

*No paper was prepared on Exchange Control because of the recent arrival in the theatre of two representatives of the International Monetary Fund to examine and report on this subject.

RECOMMENDATIONS AND PROCEDURES FOR TRANSFERRING JAPANESE FOREIGN TRADE TO PRIVATE CHANNELS

It is recommended that Government participation in foreign trade operations should be discontinued at the earliest possible date and foreign trade transferred to private channels. Present methods of operating foreign trade have hampered the normal development of trade and the recovery of export industries, resulting in a tremendous waste of funds. For example, (according to information furnished by MITI), as a result of Government participation, July 1949 inventories of imported stocks procured with United States appropriated funds and proceeds of Japanese exports amount to more than 6.7 billion yen. Much of this goods was purchased by the Government without regard to industry specifications and is unsuitable for use by Japanese manufacturers. Dead stocks of goods produced for export without knowledge of world prices and market requirements are valued in excess of 68.8 billion yen. In addition, stocks belonging to Japanese Government Kodans valued at more than 6 billion yen, composed of all types of critical and miscellaneous items including hoarded goods and Japanese Army-Navy stocks, have never been utilized or disposed of. Continued Government interference in foreign trade and existence of foreign trade Kodans will result in further financial loss and will hamper the future expansion of foreign trade.

With the elimination of the Japanese Government from participation in foreign trade, it is recommended that the commercial Kodans should be abolished immediately and the stockpiles of imported and exportable raw materials liquidated as soon as possible. In order to expedite the disposal of such stockpiles, it is recommended that the cost value shown on the books of the Kodans should be ignored and the stocks offered on the basis of present world prices of similar commodities.

The proposed interim procedure involving negotiation between private buyers and sellers with screening of contracts by MITI and imports for Government account should not be adopted. The proponents of these measures argue that the function of the Foreign Exchange Funds Division of ESS cannot be taken over by the Japanese immediately, and they, therefore, recommend the interim procedure. In actuality, the Bank of Japan, as an agent of the Foreign Exchange Control Board, is sufficiently staffed with experienced personnel to perform the functions of the Foreign Exchange Funds Division immediately.

Preparation for the change from Government to private trading can be completed within two months at the most by the Japanese agencies involved (MITI, ESB and FECB) and by the Bank of Japan. The institution of the interim procedure would require nearly the same length of time as direct transfer and adoption of an interim procedure will therefore only add confusion and be an additional detriment to the foreign trade of Japan.

Due to the dependence of the Japanese economy upon United States financial aid, SCAP should retain responsibility for supervision and surveillance of the Japanese Government in its formulation of an overall commercial policy, production plan, and import and export programs. Such surveillance is imperative to promote industrial rationalization through an efficient system of raw material allocation and to prevent wasteful production resulting in heavy accumulations of finished goods and depletion of raw materials and foreign exchange.

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EXPORTS

The present export procedures were efficient safeguards for Japanese export trade at the time when there was no single exchange rate and commodities moved at multiple ratios. Japanese export producers and traders, isolated from the world, suffered from lack of information on prices and market requirements. Surveillance of 70,000 fluctuating floor prices on export commodities further hampered export trade. Government participation under the existing conditions of red tape and corruption was justified and, due to the existence of a sellers' market, Japan was able to trade in spite of these handicaps.

The change of conditions from a sellers' market to a buyers' market, the establishment of a single rate of exchange, and the forthcoming abolition of floor prices makes it imperative that export procedures be revised to enable Japan to compete in a buyers' market. Elimination of Government participation will contribute greatly to the expansion of Japanese foreign trade and help to correct the inefficiency of the present system.

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5. *Revised procedure required for estimating earnings from exports.* Upon the abolition of the export license for most transactions, the present method of forecasting foreign exchange receipts from exports cannot be used. This will not preclude the forecasting of foreign trade receipts which is necessary for import programming and budgetary purposes. The commercial invoice will still be available for use in forecasting anticipated receipts. Estimates by statistical methods admittedly will not be as accurate as the present forecasting system based on information from export licenses and export sales contracts. With the experience gained during the past few years, however, when all export sales were licensed plus the knowledge of the foreign exchange positions of Japan's markets, a statistical projection of exchange earnings can be made sufficiently accurate for planning and programming purposes. Adoption of this system will result in considerable saving in ESS and to the United States taxpayer by the elimination of the present cumbersome bookkeeping system. Responsibility for forecasting should be assumed by the Bank of Japan under supervision of FECB.

No change in the method of tabulating actual receipts of foreign exchange will be required since a copy of the commercial invoice, bill of lading and records of amounts received by the Foreign Exchange Banks will be available, while expenditures for imports will be shown by approved import licenses and letters of credit.

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TRADE PROMOTION

The most important requisite to expansion of Japanese foreign trade is its transfer from Government to private channels. Next in importance is an intensified and intelligent trade promotion campaign. Before the war the Japanese had a world reputation for being sharp traders utilizing modern industrial methods. This past reputation rapidly disappeared because of the following circumstances. Postwar development of Japanese foreign trade has been, up to the present time, in the hands of inexperienced Government officials. Isolation from foreign markets has resulted in lack of knowledge of foreign requirements and latest methods of trade promotion and advertising and in backwardness in technological development.

It is realized that from the point of view of international law, only a limited field of trade promotion development exists until the signing of the peace treaty and reestablishment of Japanese trade relations on the basis of the treaties of Friendship, Commerce and Navigation. Nevertheless, under these limited circumstances, progress can be made in analysis of markets, sales promotion, and acquisition of industrial techniques for the Japanese.

At the present time due to the desire on the part of the United States to facilitate Japanese economic recovery and development of international trade, arrangements have been worked out for Japanese trade representatives to enter the United States. In addition, under the present foreign exchange retention scheme, Japanese foreign trade is in a position to utilize a limited amount (averaging 5 percent) for trade promotion purposes. Undoubtedly, similar arrangements can be made to allow Japanese traders to enter other countries of the world without the benefit of a peace treaty.

In order to fully utilize and exploit the opportunity to send representatives abroad for trade promotion, it is recommended that the Japanese Government, out of the proceeds of the commercial account, establish officers similar to the former U.S. Trade Commissioners in the countries and cities where they can operate on the basis of arrangements worked out with such

other countries without the benefit of the peace treaty and commercial agreements. Such trade commissioners should be responsible and under the supervision of the Japanese Government and not, under any circumstances, be under the surveillance or supervision of SCAP.

Among the principal functions of such trade commissioners should be: (a) studying and analyzing markets for Japanese products; (b) setting up a system of statistical services relating to trade potentials between Japan and foreign countries with emphasis on services to the Japanese exporters; (c) furnishing trade information service for foreign buyers and Japanese traders, with particular emphasis on credit information and intelligence services to foreign and Japanese inquirers; (d) studying foreign exchange problems, tariff problems of foreign countries, and making surveys of exported and imported commodities; (e) activities for promotion of invisible Japanese foreign trade, such as insurance, banking and tourism; (f) publication of trade information in foreign countries, covering principal Japanese industries, by areas and by commodities in Japan; (g) furnishing the Japanese Government (MITI) with information essential for commercial policy formation, overall production plan, and export-import programs, the latter dealing with pricing and availability of raw materials; (h) gathering information for publication at the request of the Japanese Government or individual manufacturers or traders on retailing, designing and market conditions of particular merchandise; (i) collecting, screening and supplying information related to Japanese production for foreign buyers and similar information for technological publication, commercial publication for Japanese Chambers of Commerce, industrial associations, or individual manufacturers or importers.

The existing foreign exchange retention procedure as embodied in Cabinet Order No. 266 concerning the Use of Authorized Foreign Exchange Credit for Promotion of Export (July 15, 1949) should be put into practice as soon as possible. Implementation of the Cabinet Order should be less cumbersome than presently operated particularly in regard to purchase of patent rights and services furnished by foreign technical and engineering consultants.

In order to centralize industrial research, it is recommended that the Japanese Government (MITI) establish a bureau similar in functions to the Bureau of Standards of the U.S. Department of Commerce where outstanding scientists and technicians will work continuously on improvement and development of new products and technical skill which will eventually be available to Japanese industry as a whole. Establishment of such research bureau will not only benefit Japanese industry and commerce, but will pool available resources of technical knowledge now decentralized. In many fields scientists are duplicating each other without knowledge or exchange of information.

It is further recommended that under the supervision of MITI a central publication service should be established where exchange of information and dissemination of new developments in technology would be released to interested Japanese industries.

In order to build good will for Japanese products, it is urgently required that such a bureau prescribe standards and high quality for Japanese export goods.

ABOLITION OF FLOOR PRICES AND SURVEILLANCE OF EXPORT PRICES

Recommendations

It is recommended that all floor prices on exports of Japanese goods be abolished immediately, except those on raw silk and manufactures thereof on which commodities floor prices should be retained until December 31, 1949 in accordance with a previous commitment by SCAP. Floor prices on silk should be abolished after December 31, 1949. These recommendations are in conformity with the policy agreed to by Washington (CM IN 92890, 16 Aug. 1949 and telecon 2635, 7 Sept. 1949) and result from a thorough investigation of the problem in Japan and discussion of export price surveillance with members of the ESS staff.

With the abolition of floor prices an efficient surveillance and check of export prices should be established to prevent flight of capital and possible dumping. This surveillance should be based on the following criteria:

1. The price of any commodity when exported should not be less than the price of like commodity of comparable grade and quality when offered for sale in the domestic market to corresponding type of trade.
2. For those commodities or grades of commodities produced solely for export and which therefore do not have a domestic price, the price when exported should not be less than the total cost of production plus necessary handling charges and reasonable profit.

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REPLACEMENT OF FOREIGN TRADE PAYMENT CERTIFICATES WITH YEN

The inflexibility and inconvenience of the Foreign Trade Payment Certificate has led to

general agreement that it should be abandoned in favor of an alternative payment medium for the use of foreign personnel in purchasing goods and services which are either especially imported from abroad or are received from domestic production for sale for foreign currencies.

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PRIVATE FINANCING OF JAPANESE TRADE

One of the prerequisites for the return of Japan's foreign trade to private channels is the establishment of commercial banking facilities for financing Japanese exports and imports. At present, procurement of Japanese imports is effected either by the Department of the Army, by SCAP or by an agency of the Japanese Government, and all exports are handled for SCAP account. In the financial transactions incident to these exports and imports, it is not clear whether SCAP is acting for his own account, as trustee for the Japanese Government, or as agent for the Japanese exporter or importer. The position of SCAP is anomalous in that he may be acting as buyer, seller, banker, agent and sovereign supervisor in the same transaction. Under this system, there is no clear delineation as to liabilities or rights of recourse in case of misrepresentation or mishap. It is therefore an open invitation to carelessness and fraud in the handling of exports from Japan because of the difficulty of obtaining redress in such cases as shipment of defective merchandise, damage due to improper packing, etc. The inevitable result is the piling up of inventories of unsold and perhaps unsaleable merchandise, loss of foreign exchange proceeds therefrom, myriad claims and counterclaims, and mounting reticence to trade with Japan. Similarly, central procurement of imports inevitably leads to a waste of foreign exchange resources in importing merchandise which is unsuitable to the needs of Japanese processors or which is damaged, spoiled or lost in the shuffle because of carelessness or irresponsibility, but always with SCAP "holding the bag". The Mission recommends that SCAP should get out of the procurement and banking business as rapidly as possible and in particular that there should be no further delay in the transfer of trade to private hands and in the establishment of facilities for financing such trade through normal commercial banking channels.

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COMMERCIAL ARRANGEMENTS FOR CONDUCTING THE FOREIGN TRADE OF OCCUPIED JAPAN

SCAP has entered into a variety of commercial arrangements for reviving the foreign trade of Occupied Japan. These include tying in of individual import and export transactions (barter), bilateral balancing of overall trade, and ordinary cash transactions outside the scope of a trade plan. Tie-in arrangements are generally informal and may be effected through simultaneous signing of export and import contracts or in arrangements under which procurement is approved on condition that a given amount of export trade will result.

Back to Back Trading: This type of trading is effected through approved letters of authority or letters of credit. In essence, this procedure provides that an import credit will only be available after a contract for Japanese exports of equal value has been approved and a letter of credit opened equal to the amount of the letter of credit which SCAP opens up for the import transaction. This type of transaction has been used particularly with Sweden where Swedish trade is carried out through government approved trade groups on the basis of balancing Swedish imports against Swedish exports. The terms of understanding for trade between Sweden and Occupied Japan provide that until a formal financial arrangement is agreed upon trade is to be conducted on the basis of "balanced trade transactions". "Back to back trading" has also been used with respect to Egyptian cotton and in procuring a number of other commodities.

Escrow: Under escrow arrangements the bank holds the proceeds of import letters of credit in its custody which proceeds must be utilized for payment of exports of equal value. This method is also available for the utilization of export letters in payment for imports. The essential difference between back to back and escrow transactions is that under back to back letter of credits foreign exchange is made available to the beneficiary, whereas under escrow transactions foreign exchange is held by the banks to effect payment for the offsetting purchase. Egyptian cotton is also an example of a commodity purchased under escrow.

Other types of transactions which may or may not incorporate the principle of trade balancing include those conducted through open account or on a cash basis through usual commercial credit instruments.

Open Account: The open account method of trading is used to facilitate foreign trade without placing any immediate burden on the dollar or sterling exchange of the countries involved. By use of local funds, payment is made to shippers in local currency; no foreign exchange is

transferred in connection with the individual foreign trade transaction. An example of this type of trading is found in the provision of the trade arrangement with Argentina. This provides that "all payments of whatever nature corresponding to direct operations between the Argentine Republic and Occupied Japan will be effected in United States dollars, through a special account that the 'Banco Central de' la Republica Argentina', representing the Argentine Government, will open under the name of the institution designated by the Supreme Commander for the Allied Powers."

Cash Trade: Trade with sterling area countries and many other areas is conducted on a cash letter of credit basis. For example, under this procedure, the foreign buyer opens a letter of credit in sterling or dollars in payment for Japanese exports; for all Japanese imports from sterling or dollar areas SCAP opens a letter of credit. These letters of credit are credited or debited to the appropriate SCAP commercial account in accordance with normal banking procedures. An example of a trade arrangement providing for handling trade on this basis is found in the arrangement with Korea. This reads as follows:

"2. Except as otherwise mutually agreed, all trade between Korea and Occupied Japan shall be conducted in terms of United States of America currency."

"3. Settlements will be effected by payments in cash on an individual transactional basis and shall be accomplished by means of usual commercial bank instruments including letters of credit or bank drafts which may be assignable in appropriate cases."

Extents to which Various Trading Methods are Used: An analysis* of SCAP's trading methods prepared by the Accounts and Records Branch of ESS/FEF on the basis of value of contracts approved from February through September 1949 indicates that by far the largest percentage of SCAP foreign trade transactions, whether carried out under trade arrangements or not, are handled on a cash/letter of credit basis (See Table 1). Where trade arrangements have been concluded settlement through a special account provided for by the arrangement is the second most widely used method. The value of contracts let on a back to back or escrow basis is relatively small in relation to the value of total contracts let; utilization of these methods is probably more common where trade is conducted outside a trade plan. The following table sets forth an analysis of the contracts let under these various methods.

TABLE I
ANALYSIS OF SCAP'S TRADING METHODS AS A PERCENTAGE OF THE VALUE OF APPROVED CONTRACTS[1]
FEBRUARY THROUGH SEPTEMBER 1949

TRADE METHOD	UNDER TRADE ARRANGEMENTS		WHERE NO TRADE ARRANGEMENT EXISTS	
	IMPORTS	EXPORTS	IMPORTS	EXPORTS
Back to Back	4.3%	1.5%	1.6%	0.5%
Escrow L/C	3.4%	2.2%	20.2%	3.1%
Open Account	33.4%	20.5%		
Cash/Ltr of Credit	58.9%	75.8%	78.2%	96.1%

[1] This does not include purchases effected with U.S. appropriated funds.

Recommendations: The trade methods which are being utilized by SCAP have developed out of the experience of those directly responsible for rebuilding the foreign trade of Occupied Japan in the immediate postwar years. It is appreciated that their decisions were made only after most careful consideration of the facts and conditions with which they were confronted; no other decisions may have been justified. However, it is hoped that the above elucidation of the commercial policy objectives of the United States may assist those officials who are responsible for the future conduct of the foreign trade of Occupied Japan. The following specific recommendations are made with the view to assisting SCAP to bring its foreign trade operation into closer conformity with the commercial policy of the United States.

1. A primary consideration in expanding the foreign trade of Japan on a multilateral basis free from planned control is the return of import and export transactions to private traders and the dispatch abroad of private commercial representatives. The latter can be expected to reestablish Japanese agencies abroad and bring the variety of Japanese products available for export to the attention of foreign buyers.

2. From the standpoint of U.S. commercial policy, transactions handled on a cash/letter of credit basis are considered preferable to back to back, escrow or open account transactions, and the use of this method for conducting trade should be furthered.

* A copy of this analysis is on file in ESS/FEF.

3. Barter through back to back, escrow letter of credit, or other means is considered the least desirable method of conducting trade and resort to this method should be discouraged and eliminated as soon as possible.

4. Consideration should also be given to eliminating Trade Plans which accompany most SCAP trade arrangements in order to permit the exchange of a greater diversity of commodities than envisaged by current trade plans and to remove the trade ceilings which these plans tend to envisage.

5. The drafting of notices by MITI and releases given to the Japanese press should be more judiciously worded so as to avoid unnecessary criticism arising from indiscriminate use of the word "barter".

6. In order to remove the necessity of balancing all trade arrangements consideration should be given to use of a clause suggested in connection with the Latin American agreements providing for consultation between the parties to SCAP arrangements with the view to transferring credits to third countries.

CONSIDERATIONS WITH RESPECT TO CERTAIN TRANSPORTATION MATTERS RELATING TO FOREIGN TRADE

Recommendations:

1. Existing merchant fleet should be fully utilized and augmented.
2. Applications for counterpart fund for use in ship construction should be processed expeditiously once shipbuilding program approved.
3. Volume and variety of cargoes available for shipping in Japanese vessels should be increased.
4. Diplomatic assistance should be rendered SCAP by U.S. Government in obtaining blanket clearances for Japanese merchant vessels operating under SCAP administered foreign trade programs.
5. SCAP's trade arrangements should include provision permitting SCAP to provide a share of the shipping required by Trade Plan and assuring non-discriminatory treatment for Japanese vessels.
6. Japanese exporters should be permitted to quote CIF and importers FOB.
7. Equitable relationship between costs involved in water and rail transportation should be restored through increasing railroad freight rates.
8. Rail and shipping subsidies should be eliminated.

[SOURCE: SUITLAND PAPERS, Z 721-10]

9-29 REPORT ON EXCHANGE AND TRADE CONTROLS IN JAPAN

Report[18] November 18, 1949
To: General MacArthur
From: J. V. Mladek and E. A. Wichin (IMF staff)

Dear General MacArthur:

On 10 October and 17 October respectively, Mr. Ernest A. Wichin and myself arrived in Tokyo in response to the invitation of the Supreme Commander for the Allied Powers. The purpose of the Mission has been to assist the authorities in establishing exchange and trade controls in Japan.

As a result of its studies, the Mission has prepared a "Report on Exchange and Trade Controls in Japan", which is herewith respectfully submitted for your consideration. There is also submitted for your consideration another more confidential and short report which it is believed you may not wish to give wide circulation because of its confidential nature.

During its visit in Tokyo the Mission has been called upon on many occasions to give oral advice concerning particular problems of exchange and trade control. It is hoped that the oral advice given and that the attached reports will be of some assistance and guidance in developing a system of foreign exchange and trade control in Japan.

The Mission wishes to take this opportunity to express its thanks to the Supreme Commander for the Allied Powers for the invitation to visit Japan. It also wishes to express its appreciation to Major General W. F. Marquat and his staff for their cooperation and assistance which have greatly facilitated the work of this Mission.

Sincerely yours,
JAN V. MLADEK

[18] The Introduction, Summary, and Supplement are printed here.

Introduction

On the basis of preliminary studies made during the first part of this Mission's visit, it had been envisioned that the Mission would prepare a written presentation of advice encompassing both the general and detailed technical problems of exchange and trade controls. However, the decision to return the Functions of exports and imports to private channels on December 1 and January 1 respectively caused the Mission to change its plan of work. The pressure of time resulting from those deadlines meant that SCAP would have to make decisions in a very short time on certain policy questions and main technical operational problems. The Mission was invited to take part in the various conferences and working group meetings concerned with those problems and rendered oral advice generally, and specifically in response to questions.

In view of the procedure adopted, this report does not intend to repeat the advice on technical detail already given or to be given during the discussions currently being held with SCAP and Japanese authorities. It is felt that at this stage in the plans it is probably more important to make a record of reasons behind the general features or the proposed system and add a few thoughts of guidance for policy making and operation of exchange controls. The guiding ideas and the warnings contained in this report have been sounded by the Mission to a limited number of SCAP officials during the various discussions. There are a great many people who were not present at the discussions who will be concerned with the operation of the exchange and trade control system. It is hoped that this report will assist them in carrying out their functions. For those who were present, the report may serve as a reminder, since principles may sometimes be more easily forgotten than technicalities.

It should be stated that while the advice given is based to a considerable extent on the professional experience gathered in the work of the International Monetary Fund, it has been given and the report written, in a private capacity of the two undersigned without consultation of the international institution which bears no responsibility for the advice and the report.

Summary

The following is a summary of the report prepared by this Mission concerning the general principles and reasoning that should be pursued in establishing a system of exchange and trade controls in Japan.

1. On the basis of the current economic situation in Japan and the proposed plans to make Japan a self-supporting economy, the Mission has taken the position that system of exchange and trade controls is needed in Japan. It feels that the system best suits: for Japan is one which would establish direct control over exchange and trade transactions. In the revenue side this means maintenance of controls in order to prevent a flight of capital and assure that all exchange is returned to authorities. On the payments side restrictions should be achieved by direct licensing of either the payment or the transaction.

2. The Mission suggests in the report that a prerequisite to the successful operation of any exchange control system is the realization that exchange and trade controls are interdependent and that they must be fitted together into one comprehensive and homogeneous scheme.

3. The most appropriate method to achieve coordination between trade and exchange seems to be in this case the use of an exchange budget. It is suggested that there should be an overall target plan for a period of one year, and possibly longer, which would estimate the total import requirements on the basis of long and short range programs and fit those requirements into the scope of the estimated exchange availabilities. Then, in accordance with the overall target plan, there should be established a short working budget in which specific and detailed allocations of the exchange available are made. In order to avoid defaults on payments and an unnecessary depletion of the monetary reserve, it is essential that the working budget be prepared with caution and moderation, remain relatively unchanged once it has been introduced, and it should provide a special fund which might finance any unforseen commercial or trade opportunities and thus provide sufficient elasticity. A monetary reserve should be maintained for major miscalculations or failures on the revenue side or emergencies on the outlay side. Owing to conditions of inconvertibility, it would appear that Japan would be required to maintain separate exchange budgets for transactions in dollars, sterling and open account transactions in accordance with trade agreements, while other currency accounts may have to be set up later.

4. The Mission recommends that as a basic principle all goods that are in short supply in Japan should either come under a system of allocation, or price and distribution control or both; that the system of automatic or general licenses on a "first come first served" basis should only be used for those commodities which it can be reasonably assured will not be in short supply in Japan. Along those lines the Mission also suggests that there are certain current invisible transactions which must be accommodated irrespective of how small the exchange availability may be, and that, therefore, these expenditures should be allocated in a fashion similar to the allocation of commodities in short supply.

5. With respect to the control of exports and export proceeds, this Mission agrees that it is necessary to license exports that are in short supply in the domestic market. However, it is felt that full consideration should also be given to the fact that it may become necessary to direct exports to certain currency areas in order to achieve a balance of payments with those areas. It is recognized that when the objectives are solely to prevent capital flight and to assure the return of exchange, the control may be effected in many ways with or without export licenses.

6. At the current time Japan cannot afford indiscriminately to allow foreign investment since all such investments should carry with it the responsibility of the government to permit the proper servicing of them. It is recommended that the authorities should gauge carefully the general offset of investments on the balance of payments and make a strenuous effort to avoid the danger of having a balance of payments laden with capital obligations while the earning power for the foreign exchange of the country has increased insufficiently.

7. From an organizational point of view it is suggested by this Mission that the budget of exchange expenditures, since it involves the interests of more than one agency, should be established by a committee or council of ministers representing those factors of the economy which either draw upon or contribute to the foreign exchange availabilities. The administrative work involved in putting the budget into effect are functions customarily performed by a central bank which, because of its organization, is usually the best suited agency to effectively carry out such operational details. The central bank should use the services of certain designated foreign exchange banks to assist in the operations of the system vis-a-vis the public. It may be deemed advisable to have a separate independent agency serve as a permanent governmental auditor, as an additional check against individual ministries overstepping the budget or other jurisdictional limitations. It is suggested, in this suspect, that this agency should be divorced from the policy and operations of the system.

8. As a means of reducing the possibility of graft, the Mission suggests a system of application for all import allocations and licenses granted, and the creation of a Committee of appeal to which importers may register complaints concerning favoritism extended to other importers, and which would have the power to investigate all such complaints. It appears that the functions of this Committee may be placed in the independent agency established as the governmental auditor.

Confidential Supplement to the Report on Exchange and Trade Controls in Japan

The following memorandum concerns itself with certain considerations of policy which the Mission feels might be of a more confidential nature than the report. It has been separately prepared in order that the report may be given a wider circulation, if that is desired.

There are two points which the Mission would like to bring to the attention of the proper SCAP authorities concerning the establishment of exchange controls in Japan.

1. With respect to the organization of exchange controls the Mission has already indicated in the course of discussions with various SCAP officials that it disagrees with their views. The Mission is not enthusiastic about the number of agencies which, through the suggestion of SCAP authorities, have been created to handle the exchange controls. Some of these agencies are of a temporary character, and it is probable that the functions of exchange controls will outlive these agencies; therefore, the Mission feels that the assignment of functions to these agencies is a temporary expedient and only postpones what will inevitably happen in the long run, i.e., the transfer of these functions to more permanent agencies.

The Mission tends to favor placing the various functions in the already existing permanent agencies. Starting at the top of the organization, it has been suggested that the chairmanship of the ministerial council dealing with the budget should rest with the Minister of Finance who is, or should be, responsible for the stability of the currency. Consequently it is, or should be, the Ministry of Finance who would be primarily concerned with the balancing of international payments. Following the general principle that the Ministry responsible for a given field should have jurisdiction over the field, it was thought that the Minister of Finance should establish offices to prepare the quarterly budgets. The Mission feels that this would be more desirable than assigning the budget functions to ESS, for the reason mentioned above and for the following reason. ESS is responsible to the Prime Minister; thus, in order to avoid giving to one ministry

functions which it is deemed make it too powerful, the functions are ascribed to the Prime Minister who already carries the strongest power in the government. It seems to be a conflicting consideration, which acting on the motivation of decreasing the power of the most influential minister by creating important departments, results in a concentration of power in the hands of one minister instead of three or four.

On the operative echelon, it is agreed that the Bank of Japan could handle the functions of exchange control satisfactorily, and in most countries the central banks do handle this part of the job. However, in practically all countries the central banks acts as the governmental agency and is responsible to the Ministry of Finance. It has been suggested on the SCAP side that FECB should assume the responsibilities for the operations of the exchange control system. Again the question of ministerial jurisdiction arises. FECB is responsible to the Prime Minister, and, therefore, in fact the Prime Minister is to be granted the overall power on the two higher echelons of the exchange control system, whereas the responsibility for the external value of the currency lies directly with the Minister of Finance and only indirectly as part of the overall responsibility of the Prime Minister.

It is the impression of the Mission that FECB had originally been created for controlling, auditing and similar functions and not for operation. As such, it fits much better into the general scheme as a body of independent men, which would be the place of appeal against malfeasance or unjust conduct of affairs. It is a strong belief of the Mission that an impartial and objective agency, devised to watch the morale aspect of the exchange controls, would be worth having in Japan. However, such an agency should not be an operative agency. If the FECB is a controlling and auditing body, then its jurisdictional responsibility and straight line of report to the Prime Minister is justified.

2. It is assumed that it may be the desire of the Allied authorities to withdraw gradually from the direct control of the Japanese economy. However, the Allied authorities for some time to come will find it necessary to maintain some controls in order to assure that the economic situation does not seriously deteriorate and that American aid funds are not misused. The controls which remain should assume indirect forms and attempt to become less conspicuous and obvious. In view of the tremendous importance of trade for the Japanese economy, it would appear that the direction of the exchange and trade controls would offer a very powerful instrument to control the main development of economic life in Japan. Close supervision of the foreign exchange budget and of the import programs and the export practices, would provide a very deep insight of the Japanese economy and its internal processes. It would also provide a good picture of the development of Japanese relations with the rest of the world. It is most important, however, to realize that exchange and trade controls form a strategic point, from which there is excellent opportunity whenever necessary to intervene in the economy of the country. It should be understood, however, that such interventions will be of maximum benefit only if they are early introduced as preventive means to avoid the development of critical problems.

[Source : Dodge Papers, Z 711-7]

9-30 FISCAL YEAR 1951 APPROPRIATION FOR ECONOMIC AID TO JAPAN

Statement January 19, 1950
For: National Advisory Council
By: Joseph M. Dodge

In considering the problem of the FY 51 appropriation for Japan, I believe the following basic factors deserve particular consideration:

1. At present, Japan is the focal point of our established Far Eastern interests. While over some period in the future it may become one of several important interests of the United States, at present it is the sole Asiatic nation in which we have both a major influence and complete control over all of the factors necessary to achieve our objectives.

2. The trend of events in this area over the past year, and particularly recently, has served to emphasize our need to reinforce and solidify our position in Japan.

3. It is probable that the development of our future Far Eastern policy will require the use of Japan as a springboard and source of supply for the extension of further aid to the Far Eastern areas.

4. What has been accomplished in Germany at substantially greater cost was because of an earlier large direct outlay plus billions of dollars of aid in contiguous trading areas which

contributed to the recovery of Germany, and multiplies the effectiveness of our direct aid to Germany. Germany was integrated into the European Recovery Program. This has not been true in the Far East. A growing market was created for German production while Japan continues to exist in an area of political and economic disturbance having production, trade and income levels still below pre-war. The actual and projected appropriations for the fiscal years 1949, 1950 and 1951 for economic aid for Tri-Zone Germany are approximately twice that for Japan. On a population basis for Germany of something more than half that of Japan, the appropriations for Germany are over three times the amount for Japan per capita. The proposed FY 51 appropriation for Tri-Zone Germany is more than twice that of the amount of economic aid requested for Japan.

5. We should note the substantial progress that has been made in Japan on relatively modest appropriations. Effective financial stabilization substantially has been achieved. There has been an increasing transfer of responsibility from the Occupation to the Japanese Government and to the Japanese people. There has been a substantial increase in exports and industrial recovery has proceeded at a heartening pace and is now at almost the level of the 1932–1936 period. For the first time (in 1949) there is a reduction in the foreign trade deficit.

In no other nation has so much been accomplished with so little.

6. The FY 51 appropriation request for Japan has been reduced substantially. On a basis of $320 Million for Japan and the Ryukyus, the reduction for FY 51 from FY 50 is 33.6%. In economic aid requested for Japan there is a reduction of 35 per cent. This compares with a proposed reduction for FY 51 in the ECA total of 21.4 per cent and for Tri-Zone Germany of 21.7 per cent.

7. There are two fundamental policy directives affecting the administration of Japan. One is the Stabilization Directive, which originated in the NAC, and the other, the NSC 13 Directive. Aggressive and progressive steps have been taken to implement both of these.

However, it should be realized that there is a certain degree of conflict in implementing these while arriving at a common objective. The progressive decontrol of the economy, according to the principles of NSC 13, contributes to the difficulty of maintaining a stabilized economy. The additional freedoms accorded the economic mechanism add to the dangers of a recurring inflation.

For example, the elimination of the local area military government teams adds to the difficulty of food collections in a nation where there continue to be shortages of essential industrial raw materials and food and where the black market has not been completely eradicated. The direct use and the indirect influence of this element are lost and have a limiting effect on the most efficient marshalling of assets.

8. The Stabilization Directive is being implemented and fulfilled to the maximum degree with the full support of the SCAP organization, and at least so far, with the minimum of difficulty considering the scope and nature of the problem.

In consequence, Japan is well on the way toward the achievement of the fiscal, monetary price and wage stability which is required by the Stabilization Directive for example, a balanced consolidated Japanese Budget has been achieved for fiscal years 1949 and 1950—namely, April 1, 1949 to April 1, 1951.

It is imperative to remember that there is a direct relationship between the amount of economic aid given Japan and the price, the wage and the tax structure in the Japanese budget computations.

The elimination or reduction of subsidies and the decontrols have been reflected in higher commodity and other prices. The same is true of increased railroad freight rates. The reduction of the price for over-quota deliveries of rice from three times the official price to two times, may, and probably will, somewhat curtail the rice collections. These and other similar factors are an integral part of the budget computations. In other words, our endeavors to achieve fiscal and monetary stability have the closest of relationships with the problems of achieving price and wage stability.

9. One of the real issues connected with economic stabilization is in its political and social repercussions. The problem is to prevent justification for demands for disruptive increased monetary wages by maintaining the present real wages or insuring slight increases. A beginning has been made on this and some noticeable results accomplished, but the issue continues to be threatened. Currently there is great political pressure for wage increases. The increases in official prices which affect living costs have been offset as nearly as possible by tax decreases, but this is a very difficult result to forecast accurately.

If there should be an adverse crop result or any failure in food collections, there would be great difficulty in maintaining the wage stabilization called for by the Stabilization Directive.

We have been very fortunate in that Japan has recently benefited from two excellent crop years.

10. The critical internal issue (which parallels the economic and financial stabilization) is in the insurance of a corresponding political and wage stabilization, and the creation of living conditions that will not contribute to encouragement of Communist activities.

The accomplishment of this largely lies in a progressive increase in the purchasing power of wages as against the shadow of the substance of an increase in monetary wages. It hinges almost entirely on improvement in the food ration and in domestic cotton consumption.

I have made a practice of asking informed Japanese what they would do, if they could control the situation, to insure political stabilization, labor stabilization, and a continuing economic and democratic reconstruction. Invariably, the reply called for some increase in food and cotton goods availability.

11. The present Japanese budget provides for an offset to increased prices for food consumption items by a decontrol of sweet potatoes, and a substitution for cereals. It was originally believed that a full substitution could be made. The present indications are that this cannot take place. It appears that the total in-take (that is, the official ration plus other purchases) which, on the average absorbs about 65 per cent of the individual Japanese income, will represent about 2,115 calories, compared with a much larger intake provided in Germany and Europe. The requested appropriation will increase the total in-take about 40 calories above FY 50, which is only a fractional increase. It is necessary to maintain as high a rationing availability as possible, primarily for the depressing effect on black market prices and the resulting improvement in-real wages.

The budget provision for cotton provides for a more significant increase. However, this is the area of domestic consumption which remains at a relatively low and completely unsatisfactory level. What is proposed would raise domestic consumption of textiles to about 57 per cent of pre-war, as against Germany, at 90 per cent of pre-war in fiscal 51. The pre-war domestic consumption of cotton in Japan was approximately seven pounds per capita, whereas the budget proposal brings this up to 3.4 or about half that level.

12. It should be emphasized that the principal components of the appropriations have to do with food and cotton referred to above. These are both commodities which are and will remain in surplus and which are now held by the Commodity Credit Corporation, or which the CCC is committed to buy under existing legislation. To that extent, they do not represent increased expenditures or an increase in future Government expenditures.

13. To summarize, the internal stabilization, politically and economically, depends substantially on effectively increasing the real value of wages and reducing black market prices as long as shortages exist. This is the only way to withstand the pressure for wage increases and stave off another spiral of wage-price increases.

Japanese FY 49 and FY 50 are, I am convinced, the most critical years in achieving a permanent foundation for the stabilization of the economy. To reduce the appropriation below the amount finally submitted for your consideration would be to run a serious danger of defeating the stabilization accomplishments to date, which have been carried out under instructions from and agreement with the NAC and NSC.

I ask your approval of and support for the amount requested for economic aid to Japan.

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY]

9-31 PROPOSALS TO CHANGE U.S. AID PROGRAM APPROACH

Memorandum June 21, 1950

To: Major General W. F. Marquat

From: K. D. Morrow, Programs and Statistics Division, ESS

Dr. Garvin's letter of 29 May to you outlines four possible alternatives to the present aid program for Japan, as follows:

1. Providing U.S. dollar funds for developing projects in Southeast Asia with or without the earmarking of such funds for the purchase of Japanese exports.
2. Diverting GARIOA funds for aid in Southeast Asia countries.
3. Granting yen credits to Southeast Asia countries, probably using counterpart funds for such purposes.
4. Substituting for GARIOA an authorization to permit Japan to purchase U.S. goods with yen which, in turn, would be appropriated by the U.S. Congress for aid to Southeast Asia.

All four of the suggestions are theoretically workable, provided appropriations are of ad-

equate size and are accompanied by *satisfactory* coordination and control. There are important differences in the several suggestions—differences sufficient to warrant giving immediate consideration only to Plan 3.

Plan 3 has a number of advantages. *First,* assurance is given of adequate aid to Japan. *Second,* it assures Japan of credit against its liability for GARIOA aid for such amounts as might be advanced and not repaid by the countries of Southeast Asia. *Third,* it is but a minor modification of the present American aid program for Japan, providing only for the extension of yen credits from the counterpart fund. This modification can be made with the least possible upset of the present aid program and already has strong support within the Japanese Government. Unless there are overwhelming reasons for change, the U.S. aid program to Japan should not be materially changed at this late date. Plans 1, 2 and 4 involve far-reaching changes, while Plan 3 involves only a modification of part of the present program. *Fourth,* Plan 3 offers the least interference with the normal trade between Japan and the areas of Southeast Asia to be assisted. The normalizing exchange of Southeast Asian food and raw materials for Japanese consumer goods can continue to be expanded, while the yen credits can be concentrated on long-range projects and thus add to, but not interfere with, growing normal trade. *Fifth,* Plan 3 can be inaugurated immediately by modification of the present counterpart fund program. Plans 1, 2 and 4 would be slow to start and take a longer time to get into full swing and thus have (little or) no effect on actual imports and exports during the next year (1951). *Sixth,* the proposal is an extension of the "import first" principle already adopted by the Occupation for the purpose of stimulating exports by expanding imports. Presently, U.S. dollar working capital is used for this purpose. Additional yen credit would further assist and relieve some of the pressure on dollar working capital. *Seventh,* Plan 3 can be adjusted automatically on the basis of the internal financing capabilities of the Southeast Asian countries concerned. Little consideration has thus far been given to this problem. There is an unknown but definite limit to the internal financing capabilities of Southeast Asian countries. As each Southeast Asian country makes a request for yen credits for the purchase of capital goods, the application for credit can be accompanied by evidence to the effect that internal financing for the subject project is available. In those instances in which the project is desirable and internal financing is not adequate, then there could be prepared a sound request for direct American aid for that part of the project. For such consumer goods as Japan could supply for such dollars, American aid to Japan could be further reduced. *Eighth,* Plan 3 can virtually reestablish the yen as an international currency without a peace treaty. (The same is true of Plan 4).

The general theory of Plan 4 is superior to that of Plan 3 in that the yen credit to Southeast Asian countries would be extended officially by the U.S. The policy of SCAP (representing the U.S.) approval for each counterpart fund project should therefore be continued under Plan 3.

Mechanically, Plan 3 is somewhat easier to operate than Plan 4. Under Plan 4 there is the prospect of involved time-consuming negotiations between the country seeking yen credits, Washington, SCAP, the Japanese Government, and the Japanese supplier. Plan 3 would in fact be consistent with SCAP's delegated authority and thus facilitate the handling of the individual credit applications. Further, the best end product from a program of this type would result if the new trade is *added* to the normal trade of the area.

The immediate adoption of Plan 3 does not preclude an ultimate shift to Plan 4. Further, Plan 3 does not preclude resort to either Plans 1 or 3 under appropriate conditions. In fact, the same project in Southeast Asia could require both U.S. dollar aid and yen credits. This might be a simple case involving both U.S. and Japanese suppliers and Plans 1 and 3. It might be a more complicated case involving both U.S. end Japanese suppliers and inadequate internal financing. In the latter case the concepts in Plants 1, 2 and 3 could all be utilized, with Plan 2 being used to provide funds for consumer goods from exterior sources. Very large developmental projects carry the threat of inflation in a country with limited supplies of consumer goods and limited capacity for internal financing. Inflationary pressures could be minimized by direct dollar aid for consumer goods requirements of external origin.

Plans 1, 2 and 4 should be rejected as alternatives *at this time* for the following reasons:

1. Plans 1, 2 and 4 shift the focus of attention from Japan to Southeast Asia. While the U.S. should direct attention to Southeast Asia, *primary* attention should still be focused upon Japan. It is very dangerous to consider that Japan will in fact obtain substantial funds in proper phase from economic aid projects in Southeast Asia. There is a preference on the part of these countries for American, British, and European goods. Second, there will be pressures on the part of both American and British firms to obtain their "just" share of such aid. Third, British ownership of many of the enterprises in the area may bring Sterling Area trade pressures

upon countries of the area. Fourth, several countries in Southeast Asia lack adequate internal purchasing power. Fifth, it is doubtful if the governments of the area concerned are strong enough to control the dollars under Plans 1 and 2 when they are already engaged in fighting the flight of capital.

2. Plan 4, while having interesting long-range possibilities, does not have within it the assurance of continuing Japan's orientation towards the U.S. Two possibilities are involved: (a) The Japanese Government might be far too restrictive of the quantities to be purchased from the U.S. and might be particularly susceptible to pressure from the agricultural segment of Japan's economy with respect to food. The Japanese Government might decide to purchase no American food as a means of continuing the "economy of scarcity" as a bulwark for Japanese agricultural prices; (b) On the other hand, the Japanese Government might wish to reorient Japan to reestablish Manchurian and Chinese trade to the virtual exclusion of American trade. The primary difficulty is that Plan 4 puts in Japan's hands the key decision—that of the quantity of goods to be procured in the U.S.—even though it provides for U.S. appropriations of the yen accumulated for American goods.

It is probably that the most restrictive influence on aid for long-term projects in the Far East Asian countries is internal financing for the necessary supplemental funds for installation and construction which, in most cases, will equal or exceed the amount of foreign exchange required for materials, supplies, equipment, and technology. Many of the countries in the Far East are spending practically all their income plus as much as can be borrowed from domestic financial sources to keep their heads above water. Probably the amount of money that could be raised in this area, exclusive of India, would be the equivalent of $50 million or about ¥18 billion, which could be handled from existing balances in the counterpart fund, leaving substantial balances available for use within the Japanese domestic economy. Even if these areas have the internal financing capabilities to absorb the equivalent of $100 million or 38 billion in aid, it represents less than 21 percent of this year's counterpart fund.

Conclusions

Plan 3 should be adopted as soon as practicable so as to speed the development of Southeast Asia, while Plan 4 should be prepared for the later, post-treaty period. The adopting of Plan 3 should not preclude the use of Plans 1 and 2 under *appropriate* conditions. The adoption of Plan 3 provides immediate aid to Southeast Asia at a time when the aid is critically needed. Finally, there would result a substantial stimulus to Japanese production for export.

[SOURCE: SUITLAND PAPERS, Z 703-2]

9-32 AN EXPORT FINANCE BANK

Memorandum November 9, 1950
By: Joseph M. Dodge

To a very large degree, the future of Japan, its progress and ultimate improvement in living standards, will depend on the continuous aggressive expansion of exports.

These exports will consist not only of certain consumption and semi-consumption products but also of exports of equipment and heavy machinery that will help fulfill the production needs of other nations. These are substantial possibilities for export expansion in markets absorbing equipment and heavy machinery. The fundamental interests of Japan warrant their progressive development.

Production and delivery of this type export takes longer than is required for most other exported products. It is, therefore, advisable to provide a mechanism for making available longer term yen credits to the producers of exported capital equipment. These loans are usually of such a nature and extend over such a period of time as to be inappropriate for commercial financial institutions to absorb in large volume.

To assist in meeting this problem, GHQ has agreed to the establishment of an Export Finance Bank. The JFY 1950 Supplementary Budget will include a ¥2.5 billion appropriation toward its resources. This amount will be matched by an equal amount from the U.S. Aid Counterpart Fund. Thus, original resources of ¥5 billion will be established for the Bank.

It is planned to appropriate ¥5 billion in the JFY 1951 budget as additional resources for the Bank and match that with an equal amount from the U.S. Aid Counterpart Fund. Over the next fiscal year, the resources of the Bank will become ¥15 billion.

The Bank will not have access to the private banking systems or to the Bank of Japan as a source of funds with which to expand its lending operations. Its resources will be provided by Budget appropriation and the U.S. Aid Counterpart Fund, insofar as these are available

for the purpose.

Before the Bank is actually established and begins operations, various details about its management and operations and the limitations, conditions and terms under which credit can be given, will have to be worked out and agreed to.

However, it has been agreed that the following principles will control these final decisions:

1. The Export Finance Bank will be established with the simplest possible structure and operating organization and with a maximum of independence from any direct government control. It will operate as an independent banking institution.
2. The operations of the bank will be specifically circumscribed by the law under which it is established.
3. The constitutional responsibility of the Bank to the Diet will be discharged through the Minister of Finance and an operating budget will be submitted annually by the Bank to the Finance Minister for administrative approval.
4. The Bank will have an outstanding individual head as President, appointed by the Prime Minister with the approval of the Cabinet, for a term of years, whose function will be to give the business a responsible, effective, and independent management.
5. The Directors of the Bank will be five in number, including the President of the Bank, and four other responsible and experienced individuals selected by him.
6. Because the institution will be essentially a bank and because of the small number and special quality of personnel required for its operation, the President and the Directors will employ, direct and control the staff, which shall not have civil service status.
7. The Bank will not compete with the Japanese Commercial Banks and only will handle business referred to it on a discount or participation basis, at *appropriate* current rates of interest.
8. The principal function and first responsibility of the Bank will be to grant Credits for financing the production of capital goods in Japan for export. However, if sufficient funds are made available and it appears advisable, a limited amount of resources may be used for financing foreign imports from Japan where the Japanese and the importers' foreign exchange restrictions permit such transactions and firm, financially responsible, and acceptable contracts have been made.
9. The bank will have no access to the Bank of Japan, the private banking system or the private capital market for operating funds.

[SOURCE: SUITLAND PAPERS]

9-33 FOREIGN ECONOMIC POLICIES (GRAY REPORT)[19]

Report to the President November 10, 1950
Prepared by: Gordon Gray, Special Assistant to the President
Published by: U.S. Government Printing Office

LETTER OF TRANSMITTAL

My Dear Mr. President: On March 31, 1950, you asked me to undertake an assignment as your special assistant to make recommendations to you in charting our course in the field of foreign economic policies and programs.

You pointed out that "our basic purpose has been, and must continue to be, to help build a structure of international economic relationships which will permit each country, through the free flow of goods and capital, to achieve sound financial growth without the necessity for special financial aid."

You further stated that "it is now time for us also to look ahead and assure ourselves that our own policies are those which will serve best to reinforce our economic strength and that of the other free nations of the world." You requested me to assist you in your task of determining "the nature, dimensions and significance of this problem" and in developing "the broad lines of policy which in turn must be laid before the public and the Congress." You instructed me to advise and assist in coordinating and stimulating the activities of the various governmental agencies which can contribute to the solution of the problem and to obtain the views of experts and interested groups outside the Government on particular aspects of the problem.

In accordance with your instructions and with the help of a small staff, I proceeded to

[19] Only part of the report printed.

develop a detailed program of analysis among the appropriate agencies of the Government directed toward adequately defining the problems which faced us and arriving at definite recommendations. I also proceeded to initiate a program for obtaining the views of leading private citizens on a systematic and widespread basis.

These activities were well under way when conditions were drastically changed by the aggression in Korea and the subsequent decisions to build up rapidly the defensive capabilities of the free world. This series of events did not in fact change the basic nature of the problem we were tackling. The paramount problem is not to achieve any specific objective with respect our total balance-of-payments position but is rather how to make our foreign economic policies serve most effectively our total national and foreign policy requirements.

These events did, however, markedly change the dimensions of the problem. At the same time, they increased the need for effective programing in the foreign economic field. In view of the uncertainties which entered into the picture and the time available to me, it has been impossible to arrive at final judgments with respect to many program matters, particularly those of a quantitative nature.

The report which I am herewith submitting to you outlines in broad terms what are, in my judgment, the major problems now facing this country in the foreign economic field and the general framework of policies and programs designed to meet these problems. In this task I have been greatly assisted by the generous and effective efforts of many Government agencies which have made available the ability and time of numerous staff members to work on specific projects. One evidence of their contribution is the collection of working papers, over 50 in number, on which many parts of this Report are based. Many top officials have given freely of their time to me and my staff in discussing various subjects in the Report, and I have also discussed the Report or certain sections of it with numerous leading private citizens in various walks of life. The analysis and the recommendations in the Report represent my considered judgment, and they should not be taken as necessarily representing the views of other officials in the Executive Branch.

While I hope that this Report will be of assistance to you in making essential decisions with respect to foreign economic policies, much further work remains to be done within the appropriate departments and agencies to convert this policy statement into an operating program.

It is furthermore necessary to assess the impact of foreign economic programs on our domestic economy in relation to the other requirements of our national policies, including civilian requirements and our productive capacity. In considering the problems falling within my terms of reference I have constantly borne in mind the overriding need for preserving a strong and dynamic economy in our own country and for maintaining the soundness of the dollar with all which that implies. Unless this is done, the objectives outlined in the Report cannot be fully attained.

I am sincerely grateful to you for your constant support and encouragement in this undertaking.

Respectfully yours,
Gordon Gray

GORDON GRAY, *Special Assistant to the President.*
EDWARD S. MASON, *Deputy.*

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E. JAPAN

The economic position of Japan is analogous, in many of its aspects, to that of the United Kingdom and some other countries of Western Europe. A relatively highly industrialized nation lacking in many natural resources, Japan's economic well-being is heavily dependent upon foreign trade. Within the Far Eastern region in particular, Japan is an important supplier of manufactures and a significant market for the food and raw material exports of its neighbors. Because of its predominant industrial position in the Far East, the potential contribution of a stable and democratic Japan is extremely important for economic growth, the improvement of living standards, and the maintenance of peace in the region.

Postwar economic recovery in Japan has been rapid. The index of industrial production is only slightly below prewar, while the index of industrial activity (which includes electric energy) now exceeds the prewar level. Agricultural output has surpassed prewar totals, and there has been a steady reduction in Japan's unfavorable balance on current international account. An essential element in this recovery has been United States assistance (totaling almost 1.8 billion dollars from September 1945 through June 1950), which enabled Japan to meet the nearly complete loss of its prewar sources of food and raw material imports in China, Korea, and Formosa (see appendix, table 15).

Further progress in economic recovery is necessary. Because of the very great increase in Japan's population, per capita income remains well below prewar despite the significant recovery in total output. Although attainment of the prewar per capita income cannot be regarded as essential to a self-supporting position, continued progress toward those levels is important to political stability and to the further strengthening of democratic institutions. The chief obstacles are the disadvantageous competitive position of certain segments of Japanese export industry (arising out of obsolete plant and equipment and aggravated by inefficient and wasteful use of manpower), the reduction in the size of Japan's merchant fleet, the international political problems associated with the reentry into foreign countries of Japanese merchant vessels and foreign traders, and over the longer run, the rapid rate of population growth.

Japan's major problem, however, has been the difficulty of finding export markets where it could earn sufficient dollars, or other currencies usable for the purchase of commodities (chiefly raw cotton and foodstuffs) that were in large part obtainable only from hard-currency sources. Thus Japan, like Western Europe, was beginning to be involved in what was essentially a marketing problem rather than a problem of inadequate economic resources. In Japan's case, the marketing problem was aggravated by the permanent reduction in the dollar market for raw and processed silk.

These difficulties, however, are not insurmountable. Even prior to the outbreak of war in Korea, it was clear that Japan had the physical capacity to expand export production sufficiently to cover the cost of necessary imports, subject to its ability effectively to compete with other suppliers. Plant capacity, management, and manpower were all available, although problems of cost reduction through improved methods and equipment remained. Some modernization of industry had been achieved and further improvements in productive efficiency were anticipated. It was thus possible to foresee that the need for net additions to Japan's resources through United States aid would probably disappear at an early date.

Currently, developments associated with or accentuated by the acceleration of United States and Western European rearmament now suggest that the dollar earnings aspect of the Japanese problem is more susceptible of early solution. Markets for Japan's exports—in southeast and south Asia, in Latin America, and in other areas outside the Soviet sphere—in all likelihood will be expanded by the increased earnings of these areas from high prices for raw materials needed in the United States and Western Europe, and because of the reduced availability of United States supplies. As the staging area for United Nations' forces moving into Korea, Japan has acquired a temporary market for goods and services for which it is being paid in dollars. It should be emphasized that the adoption of measures regarding economic development and United States policies suggested elsewhere in this Report would further improve Japanese export markets and thereby aid Japan's dollar position.

During United States fiscal year 1950, Japanese official dollar balances increased by 175 million dollars (from 103 million to 278 million dollars) and at the same time there was a net repayment of short-term credits totaling 79 million dollars. Japan's net short-term dollar position improved by 254 million dollars during the year, as compared with grants of around 420 million dollars. This strengthening of Japan's dollar reserve position was, of course, a desirable step toward the point at which dollar aid to Japan could be ended.

On a conservative estimate, Japan's exports and its gross dollar earnings in the United States fiscal year 1951 will exceed substantially the levels expected prior to the outbreak of hostilities in Korea. Offsetting this improvement will be higher costs for raw materials and for the additional imports that Japan must have to produce additional exports. The expansion of its exports, nevertheless, should permit Japan either to add further to its current dollar balances

or to build commodity stocks for future processing or consumption.

With a continuation of present favorable trends, then, Japan may be wholly self-supporting, although at a level somewhat below prewar per capita income, and in possession of substantial dollar and possibly commodity reserves by the beginning of United States fiscal year 1952. Further appropriations for Japanese aid therefore should be carefully considered and measured against the effect of the changed circumstances brought about by current developments.

In the process of achieving a position of self-support, moreover, Japan may have an opportunity to build toward a trading relationship with Southeast Asia and other areas that will permit substantial adjustment to the decline of China's importance as a major market and source of raw materials. Within such a trading pattern, Japan can supply the underdeveloped areas, where its chief markets must be found, with an important part of the capital and consumers' goods needed for development purposes. Given the necessary expansion and diversification of the productive capacity of the underdeveloped countries, Japan can hope to find new sources for its raw material imports and at the same time to develop a mutually beneficial exchange of specialized manufactured goods.

If raw materials and markets are available, Japan's economy could probably supply a markedly higher volume of exports than at present while at the same time maintaining acceptable levels of domestic consumption and investment. However, Japan is perhaps more than any other nation dependent upon imports for survival, and if it should prove unable to increase its production for export, it might need external aid to finance imports.

9-34 FOR OUR CLOSER ECONOMIC COOPERATION

Report February 6, 1951

Prepared by: Economic Stabilization Board

Recognizing the world situation and determined to actively carry out the part expected of her, the Japanese Government is ready to take necessary steps toward a closer cooperation between the U.S. economy and that of Japan. By mobilizing her skilled labor and giving maximum use to her industrial potentials, Japanese economy will be able to secure its honorable position among peace-loving nations.

With that objective in mind, further clarifications about the following items will be to our mutual benefits.

1) *The extent, scale and nature of contribution expected of Japan.*

Any indication that may be suggestive of this even in general terms will be highly appreciated, since an earlier start will save time and labor in the future.

The exact form of machinery to be created in Japan's economy to maximize its economic cooperation must be such as dovetails procurement set-up as may be worked out on the part of the U.S. and the mechanism of international scarce materials allocation.

At this moment, therefore, much still depends upon unknown factors. The attached paper is designed only to give summary to a series of measures now in our mind. They are yet in general terms and subject to finalization as situations are clarified.

2) *Importance of a stable living condition for the purpose of an orderly mobilization of labor force.*

An orderly and continuous supply of man power can result only from a stable living condition. While it can not be hoped that the Japanese working class will attain a highly decent living standard in the near future, the maximum labor efficiency can be had where workers feel that they are working for the betterment of their living.

This is an important consideration not merely from the production viewpoint but because of communist agitations and a still existing suspicion that Japan's economy might dump its cheap labor in the international market.

3) *A well balanced operation of national economy.*

An excessive emphasis upon the production of certain type of goods or service tends to create an economic anomalies and clog the orderly blood circulation of national economy. Such anomalies might imperil the future of Japan's economy whose foundation is admittedly still shaky. A well considered planning as may be worked out in advance by our mutual study will keep a sudden and tall order from breaking the harmonious operation of Japan's national economy and ensure its continuous and ever-growing contribution.

4) *About the economic control.*

An overall economic control can achieve its success when a national economy can afford to provide some leeway for certain human errors, possible dislocations, and unavoidable evasions. General acceptance and public morale is the backbone but the backbone can not be strong when general supply shortage is such that nothing short of divine wisdom can realize even a tolerably fair enforcement.

Therefore it is not meant to be a paradox to state that Japan's economy can not afford an overall and tight economic control. Intolerable hardship of life and other various unpleasant memories of the past remain as indelible scars in many minds, while they saw with their own eyes that the post-war economic stabilization has disproved the communist agitation when shops are flooded with goods as a result of progressive decontrol measures.

This is not saying that no control is necessary at all. A sound budgetary and financial policy tied with the timely regulation over the supply and demand (i.e. import and export) of goods will dispense with a never-ending spiral of controls and make, instead, a set of selective and minimum controls really effective.

5) *U.S. assistance desired.*

Japan today is one of the few countries in the world whose industrial potentials and labor force can substantially add to the economic strength of the group of free nations, if the nation is given access to a certain kind of materials, equipment and technical know-how. Although the availability of these items depends upon the future U.S.-Japan economic relation, what is desired here can be classified as follows:

a) Importation of necessities of life such as foodstuff and raw cotton which are needed to maintain labor force.

b) Adequate and timely importation of equipment, fabricated and raw materials necessary to increase production and the importation of machinery and accompanying technical know-how.

c) Extension of credits and other means of capital investment on a substantial scale.

[SOURCE: *Eibun Sengo Shiryō,* Vol. 26 Economic Planning Agency]

9-35 ITEMS OF SOLICITATION IN CONNECTION WITH JAPAN'S ECONOMIC SELF-SUPPORT

Report February 9, 1951

Prepared by: Economic Stabilization Board

I. The recent developments in the international situation call for flexible operation of the Japanese economy which will be capable of meeting the ever-shifting situation. Your special attention is therefore invited to the following:

1. Positive and flexible utilization of foreign exchange.

It is requested that measures be taken to enable positive and flexible utilization of available foreign exchange as soon as possible in order to secure and accelerate the import of essential commodities of which Japan is at present in dire need.

2. Appropriate operation of financial and banking policies.

It is requested that the public financial and banking policies including operation of Counterpart Fund and Deposit Bureau Fund be based on the principle of positively expanding the economic level through increased trade and production while strictly curbing inflation and that the initiative of the Japanese government in operation of these policies be respected.

3. Relaxation of economic restrictions.

In the light of the recent world economic trend and other factors it is believed that some new measures under appropriate formulas will become necessary in the future with regard to demand and supply adjustment, export control, price stabilization, etc. It is requested that consideration be given to providing for temporary exceptions to the Fair Trade Practice Law, Trade Association Law and other restrictive laws so that voluntary controls by enterprisers may become possible when necessary.

II. With regard to future U.S. aid to Japan, your favourable consideration is requested for the following:

1. Efforts in all the economic policies are directed toward the sole aim of achieving economic self-support and the utmost is being done to accelerate accumulation of capital required for the purpose. It is earnestly requested that U.S. aid be continued in some form or other for another few years until such self-support is attained.

2. It is highly desirable that induction of foreign capital helpful to the Japanese economy be accelerated. It is also requested that kind assistance be given for securing loans from semi-governmental organizations such as International Bank for Reconstruction and Development and Export-Import Bank.

3. In view of the increasing tension in the international situation, some international allocation organizations of essential commodities are expected to be set up in the near future. It is requested that, in such an event, allocation of food, raw materials and other commodities be secured for Japan.

It is also requested that, in view of the ban on trade with Communist China, kind assistance be given in securing the import of materials from other sources.

4. In this connection, it is of the utmost urgency to secure increase shipping bottoms. It is requested that assistance be given not only for construction of ocean-going vessels but also for chartering and purchasing of foreign ships.

[SOURCE: *Eibun Sengo Shiryō*, Vol. 26, ECONOMIC PLANNIING AGENCY]

9-36 GROSS AMOUNT OF UNITED STATES POSTWAR ECONOMIC ASSISTANCE TO JAPAN

Report April 13, 1960
To: Japanese Government
From: U.S. Ambassador to Japan

The United States provided economic assistance to Japan through shipment of GARIOA supplies and other forms of aid over the period from 1945 to 1953. United States records show that the gross amount of this assistance, as set forth in the tabulation below, came to a total of $2,027,644,581.00.

Goods furnished to Japan as economic assistance were valued at the port of embarkation according to procedures prescribed by the competent United States authorities. Goods arriving at Japanese ports were received and receipted for by officials of the Japanese Government under procedures laid down by SCAP. Shortages and damage were duly noted and recorded. Monthly summaries of the receipts of these goods were prepared and furnished to SCAP so that both the United States and Japanese Governments had access to the basic information about aid goods moving into Japan. U.S. records were adjusted to reflect damages and shortages in the final summaries of shipments which were prepared.

The major components making up United States postwar economic assistance to Japan are set forth in the tabulation below. OFLC contracts under surplus property have been ignored, since these contracts have all been discharged by payments from the Government of Japan in yen, subject to the minor adjustment of $7,384.50, as set forth in the letter of Mr. Bolster to Mr. Okuma of December 16, 1959.

United States Economic Assistance (excluding Surplus Property):		
GARIOA Assistance	$1,800,949,876.00	
Civilian Supply Program (pre-GARIOA)	129,173,871.00	
Diverted Military Stocks	59,973,513.00	
		$1,990,097,260.00
Surplus Property:		
Surplus Incentive Materials		
(Acquisition Cost $60,792,390.00)		
Amount Charged	$36,536,969.00	
Plus Ocean Transportation	4,055,058.00	
	$40,592,027.00	
Less Reacquisition and Storage	15,481,368.50	
		25,110,658.50
Diverted Military Stocks		
(other than Foodstuffs)	13,132,847.00	
Less Reacquisition and Storage	676,184.50	
		12,456,662.50
		$2,027,644,581.00

The basic statistical materials underlying the above tabulation were furnished by the United States representatives to the Japanese representatives at the meeting held on May 14, 1954.

Summary Chronology of GARIOA Negotiations

The United States representatives submit the following brief recapitulation of the GARIOA repayment negotiations to date in order to provide adequate background for the current discussions.

1. The United States proposed on May 14, 1954 that Japan make repayments totalling $703,170,590, with this amount to be repaid over a 35-year period. Interest on the outstanding balance was to be at 2½ per cent per annum, with a five-year moratorium before beginning repayments of the principal.

2. The United States delegate at the May 14 meeting presented a series of documents and explanatory material relating to the amounts and kinds of post-war economic assistance furnished Japan.

3. On May 29, 1954 the Japanese representatives submitted a detailed questionnaire concerning the data presented by the United States.

4. On July 1, 1954 the United States delegates replied to the Japanese questionnaire explaining the method of obtaining the GARIOA figures.

5. Foreign Minister Katsuo Okazaki called Ambassador John Allison to the Foreign Office on August 12, 1954 and stated that the Government of Japan hoped for an early settlement of the GARIOA debt and was inclined to favor a settlement along political rather than strictly accounting lines.

Foreign Minister Okazaki outlined a counterproposal to the United States May 14 offer which called for the Government of Japan to repay $500,000,000 over a twenty-year period, at zero interest. In submitting this proposal, Foreign Minister Okazaki stated that this formula could be defended by the Government of Japan before the Diet.

In response to an inquiry from Ambassador Allison, Foreign Minister Okazaki stated that his counteroffer could be regarded as an "informal-official" approach.

Ambassador Allison stated he would forward the Japanese counterproposal to Washington but expressed his strong unofficial view that the United States would be unable to agree to an interest-free repayment formula.

6. On August 25, 1954, Foreign Minister Okazaki called in Ambassador Allison and stated that Prime Minister Yoshida had disapproved the GARIOA settlement proposal made on August 13, 1954, on the grounds that it was not sufficiently close to the German settlement. Foreign Minister Okazaki thereupon indicated that the Government of Japan considered that the repayment figure should be $550 million. Repayments would be made over a thirty-year period and would begin after a five-year moratorium. An interest rate of 2½ per cent was proposed.

Minister Okazaki stated that repayments during the first five to seven years should be made in yen and be reloaned to Japan for internal economic development or for economic cooperation in Southeast Asia. He also proposed the provision be made to postpone payments by mutual agreement, if Japan's foreign exchange position became critical.

7. On August 27, 1954, Ambassador Iguchi in Washington handed to the Department of State an informal memorandum confirming the proposal of Minister of Foreign Affairs Okazaki.

8. On September 16, 1954, Ambassador Allison, in a letter to Minister Okazaki replied that the Government of Japan's counteroffer was unacceptable. He presented a revised proposal of $643,942,871 for the settlement figure. A copy of Ambassador Allison's letter is attached.

9. On May 6, 1955, Ambassador Allison, in a letter to Minister of Foreign Affairs Mamoru Shigemitsu, presented a revised proposal for a total settlement figure of $643,258,920. For the GARIOA portion the proposed terms were: $604,155,560, with interest at 2½ per cent; only interest payments to be made over the first five years; and repayment thereafter of principal and interest in 60 semiannual installments. The proposed terms on the surplus property portion were $39,103,363, repayable at 2–3/8 per cent, in twenty-five annual installments, beginning July 1, 1955.

A copy of Ambassador Allison's letter is attached.

10. Ambassador Allison's letter of May 6, 1955 was acknowledged by the Ministry of Foreign Affairs on May 31, 1955. However, the settlement formula presented in Ambassador Allison's letter was neither rejected nor accepted officially, nor has a counterproposal been received from the Government of Japan.

[SOURCE : GENGO SUZUKI PAPERS, FINANCE MINISTRY]

10 FINANCE

10-1 IMPERIAL HOUSEHOLD PROPERTY (SCAPIN-300)

Memorandum November 18, 1945
SCAPIN-300 (ESS/FI)

1. You will immediately take such action as may be required to insure that no transactions involving the Imperial Household property will be effected without the prior approval of this Headquarters.

2. You will nullify any transfers of Imperial Household property which were effected on or since the 15th day of August, 1945 and which were not incidental to the normal operations of the Imperial Household.

3. Except as may be further directed, all bureaus and offices, etc. of the Department of the Imperial Household may continue to exercise their normal functions, and may receive any payments and make any expenditures normally incidental to their operations; provided however that the following transactions may not be effected without the prior approval of this Headquarters:

a. The disposition or acquisition of any capital assets, including but not limited to lands, estates, securities, buildings, and art objects;

b. The voting, or the exercise of any voting rights, with respect to any securities owned by the Imperial Household;

c. The exercising of any managerial or other control or authority in respect to any enterprise the securities of which are owned or controlled in whole or in part by the Imperial Household;

d. The bestowal of any Imperial gifts or special money grants;

e. The supplementing of any item of expenditure from Reserve Funds;

f. Any loans between accounts;

g. Any item of expenditure in excess of the sums allotted for such items in the budget;

h. Any item of expenditure not provided for in the budget;

i. Any expenditure from the First and Second Reserve Funds.

4. The main budget for the fiscal year 1946 shall be submitted to this Headquarters for approval not later than 15 December 1945. Additional Budgets shall be submitted to this Headquarters for approval each time as they may arise. No expenditure may be effected subsequent to the fiscal year, 1945, unless the budget covering such expenditure has been approved by this Headquarters.

5. Prior to the issuance of this memorandum, the Department of the Imperial Household informally furnished to this Headquarters statements of the property holdings of the Imperial Household. You will promptly examine the statements furnished and within fifteen days you will certify to the accuracy of such statements. If such statements are certified to be incomplete or inaccurate in any respect, you will furnish within such period such corrections or additions as are required.

6. You will report promptly to this Headquarters the action taken to comply with these requirements.

7. An acknowledgement of the receipt of this memorandum is directed.

10-2 ASSETS OF THE IMPERIAL HOUSEHOLD (AS OF SEPTEMBER 1, 1945)

Report on the Assets of the Imperial Household[1] January 1946
By: Public Finance Division, ESS, SCAP

[1] Only Table 2 is Printed.

Table 2

Type of Asset	Appraised Value[a]	Percent of Total
Cash	¥ 33,045,960	2
Bonds, Stocks & Debentures	311,098,337	19
Land	393,974,680	23
Standing Timber	592,865,000	35
Buildings & Structures	312,208,475	19
Miscellaneous	32,074,621	2
Total	¥1,675,267,073	100

[a] September 1945 yen value.

[SOURCE: *NMA* (#23), vol. 9, Reparations and Property Administration, Part C—Japanese Property Administration, p. 27]

10-3 ON EMERGENCY FINANCIAL MEASURES

Memo to the Chief of Staff undated (End of Jan., 1946)?
Concurrences: Government Section, Natural Resources Section, Public Health and Welfare Section

PROGRAM PRESENTED

Blocking of Deposits in Financial Institutions, Currency Conversion, Price Control, Rationing, and Collection and Distribution of Essential Commodities, particularly primary foodstuffs through legitimate Channels.

FACTS BEARING ON THE PROBLEM

1. a. The program was prepared by officials of the Ministry of Finance in consultation with officials of the other Ministries concerned.

b. It was presented by the Ministry of Finance to the Chief of Economic & Scientific Section a week ago and discussions have continued between the officials of the Ministries involved and officers of the interested sections of this Headquarters.

c. The Ministry of Finance has stated that the program has been approved by the cabinet and it is desired to present it to the Privy Council on Wednesday, 30 January, and if approved there to the Emperor on Friday, 1 February.

2. The proposals contemplated are:

a. A re-adjustment of official prices to higher realistic levels. This will involve increases to both producer and consumer.

b. The use of the police to enforce the sale of rice to the government by search and seizure.

c. An energetic attack on the black market.

d. A financial program which would drastically reduce the purchasing power in the hands of the people and more equitably distributed among them. The financial measures proposed are:

(1) A blocking of all present deposits in financial institutions.
(2) The deposit and blocking of all presently outstanding currency.
(3) Issue of a new currency which would be free of restrictions.

3. a. Total food supplies, particularly rice, are considerably short of estimated requirements.

b. The government has not been able to insure an equitable distribution of existing supplies to all ration card holders.

c. Prices have continued to rise sharply until rice is presently quoted at five thousand yen per koku against an official price of one hundred and fifty yen per koku.

d. To pay the exorbitant prices the people are exhausting their savings and the banks have been making loans to employers in order that they may pay black market prices for foods necessary to induce workers to stay on the job.

e. The savings, accumulated food stocks, and bargainable goods of increasing numbers of people are being exhausted.

f. It is estimated that food stocks are being exhausted faster than was earlier estimated and that the situation may reach a serious stage within six weeks instead of May or June as was first anticipated.

4. Strong opposition to the use of the police powers is evident from newspaper reports in statements of leaders in the rural areas.

5. The blocking and currency conversion program is probably the only effective enforcement measure which could be taken without the use of the police.

6. The blocking of deposits and conversion of currency is necessary for the successful imposition of the war profits tax, property tax, and increase in property value tax which are required to be imposed by Memorandum to the Imperial Japanese Government, file AG 121.7 (24 Nov. 45) ESS/FI.

7. By directive No. 3, dated 22 September 1945, this Headquarters the Japanese Government was required to continue price control and rationing, paragraph 2.

"2. *Economic Controls.*

a. You are responsible for initiating and maintaining a firm control over wages and prices of essential commodities.

b. You are responsible for initiating and maintaining a strict rationing program for essential commodities in short supply, to insure that such commodities are equitably distributed."

8. This Headquarters is directed to permit and encourage the Japanese Government on their own responsibility to take such measures as may be necessary to attain the objections expected to be reached by the program presently proposed. Pertinent sections of the JCS directive, radio WX 68524, dated 24 September 1945, are Part 2:

"Paragraph 19. The Japanese authorities will be expected to develop and effectively carry out programs of working activity that will enable them out of their own resources and labor to accomplish the following:

A. To avoid acute and economic distress.

B. To assure just and impartial distribution of available supplies.

Paragraph 21. The Japanese authorities shall be permitted on their own responsibility to establish and administer any control over economic activities that are appropriate or necessary in order to achieve the economic ends specified in paragraph 19——subject to your approval——.

Paragraph 22. Serious inflation will substantially retard the accomplishment of the ultimate objectives of the occupation. You will therefore, direct the Japanese authorities to make every feasible effort to avoid such inflation.

Paragraph 29. You will assure that all practicable economic and police measures are taken to achieve the maximum utilization of essential Japanese resources in order that imports into Japan may be strictly limited. Such measures will include production and price controls, rationing, control of black markets, fiscal and financial control——.

Paragraph 30. You will require that all practicable steps be taken to assure a fair and equitable distribution of supplies under uniform rations scales."

9. Similar blocking and conversion measures have been imposed since the end of this war with Austria, Belgium, and the Netherlands.

10. The measures discussed have been volunteered by the Japanese Government.

11. a. The proposed blocking and conversion have been widely discussed by the people and in the press and semi-official hints have been given that the measures would be adopted, therefore, the public is more or less prepared for them.

b. The program has been advocated by bankers, who are losing deposits, by the principal liberal groups and by many others even many of those who have considerable to lose by it. All fear that otherwise run-away inflation will be inevitable.

Discussion

1. While the necessities of the program is evident, it is felt that the restoration of price control and equitable distribution can not be accomplished without some drastic measures which will insure enforcement. The use of the police power would appear inadvisable because:

a. It would arouse the people to resist a long hated instrument of oppression which they have been encouraged to believe was not gone forever.

b. It would require the reactivation of an organization which this Headquarters has required to be considerably reduced in numbers and powers.

2. The blocking and currency conversion would then by the only means by which the situation could be brought under control.

a. It is expected that these will bring about the release of the stocks of grain held by the farmers but in any case the more reasonable and equitable distribution of perishables should result because no one will have more purchasing power than another.

b. Upon completion of the program it is estimated that the new currency in circulation will be about six times that of 1937, the price of rice about ten times, of coal about fifteen times. The government has just announced an increase in wages to two and a half times and other wage and salary increases have been recommended to other employers.

3. Present rations provide only about one thousand calories of an estimated necessary eighteen hundred and the cost of the balance is fantastic and more and more people are unable to provide the needed extras for themselves. Returning repatriates without resources and goods or foods are arriving in increasing numbers to worsen the situation.

4. In emphasizing that this program has been volunteered by the Japanese government it should be considered that if its imposition is not permitted now;

a. It would probably not again be volunteered by the present government.

b. That the new Diet to be convened after the election might be unwilling to adopt it.

c. That it would be welcomed by the enemies of the present regime and greatly disliked by its friends.

d. That postponed until after the election could mean that the program could not be imposed until perhaps June or July, by which time the situation could have gotten out of hand.

5. It is believed that the prompt imposition of the financial program will greatly advance the date on which a general exchange rate can be established at private commerce between Japan and the outside world resumed.

Recommendations

1. The Japanese government be informed that there is no objection on the part of this Headquarters to the proposed blocking of deposits and conversion of currency.

2. That consideration for the proposed use of the police powers be deferred or its use denied.

3. That all possible assistance be given by this Headquarters in the establishment of a new and more equitable official pricing scheme.

4. That support be given to any other acceptable enforcement measure which will insure equitable distribution of the necessities of life.

[TAB A]
ANALYSIS OF JAPANESE GOVERNMENT'S FINANCIAL PLAN

1. The Japanese Government's financial plan is contained in two proposed Imperial Ordinances, each with a set of Enforcement Regulations to be promulgated by the Minister of Finance: the Emergency Finance Measures Ordinance (Tab "B") and the Exchange of Bank of Japan Notes Ordinance (Tab "C").

2. Emergency Finance Measures Ordinance (and Related Enforcement Regulations).

a. Content.

By these measures, all withdrawals of deposits from financial institutions, except as noted below, are prohibited from the date of issuance of the Ordinance to 31 August 1946. Deposits of the national, prefectural and local governments and deposits of financial institutions in other financial institutions are exempted. Withdrawals for the purpose of paying taxes or to carry on essential business operations or to pay wages, salaries and other allowances, or to make deposits in the same or other banks, are authorized. Each family may withdraw, for any purpose, up to ¥300 per month for the head of the family and ¥100 per month for each member. Repatriated nationals may withdraw ¥1,000.

b. Comments.

(1) The statement of a definite termination date (Articles 1 and 7 of the Ordinance and Article 2 of the Regulations) is unnecessary and from the point of view of governmental stability is considered dangerous.

(2) The general license to withdraw deposits for business expenses etc., contained in sub-sections 3 and 4, Section 1, Article 2 of the Ordinance, is too broad and it is subject to abuse. Special licenses requiring examination of individual application would permit closer control.

(3) The provisions limiting the amounts that families may draw (sub-section 5 of Section 1, Article 2 of the Ordinance and Article 7 of the Regulations) make no distinctions between persons who have incomes from wages, salaries or other sources and persons who depend entirely on their savings for current living expenses, nor do they differentiate between high-income and low-income persons. Some differentiation along these lines would appear desirable.

(4) Articles 3, 4 and 5 of the Ordinance authorize the Minister of Finance, at

his discretion, to restrict or prohibit the transfer or pledge of deposits, advances of funds by financial institutions or and to prescribe the methods whereby juridical persons may pay monetary obligations. Such restrictions and regulations should not be left to the discretion of the Minister of Finance, but should be set forth in the law itself.

(5) Under Section 2 of Article 7 of the Ordinance and Article 20 of the Regulations, deposits in finance institutions are permitted to earn interest. It should be stated that such interest will be subject to the same restrictions as the principal.

(6) If savings in financial institutions and the interest earned thereon are to be blocked, then any interest, dividends and other income received from government and other securities should be deposited and similarly restricted. In addition, restrictions should be placed on the use of funds derived from the maturity or sale of such securities.

3. Exchange of Bank of Japan Notes Ordinance (and related Enforcement Regulations).

a. Content

Under this Ordinance a "new" note issue will be created by affixing (presumably by stamping) to the present Bank of Japan notes a form of certificate to be prescribed by the Minister of Finance. After 4 March 1946, all notes not bearing this certificate will cease to be legal tender. Holders of old notes will have between 26 February and 16 March 1946 to present their notes to the Bank of Japan through normal banking channels. Within prescribed limits, new notes will will be issued in exchange for the old ones. The balance will be treated as deposits and blocked under the Emergency Finance Measures Ordinance discussed in paragraph 2 above. Each family may exchange an amount equal to ¥200 for the head of the family and ¥100 for each member thereof. Repatriated nationals may exchange ¥1,000. Enterprises may exchange enough for one day's needs. Juridical persons may exchange amounts as specified by the Finance Minister. The national, prefectural and local governments and financial institutions may exchange all notes held by them.

b. Comments

(1) The technique of converting currency notes by stamping a legend or certificate on existing notes makes counterfeiting an easy matter. It should be resorted to only if unavoidable because of scarcity of materials or facilities or absolute lack of time for printing new notes.

4. The effect of these measures will be an immediate and drastic reduction in the amount of currency in circulation and the immobilization of a large percentage of the deposits now owed to the public by financial institutions. Currency will be forced out of hoarding. The pressure of excess purchasing power on prices will be reduced. Essentially, however, the plan constitutes a device for reducing the inflationary potential rather than deflating the existing price structure. In order for these effects to be lasting, there must also be a halt to the creation of new bank deposits based on government borrowing. Otherwise the pressure will soon build up again. In addition, there is need of a government fiscal policy which will inspire confidence in the currency and the banks.

[SOURCE: SUITLAND PAPERS]

10-4 JAPANESE GOVERNMENT'S MEASURES TO COMBAT INFLATION

Memorandum February 3, 1946
To: ESS
From: Government Section

1. The attached Staff Study prepared in the Economic and Scientific Section deals with 4 related proposals by the Japanese Government, constituting a program for combatting inflation in Japan. These proposals are: (1) upward revision of official prices, (2) strict enforcement of the food selling laws, (3) a vigorous attack on the black market and (4) reduction of purchasing power in the hands of the public.

2. The measures designed to effectuate the first three proposals are under consideration in ESS, and have not been submitted to Government Section for study or comment. Two proposed Imperial Ordinances and their Enforcement Regulations, constituting the financial portion of the program (proposal four above), are inclosed as Tabs "B" and "C" and an analysis of these measures, prepared in Government Section, is inclosed as Tab "A".

3. It is understood that the drafts of these measures, all dated 25 January 1946, are being revised by the Japanese Government as a result of preliminary discussions with members of the ESS. Since the proposed revisions are not available at this time, the analysis at Tab "A" and these comments are based on the draft of 25 January 1946.

4. The excellent features of the financial plan are: (1) withdrawal from circulation of all outstanding Bank of Japan Notes, accompanied by a limited reissuance of "new" notes, and (2) prohibition of withdrawals of deposits in financial institutions, except for certain categories of deposits, financing essential activities and, within strict limits, for living expenses and other purposes. The effect of these measures will be an immediate and drastic reduction in the amount of currency in circulation and bank deposits available for spending.

5. As pointed out in the analysis, the proposed financial measures are by no means perfect, even within the field they are designed to cover. The more serious short-comings, if still present in the revised drafts, should be pointed out to the Japanese Ministry of Finance with a view to their elimination.

6. With all its faults, the Japanese Government's financial plan should be viewed as an effort on the part of the Japanese to treat their own financial ills. As such, it is a step in the right direction.

7. If these proposed financial measures are accompanied by satisfactory measures to stimulate the production and fair distribution of food and other consumer goods, and to exercise effective rationing and price controls, this Section sees no objection to their enactment.

8. From a governmental standpoint, the proposal is timely. It is believed desirable that the present government undertake the task and assume the political risks involved. A new government, formed after the forthcoming election, might hesitate to take such a drastic step at the beginning of its incumbency, thereby necessitating the issuance of a directive from the Supreme Commander.

9. It is also believed desirable that such measures be taken by the Japanese Government on its own initiative and not as a result of directives from the Supreme Commander. Disapproval by this headquarters of the proposed program would tend to shift to the Supreme Commander the responsibility for taking measures to curb the inflation.

[SOURCE: SUITLAND PAPERS, Z 703–23]

10-5 U.S. OCCUPATION COSTS IN JAPAN

Memorandum February 7, 1946
To: Mr. J. C. Vincent (Director, Office of Far Eastern Affairs, State Dept.)
From: Mr. E. M. Martin[2]

"Occupation costs" is a generic term covering a number of types of expenditure, each deserving separate consideration. The principal categories are:

1. Expenditures of yen in Japan by occupation forces, including that by troops;
2. Pay of troops in Japan in dollars;
3. Cost of supplies and equipment imported by occupation forces into Japan for their own use;
4. Cost of imports for use of Japanese;
5. Cost of repatriation of Japanese involving expenditure by occupation forces outside Japan.

It is proposed that it be U.S. policy to take the action listed below for the corresponding categories of costs:

1. Secure yen from Japanese government with no prevision for reimbursement;
2. Include as non-priority items in U.S. reparations claim against Japan;
3. Include as non-priority items in U.S. reparations claim against Japan;
4. Secure repayment as prior claim on proceeds of Japanese exports. If proceeds from normal commodity exports is not sufficient, the U.S. will propose to secure reimbursement through the export to the U.S. from Japan of gold and other precious metals not subject to restitution.
5. Include as a non-priority item in U.S. reparations claim against Japan.

Before presenting the above proposal for further discussion, I should appreciate your views as to the political desirability of approaching the countries given the greatest share of responsibility for occupation policy in Japan by the Moscow Decisions, namely U.K., China and U.S.S.R., on their willingness to share with the U.S. responsibility for certain categories of occupation costs, particularly 4 and 5 in the above listing.

It may be pointed out that their participation may have considerable advantage if it should become necessary to go before the Congress for additional appropriations for these purposes.

[2] Chief, Division of Japanese-Korean Economic Affairs, State Dept.

On the other hand their participation might well lead to a greater inroad on our freedom in carrying out occupation policies than would be considered administratively desirable either here in Washington or in Tokyo.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

10-6 THE EXTRAORDINARY JAPANESE POST-WAR TAXES

Memorandum May 14, 1946
To: SCAP
From: Leo M. Cherne, Tax Advisor to SCAP

Following your instructions and recommendations this memorandum details the extraordinary Japanese taxes to be presented to the Imperial Japanese Government for their voluntary acceptance. Failing voluntary acceptance, these objectives are to be attained by SCAP directive. The extraordinary Japanese tax program will consist of three separate levies.

1. A 100% tax upon all corporate claims against the government arising from the war as well as claims upon private institutions guaranteed by the government. This tax is to be designed to recapture amounts which have been paid and are in blocked accounts, amounts paid and in the hands of corporations, amounts which have been paid by offset, as well as claims arising from the war which have not yet been paid.

2. 100% tax upon all individual claims against the government arising, from the war as well as claims upon private institutions guaranteed by the government, in excess of 10,000 yen.

3. A capital levy upon property owned by individuals including, of course, their equities in Japanese corporations.

4. The tax upon the increase in property owned by individuals during the war years.

What the extraordinary Japanese taxes should accomplish.

1. The inflationary pressure exerted by yen and bonds must be reduced sharply.
2. The major tax revenues must come from those individuals whose wealth has most contributed to Japan's economic, political and social problems.
3. A redistribution of national wealth should be accomplished, directed particularly to the strengthening of Japan's middle class.
4. The Japanese Government should be enabled to secure the revenue needed for occupation purposes, social and economic rehabilitation and the industrial and fiscal reorganization which SCAP directives will require.
5. The tax laws must be capable of effective administration and must anticipate and block the numerous tax evasions, many of which have already occurred.

The corporate tax upon claims against the government.

Indemnity claims against the Japanese Government in the amount of some 48 billion yen are held by Japanese corporations. Claims against the Japanese Government as referred to in this tax include both these claims directly against specific government agencies or claims against private institutions which have been guaranteed by the government. A substantial portion of these claims arising from the war have not yet been settled. Almost all of the balance has been paid and is in blocked accounts. This tax would recapture the full amount of such claims which are now in blocked accounts as well as amounts which have been paid in free currency directly to the corporation or have been paid by offset against claims held by the government. Those claims which are still unpaid will be repudiated, thereby accomplishing the effect of a 100% tax upon these Government indemnites to Japanese corporations. This tax and repudiation of indemnity claims will prevent the government from paying out to Japanese corporations an amount more than five times the amount which could be recaptured by the proposed capital levy and war profits tax upon these corporations, thereby eliminating the necessity for these two cumbersome laws.

Stockholders of those Japanese corporations which have no indemnity claims will be heavily taxed by the capital levy on individuals, since the value of their shares will not be reduced by the taxation and repudiation of the indemnity claims. This in turn will balance the position between stockholders of corporations with claims arising from the war and stockholders of those corporations with no such indemnities.

The capital levy upon individuals.

The primary aspect of the capital levy are:

a. Division of all taxpayers into three groups depending upon their total wealth.

b. Taxation of the wealthiest group first, then the next most wealthy and finally taxation of the lowest group only if the revenue yield from the first two groups does not come up to the goals announced by the Ministry of Finance.

c. Exemption from taxation of all those whose property is valued at less than 30,000 yen.

d. Provision to assure that any delayed payments are made in an amount at least equal to the inflation which may have occurred up to the time of that later payment.

e. A capital levy resting upon a graduated series of rates which will in effect tax 3.2% of a 31,000 yen estate and will rise progressively to taxation of 85% of any wealth in excess of 50 million yen.

f. A final basis feature of the levy is a composite of a number of provisions designed to prevent evasion and to maximize tax collection.

To achieve these objectives for the capital levy on individuals the following revisions of the Japanese proposal are recommended:

1. The taxable population is to be divided into three groups: "A" group consisting of individuals with wealth over 500,000 yen, group "B" comprising individuals with properties valued between 100,000 and 500,000 yen, and group "C" comprising individuals with properties valued between 30,000 and 100,000 yen.
2. The filing of reports for all three groups is to be accomplished within 60 days after passage of the law. Revenue goals for group A, B and C will be made public prior to filing date.
3. Group A will pay simultaneously with the filing of reports.
4. Group B will pay 30 days after the filing date, provided that tax returns from group A fall below announced goal.
5. In the event that tax returns from Group A equal or exceed the announced goal for group A, taxation of group B will remain at the discretion of the Ministry of Finance.
6. Group C will pay 120 days after the filing date, provided that tax returns from group B fall below announced goal, and provided further that the Ministry of Finance deems taxation of group C desirable.
7. Investigation and Valuation Committees are to be established as soon as possible after the passage of the law. These committees may act as consultants prior to filing of reports.
8. Investigation of group A returns will commence immediately after filing of reports.
9. The classification of taxpayers among groups A, B and C is to be based on property values prior to allowable deductions for increased property tax.
10. Individuals whose property is valued at less than 30,000 yen pay no tax. However, if their property is valued at more than 30,000 yen their entire property is considered taxable property.
11. All taxpayers will be permitted a 3,000 yen credit against tax which will be applied at the following rates on successive increments of taxable property.

Taxable Amount in Yen	Rates
Under 40,000	10%
40,000 — 50,000	15
50,000 — 60,000	20
60,000 — 70,000	25
70,000 — 80,000	30
80,000 — 100,000	35
100,000 — 200,000	40
200,000 — 350,000	45
Taxable Amounts In Yen	Rates (continued)
350,000 — 500,000	50%
500,000 — 1,000,000	55
1,000,000 — 2,000,000	60
2,000,000 — 5,000,000	65
5,000,000 — 10,000,000	70
10,000,000 — 20,000,000	75
20,000,000 — 50,000,000	80
over — 50,000,000	85

12. Delayed payments are to be discouraged and permitted only in extreme cases.
13. All delayed payments will subject (a) to adjustment by a government price index, using the original date of collection as a base, and reflecting legal and blackmarket price movements and (b) to a high rate of interest for the period of delay.

14. A priority for type of tax payment will be established; payments in the form of lower priority properties will be permitted only when it is shown that higher priority payment is no longer practicable; the priority of payment should be established in the following order:

a. Payment in the form of yen or deposits (including blocked deposits).

b. Payment in the form of government bonds (including, local government bonds).

c. Payment in the form of negotiable non-public securities (shares, bonds, debentures).

d. Payment in the form of real properties (land, properties, etc.).

15. The government shall reserve the right to purchase any property or piece of property for the reparted valuation and make restitution in the form of government bonds whenever it deems a taxpayer's reported valuation inadequate. Conversely, a taxpayer will be permitted to sell a property or piece of property to the government whenever he deems an assessor's valuation too high.

16. In the case of gifts or donations to a charitable or cultural trust or organization where the donor retains any control or power with respect to the organization, or the donation, the entire gift or donation will be deemed the property of the donor for purposes of this tax.

17. With regard to debts, the debtor shall be permitted to deduct a debt only to the extent that the value of the debt is taxable to the creditor. In the event that the creditor is deemed an exempt individual for purposes of this tax, the debt will not be deductible by the debtor. Also, if the debtor is shown to be a higher tax bracket than the creditor, the value of the debt will be taxable to the creditor as the highest bracket rate of the debtor.

18. No preferential treatment shall be afforded to deposits for purpose of this tax.

19. An "informer" provision is to be included in the law. Specifically, any individual who supplies information to the authorities leading to the discovery of tax evasion will be entitled to 25% of the recovered amount.

20. The Ministry of Finance shall make public a list of all taxpayers in group A, their properties, and the amount of taxes paid within 120 days after the filing and collection date.

21. All responsible members of the various Immovables Estimation Committees are to be appointed by the Ministry of Finance; local electees to be used only in an advisory capacity.

22. All responsible members of the various Securities Estimation Committees are to be appointed by the Ministry of Finance; the work of these committees will be centralized and accomplished on a national scale.

23. A comprehensive Ordinance relating to the valuation of all securities (public and private) will be issued.

A tax on increased property owned by individuals.

While the keystone of the proposed extraordinary tax structure will be the capital levy on individuals, it is politically and economically desirable that there be a tax on war profits. For this purpose the proposed Japanese tax on increased property of individuals should be accepted with the following major changes:

1. The exemption would be raised to 30,000 yen. Those whose property has increased in value by more than 30,000 yen would pay on the entire increase but would be allowed a credit against the tax in the amount of 18,000 yen.

2. All increases in property value are to be taxed at the same rate, but where the particular asset (except stock) has been held by the same taxpayer throughout the 1940–1946 period no tax would be imposed. The purpose of this provision is to protect the individual against heavy taxation on purely inflationary increases in the value of property he hasn't sold. The most important illustration of such tax exempt property is a home continuously lived in by the taxpayer. Increases in the value of stock or securities are to be taxed even though the assets were held throughout the period.

To attain these objectives the following changes in the proposed Japanese increased property tax on individuals shall be accomplished:

1. All tangible properties (securities shall not be deemed tangibles) owned by the same household from the initial date up to the terminal date will be eliminated from the occupation of increased property and will not be subject to this tax.

2. No tax shall be imposed if the increased value of property is less than 30,000 yen.

3. An 18,000 yen credit shall be permitted against all tax liabilities.

4. No preferential treatment shall be afforded to deposits, savings, or other forms of credit.

5. The class B portion of increased property is to be eliminated for purposes of this tax and, except as otherwise indicated, will be regarded as class A increase of property.

6. A comprehensive price index, reflecting legal and blackmarket prices, for the period April 1940 to the terminal date, is to be constructed by the government. The index will be used as a guide to ascertain 1940 property valuations whenever 1940 property records prove incomplete, fragmentary, or non-existent.

7. The classifications, filing date, and collection dates established for the Capital Levy Law will also be applicable for the Increased Property Tax.

8. The recommendations for revision of the Capital levy law listed under numbers 7, 8, 12, 13, 14, 15, 16, 17, 20, 21, 23, 24 and 25, above, apply equally to the Increased Property Tax.

[SOURCE: SUITLAND PAPERS, Z 703–6]

10-7 MEETING TO CONSIDER MEASURES RELATING TO WAR INDEMNITIES AND TAXATION

Memorandum for the Record May 20, 1946

By: T. A. Bisson, Government Section, SCAP

1. Present at the meeting:

Finance Division: Mr. LeCount, Colonel Jennings, Mr. Cherne, Major Brentlinger, Mr. Siegal, Lt. Col. McDiarmid, Lt. Comdr. Alsin, Major Burns, Major Sherbourne, Capt. Hertzmark, Major Wood, Lt. Rickel.

Anti-Cartels: Mr. Henderson, Mr. Pearce, Lt. Comdr. Noss, Capt. Cooper, Mr. Ziff.

Legal Section (ESS): Lt. Col. Minnick.

Civil Property Custodian: Major Ware.

Government Section: Mr. Bisson.

2. Finance Division (ESS) presented for consideration two projected directives: (1) a program affecting war indemnities, a capital levy upon individuals, and a tax upon increase in property owned by individuals during the war years (1940–46); and (2) establishment of a Reconversion Financing Agency under the ESB to provide industrial credits for reconversion of essential industry. Copies of the projected directives are attached herewith.

3. Discussion of the first of these directives occupied the greater part of a two-hour meeting. Finance Division pressed strongly for immediate concurrence in principle by the interested ESS people. The Division hopes to have the directive approved by SCAP and sent to the Japanese Government within a week. Thereafter, the period up to June 15 will be utilized in preparing a bill, embodying the directive's recommendations, to be submitted to the Diet. Suggestions for improvements of detail are invited while the bill is being drafted.

4. The directive, in effect, cancels war contract indemnity claims by taxing them out of existence as one aspect of a comprehensive set of new tax measures involving:

(a) A 100% tax on all individual and corporate claims against the Government or government-guaranteed institutions arising from the war, in excess of ¥10,000.

(b) A capital levy upon property owned by individuals, including their equities in Japanese corporations.

(c) A tax upon the increase in property owned by individuals during the war years.

5. In their entirety, these measures are designed to raise revenue and retire debt, to eliminate currency, to counteract inflation, and to strengthen the lower middle class proportionately to the higher class.

6. The directive amends drastically original Japanese tax proposals, described by Cherne as "phonies" both for their numerous exceptions, the extreme administrative complexities that would have arisen, and for their inclusion of a proposed capital levy on corporations. The latter, Cherne stated, had worked in only one out of 14 historical instances. It was rejected in favor of a program levied entirely against individuals, including of course the corporate securites owned by individuals.

7. Finance Division hopes the bill will be passed by June 25, that is within 10 days after the Diet session opens for business. The first returns (Class A) from the capital levy would then be due and payable August 25, the second (Class B) September 25, and the third (Class C) October 25.

8. Total yield estimated by Japanese Government at 80 billion yen, but by Finance Division at 50 billion yen, of which 38 billion would come from the capital levy and 12 billion from the increased property value tax. This 50 billion yen (if not used for specified and directed purposes) applied to the present Government bond debt (totaling 140 billions) would reduce it to 90 billions.

9. It is proposed that this Section follow developments of this program.

[SOURCE: SUITLAND PAPERS, Z 703–6]

10-8 ADDITIONAL NOTES ON THE PROPOSED TAX PROGRAM

Memorandum May 22, 1946
To: Chief, Governmental Powers Branch, GS, SCAP

Original Japanese proposals called for both a capital levy and war profits tax on *corporations* as well as individuals. Presented impossible administrative problem, as to drafting, enforcing, etc., especially re corporations. Latter successful in only 1 out of 14 historical instances. The one instance—Czechoslovakia—had specially favorable circumstances not present in Japan. Completely unworkable proposals—"Phonies."

Order of payment: 1. Yen currency. 2. Bonds. 3. Land. 4. Securities, etc.

The war indemnity tax is *all-inclusive.* It covers (1) contract cancellations, (2) war insurance, (3) costs of plant evacuation; (4) obsolescence in postwar months; (5) guaranteed dividends. Total repudiation, except for small holder (¥10,000 and under) claims. Total indemnity claims estimated at 66 billion yen.

For the capital levy, there is a personal declaration filed. Government has option to buy at declared value. There is a 25% bonus to informers against concealed assets uncovered. All delayed payments will be multiplied by price index reflecting increased currency inflation.

For increased property tax, period covers *all* increased property values in 1940–46, *except* for property held continuously. But securities are not exempt, even if held continuously. The Japanese Government wanted to divide property into separate classes—this would have been too complicated. So, all property is lumped together for a one-procedure treatment. The increased property tax is *deductible* from the capital levy.

Tax income structure in Japan something like this:

Income	Number of persons
From ¥ 30,000 to ¥100,000	2 to 2½ million
From ¥100,000 to ¥500,000	500,000
From ¥500,000 up	56,000

Graphed, the steepness of the curve is unparalleled elsewhere and is a remarkable commentary on Japan's social structure.

Some of the difficulties and queries raised:

1. Will "paralyze" the economy. Answer: (a) Stagnation (especially as to private loans) exists now and for past six months. (b) A necessary surgical operation which, once completed, will start wheels turning on sound and permanent basis. Ninety days after, there will be an improving situation. (c) Japanese to whom they have talked have not expressed fear over "paralysis"—rather, most of them want to get it over with quickly.

Up to present, *no* bankruptcy or receivership cases. All hangs on government, and financiers and businessmen just waiting. This program will force drastic, but highly needed, banking and industrial reorganization. The only remaining question marks will then be the reparations and Zaibatsu dissolution programs. Not argued that there will not be difficulties and a shock to the economy. However, program has leaked out and much of the shock has already been absorbed.

2. Will create inevitably many hardship cases, where presumably the smaller and possibly innocent fellow will suffer. This cannot be avoided. A problem for the Japanese Government, and discretion is left in its hands.

3. How value the stocks? Minister of Finance will be compelled to use its own measure of value. No stock exchange and we do not want one quickly, but very extensive over the counter transactions are going on continuously.

The equities of individual stockholders will be protected by a pro-rata division of total assets reported.

4. Valuation of bonds offered in payment must also be left to discretion of the Minister of Finance. In black market, the quotations are not 60–75, but pegged at 98. Probably nothing can be done to obviate fact that a person can buy bonds at 60, and then turn them in, say, at the higher valuation fixed by the government for tax payment purpose. Measure announced last November, so there has been six months for evasion to occur.

5. Expected that the program will exert a good effect in mopping up currency and bonds. Inflationary situation will be improved, and bond repudiation may prove unnecessary. For a short time, there might even be a deflationary problem.

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

10-9 A MEMO ON LOCAL GOVERNMENT FINANCES

Memorandum May 22, 1946
To: Chief, Governmental Powers Branch, GS
From: A. J. Grajdanzev (Staff Member)

Before the start of war in China the total sum of the prefectural, city, town and village public expenditures was larger than Japan's national expenditures passing through the budget, as may be seen from the following:

	Expenditures in Million Yen (ord. & extraord.)	
Budget Year	National	Local
1932	1,477	1,626
1935	2,163	2,243
1937	2,282	2,717

However, the national budget of 1937 does not include the cost of operations in China. This year was a decisive year: the policy since that year became to keep down all possible expenditures of the prefectures, cities, towns and villages and to canalize all available means into the channels of war. As a result, while the national budget (including expenditures on war) soared to more than forty billion yen in 1943, total local expenditures reached only 3.6 billion yen. Taking into consideration the rise in prices since 1935 (by 1941 they almost doubled in terms of the level of prices of 1935 and by 1943 the official prices were more than double), we may conclude that local expenditures in 1943 were considerably below the expenditures in 1935. This means that no new schools or hospitals were built, that repairs were neglected, etc., and, as a result, the local institutions find themselves now in a pitiable state even in the prefectures which have not suffered from bombing.

This state of affairs would continue in 1946/47. While the national budget for 1946/47 would exceed forty billion yen, the estimates for the local expenditures amount only to eleven billion yen—one-fourth of the national expenditures.

This most unhealthy state of affairs, especially from the point of view of development of self-government in prefectures and other local bodies, should be ended as soon as possible and conditions prevailing 1932–1937 should be restored (a complete reversion to the situation in 1932–1937 is impossible for the time being because large reparation payments would be passing through the national budget).

As to the distribution of these expenditures among the local bodies, it may be seen from the following:

	Expenditures of local governments in 1943		
	In million yen	Percentages of total	Per inhabitant (in yen)
Prefectures	1,472	41.4	20.1
Cities	1,427	40.0	48.1
Towns, villages	664	18.6	15.3
Total	3,563	100.0	48.7

This table shows (1) that ordinarily prefectures expend slightly more than the cities; (2) that towns and villages spend relatively small amounts. In that respect the last column is especially revealing: while cities spent per inhabitant 48 yen a year, towns and villages spent 15.3 yen; as most of the expenditures made by the prefectures favor cities more than villages, education, health and other facilities are much better supplied in the cities than in the villages, though the population of the cities in 1943 was below 30 and the population of other communities was more than 43 millions. As a result the villages have been a source of ignorance, reaction, and the base of militarism. Here lies an important task for the future.

But the differences are even greater than these figures suggest in view of unequal distribution of wealth in Japan. Let us compare two of the richest prefectures and two of the poorest prefectures:

	Expenditures in 1943					
	In Million Yen			Percentages of Total		
	Pref.	Cities	Towns & Villages	Pref.	Cities	Towns & Villages
Rich Prefectures						
Tokyo	146	439	10	24.7	73.6	1.7
Osaka	91	266	16	24.6	71.2	4.2

Poor prefectures						
Aomori	17	6	12	49.4	17.2	33.4
Tottori	12	2	6	59.0	11.0	30.0

In the prefectures with large cities almost three-quarters of expenditures are passing through the city budgets, and only one-quarter through the prefectural budgets, leaving practically nothing for the towns and villages; in the poor prefectures the prefectural budget is the base (50–60 per cent of the total expenditures). Thus poor prefectures are more interested in strengthening prefectural budgets. As to the differences among the prefectures, while in 1943 the total per capita expenditures for Osaka prefecture were 98 yen, for Chiba they were only 25 yen, or only one-quarter of Osaka's per capita expenses.

As to the purpose which these expenditures served, one may see them from the following table:

Local Expenditures by purposes in 1943
(percentages of total)

	Prefectures	Cities	Villages
Education	28.2	12.7	33.3
Health	2.0	8.1	2.5
Social Welfare	1.0	3.2	2.9
Encouragement of industry	14.0	1.7	2.7
Police	10.6	—	—
Engineering & Works	14.9	5.9	5.6
City Planning	2.4	6.2	0.3
Public debt	11.7	17.2	6.4
Water Works	0.1	8.8	1.0
Gas & Electricity	1.0	7.9	0.0
Salary & offices	—	8.3	24.9
Others	14.1	20.0	20.4
Total	100.0	100.0	100.0
Total in million yen	1,472	1,427	664

This table shows that in the prefectures and cities the expenditures for education make the largest item of the budget—almost one-third in prefectures and exactly one-third in towns and villages. Yet this is due not so much to the care for schools, as to the poverty—the expenses for education are obligatory and little is left for everything else, especially in towns and villages where schools and salaries of officials take almost 54 per cent of the total. Health and social welfare are almost completely ignored in prefectures, towns and villages (in the latter the expenditures for health and sanitation amounted to 1/3 of yen per person per year, additions from the prefectures would probably double the figure). Only in the cities the composition of the budget was more satisfactory.

In all echelons of local government a large and growing part of the budget was spent on debt services, showing that the resources of the self-government were not sufficient even for the satisfaction of these modest needs and the local governments went deeper and deeper in debt: the national government preempted all more lucrative sources of revenue.

The local government debts amounted in 1943 to 1,400 million yen for prefectures, 2,509 million for cities and to 426 million for towns and villages, or a total of 4,336 million yen, of which about ten per cent was for education, another ten per cent—constructions against floods, etc., 24 per cent for ordinary construction, 4 per cent for construction of hospitals and other health measures and almost 25 per cent for water works, gas and electricity. It is true, as a result of inflation this burden should have been decreased; yet the local governments are more in need of loans than ever before and thus would resume borrowing on a large scale. The budget for 1945/46 foresaw an issue of loans to the face value of 1,500 million yen; the budget for 1946/47 foresees an issue of loans to the face value again of 1,500 million yen (about 15 per cent of total revenue), but actually much more shall be needed.

As to the revenue, in 1943, 37.4 per cent of it came from taxation and 62.6 per cent from other sources.

Revenue of the Local Governments

	Million Yen		Percentages	
	1934	1943	1934	1943
From taxes	597	1,333	21.6	37.4
From other sources	2,167	2,230	78.4	62.6
Total	2,763	3,563	100.0	100.0

The most important of these non-taxation sources were:

	1934 Percentages of Total Revenue	1943 Percent of the Total
Commissions, fees, payments for joint use	10.5	12.0
Government subsidies	10.6	17.0
New debts	30.7	13.4
Carry-over from the preceding year	9.7	1.0
Revenue from property	1.3	2.5
Transfers	1.9	3.4
Sale of property	0.7	1.6
Others	13.0	11.7
Total	78.4	62.6

The revenue of prefectures in 1943 was composed of the following items:

Surtaxes to the national taxes (land, house, business, mining)	154.4 million yen
Prefectural taxes (tax on acreage, ships, cars, telegraph poles, real estate, fishing, hunting, geisha houses)	38.9 million yen
Taxes centrally administered, locally shared (income tax, corporation tax, and others)	366.1 million yen
Other taxes	16.8 〃 〃
Total from taxation	576.2 〃 〃
From other sources:	
Subsidies and grants-in-aid from the National Government	417.8 〃 〃
Fees and similar receipts	92.4 〃 〃
New debts	181.4 〃 〃
Sale of property	31.2 〃 〃
Receipts from property	27.0 〃 〃
Carry-over from 1942/3	27.7 〃 〃
Others	118.3 〃 〃
Total	1,472.0 〃 〃

Thus, 38.8 per cent of prefectural income came in 1943/44 from taxes, 28.4 per cent from national subsidies, 12.3 per cent from new debts and only 20.5 per cent from other sources.

The revenue of the cities, towns and villages was composed of the following items (year 1943):

	Cities	Towns & Vil.
Apportioned taxes:	35.1	119.6
Surtaxes on national taxes (land, house, business, mine)	235.3 million yen	146.6
Surtaxes on provincial taxes	24.0	18.1
Cities' (towns'-villages') own taxes	54.8	52.4
City planning tax	62.3	0.5
Other taxation receipts	39.5	4.0
Total from taxation	415.9	341.2
Fees, rents	311.2	22.6
State and pref. subsidies, etc.	142.1	156.3
New debts	263.0	31.6
Sale of property	22.0	5.2
Receipts from property	39.7	21.4
Carry over from 1942/43	66.3	28.1
Others	131.6	57.8
Grand Total	1,426.9	664.2

Let us now compare the sources of revenue for the prefectures, cities, towns and villages:

Composition of revenue of local governments, 1943

	Percentages of total		
	Prefectures	Cities	Towns-villages
Taxes	39.1	29.2	51.4
Fees, Rents	6.3	21.8	3.4
National pref. subs.	28.4	9.9	23.5
New debts	12.3	18.5	4.8
Sales of property	2.1	1.5	0.8
Receipts from property	1.8	2.8	3.2
Carryover from 1942/43	1.9	4.6	4.2
Others	8.1	11.7	8.7
Total	100.0	100.0	100.0

This table shows that 28.4 of the revenue of the prefectures and 23.5 per cent of the towns and villages come from the subsidies from the superior echelons; this shows their great dependence upon the favors of the center and the instability of their own fiscal base. If to this we add the receipts from centrally administered taxes, the dependence upon the national treasury in case of prefectures would amount to 53.2 per cent of total revenue in case of prefectures and to 41.5 per cent in case of towns and villages. Moreover, 12.3 per cent of the revenue in the case of prefectures comes from loans.

This brief survey of local finances shows (1) exclusive dependence of the lower echelons, especially of prefectures and towns and villages, upon the favors of the center; (2) peculiar composition of expenditures with social services reduced to minimum. This has been due partially to the special understanding of their duties to the citizen which the rulers of Japan had; partially because almost all resources were used for war purposes and very little was left for the local governments.

A reform of the local finances is certainly needed in Japan.

[Annex]

Estimates of Revenue and Expenditures of Local Governments for 1946/47

	1945/46	1946/47
	Million Yen	
Revenue:		
Taxes	6,660	5,865
Rents, fees	402	854
Subsidies	3,142	2,247
New Loans	1,500	1,500
Carry-over	797	510
Others	819	754
Total	8,632	10,967
Expenditures:		
Education	1,159	2,667
Health, Sanitation	265	421
Social Welfare	112	434
Encouragement of industry	753	1,166
Police	565	1,025
Engineering & Public Works	777	1,162
Debt services	547	502
Gas and electricity	256	394
Salaries and offices	1,033	1,704
War expenses	1,746	
Rehabilitation expenses	818	891
Others	601	601
Total	8,632	10,967

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

10-10 RECOMMENDATIONS REGARDING THE MINISTRY OF FINANCE

Memorandum July 18, 1946

To: Chief, Governmental Powers Branch

From: John M. Maki, Governmental Powers Branch

It is recommended that the Government Section take no action to encourage basic alterations in the structure of the Ministry of Finance. Although the powers of the Ministry are great and affect the lives of every Japanese citizen, they are non-political and technical in nature and have to do with the fundamental problem of financing the operations of the state.

Possibly desirable changes in the powers and functions of the Ministry will come about: (1) more or less automatically as a result of actions taken which will affect the powers of other Ministries; (2) as the result of popular pressure on the government; and (3) through the automatic elimination of certain functions as the Japanese economy becomes more normal.

The budget authority of the Ministry may possibly be strengthened as the legislative arm of the government becomes more powerful and the people come to an increasing realization of the fact that it is to their interest and within their power to keep governmental expenditures at a minimum. However, this is a process that may take some years because it rests in the final analysis on the successful political education of the people as a whole.

At present the taxation powers of the Ministry are extensive. Of course, the taxation program requires Diet approval but by and large that approval has been forthcoming with little alteration in the Ministry's basic program. In view of the control the *zaibatsu* have exercised over the Diet there is little wonder that it has not been a safeguard of the interests of the people at large in matters of taxation. The most effective means of developing a responsible attitude in both the Ministry and the Diet toward problems of taxation is to inform the public as to its interests in the problem of taxation and to instill in both the Diet and the bureaucrats a sense of responsibility toward the people. Progress in this field is bound to be slow and beset with difficulties, nevertheless, to achieve the objective slowly as a matter of public education rather than as a matter of legislative action is the more likely to achieve permanent results.

The Finance Ministry currently possesses certain powers over the finances of organs of local government. However, with the carrying out of the program of decentralization of control over local government these powers will automatically disappear.

The extent and nature of the controls of the Ministry over private financial institutions, such as banks and insurance companies, may be subject to question. However, both specific problems of detail and general problems of policy in this respect are more properly the responsibility of other staff sections. However, Government Section is specifically interested in two overall problems of policy: (1) Will the public interest, in terms of the people at large, be served by such control? and (2) Does the pattern of control conform to the plans for the economic disarmament and demilitarization of Japan?

It is recommended that surveillance be maintained over the police functions of the Finance Ministry. Generally speaking, Finance Ministry policy had no power of arrest, that being reserved for the national police. Their functions have been mainly investigation, control and questioning. But in the event that the program of decentralization of police functions is carried out it is probable that the Ministry police will have to be given wider powers. It is particularly recommended that close watch be maintained to prevent the customs police from taking over the function of political censorship of all printed material brought into the country.

It is recommended that no action be instituted concerning the general structure of the system of government monopolies of tobacco and salt. This is also a problem which can best be solved by the Japanese.

[SOURCE: HUSSEY PAPERS, UNIVERSITY OF MICHIGAN]

10-11 JAPANESE CANCELLATION OF WAR INDEMNITIES

Memorandum October 14, 1946

To: Mr. H. Borton, Division of Japanese Affairs

From: Mr. R. Fearey, Division of Japanese Affairs

It would be well for JA to be acquainted with at least the following facts brought out in the attached report:[3]

1. The Japanese Government had obligated itself by July, 1946 to indemnify individuals and corporations for various types of war losses to a total of 75 billion yen. Probable future claims for losses from confiscation of overseas assets and domestic removals for reparations would

[3] Not printed. This was a Situation Report on Japan, "Comments on Current Intelligence", No. 3479.15, September 17, 1946, prepared by the Division of Research for Far East, Department of State, and concerning Japanese cancellation of wartime indemnities.

be in addition to this figure.

2. Large indemnity payments were made immediately following surrender, until in November 1945 SCAP directed that such payments should be made only into blocked account, and that payments above 5000 yen since August 15, 1945 should be redeposited in blocked account.

3. Criticism of indemnity payments has been on grounds of their inflationary effect, the burden they impose on already strained government finances, and the primary benefits accruing to firms in the Zaibatsu category, held to have shared responsibility for and to have profited from the war. Continued payment of indemnities has been defended on the grounds that cancellation would bankrupt large sections of the industrial and financial world and slow recovery. Those of this conviction argue that cancellation would not have the claimed, healthy therapeutic effect of wiping out large amounts of fictitious capital, but rather would further accentuate the capital shortage now hampering recovery.

4. SCAP has long favored general cancellation, but as in other matters possessing important political implications and relatively little related to Japanese demilitarization and reform, has been reluctant to issue a specific directive. Pressure was exerted on the Japanese Government, however, to follow the proposals submitted by Leo Cherne, SCAP consultant, calling *inter alia* for: (1) immediate implementation of the proposed capital levy on the property of individuals and the proposed tax on wartime increases in the value of property owned by individuals, and (2) abandonment of the proposed capital levy and war profits tax on corporations in favor of cancellation of all corporate claims against the government arising out of the war.

5. The Japanese Government is now reported planning to submit a Wartime Indemnities Special Tax Bill at the next session of the Diet which, if passed, would result in cancellation of 40–50 of the total of 75 billion individual and corporate war claims, the bulk of cancellations being in the corporate field. Obviously, this would both be a large cancellation and would leave a large uncancelled residue. It is further reported that the Government has already or will at that time introduce measures to prevent the economic and financial chaos which might otherwise follow cancellation. These would include a three year guarantee of certain types of bank deposits, and measures for the provision of needed liquid capital for industrial reconversion.

6. The report concludes that the Government's program is still in too early a stage for proper appraisal but at best will be somewhat less than thoroughgoing, less than many industrial and financial leaders had feared. "Unhealthy adjustments" between creditor financial institutions and debtor corporations, too, are likely to detract from the plan's effectiveness. And the question of compensation for reparation losses and removals abroad and at home will still remain.

10-12 JAPANESE FINANCE LAW

Memorandum for Record — February 12, 1947
By: Frank Rizzo, Government Section

1. The first proposition in Mr. KANAMORI's paper is that "It is contradictory to the provisions of the new Constitution, therefore, to make such organs other than the Cabinet share the power and responsibility of budget preparation". In support of this proposition he advances the following arguments:

a. Article 73 states that the preparation of the budget is a function of the Cabinet.

b. Article 86 states that the Cabinet shall prepare the budget and present it to the Diet.

c. Article 87 provides that a reserve fund "may be commended *upon the responsibility of the Cabinet* to be subsequently approved by the Diet . . . indicating . . . that the power and responsibility of the Cabinet in preparing a budget is not a mere formal matter."

2. *Discussion:* These arguments are based on the supposition that the words "prepare the budget and present it to the Diet" give the executive not only the right and duty to formulate the national annual financial plan for the government, but that such right and duty are exclusive with the Cabinet, that no other agency of the government shall have any part therein, and that the function of the Diet is merely to authorize the budget.

3. That this supposition is baseless is indicated by Article 83 of the Constitution which says that "the power to administer national finances shall be exercised as the Diet shall determine." This places the power over the purse entirely in the hands of the Diet and makes it clear that whatever budget or other financial measures are submitted to the Diet by the Cabinet, are nothing but recommendations. The Diet may reduce, increase, or eliminate, any item proposed by the Cabinet or it may add new ones.

4. Even under present practice, the preparation of the budget is not entirely in the hands of the Cabinet for the original estimates for each years expenditures originate with the various spending departments. The Finance Minister, after making such adjustments and revisions as he deems necessary, then submits a balanced plan to the Cabinet for its decision. Based upon that decision, the Finance Minister then finalizes the amounts to be allocated to each of the government agencies and returns the estimates to those agencies for revision within the over all allotments so made. These are proper functions of the Cabinet and the Finance Minister insofar as they concern the executive "agencies" of the government, but to permit either the Finance Minister or the Cabinet, by executive decision alone, to revise the budget estimates of the judiciary and the Diet and the board audit, would subordinate these three agencies to the executive. If, however, the budget estimates of these three bodies are incorporated in the Cabinet's plan as received, no executive action or revision is interposed between the expiration of budgetary needs by those agencies and the Diet which is to act upon them.

5. In the case of the Diet, it may be argued that since that body has the final say on the budget, any revisions previously made by the Cabinet can be rescinded by it. This argument is specious because for political, scientific, and technical reasons it is more difficult for the Diet to revise and readjust budget proposals made by the Cabinet than it is to approve them in the form and in the amounts submitted.

6. Recognizing that the executive is charged with responsibility for presenting a balanced budget plan, there should be no objection to the Cabinet in transmitting those parts of the budget pertaining to the agencies whose independence it is desired to preserve, to append its comments, criticism, and recommendations for the consideration of the Diet. After all, it is not the Cabinet which raises revenue but the Diet. All the Cabinet does is submit the plans and proposals.

7. The statement is made that placing the preparation of the budget under the sole power and responsibility of the Cabinet is a natural conclusion of the parliamentary cabinet system which "has been adopted as the fundamental plan of governmental structure in the new Constitution." Under this system, since the Cabinet is a "product, so to speak, of the Diet," the executive and the legislature are not "organizationally insulated from each other" as they are in the presidential system. The Cabinet, in order to continue to exist, must have the confidence of the Diet and therefore "the premise should not be that the two are in conflict with the other."

8. The above reasoning fails to take into account that cabinets are often coalition affairs and that they do not always enjoy the support of the diets from which they spring in all matters which they submit to such diets. The cabinet and the diet may be in accord on some policy and still disagree on financial matters. It also happens that even where a cabinet is completely representative of the majority party, issues may arise on which it loses the support of the majority. In these cases conflict arises.

9. Mr. KANAMORI's reasoning is based on the concept of an executive budget as practiced by the British. Under the British system, which emphasizes the integrity of the executive budget, the parliament has turned over the initiative for the formulation of the budget entirely to the executive and has deliberately eliminated its own powers over financial measures, thus Parliament may not modify expenditure proposals except to reduce them, without the consent of the cabinet, nor may it consider estimates or proposals not introduced by the cabinet. To do either of these things would constitute a vote of lack of confidence and cause the cabinet to fall. Parliament may, however, without involving the question of confidence, alter tax or revenue proposals submitted by the executive. In practice whenever the cabinet senses that the Parliament is about to modify its proposed budget by legislative action, it forestalls such action by dissolving the cabinet. The threat of dissolution and the trouble and expense of running for reelection are a powerful deterrent to diet members who might otherwise wish to modify the cabinet's budget. This gives the executive the upper hand. In a constitutional monarchy, such as Great Britain, where the democratic process is thoroughly established beyond the principal and in practice, this in not particularly dangerous and it does smooth the way of government, but in a country with Japan's background where the parliamentary system has been traditionally weak, such power in the hands of the executive would be a serious obstacle to the development of a powerful and responsible legislative body.

10. There is nothing either unconstitutional or traditionally wrong in limiting the authority of the executive in the formulation of the budget. In France, for example, which is also a "parliamentary government" the legislature has always had the power to change the ex-

ecutive budget in any way it saw fit or to replace it with an entirely new one. In the Congressional types of government, such as in a number of the states, and in the Federal government itself, the legislature also imposes this power. Thus, in these governments the executive budget is nothing but a recommendation to the legislature to be accepted, amended, or rejected, as the legislature may choose. In the U.S. and in a number of the states as well, the independence of the judiciary is preserved in the manner which has been suggested to the Japanese Minister of Finance.

11. In conversations with SCAP, Official Representatives of the Minister of Finance have expressed the fear that unless the power of the Cabinet, and particularly the Finance Minister, to formulate the budget is preserved in its old form, there is grave danger that the Diet will run wild and that appropriations will be made for which no revenue is provided. They have stated that the Ministry of Finance, since it has the experience and the expert technical knowledge required for this work, can be trusted to do it properly, whereas the Diet, lacking such experienced technicians, would be at a loss to produce an adequate budget. In the past this assumption of exclusive possession of the knowledge and skill necessary for the administration of financial affairs has led the Cabinet to think of itself as the agency which produces the state's revenue and therefore is the one best qualified to determine how it should be spent, and that the Diet had very little to say about public finances. It has not been suggested that the formulation of the budget be transferred to the Diet but it is believed that under the new Constitution the Diet will be compelled to acquire the knowledge and the skill necessary for a proper examination and criticism of the Cabinet's proposal and, where necessary, to initiate financial measures of its own.

[SOURCE: SUITLAND PAPERS, Z 703-17]

10-13 NEW FINANCE LAW

Memorandum for the Record February 17, 1947
By: Frank Rizzo

On 15 February 1947 Mr. Noda of the Budget Bureau of the Ministry of Finance together with Mr. Fujisaki of the Central Liaison Office reported that pursuant to the conference held in the Government Section on 13 February 1947 on the subject of the independence of budgetary requirements of the Diet, the Judiciary and the Board of Audit, this matter had been discussed among representatives of all interested agencies, and as a result, solutions satisfactory to all parties were being formulated as follows:

Diet: Mr. Yamazaki is satisfied with the suggestion put forth by the Cabinet that the Cabinet, in the course of preparation of the budget, may revise the estimates submitted by the Diet provided that it show the originally requested amounts alongside the Cabinet's budget figures.

Board of Audit: The Board of Audit will accept the same compromise provided that revisions in its estimates are not made by the Budget Bureau without conference and consultation with the Board. In the event agreement cannot be reached at that level, the differences shall be discussed between the Minister of Finance and the President of the Board of Audit.

Judiciary: Mr. Hosono, Chief Justice of the Supreme Court, has agreed on his own behalf but cannot give final acceptance until he has consulted his colleagues, to a compromise which provides that (1) the budgetary estimates of the judiciary will be considered and screened by a representative committee to be organized for this purpose, (2) the recommendation of that committee, while not legally binding on the Cabinet, will as a matter of practice and precedent not be revised by the Cabinet (3) in the event the Cabinet finds it unavoidable to make changes in the Committee's draft, the details of that draft as received will be shown in the Cabinet's budget plan. In that case the Cabinet will incorporate suggestions as to the source of additional funds should the Diet decide to restore all or part of any reductions made by the Cabinet.

Messrs. Noda and Fujisaki were told that it looked as if they had made good progress toward a practical solution and were requested to bring in a draft of the proposed provisions in the finance law just as soon as all parties concerned were agreed and the language had been worked out. It was indicated to them that the latest proposals would in all probability be approved.

[Enclosure]
Re-Formulation of Budget Estimates of Court Expenditures.
15 February 1947

1. With regard to the expenditures of courts too, it shall be the Cabinet which is to be legally charged with the responsibility of preparing it and presenting it to the Diet.

2. The budget amount of expenditures of courts shall be decided with the concurrence of the Court Expenditures Investigation Committee (provisional name).

3. The organization of the Court Expenditures Investigation Committee shall be provided for separately but it shall be a small group of persons including representatives from the courts, and from the Cabinet and its subordinate administrative organs in charge of finances.

4. The draft to be submitted to the Committee for consideration shall be prepared upon discussion between the officials of the courts and the Ministry of Finance based upon a tentative demand prepared by the administrative officials of the courts.

5. The draft approved by the Committee shall not be legally binding but the Cabinet shall, as a matter of practice, respect its decision in formulating the budget with a view to forming a custom of making no changes to it when putting it into the budget. Provided that, if the Cabinet finds it has to make changes in the draft approved by the Committee due to certain circumstances, the Cabinet shall attach to the budget estimates to be submitted to the Diet the draft of the Committee including all its details as the original requested amount.

6. In case of the provise of the preceding paragraph, the source of revenue to provide for the changes the Diet may make to the Cabinet's estimate shall also be clearly defined in the budget estimates.

[SOURCE: SUITLAND PAPERS, Z 703-17]

10-14 NEW FINANCE LAW

Memorandum for the Record February 17, 1947
By: Helen Loeb

1. On 13 February, 3 P.M., the following representatives of the Diet, the Courts, Economic and Scientific Section, and Government Section met to discuss the projected new Finance Law:

Mr. Yamazaki, Speaker of the House of Representatives
Mr. Oike, Chief Secretary of the House of Representatives
Mr. Yamazaki, General Affairs Secretary, House of Representatives
Mr. Matsui, Foreign Office
Mr. Hosono, Chief Justice of the Supreme Court
Mr. Reid, Public Finance Division, Economic and Scientific Section
Lt. Col. Hays, Government Section
Maj. Rizzo, Government Section
Dr. Oppler, Government Section
Mr. Blackemore, Government Section
Miss Loeb, Government Section
Mr. Fujisaki, Finance Section, Economic Division, Central Liaison Office

A representative of the Board of Audit, although invited, failed to attend.

2. The general problem was explained by Maj. Rizzo, as follows:

a. In connection with discussions on the proposed new Finance Law, it has been suggested to the Ministry of Finance that those portions of the general budget dealing with the Judiciary, the Board of Audit, and the Diet should not be subjected to revision by first the Finance Ministry and then the Cabinet, but should be incorporated in the general budget as received from the spending agencies. The object of this suggested provision is to insure that the independence which these three organs must have in order to discharge their functions under the new Constitution would not be impaired by executive action.

b. In the past, the Courts, the Board of Audit, and the Diet were all subordinate to the executive. The position of the Diet under the new Consitution as the holder of all legislative power, and the independent status of the judiciary, including its power to pass on the constitutionality of laws passed by the Diet, require that the independence of these organs from the executive agencies of the government be safeguarded. The Board of Audit, as the constitutional body which examines and reports on financial transaction of all other government agencies, also requires a status of freedom from executive domination.

c. The above suggestion has been discussed by representatives of the Finance Ministry and the Cabinet. It is their opinion that if the Cabinet could not revise the budget estimates of the three bodies in question, the Cabinet's ability to discharge its function of preparing the budget would be seriously impaired. In addition, they believe a question of constitutionality is involved.

d. In line with the Supreme Commander's policy of permitting the Japanese government to conduct its internal administrative affairs with a minimum of intervention by him or his

representatives, the representatives of the Finance Ministry and the Cabinet have been informed that the object of the SCAP Sections concerned is to assist the government in arriving at a solution which, while not impairing the functions or administrative integrity of the Cabinet, will at the same time insure that the Diet, the Board of Audit, and the Courts will retain the independence necessary for the discharge of their constitutional duties.

e. To this end the representatives of the Cabinet and the Ministry of Finance have suggested that the Cabinet, in preparing the general budget, continue to exercise what it believes to be its constitutional duty of reconciling the budgetary requests of all the spending agencies including the three under discussion in the light of revenues available, but that when the general budget is transmitted to the Diet for its consideration the original requests of the three organs also be transmitted. In this way the Diet can compare the original requests with the revised amounts as incorporated in the Cabinet budget, with the final decision to be left to the Diet.

f. This proposed solution is considered satisfactory by the Public Finance Division, Economic and Scientific Section, provided the original requests and the revised budgets of the three organs are transmitted in complete detail, with the figures in juxtaposition.

g. Since these previous discussions have been entirely with representatives of the Cabinet, the purpose of this conference is to inform the representatives of the other governmental bodies concerned and to obtain their views.

3. The views and questions of the Diet representatives were expressed by Speaker Yamazaki and Chief Secretary Oike, as follows:

a. Speaker Yamazaki stated that since the original suggestion and the solution proposed by the Finance Ministry and Cabinet have not been discussed in the Diet, he was unable to voice the opinion of the Diet. He added that when the projected new finance laws are introduced, with the approval or non-objection of SCAP, they will receive full consideration by the Diet. His personal opinion was that the Cabinet's solution might be questioned on constitutional grounds.

b. Mr. Oike suggested that if the Cabinet's solution is accepted, with the original budget requests and the revised versions presented for the full information of Diet, there will be a question as to the source of additional revenue if the Diet were to authorize the amounts originally requested.

(1) Maj. Rizzo replied that this problem had been anticipated and that the Cabinet and Finance Ministry representatives had stated that the differences between the original requests and the final Cabinet budget figures would not be so great as to necessitate special tax or revenue measures, and that such differences could be taken care of by use of the reserve fund in the budget.

(2) Mr. Oike stated that in such case provision should be made for decreasing the amount of the reserve fund in the event the Diet does not restore to the budget the amounts requested by the Diet, the Courts and the Board of Audit but approves the budget as submitted by the Cabinet. If, however, the differences between the original requests and the budget amounts included in the Cabinet's budget are not likely to be great, there is little reason for not accepting the original budget requests.

(3) Maj. Rizzo explained the Cabinet's viewpoint to be that if certain portions of the budget are withdrawn from the Cabinet's executive discretion, the Cabinet, under its duty to formulate a balanced budget, is charged with a responsibility without adequate authority to discharge it. He reiterated that the interest of the SCAP is to see that independence of the Courts, the Diet, and the Board of Audit is maintained, and that the need of the Cabinet for the authority required to prepare a balanced budget is fulfilled.

c. Mr. Oike asked for a clarification of the portion of the new Constitution dealing with the authority of the Diet to amend the general budget by increasing the total amount of expenditures.

Maj. Rizzo asked Mr. Fujisaki. (Central Liaison Office), who had attended and acted as interpreter at the previous day's meeting with representatives of the Finance Ministry and State Minister Kanamori, to state the opinion given by the State Minister when that question was asked of him. Mr. Fujisaki then stated that according to Mr. Kanamori, the Diet can increase, decrease or otherwise modify the budget in any way it sees fit.

d. Mr. Oike then pointed out a difficulty that would arise if the Cabinet's suggested solution is embodied in the new Finance Law: theoretically the Diet can modify the general budget, but the executive organs can submit additional requests for funds, while the Diet cannot do so once the budget is passed. In practice, he said, the Cabinet should maintain liaison with all organs of government.

(1) Maj. Rizzo stated that the maintenance of adequate liaison is an internal governmental problem.

4. Chief Justice Hosono stated that he liked the original suggestion providing for independence of the Courts in budgetary matters. To insure the proper and unprejudiced use of such independence, he suggested the establishment of a committee affiliated with the Supreme Court, composed of the Presidents and Vice-Presidents of both Houses, the President of the Legal Association, and financial exports to draft the Courts' budget for inclusion, as drafted, in the general budget.

a. Maj. Rizzo asked whether Justice Hosono disapproved of the Cabinet's proposed solution, to which he replied in the affirmative.

5. Maj. Rizzo stated that the sentiments expressed by the representatives at this conference would be relayed to the Chief, Government Section, and within a day or two the representatives of the Cabinet, the Finance Ministry, the Courts, the Diet, and the Board of Audit would be informed as to what position the Headquarters would take. He indicated that if the interested agencies themselves can agree on a mutually satisfactory solution giving due weight to the issues which had been discussed and safeguarding the proper functions of all the parties the main purpose of this conference will have been served. In the final analysis, whatever law is introduced by the Cabinet will undergo discussion in the Diet where, if found unsuitable, it can be modified. And if such a law as finally passed is questioned on constitutional grounds, that issue will have to be passed on by the Supreme Court.

6. Maj. Rizzo added as a personal observation that the Diet could and should do more by way of study and investigation on budgetary matters, that it could and should acquire the needed information and achieve the expertness essential to becoming, under the new Constitution, the final authority over the nation's purse.

a. Speaker Yamazaki agreed with the observation, admitted that in the past the Diet had failed to fulfill its function in regard to the budget and in this transitional period, being organizationally weak, was not yet able to exercise its full powers, but said that the new Diet Law Bill had been drafted for the express purpose of insuring a stronger Diet, one capable of being the supreme organ of legislative power, and he hoped that the Diet would become so in actuality.

[SOURCE: SUITLAND PAPERS, Z 703–17]

10-15 SETTING OF REVENUE TARGETS IN THE JAPANESE BUDGET

Memorandum January 22, 1948
To: Dr. S. M. Fine, ESS
From: Michael Sapir, Research and Statistics Division, ESS

1. Realization of point 6 in your memorandum on the ESS targets for 1948 requires many types of action. In particular putting the budget and tax assessment and collection problem in proper perspective is important. The Finance Ministry during 1947 has failed badly, not only in tax collections, but in the setting of original tax goals and the lack of revisions in tax goals as the fiscal year progressed.

2. Changes in methods of tax estimation and reporting should be required of the Finance Ministry in the coming year.

a. In setting the original tax and revenue estimates for the new budget, the Finance Ministry should be compelled to show the levels and distribution of national income production, and prices which underlie their tax liability estimates and budget tax goals.

b. As long as a serious inflationary situation continues, with sharp changes in the levels and distribution of income and rapid changes in price levels, the Ministry should be required frequently—perhaps quarterly—to reappraise the situation and revise its tax targets. This is particularly the case for personal and corporate income taxes whose yield is geared to the current situation.

c. Expenditure budgets are constantly revised through the system of supplementary budgets. Corresponding revision of revenue goals is called for. It would more sharply highlight where collection programs are falling down and where the strongest administrative action must be taken to achieve the fiscal program.

3. In the present fiscal year actual tax collections, particularly of personal income tax, are low relative to budget targets. As is not so well realized the budget targets themselves are crudely based on estimates of national income payments totalling only one-third of estimated actual levels of income for the year. The under-estimate and under-assessment of income is heavily biased in favor of the business proprietors' group and farm proprietors not subject to

with-holding of taxes at source. The Finance Ministry estimates make no allowance for black-market income. The present income tax figure in the budget was crystalized in the autumn on the basis of income estimates assuming price-wage levels of September-October.

4. Only in the case of governmental workers are budget goals explicity revised when government wage increases are granted. The budget allows for an additional 2.0 billion yen from witholding as a result of the recent supplementary payments to government workers. For no other income group in the population is such revision explicitly made.

5. More or less automatic adjustment of actual tax collections takes place however for the wage-salary group as a whole, whose incomes are subject to the withholding tax. Thus actual withholding tax collections are now running well ahead of the schedule necessary to attain the budget target. In fact the Finance Ministry has instructed its tax collectors to shoot for a target for withholding tax collections 4 billion yen higher than the most recently revised budget target indicates. This is supposed to compensate for the failure to collect from self-assessment groups and for the lag in various other types of taxes. In other words, in terms of original estimates of actual collection of taxes thus far, the personal income tax system in particular has been operating with a definite selective bias against the wage and salary earner and in favor of business income groups who are generally in the higher tax brackets.

6. Requiring the Finance Ministry to give the full setting of its tax analysis and administration will help in appraising the proper tax capacity of Japan and more clearly focus attention on just where the tax administration problem is most acute. Concentration of effort at improvement can consequently be more effective.

7. The suggestions made above are in line with good fiscal analysis and reporting as practiced in the United Kingdom, and in the United States—in the framework of "The Nation's Budget and the Government Budget." The Japanese Finance Ministry should at least make a start in this direction.

[SOURCE: SUITLAND PAPERS, Z 703–57]

10-16 ADMINISTRATIVE MANAGEMENT FUNCTION

Memorandum for the Record — March 3, 1948
By: Frank A. March, Research and Statistics Division, ESS

1. Reference is made to Government Section check note to ESS dated 17 February 1948.

2. In the Japanese Government the budget function is performed in the Budget Bureau which is one of the five bureaus of the Finance Ministry. The function of administrative management is performed in the Administrative Research Bureau which is a temporary agency attached to the Cabinet. A diagram entitled *The Japanese Government* (Exhibit A) and a statement of the *Functions of the Japanese Budget Bureau* (Exhibit B) are submitted.[4]

3. The Finance Division's endorsement on the check sheet referred to suggests a central agency for administrative management, budgeting, personnel, administration, accounting, and procurement, but proposes its location in the Finance Ministry.

4. A similar organization was tried when the United States Bureau of the Budget was created in 1921 and was located in the Treasury Department. This was not successful, and under the Reorganization Act of 1939 the Bureau was transferred to the Executive Office of the President, and the functions of the Central Statistics Committee were transferred to the Bureau of the Budget. The Executive Office of the President also includes the liaison office for personnel management which is of great value in maintaining contact with the Civil Service Commission which is an independent bi-partisan commission.

5. A diagram of the *U.S. Government* (Exhibit C) and a statement of the *Functions of the U.S. Budget Bureau* (Exhibit D) are submitted.

6. The value of the United States type of organization in reviewing the operations of the various departments and agencies for the purpose of affecting economies and promoting efficiency, and in controlling the number of employees allowed in each agency, is apparent.

7. The transfer of the Bureau of the Budget from the Treasury to the Executive Office of the President served two purposes:

a. It brought the budget function under the more direct control of the President.

b. It removed from the Treasury Department a compelling power over other departments and agencies which had made it a super agency.

8. The Present location of the budget function of the Japanese Government in the Finance Ministry establishes that Ministry as a super Ministry, since it is in a position to recommend the increase or curtailment of funds to other Ministries, and this constitutes a compelling power.

9. In a coalition cabinet the Finance Minister may represent a party other than that of the Prime Minister, and as such, his power over other ministries can produce adverse results.

10. It is recommended that provision be made for a central budget office responsible directly to the Prime Minister, and including, in addition to the present budget function, the functions of the Central Statistics Committee and the Administrative Research Bureau.

[SOURCE: SUITLAND PAPERS, Z 703–27]

[4] These and other exhibits not printed.

10-17 PLACE OF THE BUDGET BUREAU IN THE JAPANESE GOVERNMENT

Memorandum — March 6, 1948
To: General Marquat
From: Eugene Reed[5]

1. Attached[6] is a study by the Research and Statistics Division containing charts and analyses showing the organizational position and statement of functions of the Budget Bureau in the U.S. Government and in the Japanese Government.

2. The Finance Division states that all of the administrative management functions of the Japanese Government should be in a single agency but that this agency should be the Ministry of Finance, stating as a part of their argument that "The Ministry of Finance as a result of its functions in connection with economic and financial policy and practice is in fact a staff agency with policy and control functions which cut across all Ministries of the government."

3. The Labor Division strongly recommends that the Budget Bureau personnel management and other administrative management functions be established completely independent of the Finance Ministry.

4. At the conclusion of its analyses, Research and Statistics Division likewise feels that the Budget Bureau should be independent of the Finance Ministry and that the present functions of the Statistics Committee how in the office of the Prime Minister be transferred to the new independent Budget Bureau.

5. The weight of the evidence and argument is overwhelmingly in the direction of an independent Budget Bureau.

6. It is recommended that:

a. ESS take a positive position in favor of the creation of the Budget Bureau independent of the Ministry of Finance but closely associated with other administrative management functions of the Japanese Government.

b. That our reply to the Government Section Check Note on this subject welcome the proposal for consultation with them in order to discuss the best means of coordinating the work of the Budget Bureau with other administrative management functions.

c. That Mr. March be designated to handle these consultations with the Government Section with the technical advice of the Finance Division concerning such questions as time and the possibility that some of the functions presently in the Budget Bureau might remain in the Ministry of Finance. (Mr. March has had probably actual working experience in the operation of the Federal Government in Washington than anyone in this theatre. Immediately before coming to Japan, he was Acting Director of Departmental Administration in the State Department).

d. Other Divisions in ESS, undoubtedly, have an interest in this question and you may wish to bring this subject up for discussion at your staff meeting on Monday.

[SOURCE: SUITLAND PAPERS, Z 703–27]

10-18 ESTIMATED JAPANESE BUDGET EXPENDITURES FOR SUPPORT OF OCCUPATION FORCES

Memorandum — March 30, 1948
To: Mr. Lipsman, Under-secretary Draper's Mission
From: Colonel H. E. Eastwood, Assistant Chief of Staff, G-4, SCAP

[5] Chief, Public Finance Branch, ESS, SCAP.
[6] Attachments not printed.

1. In response to your request of 25 March 1948 for a definition of each of the major categories used in the presentation of the estimated requirements for facilities, supplies, services and materials to be required of the Japanese Government to meet the needs of the Occupation Forces for Japanese Fiscal Year 1948, and budget expenditures for Japanese Fiscal Years 1946 and 1947 based upon appropriations for those years, the following definitions and coverage of the different headings as used in the budget estimates are furnished:

a. TROOP HOUSING: Rehabilitation and necessary construction, including utilities, of any structure(s) to be used for the housing of troop organizations or detachments of any size including in large centers of troop population, chapels, theaters, service clubs, athletic facilities, etc.

b. DEPENDENT HOUSING: Construction of community type housing, and, in large centers of such housing, of associated facilities such as chapels, schools, commissaries, filling stations, post exchanges, etc.; the rehabilitation of Japanese residences and apartment buildings; and the erection of Quonset and pre-fabricated type housing, all for occupancy by dependent families of either military or civilian personnel.

c. OPERATIONAL FACILITIES: Rehabilitation and necessary construction of facilities such as hospitals; warehouses; shops; docks; petroleum tankage and pipelines; air force hangars, and run-ways, aprons and taxi-ways; access and interior roads and strategic highways, etc.

d. MAINTENANCE AND REPAIRS: Services and materials for the repair and maintenance of operational facilities, troop housing, dependent housing, and the provision of utilities (gas, water, electricity and sewage).

e. SUPPLIES AND SERVICES:

(1) Supplies include miscellaneous procurement requirements including coal, spare parts for automotive vehicles, office furniture, furniture for dependent housing, photographic and other signal equipment, and normal depot items which are not available from the Zone of Interior for issue to troops or organizations.

(2) Services cover contracts with the Japanese Government under which Japanese business organizations provide a complete operating, managerial or manufacturing service, such as the operation of commissaries, laundries, bakeries, transportation, automotive maintenance and repair shops, stevedoring, etc.

f. PUBLIC SERVICE: Water and rail transportation and electrical communication services, including rentals, equipment, plant, materials and labor to operate, maintain and supply such services.

g. DIRECTLY EMPLOYED LABOR:

(1) Requisitioned labor: (For Japanese Fiscal Year 1948—149,000 Japanese Nationals). This type of labor is directly employed in Engineer, Transportation, Quartermaster and other technical service installations and operations and by tactical units. In general, it consists of clerks, interpreters and translators, mechanical and skilled trade technicians, guards, motor vehicle drivers, and laborers, skilled and unskilled.

(2) Service Personnel—Labor employed for maintenance and operation of facilities, except domestic servants (for Japanese Fiscal Year 1948–73,000 Japanese Nationals). This type of labor operates and maintains facilities furnished by the Japanese Government for the Occupation Forces and includes janitors, electricians, carpenters, building managers, elevator operators, laborers, etc.

(3) Domestics (for Japanese Fiscal Year 1948–29,800 Japanese Nationals). This type of labor operates and maintains dependent housing. It does not include personal servants such as nursemaids, hairdressers, valets, chauffeurs, etc.

(4) Professional entertainment service (For Japanese Fiscal Year 1948—1,197,600 man-hours). This type of labor provides all forms of entertainment services furnished by the Japanese Government to the Occupation Forces for Special Services purposes. It includes all types of individual and group entertainers. Personnel of this class, employed in clubs, billets and other revenue-producing agencies is paid for by such agencies.

h. RENTALS: Rental charges for all facilities procured from the Japanese Government and classed as Japanese capital assets such as office buildings, billets, housing, residences, and operational facilities.

i. ADJUSTMENTS:

(1) EXPORTS (Other Areas). Covers the cost of materials, exported to areas outside Japan for the use of the military forces in such areas and transportation costs when shipment is made in SCAJAP shipping.

(2) REIMBURSEMENTS: Covers reimbursement for rail transportation for unofficial purposes; automotive maintenance for vehicles of other areas; other exports of services (invisible exports); and operational facilities for Atomic Bomb Casualty Commission, where estimates for provision of such travel, services and facilities are included within estimated requirements of the Occupation Force Budget Estimate.

2. In addition to the payment for entertainment personnel as indicated in paragraph 1, g, (4) above, personnel both of requisitioned and service classification employed in revenue-producing agencies such as Post Exchanges, clubs, theaters and Special Service Hotels is paid for by such agencies.

3. There is attached as requested, Inclosure No. 1, a copy of the summary used in the presentation made by Lt. Colonel Dyekman.

[INCLOSURE]

ESTIMATED JAPANESE BUDGET EXPENDITURES
FOR SUPPORT OF OCCUPATION FORCES
(In Millions of Yen)

	1946	1947		1948
*Troop Housing	9,874	8,899	(466)	311
*Dependent Housing	8,267	14,950	(3100)	1,600
*Operational Facilities	5,761	13,646	(2170)	2,322
Maintenance and Repairs	1,018	5,756		7,649
Supplies and Services	5,014	13,249	(1200)	13,608
Public Services (Communication)	545	3,281		4,165
Labor	3,716	8,153		7,577
Rentals	678	2,661		3,000
	34,873	70,595	(6936)	40,232
Adjustments:				
Exports (Other Areas)	875	5,269		1,275
Reimbursements	15	37		70
	890	5,306		1,345
	33,983	65,289		38,887
Comparison at current yen value	135,932	85,890		38,887

(Basis: 1946—50:1, 1947—150:1, 1948—200:1)

Figures in ( ) are carry-over from 1947 and included in 1947 estimates.

*It is estimated that seventy-five percent of the total of these three items is applicable to capital facilities which become capital assets to Japan upon release by Occupation Forces. The remaining twenty-five percent is estimated as being applicable to provision of air base facilities (except Haneda and Iwakuni Airports) which, because of prohibition of developments of air potential by Japan, will *not* be of future asset value to Japan.

10-19 JAPANESE GOVERNMENT 1948–49 BUDGET

Memorandum May 22, 1948

By: Theodore Cohen, Special Assistant to the Chief, ESS

1. The Japanese Government was informed on 7 May 1948 that SCAP clearance of the 1948–49 budget would be conditioned upon observance of the following principles:

a. Balancing of General Account—no expenditures without provision of revenue.

b. Complete and realistic estimates of expenditures and revenues.

c. No action which would impair basic minimum living standards.

d. Essential functions of government to be executed efficiently. Non-essential activities must be eliminated.

e. 100% collection of legal tax obligations from every citizen.

2. On 11 May 1948, the Cabinet submitted the outline of a budget to General Headquarters ostensibly balanced at 373 billion yen in the general account and formulated on the following assumptions:

a. A general average increase of 70% in official prices as of 1 June 1948.

b. An average monthly wage level of 3700 yen (compared to 1800 yen as of June 1947 and the 2920 yen average of the March 1948 government workers wage settlement).

c. An increase of 250% in rail freight and passenger fares and 300% in communications rates.

d. A new 1% tax on all commercial transactions other than those involving staple foods, to bring in 27 billion yen of revenue.

e. Considerable reduction in nominal income tax rates, with, however, no reduction in tax collections as a proportion of national income.

f. Sharply reduced depreciation rates for Government enterprises.

3. This budget was examined in great detail by ESS staff personnel in light of the principles noted in paragraph one above. In every case of reasonable doubt, the doubt was resolved in favor of the Japanese Government's estimates. In particular, the feasibility of increasing official prices 70% while holding wages to the 3700 yen level was doubted, but in view of reasonable arguments by the Japanese Government representatives as to the effect of reduced tax rates and increased supplies of consumer goods, no objection was interposed. Where listed expenditures appeared to be inadequate for a program, but where some reasonable doubt existed, as in the item for public works, the Japanese Government was advised that their estimate was accepted with the understanding that if it proved to be too low either the program would be curtailed or additional revenue secured.

4. As a result of the scrutiny, the Japanese Government has been advised that a minimum realistic general account expenditure estimate would be 400 billion yen, or about 27 billion yen more than proposed, with the difference made up of the following items:

a. 3.8 billion yen underestimate for cost of reparations removals and termination of the war expenses.

b. 9.7 billion yen underestimate on operating deficit of the railways and improper placement of certain rail costs in the special account as borrowings.

c. 1.5 billion yen underestimate on operating deficit of the communications services and improper placement of certain communications costs in the special account as borrowings.

d. 6.4 billion yen underestimate of price subsidies.

e. 2.3 billion yen underestimate of deficit on CMMC operations.

f. Other underestimates or improper placements in special accounts.

5. Similar realistic scrutiny of the special accounts indicated 167 billion yen of borrowing compared to the 150 billion yen proposal of the Japanese Government. Of this some 45 billion yen would be secured by inventory collateral and the remainder would be long term capital investment.

6. Since the Japanese Government had, on their own initiative, found sources for 2 billion yen more revenue subsequent to their budget submission to General Headquarters, this left a deficit of 25 billion yen to be made up to balance the general account. It was suggested that this be made up from among the following sources:

a. Transfer of the increased value of the Government food, charcoal and other inventories occasioned by the price revision into the general account. Revenue from this source is estimated at 15 billion yen, of which 12 billion yen is the food item. (This would increase the special account borrowings noted in the preceding paragraph to 182 billion yen of which about 60 billion yen would be secured by inventory collateral.)

b. Increased price of free sale cigarettes. A sample schedule was shown which would bring in 19 billion yen additional revenue.

c. Curtailment in reduction of nominal income tax rates, that is, a further increase in real income tax rates. The amount realizable would depend on the extent of curtailment.

7. In effect, the Japanese Government was advised that their 1948–49 budget proposal appeared to conform to the enunciated principles after the minor modifications noted above had been effected and the Japanese Government was given clearance to prepare the actual legislation for submission to the Diet.

[SOURCE: SUITLAND PAPERS, Z 703–17]

10-20 TAXATION PROGRAM

Memorandum[7] January 6, 1949

I. SUMMARY OF PROGRESS TO DATE

1. *April 1948*—An official of the U.S. Treasury, Internal Revenue Service, was recruited for the purpose of conducting an over-all survey of the Japanese taxation problem.

2. *July 1948*—The Chief, ESS, approved program for:

[7] An internal ESS paper bearing no indication of author.

a. Recruitment of qualified tax experts in U.S. and establishment of Internal Revenue Division, ESS.

b. Recruitment of temporary mission to conduct survey of tax structure. (Dr. Carl Shoup of Columbia University agreed to accept chairmanship of this mission).

3. *August 1948*—Internal Revenue Division of ESS established.

4. *August 1948*—8th Army directed to establish tax surveillance on permanent basis and intensify program.

5. *August 1948*—Attorney General, as a result of ESS pressure, appointed 63 special procurators in all prefectures to specialize in tax prosecution.

6. *September 1948*—National Tax Inspectors service established as integral part of tax service to conduct special tax investigations in large evasion cases. (Results to date of this group have been most gratifying).

7. *September 1948*—For first time in modern history of Japan, a Japanese was sentenced to prison for income tax evasion (case appealed). Three other convictions followed closely, but were appealed to higher courts. (Review by the appellate court of one of these cases, the President of the Tiyo Lace Net Co., Osaka, is set for 22 January 48).

8. *November 1948*—Tax experts, recruited on loan basis from U.S. Bureau of Internal Revenue and selected state and local governments, commenced to arrive for duty with ESS and 8th Army. (To date twelve men have arrived and several more will be arriving shortly).

9. *December 1948*—Attorney General commenced appointment of 36 additional tax procurators to specialize in tax evasion and prosecution.

II. TAX PROGRAM NOW UNDER ACTIVE IMPLEMENTATION

1. *Tax Administration and Enforcement:*

a. *Reorganization of National Tax Service:* Bill will be introduced next Diet session to reorganize the national tax service into one centrally controlled and directed, semi-autonomous professional system. The recently created field enforcement arm, The National Tax Inspectors, the primary function of which is to concentrate on the larger tax delinquencies, blackmarket and criminal prosecution cases, will operate independently of the other field offices and will be responsible directly to Tokyo. Target date for actual reorganization is 1 June 1949; earlier date is not considered feasible due to possible temporary adverse effect on current tax collections.

b. *Prosecution of Tax Evaders:* Continued expansion of recently established National Tax Inspectors of Finance Ministry and recently appointed Special Tax Procurators of Attorney General's Office, and continued development of coordinated procedures and training of those groups.

c. *Revision of Administrative Procedures:* A detailed survey of administrative, assessment, collection and accounting procedures of Japanese tax offices is now being conducted by two Accounts and Collections Supervisors of the U.S. Internal Revenue Service. Target date for initiation of major revisions is 1 June 49, which follows immediately after the current tax collection drive.

d. *Career-merit System:* In order to attract best available qualified personnel, establishment of career-merit system with relatively higher compensation for qualified tax collectors, technicians and administrators. This is now effective for National Tax Inspectors and is being expanded as rapidly as possible.

e. *Personnel Investigating Unit:* Establishment in central office of relatively small mobile unit whose primary function will be the screening of prospective tax personnel and the investigation of tax personnel suspected of corruption. Target date: 1 June 49.

f. *Tax Employee Training:* Continued expansion and intensification of tax employee training programs, with continued shifting of emphasis from long training courses for small number of employees to intensive courses for larger number of employees, including incumbent personnel.

g. *Publicity and Taxpayer Education:* Continued aggressive taxpayer education and general tax publicity programs through every available media, and strengthening present technical publicity section of Tax Bureau.

h. *Eighth Army Tax Surveillance:* Continued intensification of MG tax surveillance over Japanese tax administration pending attainment of reasonable degree of administration and enforcement efficiency. Four conferences and/or schools of MG tax personnel are to be held within the next thirty days.

2. *Tax Legislation, short range, for action next Diet Session:*

a. *Penalty Revision Law:* Bill will be submitted to next Diet for enactment of more effective penalty provisions governing both taxpayer evasion and corruption by tax officials,

including:

(1) Civil penalties, not now in effect, for fraud or negligence in connection with income tax returns filed.
(2) Both criminal and civil penalties, not now in effect, for failure to file income tax returns.
(3) Enactment of minimum penalties covering specific offenses. Present laws provide only maximum penalties, which often results in token fines for flagrant offenses.
(4) Penalty of a flat amount, to be progressively increased with each succeeding violation, for failure to keep honest records of income and expense.

b. *Corporation Tax Law:* A revision of the Corporation and Excess Profits Tax Laws, insofar as necessary to remove impediments to industrial production and the attraction of foreign and domestic capital, is now under preparation for submission to the next session of the Diet. The objectives of the revision are:

(1) Elimination of taxation on the difference between the selling price and the par value of newly issued stocks:
(2) Correction of tendency of current rate structure towards preferential treatment of newly formed as opposed to old established corporations; and,
(3) Adjustment of taxation on paper profits arising from book revaluation of existing assets.

c. *Land and House Tax Laws:* Revision of land and house tax laws from present law revenue levels to bring about maximum productivity through:

(1) Upward revision of abnormally low 1938 assessed values, upon which property taxes are measured; or, in the alternative,
(2) enactment of property "use tax", in event that, because of price control policies, rental ceilings cannot be increased.

3. *Tax Structure, long range:*

a. *Survey of Tax Structure:* The Shoup Tax Mission, headed by Dr. Carl Shoup of Columbia University, is scheduled to arrive on or about 1 May 49 for the purpose of conducting an over-all survey of the tax structures, with the primary objective of revising the structures to: (1) Maximize revenues to meet over-all budget requirements, (2) promote more equitable distribution of the tax burden; and (3) reallocate revenue sources among national, prefectural and local governments.

[SOURCE: SUITLAND PAPERS, Z 703–6]

10-21 TAX DATA FOR ECONOMIC MISSION

Memorandum[8] January 27, 1949
Prepared by: Internal Revenue Division, ESS

1. *Introduction:* A drastic reformation of taxation customs in a one to two-year period would constitute a formidable undertaking in any nation, much less a nation as steeped in tradition and as subservient to the *status quo* as Japan. For decades prior to 1947, tax-payers and tax collectors became accustomed to an unwritten code regarding tax assessment and tax payment. Assessment was strictly a Government function, one in which the taxpayer took little part. Taxpayers, while nominally required to furnish income particulars to the Government, rarely did, and paid no penalty for failing to do so. Appeals for reconsideration of assessments were rare, as assessments were invariably far below realized incomes. Thus taxpayers were under little compulsion either to report actual income, or to correct the tax collector's arbitrary assessment.

2. During the first two years of the Occupation several substantial revisions and/or new tax measures were adopted; including the enactment of the Capital Levy and a revision of the income tax law, the latter incorporating for the first time in Japan "pay-as-you-go" and "self-assessment" features. The self-assessment feature represented, more than any other tax measure, a drastic break with the past.

3. The trend of National tax collections, including tobacco monopoly revenues, since the inception of the Occupation, is indicated by the following:

[8] No tabs printed.

Year	Tax Collections (billion of ¥)	National Income (billions of ¥)	Percentage
1946–47	37.9	500.0	7.6%
1947–48	190.0	1,156.0	16.4%
1948–49	410.4	2,393.0	17.2%

It is interesting to note, in connection with the above, that between 1945 and 1947 the U.S. national tax revenue fell from 20.2% to 18.3% of the national income, while the Japanese tax revenue increased from 7.6% to 17.2%; and the Japanese personal income tax increased from 2.4% in FY 1946–47 to 7.3% in FY 1948–49, while in the U.S. personal income tax decreased from 10.1% in 1945 to 8.8% of the national income in 1947. Liquor and tobacco (monopoly bureau) excises are playing an increasingly important role in Japan's fiscal system. (For a comparison of U.S. and Japanese tax collections with national income figures, see Tab D).

4. *Tax Collections:* The national and local taxes collected during the fiscal years 1946–47 and 1947–48, and estimated to be collected during the fiscal year 1948–49, are summarized as follows:

	1946–47	1947–48	1948–49
		(in millions of yen)	
National Taxes:			
Income	12,173	79,362	183,468
Withholding		27,698	61,271
Self-assessed		51,664	122,197
Increased Income Tax	5,700	9,000	500
Corporation	1,269	7,463	18,056
Liquor	2,331	27,401	45,776
Commodity	2,214	8,367	17,508
Tobacco (monopoly bureau)	7,645	41,875	94,353
Sales Tax (1)	—	—	21,400
Admission Tax (2)	1,042	5,665	4,035
Others	5,512	10,860	25,353
Total	37,886	189,993	410,449
Prefectural and Local Taxes:			
Inhabitant	156	8,688	14,118
Land	292	795	2,730
House	298	756	3,590
Business	834	10,653	24,975
Admission (2)	—	—	6,373
Others	2,248	3,097	18,175
Total	3,828	23,989	69,961

(1) Effective 1 September 1948
(2) Transferred from national to local governments 1 August 1948.

(For a detailed description of the major national taxes, see Tab B; of the prefectural and local taxes, see Tab C; and for a detailed break-down of prefectural and local taxes collected, see Tab I.)

5. For details of tax collections for the fiscal year 1948–49 thru 10 January 1949, see Tab E. It is to be noted that tax collections as of 10 January 1949 indicated total receipts of 165.5 billion yen, or 52.4% of the 1948–49 budget goal of 360.1 billion yen. (The actual percentage is approximately 54%, since the table includes sales tax receipts thru 30 November only). The self-assessed income tax was only 33.8% of the budget goal and is the primary tax collection problem. However, it should be noted that the self-assessed income tax was only 13% of the budget goal during the same period in the last fiscal year. Similarly, almost all other levies showed a smaller percentage during the 1947–48 fiscal year than they presently indicate. It is expected that there will be a large increase in tax collections during the last quarter of the fiscal year because several groups, particularly the farmers, are not required to file income tax returns until 31 January. The crucial period for collections is just ahead and it is expected that intensive efforts of tax officials will result in immediate substantial improvements in the tax collection problem.

6. In December 1948 the Japanese Diet passed a supplementary budget which increased tax revenue (including Government Monopoly Bureau net revenue from tobacco, salt and camphor) from 361 to 410 billion yen. This represented 86.6% of the total budget amounting to 473 billion yen. (The remaining 63 billion yen was obtained from miscellaneous revenue sources including such items as price differential profits and licenses.)

7. *National Government Budget Tax Estimates for fiscal 1949–50:* Tentative discussions have been had recently with regard to the 1949–50 tax budget. The figures given below are considered highly tentative and are dependent to a great degree, especially in the case of the income tax, on the outcome of collections during the next few months. Further, it is assumed that there will be no change in the price level or rate structure of existing taxes.

National Tax (including Monopoly Bureau)
Estimate for fiscal year 1949–50
(in billions of yen)

TAX:		
Income		
Withholding	93.0	
Self-assessed	168.0	
Total		261.0
Corporation	22.0	
Liquor	52.5	
Transactions	40.0	
Textile	13.0	
Commodity	23.0	
Miscellaneous	20.0	
Total		170.5
		431.5
Monopoly Bureau (tobacco)		110
		541.5
New Levies:		
Gasoline		5
		546.5

8. *Tax Administration and Enforcement:* Although certain modifications in the tax laws are obviously still necessary, it has become increasingly clear that the basic problems of Japanese taxation lie primarily in the fields of tax administration and enforcement. Many of the tax laws which on the surface appear to meet equity standards have failed to do so because of inadequate and cumbersome assessment, collection and enforcement methods.

9. In April 1948 an official of the United States Treasury, Internal Revenue Service, was recruited for the primary purpose of surveying this field. As a result of this survey, qualified and experienced taxation personnel were recruited, on a loan basis from the U.S. Internal Revenue and certain selected state and municipal governments, for duty with this Headquarters and the Eighth Army; an Internal Revenue Division of ESS was established; and negotiations were completed for a mission, to be headed by Dr. Carl Shoup of Columbia, to visit Japan on or about 1 May 1949 for the purpose of conducting an overall survey of the Japanese national, prefectural and local tax structures. For details of the tax program now under active implementation, see Tab A.

10. *Reorganization of Tax System:* One of the major objectives of tax administration reform is the reorganization of the Japanese national tax system, which has a total personnel complement of approximately 50,000. This system is headed by the Taxation Bureau of the Ministry of Finance with personnel numbering slightly over 200 individuals. Eleven regional bureaus are responsible in their respective areas not only for tax collections (approximately 55% of each bureaus personnel), but also for all other duties of the Ministry of Finance, except the Monopoly Bureau. District tax offices, which are almost completely independent of the regional bureaus and the Ministry of Finance, now number 498. These district offices have very broad, practically autonomous powers with regard to all matters relating to the assessment and collection of taxes. Thus, responsibility within the existing organization is very difficult to place.

11. Present plans contemplated the establishment, on or about 1 June 1949, of a national tax administration as a semi-autonomous agency of the Finance Ministry. Under this proposal the regional tax bureaus will be directly responsible to the Tax Bureau, and the 498 district tax offices will be under the supervision of their respective regional tax bureaus.

12. *Tax Enforcement and Prosecution:* Enforcement of the tax laws has been notoriously weak. Not a single known case of conviction or punishment for tax evasion had ever been recorded in Japan until November 1947. When questioned on this point, Japanese officials replied that criminal punishment for tax evasion was contrary to their philosophy of justice. Under 1946 and earlier tax laws, furthermore, it would have been extremely difficult for the Government to prove evasion or fraud. At any time prior to actual indictment, a suspected tax evader could have confessed his guilt, paid the evaded amount, and absolved himself from further "punishment".

13. Concurrent with the formation of the Internal Revenue Division in ESS two steps were taken to strongly implement enforcement measures:

a. Prior to August 1948 the Attorney General's office did not have a single procurator assigned specifically to the extremely specialized problems of tax evasion cases. During that month under pressure from ESS, the Attorney General appointed 63 procurators. These were assigned to every prefecture in Japan as well as regional offices of the Procurator General. In December 1948 this number was increased by 35 additional personnel. Since the establishment of this group, for the first time in the modern history of Japan, taxpayers have been sentenced to prison for income tax evasion. (Despite these convictions, however, none have as yet been imprisoned due to appeal of their convictions.)

b. In September 1948 a "National Tax Inspections Division" of the national tax service was formed. This division operates independently of regional bureaus and local tax offices to gather data and investigate tax evaders. During its first 3½ months of operation it was responsible for almost 4 billion yen additional tax which might not otherwise have been detected. With the expansion and increase in the efficiency of this enforcement arm, substantial benefits, both direct and indirect, should result. It is expected that the indirect benefits will far outweigh the direct benefits because of the great increase in voluntary taxpayer compliance which should be brought about by a strong enforcement and prosecution arm of the service.

14. Results to date of the activities of these two groups are most encouraging, and it is expected that their combined efforts will result in numerous criminal evasion convictions and greatly increase voluntary compliance on the part of taxpayers.

15. *Penalty Revision:* Although the tax laws contain numerous penalty provisions, they are sometimes lacking in the most appropriate places. For example, there are no penalties at present for the following offenses:

a. Civil penalty for fraud or negligence in connection with the filing of income tax returns;

b. Failure to file income tax returns:

c. Failure to keep honest records of income and expenses.

16. *Military Government Tax Surveillance:* In January 1948 Military Government tax surveillance teams were established in all regional MG Headquarters and every prefecture to assist in the problem of tax collections. Material was sent to them outlining the nature of their duties as well as a brief survey of the Japanese tax system. These teams visited local tax offices at least twice a month. They noted the progress of tax collections and determined the reason for collections falling below established goals. During their first full month (February 1948) of surveillance, tax collections climbed to the highest point (31 billion yen) ever reached. The major benefit derived from Military Government surveillance of tax administration apparently was the prestige which it gave to the tax collectors. The mere presence periodically of allied officers in Japanese tax offices is often sufficient to bring about an extraordinary expansion of tax collections in that area.

17. Recently four United States Internal Revenue Agents (three more are expected to arrive shortly) were assigned to duty in the major Military Government regions. They will supervise and coordinate the tax surveillance activities of the prefectural tax surveillance teams. Conferences have been held and will continue to be held frequently among ESS/Internal Revenue Division personnel and Eighth Army regional and prefectural tax surveillance personnel. The tax surveillance program, which is now on a permanent basis, has been given top military government priority. It is expected that their help will materially assist in meeting the 1948–49 budget goal.

18. *Education and Publicity:* One of the major requirements to enable the Japanese tax system to break away from this antiquated method of tax assessment and collection is the adoption of a broad program of training, both for tax collectors and taxpayers. Publicity efforts have been expanded to indoctrinate the taxpayer on such matters as the necessity for taxation; the manner and time of filing returns, and penalties for failure to pay taxes. Schools receive frequent revenue information presented in an appealing fashion, giving details of the more important tax levies. Present employee training programs have been and are being drastically expanded. Increasing emphasis is to be given to intensive courses for larger numbers of employees rather than long courses for a small number of individuals.

19. Because the tax field has not been able to draw large numbers of highly qualified personnel, due primarily to their relatively low pay, a career-merit system, which will have as one of its objectives the placing of qualified individuals in their proper places, will soon be estab-

lished. Encouragement will be given to all tax officials to demonstrate their ability to perform the work of positions requiring higher qualifications than their present jobs. By making the tax service attractive to qualified individuals, by building up an esprit de corps among its personnel, and by intensive training of its employees, it is believed that the major obstacle to an efficient tax administration—"personnel"—can ultimately be overcome.

[SOURCE: DODGE PAPERS, Z 711-1]

10-22 REORGANIZATION OF NATIONAL TAX ADMINISTRATION OF THE JAPANESE GOVERNMENT (SCAPIN-2001)

Memorandum May 4, 1949
SCAPIN-2001 (ESS/IR)

1. The Nine-Point Economic Stabilization Directive of 19 December 1948 directed the Japanese Government to adopt measures designed, among other things, to "accelerate and strengthen the program of tax collection and insure prompt, widespread and vigorous criminal prosecution of tax evaders." These objectives, as well as the objective of fair and equitable tax administration, can be attained most effectively through the establishment of a professional tax system staffed, insofar as possible, with personnel of high moral and professional qualifications.

2. As a part of the program to accomplish these objectives, the Japanese Government will at the earliest possible date take necessary measures to:

a. Create within the Ministry of Finance a Tax Administration Bureau as an external bureau for the administration of national taxation. This bureau should have complete authority over its regional and local offices, and be responsible for all national taxation matters except these shown below under b.

b. Transfer to the created bureau all taxation functions of the present Taxation Bureau, except those functions dealing with tax legislation and research pertaining to tax legislation. The excepted functions should be retained within a Taxation Research Bureau, an internal bureau of the Ministry of Finance.

c. Divorce regulation of all matters alien to taxation from the regional financial bureaus and reconstitute these bureaus as regional tax offices and integral parts of the external Tax Administration Bureau.

d. Transfer all functions alien to taxation of the regional financial bureaus to such agencies as the Minister of Finance may designate in accordance with the requirements for regional and district administration and following the policy of simplification and consolidation of governmental activities.

e. Retain the Customs Division, now in the Taxation Bureau, within the internal organization of the Ministry of Finance.

f. Provide tax personnel who are competent, qualified and trained, insofar as possible, and adequate in number to administer and enforce vigorously, but fairly, the tax laws of the Government.

3. Direct communication between the Economic and Scientific Section, General Headquarters, Supreme Commander for the Allied Powers, and the Ministry of Finance regarding matters within the scope of this memorandum is authorized.

10-23 PROBES INTO SCANDALS IN TAX OFFICES

Memorandum No. 16 (B?) May 18, 1949
Prepared by: Parliamentary and Political Division, Government Section

Members of the Urawa (Saitama-ken) Tailors and Vegetable association testified as follows yesterday before the H.R.[9] Examination Committee:

1. The leaders of the associations make the tax allotment list of the members without asking their opinions or negotiating beforehand with the tax office.

2. Tax Office officials decide tax assessments dogmatically by mere desk calculations without investigating the actual status of the traders.

3. The traders have little or no knowledge of accounting in their own business.

[9] Probably "House of Representatives".

4. Protests raised by traders on the amount of tax are seldom taken into account, except in the case of certain influential persons.

5. If traders want to have their protest heard, bribery is necessary.

6. The leaders of the associations and vicious tax officials are so rotten that they decide the amount of tax of the members of the associations as they please.

7. Because the members of the associations are not conversant with the procedures of tax assessment, the tax office unilaterally decides the amount of taxes.

8. Testimony was emphatically made to the effect that in Saitama prefecture the tax offices have more power over the people than the police.

[SOURCE: SUITLAND PAPERS, Z 703-6]

10-24 NATIONAL ADVISORY COUNCIL[10] VIEWS ON SHOUP TELEGRAM

Memorandum July 21, 1949
To: Mr. West
From: Robert C. Snyder, Finance Section

1. Attached is a draft consolidation of NAC views on Shoup No. 2.[11]

[ENCLOSURE]

COMMENTS AND QUESTIONS ON MR. SHOUP'S CABLE NO. 2

General Comments and Assumptions

Any comment on Mr. Shoup's cable must start with the fact that Japan is now going through a testing period. The budget adopted in line with Mr. Joseph Dodge's recommendations is still only a plan—a plan intended to place Japanese finances on a firmer basis and to bring about a more stable and rational price structure. The execution of this plan has hardly started. It seems, therefore, premature at the present time to consider tax plans for the next fiscal year, beginning in April 1950, except in a most tentative way.

It is assumed in the following comments and questions that "too much deflation," as used in paragraph (2) of the cable, refers to an excessive deflation of prices, incomes, and credit which might have the effect of reducing production and investment incentives, resulting in production going to or staying at levels lower than would otherwise be reached. This danger does not seem to arise immediately and there may be some question whether it will arise next year, even if the government's surplus receipts should increase, as assumed in the cable. It is recognized that the more halting of credit and price inflation is bound to have temporarily embarrassing results for many businesses and is likely to create some temporary unemployment. "Excessive deflation" presumably would not exist until these effects became cumulative. It is assumed that the cable is *not* addressed to the question of how to deal with special situations of unemployment or of inequitably curtailed incomes, except as these are part of a general situation of excessive deflation.

It is also assumed that when Mr. Shoup speaks of tax reduction, he means an actual reduction in tax receipts, not a reduction in tax *rates* as part of a program to obtain the same amount of revenue more equitably.

Comments on Paragraphs 4 and 5 of Cable

Obviously the government's success or failure in accumulating a yen surplus from an excess of its receipts over its expenditures would have only an indirect bearing on the amount of aid needed in the form of U.S. dollar-financed imports. Domestic taxation is not a means of financing imports, which must be paid for in foreign exchange, either earned by the Japanese economy or donated by the U.S.

Nevertheless, taxation is one kind of measure a country can use to influence the development of production and the structure of incomes and prices. In Japan's present situation there is certainly a connection between tax policy and the justification for U.S. aid. U.S. aid can be fully justified only if tax policy is adjusted to prevailing conditions in such a way as to obtain the best balance among certain objectives which may or may not be temporarily in conflict with each other, e.g.:

(1) to sustain and raise the levels of agricultural and industrial production,
(2) to increase Japan's ability to utilize its existing capacity to export at fair and

[10] The National Advisory Council on International Monetary and Financial Problems.
[11] Other enclosures omitted.

attractive prices, if provided with the necessary imported materials,

(3) to avoid any tendency toward establishing the fixed expectation of a standard of living for broad groups of the population which would require permanently larger imports than Japan can be expected to pay for with own exports, and yet

(4) to avoid excessively harsh social and political consequences.

The first two of these purposes would seem to be best served, under present conditions, by a tax policy which would help to prevent revival of inflationary forces, even though such a policy might not result *immediately* in a rise of production and exports. Until there are signs of a general and widespread decrease in production, the questions raised in Mr. Shoup's cable might therefore seem to be premature. It is recognized, however, that a policy of tax reduction has strong political support in Japan. Doubtless these political demands go beyond tax reforms (which might reduce rates without reducing total receipts) and include a lowering of taxpayers' actual payments. Such demands ought to be viewed in the light of the last two purposes of tax policy listed above.

Adequate consideration of matters so simple on the surface and so complex in reality as these would require a good deal of information of the kinds suggested by the following questions.

Questions

1. What are the possibilities of tax reforms being carried out which will meet the political pressures for tax reduction without actually lowering total tax revenues?

2. What price subsidies are expected to be reduced in FY 1950–51 as assumed in paragraph (1) of the cable? How much reduction would there be in subsidies on imported foodstuffs?

3. What tax revenues would be reduced in FY 1950–51, as assumed in paragraph (3) of the cable? Would these be mainly income taxes? How much reduction from corporation tax, from "self-assessed" personal income tax, from withholding tax? Or would the reduction be mainly in sales taxes? If so, what groups would receive the benefits? What reduction would there be of taxes paid or borne by farmers?

4. In view of questions (2) and (3), is it not an oversimplification in paragraph (3) of the cable to speak of "no net relief for the Japanese consumers"? Will those whose real incomes decrease in 1950–51 as a result of subsidy reduction and other factors be the same or a different group from those affected by tax reduction?

In this connection, what is the probable future development of free or black market food prices? Is it not likely to be downward, with the effect of offsetting the rise in official prices for imported food, so far as urban consumers are concerned? And might not farmers, as a group, simultaneously gain by higher official prices for domestically produced food and lose by lower black market prices? If so, might not the loss of income or purchasing power concurrent with reduced food subsidies eventually fall on traders and the lowest income groups in the cities, rather than on the majority or urban or rural consumers?

5. Information available here indicates that import subsidies in the current fiscal year budget are about 90 billion yen and so-called "domestic price band" subsidies are somewhat larger than 100 billion yen. Is it not correct to assume that the contemplated reductions in FY 1950–51 apply to both classes? Further, would not a major part of the subsidy reductions apply to materials used in industry or agriculture, affecting consumers only indirectly depending on various price developments? (In this connection, it is noted that the total amount of subsidies on imported food is about 45 billion yen, while fertilizers account for another 12 billion yen.)

6. How should the effect of decreased subsidies on industrial materials be appraised? Is it correct to assume, as in paragraph (3) of the cable, that the burden will be passed on nearly 100 per cent to consumers? Would not a significant part have to be absorbed by producers of exports, and compensated for by reductions in other costs or profits? Might not a substantial part similarly be absorbed and compensated for in the operations of manufacturers and traders selling to the domestic consumer? Would the reductions in other costs and profits largely take the form of reduced consumer income? Is it not likely that there would be substantial reductions in disclosed and undisclosed profits, some part of which has hitherto been reinvested in higher priced inventories and has therefore not been real profit?

7. Would the assumed deflationary influences of decreased subsidization and of concurrent shifts in free market price relations be better counteracted by general tax reduction or by increased expenditures of a useful type (e.g. government investment outlays for more efficient railroad operation, for improvement of agricultural output, etc.)?

8. Has thought been given to some combination of increased investment expenditures together with tax reduction for groups now relatively over-taxed, as a method of compensating for the reduction of subsidies?

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY, Z 711–20]

10-25 REFORM OF JAPAN'S TAXATION SYSTEM

Recommendations — August 26, 1949

Prepared by: The Shoup Taxation Mission, Carl S. Shoup, Chairman

The recommendations of the tax mission cover four general topics. First, the total amount of taxation assumed to be necessary for the next fiscal year, 1950–51, and the proportions to be raised by the national government and the local governments. Second, the major changes in the structure of the tax system, as for example, the part of the national total that is recommended to be raised by the personal income tax. Third, the changes to be made within each tax, as for instance, the way in which members of a co-living family shall be treated under the income tax. Fourth, some administrative considerations, such as methods of inducing taxpayers to comply with the law, and of allowing them to appeal against reassessments, and the role, if any, that business associations should be allowed to play in getting the income tax assessed and collected.

The report will present in detail not only the recommendations, but the reasons why they were reached. It is hoped that through the publication of this report an intelligent discussion of the Japanese tax system will develop, in the Press, in national and local tax offices throughout the country, in business circles, in women's organizations, and in the universities and secondary schools.

The total amount of tax revenue to be collected during the fiscal year 1950–51 is assumed to be only slightly less than during the current fiscal year. This is partly because the danger of further inflation has not yet disappeared, and partly because the local governments need more tax revenue of their own, if the programme of local autonomy is to be maintained. However, these remarks do not include the so-called voluntary contributions collected in most localities, often to erect school buildings, or to supply other local services. It is expected that these local contributions will decrease greatly next year, if the local governments have adequate tax sources of their own. If the voluntary contributions are counted in with taxes, as indeed for most purposes they should be, the programme recommended by the tax mission assumes an appreciable, but not a substantial, reduction in total revenue.

Moreover, the determination of the total amount of tax revenue to be raised is not the primary responsibility of the tax mission, for that amount depends partly on the amount of government expenditures and the extent to which the government debt should be retired. The policy on these two issues must continue to be that formulated under the Dodge Stabilization Plan, namely, continued reduction in national government expenditures, chiefly through the reduction of price subsidies, and continued debt retirement.

The assumptions made are that the total national government revenue from taxes in 1950–51 will be 576 billion yen, compared with 635 billion yen budgeted for the current year. It is also assumed that in 1951–2 the national government's need for tax revenue will be somewhat lower than for 1950–51, owing to continued retrenchment in expenditures.

Both of these totals of tax revenue include 120 billion yen profit from the government tobacco monopoly. In addition, the national government's general account is assumed to receive about 70 billion yen from miscellaneous receipts, the same amount as budgeted for this year.

The total of local tax revenue is assumed to rise from 150 billion yen this year to 190 billion yen in 1950–51, if the voluntary contributions are not counted. If they are counted, it is difficult to express the result in figures, since the total amount of such contributions is not known, but if, as seems possible, they are as much as 40 billion yen this year, and if they decline to 10 billion yen next year, the total of local government taxes and contributions rises only slightly, from 190 billion yen this year to 200 billion yen next year. The local governments are also expected to continue to receive 25 billion yen a year from rents, fees, and other miscellaneous sources. 'Miscellaneous' does not include borrowed money.

Total taxes, national and local, are therefore assumed a total 766 billion yen in 1950–51, compared with a budgeted amount of 785 billion yen for 1949–50, a decrease of about 20 billion yen, if voluntary contributions are not taken into account. If they are included, the tax total declines from about 825 billion yen to about 776 billion yen, though both these totals are conjectural owing to lack of information on contributions.

The tax mission recommends that the personal income tax continue to be the major source

of revenue for the national government, but that the revenue from this source be decreased slightly next year, to about 290 billion yen from the 310 billion yen budgeted for the current year. The decrease in rates and increase in exemptions is considerably greater than this small decline would suggest. This is possible partly because it is expected that taxable personal incomes will be somewhat greater in 1950 than in 1949, even if business activity merely levels off, and assuming no rise in prices. Another reason why so much can be expected from the personal income tax in 1950–51 is that collections of back taxes will still be large, in view of the assessments made at the high rates in force the present year. Ultimately, the personal income tax yield would be expected to level off at about 278 billion yen, if business activity and the price level did not change, and if there were no improvement in the degree of taxpayers' compliance with the law, and in the efficiency of the tax administration. Actually, it is expected that the lower rates and higher exemptions recommended by the mission would have a favourable effect on both these factors. The yield might therefore be expected to level off at a somewhat higher figure, but, in order to take no chances with the nation's economic stability, it is best not to count on those factors for the immediate future.

The mission recommends that, with respect to the small number of well-to-do-persons, the present very high top rates of the income tax be replaced by a tax on the net fortune, or net worth, of these individuals. Under this recommendation, an individual with three dependents and a large income would pay only 55 per cent income tax on all that part of his income in excess of 360,000 yen, but he would also pay an annual low-rate property tax on his net worth (his total assets, minus his total liabilities). The rate would start at ½ of 1 per cent on that part of his net worth that is in excess of 5 million yen. The rate would rise, until it reached 3 per cent on that part of the net worth in excess of 50 million yen. In general, at these rates, it would not be a paying proposition for the wealthy tax-payer to try to hide his wealth in the form of bank notes or precious stones instead of leaving it where it could earn interest and dividends. The tax would yield only 2 billion yen, but it is also true that the very top rates of the income tax do not add much to revenue, at least under present conditions, where the number of wealthy taxpayers is small. The mission points out, however, that the fact that a certain group of taxpayers is small in number is no reason for excusing them from paying their fair share of the tax bill.

The role of the income taxes on corporations decreases under the tax mission's recommendations, provided all the other recommendations of the mission regarding ways to stop evasion and avoidance of the personal income tax by well-to-do investors are adopted. It is recommended that the excess profits tax be repealed, effective 1 January 1950; it is too complicated a tax to be satisfactory during peacetime, at least under present conditions in Japan. The corporation tax rate remains at 35 per cent, but there is a 6 per cent tax on the increase in book value of assets that occurs under the revaluation of assets that is recommended by the mission. The net result of these corporate tax recommendations is that corporations are estimated to pay considerably more next year than the budget estimate of 27 billion yen for this year. Actually, it appears that collections this year may reach nearly 50 billion yen, and it is approximately this amount which is expected from corporations under the recommendations for next year. Repeal of the excess profits tax, and allowance of extra depreciation that will result from the revaluation of assets, will lose about 30 billion yen of revenue next year, but the revaluation tax will bring in about 30 billion yen. The total yield of the revaluation tax might be as much as 60 billion yen, but the mission recommends that only half the tax be paid next year. One-quarter would be due in 1951–2 and one-quarter in 1952–3. In later years, after the revaluation tax had been paid in full, but while the effect of the higher depreciation and the repeal of the excess profits tax was still being felt, the yield of the corporation tax would drop back to 20 billion yen or 30 billion yen annually.

In the opinion of the tax mission, profits earned in the corporate form should not be taxed more heavily merely because they arise under that form. On the other hand, use of the corporation as a means of avoiding the personal income tax, or postponing payment of that tax for a long period, should not be permitted.

Taxes on gifts during life-time and on descendants' estates are estimated to yield only 2 billion yen this year. The mission recognizes that this tax is not likely to be a major source of revenue, but it recommends a substantial change in the manner of imposing the tax, which should eventually increase the yield and also make the tax more equitable.

No change in the role of the tobacco monopoly, which contributes 120 billion yen profit to the general account, is recommended.

The mission believes that the present rates of the liquor taxes were put at too low a level when they were decreased in the spring of 1949, in what was said to be an effort to maximize

revenue. It is recommended that the rates be increased, in the expectation that the liquor tax revenue would rise to at least 80 billion yen next year and probably to higher levels.

Complete repeal of the textile taxes is recommended by the mission. For the most part, these are taxes on necessaries of life. Some part of the expenditures on textiles are of a somewhat luxury nature, but it is difficult to isolate and measure that part; moreover, the producers of silk are undergoing a severe readjustment and should not be further imperilled by a continuance of the 40 per cent tax on silk. The tax is recommended for repeal as of 1 March 1950, except that the 40 per cent rate should be cut to 10 per cent as soon as possible, to lessen the transitional effect that may be caused as silk merchants try to keep inventories at a minimum in anticipation of the forthcoming tax decrease. The textile tax is estimated to yield 17 billion yen in 1949–50.

The commodity taxes, or excise taxes, which are estimated to yield 27 billion yen this year, are recommended for continuance at the same level of yield next year. They are, in general, taxes on luxuries, and as such are needed at the present time. Some minor changes are recommended.

The mission recommends that the transactions tax be repealed, but only if the expenditures of the national government, aside from debt reduction and grants to the localities, are reduced next year to 450 billion yen or less. Otherwise revenue needs dictate maintaining the transactions tax. In any event, a certain minimum amount of reduction in the personal income tax, and the repeal of the textile taxes are given priority over any reduction or repeal of the transactions tax. However, the transactions tax is not a desirable kind of tax, in the opinion of the mission, and it should in no case be increased from the present 1 per cent level. Its yield for the present fiscal year is estimated at 45 billion yen.

Other internal revenue taxes of a minor nature total 22 billion yen in this year's budget, and no substantial changes are recommended for the present in this area, hence about the same yield is expected next year.

At the local level, the mission recommends that the prefectures get about the same amount of money from their own taxes next year as they are scheduled to receive this year (about 70 billion yen). However, it is recommended that this money come chiefly from three taxes, each of them to be solely the property of the prefectures, in place of the present system, whereby the prefectures share with the cities, towns, and villages the proceeds from seven important taxes.

Under the plan of the tax mission, the prefectures would obtain between 40 and 50 billion yen from the enterprise tax, which at present yields 26 billion yen to the prefectures and another 26 billion yen to the municipalities. Thus the enterprise tax would decline slightly in importance. It is also recommended that the base of the tax be changed from profits to a broader base, known as 'valueadded', to be explained below.

The prefectures would get another 10 billion yen from the admissions tax and slightly more than this from the amusement taxes. It is recommended that the rate of the admissions tax be reduced from the present 150 per cent to 100 per cent, whereby the yield would drop from its current estimated level of 14 billion.

A few miscellaneous taxes would bring the prefectures another 5 billion yen.

The mission recommends that the real property acquisition tax be repealed. This tax hinders the transfer of property, thus preventing it from being put to its best use. The tax is also too great a capital charge on the building of a new structure.

Also recommended for repeal is the local tax of 5 per cent on retail sale of liquor, in view of the recommendation for strengthening the liquor tax at the national level.

The tax mission recommends that the cities, towns, and villages be given additional taxing power sufficient to raise their revenue from the nearly 80 billion yen estimated for the current year to nearly 120 billion yen for the year 1950–51. The mission expresses the opinion that the need for further financial support for local autonomy is acute in the municipalities, rather than in the prefectures.

The 120 billion yen would come almost entirely from two major taxes, the inhabitant's tax and the land and house tax. The municipalities would have exclusive use of these taxes, instead of sharing the proceeds with the prefectures as at present. On the other hand, the municipalities would no longer get a share in the enterprise tax, the admissions tax, or the amusement taxes, and would lose their current revenue from the real property acquisition tax and the liquor consumption tax, owing to the repeal of these levies.

The land and house tax, under the mission's recommendations, would be extended to become a tax on all real estate and depreciable property, and the current rate would be raised, so that the yield would increase from the 14 billion yen estimated for the current year, to slightly more than 50 billion yen.

Miscellaneous taxes would account for 7 billion yen for the municipalities instead of 11 billion yen as at present.

The tax mission recommends a large number of changes in the definition of the tax base, and in the tax rates. The more important of those recommendations are given here.

For the personal income tax, the mission recommends:

(1) An increase in the personal exemption, from 15,000 yen a year to 24,000 yen. Part of this increase, as explained below, represents a combining of part of the present earned income credit with the personal exemption.

(2) A change in the dependant credit, equivalent to an increase. At present, the taxpayer is allowed a credit against the tax, a credit of 1,800 yen per dependant. It is recommended that this allowance be changed to a deduction from income, and set at 12,000 yen per dependant. The present credit against the tax adds 9,000 yen to the exemption level for the first two dependants and slightly less than 9,000 yen for the third and following dependants.

(3) An absorption of part of the present earned income credit into the personal exemption, so that the only part of the present 25 per cent earned income credit that continues to appear as a distinct item on the return is a 10 per cent allowance. In this way, 15 per cent out of the present 25 per cent allowance is in effect extended to farmers and businessmen, indeed, to every one. The mission believes that the present 25 per cent difference between the wage or salary earner and the small businessman or farmer is too great. In principle, this could be altered by keeping the full 25 per cent credit for the wage and salary earner and extending a 15 per cent credit to the farmer and small businessman. This is in fact just what is recommended for the balance of the present year, from 1 October 1949 to 31 December 1949. But as a permanent method, it is undesirable because it runs contrary to simplification of the tax-return form. Consequently, instead, the personal exemption is increased, in the mission's plan, much more than would otherwise have been recommended. This means that 15 per cent out of the present 25 per cent credit is extended even to investors who have no true earned income, but this is a slight defect that is permitted in order to gain greater simplicity of the tax-return form; that form will then need to have only one line for earned income credit (10 per cent for wage and salary earners) instead of two lines (25 per cent for wage and salary earners and 15 per cent for farmers and other unincorporated business). Maximum earned income credit is limited to 20,000 yen.

(4) A lowering of the schedule of income tax rates. A copy of the schedule recommended by the mission is given below:

Taxable Income Bracket	Rate
0— 50,000	20%
50,000— 80,000	25
80,000—100,000	30
100,000—120,000	35
120,000—150,000	40
150,000—200,000	45
200,000—300,000	50
over 300,000	55

The most striking feature of the rate scale is that the top rate is only 55 per cent. This 55 per cent rate applies to that part of a taxpayer's income that exceeds 300,000 yen. The tax mission is of the opinion that unduly harmful economic effects can be avoided if the top rate imposed on the well-to-do taxpayers with incomes over 300,000 yen is limited to 55 per cent. This recommendation is dependent on the enactment of a net worth tax described in 6, below.

(5) A few illustrations will indicate the extent of the tax reduction recommended under 1 to 4, above. A married man with two dependent children, whose income is from an unincorporated business or a farm, with a net income of 100,000 yen before deducting the personal exemption or the allowance for dependants, will pay 8,000 yen income tax, instead of 17,850 yen as at present. This is the type of tax-payer who receives the largest percentage tax relief, under the mission's proposals. Such taxpayers have been discriminated against in recent years, because of the unduly large differential in favour of workers through the earned income credit and the relatively small allowance for dependants. A tax-payer with the same family, but an income of 200,000 yen would have his income tax reduced from 58,850 yen to 38,500 yen. If his income is 1,000,000 yen, the tax falls from 567,000 yen to 467,000 yen; but such a taxpayer would probably have a net worth of more than 5,000,000 yen and hence also pay something under the net worth tax.

A married man with two dependent children who earns 100,000 yen as wages or salary would find his tax reduced from 9,600 yen to 6,000 yen. At a 200,000 yen salary his tax would fall from 42,100 yen to 30,500 yen. At 1,000,000 yen salary the tax falls from 541,350 yen to 456,000 yen. This million-yen individual might own little or no property, hence not be subject to the net worth tax.

For single persons with no dependants the effect of the tax reduction is less marked; having no dependants, they do not get the benefit of the increase in the dependants allowance. If the net income is from farming or unincorporated business and is 100,000 yen, the decline in income tax is from 23,250 yen to 16,500 yen. If the net income is 200,000, the tax falls from 64,250 yen to 54,200 yen. At 1,000,000 income the tax falls from 573,000 yen to 486,800 yen, but this individual is likely to be subject to the net worth tax.

A single wage or salary earner with no dependants, net income 100,000 yen, would have his tax reduced from 15,000 to 14,000 yen. This relatively smaller reduction reflects the tax mission's view that compared with other types of income tax payers, the single wage earner with no dependants has been given rather favourable treatment under the present law. Moreover, the mission recommends the repeal of the present provision that requires all members of a co-living family to file a joint return. This recommendation gives relief to many single taxpayers, a relief not reflected in the example just stated. At 200,000 yen net income the reduction in tax is from 47,500 yen to 45,200 yen. At 1,000,000 yen the tax falls from 546,750 yen to 475,800 yen.

The mission, warns against placing too much emphasis on these comparisons of national income tax alone. On the one hand, the increase recommended in the local inhabitant's tax makes the total income tax reduction less than the national figures alone indicate. On the other hand, the effect of the mission's plan on the low-income taxpayers must take into account the recommendation that the textile tax be repealed, that the rate of the admissions tax be lowered, and that, if government expenditures drop to a specified level, the transactions tax be repealed. The mission emphasizes that each one of its recommendations is related to all the others. 'What we are recommending is a tax system, not a number of isolated measures having no connexion with one another.'

A number of other changes are recommended for the income tax including: a liberalized definition of a dependant; a provision for averaging the income from author's royalties and other irregular income so that the taxpayer will not be unfairly pushed up into the higher rate brackets; a special additional exemption of 12,000 for the blind and others with extreme physical handicaps; and deduction of medical expenses and loss of property due to accident or theft, to the extent that the total of such expenses and losses exceeds 10 per cent of the net income. The mission recommends full inclusion of capital gains in taxable income, not merely 50 per cent as at present with the following provisions: full deduction of capital losses; the gains and losses to be averaged forward over five years to keep the taxpayer from being pushed up into the higher rate brackets; and no gains or losses to be taken into account if they result under a fluctuation of the price level of more than 15 per cent, so that mere paper gains will not be taxed, and mere paper losses not allowed. The mission emphasizes that full inclusion of capital gains and losses, with those qualifications, is an essential part of its plan to prevent the double taxation of corporation income and the avoidance of personal income tax through retention of earnings in a corporation. If capital gains and losses were only partly taken into account, or were ignored, the whole structure of corporation and individual income taxation would have to be changed, and harsher and less fair measures would have to be imposed.

With respect to foreign nationals, the mission believes that the top rate of 55 per cent (plus a few points under the inhabitant's tax) should not prove an important barrier to their activity in Japan. The net worth tax would apply to foreign nationals only in exceptional cases, and, depending on the degree of encouragement that is desired to be accorded them, they might or might not be exempted entirely from the net worth tax. The mission recommends, moreover, that when adequate experience has been obtained with the net worth tax to show that it is a reliable source of revenue, the top rates of the income tax should then be further reduced to 50 per cent or even 45 per cent.

(6) The net worth tax is recommended at rates which will enable this tax to be paid out of income. The specific rates recommended for 1950–51 are as follows:

Net worth up to 5,000,000 yen is exempt.

Individuals with net worth of more than 5,000,000 yen would pay, on that part of the net worth in excess of 5,000,000 yen, but not in excess of 10 million yen, 0.5 per cent (one half of one per cent) on that part. For the 10 million yen to 20 million yen bracket the rate would be 1.0 per cent; for the 20 million to 50 million bracket, 2.0 per cent; for the part above 50 million, 3.0 per cent.

At these rates it would hardly ever pay the taxpayer to try to evade the tax by hiding his

assets in a non-income producing form, as in bank notes or precious stones. In the first place, he would almost surely be found out sooner or later, since the income tax assessor has an interest in checking on the taxpayer's net worth, to find out if he has reported his income correctly, from dividends, interest, and rentals; when the taxpayer gives a gift or leaves an estate at death, a similar rechecking occurs; when he sells an asset and is taxed on the gain or wants a deduction for the loss, he is checked again. And his holdings of real estate will be subject to check under the local house and land tax. The four taxes (income tax, net worth tax, tax on gifts and bequests, and land and house tax) so interlock that any attempt at evasion would become quite hazardous for the taxpayer.

In the second place, the mission points out, if the wealthy individual is willing to put his wealth where it will earn a good return, the combined burden of the income tax and the net worth tax will still leave him something, whereas if he hoards his wealth he gets zero income from it. An investor subject to the top rate of 55 per cent, and getting 10 per cent on his investment, will lose 15 yen a year on each 1,000 yen of capital if he hoards his wealth in non-income-producing form, even if he successfully and illegally evades the net worth tax at the top (3 per cent) rate. And if his hoard is discovered and assessed, he would have lost 45 yen a year by hoarding. If he pays net worth tax at only the 0.5 per cent rate, he obtains no income if he hoards, but if he invests at 10 per cent he would obtain, after paying the income and net worth taxes, a net return of 40 yen on each 1,000 yen of capital.

For the corporation income tax, in addition to the changes already noted earlier, the mission recommends that the present 20 per cent withholding rate on dividends be repealed, since the 35 per cent tax on corporate profits is itself to be considered a withholding tax. The stockholder receiving the dividend is given a credit against his individual tax of 25 per cent of dividends he receives, to compensate for the 35 per cent tax paid by the corporation. Still personal income tax can be indefinitely postponed by the corporation's retaining earnings instead of distributing them promptly as dividends; so, to compensate the government for the loss of interest it suffers from such postponement of personal tax payment, it is recommended that the corporation pay an interest surcharge levy of 1 per cent a year on the earnings that it retains. This applies only to earnings made in 1950 and later years, not to the surplus already accumulated before 1950.

A number of problems common to the corporation income tax and the personal income tax are treated by the mission.

First, the essential steps in the recommended programme for revaluation of assets are given in the main report, and full details in an appendix to the report, both of which will be published shortly.

Second, it is recommended that the special 65 per cent tax on inventory profits be repealed except where the rise in inventory is due to a price rise following the abolition of subsidies.

Third, net losses should be carried over to other years to be offset against the income of those years, and, in the opinion of the mission, there should be a limited carry-back as well as a carry-forward.

Fourth, an option to the taxpayer to use any one of several methods of accounting for inventory and for depreciation, under proper safeguards, is recommended.

Fifth, stricter enforcement of the provisions against deducting capital outlays all in one year is urged, as also disallowance of heavy entertainment expenses now commonly deducted as business expenses.

For the rest of the national taxes, the statements made earlier in the report indicate the changes recommended by the mission.

Among the local taxes, it is recommended that the inhabitant's tax contain simply the flat *per capita* element and an income element, not a property element, in view of the taxation of property recommended under the new house and land tax and the net worth tax. The municipalities could levy the income element either as a percentage of the national personal income tax, or as a percentage of the income (after exemptions) used in computing the national tax, or as a percentage of the income left after deducting both the national tax and the personal exemptions. The tax could be either flat-rate or progressive. Maximum rates would be 10 per cent, 15 per cent, and 20 per cent, respectively, for the three methods.

The land and house tax, under the mission's recommendations, is transformed into a tax on the capital value of land, buildings, and other depreciable property, not including stock in trade, securities, cash, and other non-depreciable assets. An appraisal at current values is recommended, except that farm land is to be valued at the official price, multiplied by an adjustment factor designed solely for the purposes of this tax; this factor is not to exceed 25, and is to be reduced if the official price of farm land rises.

The enterprise tax is recommended for revision, by enlarging the tax base from profits to 'value-added'. The tax would be imposed on gross receipts minus the cost of everything bought from other business firms, including capital equipment like buildings and machinery. There would therefore be no depreciation accounting involved, and no inventory accounting. Another way of defining the new tax base is to say it is the sum of profit, interest paid, rental paid, and payrolls. This base is chosen because it is economically neutral. It does not favour the vertically integrated concern, and does not discriminate against the use of machinery and other capital equipment. Farmers would be exempt from the tax.

The mission places great emphasis on the need for greatly improved administration of the tax laws. Its recommendations for a fair and economically beneficial tax system cannot be of practical significance unless taxpayers are willing to comply with the law, and tax administrations are able and determined to enforce the law fully and not arbitrarily. Much more improvement along these lines is needed, in the opinion of the mission, although a good start has been made at the national level with the recent establishment of the Tax Administration Agency, the National Tax Inspectors, and the National Tax Investigators. The mission recommends that the number and the quality of national tax personnel be increased well above the levels resulting from the recent 20 per cent decrease in number of authorized personnel. At the local level, too, increases in number and quality are deemed necessary.

The scope of the mission's task did not extend to all matters of detail in administration, but the mission's report does present, in a separate chapter, a number of specific recommendations for improving the processes of assessment, appeal, and litigation under the national income tax. Among these recommendations are the following: that business associations be not allowed to have anything to do with determining the amount of income tax their members pay; that a special group of officials in the national tax offices serve as a Conference Group to confer with the taxpayer when he cannot reach agreement with the official who made the original reassessment; that a special 'blue return' form be available to businessmen and farmers under the personal income tax if they keep books in accordance with standards laid down by the Ministry of Finance, and those who met the requirements for filing on such a return be assured that they will not be reassessed without examination of their books; that most farmers be relieved of the necessity of filing declarations of estimated income, and be required to pay at the time they receive money from the sale of crops, by a system of withholding at the source on payments made to them by government bodies for their crops, and that this be coupled with a much closer approximation to each farmer's actual income as shown by production records and other data relating to him, in place of using average data for an area; that a special tax court be set up to handle tax cases; and that the role of the certified public accountant be greatly expanded.

A change in the fiscal relations on the national, prefectural, and municipal governments is recommended by the mission. In place of many of the specific grants (subsidies) now made, a general equalizing fund is recommended; also a new body, a Local Finance Commission, designed to implement the new inter-governmental relations.

The Tax Mission is composed of seven members, who spent four months of the summer in Japan. The director of the mission is Professor Carl S. Shoup, of the School of Business and the Graduate Faculty of Political Science at Columbia University, New York City. The other members of the mission and their professional connexions are:

Dean Howard R. Bowen, College of Commerce and Business Administration, University of Illinois.

Prof. Jerome B. Cohen, Department of Economics, College of the City of New York.

Rolland F. Hatfield, Director of Tax Research, Department of Taxation, St. Paul, Minnesota.

Prof. Stanley S. Surrey, School of Jurisprudence, University of California, Berkeley, California.

Prof. William C. Warren, School of Law, Columbia University, New York City.

Prof. William Vickrey, Graduate Faculty of Political Science, Columbia University, New York City.

[SOURCE: *Contemporary Japan*, Vol. XVIII, Nos. 7–9, July-September, 1949]

10-26 TAX PERSONNEL LEVELS

Memorandum for File September 30, 1949
By: Harold Moss, Chief, Internal Revenue Division, ESS

1. The administration of taxes by the Japanese Government has been, and still is, inadequate, inefficient, inequitable and arbitrary. Part of this is due to the continued existence, even under the Occupation, of the Oriental concept of a tax machine, with unlimited and arbitrary power in the hands of the tax collector, and with little or no right of appeal in the hands of the taxpayer. The existence of such conditions represents a huge reservoir of perfect propaganda for the Communists, propaganda which because of its veracity cannot be refuted by denials. (See enclosed excerpts from "Manual for Battle of Taxes, incl. 1). That condition is also encouraging distrust and lack of mutual respect between the Japanese Government and its citizens. Continuation of this would be contrary to the basic philosophy behind the Occupation and could very well undermine the whole democratization program, as well as jeopardize all Occupational objectives.

2. The Japanese Government has recognized this condition for some time, at least in part, and has gone to the people repeatedly and promised both a reduced and equalized tax burden. In its actions, however, it has attempted, and is attempting, to realize the major campaign tax promises for repeal of the transactions tax and reduction of the income tax, but evidently intends doing the minimum *if anything* with respect to improving and strengthening the tax administration.

3. The importance of strengthening the tax administration has been repeatedly stressed by such groups as the Johnson-Hoffman-Draper group in 1943, the Young Mission, the Dodge Mission and the Shoup Mission. The Nine-Point Economic Stabilization Directive of 19 Dec 49 directed the Japanese Government to:

"ACCELERATE AND STRENGTHEN THE PROGRAM OF TAX COLLECTION AND INSURE PROMPT, WIDESPREAD AND VIGOROUS CRIMINAL PROSECUTION OF TAX EVADERS."

In SCAPIN 2001 dated 4 May 49, which required the Japanese Government to reorganize its tax administration along more efficient and professional lines, the Government was directed, in part, to provide tax personnel:

"adequate in number to administer and enforce vigorously, but fairly, the tax laws of the government."

4. Within a short time the Government, however, notwithstanding the above directives, proposed to take action to *weaken,* rather than strengthen, the tax program. In arriving at its decision to reduce authorized tax personnel 20%, it gave no consideration to the actual needs of the service, and *definitely ignored both the Nine-Point Directive and SCAPIN 2001.* This Division was unalterably opposed to the proposal, and vigorously objected on the grounds that the entire tax program was being jeopardized. As a result of this objection, an informal arrangement was reached with the Minister of Finance, viz:

That the reduction in tax personnel would not be objected to by GHQ, provided aggressive action was taken, immediately after the reductions had been made, to *restore the personnel* at least to the levels that existed prior to the reductions. (It was intended to use SCAPIN 2001 as a basis for making an exception to the personnel policy).

This matter was informally discussed with the Government Section and it was informally agreed that necessary pressure would be applied, to the Cabinet on the basis of SCAPIN 2001 if necessary, to bring about *restoration of the personnel after the discharges had been completed.* (The discharge of the personnel afforded an excellent opportunity for the elimination of undesirables and incompetents. As to the restorations, it was desired that authority to restore the personnel be granted in August or September in order not to jeopardize too greatly actual collections for this fiscal year, as well as the tax reform; new employees recruited after November would be of little value to the tax service this fiscal year.)

5. Notwithstanding the foregoing, however, the Government in both its proposed supplemental FY 1949–50 and its FY 1950–51 budgets does not contemplate any upward revision of its current tax personnel level, as discussed above, and proposes to reduce all other tax administration and enforcement expenditures by approximately 10%. This position, following immediately upon the heels of the Shoup recommendations and the Prime Minister's letter advising that these recommendations would be vigorously implemented, clearly indicates, in the opinion of the writer, that the Cabinet does not intend voluntarily to bring about *any* major tax administration reforms, either national or local.

6. Extensive discussions have been had with Ministry of Finance officials, including the Finance Minister. It is contended that the Minister in this matter is politically in an untenable position because of his role as "hatchet man" for the entire Government. It is said that he cannot insist on substantial personnel and expenditure reductions in all other Ministries and, at the same time, insist upon an expansion of his own Ministry. (Rationalization of personnel by transfer within the Ministry of Finance itself is impossible because approximately 70–75% of the Ministry's personnel are in the tax services).

It appears that there is considerable merit in this contention, and that the Finance Minister, no matter how sincerely he may try, cannot successfully bring about the adoption by the Cabinet of an ambitious program for a revolutionary reform of the tax administration.

7. The question of whether additional personnel are required has been extensively considered by the Shoup Mission, the 15 Treasury Department tax specialists now on duty in Japan, the 10–12 other qualified tax specialists, including experienced men on loan from the City of New York and the State of Illinois. All unanimously agree that additional personnel must be provided if the objectives of fair and equitable tax administration are to be realized. It is also unanimously agreed that, if the only objective is one of revenue, and if there is no objection to continued mass unfair and arbitrary reassessments and to a continuation of the system which gives no rights or equity considerations to the taxpayers, then additional personnel will not be required. In the latter event, the experienced tax personnel of the Occupation should be replaced by military surveillance personnel with instructions to require the Japanese to bring in the revenue, irrespective of consequences and methods.

8. Dr. Shoup in his report, in several different places, recommends improvement and increase in tax personnel. On page D46 of the Shoup Report Appendix (copy enclosed) the following appears:

"*Increase in Personnel.* A basic need underlying all of the above recommendations respecting personnel and all of the suggested administrative improvements is an increase in the number of tax personnel. It is "sen wise and yen foolish" to deny the employment of tax personnel in adequate numbers. The funds spent for enforcement of the tax laws are amply rewarded by the greater increase in revenue collections. The funds must be wisely spent and the additional personnel properly selected and properly assigned. But if these cautions are observed, the end result is bound to be favorable to the Government even if viewed solely as matter of funds spent and funds received. In addition, much is gained in respect for a Government and its laws if the tax measures are properly enforced."

9. The Occupational objectives in the field of taxation have been outlined to the writer in no uncertain terms. Whether or not those objectives can be realized, especially in an Oriental country where the politicians and bureaucrats (including many of the tax officials) are basically and historically opposed to and unsympathetic with such ideas and *equity* objectives, remains in grave doubt, even under the most favorable circumstances. If the sabotaging of those objectives for purely political reasons by those politicians and bureaucrats of the Japanese Government continues, as is now indicated, then the attainment of even a reasonable degree of the Occupation's democratic and equity tax objectives will become impossible.

[SOURCE: SUITLAND PAPERS, Z 703–6]

10-27 LOCAL TAX LAW

Letter March 18, 1950
To: General MacArthur
From: Prime Minister Shigeru Yoshida

My dear General

The government will soon be submitting to the Diet a bill for revision of the Local Tax Law, which sets a fixed rate of 1.75 per cent for the municipal property tax applicable throughout the fiscal year 1950, as is recommended in the Shoup Mission Report.

On the other hand, the government's tax program is being vociferously attacked by Opposition parties on the score that local taxes are being raised by far out of proportion to the reduction in national taxes, and the public appears to be blindly falling in line with this propaganda. Of course, there is an obvious and pressing need of holding down taxes as low as possible. Unless some concrete and definite step is taken in that direction, the government will have a very hard going in the months ahead, what with the June election for the House of Councillors looming in the offing.

In view of these circumstances, and in view of the fact that tax reduction is feasible if government spending is reduced, and that the government is actually and vigorously continuing its fiscal retrenchment policy at both national and local levels, I would propose that the flat rate of 1.75 per cent be enforced for the first half of 1950, and the same be made a standard (flexible) rate for the second half of the year in so far as those municipalities are concerned, which have succeeded in reducing substantially their budgets through a personnel cut or rationalization of administrative machinery. Inasmuch as the tax on municipal property is to be a standard rate from 1951 on, my proposal does not deviate from the Shoup recommendations except in the one respect that it moves up the liberalization of the fixed rate by half a year—and that only to a limited extent.

I am convinced that the measure I propose is economically sound as it is politically efficacious. It will be an incentive to economy for every city, town and village. It will remove much of the psychological tension and create a healthy atmosphere for compliance with the new tax law. Incidentally, it will strengthen the position of the government in the coming elections. If this proposal of mine meets with your approval, it will be presented to the Diet by the Liberal Party, in the form of an amendment to the Local Tax Revision Bill.

The question of municipal property tax has already been discussed quite exhaustively between our government representatives and your headquarters. I venture to submit my proposal, hoping that it will receive your prompt, personal attention and favorable consideration.

[SOURCE: SUITLAND PAPERS, Z 703-6]

10-28 REVISED LOCAL TAX LAWS

Letter — March 21, 1950
To: Prime Minister Shigeru Yoshida
From: General MacArthur

Dear Mr. Prime Minister:

I am in complete agreement with the necessity for reducing the tax burden on the people of Japan as reviewed in your letter to me under date of 18 March 1950. The Shoup recommendations, to which your government has made commitment, provide an appreciable relief during the 1950–51 Japanese Fiscal Year and lay the groundwork for significant further reductions in the following year.

Fundamental to the implementation of the Shoup tax proposals is the requirement that revenues accruing to local governments be adequate to provide rendition of full governmental services to the peoples of the municipalities. As you are aware, I am convinced that democratic government for Japan must evolve from the thousands of local communities administering to the needs of the public under a sound program of local administration to include an acceptable fiscal system.

In Dr. Shoup's final report he placed particular emphasis on the need for increasing revenues and facilities at the local level and he urged a fixed rate for the Minicipal Property tax during the inaugural year of the program. In the event that some municipalities are able to function effectively with lower revenue requirements, the standard rates of the Inhabitants Tax, which is not set at a fixed percentage could be varied to obtain the flexibility you seek.

I feel that it is imperative that the revised local tax laws become effective as of April 1st 1950 in order that the localities may be assured of a full year's revenue. As any later initiation of the new system could imperil the entire local tax reform, I trust your government will recognize this situation and that it will take necessary action to insure the attainment of the prime objective on which we are all agreed.

I am fully aware of the political problems posed by the tax reform program but I am confident that the citizens of Japan will recognize that their best interests in the long run will be served by its enactment without modification in its major provisions.

[SOURCE: SUITLAND PAPERS, Z 703-6]

10-29 JAPANESE GOVERNMENT BUDGET FOR FISCAL YEAR 1951–52

Memorandum — April 24, 1950
General Distribution
From: Chief of Staff, SCAP
Confidential

1. The following policy regarding the formulation of the Japanese Government budget for FY 1951–52 has been announced by the Supreme Commander for the Allied Powers:

a. The budget must be balanced.

b. The total budget requirements must be lower than those contained in the JFY 1950–51 budget.

c. The budget should provide for a further reduction in taxation consistent with provisions of the Shoup Tax Mission recommendations.

d. Provision should be contained in the budget for an increase in government wages based upon an appropriate restudy of the situation by the National Personnel Authority.

e. Occupation costs must be held to the lowest practicable level and should be lower than in the 1950–51 budget.

f. Appropriations for the reduction of the national debt should be held to the minimum consistent with measures for continued economic stabilization. (Counterpart and general account funds for this purpose will be greatly reduced.

g. No supplementary budgets will be authorized except for the single readjustment budget to be made effective before the beginning of the final fiscal quarter.

h. Price subsidies should be further reduced and eliminated wherever possible.

i. The timing of budgetary considerations within General Headquarters and the Japanese Government should be phased to permit such consideration in the Diet as will insure the submission of the JFY 1951–52 annual budget to the House of Councillors not later than the last day of February 1951.

2. Elimination and relaxation of controls exercised directly or indirectly over the Japanese Government agencies by sections of General Headquarters will be effected to the extent feasible in keeping with the Supreme Commander's policy that responsibility for the conduct of their own affairs be transferred to the Japanese Government as rapidly as the capacity to assume such responsibility is demonstrated. It is desired that, consistent with directives from higher authority, appropriate sections of General Headquarters assume the role of offering advice and guidance to agencies of the Japanese Government, as distinguished from precise and detailed direction.

3. As a concomitant of the policy of relaxation of controls, significant reductions in the personnel strength of General Headquarters will be effected. This action will be reflected in a diminished necessity for both U.S. appropriated funds and Japanese appropriated funds. The objective will be to establish within General Headquarters sections the minimum number of competent personnel adequate to discharge the functions of furnishing advice and guidance and, correspondingly, to reduce personnel not essential thereto. Further and more detailed instructions regarding the reductions in personnel within General Headquarters will be issued separately.

4. A timetable which will govern the formulation, review and submission of the Japanese Government budget has been established and is attached hereto as inclosure 1. Technical contact with Japanese Government agencies will be maintained by General Headquarters sections concerned within the scope of their activities. General technical and policy contact with the Japanese Government will be the responsibility of the Economic and Scientific Section. The SCAP Planning board, consisting of the Chiefs of the Economic and Scientific Section, Civil Information and Education Section, Public Health and Welfare Section, Natural Resources Section, Civil Transportation Section and Civil Communications Section, with Major General W. F. Marquat as ex-officio chairman, is the General Headquarters agency established for the purpose of inter-section coordination. In the event of failure to arrive at satisfactory agreement with respect to any matter of substance, the case will be submitted to the Chief of Staff for final decision, through the Deputy Chief of Staff, SCAP.

5. The Chief of the Economic and Scientific Section is charged with transmitting to the Japanese Government the timetable set forth in Inclosure 1[12] and the pertinent provisions of

[12] Not printed.

the budget policy announced in paragraph 1, above.

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY]

10-30 DR. SHOUP'S MODIFICATIONS OF THE VALUE-ADDED TAX

Memorandum June 3, 1950
To: Henry Shavell
From: M. Bronfenbrenner, Tax Economist

1. In connection with the revision of the Local Tax Bill, Dr. Shoup has recommended four principal modifications in the Value-Added provisions, along with a one-year postponement. These modifications are:

a. Elimination of the differentially low rate for "professions" as distinguished from "business".

b. Elimination of the special one-year "relief provisions" for various businesses whose value-added is high relative to profits (banking, transportation, warehousing, etc.).

c. Change from a current-year to a previous-year value-added base.

d. Leaving the rate uncertain until after the first-quarter collections in 1951–52.

2. My personal predilection are all in favor of changes (a) and (b). There is in Japan, however, strong sentiment in favor of special treatment for professions as against business, which was responsible for the inclusion of the differential rate in the previous drafts. The one-year relief provisions were introduced at the behest of some of the most powerful lobbies in Japan. They have tasted blood, so to speak, with the defeat of the Local Tax Bill,* and may be more rather than less obstreporous this Summer.

3. Uncertainty as to the value-added tax base was probably responsible for Dr. Shoup's suggestions (c) and (d). Confronted with Japanese pressure for lower rates, he seems to have devised an ingenious scheme which will permit postponement of rate-setting and tax-collection until the base has been determined. It is easy to understand Dr. Shoup's decision, but it nevertheless seems preferable to me that the tax be kept on a current basis, and that the rate be fixed definitely in the law. If necessary, we should compromise with the Japanese in the matter of rates, which can always be raised next year if they prove too low to support local expenditures without recourse to "contributions".

4. To base this year's tax on last year's value-added emphasizes one of the alleged drawbacks of the tax. Refer to its uncertain incidence, especially at the outset. Ostensibly the tax is to be shifted forward to the consumer, both under a current and under a prior-year basis. So long as a firm's business remains on an even keel, the change of basis presents no real problems. For periods of *declining* business, however, a firm will find itself paying in this year for the value it added last year, when its fortunes were better, and it will be difficult to keep from bearing some part of the tax itself at just that period when it is most difficult to do so. Upward movements in the tax rate will have the same effects as declines in the taxpayer's business. That is, they will force him to pay part of the tax himself, at a time when it is most difficult to him to do so.

The bearing of a gross-income or value-added tax by a business firm is, I venture to suggest, a serious matter, especially for such businesses as have heavy payrolls and relatively low profits (or actual losses). If there is any serious chance of large numbers of firms being unable to shift a tax of this sort, it would be better to use net rather than gross income as a tax base, and value added is quantitatively too close to gross income for my comfort.

5. In advocating delay in setting the standard rate for the value-added tax, I wonder whether Dr. Shoup did not overlock temporarily the use of these standard rates in determinihg allocations under the Equalization Grant. With standard rates for the value-added (and municipal property) tax undetermined, allocations under the Grant will be more likely than ever to become matters of administrative discretion and pork-barrelling. Some standard rate should certainly be set up for Equalization Grant purposes, and I for one should consider it highly cumbersome to reduce this to a "shadow" standard rate while the actual standard rate was left indeterminate. My recommendation then, would be for a standard rate to be included in the law itself, and used in the allocations under the Equalization Grant. My first choice as to such a rate would be 3.5 per cent for 1951–52, but a cut to 3.25 per cent as a compromise measure might be acceptable.

* The private railway lobby, in particular, claims to have defeated the Local Tax Bill through its influence with the Ryokufukai in the House of Councillors. This group, which generally goes along with the Government on fiscal measures, bolted on the Local Tax Bill, and this bolt was responsible for killing the Bill.

[SOURCE: SUITLAND PAPERS, Z 703–3]

10-31 DR. SHOUP'S PRESS STATEMENT

Memorandum September 17, 1950
To: Major General Marquat
From: Harold Moss, Chief, Internal Revenue Division, ESS

1. Transmitted herewith is a draft of Dr. Shoup's comprehensive press statement scheduled to be delivered at a CLSE press conference at 1900 hours next Thursday, 31 September 1950.

2. In view of the extreme shortage of time available for coordination of this statement within the Headquarters, copies of the statement have been hand-carried to only those agencies having a direct and primary interest in Dr. Shoup's recommendations; ESS/PF, ESS/PD, ESS/LA, NRS, GS, LS, and CPS.

3. Attention is invited to the introductory paragraph of Dr. Shoup's statement, to the effect that his report is one to GHQ and as such does not necessarily reflect the views either of SCAP or of the Japanese Government.

4. On the basis of a careful examination of all of Dr. Shoup's conclusions, suggestions and recommendations, this Division concludes that there is nothing contained in the study that is directly or indirectly at variance with established SCAP policy. To make absolutely sure of this, however, the opinions of the aforementioned agencies (par. 2 above) have been requested on this point.

5. A brief analysis and outline of Dr. Shoup's press statement follows:

a) *The National Budget.* Dr. Shoup examines the budget prospects for the next fiscal year and concludes that a surplus is in prospect. If the surplus available for tax reduction turns out to be in the order of 25 billion yen, Dr. Shoup concludes that it should be utilized in three ways: (1) extension of a 10% earned income credit to farmers (approximate cost: 4 billion yen); (2) increasing the allowance for dependents in the income tax (approximate cost: 9 billion yen); and (3) increase of the Equalization Grant by 12 billion yen. If the surplus for next year is in the order of 45 billion yen or more, Dr. Shoup recommends (4) a reduction in the progressive income tax rate scale in the low and middle income levels and an increase in the basic exemption; and (5) the repeal of certain commodity taxes on business items and on articles of common household use. If the surplus available for tax reduction exceeds 45 billion yen, Dr. Shoup recommends further reductions in the Commodity Tax and further increase in the Equalization Fund.

b) *Local Budgets.* Dr. Shoup concludes that local governments will probably have to increase their total expenditures in FY 1951–52, perhaps in the order of 60 billion yen. This amount, Dr. Shoup concludes, is too much to be obtained from additional local tax revenues. He recommends, therefore, that the equalization grant be increased as much as possible to cover this increased expenditure.

c) *Administration of the National Income Tax.* Dr. Shoup comments upon the administration of the Self-Assessed Income Tax and suggests specific ways to improve both administration and taxpayer compliance.

d) *National Tax Problems not involving substantial changes in the revenue.* Dr. Shoup reviews the question of enforcement of the liquor tax, and recommends against any rate reduction. He also comments upon technical matters pertaining to the Net Worth Tax, Gasoline Tax, and Corporation Tax.

e) *Local Tax Problems.* The report offers specific guides for the revision, administration, and enforcement of the Real Estate Tax and Value Added Tax. It also offers suggestions concerning the Local Autonomy Agency and the Local Finance Commission.

f) *Intergovernmental Fiscal Relations.* The report suggests guiding principles for the revision of the equalization formula so as to provide for more equitable and efficient distribution of the equalization grant. It also recommends a modification of the recommendation of last year concerning the distribution of disaster and rehabilitation expenses. It also comments upon Promotional Grants.

6. In addition to the Press Statement, Dr. Shoup is preparing a series of memoranda, mostly technical in nature, expanding upon some of the subjects, covered only briefly in the Press Statement. It is expected that some of these memoranda will later be released to the Japanese, and should prove of material assistance both to this Headquarters and to the Japanese Government in the implementation of such programs as the Equalization Grant Law, etc.

7. In overall terms, this Division regards Dr. Shoup's study as an invaluable adjunct to last year's report, and one that will greatly facilitate the attainment of a more permanent and more equitable tax system in Japan. Due to time limitations a more detailed analysis of Dr. Shoup's study cannot be properly made at this time. However, we expect to have a more comprehensive analysis ready for submission to you within the next three or four days. This analysis will include all material views and opinions expressed by other ESS divisions or SCAP sections.

[SOURCE: SUITLAND PAPERS, Z 703-3]

10-32 CONFIDENTIAL SUPPLEMENTARY TAXATION REPORT

Report September 21, 1950
To: SCAP
From: Carl S. Shoup

The present confidential report supplements the statement given to the press on September 21, 1950, on the conclusions and recommendations of the Shoup Tax Mission, and the technical memoranda designed to be released shortly thereafter.

As it turns out, there is little of a confidential nature to add to these reports. There are three chief points: The degree to which the Japanese Government should be given freedom of action regarding the tax matters covered in our reports of this year; the role of the tax system if serious inflationary pressures develop within the next twelve months; and forgiveness of tax evaders.

1. *Degree of Freedom of Action for Japanese Government*

Last year we attempted to construct an entire tax system. The importance of following each recommendation as closely as feasible was thus enhanced; a system, like a house, can be thrown badly out of shape by one or two serious omissions. This year, we are attempting only to recommend a better shaping of the system which, thanks to the care with which last year's recommendations were implemented, now exists in fact.

Moreover, the Japanese Government is to a high degree committed to the system, by now. It has no other feasible alternative for the time being, but to try to make it work. Whether Japan will remain committed to it after the Occupation is anyone's guess; but for the next year or two the Government can have little to gain by deliberately making the system stall.

Finally, we believe that there has already developed in Japan a substantial amount of technical, professional interest and pride in trying to understand and handle a modern tax system.

Consequently, we view our present recommendations in somewhat the following light: They are the best we could formulate in this brief visit, but we recommend encouragement of debate by the Japanese oversome of the more complicated or controversial issues, so long as it does not run contrary to the basis assumptions like strengthening of local autonomy prevention of large accumulations of wealth in the hands of a few, and a fiscal policy aimed at preventing both inflation and deflation.

In the long run, anything that promotes among the Japanese an intelligent discussion of the tax issues will be beneficial for the tax system; and, as the end of the Occupation comes in sight, the fact that the Japanese want one among several more or less equally acceptable options is a strong argument in its favor.

2. *The Role of the Tax System in a Future Inflation*

Here, we are looking ahead only for a year or two, and attempting to answer the question, what role may the tax system be expected to play if defense of war requirements by the United States or other countries exert a strong upward pull on the Japanese price and wage levels?

If the present tax system were a mature one—if it had been in force for many years and had become thoroughly accepted by the people—the answer would be that it would no doubt play a major role in checking such an inflation. The progressive-rate nature of the existing system would automatically soak up a large part of the newly created purchasing power; and increase in tax rates (and lowering of exemptions) would absorb still more.

In fact, of course, the system is not mature. It stands a good chance of survival if no greater load is placed on it than is contemplated in the budget for 1951–52. Within a few years, if those conditions continue, the tax system may well develop into a tested and tempered weapon that can withstand shocks, and can be stepped up in power. But at present, an inflationary shock of great magnitude would probably cause it to disintegrate. To the taxpayers, open evasion would once more seem justifiable; and to the disheartened administrators, it might seem inevitable. This may be too pessimistic a conjecture; but on one further point there seems little doubt, namely, that any attempt to check an inflation in the near future by a substantial increase in rates and lowering of exemptions would not have much success, except at the price of wrecking the equity elements of the system as frantic administrators used every device at hand to bring in the revenue.

Concretely, it would be impracticable to plan on a resumption of debt retirement on the scale of the past two years, unless government services were drastically curtailed.

If strong inflationary pressure develops, it should be met, in our opinion, primarily by control of credit, and, secondarily, by direct control of wages and prices.

A period of such pressure is likely to be marked by a large increase in business profits, even under price control, and especially without it. Should an excess profits tax be imposed, in that event?

Again, considering only the next year or two, we are inclined to answer no, although no one can be positive about such a problem in advance. Our answer rests primarily on administrative grounds; we believe that if the Tax Administration Agency were required to add an excess profits tax to its present work, it would not do a good job on any of the major taxes. As an alternative, we should prefer, from this point of view, a straight increase in the corporation tax rate and perhaps also the individual tax rates, though these, too, would cause trouble, as indicated above.

All these remarks, we emphasize, apply only to the next year or two. Beyond that, we should hope that the tax system would be able to play a much more important role in the event of inflation.

3. *Forgiveness of Tax Evaders*

Evasion and under-reporting of income remain today the most serious administrative problems in the new tax system. The new system inherited large scale evasions from its predecessor when the surtax rates reached 85 per cent. Those taxpayers who underreported their incomes in prior years are now confronted with a difficult choice. They can become honest and file a correct return, but they will then be in danger of reassessed for four or five back years plus interest and penalties; bankruptcy would then be the inevitable result for many taxpayers. Or they can continue to underreport and evade taxes on the theory that the Government will not be successful in discovering their unreported income; those taxpayers will probably be successful in evading taxes to a substantial degree unless great improvement is made in the administrative investigation of returns.

This improvement cannot be expected in such a short time for many reasons. The important thing is to get all or substantially all taxpayers voluntarily filing their personal tax returns and reporting their true incomes. This cannot be done with respect to those taxpayers who face larger reassessments for back years if they file an honest return for the current year. If this spiral can be broken, there is more than a reasonable chance that the desired substantial voluntary compliance can be achieved for future years.

This improvement in voluntary compliance will probably occur if tax liabilities of these past years that were not reassessed as of January 1, 1951 are forgiven. This at first seems to violate the principle of equity. But at best the problem involves mixed equities whatever is done. Here it is believed that administration should override equity. The important thing seems to be to get the true *gross* incomes of substantially all taxpayers for 1950. If this is accomplished, thereafter reassessments based on true gross income of 1950 can be used effectively in reassessments for later years.

The Statute of Limitations governing the assessment of taxes is provided by Article 30 of the Accounting Law, which deals with claims by and against the government. Under it, tax assessments must be made within five years from the date that the tax is due and payable. It appears that the five year statutory prohibitions against assessment applies even though the taxpayer has filed a fraudulent return. A period of five years for reassessment against a taxpayer appears unusually long. Taxpayers should be assured, within a reasonable time after the filing of a return, that no adjustment will be made in their tax liabilities in the absence of fraud. We therefore recommend that the present Statute of Limitations be changed so as to prohibit the assessment or reassessment of personal and corporation income taxes, three years after the date on which the return was due, or two years after the date on which the return was fired, whichever is later. This statutory prohibition should not, however, apply in the case of fraud on the part of the taxpayer or failure to file a return.

We recommend that all taxpayers who in their 1950 returns disclose substantially all of their true gross income, say 95 per cent or more, and pay the personal income tax thereon

by the due date of the 1950 final return, be not subject to new or additional assessments for personal income taxes for 1948 and earlier taxable years. The year 1948 was taken as the "cut off" year because definite improvements in the income tax laws were introduced in 1949.

It is believed that the areas of evasion can be limited greatly in the future by information returns from brokers, bankers and the like. But if this reporting system is instituted without some procedure for taxpayers to avoid reassessments for four or five past years if they now file honest returns, cash withdrawals from the banks and brokerage houses may follow. This might have substantially adverse effects on the Japanese economy.

There are great risks other than mass cash withdrawals. The reporting agents must voluntarily file these information returns. Sanctions here are hard to enforce. Brokers, bankers and others are not likely to cooperate if they believe their customers are not receiving fair treatment. The absence of a forgiveness system is certain to lead to that belief and to a failure of a willful neglect to file the information returns. The information system would therefore collapse, and years would pass before it could be tried again. But if the forgiveness principle is adopted, withdrawals are likely to be at a minimum, and the cooperation of the brokers and bankers in filing the information return is likely to be wholehearted. All those observations leads to one conclusion, that information returns should not be required unless some forgiveness is provided by law.

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY]

10-33 TAX SURVEY CONCLUSIONS AND RECOMMENDATIONS (THE SECOND SHOUP MISSION)

Memorandum[13] September 21, 1950
To: SCAP
From: Carl S. Shoup, Chairman, Shoup Tax Mission

Submitted herewith is a statement of conclusions and recommendations covering our resurvey of the Japanese tax system, which we recommend be released both to the Japanese Government and to the Japanese public.

The statement is based primarily on the past 7 weeks of travel and study in Japan. When we arrived, the new national tax system had been in force for some months, but the new local tax system had been enacted by the Diet only the day before. Even under the national tax system, there had not been time for substantial experience. The first installment payment under the new reduced income tax, for instance, was just falling due.

On the other hand, there had been a year of intensive debate throughout Japan over the recommendations submitted last year. Despite the limited amount of experience with the new system, therefore, we found no lack of issues to study.

The present statement is consequently a compound of three things: an appraisal of such experience as has been gained under the new system; a statement of position on new issues that have developed in the public discussions of the past year; and an analysis of the chief problems that the coming year may bring. Unlike last year's report, it makes no attempt to be comprehensive; many segments or aspects of the tax system are not touched upon at all.

The main conclusions and a considerable amount of supporting data and reasoning are presented in this statement, but many technical details have been deferred to a series of supplementary memoranda to be released within the next week or so.

A. THE NATIONAL BUDGET: THE USES THAT MAY BE MADE OF THE PROSPECTIVE SURPLUS

At the time this statement is being written (September, 1950), the exact amount of the surplus available for tax reduction in the 1951–52 fiscal year is still uncertain. We therefore consider what uses might be made of various amounts of surplus. There is no doubt, on present prospects, that there ought to be substantial tax reductions, and that the outlay side of the budget should be at a level to make such reductions possible.

Another urgent need, however, is the avoidance of unduly high and unfair local taxation, by increasing the equalization grant from the proposed 108 billion yen level. If this increase is not made there is little doubt that the localities will raise local rates well above standard rates in many cases, will levy special taxes, and will even fall back on the so-called voluntary contributions which our report last year condemned. The reasons why these events will occur if the

[13] Portions omitted.

equalization fund is not increased are given in the section below on Local Budgets. Again, the expenditure on services rendered by the national government should be at such a level as, combined with national tax reduction, will make this increased grant to localities possible.

In the tax field, we must again register our belief that the farmer, and to a lesser extent the other taxpayers who work independently, should receive treatment more nearly parallel to that accorded those who work for a regular employer. We recommend that the farmer and fisherman be given an earned income credit of 10 per cent of their net profit (but not more than 10 per cent of 150,000 yen). Extending the credit to other self-employed taxpayers might be considered in a later year if the budgetary condition improves. Meanwhile, "parallel treatment" means just as strict enforcement for the farmers and other self-assessed taxpayers as has already been reached under deduction at the source from wages. This goal has already been substantially achieved, for farmers. As to the others, a large part of our present statement is devoted to devising ways of ensuring that they pay the full amount of tax they owe, and we believe that it can be done.

An increase in the allowance for dependents is also a particularly good use for a budget surplus. We suggest increasing the allowance for the first two dependents in any one family.

If the prospective budget surplus turns out to be about 25 billion yen for 1951–52, we recommend that the three measures above be taken. The equalization fund increase should be at least 12 billion over the budget estimate of 108 billion (larger than this, if budget conditions permit, as noted below) to a total of approximately 120 billion. The credit to farmers would cost about 4 billion. The rise in the dependents allowance could be set so as to take up the balance.

Another urgent need under the income tax is a decrease in rates and an increase in the basic exemption. If the budget surplus promises to be 45 billion or so, we recommend reduction of the rates in all of the brackets except the first (where the starting rate should not be low, to avoid processing many more returns with only a nominal tax) and the brackets above 300,000 yen. As much relief as possible should be given within the brackets 50,000 to 150,000, for reasons given below. The basic exemption should be raised as far toward 30,000 yen as the revenue needs will allow.

In making estimates of the revenue loss from those income tax changes, the probability that compliance will improve as the exemptions go up and the rates go down should be allowed for. The revenue loss may be expected to be appreciably less than if no improvement in compliance could be anticipated.

If the surplus promises to be still larger, the commodity taxes on business items and on articles of common household use should be repealed. And the equalization fund should be increased by another 10 billion yen, to a total of approximately 130 billion yen. At this point, about 60 billion of surplus will have been used up. If the national government has still more available, certain reductions might well be made in the remaining commodity taxes.

We now present more of the reasoning that prompts those proposals for the personal income tax.

High priority on the above list is given to reductions in the personal income tax. Such reductions are necessary if tax officials and taxpayers are to be given adequate opportunity to complete the transformation of the income tax from its former status as an arbitrarily determined tax characterized by extreme evasion and great delinquency in payment, into a modern tax instrument that spreads the burden fairly under a law that taxpayers respect and administrators enforce. The progress made toward this goal during the past twelve months has been as substantial as we last year had expected it would be. The greater part of the job still lies ahead, however. The number of taxpayers must be reduced to make the task of administration more practicable, and the amount of tax due from each taxpayer must be reduced more nearly to what he will regard as a reasonable amount. To be sure, if international events should induce a substantial rise in inflationary pressure in Japan in the next few months, income tax reduction may have to be foregone in the interests of price stabilization. Barring such a development, we regard a reduction in the income tax as imperative.

But in reducing the personal income tax it is necessary to decide whether to emphasize basic exemption and dependents allowance, or to stress decreases in the tax rates.

Those who argue that emphasis should be on increasing the exemptions point out that:

(1) By raising the exemptions, large number of taxpayers are removed from the tax roll entirely, thus reducing the administrative burden more than would a reduction in rates, which takes no taxpayers off the roll:

(2) It thereby takes a greater load off the lowest-income taxpayers than would a reduction in rates.

(3) At the same time, an increase in the exemptions does give some relief to every taxpayer, even the largest.

With regard to the rate scale, an important question is whether the marginal rate—the rate that applies to the next yen that the taxpayer might obtain by additional work or additional business activity—is so high as to discourage him from working more, or doing more business. For manual workers who have to decide whether to work overtime, etc., the critical area is probably in the brackets of 50,000 yen to 100,000 or 150,000 yen of taxable income. The first two of these amounts corresponds approximately to a monthly wage of about 12,000 yen for a taxpayer with a wife and three dependent children, or a single taxpayer respectively. The present taxable rate on that part of the taxable income (i.e., income after exemptions), from 50,000 to 80,000 yen, is 25 per cent, to which may be added an average inhabitants tax (local tax) amounting to another 4 percentage points—29 per cent, altogether. In the range 80,000 to 100,000 yen the combined national and local bracket rate is 30 per cent plus 5.4 per cent, or 35.4 per cent. This marginal rate is close to, if not beyond, the point at which it may be deterring extra work by wage and lower-salary employees. In the 100,000–120,000 bracket of taxable income the combined rate is 41.3 per cent; in the 120,000–150,000 bracket, 47.2 per cent.

The impact of those rates will be automatically moved to a higher income level if exemptions are raised, and (for farmers) the earned income credit extended; the marginal percentages given above will apply only to workers with slightly higher incomes. But the difference will not be material. On the other hand, for reasons to be given later in this statement, it is likely that next year the municipalities will be forced to select an option under the inhabitants tax of a kind that adds somewhat more than the percentages listed above to the marginal tax on those with incomes of 10,000 yen a month or less.

The present combined national and municipal rate on the 150,000–200,000 yen bracket is 53.1 per cent (45 per cent plus 8.1 per cent). On the bracket 200,000 yen—500,000 yen it is 59 per cent; and on all over 500,000 yen the marginal rate is 64.9 per cent. Very few workers, farmers, or small business men are found in these ranges. The question here, rather, is the effect on incentive to invest, or to work toward high-paying executive positions. We do not believe that those deterrent pressures are too strong in Japan at the present time, especially in view of the elimination of double taxation of corporate income through the dividend credit granted under the income tax.

As to the deterrent effect on manual laborers, if it does exist, it may still result in little or no reduction in total production of the Japanese economy. The slack might be taken up by workers who do not have a full job to do, but who are nevertheless on the payroll on part time, or are available to be hired at once. Consequently, if one worker decides to indulge in foregoing overtime work, or in absenteeism, or in slack work under a piece-rate wage system, there may be another worker ready to produce that extra amount of product.

Another reason given for substantial rate reduction, including a reduction in the brackets above 200,000 yen, is that the taxpayers in those brackets do not regard the present system as a just one and will simply refuse to comply with the law until the rates are moved down to levels that correspond with those individuals' ideas of what they ought to be asked to pay. This argument is difficult to appraise. No tax can succeed if it really runs directly counter to deep-seated notions, especially those founded in tradition, of what the taxpayer thinks is reasonable. But taxpayers' complaints on this score can scarcely be taken at their face value. If those Japanese taxpayers who represent, say, the top 10 per cent of income recipients in the country are inclined to believe they are being too harshly treated by the present income tax schedules (plus the net worth tax), they may feel less strongly on this point after contemplating the tax burdens of their British and American counterparts in the income distribution.

B. Local Budgets

The prefectures and municipalities will probably have to increase their total expenditure in the 1951–52 fiscal year. There are several reasons for this:

1. There are no substantial items in the local budgets like price subsidies and debt retirement, which have been large because of inflation and the program of checking it, and which may now be reduced greatly as inflation has come under control.

2. The national government is contemplating an increase in the demands it makes on localities to render certain services, or the inducements to do so, while it at the same time proposes to defray a part but not all of the cost of these services. The rest of the cost adds to the total of expenditures that the localities must meet from their own resources. The Local Finance Commission has estimated that the draft of the national budget now being considered by the Cabinet for 1951–52 contains items of this kind which would, if enacted, result in an additional expenditure by localities in 1951–52 (over 1950–51) of 13 billion yen for welfare activities and another 12 or 13 billion yen for public works.

3. The national government is proposing abandonment of the arrangement in force this year with respect to the cost of repairing damage to public properties by natural diasters. This arrangement calls for 100 per cent of the cost to be borne by the national government, with some exceptions. The national budget for 1951–52 is at present predicated on a substantial return to the old system, whereby the local governments in general paid one-third the cost of such rehabilitation. The Local Finance Commission estimates that this would add 16 billion yen to local expenditures next year.

4. The national government proposes to raise the salaries of its employees in 1951–52. Article 9 of the Supplementary Provisions of the Local Autonomy Law and Article 55 of the Cabinet Order No. 19 of 1947 which implements that law are interpreted by some to mean that the localities must follow suit; and in any event, it seems likely as a practical matter that the localities will be obliged to do so. The Local Finance Commission estimates that this would add 17 billion yen to local expenditures (teachers, policemen, and firemen, 11 billion yen; others 6 billion yen).

5. The normal growth in population will call for 2 or 3 billion yen additional expenditures.

On the other hand, there is no doubt room for appreciable saving by increasing the efficiency of operation of the local governments. In part, such increase can be obtained overnight simply by having the will to do so; but in part it can be obtained only gradually over the years, as local officials gain experience and skill in managing their own affairs—something in which they have not had much experience so far.

The total additional expenditures in items 2 to 5 above is 60 billion yen. Even if it is discounted a good deal, it remains too high to be covered by additional tax revenues that the localities should try to extract from their existing system. Moreover, these remarks so far make no allowance for the likelihood that the current year's outlays will be substantially below what is needed for the services that the local units are supposed to render, but in fact may not be rendering owing to inadequate revenues.

For these reasons, we believe that, if inequitably high and economically harmful levels of local tax rates are to be avoided in 1951–52, the national government must forego some of the national tax reduction that it could otherwise obtain, and (1) refrain from throwing back on to the localities so much of the cost of disaster rehabilitation as the present plans contemplate, (2) increase the size of the equalization grant. Although national taxes would under this plan be somewhat higher than they would otherwise be, we believe that this failure to decrease national taxes still further would be less harmful than the heights to which local taxes might otherwise rise.

There would not, of course, be a 1-to-1 correspondence; the amount of increased local taxes avoided would not be as great as the decrease in national taxes foregone. But this difference is justifiable on the grounds that, regardless of items 1 to 5 listed above, an increase in the equalization grant is called for. This is discussed in a separate section below on the equalization grant.

Even with reasonable increases in local tax rates, and the measures recommended in the second paragraph immediately preceding, the localities will probably be short of funds, and therefore may request permission to borrow more in 1951–52 than in 1950–51.

In general, then, 1951–52 will be a critical year for local finance. The way in which the problem is met will in large part determine whether local autonomy will develop. Local autonomy will not be harmed by an equalization grant, for the locality is still able to reap its own rewards (in the form of a lower local tax rate) by increasing its efficiency and thus diminishing its expenditures; and the locality is still put under the necessity of financing 100 per cent, from its own taxes or borrowing, any increase of services beyond those possible under the grant. But inadequate total finances can kill local autonomy.

In addition to all these factors, there is the influence of the forthcoming report of the Local Administration Investigation Committee to take into account. The findings of this committee will be of great importance in judging the revenue needs of the localities.

The problem of a local financial system adequate to support local autonomy in Japan is on the road to solution, but is still some distance from the end of the journey.

C. Administration of the National Income Tax

February, March, and April of this year were in many ways one of the most difficult periods that income taxpayers and income tax administrators in Japan have ever encountered. Al-

though tax relief has been enacted, it could not take effect until July, 1950 (with minor exceptions). The very high rates and very low exemptions of the old system were still in force; but the inflation of money incomes had been stopped, and some taxpayers were suffering from reduced business, or unemployment. Hence the tax administration found it difficult to induce complete compliance.

At the same time, the administrators were forbidden to use the old methods of arbitrary reassessment, aimed at meeting a predetermined goal, or quota, for each tax district.

Under the circumstances, it is not surprising that taxpayer compliance was inadequate, and that arbitrary reassessment was not completely eliminated. Truly, the period of early 1950 was a formidable hurdle to surmount. It has left behind it some problems, including a huge tax delinquency that must be attended to within the next few months.

Nevertheless, the hurdle has been cleared. Every taxpayer who has filed his preliminary return for 1950–51 must have realized, upon computing his tentative tax, how substantial is the tax relief brought about by the Diet's action last winter. And most taxpayers, we believe, are aware that a new era has dawned in Japan in the relation of tax administrator to taxpayer.

Our Mission has studied this last point in some detail. We can assure the Japanese taxpayer that the top officials of the Tax Administration Agency and the Taxation Bureau are sincerely engaged in an ambitious effort to administer the income tax precisely in accordance with the law, without arbitrariness. No doubt this spirit has not yet been completely realized in action. At some of the lower levels of administration the old faults remain. But such faults will be eliminated fairly rapidly, provided that the taxpayers, in their turn, likewise show a respect for the law. The taxpayer and the tax official will then have mutual respect for, and confidence in, one another. This is the aim. When it is substantially achieved, both parties will wonder how they ever could have lived under the old system of mutual distrust and recrimination.

We turn now to listing some of the specific measures that will aid in reaching this aim. They fall into these main groups:

1. Determining Income and Tax Liability
2. Collecting the Tax
3. Tax Administration Personnel and Office Operations
4. Taxpayers' Representatives
5. Prosecution of Tax Evaders
6. Elimination of Corruption
7. Statute of Limitations and Other Points

In each one of these groups we make a number of specific recommendations. Further details will be given in supplements to this report, to be released shortly. Any one of the recommendations taken by itself may seem of minor importance, or sometimes even trivial. Yet by taking action on all these points at once it will be possible to improve administration of the income tax substantially.

1. *Determining Income and Tax Liability*

a. The tax-return form can be simplified further.

b. It should be made clear to the taxpayers that (1) minor bookkeeping errors will not deprive them of the blue-return privilege; (2) farmers and small business men can file a blue return even if they have only a single-entry, not a double-entry, system of keeping books; (3) actual posting in a ledger of sales and purchases invoices is not necessary if those invoices are carefully filed. The Tax Offices, in turn, should realize that not every blue return need be investigated. The Tax Offices should encourage the filing of blue returns by all taxpayers who are willing to meet the minimum requirements for doing so.

2. *Collecting the Tax*

On July 31, 1950, there was 73 billion in unpaid self-assessed income tax. Of this large total, 47 billion was on 1949 incomes. The other 26 billion was on earlier years' incomes.

So long as this huge amount of unpaid back taxes stands in the way, it will be difficult, if not impossible, to administer forthcoming tax assessments and collections fairly. Indeed, the single most important administrative problem under the income tax at the present moment is how to clear up this accumulated delinquency. It should be cleared up by the end of this calendar year, or at least by the end of the current fiscal year. To a considerable degree, this aim can be achieved by transferring personnel from many of the rural tax offices, where delinquency is not so serious a problem, to industrial regions, especially Osaka and Fukuoka, where the delinquency rate for taxes on 1949 incomes is exceptionally high, and Tokyo, where the total amount is great, although the rate of delinquency is about average. Additional temporary personnel will also be required.

How may a recurrence of such delinquency be prevented? Partly by taxpayers' keeping better books and records, so that they are not reassessed in amount much beyond that which they had expected to pay; but chiefly by the development of savings plans for taxpayers.

Farm Cooperative Associations have done valuable work in assisting farmers to save to meet their tax payments, and should increase this activity. Fishermen have associations which should develop similar savings plans. In some places, taxpayers have formed tax savings associations; annual dues are paid to these associations in return for the service of collecting small amounts from their members at frequent intervals and holding the sums for tax payment. Such associations should be encouraged, so long as their membership is not composed of only one or a few trades; otherwise, they might develop into the old boss-dominated industry associations. The associations should not be permitted to represent their members in discussions with the tax authorities, or to file tax returns on behalf of their members. These are duties and responsibilities of each taxpayer.

Cooperative banks are promoting savings by small taxpayers through the use of solicitors or collectors; other banks and financial institutions might also develop systems of periodical house-to-house collection of savings for tax payments.

Attachment of property for non-payment of tax will no doubt still be necessary, even if these improvements in collection are realized, but much less frequently than at present. Attachment should become so rare that it brings with it a moral stigma, characterizing the taxpayer as an irresponsible member of the community.

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3. *Value-Added Tax*[14]

The value-added tax is to replace the enterprise tax based on profits, in 1952, as the chief source of tax revenue for prefectures.

a. *Shifting the Tax to Consumers*

A common complaint is that the value-added tax, not being restricted to profits, will bear unfairly on those firms with a large labor element. But this complaint seems to assume that the value-added tax is supposed to be borne out of profits, like the present enterprise tax. Instead, the value-added tax is supposed to be passed on to purchasers in higher prices; it is a type of sales tax.

b. *Depreciation on Assets in Existence January 1, 1952*

In our report last year we recommended that value-added be computed by deducting from sales all purchases from other business firms, including purchase of machinery, buildings, etc. We concluded, therefore, that no deduction of depreciation should be allowed, since this would produce a double deduction of the same item.

Further study has convinced us that this recommendation, and the resulting law, are unfair to concerns that finish a capital equipment program shortly before the tax takes effect. They will be spending relatively little in the first years of the tax for capital equipment, hence will have little to deduct in computing value-added. A newer competitor, on the other hand, may be getting substantial deductions, since he will be spending large amounts for new equipment.

To avoid this injustice, we recommend that the law be amended to allow firms to deduct, in computing value added, depreciation on all property owned by them as of January 1, 1952 (the date when the value-added tax takes effect), and, in addition, be allowed to deduct, as under the present law, the amounts spent on acquiring buildings, equipment, etc., on and after that date. On such buildings, equipment, etc., purchased on and after January 1, 1952, no depreciation could be deducted; to allow this would be to grant double deduction.

c. *Depreciation Option for Assets Obtained After December 31, 1951*

Business concerns that keep an extensive set of double-entry books complain that it would be much simpler for them to compute value-added if they could deduct depreciation on all present and future buildings, equipment, etc., and not deduct at all the expenditures on acquiring those objects. They could then compute their value-added by summing their profits as computed for national-income tax purposes, their payrolls, and their interest and rental payments. Their gross income for the value-added tax should not include sales of such depreciable assets.

There is no objection to a business firm employing this concept of value-added if it does so consistently. We therefore recommend that the law be amended accordingly, to give the taxpayer this option.

d. *Value-Added Deemed to be Certain Percentage of Sales*

[14] Only this part of Section E, Local Tax is printed here.

The present law provides that for the first year of the new tax certain businesses may use as the tax base, not value-added, but specified percentages of gross sales for the year.

While there may have been some need for such transition provisions if the law were to take effect at once, the fact its application has been postponed to January 1, 1952, materially lessens the necessity. Such provisions are dangerous, in that they tend to become permanently embedded in the law, although inserted at first as temporary measures; and thus discrimination in favor of certain taxpayers takes root. We therefore recommend in general that Article 74 of the present law be repealed or substantially restricted in scope.

e. *Differential Rates*

The present law sets the standard rate of the value-added tax at 4 per cent, except that for a long list of businesses, chiefly live-stock breeding, fishing, professional activities, and personal-service businesses, the standard rate is 3 per cent. The maximum rates are set at 8 per cent and 6 per cent, respectively.

We do not think there is a justification for such a rate differentiation. If the tax is to be shifted forward to consumers by raising selling prices and fees, there is no reason why it should be imposed at a lighter rate on these businesses than on others. There is no proof that it will be harder for livestock breeders, or dentists, or tax consultants to shift the tax to their customers than it will be for the steel mill, the retail shop, or the pottery manufacturer to do so.

We therefore recommend that all businesses subject to the value-added tax be taxed at the same rate.

f. *Rate-Regulated Enterprises and Goverment Corporations*

To maintain competitive relations between the private and government railroads, the JNR should also pay the value-added tax, under rules for computing the profit element of that tax to be set by the Local Finance Commission. These corporations, government as well as private, cause the prefectures certain costs of government, and should pay their share. Although at first sight prefectural highway expense might appear to be stimulating competition with the railroads rather than aiding them, actually these expenditures are needed by the railroads in order to enable freight and passengers to get from farms, houses, and factories to railway terminals.

[SOURCE: SUITLAND PAPERS, Z 703-3]

10-34 DR. SHOUP'S CONFIDENTIAL MEMORANDUM

Memorandum September 26, 1950
To: General Marquat
From: Harold Moss, Chief, Internal Revenue Division, ESS

1. Transmitted herewith is a confidential memorandum for the Supreme Commander from Dr. Shoup. As indicated in the memorandum Dr. Shoup considers three points to be of a confidential nature: (a) the degree to which the JG should be given freedom of action regarding this year's report; (b) the role of the tax system if renewed and serious inflationary pressures develop within the next year or two; and (c) the forgiveness of tax evaders.

2. In transmitting the attached memorandum, the following comments and observations are submitted:

a. *Degree of freedom of action for the JG:* We agree fully with Dr. Shoup's observation that the JG is by now to a high degree committed to the present tax system, and really has no feasible alternative at present. We fully endorse Dr. Shoup's view that Japanese debate over some of the more controversial tax issues discussed in the present report should be encouraged, as it contributes to the healthiness of the growing Japanese democracy.

b. *Future inflation and the tax system:* Dr. Shoup's point here is that the present tax system is still immature, and that it should not be called upon to counteract renewed inflationary pressures, should they develop, except as a last resort. He is of the opinion that, pending maturity of the new tax system, such pressures should be met primarily by the banking system, through restriction of credits, and secondarily by price and wage controls.

c. *Forgiveness of tax evaders:* In brief, Dr. Shoup feels that a certain amount of forgiveness of past tax evasion is a necessary prerequisite to the voluntary filing by taxpayers of more honest declarations of income. The reasoning here is that current filing of an honest return would expose the taxpayer to reassessments by the tax officials for all open prior years. He proposes to meet the issue by a reduction in the present 5-year statute of limitations to three years, and in addition, bar the reopening of returns for 1948 and prior years in those cases where a taxpayer becomes honest and files a 1950 return declaring therein at least 95% of his current

year's income. While we must admit that there are advantages to Dr. Shoup's proposal, and are in agreement with respect to the reduction of the statute of limitations to three years, we seriously question the advisability of adoption of the forgiveness feature primarily because of its potentially serious effects upon Japanese taxpayer psychology.

3. Since 1947 this Division and the Japanese Government have been promising vigorous prosecution of tax evaders, and have made what is believed to be satisfactory progress in this respect. Tax evasion is gradually becoming less prevalent. Dr. Shoup's recommendation of this forgiveness measure might well, in the opinion of this Division, "backfire" because the more honest taxpayers might reasonably be led to expect that further forgiveness may be made in the future. Forgiveness might be taken as a sign of relaxation of Japanese tax enforcement. Also, the taxpayer who has been honest since 1947 may have doubts upon seeing forgiveness of tax evaders being condoned, even temporarily. This Division feels that other techniques can be utilized for achieving Dr. Shoup's objective for the establishment of a workable and efficient information return system.

4. The problem is further complicated because of the numerous 1947 and 1948 tax fraud cases pending in the Courts. Should tax amnesty, in effect, be granted for 1948 and prior years, it is highly probable that the Courts will find ways and means to dismiss the pending cases, with resulting adverse effects on the whole tax enforcement program.

5. Were we certain that Dr. Shoup's proposal would accomplish the desired objective, we would probably feel that the advantages to be gained would outweigh the disadvantages. However, since we are so uncertain as to what can be gained (if anything) by adoption of the proposal, and so certain as to what will surely be lost, we recommend that alternatives be further explored and that the forgiveness recommendation not be adopted, at least for the time being. This Division is therefore continuing discussions on this problem with the Japanese tax authorities, brokers, bankers, and others concerned, with the view of working out a suitable alternative. Basically, the personnel of this Division, without exception, are opposed to any plan which, if adopted, would make it possible for an honest taxpayer to say: "I have been a 'sucker' for filling an honest tax return".

[SOURCE: DODGE PAPERS, DETROIT PUBLIC LIBRARY]

11 THE "DODGE LINE"

11-1 THE GENERAL ECONOMIC AND POLITICAL PROBLEM AND ITS RELATIONSHIP TO BANKING

Statement undated (1947?)
By: Joseph M. Dodge

World Conditions

There is a well developed socialist trend apparent all over the world. It has come to its peak in Europe, where socialism has assumed the dominant political position. There the broad issue is between some form of democratic socialism, and state-ism or totalitarianism and the police state.

There have developed in this Country certain definite socialistic trends which have been apparent to everyone. The domination of the Government over civilian and business life and its impacts and controls have been progressively increasing. These trends have become strongly established, assisted by the war conditions. The controls may increase or may decrease. However, they probably will not decrease at the same rate as they increased. There is little likelihood of all the Government interests and controls created in the last dozen years being entirely eliminated.

Fundamentally, every extension of Government interest or control requires more extension in the same or another direction to support the effectiveness of that already existing.

The world political problem today is the extent to which Government controls or ownership will replace private enterprise and how or whether any degree of the former can be balanced with the latter so as to leave a substantially effective system of free, private enterprise.

Underlying these problems and trends is the ultimate fact that the expansion of socialism and Government control and ownership finally leads towards some form of totalitarianism.

United States

An attempt was made to continue war time controls over the economy into the post war period. The end of the war, ineffectiveness, and lack of public support has forced the elimination of most of them. The end of these controls will have far-reaching consequences. Most of the direct responsibility for what happens in the future will pass from the Government to labor and to business. There will be an even greater difference in the operation of the economy of the United States and that of socialist Europe. This will place the United States even more clearly in focus as the only relatively free economy, and place on labor and on business the need for insuring its success.

These United States are the last stand of relatively free enterprise. How much freedom will be retained and how long this freedom will last largely will depend upon the ability of the people, the workers, and the businesses of the Country to recognize, understand, and meet their obligations to the Nation as a whole.[1]

11-2 STATEMENT OF THE YEN EXCHANGE COMMITTEE ON ESTABLISHING THE EXCHANGE RATE FOR JAPAN

Draft Statement June 2, 1948
By: Yen Exchange Committee

A. The Committee is in unanimous agreement that a single exchange rate system for Japan should be an objective of the occupation. This Committee was instructed last October to prepare a plan for the establishment of an exchange rate system early in 1948 and the report of the Committee of 10 January 1948 fulfilled that specific assignment. If an exchange rate system per se had in fact to be instituted in early 1948 the system indicated in the report of 10

[1] Subsequent sections deleted.

January 1948 would still be advocated. It is recommended that a single exchange rate system should not be instituted in Japan's foreign trade until substantial progress has been accomplished simultaneously in three general areas of the economy. The three areas where substantive improvement should take place prior to the fixing of a single exchange rate are as follows:

1. Correction of present price dispersions in export and import yen-dollar relationships.
2. Creation of conditions in which efficient direct price subsidies and tax levys could, if necessary, replace present price ratio system in foreign trade.
3. Further progress toward price and economic stabilization.

B. The three areas of the economy mentioned above will be described below in turn:

1. *Price Dispersion:* Dispersion in the present effective yen-dollar prices of exports and imports and the general lower level of import yen-dollar prices compared to export values results from the following price policies:

a. Yen prices of exports and imports have been established at the same prices for the same or similar commodities sold in the domestic economy.

b. Because of the general worsening of the position of the wage earning classes, emphasis has been to minimize pressure on that class and on prices in the cost of living items in the family budget; therefore, imported foodstuffs, 15–18% of total foodstuffs consumed, have been released at prices in parity with yen prices of foodstuffs produced domestically. No attempt has been made to have food imports serve as a revenue raising source for the government over and above yen prices at parity with domestic foodstuffs. There is, therefore, no specific subsidy enacted by the legislature for foodstuffs. It would not be desirable to price imported foodstuffs higher to raise additional revenue for the government as a result would be to increase the cost of living thus increasing costs, perhaps with the result of widening the gap between government expenditures and income. Moreover this method would be regressive, falling hardest on the group least able to protect themselves. Compensating for increases in imported foodstuffs by subsidies to consumers would achieve no net additional income to the government but involve additional administrative measures introducing political uncertainties and reducing efficiency without achieving improvement in economic price influences or in net government revenue.

c. Yen-dollar equalization among and between export and import commodities has not been forced because industrial and commercial rationalization has yet not been attempted. Foreign trade has not recovered at the same rate as the general industrial index. The level of export trade is now one-fourth of parity with current levels of industrial activity. While the industrial index is about 45–48 per cent of 1930–34, exports are about 12–14 per cent of 1930–34. Yen price equalization with world prices has not been forced as the deliberate choice has been made by the Japanese to try to restrain the general price level without causing widespread unemployment. Alternative employment opportunities do not generally exist in Japan today and effective public relief for unemployment could not be depended upon. Thus minimum prices to cover costs of production at full capacity payrolls has been allowed as Japanese official price policy.

d. Exchange quality at this time between yen and dollar prices would, depending on how it was implemented if the rate was fixed at a medium level, force industrial rationalization resulting in unemployment. If fixed at a very high level the result would be inflation substantially worsening the condition of the wage earning classes. It is believed that a single rate system at this time would cause economic and political disorder negating the economic benefits which might be derived from adjustment of domestic prices to world prices. Correcting present price dispersions in exports and imports on a calculation of purchasing power parity with dollars would be grossly inflationary for the following reasons:

(1) As mentioned above use of GARIOA imports as an additional revenue source will be inflationary to a greater or lesser degree, depending upon the degree of subsidy added, and directly with the degree of efficiency achieved in administration of the subsidy programs.

(2) Prices of exports (in yen) are relatively much less important at this time in the total economy than in the base period 1930–34. Adjustment of all prices upward to a degree sufficient to stimulate exports without widespread subsidies would be inflationary because taxes would not recover more than a portion of the profits accruing from such price levels; the general government revenue would not keep pace much less gain on general increases in the price level; there would be more money in circulation; the widened rather than a narrowed gap between government revenue and expenditures would

in this situation, of course, result in additional note issue.

e. It is believed that substantial progress can be made in the next months toward correcting the existing price dispersions in export and import commodities and that compression and equalization in prices will follow from the following anticipated influences and planned actions:

(1) *Increase in volume of exports and imports.* The total value of exports in 1947 was $173,000,000. The value of exports in 1930–34 adjusted to 1947 prices would be $1,800,000,000, therefore, in terms of parity with 1930–34 Japanese exports amounted to 10 per cent of the base period. ESS plans for balanced economy assume the possibility of balance in payments (if domestic consumption is restrained) when Japan has reached the level of a billion dollars in exports. It is believed that in many export industries an increase in the volume of exports will be accompanied by a lowering of unit costs. This influence will operate to restrict price rise in export industries that are expanding and may in general terms act to reduce yen-dollar ratios in some industries. This Committee desires to make the point that *price rationalization* at this time at an export level of $173,000,000 less than 10 per cent of 1930–34 or 17 per cent of minimum estimates of the level of balance may be premature and may impose undue hardships on such industries which operate at low levels of capacity with high fixed charges for full employment payrolls. It is agreed that when Japanese exports have achieved the level of $500,000,000 or more that prospects for fixing a single exchange rate will have increased materially. Price rationalization can accompany an expanded level of production for export. It is considered undesirable to force rationalization which may restrict rather than expand export production.

(2) *Price adjustments of the import ratios by administrative action?* The Committee recommends a separation of import accounts between the GARIOA imports and the economic imports for export industries. These raw material imports brought into Japan for export industries, directly or indirectly, can properly be charged in at a rate comparable with the average of the rate applying to the specific export industries. By this method price rationalization can be introduced in the price structure and by such selection of imports, prices can be brought into relative parity with export ratios by such administrative action. Such equalization of prices for the most part, will have a tendency to raise the import yen prices and also the export prices they affect but the influence will be felt on the lower price categories; this effect if controlled will narrow existing price distribution. GARIOA imports should, it is recommended, be released in the domestic economy in consonance with the policies of maintaining consumer price levels. In practice this will require release of imported relief materials at yen prices for domestic production of comparable commodities.

(3) *Administrative control on changes in the price ratio.* It is recommended that price equalization be enforced in the next months by deliberate administrative action through the mechanism of a price ratio system. A limited number of price categories should be formally established as soon as possible. It should be the explicit policy of the administration of the price ratio system successively to diminish the number of price categories and enforce compression toward a single exchange rate. This can be accomplished by distinguishing between low and high cost producers. When price changes are necessary they may be permitted for the low price ratio group but now allowed in the higher ratio categories. A part of this process of control will include more intensive analysis of the prevailing cost of production. Continuous pressure can then be maintained against the high cost producers.

2. *Subsidy and tax system.* A single rate exchange system can be established and exports will not be lost (prior to the achievement of full price equalization) if a proper subsidy system could be implemented. The converse of this problem appears when a single exchange rate may be fixed at a rate giving certain industries very high profits; in order not to have such excessive profits act as an inflationary influence, adequate taxation by the Government to recover these excess profits would be necessary to evaluate the prospects for a satisfactory subsidy and tax system a few facts are reviewed: The Katayama Cabinet fell on a budget issue. We

have seen a sizeable amount of net issue take place last autumn from the inability of the Japanese to collect taxes already levied and due. The budgetary issue remains as the crucial one for this cabinet and already additional tax revenues are recorded by increasingly regressive measures. It is felt that at present it would endanger Japan's foreign trade program to have to rely on the Diet for subsidies which in turn are dependent on additional tax collections. While it is felt that at this ratio method would be infeasible, it is expected that in the future Japanese Government efficiency will improve, the requirement for subsidies will lessen, and a tax subsidy program might be feasible thereafter.

3. *Economic Stabilization.* Four criteria to the achievement of sufficient economic and price stabilization for the institution of a single exchange rate may be mentioned (this includes an assumption that some subsidies may be necessary).

a. *Improvement in food situation.* Strong pressure on prices is now exerted from a continuous rise in the cost-of-living items. As indicated, 75 percent of family expenditure in urban areas is for food and two-thirds of this expenditure is for one-third of the food consumed that is purchased in the black market. It is anticipated that the proportion of food moving in official distribution channels will be increased and also the ration level will be raised to more closely approximate the minimum necessary consumption level. Some improvement is expected this summer, and if achieved will become a major buttress towards a condition of relative price stability.

b. *Increasing industrial activity.* Further increase in the domestic coal production, the major limiting factor in the domestic economy and large scale imports of industrial raw materials are expected. The rising level of industrial activities should exert a deflationary influence and, in general, aid in stabilizing price levels.

c. *Better price control and wage control.* If distribution controls are vigorously implemented, more producers goods will be purchased at official prices and black-market operations will have diminishing effect on the cost of production in industry. Also, along with controlled prices, the Japanese have considered and may enact wage control program which will lessen the pressure on industrial prices. Wage control will, of course, depend upon the improvements mentioned above; i.e., increased food ration and larger proportion of family requirements purchased at official prices.

d. *Improved public finance.* Better management of public finance is to be expected as Japanese postwar governments, and the Occupation, both become familiar with the principles and mechanisms necessary for public financial management in present Japan. With relative stabilization of prices and with adequate tax collection programs, government operation should not be necessary through greater increases in note issue.

4. *Conclusions:* In sum, this Committee feels that three major considerations, (1) present price dispersion in foreign trade commodities, (a) existing political difficulties which prevent an efficient system of taxation and legislatively enacted subsidies for foreign trade and the progress that is still to be made toward stabilization suggest that a single exchange rate system should not now be instituted. On the other hand, it is felt a formal price ratio system is essential immediately to implement a major change in the methods of trade. The price ratio system mentioned is not described in this general statement. It should be clear, however, that it is not considered as a formal exchange rate system for Japan, or a substitute for a single exchange rate system. For financial transactions, it is proposed that the military conversion rate be changed and used for invisible trade such as remittances, purchase of working capital, investments, etc. The Committee wishes to go on record that there are deflationary economic influences appearing in Japan's economy and there are expanding prospects for foreign trade working towards condition that will permit the establishment of a single exchange rate (perhaps supported by subsidies) within the short-run future. How rapidly that "future" can be reached depends, in part, upon the progress made simultaneously in the fields of economic stabilization, administrative action through a price ratio system, improvement in government efficiency in public finance. The Committee does not want to leave the impression that it is avoiding the question of when a single exchange rate maybe fixed, instead, the Committee insists that it has clearly indicated the criteria which can determine when a single exchange rate can be instituted, supported and efficiently managed. Finally, the Committee restates its position that general price adjustment in Japan to achieve equalization with dollar prices is not feasible at this time.

11-3 THE JAPANESE RECOVERY PROGRAM

Memorandum October 18, 1948
To: The Under-secretary of the Army
From: R. Reid[2]

Confidential

P.L. 793, 80th Congress, making available recovery funds for Japan for the fiscal year 1948/49, seeks to encourage re-establishment of a self-sufficient economy in Japan in the shortest possible space of time. Achievement of such a state will be expected to:

1. Fulfill Potsdam Declaration guarantees that Japan would be ensured a viable economy;
2. Create the most favorable possible climate for the development of civil, political, and economic liberties;
3. Aid Japan to resist the intrigues of the Asiatic Cominform;
4. Further the economic recovery of the entire Far East;
5. Relieve the U.S. government of the present heavy burden of relief and recovery expenditures.

Concomitant assumptions on the part of Congress at the time of passage of the legislation undoubtedly were that:

1. The above aims were not in conflict with the controlling aims of the Occupation:
   a. To ensure that Japan would never again be a menace to the peace of the world; and
   b. To guarantee to Japan a freely constituted and democratic form of government; and
2. That Japan could achieve self-sufficiency in five years.

The fact that the recovery program is already under way will have a beneficial influence over requests for a new recovery appropriation for the fiscal year 1949/50. The advantage will be tempered somewhat, however, by the facts:

1. That funds in excess of those granted this year will probably be requested for the ECA program in Europe, on the grounds that it is imperative to protect this year's $5,000,000,000 investment;
2. That a Republican administration will probably incline towards expanding the China Aid Program;
3. That a Republican administration will probably attempt to make an overall cut in total government expenditures;
4. That specific legislative authorization for Japanese recovery expenditures may be required commencing next year; and
5. That Congress will probably ask for specific reports on progress achieved under the 1948/49 recovery program.

In consequence, it can be anticipated that requests for EROA funds for Japan for the forthcoming year will undergo searching review, particularly by the appropriations committees of the two Houses, and that the requests may well involve the most exhaustive hearings to date on the entire Occupation. The following notes are designed to anticipate specific queries which may arise in such hearings and to suggest appropriate preparations therefore.

In general, it may be assumed that Congressional inquiries will involve both internal and external matters, i.e., (1) that assurances will be required that the beneficial internal influence of recovery appropriations has not been wiped out by Occupation-imposed controls on the Japanese economy; and (2) that further assurances will be required that the Japanese aid program has been correlated to the maximum extent possible with other U.S. aid programs throughout the world.

INTERNAL

Congressional discussions on this point will probably evoke the homely simile that to drive a car with one foot on the accelerator and one foot on the brake is hardly to be desired. The following will probably be noted critically in committee hearings as the principal brakes on recovery:

1. The deconcentration program.

[2] Office of the Under-secretary of the Army.

2. Uncertainty over reparations.
3. Labor problems.
4. Lack of encouragement for foreign investments.
5. Lack of an exchange rate.
6. The purge.
7. Controls over foreign trade.
8. The possibility of further legal reforms.
9. Lack of wage controls.
10. Occupation drains on the Japanese economy.
11. Future vulnerability of Japan to Communist intrigues.
12. Limitations on the level of industry.
13. Failure to complete restitution of foreign properties.
14. Failure to publicize the extent of American contributions to Japan.
15. The present dollar economy.
16. The high cost of shipping.
17. Limitations on fishing areas.
18. Limitations on the tourist trade.
19. Restrictions on travel abroad by Japanese.
20. Restrictions on emigration.
21. The Far Eastern Commission.
22. Uncertainties with respect to a peace treaty.

Any reply to these allegations must necessarily underline the importance of a balanced program: the Potsdam Declaration and the Initial Post Surrender Policy cut two ways; Japan is to be ensured a viable economy, but not to the exclusion of certainly badly needed reforms. It must be emphasized therefore that the recovery program does not contemplate abandonment of the reforms now under way but that it is vitally concerned with finalizing them in order that the uncertainties which presently beset business on all sides may be swept away.[3]

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11-4 CONVERSATION WITH MR. DODGE REGARDING STABILIZATION MESSAGE TO GENERAL MacARTHUR

Memorandum for the Record[4] November 11, 1948
By: George A. Lincoln, Office of the Under-secretary of the Army

1. I have discussed the Young Report and the problem of Japanese stabilization at length with Mr. Dodge.
2. He posed immediately two questions:
   a. Exactly what is the program that is required?
   b. Who and where are the individuals or organizations *capable* of carrying out the program?
3. Mr. Dodge points out that, on the basis of information available, we have no adequate foundation for giving directives as to specific items of stabilization to General MacArthur. Hence, he agrees that the approach of "intensification" is a correct approach, and probably the only sound approach available. Otherwise major errors might be made due to our lack of information.
4. Mr. Dodge was particularly impressed by items which included the following:
   a. 121% of employment, 39% of output as against 1930 and about 20% as against 1940.
   b. Manufacturing output of 41% against 1930, 34%.
   c. An increase in money supply between February 1947 and February 1948 of from 173 billion to 413 billion, represented by 107% increase in bank deposits and 104% in the note issue.
   d. 180 billion increase in government debt for the March 1948–1949 period.
   e. A possible 100% increase in the note issue in prospect.
   f. A loan increase in the banks of 90% on the deposit increase.

[3] Subsequent sections deleted. This paper runs to 32 pages, double-spaced.
[4] An attached comment reads: "Mr. Dodge notes that the figures mentioned herein should be checked before further use."

g. A 52 billion inclusion in the regular budget for subsidies.

h. Mr. Dodge noted also with concern the available information that there was a major deficit in export-import financing; i.e., apparently the counterpart GARIOA arrangements were handled in such a way that they did not even cover the exports, although these exports were only about 30% of the total imports sold or distributed in Japan.

5. Mr. Dodge points out that an economic catastrophe or a further major economic reverse could wipe out in considerable part the major gains made in the political, social and democratic fields in Japan.

6. General MacArthur in his message admits that action must be taken.

"Admitted ultimate adoption of money measures proposed will be required for stabilization." He asks the question: Why not do it now?

7. Japan's economy is now only some 35% of 1934. Germany's, on the other hand, is over 70% of 1937. Western Germany, following currency reform and other economic reform measures, has jumped economically some 40% in three months. The adverse comparison is obvious, particularly when one takes into account the relative degree of control exercised by the United States in Germany and Japan.

8. Every report seems to indicate an adverse or continuing undesirable trend of economic events.

9. The three years which have elapsed since V-J Day are an item which should arouse increasing concern when applied to the unfavorable economic situation and present trend. The passage of time adds to the difficulty of imposing corrective action—adds to the hardships of this necessary action and increases the likelihood that the responsibility will be ascribed, in the minds of the Japanese people and government, to occupation rather than to the results of their participation in aggressive war.

10. Mr. Dodge points out that nothing has been shown him indicating we have a tenable position in:

a. Defending the current economic situation and trend of economic events in Japan before other interested departments.

b. Defending the Army administration of the Japanese occupation before the Appropriations and other responsible Committees of Congress.

11. Turning to remedial action, Mr. Dodge considers that the message to General MacArthur on stabilization, as now drafted, is a sound message and is probably as far as we can go and still remain sound at the present time. He suggests that the apparently critical situation indicates more strength in presentation—this strength being rather in the broad policy discussions than in the technical discussions. Some of the thoughts of the preceding paragraphs might well be incorporated, perhaps, in Part 3 of the message from the Secretary of the Army.

12. Mr. Dodge expresses the thought that neither he nor anyone else could move with any great competence in this problem in Japan unless there were something available in the nature of a bible, setting forth pertinent data and programs in each avenue of approach to stabilization. He raises for consideration that this bible would probably be best created by a technical mission, which would require sixty-ninety days to produce a report something like the following:

a. Review of present economic and financial situation—its past and future trend.

b. Steps taken to date in field of economic and financial stabilization and their results.

c. Programs of action intended to accomplish a stabilization.

d. Effect of implementation of "c".

e. Recommendations on any changes or additions necessary to accomplish desired result.

13. It is pointed out that the Johnston Report and the Young Report are not directed toward this specific problem, and what is included in the Young Report is supplementary to the mission with which they were charged. The very fact that the Young Report, which was initially directed at the problem of general exchange rate, came to the conclusion that stabilization must come first, and hence touched heavily but not completely on this area outside of its general mission, is a reason for caution in pressing the general exchange rate before drastic preliminary action is taken to initiate stabilization.

14. We have now for consideration much more than the single message proposed to General MacArthur. Items include:

a. The element of timing. It would seem that we must show some positive progress in this business within the immediate future for reasons of the national interest external to the United States, the taxpayers' interest, and the probable interest of Congress.

b. The question of a possible technical group in the stabilization business. This probably should include experts in public finance, taxation, currency and credit, wage and prices, foreign trade, and any other necessary appropriate fields.

c. We must consider General MacArthur's request for someone to help him in instituting necessary economic and financial reforms.

d. We must consider the reports and presentation for submission to Congress which will meet the situation touched upon in part in the early paragraphs of this memorandum.

15. It seems almost essential that we get this message out to General MacArthur in a few days and that we include, either in the message or in succeeding messages, a series of questions addressed to this problem and compelling SCAP to focus continual attention on this problem.

11-5 MESSAGE CONCERNING STABILIZATION PROGRAM

Telegram No. W81014 December 11, 1948
To: SCAP
From: Department of the Army (Office of the Under-secretary)

Confidential

1. With reference to our rad 80566 and 80640, your comments made some months ago have been fully taken into account and the National Advisory Council and the National Security Council have come to the conclusion that the situation is sufficiently serious, despite progress made in recent months, so that recommendations to the Japanese government are no longer sufficient and that it must be directed to carry out this necessary program of stabilization. In consequence, the JCS is sending you an interim directive as agreed upon and concurred in by the National Security Council. This action by the National Security Council disposes of any possible inconsistency between Paragraph 6 and Paragraph 15 of NSC 13/2 and determines that national policy requires that the Japanese Government be directed to adopt and carry out an economic stabilization program.

2. In view of the very substantial amounts which this government is appropriating for economic assistance to Japan, this action is consistent with the requirements for certain very definite actions by sovereign nations in the fields of both foreign and domestic economic policy as condition of the receipt of American aid under the Economic Cooperation Act. For example Section 11 5B (2) of PL 472, 80th Congress, provides that each country receiving assistance from ECA shall take "financial and monetary measures necessary to stabilize its currency, establish or maintain a valid rate of exchange, to balance its governmental budget as soon as practicable, and generally to restore or maintain confidence in its monetary system". The fact that such conditions must be required of the Japanese by SCAP administering the occupation, rather than by the US Government dealing directly with the Japanese Government in connection with US aid, is not considered to impart an undemocratic character to the requirement. In issuing the appropriate directives to the Japanese Government you should make it clear that continuance of large scale aid to Japan by the US depends on the Japanese Government's taking those necessary steps, harsh and difficult as they may be which are designed to bring about internal economic stability, and that such a program of austerity alone can save the people of Japan from economic disaster and even greater suffering.

3. The directive being sent you properly leaves the choice of specific measures to your discretion but it is well understood here that the program will of necessity include measures which will be unpalatable and will create temporary hardships. Implementation of the stabilization program will require the issuance of specific directives to the Japanese Government and continuing close surveillance to assure prompt and vigorous implementation. It will require substantial reductions in governmental expenditures, increase in revenues, stabilization of wages and prices, rigorous control and limitation of credit, improved effectiveness in existing allocation and rationing programs, and increased production of indigenous raw materials. Removal of excess persons from payrolls of government and government enterprises and the reduction or elimination of governmental programs of low priority will be required. An increased and expanding production for export must be required, looking toward the eventual balancing of exports and required imports. The program which the Japanese Government is to be directed to enforce follows closely the stabilization program already recommended to the Japanese Government by you, together with the establishment of a single exchange rate shortly after the stabilization program has been initiated.

4. Please advise if and what additional expert assistance is required in connection with

this program.

5. The directive will be filed with the Far Eastern Commission on a classified basis. We intend to publish the directive simultaneously here and in Tokyo but wish your recommendation first as to whether publication of last sentence respecting the single exchange rate would be damaging.

Part 2. For your information the directive which you will receive from the JCS follows:

"You will direct the Japanese Government immediately to carry out a program of economic stabilization by adopting whatever measures may be required rapidly to achieve fiscal, monetary, price and wage stability in Japan and to maximize production for export.

In the development of the above program you will direct the Japanese Government to adopt measures designed to:

A. Achieve a true balance in the consolidated budget at the earliest possible date by stringent curtailing of expenditures and maximum expansion in total governmental revenues, including such new revenue measures as may be necessary and appropriate.

B. Accelerate and strengthen the program of tax collection and insure prompt, widespread and vigorous criminal prosecution of tax evaders.

C. Assure rigorous limitation of credit extension to projects contributing to economic recovery of Japan.

D. Establish an effective program to achieve wage stability.

E. Strengthen and, if necessary, expand the coverage of existing price control programs.

F. Improve the operation of foreign trade controls and tighten existing foreign exchange controls, to the extent that such measures can appropriately be delegated to Japanese Agencies.

G. Improve the effectiveness of the present allocation and rationing system, particularly to the end of maximizing exports.

H. Increase production of all essential indigenous raw material and manufactured products.

I. Improve efficiency of the food collection program.

The above plants will be developed to meet a target date for the establishment of a single general exchange rate not later than 3 months after the initiation of the stabilization program by the Japanese Government."

11-6 NINE-PART INTERIM DIRECTIVE ON STABILIZATION

Telegram No. W81058 December 11, 1948
To: SCAP (MacArthur)
From: The Department of the Army (Joint Chiefs of Staff)

Secret

The following Interim Directive of the US Government, Serial Number 96, prepared by the Department of the Army in accordance with Paragraph III, 3 of the terms of reference of the Far Eastern Commission and concurred in by the National Security Council, has been received from the Department of the Army for transmission to you for necessary action:

Interim Directive begins;

"1. You will direct the Japanese Government immediately to carry out a program of economic stabilization by adopting whatever measures may be required rapidly to achieve fiscal, monetary, price and wage stability in Japan and to maximize production for export."

"2. In the development of the above program you will direct the Japanese Government to adopt measures designed to:

a. Achieve a true balance in the consolidated budget at the earliest possible date by stringent curtailing of expenditures and maximum expansion in total Government revenues, including such new revenue measures as may be necessary and appropriate.

b. Accelerate and strengthen the program of tax collection and insure prompt, widespread and vigorous criminal prosecution of tax evaders.

c. Assure rigorous limitation of credit extension to projects contributing to economic recovery of Japan.

d. Establish an effective program to achieve wage stability.

e. Strengthen and, if necessary, expand the coverage of existing price control programs.

f. Improve the operation of foreign trade controls and tighten existing foreign exchange controls, to the extent that such measures can appropriately be delegated to Japanese agencies.

g. Improve the law effectiveness of the present allocation and rationing system, particularly to the end of maximizing exports.

h. Increase production of all essential indigenous raw material and manufactured products.

i. Improve efficiency of the food collection program."

"3. The above plans will be developed to meet a target date for the establishment of a single general exchange rate not later than 3 months after the initiation of the stabilization program by the Japanese Government."

11-7 SCAP COMMENT ON STABILIZATION DIRECTIVE

Telegram No. C66236 December 12, 1948
To: Department of the Army (For the Office of the Under-secretary)
From: SCAP

Confidential
Reurad W 81014.

1. Reference query contained in paragraph 5, no logical reason is seen for the exclusion of last sentence respecting the single exchange rate.

2. Directive calls for the imposition of economic controls probably without historical precedent. Its implementation will require reversal of the existing trend toward free enterprise under the influence of Japanese thought and initiative, and negation of many of the fundamental rights and liberties heretofore extended to labor and other segments of Japanese society pursuant to the philosophy underlying controlling allied policy. Imposed at this time when the Japanese are registering such marked and decisive strides toward their own economic rehabilitation and when the austerity of Japanese life is already reflected in an average monthly wage equivalent to less than twenty dollars United States currency and for whom a 1500 daily caloric basic ration is still an objective rather than a realization, its effect upon the local situation is impossible accurately to guage. In these circumstances success of the program will depend upon the quality of the spiritual leadership we have developed in the course of the occupation, as its implementation by forcible means is out of the question even had we available an infinitely stronger force than we now have. If the Japanese people follow us, if the workers remain at their jobs despite the freezing of their wages and sharp curtailment of the rights and liberties long extended them as inherent in a free trade union movement and they ignore the heavy communist pressure which is inevitable in such a situation, if capital and management moves with vigor and determination and enterprise, despite the controls involved, and if Japanese politicians and political parties faithfully subordinate themselves and their policies and political efforts to the stated objective and the means prescribed for its realization, we will succeed. If any of these human forces fail in their part, explosive consequences well may result, but I shall do my best. MacArthur.

11-8 CONCERNING DODGE'S APPOINTMENT AS FINANCIAL ADVISOR

Memorandum December 13, 1948
To: Mr. Cleveland Thurber, Board of Directors, The Detroit Bank
From: Joseph M. Dodge, President, The Detroit Bank

This memorandum is confidential and you are asked not to discuss its contents outside of the Board Room.

About four o'clock Friday afternoon I received a telephone call from Under Secretary of the Army, William Draper, stating that a telegram had been dispatched to me from the White House and they were standing by with a plane to pick me up at such time as I determined I wanted to use it.

About 4:15 p.m. the telegram arrived, requesting me to see Mr. Truman at 11:15 a.m. Saturday, December 11, 1948. About 4:30 p.m. Mr. Connally, the President's Secretary, telephoned me to confirm the telegram, stating that the President had some matters he wanted to discuss with me.

In the meantime we arranged a reservation on the 5:45 p.m. B & O, arriving in Washington Saturday morning, and the War Department was advised a plane would not be necessary.

At 11:15 a.m. Saturday I called on President Truman at his office. Secretary Royall and Under Secretary Draper also were there.

I was very cordially received by the President, who expressed appreciation for my coming on such short notice, but stated the reason for it was that he had a very important problem to discuss with me—namely, the economic situation in Japan and its relation to what has been happening in China.

Mr. Truman stated that the Japanese economic problem had moved to the highest level of consideration, that he had taken a personal interest in it, and was completely informed about it. He said that in the last ten days it had been thoroughly discussed by the Joint Chiefs of Staff; the National Advisory Council; and the National Security Council, of which he is Chairman. These discussions went forward both at the technical level and policy level. A course of action and policy decision was taken by the National Security Council at a meeting held on Thursday which was implemented by action of the Joint Chiefs of Staff.

All of the Government Departments were in complete accord with the program. This included himself, the State Department, the Department of Defense, the Department of the Army, the Department of the Navy, the Department of Air, the National Securities Resources Board, the Treasury Department, the Labor Department, and the Department of Commerce, all of which were represented at the Conferences by their Chiefs, except that Mr. Lovett represented Mr. Marshall.

President Truman stated he personally had approved the course of action taken and the means of implementation adopted, which involved some readjustment of the heretofore effective policy in Japan. He stated that of course the seriousness of the situation was complicated by the events in China and proceeded to amplify that. The actions taken Thursday were responsible for his request to see me on Saturday.

Further the President stated that it was the unanimous opinion of the Members of the National Security Council, without qualification or dissent of any kind, that I should be asked to assist him and General MacArthur in meeting the problem, and that he had requested me to come there so he could "personally ask me and plead with me" to do it. He said he had been informed that I knew something about the problem and the seriousness of it.

I told the President that I did know something about the problem, having spent one-half day about two weeks ago reviewing the cables and reports on the situation, and that frankly I did not like anything I had read. He said he thoroughly understood that. I said I was particularly concerned about the three year lag in effective economic control and the resulting present situation. He said he was too. I told him I thought this made the problem particularly difficult and that a reasonably prompt and effective answer to it perhaps was impossible. He agreed. I said I believed that if what I thought might be the necessary action was taken, probably there would be created internal difficulties, perhaps serious ones. Mr. Truman said that was recognized and they were prepared to meet it.

I stated that from a personal standpoint it would be extremely difficult to assume any such responsibility under circumstances where I did not personally know the Commanding General and where I was not known to him (in contrast to my experience in Germany). Mr. Truman said I should anticipate no difficulty of that kind for reasons he gave in some detail.

I told Mr. Truman this was not a one-man job and if it was to be done, considerable help would be needed of the highest technical ability, that people would have to be tapped to assume necessary responsibilities. He said they would be and that I would have the support of every Department of the Government and any necessary assistance would be made available.

Then on the personal basis I reminded him of the various services I had given with the permission of my Board of Directors and he said he knew all about them and also why he had given me the Medal, the button of which I was wearing.

I told him that in view of these services, my Board was disposed to think, and I believed justifiably so, that I had done my share. He said he could understand that and did not blame them, but after all if when the Government was in trouble and could not depend on men like myself to assist it, it was in a bad way. I said if any arrangement was possible and would be at all palatable to my associates, it would have to be on an extremely flexible time basis. In other words, not involve a long-term absence. He said that could be easily arranged.

After again emphasizing the importance of the problem and his own interest in it, and his request for me to be of assistance to him, the meeting ended.

Sunday morning Under Secretary Draper telephoned me at home and told me that after the meeting with the President, Secretary Royall had sent a personal cable to General MacArthur, a copy of which is attached.

Sunday morning also a personal cable was received by Secretary Royall from General MacArthur, a copy of which also is attached.

Because of the nature of the action taken at the highest level in Washington, and the inevitable possibility of personal complications with the SCAP Commander, this was construed as particularly favorable and encouraging, and the cable was immediately sent to the White House.

Subsequent to the White House meeting, at discussions with Secretary Royall and Mr. Tracy Voorhies, Assistant to Mr. Forrestal, again I emphasized the responsibility I had here and the certainty that I should not commit myself to a continuous protracted absence. There was no disposition to counter the point. In fact Mr. Voorhies said he thought the work could be done better if the individual did not become too involved in the local situation. There was some discussion about the possibility of Secretary Royall and Mr. Snyder going over either with me or at approximately the same time after the Inauguration on January 20.

I am presenting to you what took place so you may discuss it in my absence Tuesday. I am not pleading the case. As you know, it will involve an extension of substantial personal sacrifice, and mental and physical strain. I have no strong personal desire or ambition to undertake it and will be completely amenable to any decision you may make with regard to it.

I do not shrink from the obvious difficulties or the possibility of ultimate failure. I have been in difficult spots before. There are two favorable factors connected with the situation as it exists now. One is that almost any constructive action will be an improvement. The other is that high level policy decisions have been taken and it will be a process of assisting the implementation of these, with the appropriate support of the top Government levels where the present situation and the difficulties related to it apparently are fully recognized.

From my own standpoint an acceptance, with your approval, would be contingent on three principal factors:

1. Personal arrangements which will reduce possible complications to a minimum.
2. A clear understanding as to the time factors involved, including the right of acceptable substitution.
3. A physical examination which would remove any concern that the effort might be severely detrimental to my health, or that I have any unknown disabilities which might be aggravated by doing it.

11-9 BACKGROUND AND IMPLEMENTATION OF STABILIZATION PROGRAM

Letter December 14, 1948
To: General MacArthur
From: William H. Draper, Jr., Acting Secretary of the Army

Dear General MacArthur:

I have asked Dr. Fine to explain to you fully the background of the past two weeks' discussions here, which resulted in the exchanges of cables concerning economic stabilization. When the problem arose acutely here Dr. Fine was extremely helpful in giving to us and to the other Departments concerned background information, and particularly information concerning the improvement that has been shown during the past few months.

I am hopeful that Mr. Joseph Dodge will accept the President's request but, if for any reason he should not, I want you to know that Secretary Royall and I will personally follow the matter to get someone else as nearly equal in caliber as possible.

Secretary Royall left Saturday for a brief visit to Berlin and the other European countries in which the Army has direct or indirect responsibilities and will be back here about the end of the year. His tentative plans are to leave for Tokyo immediately after the inauguration, about January 21. If Mr. Dodge accepts, he will probably go to Tokyo with the Secretary, who hopes also to have someone in an important position with several of the interested Departments accompany him for their education as well as for whatever assistance they can give.

We have taken certain steps to expedite the procurement of items which you requested and a number of other matters have been discussed in the way of assistance to your future program, which Dr. Fine can give you in more detail.

The President has taken a very real personal interest and has assured Secretary Royall and Mr. Dodge that he will assist in the economic problems that lie ahead of you in every way

possible.

With kind regards,

Sincerely,
William H. Draper, Jr.

11-10 REPORT ON ACTIONS BY INDUSTRY DIVISION ON STABILIZATION PROGRAM STATED IN RADIO W81059

Memorandum December 17, 1948
To: Deputy Chief, ESS
From: W. S. Vaughn, Chief, Industry Division, ESS

Secret

1. Reference l. g. of subject radio. Actions taken to date by Industry Division include:

a. Reduction of period of validity of allocation tickets thereby preventing diversion of commodities to non-essential users.

b. Reduction in time of screening allocation plan resulting in the speeding up of actual allocation of commodities for industrial production. This in turn has made it possible to accelerate the delivery of commodities for export and will in the future materially increase exports.

c. Increased the volume of commodities for export production. This was accomplished by closer screening of the allocation plan and denying commodities to non-essential producers. Results of these increases are reflected in accelerated steel, cement and shipbuilding programs for export.

d. Industry Division, for the past eight months has been working on a simplification of the allocation system with a view to making the system easier to check by the Japanese Government and easier for SCAP surveillance. During this period, increased emphasis has been placed on surveillance over the operation of the existing system.

e. Industry Division is currently working on its plan with other Divisions of ESS for the simplification and control of the allocation system.

2. Reference 1.h. Industry Division, since April 1, 1948 has given closer surveillance to the Japanese Government in maximizing the production of all essential indigenous raw materials and manufactured products. This has been accomplished by closer liaison with personnel of the Japanese Government and Japanese industries responsible for this segment of the national economy; by closer liaison with other SCAP Sections and other Divisions of ESS. A review of the published industrial production index for Japan based on 1930–1934 monthly average (equaling 100) will show a steady climb from 49.8 in April 1948 to 61.5 in December of 1948. Industry Division is presently developing a procedure to assist the Japanese Government and Japanese industries in programming maximum production of: all essential indigenous raw materials; the generation of hydro-electric and thermal electric power; the manufacture of end products.

11-11 INFORMATION FOR REPLY TO STABILIZATION DIRECTIVE

Memorandum December 17, 1948
To: Deputy Chief for Operations, ESS
From: Floyd L. Whittington, Acting Chief, Price and Distribution Division, ESS

Secret

1. Substantial progress toward rehabilitation of the Japanese economy is best evidenced by the rapid gains apparent in the Japanese standard of living. The directives contained in W 81058 will strengthen SCAP in clarifying to Japanese the continuing interest of the U.S. in supporting such controls as are necessary to secure economic stabilization through economic rehabilitation. The future actions outlined below are predicated not only upon the issuance of a directive to the Japanese Government to carry on a program of economic stabilization, etc., but upon the continued maintenance of pressure necessary to force compliance, at all Japanese Government levels, with such a directive.

2. Reference 2e. All items not specifically exempted from price control remain under blanket control. The old system of continual review of prices was abandoned in 1947. Prices

generally were brought into appropriate relationships and subsequent price movements have been made in widely-spaced waves, as dictated by uncontrolled wage increases. Substantial progress has been achieved during the past year in developing uniform standards for collecting, analyzing, and submitting cost data used in the pricing of indigenous products and services. Agricultural products are priced by parity standard; all other commodities are priced through the cost-of-production method. Improved policy has resulted in ability to maintain given price levels over comparatively long periods.

a. To combat irresponsible wage demands, SCAP has recently been instrumental in the Japanese Government's promulgation of a pronouncement that no deficit financing, no subsidies, and no price increases would be permitted to enable employers to meet wage demands. This is expected to cause rationalization of export and other industries to the extent that no unmanageable unemployment problem is created. Steps are being taken to bring yen-dollar ratios for exports and imports into closer relationship, including the examination of present high charges for the preparation of merchandise for export. In event export packing and handling charges continue to greatly exceed those experienced in other countries SCAP surveillance will be imposed.

b. Radio, newspaper, and other types of campaigns are acquainting consumers with official prices and rationing procedures to decrease blackmarket patronage. These campaigns are quite specific and extensive and keep consumers apprised of the progress of the current price stabilization program.

c. Enforcement is being strengthened through careful staffing of the new Japanese Economic Investigation Board, closer relations with the procurators' offices, and clearer instructions to Japanese police agencies. This enforcement agency supervises the planning and execution of programs coordinating enforcement for all economic control agencies. Special campaigns are carried on in given commodity fields and the program is being expanded as rapidly as possible.

d. In an increasing number of cases the supply, demand, and price situation has become such that it has been possible to decontrol certain items, and it is expected that the list of such items can gradually be extended. In exceptional cases some decontrolled items may have to be recontrolled.

3. Reference 2 g. Seventy percent of representative Japanese family expenditures is for food, the remaining thirty percent being spread over such items as clothing, shelter, light and fuel, transportation, etc., each of these items comprising a small percentage of total family expenditures.

a. All major basic foods are rationed. Staple foods are purchased by the Japanese Government and distributed by a public corporation under continuous scrutiny of Military Government Teams. MG Team surveillance during the past year has greatly improved the collection and distribution of fish and vegetables. A new rationing census has been made to eliminate "ghost" population, rationing forms and accounting have been improved, and the supplementary ration administration system strengthened. Competent observers have stated that the Japanese food rationing system is probably the most comprehensive and efficient in the world.

b. Clothing and textile distribution have within the past six months been greatly improved, although supplies for general distribution are extremely limited. The major part of the textile supply is pre-empted by incentive goods programs and special allocations are made to meet the minimum needs of industrial occupational groups contributing most to the maintenance and recovery of the Japanese economy. These programs are continually refined and extended, and recent results have been highly satisfactory.

c. Rents are controlled at very low levels. A recently issued fuel regulation should have important stabilizing effects as increasing pressure is brought to bear upon prefectural officials. Firm controls are contemplated to force the issuance and acceptable administration of new soap, vehicle, tire and footwear regulations.

d. Supply, demand and price conditions have permitted distribution decontrol of matches, light bulbs, pots and pans and other minor items. Most other Japanese cost-of-living items do not lend themselves to rationing procedures.

e. The Economic Investigation Board is effecting campaigns, through the various administrative and supervisory agencies, to prevent distribution of rationed items outside authorized channels or at higher than official prices. This agency reports to other Japanese Government agencies and to SCAP weakness in distribution and price control techniques and administration and recommends specific corrective measures. Recent actions against corrupt Japanese officials are having salutary effects.

4. Reference 2i. The food collection program can be improved only in minor respects.

There is constant MG Team pressure on food collections and incentive goods offerings are important inducements to the producers to deliver. Under MG Team and SCAP field personnel supervision, collection techniques are being refined and improved.

a. A thorough re-study of farm retentions is being made with the view of developing a program to reduce the amount of excess food stocks retained on farms to a minimum. A proposed amendment to the Food Law will, if passed, provide that additional quotas may be assigned to farmers at harvest time. This is designed to eliminate the possibility that farmers will not deliver available food in excess of the quota assigned prior to planting.

b. Fishing gear is becoming more plentiful, and the increased amounts available to fishermen under the link system will tend to increase the amounts of fish flowing through legal channels at official prices. Economic Investigation Board supervision of fish collections and distribution will be maintained and improved.

5. The material contained in paragraph 4 above was furnished to this Division by NRS, which is responsible for food collections.

[SOURCE: SUITLAND PAPERS]

11-12 WAGE STABILIZATION

Memorandum December 17, 1948
To: Chief, ESS
From: Chester W. Hepler, Labor Division, ESS
Secret

1. Reference Radio from DA (Joint Chiefs of Staff) to SCAP (MacArthur) W81058 dated 11 December 1948 which directs SCAP to "direct the Japanese Government to adopt measures designed to establish an effective program to achieve wage stability" immediately.

2. In accordance with instructions from ESS, Deputy Chief, that ESS/LAB submit immediately a plan to carry out the requirements of reference radio, ESS/LAB recommends the adoption of a policy contained in Memorandum for Major General, W. F. Marquat, subject, "Economic Stabilization" dated 8 November 1948 and signed by the Chiefs of ESS/IND, ESS/LAB and ESS/PD. In implementation of this plan the Japanese Government should be directed to:

a. Revise the official prices immediately to reflect current economic conditions, including the recent raise of government workers wages.

b. Take appropriate legal steps to adopt as formal public policy, binding on all government agencies, the three principles that no employer will receive government support through increase in official prices, deficit financing, or additional subsidies in excess of available government revenue for the payment of wage increases.

3. This plan is recommended because it is the most effective method of achieving wage stability with minimum economic and political repercussions. Under current economic conditions in Japan, no significant rise in the general wage level is possible unless the government, through one of the three avenues mentioned above, participates in or approves such an increase. Gradual increases in wages would still be possible, but only through increased production, higher efficiency, lower unit costs, and consequent higher profits from which workers can obtain their fair share through the normal processes of collective bargaining. Therefore, the plan provides pressure on both labor and management to increase production. Furthermore, the plan requires no costly bureaucratic enforcement machinery.

4. Direct wage controls are not recommended at this time because they will not effectively stabilize wages, since

a. The operation of such a program by the Japanese Government, with its attendant technical complexities, is administratively impracticable.

b. The immediate effect of direct controls would be inflationary because:

(1) Maximum levels established under such a program historically tend to become prevailing or even minimum levels.

(2) A strict wage-control program inevitably becomes involved in questions of equity which necessitate consideration of minimum wages, inequalities between workers or groups of workers, and rises in cost of living, each of which tends to push the general level of wages upward.

5. Direct controls will necessitate a ban on all acts of dispute connected with demands for wage increases. Such a ban on strike activity would deal a crushing blow to the Japanese trade union movement which the occupation has encouraged and developed as a bulwark for democracy in Japan. Further, this ban would

a. Be contrary to the FEC 16 Principles which specifically guarantee the right to strike.

b. Require a degree of surveillance and enforcement which is beyond the present capacity of the Japanese Government.

c. Give ammunition to Communists in their current propaganda campaign to convince the Japanese people that the United States is pursuing a policy of imperialistic domination of the Japanese nation and complete suppression of the Japanese trade union movement.

6. ESS/LAB has available a detailed plan for direct wage control which can be submitted on short notice. Consideration of any plan for direct controls is, however, not recommended at this time.

[SOURCE: SUITLAND PAPERS, Z 703-23]

11-13 SCAP'S EXPLANATION OF STABILIZATION PROGRAM TO JAPANESE GOVERNMENT

Letter December 19, 1948[5]
To: Prime Minister Shigeru Yoshida
From: General MacArthur,

Dear Mr. Prime Minister,

I am just in receipt of an interim directive from the government of the United States forwarded to me in accordance with the terms of reference of the Far Eastern Commission. This directive establishes a series of objectives designed to achieve fiscal, monetary, price and wage stability in Japan as rapidly as possible, as well as to maximize production for export. Such objectives, which are listed as an inclosure to this letter are clear and explicit and as pointed out in the public release of the United States State and Army Departments follow an objective pattern, the general aspects of which have heretofore been communicated to the Japanese Government as a means towards the ultimate desired stability.

The directive proceeds from the premises that the prompt economic stabilization of Japan is a primary objective common both to the Allied Powers and the Japanese people; that the American people so long as called upon to underwrite existing deficits in the indigenous resources required to sustain Japanese life are entitled to the maximized industry of the Japanese people and the minimized loss incident to the maldistribution of available resources or failure vigorously to produce native raw products or curb extravagance and waste in the operation of government and industry; and that by positive Allied intervention many obstructions incident to improvidential political conflicts, unobjective labor strife and destructive ideological pressures best be avoided.

The fundamental objective of this motion, reduced to language which all may understand, is the prompt achievement of that degree of economic self-sufficiency which alone can justify and insure political freedom. For there can be no political freedom so long as a people's livelihood is dependent upon the largess of others. Nor may a people fully mobilize the collective will as an impregnable barrier against evil and destructive ideological pressures and as an irresistible force toward progressively improved living standards, if lacking in that resolute dignity which alone springs from mastery over its own deficiencies.

Necessarily, the action of the United States is tied in to the problem of relief and recovery appropriations, which may be expected in future only in ratio to progress made through the combined efforts of the Japanese people toward achievement of the states objectives. This will call for a reorientation of Japanese thought and action, with both subordinated to a primary purpose common to all or the people. It will call for increased austerity in every phase of Japanese life and for the temporary surrender of some of the privileges and immunities inherent in a free society.

There will be no place for interference by management or labor with the acceleration of production, for the burden will be shared by every segment of Japanese society. There will be no place for political conflict over the objectives to be sought as these objectives are stated with crystal clarity. Nor will there be any place for ideological opposition as the purpose to be served is common to all of the people, and any attempt to delay or frustrate its accomplish-

[5] The Nine-Point Economic Stabilization Program was released to the press on December 18 Tokyo time and simultaneously in Washington.

ment must be curbed as menacing the general welfare.

In keeping with my long established policy, insofar as is possible, I shall look to the Japanese Government and people for the vigorous and faithful fulfillment of this stabilization program have faith in their ability, however, stern the requirement and great the personal sacrifice, to achieve so worthy a national goal. The course ahead may well prove difficult but its impact upon individual life will be minimized if the burden is equalized among all of the people.

It is my earnest hope and indeed my confident expectation that all Japanese men and women will rally with vigor and determination to the challenge of this objective. If they do, Japan will evolve a pattern of progressive stability for all of strife-torn Asia to emulate. If they do not, Japan may perish.

Very sincerely,
DOUGLAS MacARTHUR

11-14 JAPANESE GOVERNMENT'S RECEIPT OF STABILIZATION PROGRAM

Letter — December 19, 1948
To: General MacArthur
From: Prime Minister Shigeru Yoshida

My dear General:

I desire to acknowledge the receipt of your letter of today's date concerning the United States Government's directive on a comprehensive program for Japan's economic recovery and stabilization, and hasten to express to you my heartfelt thanks for your earnest advice and detailed analysis of the present economic situation of Japan.

As you have pertinently pointed out in your letter under reference, speedy economic rehabilitation of my country has become a common objective both to Japan and the Allied Powers particularly the United States of America.

The objectives set forth in interim directive of the United States are those which you have hitherto repeatedly indicated to my government and I am happy to say that their importance is fully appreciated by my government.

Fully realizing that the sacrifice and determination of the Japanese people can alone solve this situation, my government determines to respond to your faith in the ability of the Japanese people in the achievement of these objectives.

Yours sincerely,
Shigeru Yoshida

11-15 STABILIZATION OF JAPANESE ECONOMY

Memorandum[6] — December 20, 1948
To: W. F. Marquat, Chief, ESS
From: Antitrust and Cartels Division, ESS

1. ESS/AC was not requested by Chief of Section to submit proposals which would contribute to stabilization of the Japanese economy. It is presumed that such request was not made because the recently announced stabilization directive made no reference to deconcentration. However, the FEC directive regarding conduct of trade with Japan does require that the development of Japanese foreign trade must be conducted in such manner as to "insure competitive conditions in trade free of contracts or arrangements which limit access to markets or foster monopolistic controls and prevent excessive concentrations of economic control in Japan and monopolies in foreign trade, whether with the participation of Japanese or foreign capital".

2. Chief, ESS/AC considers it to be of major importance to avoid the preparation of a program which would cause any interpretation to the effect that there is conflict between economic democratization and economic stabilization. Consequently, Chief, ESS/AC submits the following brief outline of a few proposals which merit consideration in preparation of an overall stabilization program:

a. *Reorganize into efficient companies the major excessive concentrations in Japan, disposing of the non-essential properties and non-essential employees.* There is little sound basis for doubt that such reorganization would result in increased efficiency of management and decreased cost of production. It is reasonably certain that reorganization of coal, fertilizer, steel, and textile companies would decrease substantially the cost of coal per ton, of fertilizer per ton, of steel per ton, and of textiles per yard. Concurrently, a significant portion of the credit (new money) pumped into companies does not go to the production of any exports or other essential uses. Hence the financial condition of companies is impaired and the increased cost goes as an inflationary factor in raising the prices of products produced. Few things are more impractical and theoretical than acceptance of the oft-repeated dogma that big companies are more efficient than smaller companies.

b. *Require the dissolution of the major portion of the trade associations in Japan or limit to one or two associations the number of such organizations to which any one company may belong.* The dues paid to associations, many of which perform no useful functions, is a substantial factor in the cost of production of essential commodities. Concurrently many Japanese companies pay dues to 25–50 different associations.

[SOURCE: SUITLAND PAPERS, Z 703–17]

[6] The copy of this memorandum printed here does not appear to be complete.

11-16 HEPLER'S MEMO ON WAGE STABILIZATION

Memorandum — January 8, 1949
To: Chief, ESS
From: Chester W. Hepler, Chief, Labor Division
Confidential

In accordance with your request, I am attaching herewith a program to achieve wage stability under the nine-point stabilization program.

[ANNEX]
PROGRAM TO ACHIEVE WAGE STABILITY

1. The Japanese Government will take legal steps as formal policy, binding on all government agencies, the "three principles" that no employer will receive increases in official prices, deficit financing, or additional subsidies in excess of available government revenue for the payment of wage increases.

2. Legalization will be accomplished by the inclusion in all appropriation bills (except subsidy bills covered by available revenue of the following rider. "No part of any appropriations contained in this Act shall be used for subsidizing industries in order to provide wage increases, loans to cover deficits occasioned by wage increases, or salaries to government officials who, as part of their functions, grant increases in official prices for the purpose of increasing wages.")

3. Of six million organized workers in Japan, wages of three million (government and Occupation force workers) are directly controlled. For the other three million, no significant increase in the general wage level is possible under present economic conditions unless the government approves such increase. Legislation covering the "three principles" plus direct ESS surveillance would prevent such approval. Gradual increases in wages would be possible, only through increased production, higher efficiency, lower unit costs, and higher profits from which workers can obtain their fair share through collective bargaining. In case of disputes in key industries, continued ESS/LAB liaison with labor, management and labor relations committees would ensure that collective bargaining is carried on equitably within the framework of the "three principles."

4. If, after a reasonable period of time, the "three principles" fail to achieve wage stability, the following program of direct wage controls for all workers could be instituted:

a. Freeze all wages as of a given date pending establishment of criteria for permissible wage increases and necessary administrative and enforcement machinery.

b. *Criteria:*

(1) Enterprises will be permitted, without prior approval, to grant increases up to the industry-area average.

(2) Increases above the industry-area average will be permitted if approved in advance by the administrative agency on the basis of sound criteria.

(3) All enterprises will be required to increase individual wages to a statutory minimum wage established under provisions of the Labor Standards Law.

(4) In case of substantial increases in cost of living, the administrative agency will be empowered to establish criteria for the maintenance of real wages.

c. *Administrative Machinery:*

(1) A National Wage Stabilization Board will be created with full legal powers to establish criteria, act on applications for wage increases, order wage adjustments, make necessary inspections, and ensure compliance with wage regulations through enforcement of penalty provisions.

(2) Members of the Board will consist of representatives of Finance Ministry, Labor Ministry, Commerce and Industry Ministry, and ESS with a chairman appointed by the Prime Minister.

(3) The Board will establish regional or prefectural boards.

(4) Adequate professional, technical, and clerical staff will be provided to carry out the Board's responsibilities.

[SOURCE: SUITLAND PAPERS, Z 703-20]

11-17 PLANS OF THE PRICE AND DISTRIBUTION DIVISION FOR IMPLEMENTATION OF NINE-POINT PROGRAM

Memorandum January 8, 1949
To: Chief, ESS
From: Floyd I. Whittington, Acting Chief, Price and Distribution Division, ESS

1. The nine-point economic stabilization program set forth in 2a through 2i of the subject radio constitutes an interim directive from the United States Government to SCAP to require the Japanese Government to put into effect an economic stabilization program that will make possible the early establishment of a single general exchange rate. The implementing of 2e, 2g, and 2i are for the most part the responsibility of ESS/PD. Allocation as referred to in 2g is a responsibility of the Industry Division. Improving the efficiency of the food collection program referred to in 2i is a primary responsibility of the NRS. The Food Branch of ESS/PD maintains liaison with the Agricultural Division of NRS, thereby representing ESS's interests in the food collection program. ESS/PD submits with this memorandum joint plans for the implementation of 2i. Prior to a review of the program submitted by other ESS divisions co-responsible for the implementation of this program, the inclosed proposals are based on the assumption that each of the nine principles will be inflexibly administered. ESS/PD is aware that after all divisional programs have been coordinated additions to or deletions from the proposals contained herein may be necessary.

[ENCLOSURE]

Reference paragraph 2e. The methods of strengthening and expanding the coverage of existing price controls specified in 2e have been dependent upon the establishment of specific single exchange rate policies. As a result of discussions between representatives of the various ESS divisions, the Special Assistant to the Chief of ESS, and an ESS director, determinations have been made that a general price revision can be avoided despite the establishment of a single rate of exchange. The desirability of maintaining the present price level at the time a single rate of exchange is established cannot be overemphasized. The principles and methods to be used in holding the general price level despite the impact of the initiation of a single rate of exchange and the substantial wage advances made since the last general price revision in June-July 1948 are as follows:

a. *Imports:* Projected dollar volume of imports as against projected volume of exports is $950 million and $500 million, respectively. If the same rate of exchange is applied equally to both groups, sales of imports in yen will yield almost twice as much as the yen cost of acquisition of exports. However, a single rate of exchange is being imposed at a time of domestic inflation and distortion of production, wages, and prices and considerable discrepancy between import and export ratios. Serious stimulation of inflation would result in unqualified imposition of a single exchange rate. It is therefore being proposed to subsidize, out of yen proceeds of imports, two groups of imports: (1) cost of living items (foods, fertilizers, and cotton) and (2) important industrial materials.

b. *Domestic prices:* The chief internal threat to the price structure arises from (1) the impact of increased costs arising from the imposition of the single rate of exchange, (2) wage increases, and (3) changes in indigenous subsidy policies. The first was discussed in the preceding paragraph.

(1) *Wages:* Recent wage disputes, especially those among the electrical, coal, textile, metal mining, and railway industries have threatened the price structure despite the public announcement of the "three principles." It is now felt that after 1 March 1949, increased production of coal to the new projected level of 42 million (or more) tons will enable the operators to meet all current wage commitments, even after the current 2.4 billion wage subsidy is withdrawn. Electrical industry information indicates the companies to be in a more profitable position than previously indicated; consequently, the current 880-million yen wage subsidy, to be withdrawn at the end of the 1948 fiscal year, can be compensated for (a) through company earnings, or, if necessary, (b) through price increases to the general (but not industrial) consumer. The setting of the exchange rate will automatically improve—to a greater extent than necessary—the financial ability of cotton and most other textiles to pay increased wages since the exchange rate applied on most of the current textile processing charges are lower than any contemplated single exchange rate.

(2) *It must be assumed, at this point, that wage stabilization is to occur and, except as otherwise noted, that production increases are to compensate for (a) such wage deficits as are now occurring, (b) future wage increases, and (c) additional income from which to meet (a′) decreases in unit subsidies, (b′) capital expenditure commitments, and (c′) entrepreneural returns.*

c. *Miscellaneous price increases:* Of the estimated 54–56 billion yen JGR deficit to occur in FY 1949, approximately 24 billion is said to arise from wage increases. Instead of carrying this deficit into the budget, a passenger rate increase of from 125% to 140% is felt to be advisable. This will return sufficient revenue to cover the deficit. The alternatives are (1) freight revision of some 250%, or (2) a freight and passenger rate increase approximating 85%, both of which will require a general price revision, the "chain reactions" of which will in turn greatly increase the magnitude of the increase required to eliminate the deficit. Preliminary estimates indicate that this, together with communications increases, may result in about a 2.3% increase in the CPI.

(1) Communications anticipated deficit for FY 1949 is placed at 14.2 billion yen by the Finance Division. A price increase of approximately 30% is estimated as being required to eliminate this deficit.

(2) Initiation of the single rate of exchange will require a considerable number of price revisions in primary and secondary commodities in which unsubsidized imports form a part of the cost of production. Under the policy generally agreed upon, however, this group of commodities will be comprised of those which will have but minor effects on costs of living or on the general price level.

d. *Indigenous subsidies:* It was originally contemplated that present unit subsidies would be continued for the stabilization band of items at a cost, based on projected production figures, of approximately 118 billion yen. In accordance with studies of other divisions, especially Industry Division, however, it is now believed that as a result of increased production, the indigenous stabilization band subsidy can be reduced to 100 billion yen, again assuming stabilization of cost components.

(1) Projected subsidy requirements, based on the best judgment of the representatives of the interested divisions and representatives of the Chief, ESS, indicate the following conclusions as to "Stabilization" band subsidy requirements and distribution:

	Billions of Yen
Pig Iron & Steel	50
Copper	4
Fertilizers	18
Soda Industry (Soda Ash & Caustic Soda)	1.5
Coal to special industries	26.5
Total Projected Stabilization Band	100.0 Billion

(2) Additional indigenous subsidy requirements to be used in stabilizing the economy are expected to total 16 billion yen, of which 11 billion yen will cover the CMMC deficit, and 5 billion yen for miscellaneous subsidies, such as transportation of fish and vegetables. Inasmuch as removal of CMMC subsidies would affect shipping costs, and since water transportation is already disproportionately high, it is not considered advisable to raise water transport rates.

e. *Additional measures to maintain price stability:* In order further to mitigate the impact of the establishing of a single rate of exchange and the potentially dangerous effect of introducing world market prices into the Japanese domestic economy where indigenous prices based on cost of production and world market prices substantially differ, consideration is being given to the development of the following pricing policies:

(1) Where world market price is higher, to retain cost of production producer prices and effectuate a single pooled consumer price (i.e., in the case of lead, the producer price is ¥80,810 per metric ton, and the world market price, based on a 300 to 1 rate, is ¥142,500 per metric ton. To adopt the world market price would, in effect, be an abandonment of price control over the commodity based on costs of production, and would result in large windfalls to the domestic producer and undermine stabilization policies by enabling such producers to have a great competitive advantage in profits from which to make capital expansion, pay disproportionate wages, etc. Moreover, the effect of a precipitate increase of price of this nature is, in itself, inflationary).

(2) Where the world market price is lower than the indigenous cost of production price. In some cases where indigenous production is insignificant and no adverse economic effects will occur if the world market price is adopted, no action would be necessary. However, in many cases (i.e., petroleum), it will be dangerous to establish the world market price as the official price since such action will tend to discourage indigenous production. On the other hand, it will be inflationary to raise the world market price to the indigenous level. A preferable method, in selected industries, will probably be to effectuate a price pooling arrangement. This will enable domestic producers to continue to cover their costs of production and at the same time the consumer will benefit by the effect of lower world market prices. A continuation of studies on problems inherent in the establishing of a single rate of exchange is continuing together with possibilities for appropriate pricing policies. Not all problems can now be foreseen.

(3) A constant evaluation of world market vs. indigenous prices will be undertaken. In some cases, world market prices will have a deflationary effect and an evaluation and testing of the validity of cost-of-production pricing will be necessary. As rapidly as feasible, world market prices will replace domestic prices.

(4) The Price and Distribution Division has followed a policy of decontrolling prices under specific criteria which will not result in such actions having an inflationary effect. These criteria require that supply and demand be balanced, that the commodity is not essential to daily living or important industrial production and where control is administratively infeasible. Such policies will be continued. However, a constant review of decontrolled prices will be maintained and re-control instituted where necessary.

(5) In some instances, where pressures against the price structure or against the general program to reduce subsidy becomes great and can be relieved through a program of rationalization, Price and Distribution Division will refer such problems to the Industry and Labor Divisions for such action as required by 2-G of subject radio.

Reference paragraph 2g. It is considered that the Nine-Point Program will not necessitate any policy changes with respect to the administration of food rationing. However, there are certain aspects of the food program which will be improved substantially because of the anticipated increased cooperation of the Japanese Government. Most attention is given to the distribution of scarce items to those workers who contribute most to the maintenance and advancement of the economy of Japan and to certain groups who require minimum amounts of textiles to prevent disease and unrest. The entire enforcement program will receive its greatest stimulus from the support that the Nine-Point Program gives to rigid enforcement of strengthened and expanded controls. Now an improvement in the enforcement of economic laws can be achieved by completing recruitment for the Economic Investigation Board and increasing the staff of the Procurators' offices and courts. Implementing programs which are currently operating or planned are as follows:

a. The census of ration population completed in August 1948 revealed a ghost population—that is, the padding of ration lists with non-existent people—of about two million. A related problem is that of misclassification of self-suppliers as partial self-suppliers, and partial self-suppliers as non-self-suppliers. While this problem is more difficult of eradication because it involves crop estimates and surveys of small plots of land owned by non-farmers, a great deal can be accomplished in this area. A program involving a coordinated drive by the Government and MG is presently being prepared to attack these problems.

b. The political party now in power had as one of the planks of its platform the abolition of fish and vegetable rationing. Although SCAP has insisted on the continuation of the rationing of perishable foods, the effectiveness of the rationing systems has inevitably suffered. The Nine-Point Program will result in the cooperation necessary to pull the fish and vegetable rationing systems up to, and possibly surpass, their former effectiveness.

c. Marked improvement in the Japanese administration of the textile distribution regulation has been made during the past year. The bulk of available textile goods has been distributed under incentive programs for rice, potato, summer grain and vegetable farmers and

for fishermen, coal miners and charcoal and firewood producers. Other necessary items have been distributed to such essential occupational groups as iron and steel workers, fertilizer workers, metal miners and transportation workers. This type of distribution program will be continued and improved. Problems of incentive goods supply will be complicated by the near-exhaustion of supplies of United States Army surplus items which have gone to these programs during Japanese fiscal year 1948.

d. The coal miner incentive goods program is to be revised in order to tie reward more closely to actual tonnage produced.

e. A recent charcoal and firewood collection and distribution regulation has just come into operation and it is obviously necessary to guide and supervise Japanese administration of this regulation until such time as operation can be reduced to routine.

f. Pressure is being exerted for the promulgation of a soap regulation which is already in final form, and this also will involve detailed supervision.

g. A program is under way for closer accounting of domestic textile output in relation to input. It is expected that this system will make available more textiles of the type needed for distribution to the general population. The intent is to make the most of the limited amounts of goods available, supplying first the needs of those occupational groups who are indispensable to the advancement of the domestic economy and export program.

h. Programs designed to attack blackmarketing at the retail level and to implement the rent control program are now under preparation.

i. It should now be possible for the Economic Investigation Board to execute administrative inspection over the ministries and other agencies responsible for the administration of economic controls. After an intensified period of investigation continued surveillance on a routine basis should be maintained.

j. Enforcement is being strengthened through careful staffing of the Japanese Economic Investigation Board, closer relations with the procurators' offices, and clearer instructions to Japanese police agencies.

k. The Economic Investigation Board is affecting campaigns, through the various administrative and supervisory agencies, to prevent distribution of rationed items outside authorized channels or at higher than official prices.

Reference paragraph 2i. Actions taken or anticipated by ESS/PD and NRS to improve the efficiency of the food collection program are as follows:

a. SCAPIN 6257A was issued on 24 December 1948, requiring the Japanese Government to amend necessary laws to provide for revision of preplanting quotas upward at harvest time when harvest conditions permit. This SCAPIN also requires that the Japanese Government continue to provide an incentive for farmers to maximize food production.

b. The Statistics Branch, Agriculture Division, NRS, has been strengthened by the addition of a specialized crop reporting statistician. Every effort is being made to strengthen the crop reporting service of the Ministry of Agriculture and Forestry in order that accurate crop estimates may be obtained and quotas assigned at the highest practicable level.

c. The incentive goods and distribution systems have been strengthened by closer collaboration with food collection officials and Military Government teams.

d. Although the responsibility of food collections rests with NRS, ESS/PD has always worked closely with NRS with respect to this problem. A campaign to achieve specific over-quota goals for the 1948 crops is now being worked out with NRS and will shortly result in a collection drive.

e. The collection of indigenous oils has always been difficult because of a multitude of small producers of oil bearing seeds and fish oil. The high cost of imported oil, however, requires that every possible effort be made to maximize the collections of these oils for rationing purposes. A campaign to increase substantially collections of oil is presently in progress.

f. Vigorously enforced control over the transportation and sale of staple foods will be of material aid to the food collection program. Agreement has now been reached between ESS/PD and the Legal Section on procedures designed to expedite confiscation of illegally transported staple foods.

[SOURCE: SUITLAND PAPERS, Z 703–20]

11-18 PROGRESS REPORT ON ACCOMPLISHMENT OF NINE-POINT STABILIZATION PLAN

Memorandum February 9, 1949
To: Chief, ESS
From: Walter K. LeCount, Chief, Finance Division, ESS

In accordance with your request, we submit herewith progress to date on implementation of the nine-point stabilization plan:

Point #1. ACHIEVE A TRUE BALANCE IN THE CONSOLIDATED BUDGET AT THE EARLIEST POSSIBLE DATE BY STRINGENT CURTAILING OF EXPENDITURES AND MAXIMUM EXPANSION IN TOTAL GOVERNMENT REVENUES, INCLUDING SUCH NEW REVENUE MEASURES AS MAY BE NECESSARY AND APPROPRIATE.

Since no budget has as yet been formulated since the release of the nine-point stabilization program, no specific progress can be reported at this time.

Discussions are under way with the Ministry of Finance, with Price and Distribution Division and Dr. Stephan looking toward the full implementation of the first of the nine-points in the imminent budget for the 1949–50 fiscal year.

Point #3. ASSURE RIGOROUS LIMITATION OF CREDIT EXTENSION TO PROJECTS CONTRIBUTING TO ECONOMIC RECOVERY IN JAPAN.

The Bank of Japan bank loan policy has been tightened further by adjustment of the graduated bank rate system so as to reduce greatly the spread between the rediscount rate and banks' loan rates as loans from the Bank of Japan increase relative to deposits.

Loan priority schedules approved on 4 January 1949 have been put into effect. Adjustments made took into consideration production programs and materials supplies. Particular consideration was given the following:

a. Export industries.
b. Essential industries (coal, fertilizer, etc.) and those closely related to them.
c. Industries which make best use of imported materials.
d. Industries producing daily necessities.

The Reconversion Finance Bank January-March (Fourth Quarter) Program was reduced after review by 1.6 billion yen due to disapproval of that amount programmed for increase of loans by RFB to the Solid Fuels Distribution Kodan, price adjustment Kodan and Grocery Distribution Kodan. The final program provides for use of an outside amount of 22.3 billion yen out of 25.3 billion available, but this was approved subject to review of actual loan requests on a ten-day basis throughout the quarter and those will be met only when necessity is demonstrated.

Discussions are in progress with the Japanese to determine the least inflationary method of raising RFB funds after 31 March 1949.

Point #6. IMPROVE THE OPERATION OF FOREIGN TRADE CONTROLS AND TIGHTEN EXISTING FOREIGN EXCHANGE CONTROLS, TO THE EXTENT THAT SUCH MEASURES CAN APPROPRIATELY BE DELEGATED TO JAPANESE AGENCIES.

SCAPIN 1968 issued 2 February 1949 directing the establishment of a Foreign Exchange Control Board which, under SCAP supervision, will improve foreign trade controls and tighten existing foreign exchange controls.

It is believed that the Board or at least the chairman will be selected by the Japanese Government on or before 14 February 1949.

The Board should have completed its coordination work, promulgated its regulations, cause to have amended the Foreign Exchange Control Law and be reasonably effectively operative by 30 April 1949 and in full effective operation by 31 July 1949.

[SOURCE: SUITLAND PAPERS, Z 703–20]

11-19 JAPANESE BUDGET 1945–49

Memorandum February 9, 1949
By: Joseph M. Dodge

Notes on a conference by Dodge, Reid, O'Leary, Diehl and Stephan—with LeCount, Reed, Brower, Allison, MacGlauflin and Hutchinson—9 to 12 AM, Saturday, February 5, 1949.

BUDGET HISTORY

FY 1945–46—Budget limited to 2 billion yen a month.

FY 1946–47—Originally submitted a 12 billion yen budget, with a later budget to be submitted. Were told to include necessary items. In April the amount was 30 billion yen, in June 56 billion yen, which was balanced with proceeds of capital levy tax. The final budget was 119 billion yen.

FY 1947–48—The original budget was 110 billion yen. This was recalculated on the basis of price increases to 235 billion yen. The final estimate was 212 billion yen. It ended with a total of 214.25 billion yen.

FY 1948–49—The budget estimate was 414 billion yen. However, the wage and price levels were inconsistent with each other, and the subsidies authorized and provided for. Prices were increased 70% (which turned out to be an actual approximate 92%) and should have been 125%. There was one supplemental budget to cover a 6300 yen wage level and deficits originating from the original budget.

In connection with this wage level, the Japanese Ministry of Finance proposed 5300 yen a month against a demand for 7500 yen and that it be effective November 1st, 1948. SCAP staff is reported to have prevailed at the 6300 yen rate, effective December 1st, 1948.

It is to be noted that this increase from the Japanese Government proposal of 5300 to 6300 a month was apparently stimulated by the SCAP organization and went into effect ten days before the Stabilization Directive was issued. It will have a notable effect on the 1949–50 budget inasmuch as this affects 3,000,000 government employees. It becomes particularly significant as a base to which the wage of electrical, coal and other workers will be related. It also controls price and subsidy demands.

The end budget was 473 billion yen, for the General Account (only), which it is reported will be balanced and may produce cash surplus as a result of a tax drive.

PREPARATION OF THE BUDGET

The Ministry of Finance calls for estimates in September for submission in October. The budget is submitted to the Diet at its normal session in December.

When the Budget Bureau completes its review, it recommends the budget to the Military Government. The Military Government is now looking at the preliminary requests of the Ministries for the current budget (as of 2/4/49).

The budget is tentative until approved by the Cabinet. The essential responsibility rests with the Ministry of Finance. The personnel of the Ministry of Finance of the professional grade, numbering about 110 to 250 out of a total of 700, is considered able but the agency is too small to handle the problems. While there is reasonably good top level staff, it is subject to many and varied political pressures and often strains at gnats and lets the elephants go by.

The Ministries submitting the budget to the Ministry of Finance apparently assume little responsibility except to assemble programs and maximum estimates. The figures are not reliable nor accurate, the real meaning of the figures is often obscured, and the information supporting the figures sketchy. The result is a mere rough compilation. There are apparently no budget officers in the individual ministries.

Apparently the budget is not used in any way as an instrument of administration or control or as a tool of financial management, and there is no machinery for administration of the final budget. It is difficult or impossible to relate the new budget to accomplishments under the old budget and determine over-expended or under-expended amounts. It is difficult to get policy decisions reflected realistically into the budget. There is a tendency to evade the revenue problem and to attempt to base budget figures on existing or past circumstances without taking the future into account. There is no form of obligation control and record. The basic record is the actual payment.

There is little understanding of what is actually meant by a balanced budget—no realistic version.

SCAP RELATIONSHIP WITH THE JAPANESE BUDGET

Japanese budgets require the final approval of the Supreme Commander and in this respect SCAP holds the veto power.

Internally there is evidence of a lack of coordination of policies and programs as they may affect the Japanese budget. SCAP programs get under way without any measurement of their

financial implications, or perhaps go ahead irrespective of the financial implications. There is a tendency to be unaware or to fail to give conscious consideration to the financial results of proposed actions in making final decisions. There is no procedure for raising these questions specifically with respect to each proposal and all proposals.

An effective stabilization requires relating all policy decisions to the budget as an instrument of financial policy.

This suggests strengthening the budget control and interpretation of inflationary items and factors, ensuring a realistic approach.

While the Japanese budgets are essentially Japanese and not SCAP budgets from the standpoint of their official origination, nevertheless there is a certain amount of cross firing between SCAP staff sections and comparable Japanese Government sections in the preparation and development of projects to be included in the budget. This goes on at the lower level. The result is financial management from the lower rather than the higher level.

REPORTING ON THE BUDGET

It is suggested that the report on the budget include the following subjects:

1. A summary of the budget history since 1945 which will include the original budget estimates, the additional supplemental budgets, the deficits, and how covered—by borrowings, currency increases and private debt.
2. Ministerial processes of budget creation.
3. The SCAP processes of budget control and review.
4. The administration of the budget. The determination and disposition of over or under-expenditures, the accuracy of the accounting and the relation to the new budget.

In connection with this, it might also be well to tabulate the pay level increases of Government workers since 1945 and the effect on the budget of these increases.

11-20 JAPANESE GOVERNMENT BUDGET, 1949–50 FISCAL YEAR

Informal Memorandum — February 17, 1949
To: Minister of Finance, Ikeda
From: W. F. Marquat, Chief, ESS

1. As you know the formulation and execution of the Japanese Government budget for the coming fiscal year is of critical importance to the successful implementation of the 9-point economic stabilization program. The Economic and Scientific Section is therefore developing general principles to be followed in preparation and execution of that budget. These principles will be notified to you from time to time as they are formulated. The basic principle which will underline the entire strategy policy is that there must be attained and maintained a true balance in the total consolidated budget including both the general account and all special accounts. Such a balancing of the budget is considered to mean the equating of all expenditures of the Japanese Government, including expenditures for capital construction, inventory financing, and credit extension with all revenue of the Japanese Government including the accumulation of reserves in insurance and other accounts so that at the worst there may be no net increase in the government debt and, to the extent possible, to permit a net reduction in the government debt over that outstanding at the beginning of the fiscal year. It is also necessary that such a budget cover entire activities, including both administrative and operational activities, of all kodans, special funds, government corporations, and the Reconstruction Finance Bank. In addition such a budget must provide for all subsidies actually contemplated to be made in effect and is not to be adopted on a basis of providing for actual subsidies in the form of deficit loans from the Reconstruction Finance Bank, unrealistic pricing of imports and exports, or in similar indirect forms.

2. The achievement of such a budget will require the most rigorous economy in all government programs and will require the limiting of government activity to the minimum necessary to the maintainence of essential government services and to the accomplishment of the purpose of the occupation.

3. As well as being balanced, the budget adopted must represent a financial plan for the entire fiscal year. As such it must provide for the full cost of all foreseeable operations to be carried on or contingencies likely to arise during the fiscal year and is not to be based on the assumption that there will be later supplemental budgets.

4. Insofar as the revenue side of the budget is concerned, it is apparent that the present financial condition of the Japanese Government and the present economic condition of Japan, dependent as it is on a large volume of American aid, is such that no substantial change in the tax structure likely to result in any significant net reduction in tax revenues to the government or reduction in the tax burden of the Japanese people over that which would result during the next year under existing tax laws can be contemplated.

5. In formulating the budget for review by this Headquarters, it is essential that the Finance Division be furnished all information and supporting data which it considers necessary for this review.

6. After formulation and adoption of the budget must be executed in accordance with a plan of obligation and expenditures prepared in advance of the issuing of obligations and approved by ESS. Similarly, it will be necessary to install budgetary control procedures adequate to insure the execution of the budget in accordance with that plan and in accordance with the budget. Representatives of ESS will be available to assist you in the development and installation of such plans and procedures.

[SOURCE: *Eibun Sengō Shiryo*, vol. 15, ECONOMIC PLANNING AGENCY]

11-21 JAPANESE GOVERNMENT BUDGET

Memorandum — March 4, 1949
Summary of Meeting[7] with Finance Minister Ikeda
By: J. M. Dodge

1. Mr. Ikeda opened the meeting by stating that there would have to be some delay in the introduction of the budget from the originally scheduled date of March 10th, that many changes will be necessary in it and time will be required to pre-educate the various members of the Diet before its introduction.

2. He then referred again to the Transactions Tax and we re-stated our position about it in these terms:

a. There are so many unclear answers to problems of prices, wages, subsidies and capital rehabilitation projects that we believed this revenue was necessary.

b. To give up this established tax and attempt to impose new taxes and create new sources of revenue would add an unnecessary complication to the present tax collection process.

c. The sales tax was particularly appropriate to control consumption in an economy in which prices were rising.

d. If the problem arose from its abuses, the abuses should be corrected rather than the law repealed.

e. These tax records were a basis of income tax assessment and the abolition of the tax could easily reduce that revenue.

Mr. Dodge stated that he was willing to assume the responsibility of making a public statement that this tax should not be repealed if that would be of assistance in meeting the political problem and would be agreeable to General MacArthur. Mr. Ikeda said he would like to discuss the matter with the Prime Minister before any such statement was made which was agreed to with the clarification that the views of the Prime Minister would not necessarily cause any change in our opinion about the advisability of continuing the tax.

Mr. Ikeda went on to explain his views of the Transactions Tax. He said it was not a bad tax in theory but was an appropriate one. In FY 48 the receipts were 21 billion and are estimated at 51 billion by FY 49. The collections for the four months ending January 31, 1949 were 11 billion. Any transaction over 50 yen requires tax revenue stamps and below that a record and declaration. The burden of the records on the sales and stamps falls on the large number of small business enterprises. One department store is said to employ more than 30 extra people for tax recording purposes. The self-assessment is not working with the result there must be arbitrary assessments which take effect in forced sales of tax stamps by the collectors to the merchants. Most taxpayers are completely willing to pay a tax which is the equivalent of 1% but seriously object to the use of this measure of volume in the collection of income tax. The process resolves itself into a false collection of income tax based on a false and forced sale of stamps. The tax increased the number of tax officials by 7,000 and it costs 2 billion annually to collect. The tax is used by the Communists to build up complaints against the government. It is certainly a good tax to use in an inflationary period but it got off to such a poor start that it is impossible to change the public attitude toward it. There are 3,100,000 payers of the

[7] Held March 3 from 1400 to 1645

Transactions Tax.

Mr. Ikeda proposed to substitute a producers tax which would limit the number of taxpayers to about 450,000. This would involve less in collection charges and provide easier enforcement because these are sources accustomed to keeping adequate records. The 51 billion in revenue estimated for FY 49 could only be collected by forced sale of stamps.

He was asked why wholesale businesses were not included, and he seemed to believe they could and should be.

He said he would rather give up the income tax reduction (a loss of revenue which he estimated at 40–42 billion) than continue the Transactions Tax. He said the proposed new Financial Transactions Tax was not a good tax but it was an economical one to collect on money transactions. His real objective was to repeal the Transactions Tax by name, substitute other taxes which would have a similar effect, reduce the cost of collection and limit the sources of collection. He said that in prewar days the flow of goods through various channels was known and it was easier to assess and collect such a tax as this but since the war the established pattern had been completely disorganized, the tax collectors were mostly repatriates without experience, knowledge and quality and were not competent to enforce the tax equitably. He believed that to maintain this tax would destroy a large measure of the belief in democratic representation inasmuch as this had been a major issue in the recent elections.

We re-stated our belief that the tax should be retained because it was a basic requirement not only for revenue but to meet the type of problem existing here. Also, that if the administration of the tax was the principal cause of complaint that this perhaps could be met by appropriate reduction in the amount of estimated revenue and an improvement in the allocation and assessment of the tax. This combination should substantially eliminate the most serious complaints. While it is always advisable to eliminate inequities it is even more desirable to have revenues under present conditions. The revenues should come first. The real reason for the arbitrary assessments had been given as the general attempt to evade the payment of the tax which raised the question as to whether the inequity was on the part of the taxpayer or the tax collector.

3. The Railroad Special Account was the next subject. Mr. Ikeda reported that there was an estimated deficit for FY 49 of 52 billion. This he intended to offset by a 32 billion increase in the freight rate (100–110%) and 20 billion of savings in operations. He stated that the railroads would require 20 billion of additional investment for construction which could be provided from the surplus in other government accounts and loans from the city banks or the government Deposit Bureau, which would be from savings deposits. No deficit financing was contemplated. The original request for new investment was 34 or 35 billion. He said the increased freight rate would have to be put into effect April 1st. so an early decision was necessary to provide for the mechanical problem of introducing the new rate.

He said that prewar the freight rate was 11% or 12% of cost and now only about 4% which justified the increase.

We asked why passenger rates were not increased to reduce unnecessary travel and operating losses in the railroad system, and pointed out that the increased freight rates would have some effect on the parity index and prices. The passenger trip service is reported as profitable but the commuter service loss is about 40¢ on the dollar.

Mr. Ikeda said that the loss on the commuter service was taken deliberately so as to help meet postwar living conditions where so many people could not live near their work. On the parity price question he said that the staple foods price could be maintained but that coal and some other prices might have a slight increase. He said that for 1950 and 1951 they could reduce the railroad personnel about 100,000 and save 10 billion annually.

We said we still believed an increase in passenger rates was in order under present conditions particularly as we doubted the cost accounting which threw the whole load of the loss on freight traffic and showed passenger traffic as profitable. It was too easy to do.

4. The next subject was the communications system. Mr. Ikeda said they proposed to increase the charges on envelope mail 50%, on telephone 20%, on telegraph 30% and that the increased rate, if any, on postcard mail had not yet been determined. (He said the telephone and telegraph system was creating a surplus and the postal system a deficit.)

He said the communications system had asked for 43 billion for construction which had been cut to 10 billion. This was for telephone installations and restoration and not extension of existing facilities. He believed part of the 10 billion could be financed by the city banks.

In FY 1948 the railroads borrowed 22 billion and received a 30 billion subsidy. In FY 1949 it was proposed that the railroads borrow 20 billion with no subsidy. In FY 1948 the communications system borrowed 14 billion and had a 6½ billion subsidy. In FY 1949 it was proposed that it borrow 10 billion with no subsidy. In both cases the proposal was that there would be no subsidies and as much as possible of the borrowing should come from savings accumulations.

5. The next question was the financing of the prefectures.

It was pointed out to Mr. Ikeda that if the proposals to borrow for the railroads and communications systems were to use up the savings funds of the government depository and other sources and were accepted it would leave only limited resources for municipal loans.

Mr. Ikeda stated that he proposed that the loans for the railroads and the communications system come from pension funds and insurance accumulations, rather than other accumulated savings.

He said that the net savings increase from April 1948 to March 1949 was 28 billion excluding the increase in insurance accounts and pension funds, the latter increasing 6 billion. He believed the latter increase would far exceed 10 billion in FY 49 because the government was intending to elevate the insurance per policy from 20,000—30,000 to 50,000. He said the Deposit Bureau was now investing 24 billion in local bonds for FY 48. He proposed that local bonds be subscribed to by the Deposit Bureau within the limit of the funds available less insurance and other funds used by the railroads and communications system.

He stated that the net increase in FY 48 of all savings and deposit accumulations was 370 billion exclusive of government and inter-bank deposits. The comparable increase in FY 49, or perhaps decrease, would depend upon the financial policy of the government. Of an issue of 250 billion of government bonds 65% was held by financial institutions, 25% by the Deposit Bureau and 10% by private holders and institutions.

6. Referring to the last meeting reported in a previous memorandum Mr. Ikeda said that he completely agreed with the principle of eliminating hidden subsidies and particularly with those connected with the export and import account. He said the export and import account was now borrowing 25 billion and by the end of FY 48 this amount might have to be increased 3 or 4 billion. In the first quarter of the new fiscal year it might have to have new borrowing of the same amount, viz. 25 billion. Of course, this would be offset by a reduction of previous borrowing. This borrowing is the result of unrealistic pricing of import foods and cotton, on the latter of which the current rate is 70 to 1. Mr. Ikeda believes he should draw out the subsidies on staple foods immediately and follow that with the subsidies on cotton but the timing of this was not yet clear. He said this was the only way that the government could or should use the funds provided for relief as a counterpart and at the same time show publicly the amount of U.S. aid.

He referred to the price subsidies and the contentions within the Japanese Government as to whether the amount should be 70, 85 or 90 billion. He said if the government was soft here it would only result in the desire for more and more subsidies. He said the government had been entirely too liberal in their price formulas on the secondary processing of raw materials. The only way to get businesslike results was to try and keep the price level intact and reduce subsidies and force individual industries to find the way to survive. There is no incentive if the efficient and the inefficient both are permitted to live under the same price level. Japan must face the fact that she has lost a war, but regardless of that he had never heard of any industry going bankrupt regardless of its inefficiency. It was a greenhouse economy and there was a need to break some of the windows in it or make business swim by throwing them in the water. Admitted that all of the windows could not be broken at one time, but some of them must be broken so that the air can begin to sift in.

He said that coking coal and pig iron subsidies should be eliminated and these should go on a free basis as they are now imported at lower yen values than food. He said that the Price Board of the Japanese Government was very much concerned about this problem but he could see no reason to change his general belief except perhaps in the case of specific industrial cases where it can be properly justified. He believed if the businesses could not adjust themselves to survive that they should change their business or quit. He said that industry and the Price Board were too much absorbed in building up costs to justify prices. The Price Board did not know enough about business details and operations to defend themselves against smart business operators who are putting it over on them. The proof of this is the clearly established and widely known fact that the secondary business was making the most money.

He said that the Japanese Economic Stabilization Board had tried to compare their figures which called for larger subsidies with those of the Finance Minister and that the differences were very apparent. ESB wanted to subsidize gas coal and the Minister does not. The same with coking coal and various other manufacturers with other similar variations.

He said the fertilizer subsidy of 19.8 billion was being paid by the taxpayers and that fertilizer

should have a realistic price to the farmers and it should be permitted to affect the price of rice because there is no comparison between the prices of rice and wheat in Japan and that of any other country.

He concluded by saying that the Diet may reconvene on March 10th but as it looked now they would have nothing to discuss and it might be necessary to postpone the convening of the Diet for ten days.

We agreed to cooperate with ESS in clarifying final decisions in principle on the various controversial issues and conveying these decisions to him as rapidly as possible so he could incorporate them in the budget.

He emphasized the fact that when this budget was completed and prepared he wanted it to be his budget and not a SCAP budget and he intended to take the full responsibility for it in whatever final form was reached; that he had been assured by the Prime Minister that he would be supported in his conclusions.

J. M. Dodge

11-22 INFLATION vs. STABILIZATION

Memorandum March 6, 1949
To: General Marquat
From: Sherwood M. Fine, Director, Economic Planning, ESS

1. The attached study, prepared by Mr. A. O. Hirschman of the Federal Reserve Board, is a searching analysis of economic and financial conditions in Italy. The study first comments upon the fact that Italy apparently has not found it easy to absorb ECA aid despite its fundamental poverty and unsolved economic problems. By comparison, France, with its balanced economy and considerable resources, continues to require ECA aid which appears to be disproportionate to that of other recipient countries.

2. The analysis presented indicates that the continuing inflation in France reflects the existence of an ambitious investment program and a comprehensive effort to correct sore spots in the economy. In Italy, however, despite its much greater relative backwardness both in agricultural cultivation and industry, no effective overall rehabilitation program has been formulated and hence the price level has not been pushed upward by such pressure. One of the larger points in the present article is the contention of the author that the most important single index concerning the health of an economy is not necessarily the prevalence or absence of overall stability. Price and monetary stability may conceal profound internal and external maladjustments and abysmal poverty. On the other hand, an upward movement in the price level, which is the result of an ambitious rehabilitation and investment program, need not obviously be viewed as a serious or unfortunate situation.

3. The relevance of the foregoing to the Japanese situation is not difficult to determine. Part of the inflationary impulse manifested during 1948 derived from the expansion of credit essential to the gearing up of industry and trade to higher levels. In the coming months, as well, potential inflationary threats may be discerned in the loan requirements of an expanding internal and external economy. While the inflationary contribution, prompted by an expending economy, may very well be largely neutralized by appropriate fiscal policies and effective direct controls, such inflationary threat is always a possibility during aperiod of economic improvement.

4. One generalization which would appear to flow from the attached study of the Italian experience is that stability is an objective which should not be sought for itself alone. Of greater importance is the attainment of higher industry and trade levels, both internal and external, so that a higher standard of living may be effected along with improved technological standards incidental to new investment.

5. Thus the moral would appear to be that the uncritical wooing of stability at any price is likely to threaten the very core of an economy and perhaps the society of that people as well. Any stabilization objective must be measured alongside numerous other economic objectives including that of increased output, increased productivity, increased national income, increased investment for modernization of plant and equipment, etc.

[SOURCE: SUITLAND PAPERS]

11-23 DRAFT SUPPLEMENTARY BUDGET RECOMMENDATIONS OF DODGE MISSION

Comments March 7, 1949
By: Labor Division, ESS

1. The Dodge Mission Recommendations, as written, imply such drastic measures that full implementation would not only seriously threaten the objectives of the nine-point Economic Stabilization Program itself, but also would jeopardize other basic, stated missions of SCAP. There is no quarrel with most of the Recommendations as individual measures and as long-term objectives. However, taken as a whole and in the time context of the 1949–50 FY budget, the Recommendations are too severe and seem to have disregarded dangerous social, political, and economic consequences inherent in them.

2. The Recommendations with the probable resulting dangers with respect to labor are as follows:

a. *Reduction of Subsidies*

Several essential industries are operating with relatively high unit costs due to low production caused to a large extent by shortages of raw materials and critical capital equipment. These shortages may be ameliorated but not eliminated this FY. Therefore, sudden large-scale retrenchment of present subsidies for these industries would mean, either:

(1) A decrease in wages resulting in serious labor unrest with an inevitable decrease in the present low level of production, or

(2) Large-scale discharge of workers to reduce over-all wage costs. Such discharges probably would be beyond the actual number presently surplus, and so, would have an adverse effect on production.

b. *Restrictions on Credit*

Drastic restrictions on long-term credit by the government at the same time that "excess purchasing power" is drawn off by a strict taxation and collection policy probably would leave little available sources of money for essential industrial investment, or even for working capital purposes. There are evidences that point to just such a situation at present. The whole of some essential industries are not paying all of current wages due, nor are they making payments due on new equipment needed for increased production. A tightening or, in some instances, a continuation of the present tight credit situation would most likely tend to paralyze production. Again, this would mean a decrease in wages or a lay-off of workers. Either would create labor unrest and opportunity for radical agitations.

c. *Increases in the Cost of Living*

An increase in the official prices for staple foods, railroad fares, communications, and other items would increase the cost of living. In such a case, concerted pressure for increased wages would be inevitable. These pressures would tend toward strike action as an outlet because wage increases would have to be resisted in accordance with the Recommendations. There would be a loss of production due to strikes unless there is an outright ban on strikes. A ban on strikes would probably lead to production sabotage and certainly to serious international political repercussions.

d. *Disproportionate Burden for Workers*

The Supreme Commander in his letter to the Prime Minister stressed that any burden of the Economic Stabilization Program should be spread equally. Increases in the cost of living resulting from increased costs of those items specified in the Recommendations, with no comparable change in wages, would affect workers disproportionately. The workers are very sensitive about these facts. This is another manner in which implementation of the Recommendations would increase social unrest and the instability of labor-management relations.

e. *Unemployment and Restriction on Unemployment Measures*

Strict implementation of the Recommendations with respect to government personnel would result in unemployment for 1,000,000 to 1,500,000. Even if the purpose is not exactly as stated in the Recommendations, plans under development indicate reduction of around 600,000 government workers. The severity of the other measures in the Recommendations, as discussed above, probably would force large-scale unemployment in private industry. Then add to this, a disapproval in principle of public work relief projects, a retrenchment of public works programs, a limitation on the use of unemployment insurance, an implied reduction or no increase in funds available for straight relief, all of which are indicated in the Recommendations, and a potentially dangerous political and social situation of large-scale unemployment

becomes explosive. This situation would certainly jeopardize the long-standing Occupation objective to "prevent disease and unrest." And it should be pointed out that, in the long run, costs resulting from large-scale unemployment can be higher for U.S. taxpayers than preventative measures to minimize and alleviate unemployment in the first place.

3. With certain modifications in the general lines of the ESS plans for implementing the ESP, most of the potential changes in the Dodge Mission Recommendations could be eliminated or at least alleviated. In that form, implementation of the Recommendations could assist SCAP materially in the labor objective, implied but not stated above, of keeping Japanese workers away from Communist control and influence. As now stated, it is seriously felt that the Communists would receive considerable comfort from implementation of the Recommendations. The dangers are in degree, not in intent.

11-24 JAPANESE GOVERNMENT BUDGET (DODGE-IKEDA TALK)

Memorandum March 10, 1949
By: Joseph M. Dodge
Summary of Meeting[8] of Dodge with Finance Minister Ikeda

Mr. Ikeda opened the meeting by referring to Mr. Dodge's press statement which he said was extremely helpful and welcomed by everyone. The only adverse reaction was anxiety among certain industrialists that a tighter money policy might penalize industry and exports.

(Note: Obviously the industries which had been feeding at the trough of government subsidies and deficit financing from government funds, provided by taxing the general public, would be concerned.)

Mr. Ikeda went on to report on his further studies of the budget problem.

1. His first comment was on the relationship between the price level and subsidies and the need to level up certain Japanese prices to the international or world economic level. He said he was in thorough accord with minimizing government subsidies and holding the general line on prices; that he was not contemplating any major change in prices but that some costs must rise with the reduction or eliminating of subsidies and that he recognized that to cut down subsidies would bring upward pressure on certain prices.

He pointed out that the contention of some sections of ESS that the price subsidy should be increased from 70 billion to nearly 100 billion was contrary to his own policy to bring prices up to an international level.

2. He then spoke of the need for continuing or establishing agencies to finance housing, education and industry but said there was no question of the need for a complete reorganization of R.F.B. He said that Government funds would be required for certain special reconstruction activities. His own view was that the R.F.B. should be stopped from making any new loans and concentrate its efforts on collecting outstanding loans, but that there must be some method of financing industry shown the Diet to offset the elimination of R.F.B.

3. He then referred to the Yoshida Cabinet commitments. The principal three are (1) the reduction in government personnel, (2) the reduction of the income tax and repeal of the transactions tax, and (3) more public works.

He said that the separation allowance principle was a vested interest of government workers and that they had no firm plan as yet to meet this. He said this was being tentatively considered as six months pay plus one months pay for each year of service. On the Kodans, which were fairly recently established agencies, he thought it might be three months pay. There is no unemployment insurance applying to government workers.

It was suggested to him that care must be taken to see that any separation allowance did not overlap and duplicate new employment of the individuals involved. Also, that we had been informed that while industries frequently claim they do not have the financial resources to meet required separation allowances many of them actually have it but to admit having it would disclose they had been cheating on the income tax.

Mr. Ikeda said that inasmuch as the government proposes to set the example on employee dismissals it would need to have unemployment measures to offset this. However, he agreed with Mr. Dodge that this should be worked out when the actual amount of unemployment was proved by events.

Mr. Ikeda was told that care had to be exercised to avoid too much encouragement for

[8] Held March 9 from 1430 to 1600.

continued unemployment. If too many and elaborate plans were made and advertised to meet this problem there would be no incentive to the individual to answer his own problem by seeking other employment and no substantial element created which would force him to seek other employment. Also, that the extremely liberal separation allowances provided a cushion for readjustment and that to substitute employment for those dismissed with public works was no improvement, as that was equally inflationary. It would serve merely to transfer the individuals from one government payroll to another.

Mr. Ikeda said that he intended that most of the unemployment would be absorbed by export industries or in the development of natural resources such as coal and other products; that public works should include projects for land reclamation, for the development of additional food supplies and to meet enlarged food requirements; and that some local damages could not be postponed. He said that a minimum of 70 billion yen had been asked for and it was proposed to cut this to 50 billion yen. He expressed the desire that EROA appropriations should include more improved machinery to facilitate production of basic products.

He was reminded again that these public works appropriations were those least wisely administered and least productive. He was told that we had had conferences with various mayors on their own budgets and we found that they included in their expenditures many items that were not rational under present circumstances, viz., new parks, street widening projects, city planning, reclamation projects which cost many times the value of the land reclaimed, improvement of harbors beyond past, present or immediate future use. We found these municipal authorities had firm ideas as to how much they wanted to spend and borrow but no clear views of their own revenues and that their projects seemed to be designed to acquire the largest possible amount of funds for the public purse.

Mr. Ikeda then referred to the proposed tax reductions and stated that the tax bureau had developed statistics on the present burden of taxes and that it was their belief that it was hitting the ceiling.

He was reminded again that under present circumstances the objective of any tax system should be to draw off the maximum revenue and the maximum amount of purchasing power. He was told that we did not believe there was any validity in comparing the tax burden of Japan with any other country, particularly the United States. The inflationary pressures were much greater here than in the United States, nevertheless, Mr. Truman had proposed an increase of some $4 billion in taxes.

Mr. Ikeda commented that the Communists were gaining ground principally by using the tax burden as a basis of propaganda.

It was pointed out to him that perhaps the basic comparison should be with what the tax burden might be if U.S. aid were to be less. Also, that if inflation is not checked and proceeds as it has in the past one sure result would be that the communists would win anyhow, that no one can afford to be black-mailed by the communists. The issue must be met and the public usually responds to strong leadership.

(NOTE: Intelligence reports emphasize the communist use of the tax burden to solicit membership and to disturb the government, frequently offering to obtain tax reductions for party members, but the report also emphasizes that the trouble is caused not so much by the amount of the tax as the inequities in tax administration.)

Mr. Ikeda said that the Japanese economy was something like a jalopy (automobile) which was expected to be supplied with oil and gas from the U.S., but which never is repaired. He said the entire effort of the present administration was going to be on the repairs but he wanted to continue to expect to be supplied with gas and oil.

In connection with this he was reminded of the comment made by Mr. Dodge at the press conference that the nine-point stabilization program was not a substitute for reconstruction but to provide a reconstruction without "fiction" (which was misquoted in the newspaper as "friction") and that what bothers the United States is the "fiction".

Mr. Ikeda spoke again of the price level and subsidies and his firm belief that prices should be permitted to reach the international level, where they were now below it.

He was told that in setting up the counterpart fund offsetting U.S. aid that it was our idea to predicate this on minimum subsidies which would leave a provision for debt reduction and a substantial fund for capital reconstruction purposes to be administered under the approval of SCAP. It was our belief that the subsidies could be held low enough so as to provide a substantial amount for other purposes and a source of funds for many of the projects he had previously mentioned. We envisaged the foreign trade fund being divided into two parts: (1) A counterpart fund and (2) a commercial foreign trade account. From the counterpart fund there would be only limited import subsidies. The minimum balance in the commercial foreign

trade account would be provided for by a budget appropriation. The remaining balance of the counterpart fund after the minimum subsidies would be available for other purposes.

Mr. Ikeda said that he was 100 per cent in agreement with that proposal and firm in his conviction that there should be some repercussions on prices. He said it would be necessary, in his opinion, to take a bold step in the price level of some goods even if it has to be appreciable and face the item now so as to force business and industry to rationalize itself and live under a realistic price policy.

He was advised that it was intended to retain a part of the subsidies on food, fertilizer and pig iron but with subsidies only to imply on imports.

Mr. Ikeda said he was in something of a predicament as he was sandwiched in between the Dodge proposals and those of the Liberal Party. He said he believed in our policy not only in principle but as a matter of logic except as it pertained to the transactions tax. He said the fate of that tax might shake the public's belief in the democratic process and that economic stabilization was also related to political stabilization.

Here, he was reminded of the case of the British Socialist Labor Party which took office on many promises which it was not able to keep immediately and has had to delay implementing over the period of its tenure in office. Also, that his party's pre-election promises could hardly be construed as having to be carried out the first month the new government was in office, in effect they had four years in which to achieve their goals.

We then brought up the subject of the band subsidies proposed by Mr. Ikeda to be 70 billion and by the Japanese and ESS Price Boards to be 99.7 billion. Attention was called to the fact that this latter proposal included 30.7 billion for coal, 18.6 billion for pig iron, and 26.5 billion for steel. This is a total of 75.8 billion out of the proposed 99.7 billion. It was also pointed out that the Price Boards were using a higher production figure which resulted in a greater total of subsidies, which seemed unrealistic.

Mr. Ikeda said that any subsidy reductions would inevitably have price repercussions and labor resistance could be expected. He believed these should be taken now and met, if there was to be any resolution of the problem. He then expressed his deep appreciation for the many extra hours of day and night work being put in by the ESS personnel working on these problems.

General Comment not included in the Discussion:

It is interesting to observe that Mr. Ikeda's proposals are in some respects more drastic than our own. For example, we suggest that R.F.B. expansion be stopped but that they be permitted to make new loans out of the collection of existing loans. Mr. Ikeda takes the position they should not be allowed to make any new loans. This in effect puts them in liquidation. We are inclined to believe that if the R.F.B. is allowed to make new loans with the proceeds of its collections that will force collection activities to an even greater extent than complete prohibition because there will be an incentive provided for the collection activity.

At one time Mr. Ikeda took the view that the counterpart fund should be set up without any provision for import subsidies from it.

The principal area of difficulty appears to be in his desire to reduce budget appropriations for band subsidies to 70 billion as opposed to the ESS conclusion that nearly 100 billion will be required to maintain the present price level. Mr. Ikeda's view is that there should be an official price readjustment. This is, of course, supported by the practical fact that prices are still moving up and that most of the official prices are below international levels.

One of the ESS contentions is that if the transactions tax is maintained and there is no income tax reduction the 100 billion of subsidies can be provided and the budget still balanced. Mr. Ikeda obviously prefers a price rise and the elimination of the tax, probably for political reasons. He says he will make certain that the 70 billion proposal will be supported by the Cabinet.

This places the ESS in the peculiar position of proposing greater subsidies than the amount the Japanese Finance Minister says he is willing to stand on and can support.

11-25 JAPANESE BUDGET 1945–49

Memorandum March 24, 1949

Summary of Meeting[9] with Finance Minister Ikeda, and with Five Party Leaders

[9] Held March 24 with Ikeda from 0830 to 0945, and with Five Party Leaders from 0945 to noon.

Mr. Ikeda expressed the view that the revenue side of the budget represented by the taxation was extremely burdensome and because of the arbitrary manner in which most collections are made was certain to be a source of trouble. He said they were prepared to carry out the budget and gave assurances that regardless of the approaches made to us the transactions tax would be given up.

He said that in FY 48 the income tax prediction was 180 billion yen which amount they approximately were going to collect. The income tax revenue increase to 310 billion was an abrupt change from an inflationary to a deflationary trend.

It was pointed out to him that this was not an increased tax, that it was the same tax that had been in effect last year, applied at the same rates and effectiveness to the increased money incomes which had resulted from the inflation marking up the yen. Also, that in an inflationary situation the pressure should be on incomes and through taxation on the consumer. The budget is not deflationary on the expenditure side because expenditures remain extremely high. The program to reduce taxes had to be predicated on an improved administration which would assure the collection of the taxes at any rate which might be established, improved acceptance on the part of the people in meeting their tax liabilities, reduced subsidies, reduced other budget expenditures and on the results of an expert survey by the Shoup Mission. It was emphasized that there can be no basis for reducing taxes unless there is a foundation put under the tax administration that would ensure whatever tax rate might be established actually being collected.

Mr. Ikeda expressed particular concern about the impact of the tax on the lower income brackets. He said it was cutting into their subsistence requirements and he believed the tax should begin on a base which recognized living costs as established by the prices of the rationed goods. He asked that we consider the increase of the basic tax deduction from 15,000 to 18,000 and the dependent credit from 1800 to 2400. On question, he said he thought this would cost about 25 billion yen. He said he believed there was sufficient cushion in the budget to allow this.

Mr. Ikeda said that too much pressure on the taxpayer would be considered exploitation of the taxpayer and would be capitalized on by the opposition and might defeat the purpose of the budget. He also stated that by absorbing the carry-over or deficit in this budget it hit the budget very hard and really meant 13 months of expenditures covered by 12 months of revenues.

He next mentioned that there was no reserve fund in the budget for emergency relief or disasters. He said any such appropriation, if not provided for as a contingency fund, would need Diet action as they are not in continuous session and 40-day notice would be required. Last year this reserve was 3 billion and he suggested 2 billion for this year.

(Note: The first move in disaster relief is not an appropriation. It is physical action and the extent of the physical action necessary should determine the appropriation, so a delay is not a real obstacle. Further, the creation of a reserve only brings pressure to spend it with the result that it is not available when needed.)

He requested that the Finance Minister be allowed to alter the allocations under the 50 billion yen public works appropriation and was referred to Mr. Reed to discuss that subject.

On the time table he said it would require at least three days to change the form of the budget to one customarily used by them, then would follow the printing and, as he saw it, it would be presented to the Diet April 1 or 2 and should be passed by the 10th as the minimum, and the 15th as the maximum. He believed they would have to make some minimum appropriations for perhaps the first 20 days of April but assured that they would not go beyond that and there should be no worry about procrastination. He thought a shorter term of consideration would not be democratic and he did have a problem of meeting internal party and Diet opposition.

He suggested that they would have to postpone the debt service due April 1 and could not pay it by resolution as it is a provision of the budget. Supplementing that he believed that minor appropriations would have to be made for prison and hospital costs and payrolls due April 8, 9 and 10.

He was again told that the delay in meeting the payroll of a few days was not considered material and could be turned into political use as the delay would arise from the opposition in the Diet.

Mr. Ikeda suggested that Mr. Dodge should hold a press conference on the budget which he said he would consider only after the budget had been announced by the government. Mr. Ikeda was reminded that he had agreed there would be no release of the budget figures to the Japanese press which was not simultaneously given to the U.S. press.

11-26 JAPANESE BUDGET

Memorandum March 25, 1949
Summary of Meeting[10] with Finance Minister Ikeda

The objective of Mr. Ikeda's interview was further consideration of a token reduction in the income tax by increasing exemptions. He said he had discussed the matter with Mr. Moss yesterday afternoon. Mr. Moss had reported discussing it with Mr. Dodge later and reported back to Mr. Ikeda that Mr. Dodge had not changed his opposition to it.

Mr. Dodge said it was true he had opposed a reduction in the income tax; that he believed it a mistake to prejudge the results of the Shoup Technical Mission on taxes; that there was no leeway in the budget substantial enough to absorb the reduction and that this proposal was one that should only be considered after a demonstration that the position of the budget could be maintained or improved.

Mr. Ikeda said that he recognized that any fundamental change in the taxes should wait, but he was convinced that the projected increase in the price of rice and the tax would cut too heavily into the subsistence cost.

Mr. Dodge said that it was true that the tax burden was heavy; it was also heavy in the United States and even heavier in some other countries. It should be heavy here under the circumstances and in principle the time had come for them to pay for some of their past mistakes. The projected increase in the cost of rice was inherent without the budget and the budget could not be blamed for it. The income tax deductions had been increased from 4,800 to 15,000 on July 1, 1948 and the dependent reduction from 400 to 1800 as of the same date and tax payers were only getting the full effect of these deductions in FY 49. Mr. Ikeda said this was true as to the excise tax, but with respect to the withholding taxes these deductions had been effective since July. Further, that he advocated that the indicated higher price of rice and commuters railway fare costs could be partially offset by a token reduction in the tax.

He was told that for all we know the present tax deductions might be too high now as against the situation that might exist next July or August. If this should prove true it would be harder then to reduce if increases are made now and easier to make reductions if they appeared practicable and were supported.

Mr. Ikeda said that according to his figures the basic deductions should be 24 or 28 thousand yen as against the present 15 and the dependent credit should be 3800 as against the present 1800 if living costs were to remain without any further cut.

He was reminded again that it was the problem of the Shoup Mission to explore and recommend with respect to these situations and we should not prejudice their conclusions. Also that it was believed that a heavy tax burden was necessary; that there should be an end to answering all problems from the budget; that the more complaints there were about taxes, the more incentive there would be for the government to accomplish reduction of expenditures because everything the Japanese Government has done to date has contributed to the high taxes.

Mr. Ikeda said that there is no question but what the patient was ill and needed a doctor but he believed a token reduction in the tax would serve as a sedative to relieve the shock and permit carrying out of the budget and provide support to the budget.

He was told that it was time to stop ducking the issues; that the history here showed a continued series of concessions made on promises which had not been performed; what we wanted was a record of performance. This was not a reflection on Mr. Yoshida or himself, but on the practice of the Japanese Government. It was suggested that if the United States had been as lax in meeting its obligations with respect to Japanese aid as the Japanese had been in meeting their obligations to the United States, they would have been in even more serious difficulties.

Mr. Ikeda said that he wanted only this concession. He was asked if it was understood that if he obtained this concession there would be no other claim or dispute about the budget. He had every assurance and could give every assurance that this was true.

He was reminded that history showed that any concession was but a precedent for further concessions and that past concessions had been construed by everyone as an example that the stand taken was neither firm nor sound.

Mr. Ikeda asked again for this one concession. Mr. Dodge said that he did not see how he could agree to it. The country was insolvent internally and externally and had been living

[10] Held March 25 from 1045 to 1200.

beyond its means. It must get back within its means. It had been travelling in a direction requiring more United States aid instead of less and that direction would have to be changed.

Mr. Ikeda said that he believed this single thing would be paving the road for the budget and he was not sure of carrying it out without this concession. He was told that there would be more of a disposition to make a concession if there had even been any record of accomplishment by doing so, that there was every sympathy for the position of Mr. Yoshida and Mr. Ikeda, but even more sympathy for the United States. That the Japanese did not realize what an easy time they had had with respect to the occupied areas which were within the knowledge of Mr. Dodge.

Mr. Ikeda went on to say that the people were already sensing that they had a tough road ahead of them from the news that had leaked out about the budget and believed the medicine could be sugar-coated and still be strong medicine. Also that if he was believed qualified to carry out the budget he should be given this chance to support his position. He said that it might be necessary for him to turn over to someone else the carrying out of the budget.

He was told that strike and resignation proposals seemed to be the usual answer when the Japanese did not get what they wanted.

He asked if a request from Mr. Yoshida would be more effective and was told that Mr. Ikeda's request had as much weight as that of anyone.

Mr. Ikeda said he hoped Mr. Dodge was not offended; was assured that he was not; and asked for an opportunity to see him again which was accepted.

11-27 JAPANESE BUDGET

Memorandum March 28, 1949
Summary of Meeting[11] with Finance Minister Ikeda
By: J. M. Dodge

Mr. Dodge said that the Steering Committee of the Economic Rehabilitation Planning Committee had been asking for an appointment with him which had not been granted and he would only do so at the request of Mr. Ikeda. Mr. Ikeda believed such a meeting was premature and should not take place until after the budget was introduced.

Mr. Ikeda was asked about the story in the Nippon Times about possible resignation of ICHIMADA and he said he had no information which indicated there was any basis for it.

Mr. Ikeda was told that a cable had been received this morning giving the names of the Shoup tax mission and when they were expected to leave the States for Japan. Also that arrangements had been made to cable Washington today asking for an immediate release on this publicity as a help in the tax problem related to the budget.

Mr. Ikeda then referred to the income tax reduction question. He said he thoroughly understood that the problem of resisting pressures of Japanese Government agencies and SCAP divisions for changes in the budget would make it necessary for any such change, if it is made, to come at the last minute. He said it was not advisable to change the total of revenues appearing in the budget even if the change were made because it could be met by shifting increases in revenues to other items. Also, that any reduction must be made in such a way as not to prejudice the function of shiphoning off purchasing power and not to pre-judge the Shoup mission. He said that in his view a slight change in the basic deduction and dependency credit would result in only such loss of revenue as could be absorbed by other tax items, that it was not large and could be hedged in other tax items. He said that such a change does not mean as much in Japan as in the United States because of the way taxes are collected here. As a tax expert he was very hesitant to keep the present tax scale.

He was told that the party publicity was referring to this 1949 tax revenue as a tax increase, which was not so. The estimated tax revenue is based on the existing taxes at the effective rate of FY 1948 applied to present incomes and prices. Further, that a concession to meet a political promise was not acceptable.

Mr. Ikeda said that he considered the reduction in the tax (increase in deductions) a minor technical matter and that with his long knowledge of the tax operations he did not believe the present tax could be retained unchanged and he could still be held responsible for full enforcement of the revenues called for by the tax.

Mr. Dodge said his view was based on four primary considerations. The first was that the

[11] Held March 28, 1415 to 1530.

present tax revenues should be maintained to create the maximum pressure on consumption. The second was that to make a change now would pre-judge the work of the Shoup mission. The third was that to open the budget on this item would lead to demands to open it on all other items. The fourth was that the acceptance of the proposal no matter how excused, unquestionably would be used and presented to the public as having been accomplished by political pressure brought on SCAP. It was believed these considerations outweighted the points mentioned by Mr. Ikeda.

If the Shoup mission should approve of the adjustment after a thorough study of the tax situation it would only then become a technical matter. The Shoup mission was beginning its work early in April. Certainly in the first four months of the present Japanese fiscal year the tax problem and recommendations with respect to it should be clarified. This was a program immediately going into effect. That still left two months in which to make any adjustments in the tax law warranted by these recommendations, within the first six months of the 1949 fiscal year. Thus the whole tax picture and what should be done about it should and probably would be resolved within this period. At the end of six months we would know what could and should be done. Whatever is done should be the result of a combination of improved administration of the budget and the tax collection system, and the Shoup mission recommendations. Finally the issue really was a question of timing. Any adjustment made at this time would be a political adjustment and not a technical adjustment established after a thorough survey of the problem.

Mr. Ikeda said he hoped this was the last time it was necessary for him to discuss the matter of tax adjustment. He then referred to the need for an interim appropriation. This had been prepared covering only the minimum requirements of the period April to April 15 and amounted to about 4.6 billion yen. He said that had to be put through the Diet first and could require two days, one in the Upper House, and one in the Lower House. In the meantime, they were studying the budget and re-working it to conform with their own type of presentation. This would require several days. The present schedule was for the Prime Minister to make a speech on the "State of the Nation" on the second of April. The Finance Minister would introduce the budget on the fourth of April, and at that time give his budget message. He said that some of the political leaders wanted the publicity on the budget to consist of a comparison between the original Japanese proposal and the present budget. However, he and Mr. Yoshida had agreed that they would discuss nothing but the final budget. He said there would be no publicity on the budget prior to its introduction in the Diet and then the publicity would take the form of his budget message.

After some general discussion about various technical items in the budget he left with the request that he be able to discuss technical problems with various members of the ESS Public Finance group and the Dodge mission so as to be sure to have the information necessary to answer questions in the Diet.

11-28 JAPANESE BUDGET

Memorandum March 31, 1949
Summary of Meeting[12] with Finance Minister Ikeda
By: J. M. Dodge

The principal purpose of Mr. Ikeda's interview was to tell us two things.

1. There had been a demand from certain elements within the party at a party meeting that Mr. Yoshida and Mr. Ikeda should require a directive from SCAP to adopt the budget as submitted. This had been denied and it was their determination to adopt the budget without an order.

2. He further said that there would be attempts made by the opposition to amend the budget which might attract some sympathetic support and votes from members of their party. He said their position would be that there could be no amendment of the budget. However, in taking that stand they wanted positive assurance that this position would not be upset.

He referred to what he called a bitter experience in establishing the wage level at which time it was agreed between the government and ESS what the wage level should be. A Bill was introduced to that effect which, due to certain influences, was amended substantially increasing the rate which was approved by SCAP and passed. He stated this was very embrassing and under t e present circumstances should not be repeated.

(Note: This apparently refers to the wage level increase of 1 December 1948 which the government wanted to establish at 5300, was finally set at 6300 and which went into effect 10 days before the issuance of the stabilization directive.)

Mr. Ikeda said that Mr. Yoshida had called on General MacArthur Tuesday evening and assured him of the full support of the program by himself and Mr. Ikeda.

Mr. Dodge told Mr. Ikeda that he would arrange to see that he had proper assurance that there would be no amendment to the budget approved. He said that there would be no additional provisional budget authorized other than the 15 day minimum expenditure appropriation. It was our firm intention to have no provisional budget of any kind in view of the past record of delays. This 15 day budget was only agreed to because the budget negotiations had extended over such a period of time that Mr. Ikeda had only received the summary figures on Wednesday March 23 and the necessary supplementary figures thereafter. It was pointed out that most of the delay was occasioned by what we considered protracted and unnecessary negotiations on the part of the Japanese Government and that they were responsible insofar as they had not moved rapidly to get discussions on the budget underway in the Diet. Nevertheless, in view of the entirely new and different approach to the budget problem it was not considered desirable to have the presentation of the budget to the Diet made under the circumstances where in order to obtain passage it would be necessary to restrict the discussion of it to only four or five days. For example, if the budget were introduced on the 2nd or 4th of April to meet the liabilities accuring in the first 10 days of the month would require its passage by the 8th of the month.

Mr. Ikeda was reminded that he had given assurances there would be no procrastination in the passage of the budget. Based on those assurances the 15 day minimum provisional appropriations were allowed but there would be no repetition or extension.

[12] Held March 30 from 1015 to 1045.

11-29 DODGE'S STATEMENT ON THE JAPANESE BUDGET

Statement April 15, 1949
For: Immediate Release
By: Joseph M. Dodge, Financial Adviser to SCAP

The following statement on the Japanese budget was made public today by the Honorable Joseph M. Dodge, Financial Adviser to the Supreme Commander:

Introduction

Every element of the budget problem can be discussed and amplified almost indefinitely in any direction. It is not my intention to do this but to make comments on its more important aspects which will suggest appropriate analyses and conclusions. I already have observed keen interpretations of the economic implications of the budget in the press.

General Comment

The creation and implementation of a balanced budget is the first requirement of the Nine Point Stabilization Program. As such it is the unqualified obligation of every political party and every individual. It should have been made an integral part of each party platform. It is a Japanese national problem, not a political party problem. It is essential to establishing a sound foundation for further economic reconstruction and the effective use of U.S. appropriations made for the benefit of the Japanese economy.

The stabilization program requires of the Japanese government what the former Allies of the United States, who are receiving its aid, have agreed to do in formal contracts with the U.S. government.

There seems to be astonishingly little comprehension among the Japanese people of the real stituation of their country. Nothing should have been expected as the result of the war but a long term of hardship and self-denial. The nation continuously has been living beyond its means. There has been a general disposition in the Japanese government to accede to any demand to spend more and more and to attempt to spend every source of income more than once. Too much of this spending has not been put to productive use.

Any measurement of the direct and indirect losses resulting from the war will clearly show that Japan cannot afford to dissipate capital. It has suffered severe physical loss and damage

and economic and financial dislocations. It has lost its empire and with that has lost great investments and sources of raw materials, production and trade. Also there has been a loss of the influences that empire brought to bear on other contiguous trading areas. Japan's population has been increased by repatriation and concentrated to its homeland. There is a large net gain in population each year. These are serious problems. Their effects reach everywhere and they cannot be quickly or easily overcome.

Any realistic view of the economic problem suggests a rough and rocky road which will severely test the strength, character and loyalty of the people. The economy has travelled the early part of this road in a damaged and unrepaired vehicle but the vehicle and the passengers have been protected from road shocks by a cushion of U.S. aid. It is time the Japanese began to face up to the unalterable facts of their own life and organize themselves to meet their own problems and regain their independence by their own efforts.

A better perspective of the problems of the present situation can be achieved if they are properly related to what the conditions might have been without the benefit of U.S. aid or might become when this aid has to be reduced or withdrawn.

It will require the active and continuous support of every individual in meeting its national problems for this country to regain an independent status in world affairs. U.S. aid only can serve as a stimulant to the efforts of the Japanese people to find the way to develop a self supporting economy as a result of their own labors.

There is no place where inflation takes over quicker and moves faster than in a shortage economy. Productivity is decreased and not increased by government spending. It should be remembered that a government can neither spend nor give away except what it first acquires from someone. Governments only spend other people's money. Wealth must be created before it can be divided.

The Japanese people should demand a balanced budget and should then direct their attention to the elimination of excessive expenditures, wastefulness, subsidies, over-employment and the general dependence on government instead of individual or group accomplishment. It is these which must be revised to produce later tax reductions.

The Government Budget

The government budget is the financial structure within which the government conducts its business. It is the window through which the people should clearly see what the government intends to do, how it will operate and what its impact on the people and the economy will be in the coming fiscal year.

Heretofore, the budget has not adequately served this purpose. The two principal reasons for this are that the facts have not been made clear by the form of the budget itself and that the discussion and publicity has always centered around only one part of the budget, the general accounts. Another important part of the government operations is represented in the special accounts, which have been largely ignored.

These two parts are closely interrelated. One part could show a balance or even a surplus and the other show even a greater deficit. One could show a small deficit and the other add to this a much larger deficit. Combined, as they should be, in a consolidated budget the real facts of the government financial position and intentions are shown and in this way part of the window is cleared.

This fiscal year's budget is intended to accomplish a balance of all government accounts. It discards the practice of encouraging and permitting the people to believe the situation is different than it is by emphasizing merely the result given in the general accounts of the government which is only part of the story of what the government is doing with public funds.

The Japanese government budget system is inadequate, both in its mechanism and the time elements allowed for preparing a budget. It has been completely ineffective as an instrument of administrative control. It is neither clear nor understandable. It has not shown all of the current government obligation. The record of the past shows that it has had little meaning. It has been a record of budget delays, provisional budgets, supplementary budgets and deficits.

The 1948 Deficit Record

In 10 months of the last fiscal year the government debt increased 178 billion. At the end of the fiscal year the government had an unfunded deficit of about 48 billion. A large part of this increase in debt was nothing more than a funded deficit. Any combination or adjustments of these figures indicates an actual deficit of more than 150 billion for fiscal year 1948.

The Overall Budget

The total figures of the consolidated budget will appear large for several reasons. First, because it is a consolidated budget. Second, because it is on a higher inflation level than existed a year ago. Third, because there are so many elements appearing in the budget for the first time, which had previously been obscured in other accounts. Fourth, because the budget computation includes many inter-account transfers, viz., amounts appearing on the disbursement side of one account and the revenue side of another.

The total of the publicly reported budget is about one hundred per cent greater than the actual budget transactions. The general accounts represent only about one-sixth of the reported total budget. The tax revenues represent only about one-eighth of the total reported revenues. The remainder comes from other special and general account revenues.

The Japanese press reports a total budget in excess of 4 trillion yen. This figure includes approximately 400 billion yen for local government budgets which are independent of the national budget. The 3.6 trillion yen national budget is further reduced to about 2 trillion yen by accounting transfers and necessary temporary borrowing to finance current transactions. The budget is balanced in consolidated form at an actual level of about 2 trillion yen.

In the most general terms the normal increase in expected tax revenues at the existing rates due to inflationary increases, and the limitation of expenditure expansions has been set aside to absorb the heretofore concealed subsidies, to create the Counterpart Fund representing U. S. aid, to absorb the unfunded deficit and other losses in government accounts and to retire a portion of the existing government debt.

The actual total of approximately two trillion for the consolidated budget compared to any estimate of annual national income shows that an appalling proportion of the total national business is represented by government transactions viz: transactions which proceed through government instead of private channels. Some estimates indicate this is as much as two-thirds.

The Government Revenues

The larger estimated tax revenues of the government in this year's budget have been generally referred to as "tax increases". This is inaccurate. The tax revenues in the present budget are at the already existing tax rates applied to a higher level of income and prices. This is one of the products of inflation.

The attainment of the revenue objective under the taxes set forth in the budget is essential to meet the expenditures provided for in the budget.

The tax rates themselves are high but the effective collection under the rates are low. There is a real need for greater equity in tax administration. But no tax rate will be equitable or effective until each individual is willing and is required to pay his proper share of the tax burden. Modification of the existing tax rates can be justified only when the people wholeheartedly do their part in meeting their tax liability.

The administrative requirement is to insure that every individual pays his full legal tax debt. The honest tax payer should not be penalized by being forced to carry the load of the tax evader. The profits of the tax evaders and the black market operators should be the first and most vigorously attacked.

Tax reduction must be predicated on an assured revenue under whatever rate is established. Taxes cannot be reduced in face of a record of progressively greater government spending. They can only be reduced as a result of progressively less government spending. After accomplishment, not before.

Emphasis to date has been on a maximum of government expenditures instead of on a minimum. Under these conditions there can be no other result than an increased tax burden.

In insisting on the removal of the deficit financing the most vicious type of general taxation has been eliminated. Actually, everyone has been paying two types of taxes. One type is composed of legal taxes, the other is the indirect taxation reflected by uncontrolled and continuous government deficit financing.

The Government Expenditures

Government expenditures remain high. Planned expenditures are all shown for the first time. Subsidies are revealed for the first time. Where there is concern about the level of taxation the level of expenditures also should be noted. It is government expenditures that determines tax requirements.

There has generally been no "slashing" of expenditures. Most expenditures actually are higher than last year. The saving on expenditures has been primarily in restricting their further

large expansion. The reductions are from extremely high original estimates of proposed expenditures, which were inappropriate to the general financial means available. This is an accomplishment only in that it modifies the past practice. There is still much to be done and much that can be done to reduce expenditures.

The Government Subsidies

Since the end of the war large amounts of U.S. goods have gone into the foreign trade account but this fund shows no balance because the imported goods have been sold at so much less than cost. This process has obscured subsidies from the view of the public.

One leg of the "stilts" has been built from subsidies. These have been hidden in the transactions of the foreign trade account and have not been clearly shown in the budget. Actually they are government grants to particular producers, or consumers, from the government tax revenues collected from all of the people and from the proceeds of the U.S. aid furnished Japan. Now these actions will be made clear and grants of tax money to reduce prices of special goods or products to consumers will be seen.

Subsidies are exposed in the budget so as to clearly place the responsibility for their use in the Japanese government and to ensure that appropriate action will be taken to reduce and finally eliminate them. They represent a large amount, seen for the first time. But the amount is actually much less than it would have been had the practice of last year been fully extended to the wage and price levels of this year. The amount does embody a substantial reduction. It should be progressively eliminated.

This practice of the general use of subsidies is abnormal and undesirable. It creates fictious and unnatural price relationships. Also it is more costly than the mere figures indicate. The amount collected in taxes for subsidies is first reduced by the cost of tax collection and then progressively reduced by the other administrative costs of the government and the operating costs of every Kodan or government department handling the transaction until the remainder is actually applied to a consumer price of food, material or product. Thus the consumer taxpayer inevitably receives back only part of what he pays out for this purpose. But the taxes are paid by all of the people and except for subsidies granted to hold down the price of basic foods consumed by all the people, the tax proceeds going into subsidies are distributed for the benefit and protection of special groups of people.

Something can be said in favor of certain price increases perhaps costing the consumer less than some taxes are now costing him. Too much of the price of too many materials and products is collected by the Tax Bureau of the government instead of in the market.

Whatever these subsidies may be, and whatever amount of them may be considered necessary, they should and must be paid from tax revenues and not from the proceeds of the U.S. aid. By the transfer of these subsidies from the foreign trade account and making them a change to government revenues it has been possible to set up the Counterpart Fund as the equivalent of U.S. aid imports.

The Counterpart Fund

The Counterpart Fund sets up in the budget for the first time the estimated amount of U.S. aid which may be received during the coming fiscal year. The use of this fund will be under the control of SCAP. It is a powerful fiscal instrument for helping meet the future trends of the economy. Its use will be closely supervised and follow the general principles of similar U.S. aid funds elsewhere but related to the particular conditions of this economy. Its principal uses will be for the retirement of government debt and for capital investment purposes which contribute directly and quickly to economic reconstruction. It will not be a political grab bag. In considering releases from the Counterpart Fund for investment projects great weight will be given to the progress made in achieving the tax goals set forth in the budget, how the budget expenditures are being administered, and the fulfilment of the terms of the Nine Point Stabilization Program.

Credit Policy

The balanced consolidated budget for the 1949 fiscal year together with the Counterpart Fund provide instruments with which the Government operations may be carried on without contributing to an inflationary expansion of the money supply. These also supply the means through which the legitimate requirements of industry for working capital and equipment funds may be met without an inflationary impact. The effect of this is closely related to credit policy. Investment expenditures from the Counterpart Fund will offset in advance by collections from the proceeds of imports. However, through the investment funds and the retirement of RFB

and other government debt provided for in the budget and through the Counterpart Fund substantial means have been created for meeting the needs for extending sound and proper credit and for essential capital investment purposes.

[Source: Suitland Papers, Z 703-22]

11-30 JAPANESE BUDGET

Memorandum April 15, 1949

Summary of Meeting[13] with Minister Ikeda

On the budget Mr. Ikeda said that originally many of the Appropriation Committee members could not see any good in it but are now beginning to see its advantages and he expected it would pass the Diet with no amendments. He said that certain malcontents had accused him but later apologized. He asked if Mr. Dodge would be willing to meet these malcontents, agreed and an appointment was made for 1100 Thursday. He said the Lower House had practically covered all the angles of the budget but the Upper House still had to do this. He expected Diet approval on the 18th or 19th and urged again that Mr. Dodge hold a press conference on the budget.

Mr. Ikeda then referred to the proposal for establishing a Policy Board in the Bank of Japan. He said whereas Mr. Ichimada had originally demanded that he be Chairman of the Policy Board as well as the Management Board, he had agreed that the Chairman of the Policy Board should be elected by its members. Mr. Dodge reviewed the interview with Ichimada previously reported.

Mr. Ikeda said that he thought it was difficult to obtain suitable Policy Board members from individuals already holding positions elsewhere, that the pay would not be adequate or make the job appealing. Mr. Dodge said that he believed the compensation should be appropriate to the importance of the position but the real appeal should be a patriotic one in terms of a necessary contribution to the problems of the country and the prestige attached to a position created by appointment of the Prime Minister.

Mr. Ikeda said as he understood the situation the legal status of such a Policy Board would not be that of a Government agency but an instrument of the Bank and that it would not hold auditing authority over other banks. However, it would have the power to require necessary reports.

On the subject of long-term loans to industries and other businesses he said that the ESS had already approved a proposal that Industrial Bank debentures could be issued up to the amount of 20 times its capital rather than 10 times, as is now provided. He believed that another bank, the Hypothec Bank, should also have the privilege of increasing its debenture issues. This bank has practically suspended business. Its loans are made to small businesses and agriculture. It has been a sound bank. When the war indemnity cancellations caused other banks to reduce their capital this bank did not have to do it. Mr. Dodge asked who bought the debentures and if they were purchased by the Bank of Japan which would tend to monetize their debt and Mr. Ikeda said no, they were bought by city banks and individuals. He asked that this proposal be examined further. He said that the city banks were reluctant to make longer term loans direct but were willing to buy debentures of these banks in the form of an indirect loan, which did not have a Government guaranty.

He said he believed it was extremely necessary that the stock exchange be reopened as quickly as possible so as to provide a means through which industries could finance their own needs. He said particularly the exchanges in Tokyo, Osaka and Nagoya were highly necessary and desirable.

Mr. Dodge agreed to this in principle subject to the approval of SCAP.

He next referred to the use of the Counterpart Fund, particularly for the immediate needs of the months of April and May and to bridge the near-term requirements. He suggested that in the event the Fund was not immediately available for use there might be some temporary deflation instead of merely dis-inflation.

Mr. Dodge said we were in the process of spelling out the technical terms which would cover the availability of the Fund. This had some complications connected with the methods of procurement, delivery, prices and other charges. It might not be possible to resolve all of these technical matters until some of our staff had returned to Washington.

Mr. Ikeda then asked if the Counterpart Fund was directly related to U.S. appropriations

[13] Held April 13 from 1100 to 1230.

for aid. The reply was that it was related to the appropriations insofar as they represented the actual delivery of goods here in Japan during the Japanese Fiscal Year. It was pointed out to Mr. Ikeda that very little of EROA goods had actually been received here up to the beginning of the Japanese FY 49. Thus there was a backlog of goods on the way to Japan which arose from the U.S. Fiscal 49 appropriations which would arrive in Japan during the Japanese FY 49 and that also the proceeds from some of the US FY 50 appropriations would arrive during the Japanese FY 49.

Mr. Ikeda stated that a great many problems relating to the economy and the budget would depend upon the administration of the Counterpart Fund. He believed the Ministry of Finance should have the primary responsibility as to its proper and timely use. The general economic plan, however, would be under the administration of the ESB which would not only be concerned with individual proposals for use of the Fund but its greater purposes. Mr. Dodge said these details were being considered.

Mr. Ikeda said he believed the function of the Fund was as important as all of the other functions of the Finance Ministry and needed a powerful agency in the Japanese Government headed by a man of equal stature to the Finance Minister as his right-hand. He was told that frequently in European ECA countries the fund was operated by a Minister, without portfolio, on the side of the receiving country.

Mr. Ikeda thought that it might be advisable temporarily to establish someone in the government to have the responsibility of the Fund either as a Vice-Minister or as a Financial Commissioner at the level of a Vice-Minister. He asked if there were any plans in SCAP Headquarters to establish a comptroller and was told that there were.

Mr. Ikeda pointed out that in the ECA countries in Europe they have all developed some kind of a longer term economic plan and that there was nothing of the kind here. He said the ESB had some plans of this nature which would obviously either have to be revised or scrapped because working them out would depend on the uses to which the Fund was put in the near term and in the future. He wanted to know how SCAP Headquarters could be of assistance on this.

Mr. Dodge said that he believed that was primarily a responsibility of the Japanese Government subject to careful examination and approval by SCAP. He thought in the case of Japan there were really two steps required, one a plan for this year and another longer term plan which would absorb and coordinate the plan of the immediate year. Mr. Dodge emphasized particularly that any plan proposed would have to include a forecast of a decreasing amount of U.S. aid. Also, that the Counterpart Fund will not be a political grab-bag as Government funds had been in the past. It would not be easy money for anyone to reach and obtain.

Mr. Ikeda said he visualized the situation as the Government having two pockets. In one of these were the funds obtained from Japanese taxpayers and in the other pocket the funds obtained from U.S. taxpayers. (Very good). He said the principal question in the Diet was how they were going to use the funds in the U.S. pocket.

He was told again that this would not be an easy pocket in which to reach. That the funds would be expended only on fully justified specific cases and projects which had been carefully screened and were determined to be constructive and necessary. He was warned that he had better begin establishing the idea now that this was true, to avoid later trouble and complications. The basic questions would be the productivity of the use of funds and whether or not they actually added to the capital of the country and particularly to its exports. The first question asked in connection with every proposal would be the elements of possible waste in its use. This was an investment of U.S. dollars with which Japan had to come out with more than was put in.

Mr. Ikeda said the implications of the budget meant that Japan would face a general price revision which would gradually raise prices to the international level. He was told that we thought the same, however, this had to be accomplished in a progressive manner and in such a way as not to create great local disturbance.

Mr. Ikeda referred to the immediate increase in the price of rice of about 13½ percent and railway passenger fares of 60 percent. He said probably there would be other price changes necessary during the year, particularly on the barley crop and the Autumn rice crop. These would all have a somewhat depressing effect on the workers' wage value and might bring some problems in the summer or Autumn.

On the tax reduction he said he was being very careful to make no commitments but has stated that they would try their best to reduce taxes as a result of the work of the Shoup Mission. He said this was his own belief and that he would try to minimize Government expenditures so as to create a surplus which would make this possible. He then said that he was

encouraged to take this position by the fact that the Government actually had a surplus in 1948 which arose from tax collections over their estimates (which he claimed to amount to 30 billion) and an unused appropriation of 8 billion. He thought this 38 billion plus savings in Government costs in FY 49 would be an appropriate excuse to ask for reductions in taxes later in the year.

He was told that this was an astonishing statement, and asked if he did not know the figures of the Japanese budget which show an unfunded deficit of 48 billion for 1948 and a funded deficit represented by an increase in the government debt of a large amount. He seemed very surprised at this and wanted to look into it. (Later it developed that of course he had not taken into account the deficits in the Special Accounts of the budget, a traditional Government error.)

Mr. Ikeda said that the Government goal was a net increase in savings accumulations during the year of 230 billion. He also said the Bank of Japan note issue could be held under 350 billion. At the end of March it was 312 billion and on April 7 308 billion.

Mr. Ikeda was given a confidential copy of Mr. Dodge's press release in advance of its use on the condition that it be only for the information of himself and Mr. Yoshida.

11-31 JAPANESE BUDGET

Memorandum April 22, 1949
Summary of Meeting with Mr. Ikeda[14]
By: J. M. Dodge

Mr. Ikeda said the real purpose of his call was to express his official appreciation of the support and assistance Mr. Dodge had given him in connection with the problems of the budget and also to give a brief summary of the principal points raised in the Diet about the budget. He said that:

1. All political parties were greatly concerned about the high tax burden of the people.
2. There were many criticisms of the large amount of the subsidies.
3. Some doubted the timing of this move to balance the budget and the extent of the change which would be caused by the budget and believed it was too drastic and there would be too much siphoning off of yen currency, which might result in deflation rather than disinflation.
4. Some tried to preach that the government was giving unwarranted profits and larger power to the financial institutions and the financiers.

Mr. Ikeda said he had been continuously borrowing the ideas of another person in answering all of the problems in connection with the budget but had become so used to those ideas that they were now his own.

He then referred to what he was contemplating in connection with the implementation of the budget. He said he would like to see the price and import subsidies reduced to a minimum and to create a surplus from the operations of the current fiscal year. One of the principal difficulties on this road is the Japanese Government Price Board which was strongly determined to hold the price line as a matter of policy and this was powerfully supported by ESS advisers.

He said that he and others would like to see the Dodge group or its representatives return to Japan because of their neutral position toward existing problems and that Mr. Yoshida had asked General MacArthur for an impartial advisor on economic policy. He believed that any switch from older established policies would need someone to see that necessary changes were made without too much reluctance.

He referred to the FY 48 carry-over deficit of 48 billion and the fact that they expected to collect about 30 billion yen more in revenues than were estimated for the FY 48 year. He hoped any such surplus could be used to reduce the income tax sometime during the fiscal year.

He then referred to the problem of credit control and pointed out that if the Counterpart Fund was largely used for the retirement of government debt and RFB debentures now held by the Bank of Japan it would mean a further reduction in the currency issues which was a substantial deflationary act. He said it might be better if these retirements of government debt would be from portfolios of the city banks but if that were done there would be the question of insuring the use of these released funds for industrial reconstruction and production

[14] Held April 22 from 1430 to 1530.

instead of loans to "good black-market risks." He believed the reform proposed for the Bank of Japan was intended to provide a mechanism for the control and adjustment of the availability of funds. However, there would not be sufficient control merely by the adjustment of the rediscount or borrowing rates and more direct credit controls would be needed if funds were to be pushed into channels which would help production. He referred to the proposed expansion in the issue of Industrial Bank debentures which would provide the city banks with a means of loaning to industry indirectly on a longer term basis, stating that the present issue was three billion and that there was a margin of seven billion available from this source if the debenture issue was increased to ten. This could be added to by a similar increase in the authorized debenture issue of the Hypothec Bank and perhaps of the Central Bank for Agriculture and Forestry.

Mr. Dodge referred to Mr. Ikeda's comments as follows:

1. The high tax burden. It was pointed out that available statistics indicated that the tax burden in relation to national income during the war years of 1942–43–44 was reported at about 22 percent. In 1945 this dropped to less than 10 percent and in 1946 went up to about 18 percent. An average for these two years was about 13 percent. In 1947 and 1948 the average was about 20 percent and in 49 it was estimated in one case a 22 percent and another a 26 percent. This included government and local taxes but not monopoly revenues. It was apparent that only in the current fiscal year or perhaps including last year the tax burden had returned to the war level. Also that if the war level of taxation had been maintained in 1945 and 46 as was the case in most other countries it perhaps would not now be necessary to maintain such a high level. As a matter of fact the tax burden in the U.S. was 25 percent and in the United Kingdom between 35 and 40 percent. It may be true that the little fellow in this country pays a much higher share of the taxes but if that is true the problem is to collect a larger portion of the taxes from those in the higher brackets.

2. Subsidies. It was suggested that it would be very natural to criticize the large amount of subsidies, particularly when they became apparent for the first time as a result of our action in exposing them in the budget.

3. Timing. For a politician there would never be a right time to stop inflation. This is the kind of action which everyone tries to put off and putting things off is the tradition of the Japanese Government. On the other hand when a thing has to be done the way to begin is to start. The fact that there may be less yen in circulation does not of itself prove deflation as the objective is to have not so much yen in circulation at an increased value for the yen itself and a smaller number of yen to do the same amount of business. Therefore, the reduction of the number and amount of yen in circulation is not an accurate measure of deflation.

4. Financial. The process of transferring credit and capital transactions out of the hands of the Government into their proper sources would naturally cause some objection. They do not belong in the Government. There would be created the natural limitations which go with the creation of debt rather than the giving of grants and subsidies. Obviously it should not and would not be as easy to obtain credit from banks as it had been to do business with politicians freely dispersing the tax revenues obtained from the people.

We had asked the ESS authorities to prepare a program to reduce subsidies and we were pressing them for its accomplishment. Our concern was that this should be done at a rate which would not create great price disturbances which, in turn, might complicate the labor situation.

The theoretical surplus referred to by Mr. Ikeda, which he hoped to use for tax reduction purposes, resulted in a warning that it was not the objective of the Shoup mission to come here and provide immediate tax reductions. It could be assumed that there would be no agreement to a tax reduction until the effects and results of actual administration of this year's budget had been made clear. It was suspected that we had only reached the beginning of a period of attempts again to open wide the doors of the budget. The Government had other liabilities to provide for such as the claims for U.N. property losses in Japan.

It was probably true that a mere readjustment of the rediscount or the borrowing rates would not serve to ensure available credit moving into reconstruction channels and steps might have to be taken to guard against an improper diversion of these loanable funds. It was pointed out that the proposed expansion in the debenture issues of the Industrial and Hypothec Banks or other banks could be turned into a substitute for the discontinued RFB loans and we could not afford to replace a budget inflation by a credit inflation. While there might be some arguments for providing an expansion of lending power for reconstruction purposes there had been little evidence so far that lending by the banks had been well administered in the past. An example of that was the fact that if the bank lending had been well-administered there would

not have been the shortage of available credit for sound and necessary purposes now claimed. As stated before there apparently had been promiscuous over-lending followed by promiscuous stopping of lending. Also a substantial part of the present credit shortage was due to the siphoning off of funds by tax collections and failure on the part of the Government to maintain its current disbursements.

11-32 THE STABILIZATION PROGRAM: PROBLEMS AND RESULTS (DODGE TO IKEDA)

Letter (Washington) August 9, 1949
To: Hayato Ikeda, Finance Minister
From: Joseph M. Dodge, United States Minister and Adviser

Dear Minister Ikeda

As you can imagine, I have been following the reports on the situation in Japan with special interest. Since my return I have been on a regular schedule to Washington. At each visit I review the cables and reports received from Japan and meet with the authorities and representatives of each Government Department having a primary interest in following the Japanese problem. Also, I receive the Nippon Times and other Japanese publications, and follow articles appearing in the United States Press.

We have observed the courage with which Prime Minister Yoshida, you, and others of your Administration have been meeting your problems. That these would occur was clearly seen by the authorities in Washington at the time the Stabilization Directive was considered and issued. None of the difficulties were unexpected. The situation in China was apparent and undoubtedly will affect Japanese trade until it is resolved. The heightened problems of the sterling bloc are an additional complicating factor.

Generally it seems to be overlooked that the trend of world affairs makes it even more necessary to stabilize and correct the internal situation in Japan. What has been happening in other parts of the world emphasizes the need for the program already initiated in Japan. What was done in Japan actually has preceded a steadily increasing need for the type of action taken. The fact that a start has been made will prove to be both constructive and fortunate.

One of the fundamental problems of international trade arises from the creation of a domestic price level which seriously interferes with the expansion of foreign trade. This is becoming evident in several important areas of the world, as well as in Japan.

The preference of workers for the shadow of a high money wage rate over the substance of real purchasing power, the prevalence in business and industry of uneconomic production, and extravagant non-productive government expenditures all combine to contribute to a progressively less competitive price-level in world markets.

During and after the war Japan could not supply its normal foreign markets. In the meantime some of these markets have disappeared, have materially changed, or have shrunk. Many countries, which formerly depended on Japan for goods, have been busily engaged in learning to supply themselves. This leads to trade restrictions intended to protect their own developing production. Other countries are following the belief that their future welfare also depends on greatly increased domestic production.

During the war and immediately thereafter the test of most economies was how much could be produced irrespective of cost. Now the principal task is to adjust an increasing volume of output more exactly to the demands of a growing foreign competition. An increased volume of production is not automatically followed by more exports and a better balance on foreign account. Therefore, production alone will not suffice to meet the problem. It must be combined with suitable economic and financial policies.

Currency and other trade restrictions have been multiplying rapidly, and foreign trade tends to become more and more rigid and compartmentalized. Some authorities already have reached the conclusion that many countries are in for a reduction in their standards of living, which will be forced by the further planned restrictions of trade. With this, there seems to be a total inability to comprehend the possibility of United States aid being reduced or ended and to adjust themselves to that idea.

Declining prices also suggest that we are entering a period of the most intense competition in international commerce. The problem of finding adequate foreign markets largely will depend upon more efficient, higher quality production, and the assurance of competitive prices. Those with the lowest costs will acquire most of the business. And the high cost of government

is included in the price of exports.

Japan's problem is to prepare itself now to engage in this intense world competition on an effective and self-sustaining basis. Japan can not provide for itself as a high cost, low quality producer. Fundamentally the Stabilization Program is aimed at ensuring Japan an opportunity to meet this world trade problem.

You will be interested to know that the problem of government subsidies has become a major one in countries other than Japan. Here are some pertinent reports.

Recently in Argentina the props under retail food prices, held at artifically low levels under a grotesque subsidy structure, were unceremoniously removed and over-night most of the basic food stuffs went up as much as one hundred per cent.

With this year's Budget, the British have had to bring to an end the rise in government subsidies. Belgium has had to take similar action.

Other governments have had to take drastic measures of economy. In Italy one of the government agencies providing subsidies or relief funds to industry, the Fondo Industria Meccancia, is to be liquidated.

In France more than 200,000 posts in the Civil Service and the nationalized industries have been done away with, as a measure of economy, since the beginning of 1947. To cut losses, the French Cabinet decided certain government-owned aviation factories should be closed or returned to private management. The National Assembly has approved substantial economy cuts in expenditures, and authorized a wide reorganization of the railways.

The price of government in Great Britain today is 40 per cent of the total of all private incomes. There certainly never has been any country which taxed itself to anything like this extent.

These are a few samples of the problems of other nations. They suggest that Japan is not alone with its problems, and that its problems do not differ a great deal from those of other nations. In actually meeting them with corrective action, Japan is on the way to obtaining sound longterm benefits and avoiding even more serious difficulties.

There are no needed anti-inflationary adjustments, or adjustments needed to place Japan in a position to compete efficiently in world markets which can be made without creating problems. The change from a substantially uncontrolled high cost economy, supported by handouts in the form of government subsidies and bank and government credit, to any more normal procedure is certain to bring some temporary embarrassments. The adjustments can be accepted and met as necessary and inherent to the situation, or avoided by a continued inflation with unquestionably disastrous results.

It is no surprise that exaggerations and alarms should arise from sources that in the past have advocated or encouraged the road of inflation for their own purposes. Any change from the flow of a progressive and extreme inflation inevitably encourages the internal enemies of the country to attempt to restore the progress of inflation or, failing that, plunge the country into a crisis. This is accomplished by spreading unwarranted seeds of fear.

One of the difficulties of correcting an inflation always arises from the fact that it has been extremely profitable for some, at the expense of most of the people; it has been a process that allowed many others to avoid making painful financial decisions; and it has minimized the consequences of financial mistakes. During an inflation people learn to act as though costs and money values did not matter, but it is becoming more certain every day that costs and prices are beginning to matter very much.

There has been and is an urgent necessity for the Stabilization Program. It is essential for the economic recovery of Japan. The objectives of stabilization and recovery are not in opposition, but are directly related and interdependent, and everyone in Japan has a personal stake in their achievement. It is an important and necessary step toward the eventual attainment of economic self-support and of optimum recovery under conditions of self-support.

While adjustments are taking place, in fact adverse effects are being minimized by substantial aid from the United States. Without this aid, the same problems of inflation or world trade conditions would have to be met with much greater penalties and difficulties, and with a much lower standard of living.

Alarmist reports and interpretations of currency and credit shortages appear to have little real foundation.

Reduction in the total of currency in circulation was intended and is to be expected. It is applied to an inflated price structure and an extensive higher priced black market. It tends to increase the real value of the reduced monetary means, which is an anti-inflationary objective.

An inflation requires large amounts of currency both for legal use and for black market activities, conducted outside of banks. The continued ability of consumers to pay high black market prices for consumption goods under conditions were a substantial part of basic consumption requirements are supplied by the United States indicates a surplus of purchasing power. A decline in the volume of money can be almost as much of a deterrent to excessive consumption buying by those obtaining windfalls from the inflation as ration coupons, and is much less complicated.

If an effective stabilization is carried through, it should encourage saving, reduce or eliminate the black market, increase production efficiency, and further lower prices, all of which will permit an additional decline in the volume of currency in circulation. Inflation, black market activities, and a continual rise in prices destroy both monetary and moral values. It is time that money reacquires some of its practical values.

At a recent reported total of about 285 Billion Yen, the currency issue is still approximately 190 times what it was in the 1930–1934 period. It is approximately 70 times what it was at the end of the war. This is despite the substantial currency reduction brought about by the government action of 1946. The level of production remains below that of the 1930–1934 period. It is ridiculous to attempt to pervert a 20 per cent shrinkage in currency outstanding from an abnormal seasonal peak of approximately 350 Billion Yen to 285 Billion Yen, into a currency shortage or a forerunner of national disaster.

The alleged shortage of credit results from the demands for it created by high prices and high wages, and the general policy of over-lending to borrowers who have been permitted to become overloaded with unrepayable debt. This loose credit practice has contributed directly to the inflation spiral. It has been magnified by those who have borrowed freely and unwisely in the expectation of being able to repay the debt with a further inflated currency of less value. Anywhere these circumstances exist and loan credit standards are applied more carefully and realistically, credit is certain to become less available. But, the real fact is that there is a greater shortage of credit-worthy borrowers than of credit.

It is certainly true that more capital is needed in Japan for most forms of industry and commercial enterprise. Again this is a problem which is common to most of the rest of the world. But real capital either must be created or supplied from internal or external sources. Unfortunately, in Japan its internal production operations have tended to dissipate capital and not create it. The inflation process undermined both the incentives and capacities of Japan to create new capital, despite the abortive attempts of government to do so through excessive advances of public funds to industry and trade, obtained by the use of government credit and taxation. This only made the Stabilization Program more necessary. A sound foundation had to be laid for the creation and acquisition of real capital and its future constructive and economic use.

Apparently there is little realization in Japan that every dollar of the large amount of United States aid already provided Japan has supplied, to some degree, additional capital to Japan. This is true even if the assitance is represented by food, fertilizer, and medical or other supplies furnished under GARIOA appropriations. It does not necessarily solely apply to raw materials supplied by EROA appropriations. All forms of aid have allowed the Japanese an alternative use of their own resources which otherwise might have had to be used for the maintenance of mere existence.

If adequate tax revenues are maintained and government expenditures are reduced, there are mechanisms provided in both the Budget and the Counterpart Fund to meet any situation likely to develop which can be attributed to the financial changes that have recently taken place. Sound administration of the Counterpart Fund and Budget revenues and expenditures will do much to minimize the results of any additional factors of world disturbance.

Before we left Japan the mechanism for establishing and using the Counterpart Fund had been agreed. When the appropriate Japanese authorities agree upon and submit a program which conforms to the principles clearly established and publicized, governing the use of the Fund, this Fund can be activated.

Many of the proposals originally advocated appeared essentially political in their motives and inconsistent with the objectives and possibilities for the most productive use of the Fund. The delay in submitting a suitable program and the details of the proposed individual projects underlying the program only served to add to the difficulties of the United States authorities in analyzing and approving allocations and disbursements.

Nothing would be more inconsistent with international economic reality or more detrimental to the continued recovery of Japan and a continuation of United States aid than to accept the studied exaggerations of those who would attempt to reverse the Stabilization Program. The need for a rationalization of the domestic and export economy has only become

more urgent. The return to any semblance of an inflationary program would serve to raise prices and further depreciate the Japanese international competitive position.

What Japan needs above everything else is to increase its productivity and its exports. Both are extremely low. Productivity is not the maximum quantity of production at any cost. It is the highest possible return on the use of all forms of productive resources. A world competitive ability only can be accomplished through increased efficiency of production, higher quality products, and better distribution at reduced costs. None of these either can be or will be accomplished by a continued inflation, or by the continued use of the proceeds from United States aid to cover the selling losses on production and exports.

There has been general astonishment here over the exaggerations of local conditions that appear to have little support from the underlying statistics of Japanese progress. The tendency of certain ostensible financial and economic authorities of Japan to over-estimate the adverse effects of the Stabilization Program and under-estimate or ignore any of its benefits causes more concern than any of the actual facts of the situation. Constructive attitudes are noticeably lacking. This suggests the possibility of a deliberate attempt to reverse the Stabilization Program and return to outright inflation.

The Stabilization Program has made possible definite steps of progress. One of many was the establishment of the single exchange rate. Dr. McDiarmid put it very well when he pointed out that Japan has introduced a single rate without devices such as export subsidies, export taxes, and special import or export rates, that many countries, even some not violently disturbed by the war, have believed it necessary to employ. This is a real accomplishment.

For the first time prices and wages have shown signs of actual stabilization. Industrial activity has remained substantially stable. The actual rise in unemployment has been greatly exaggerated. Unemployment is reported at a surprisingly small figure, when the tremendous postwar increase in the Japanese labor forces through overseas repatriation is taken into consideration.

The May decline in exports reflects the inflated forward-buying earlier in the year in anticipation of the exchange rate or of changes in local import controls elsewhere, as in India. Export trade prospects may have become more precarious and there may be added complications from any continued adverse turn in international trade conditions. But if so, that only highlights the need for rationalized production in export industries. Later reports show some recovery of exports in June and July.

The economic welfare of the Japanese people should be enhanced, not injured, by cooperative support of the stabilization program. The constant encroachment on the living standards of Japanese workers of spiralling consumer goods prices, and the parallel dissipation of productive resources into uses contributing little or nothing to the supply of essential goods, have been a direct result of inflation in Japan, as in several other countries. No development short of war itself could have been more damaging to the viability of the Japanese economy and, ultimately, to the real income of the Japanese consumer. To describe measures directed to the correction of this situation as an "austerity program" is surely a false interpretation of the facts. There is already ample evidence in Japan that the supply of food, clothing, and other essentials moving to the consumer through legitimate channels of trade is on the increase.

The termination of government deficit financing definitely strengthens government credit and should contribute to a more general and genuine market for government bonds. The fact that workers will be paid in a currency, the value of which does not continue to shrink, is an encouragement to thrift, saving, and investment.

It may be that the substantial isolation of Japanese public officials and the people of Japan from a general knowledge of what is occurring elsewhere in the world contributes to an unwarranted and distorted view of their own problems. Many other countries have comparable problems. This does not deny the difficulties or the problems, many of which are serious and are not easily met. It does deny unfounded pessimistic and premature conclusions.

This is a test period for the Japanese people and the Japanese economy. The result of the test can not be determined in any 60 or 90 days. Certainly the honor and self-discipline of the people of Japan should be sufficient to meet the problems, particularly when this is being done with substantial assistance from the United States, which can not and will not be forthcoming from any other source.

Repeatedly the United States has accorded assistance to Japan on a large scale. The receipt of these resources has been of great value to Japan. Unfortunately, in too large a part, they have been put to uses which only served to postpone the internal adjustments that are necessary and inevitable. It will be extremely difficult to convince the people and the Congress of the United States that a substantial part of this assistance should be continued without the

clearest kind of evidence that the Japanese people have organized themselves to meet effectively their own problems.

There has been no change in the conviction here that the Stabilization Program was advisable and is absolutely necessary, in the interests of both Japan and the United States.

[SOURCE: SUITLAND PAPERS]

11-33 BANK OF JAPAN'S OPINION ON FINANCIAL ISSUES

Letter of Transmittal November 14, 1949

To: Major General W. F. Marquat

From: Hisato Ichimada, Chairman, Policy Board, The Bank of Japan

Dear General:

We have today presented to Mr. Dodge the Bank of Japan's opinion on various problems which are deemed most important of all financial issues at present. We are enclosing a copy of the same in the hope that you will peruse our opinion and give your special consideration to it.

Yours faithfully
Hisato Ichimada

[ENCLOSURE]

I. MATTERS DESIRED FOR IN CONNEXION WITH THE BUDGET FOR THE 1950 FISCAL YEAR

Inflation in this country has entered the process of ending due to the enforcement of the equi-balanced consolidated budget for the current fiscal year, and prospects for economic stabilization are fairly clear. Thus it is desired that consideration be granted for providing appropriate flexibility within the limits of sound public finance in the Budget for the 1950 fiscal year so that it will conform with the actual trend of Japanese economy.

Consideration is especially requested for the following points:

(1) In order to maintain the Japanese exchange rate and to promote foreign trade, it is necessary to accelerate further enterprise rationalization, and it is expected that a considerable number of unemployed will arise as a result. Therefore, it is considered that it is unavoidable to have the Government effect counter-measures by conducting a certain volume of works within the extent required to prevent the occurence of serious social problems.

(2) A large number of Japanese enterprises depend on Government enterprises. Especially, the vehicle industry and the communication equipment industry conduct the major part of their production by orders from Government enterprises. Of course, liquidation should be effected in respect to enterprises that warrant liquidation. However, the above-mentioned enterprises have suffered a serious blow as a result of the sudden reduction of orders pursuant to the current fiscal year's Budget, great difficulties in financing having arisen, and the situation is that their allied industries as well will not be exempt to serious effects. This was an unavoidable measure for this fiscal year, but special consideration is desired for the securing of an appropriate volume of orders in the next fiscal year's Budget so that the enterprises may work out a standard on which to base future production.

(3) While it is contemplated that a considerable amount of Government debt redemption will be listed in the Budget for the next fiscal year, it is necessary to fully consider its relation to money and banking policies, and further it is considered that the Government bonds held by the Bank of Japan should be preferentially redeemed in the case of Government bond redemption.

(4) In respect to industrial loans from the U.S. Aid Counterpart Fund, the number of applications for loans which the Bank of Japan has finished examination and sent to the Ministry of Finance amount to 29 cases, ¥8,800 million, but the cases approved to date are only 2 cases, approximately ¥400 million. In case it is necessary for Japanese economic reconstruction to make direct loans to industries from the Counterpart Fund, it is important that it be effected appropriately at the proper time, and therefore, your special consideration is requested for their speedy handling.

Further, while these loans are by nature financings to industries, each individual case is handled as a Treasury disbursement, which involves duplicated examination and complicated procedures, and therefore it is considered that it is necessary to simplify these points.

Finally, it is requested that it be approved to have financial institutions effect stop-gap loans prior to GHQ approval of the Counterpart Fund loans and to have the stop-gap loans

repaid by the Counterpart Fund loans after GHQ approval in cases where the Counterpart Fund loans are delayed due to procedural or other reasons, and where there is a danger that industrial activity will be prejudiced.

II. The Effects of the Shoup Recommendation on Capital Accumulation

The conclusions in the "Report On Japanese Taxation By The Shoup Mission" are very consistent theoretically, and it is considered that they will be an important guide in the improvement of Japanese taxation. However, it is necessary to effect sufficient caution, with due consideration to the present conditions of Japan, in putting these recommendations into effect, so that it will comply with the actual conditions of the society and economy. Particularly, in respect to capital accumulation, the Report recommends abolition of anonymous time deposits and the intensification of inspection of deposits by tax offices. However, deposits occupy a very important position in the capital accumulation of this country, and therefore, it is necessary that any measures that might have the effect of disturbing the depositors' psychology and of eventually rendering the increase of deposits difficult hereafter should strenuously be avoided. An examination of the proportions capital stock, corporate debentures and financial institutions' loans occupy in the amount of industrial funds supply in Japan at present reveals that they are 20%, 10% and 70% respectively, and thus the supply of funds by financial institutions is predominant, and moreover, approximately 90% of corporate debentures are subscribed to by financial institutions. Further, the major part (90% prewar, 75% at present) of deposits in this country are interest-bearing deposits and they are important means for the people's savings. As the measure for capital accumulation hereafter, under these actual circumstances, it goes without saying that direct investments should be developed, but for the present much may not be expected of them, and thus it is necessary to further provide sufficient consideration for the increase of deposits. Ever since the release of the Shoup Report a tendency of withdrawals and transfer of deposits is to be noticed, and especially it is considered that anonymous time deposits have been directly affected by the Report. However, inasmuch as anonymous time deposits amount to approximately ¥79,000 million (56% of total time deposits with all Japanese banks) as at the end of September, 1949, and as their abolition would have serious effects, your special consideration is solicited for the retention of the anonymous deposit system for the time being. At the same time it is desired that careful handling be effected in the inspection of deposits by such measures as limiting them to cases where tax evasion is strongly suspected, so that the general depositors' willingness to maintain deposits will not be impaired by the feeling of insecurity and the troublesomeness that such inspection would involve.

It is further recommended in the Report that a registration system of unregistered securities be enforced and that the registration of transfer of ownership of stock be effected within one month. However, we wish to request that the first recommendation be not put into effect inasmuch as it is considered that it would impair the smooth circulation of negotiable securities and would become an obstacle to the acquisition of industrial funds. Also in respect to the second recommendation it is desired that the period in which the registration of transfer of stock ownership should be effected be extended to six months or so, inasmuch as it is considered that it would be almost impossible for technical reasons in the actual conditions of Japan to have such registration effected within a short period.

III. Real Estate Mortgage Financing

It is extremely important, in view of the industrial structure and distribution of enterprises in this country, to open a way of financing to small and medium-sized enterprises which do not possess suitable collateral other than real estate. Real estate mortgage financing institutions in Japan before the war consisted of the Hypothec Bank of Japan and numerous Agricultural and Industrial Banks (all of which were amalgamated with the Hypothec Bank by the end of 1944), which raised funds mainly through the issuance of debentures. However, real estate mortgage finance is very unsmooth at present due to the fact that the Hypothec Bank has been converted into an ordinary bank and has suspended debenture issuance. In the circumstances, the Policy Board, upon studies of countermeasures, considered that it is urgently required that a new real estate mortgage financing institution be established, and arrived at a conclusion that, as the general idea, for the present it was appropriate that the institution should start with a capital of ¥500 million subscribed by the general public and raise funds by issuing debentures up to 20 times the amount of capital, and apply such funds for financing to small and medium-sized enterprises on the security of real estate mortgages.

Incidentally, it appears that the Government is planning Treasury disbursements for house construction for the masses in the Budget for the next fiscal year, which is considered an appropriate measure. It is considered that it would be most effective to have the above-mentioned new real estate mortgage financing institution handle the operation business of such disbursements.

IV. Operation of Deposit Bureau Funds

Approximately 90% of the Deposit Bureau funds consists of petty savings of the general public, such as postal savings, etc. In nature the above funds do not differ in any respect from those of the general financial institutions, but moreover are, comparatively stable. Hence they have in the past been invested in financial debentures and special corporate debentures, as well as in government bonds and local government bonds, thus playing an important role in the facilitation of industrial funds. At present, however, the operation of Deposit Bureau funds is restricted to accommodations of loans to governmental organizations, i.e. undertaking of local government bonds or accommodations of loans to public corporations. For this reason, there was a surplus of approximately 30 billion yen in Deposit Bureau funds at the end of October, and even if an increase in the amounts of local government bonds to be undertaken (allowing for the raising of the debt floatation limit by about 8 billion yen) and loans to be made to public corporations between now and the end of the current fiscal year is taken into consideration, it is expected that the surplus in Deposit Bureau funds during the current fiscal year will amount to approximately 15 billion yen.

In the light of the nature of Deposit Bureau funds, as mentioned above, a sufficient reason cannot be seen for restricting the operation of Deposit Bureau funds to governmental organizations. Moreover, it is not believed proper to withhold such accumulated funds as surpluses at a time when there is a pressing demand for industrial funds. Such surplus funds should at least be returned to the market so that they may contribute to the facilitation of industrial funds. In this way it will be possible to provide funds necessary for economic reconstruction without advancing inflation. To accomplish this purpose, it would be appropriate, from the standpoint of the structure of the Deposit Bureau and unification of financial policies, to adopt a method of supplying funds to industries indirectly through financial institutions by the undertaking of financial debentures rather than by direct investment of the Deposit Bureau funds. The Central Cooperative Bank of Agriculture and Forestry, the Central Bank for Commercial and Industrial Cooperatives and the afore-mentioned new real estate mortgage financing institution are all required to secure funds by the issuance of financial debentures. Moreover, since it is difficult, under present conditions, to expect absorption of any large amount of such financial debentures in the general market, it is believed that the undertaking of such debentures with funds of the Deposit Bureau would be most desirable and would contribute greatly to the economic reconstruction of our country.

11-34 DODGE-IKEDA TALKS

Memorandum May 3, 1950
Summary of Meeting between Dodge and Finance Minister Ikeda
By: Joseph M. Dodge

1. Two long personal conferences were held with Minister Ikeda, one on Sunday, 30 April, from 9:45 a.m. to 1:45 p.m., and one on Tuesday, 2 May, from 3:30 p.m. to 7:30 p.m. A brief summary of the subjects discussed and some of the points relative thereto follow.

2. On the passage of the budget, the Diet argued mostly about the wage base for government workers and the appropriateness of the debt retirement provisions. The government workers' wages were too low and the debt retirement too high. This will cause deflation instead of disinflation. It is substantiated by increasing stockpiles of goods, increasing real and potential unemployment, and Japan is now in the first stage of deflation.

3. Aside from this, Mr. Ikeda said there are increasing cases of bankruptcy or approach to bankruptcy in small business. Self-assessed tax collections are lagging behind. However, the estimated deficit of about 20 billion yen in self-assessed taxes is offset by over-collections of the withholding and corporation taxes. Total taxes will meet the goal set. Other minor revenue deficits will be offset by savings in expenditures. The year will close with an estimated 4 to 5 billion treasury surplus.

4. On the implementation of the Stabilization Program, the principal problems are (1) the export outlook is not good; (2) measures are needed to soften up any outright deflationary

effect; (3) adjustments of price-wage relationships; (4) an increase in money wages of government employees.

5. At Mr. Ikeda's meeting with General MacArthur, the General emphasized the need to scale down the size of the budget, to reduce taxes and provide some moderate increase in government workers' wages.

6. There was an extended discussion of the government wage problem at both meetings. Mr. Ikeda emphasized that there had been implementation of the wage stabilization element of the Stabilization Directive and that he believed there was no longer any danger of setting off a spiral of wage increases by wage action taken in connection with government workers due to the decline in black market prices and other prices, and the fact that workers now were more concerned about continued employment than wage increases. He did not believe a wage increase for government workers would add fuel to the fire of other wage demands.

He said the book discharges last year of government employees were 250 thousand but the actual eliminations were 160 thousand. In FY 1950, the budget provides for 660 thousand government workers in the General Accounts, not including government corporations. These would be reduced about 1% by contemplated reorganizations. Further reductions could be accomplished by eliminating the constant 2% of vacancies existing within the budget provisions and by eliminating replacements as vacancies occur. The combined reductions from these sources alone would aggregate about 4%.

Of the 660 thousand government workers in the General Accounts of the budget, 230 thousand are Occupation employees. Thus the net government workers is 430 thousand.

The present base wage is 6307 yen per month and with dependent and district allowances this averages 6715 yen. With communication workers this is 6165 yen due to a predominance of women employees and in the railway it is 7050. The recommendation of the National Personnel Authority was for a 7877 base wage per month, which, with the allowances, would total an average of 8164 yen.

The additional cost would apply only to government, and not to Occupation, workers, as the latter receive a much higher wage. It is estimated to cost 15 to 20 billion yen on an annual basis. This needs to be carefully checked.

Offsets would arise from interest savings on retired government debt before maturity (if retired) from unexpended appropriations for CMMC, from large elimination of subsidies below provisions in the budget, and from substantial budget savings in non-personnel costs due to price declines.

It was considered important that this wage adjustment be made so as to be related to the increase in the official price of rice to be established in the fall of 1950 or in January 1951. It should probably be effective September 1 and established, if agreed upon, at a special session of the Diet at that time, would not be retroactive, would effect 7/12 of the FY 50 fiscal year, and the whole of FY 51.

Mr. Ikeda was asked to state exactly what he thought was necessary. The answer was to establish the possibility of a government employee wage increase not to exceed the NPA recommendation, and that this should be tied with a program to substantially reduce the total number of government employees, and a token tax reduction.

He was asked to submit a specific proposal for consideration that would show what was wanted, what it would cost, where the payment was coming from, the conditions under which this would be made effective, and what effect it would have, if any, on the budget provisions for debt retirement.

Mr. Ikeda was reminded that there must be a sharp distinction between continuous and "one-shot" budget savings. This proposal was for a continuing higher level of budget expenditures in this category and would absorb and greatly exceed any budget savings in non-personnel costs that would normally result in a continuing lesser total of expenditures.

(Note: A "token" tax reduction is completely inconsistent with such a proposed increase in government expenditures.)

7. The lag in the self-assessed tax collections was accounted for by estimates of 190 billion yen of revenue based on projections of 1947 and 48 that apparently disregarded the inflationary factor that existed in those years and did not exist in 1949. This estimate was adjusted downward to 170 billion yen, but collections are expected to be 150 billion.

In 1949, revenues were reduced by loss of black market profits and small business markups in inventories, viz., price declines instead of price increases. Also in 1949 many individual businesses incorporated for the tax benefit. There were 60 thousand more corporations, which is 30% of the total. This also had an effect on the payroll tax, where employer became employee. It was a shift within the tax structure. The corporation tax originally estimated at 27 billion yen, adjusted to 50 billion yen, may bring in 58 to 59 billion yen. The payroll tax originally estimated at 120 billion yen, adjusted to 140 billion yen, may bring in 150 billion yen. The loss on self-assessed tax will be offset by the gain in these two taxes.

8. The provisions for debt retirement in the FY 50 budget and counterpart fund total 128 billion yen. Fifty billion of this amount is from the counterpart fund and 78 from the budget. Fifty billion of the latter amount is from current revenue and 28 billion is mandatory debt retirement as a result of FY 49 surplus.

The question here is the necessity or advisability of continuing debt retirement at this rate and what alternative uses of these funds are appropriate and can be considered without losing the protection of these provisions against a recurrence of inflation.

9. A very preliminary forecast of the FY 51 budget (to be effective April 1, 1951) indicates total expenditures at 5.266 billion against 6.614 billion in FY 50, and revenues of 6.273 billion in 1951 against revenues of 6.614 billion in 1950. This is an excess in revenues of about 100 billion, before any provision for debt reduction or tax reduction. It is to be noted that FY 51 revenue is 341 billion less than FY 50. Expenditures in FY 51 as estimated are reasonably comparable to FY 50, with the substantial saving in deficits and transfers of 7.8 billion and in subsidies of 42 billion.

10. Mr. Ikeda reported that rationalization is substantially behind schedule in both the coal and shipbuilding industries. The cost of steel ships is about 85 thousand yen per ton as against a foreign producers equivalent of about 70 thousand yen. He believes rationalization should be forced by restricting the use of funds, and the counterpart fund should not be an instrument of avoiding rationalization. The high cost of shipbuilding is a result of high cost steel and high cost steel is a result of high cost of coal, particularly coking coal. In Japan coking coal is about twice the price per ton (5500 yen) as Pittsburgh. This problem can be met by importing from India and China at approximately $10 to $12 a ton, CIF Yokohama. That should get the price of coking coal down to 3500 yen a ton or about $10 in Japan. Mitsui Kyushu Mines claim that an investment of 1 billion 700 yen will enable them to save 1500 yen a ton. The 3500 yen per ton price is necessary to get reasonable costs in steel and shipbuilding. Mr. Ikeda believes the counterpart fund should go to hydro power first, coal improvement second, and shipbuilding third, because of the above, and that a present shipbuilding is having an undue priority for these economic reasons re-examined and the taxes reduced for the reasons given. This he will discuss with Dr. Shoup.

. . . . . .

14. There was considerable discussion of the problem of disinflation vs. deflation. Mr. Dodge pointed out that most of the complaints were based on the *provisions* for debt retirement and assumed results of debt retirement action not yet taken. There should be a distinction between propaganda and facts. Mr. Dodge reviewed a summary of the overall debt position of the Government at the end of 1949 against 1948. In this there was no indication of a marked deflationary reduction, particularly when related to the increase in local government and corporation debt (bonded) and the large increase in outstanding bank credit. No substantial reduction of purchasing power was apparent, rather a substantial increase seemed to have resulted. It was not apparent that debt retirement had resulted in an actual deflation of the money means in FY 50. What was needed was effective spokesmen for the stabilization program who could capitalize on its benefits and combat the spokesmen for the vested interests in inflation. The latter were vocal and had a public forum but the consumer who had been milked in inflation and was now receiving benefits was the silent man. The benefits were ignored and minimized and the problems magnified.

15. Increased public works expenditures were discussed and their inflationary effect in the shortage economy. It was suggested that there should be a capital budget that measured the relationship between the accumulation of private savings and domestic capital investment, including capital investment made and financed by the government.

16. Mr. Ikeda was asked to state definitely what were the principal objectives and hopes for accomplishment or assistance in his Washington interviews. He gave them in this order.

(1) A provision for creating and using export credits—essentially an agency to provide yen credits and internal capital funds for export purposes. Included with this was the maximum effective use of the counterpart fund and Deposit Bureau funds for capital purposes.

(2) Some agreement on the possibility of establishing a higher level of government employee wages, which was considered a political necessity.

(3) A reasonable modification of the local tax law.

(4) A greater reduction in the subsidies than provided for in the budget, the elimination of remaining kodans, and a tax reduction to offset these government savings which is to

be related to the final upward adjustment of official prices.

Mr. Ikeda was asked to submit specific proposals for consideration in connection with each of these projects, which he agreed to do.

Mr. Dodge emphasized to Mr. Ikeda that there was no possibility of obtaining decisions in Washington on these or any other proposals or problems that he could use publicly or carry back as "political gifts". These matters are in an area in which SCAP has final decision. The most we could do is explore and discuss the possibilities and then convey the substance of these discussions to SCAP for further consideration.

11-35 DODGE COMMENTS ON MEETING WITH FINANCE MINISTER IKEDA AND ON GENERAL ECONOMIC STATE

Letter May 8, 1950
To: General MacArthur
From: Joseph M. Dodge

Dear General MacArthur,

When I was in Tokyo it was my policy to summarize for you the substance of my meetings with Japanese Government officials. Following the same principle, enclosed is a report of two personal conferences with Minister Ikeda in Washington.

In addition to this memoranda, there is another, classified as Secret, about a discussion of the Japanese Treaty problem which will have to be sent on by courier.[15]

I know you will understand that I do my best to report these as simply and as objectively as possible, leaving out only what appear to be unnecessary details. I handle each problem presented the best I can at the time and if mistakes are made, they are my own and are unintentional.

When Mr. Ikeda arrived the press put the heat on me about the purpose of his visit. I was aware of the false build-up given this by the Japanese press and a certain individual of the American press in terms of a personal plea for a modification of the so called "Dodge Line". I told them that Mr. Ikeda had come here because he was a high official of the Japanese Government which, because of present circumstances, had a particularly close relationship with the United States Government, and since he never had visited this Country, I had suggested to you and to Prime Minister Yoshida that it would be advisable for him to make this visit whenever it could be done. I said its purpose was to make him acquainted with officials of our Government, and to give him an opportunity to study the operations in our Government that corresponded with his responsibilities in Japan.

Then, to reinforce this, I set up a schedule of personal introductions to Government officials and conferences over the two weeks, which have been cabled to you.

He was certain to have a number of special projects he wanted to discuss. So in answer to inquiries by the press as to what we were going to talk about I said, "Anything of interest to Mr. Ikeda". Further, you will note in the last paragraph of the enclosed memorandum that I told him nothing could be decided here and there could be nothing he could use publicly or openly carry home as a "political gift".

I have devoted a great deal of my time to listening and to discussing the details of Mr. Ikeda's problems. This has resulted in a willingness on his part to be extremely frank with me. As a result, it may be that he reports to me some things that he does not to others. I have encouraged this because I believe it has been helpful.

My point in mentioning this is to ask you to protect him to the extent that anything I may tell you that Mr. Ikeda has said is not in any way held against him or used against him. Also because these memoranda are made from my own notes and memory and might be subject to some revision or modification if Mr. Ikeda were to review them, which he does not. (Except for the one on the Treaty).

I would prefer that these memoranda not be disclosed to anyone, other than Major General Marquat and the one on the Peace Treaty not be seen by anyone but yourself.

My comment to Mr. Ikeda about the Peace Treaty situation was strictly a personal one, in an attempt to highlight what appeared to be the principal obstacles to an immediate Treaty. What I did say was intended to modify any unfortunate and unrealistic over-optimism. I would prefer to be wrong although, at least at the moment, I believe I am more nearly right than wrong.

[15] These memoranda are not printed.

When I left Washington last Thursday, the situation in the Department of the Army with respect to Occupied Areas was not clear. There was no reallocation of Tracy's responsibility within the Department. Major General Magruder is acting in his place. Tracy has offered to continue as consultant on Occupied Areas problems, but no action had been taken. He has said he will carry the appropriation problem through the Senate hearings but is planning to work with Gordon Gray, recently appointed Special Assistant to the President on the International Dollar Gap problem.

Thursday I had lunch with Gordon and he is busily engaged lining up an organization for the project. He has enlisted several top-quality men, including Ed Mason and Calvin Hoover. I believe his problem will turn out to be much broader and more involved than was thought originally. I saw the studies and documents relating to his appointment. Primarily they were directed to the commercial and foreign aid aspects of the overall Dollar Gap.

Since that time the issue of increasing foreign military aid has arisen. This promises to be a more extensive program than the initial disclosures indicate, and will directly affect the Dollar Gap. It will be necessary to have some integration of the two. The problem was complicated enough but now is becoming more so. So far there has been no clear definition of the issues and Gordon is working on that. He has indicated an intention to use Tracy to explore its military aspects.

So far it seems to me that there has been entirely too much emphasis on the idea that the seriousness of the problem will involve penalties and restrictions on United States economy without comparable emphasis on the requirements and responsibilities of the foreign Nations receiving the assistance.

Frank Pace is installed as Secretary of the Army and I saw him when I was in Washington week before last—on the day of Mr. Ikeda's arrival. I told him that some steps should be taken to make sure the able team (excluding myself) Tracy had gathered together to work on the problems of Occupied Areas was not disorganized, disbanded, or allowed to drift away because of the recent changes in the Army Administration. I believe the loss of Tracy's long experience makes it all the more necessary to retain the others who have the experience, the understanding, and the technical knowledge that come from struggling with these problems over a long time, and thoroughly knowing their background. Frank assured me this would be done and told me to give the individuals any assurance I thought necessary. I am sure he was sincere. However, some of these men—like General Eichelberger, Bob West, and John Logan—are volunteers and are not likely to want to continue under unfavorable or unacceptable circumstances. The same, of course, will be true of Reid, Garvin, and others.

The Administration is facing the unpleasant problem of reversing itself on the cost of the military establishment and justifying the reversal after strong public statements on economy and reductions in these expenditures. The recent increases I think are only token amounts compared with what finally will be needed. We will have our own increased military costs and the increased costs of foreign military aid to move into the place created by declining ECA appropriations. As you can be sure they would, the European Nations are contending that their Budgets can not stand any increased military expenditures and therefore most of the cost will have to come from the United States Budget.

Our financial and economic commitments in the military area versus economic aid in Europe and, in the area of economic aid to the Far East versus Europe (including in the latter some military aid), seem to be on the move toward much larger totals.

Week before last I attended a meeting of the Advisory Committee on Financial and Monetary Policy for the ECA and as part of the agenda there was quite a discussion of the problem of co-ordinating aid for the Far East. The good sense of this and the possible dollar saving seem to be gaining ground in official circles. There is still a long way to go, but the possibilities are being actively explored.

Paul Hoffman emphasized that while, under his statutory responsibility, he could give Japan every reasonable preference in the first opportunity to do business, and perhaps ignore minor unfavorable price competitive differences he could not justify or satisfactorily explain to Congress any substantially unfavorable Japanese price differentials. There is no way under the present set-up to guarantee Japan a market with ECA funds appropriated for specific purposes regardless of the price of its goods or services. They must be competitive—or reasonably so.

Obviously to do otherwise would be to subsidize Japanese exports with United States appropriations. Also, if Japan is to stand on its own feet in a competitive world market it would be no favor to the objectives of either Japan or the United States to establish its trade on a non-competitive or completely unsound and unrealistic basis. That process would eventually break down with disastrous results.

I suggested that a contributing factor toward doing something more about co-ordination in the Far East than had been done in Europe is in the fact that we would be dealing with a number of new national Governments and small new Nations rather than the larger Nations and longer-established Governments of Europe. We have a better chance of changing our basic approach when and if a co-ordinated program is initiated than we have of changing the extremely compartmentalized trap we have been in for two years in Europe.

The business situation here is extremely good, at least on the surface, but business managements remain conservative. The longer-term economic picture has not noticeably brightened. Remaining deficits in the supply of durable consumer goods, such as housing and automobiles, are being rapidly eliminated. This forecasts future replacement demands at a lower level.

Mr. Nourse, former head of the Economic Advisors, recently stated, "If I were sitting in the Kremlin, I think I would be quite complacent as I view the progress of the Battle of the Budget Bulge. Viewing it from Washington, I am deeply concerned". He thinks it is monstrous that more and more American millions should be shoveled out to others every time Stalin makes a move. Foreign demands on Washington continue to multiply. We are doing a better job of scaring ourselves than ever could be done by the Soviets.

Tomorrow night I am leaving for Washington to wind up Mr. Ikeda's visit there and hold a conference with him and the NAC group. Friday night he is going to New York and have the weekend to see this wonder of the world. Dr. Reid will accompany him. You will be advised of his schedule. While he is there he will see Dr. Shoup. I will not go to New York because Mr. Ikeda will see Bill Draper and other bankers and I want no misinterpretations to the effect that The Detroit Bank is lending money to Japan or that Joe Dodge is furthering the interests of any New York bank, investment, or industrial business.

11-36 ECONOMIC AND POLITICAL SITUATION IN JAPAN AND UNITED STATES DOMESTIC POLICIES

Letter May 22, 1950
To: Joseph M. Dodge
From: General MacArthur

Dear Joe:

Thank you so much for your full letter concerning Ikeda's visit to the United States and for the books which have just arrived. I appreciate your thoughtfulness in both instances very much indeed.

In spite of all reports to the contrary the general economic situation here is constantly improving. A very sound basis of stabilization is being accomplished although it is meeting increasing pressures from various groups. The general situation has been enormously complicated by the Red successes in China and other parts of Asia. Had this debacle not occurred we would have been well on the road to our final goal. Just at present Yoshida and the Liberal Party are so enmeshed in the political fight that their economic balance is not entirely ratonal. After the election I believe the situation will again become composed.

One of the greatest difficulties I have to overcome, and a growing one, is the basic difference in the policies we are imposing here and the policies being followed in the United States. These people are human and they just do not understand why we do not practice what we preach.

With renewed thanks and appreciation.

Very faithfully,
DOUGLAS MacARTHUR.

11-37 GOVERNMENT FINANCING AND TAX POLICY

Letter of Transmittal May 22, 1950
To: General MacArthur
From: Prime Minister Shigeru Yoshida

My dear General,

Finance Minister Hayato Ikeda has come to Kyoto to report on his U.S. tour.

I enclose herewith for your perusal a copy of his recommendations to me, which, he says, evolved in his mind in the course of the discussions he had with American authorities.

I hope to have the pleasure of calling on you very soon.

[Enclosure]

REPORT OF FINANCE MINISTER HAYATO IKEDA TO THE PRIME MINISTER

A. As a result of my conversations in Washington with the National Advisory Council's working group, headed by Mr. Joseph Dodge, there evolved in my mind a line of action, which, if sanctioned by the Allied headquarters, should go far, I believe, toward the solution of the current fiscal problems confronting the Government. I recommend that the Prime Minister submit to the Supreme Commander for the Allied Powers the following plans for his consideration.

1) To establish an Export Finance Corporation (100% Government owned), which will be capitalized at around 2 billion yen and may issue debentures of 40 billion yen at the maximum (figures are subject to future study), and which will furnish export trades and manufacturers with long-term loans and also extend credit to overseas importers and importing nations. The capital will be furnished from the General Account. The Deposit Bureau fund may be utilized for subscription to the debentures.

2) To raise the Government employee's wage base to about 7,200 yen effective July 1,1950 (or possibly to 7,568 yen effective October 1, 1950) by reducing such appropriations in the current budget as price subsidies, and cutting down personnel and other expenditures under a retrenchment policy, including reduction of the number of public servants on the pay-roll.

3) To study the means whereby the Deposit Bureau may assume, in so far as it can afford, an amount of credit which other creditor accounts of Government (e.g. Counterpart Aid Account, General Account) currently hold or are scheduled to hold in this fiscal year against other Government or Government enterprises debtor accounts (e.g. Communications Special Account, Railway Corporation, Housing Corporation). This would enable the Deposit Bureau to maximize its investment in Governmental enterprises while other creditor accounts will be enabled to invest in non-Governmental enterprises—as, for instance, extend more loans to small business.

4) To tentatively hold the 50 billion yen debt retirement program scheduled to be effected with the fund in the Counterpart Aid Account. This does not mean that the Government will not spend the amount of the Counterpart Aid Account for debt retirement purpose. Rather it means that the Government will further study carefully how and when should the debt be retired and in what amount.

5) To improve the condition of national economy and budget implementation so that the final and simultaneous adjustment of co-related factors of the stabilization program will become possible sometime early 1951. This would include increase of domestic rice price and resultant elimination of subsidy to imported food; national tax reduction; and if necessary, further wage adjustment.

If this is accomplished, the Government can further scale down its budget; the whole national economy will operate with less Government support, and the burden of economic reconstruction will be more equitably distributed among different social classes.

B. At Mr. Dodge's suggestion I conferred twice with Dr. Carl Shoup on the problem of local taxes. Dr. Shoup told me that he would agree, subject to SCAP approval, to the following changes in the Government bill introduced to the last session of the Diet.

1) Real Property Tax

To work out a formula whereby the tax rate will be determined prior to the payment of the third and final instalment of the tax. The rate thus fixed should not exceed 1.8%. For the first two installments the rate will be tentatively fixed at 1.7%.

2) Inhabitant Tax

There will be no substantial change from the original bill.

3) Value Added Tax

The enforcement of the tax will be postponed until 1951. For 1950, enterprise tax will be enforced at the rate of 12% on the profit accrued in 1949. Primitive industries such as farmers and fishermen will be exempted from the tax. For 1951, the tax will apply to the value added in 1950 at an initial and tentative rate. The rate will be finally fixed prior to the last installment payment by using the formula similar to 1) above.

C. Persons in important positions suggested to me that the Japanese Government might

request SCAP to use his good offices for Japan's admission into the International Monetary Fund and the International Bank for Reconstruction and Development. The general atmosphere seems to be favorable. I recommend that SCAP guidance be solicited in this matter.

D. It is earnestly hoped:

1) SCAP will approve the plans mentioned under A and B above.

2) Assistance from SCAP staff members will be given to draft the plans in detail.

3) SCAP will authorize the issuance of a statement by the Prime Minister as soon as possible after SCAP approval.

[SOURCE: SUITLAND PAPERS, Z 703–44]

11-38 FINANCE MINISTER IKEDA'S PROPOSALS AND PRINCIPLES OF ECONOMIC STABILIZATION PROGRAM

Letter May 25, 1950
To: Prime Minister Shigeru Yoshida
From: General MacArthur

Dear Mr. Prime Minister:

I have given thoughtful consideration to the report of Finance Minister Hayato Ikeda forwarded with your letter to me of May 22nd. Many of the proposals contained therein would be in conflict with the principles of the Economic Stabilization program directed from Washington and transmitted to you by my letter of December 19, 1948, which must guide the formulation of Japanese economic and fiscal policy in consideration of continued economic aid from the United States. They would, if adopted, require a complete revision of the national budget only recently enacted into law and entail abandonment, in favor of an inflationary course, of essential measures designed to implement the stabilization program, the success of which has already been established.

As has been widely reported in the press, the world at large stands in admiration of Japan's efforts toward economic stabilization and the significant accomplishments achieved thus far. This attitude was particularly noticeable during Mr. Ikeda's recent visit to the United States were Japan's budgetary position was most favorably commented upon. Nothing could be more unfortunate than ill-advised action at this time which would impair this renascent international reputation, such as reversion to previous inflationary policies whose ill effects are just now responding to adequate and proper measures as reflected in recent economic developments.

Industrial activity in April has increased for the third successive month and now stands at 104% of the 1932–36 levels. April exports have reached $61 million, another postwar record, and total export proceeds for the year ending June 1950 should reach $600 million, including income from invisible exports. In April the consumer price index stood at 11% below its postwar high of just one year ago. Without infraction of nominal wage levels, the cost of living has been reduced for the average individual thereby effecting a defacto increase in real wages. At the end of January, according to press reports, dividends of 268 companies whose shares are listed on the Tokyo Securities Exchange averaged 12.8%, while in eighteen months the number of companies paying dividends rose from 32% to 51%. Overall taxes for the present annual period are approximately ¥50 billion less than last year and tax relief has been advanced in some cases as far as a quarter of a year ahead of the beginning of the new fiscal period. The overall tax load on the Japanese people in relation to the aggregate national income is less than that of the United States, England, Germany and many other countries.

All of these contributions to the economic welfare are measures of historic importance which have been responsible for the development of a degree of recovery in Japan comparing favorably with many of the victorious nations of World War II. It is difficult to comprehend a proposal which would effect drastic revision in policies and programs which have produced such satisfactory results.

Any proposal for changes in the Local Tax Law Revision Bill will require careful study to insure that the revenues derived from the new local tax rates are sufficient to meet the revenue requirements of local governments without necessitating grants from the national treasury in addition to those already provided in the 1950–51 budget, and that the basic principles of taxation upon which the tax program is based are not violated. This is a matter which may be the subject of joint studies between representatives of your government and the Economic and Scientific Section of this Headquarters prior to the next session of the Diet.

Admission of Japan into the International Monetary Fund, the International Bank for Reconstruction and Development and other similar international organizations has commanded

my interest for some time. The matter is clearly involved in the accord of international acceptance which, in spite of repeated efforts by the Occupation, has been refused by some of the Far Eastern Commission nations. Efforts along this line shall be pursued with tactful perseverance, but you must not lose sight of the many practical obstacles which bar the way.

I have heretofore outlined certain objectives which should govern in the preparation of the budget for the next fiscal year if the present rate of progress continues and economic conditions warrant. These objectives are:

1. The budget must be balanced.

2. The total budget requirements should be lower than those contained in the JFY 1950–51 budget.

3. The budget should provide for a further reduction in taxation consistent with provisions of the Shoup Tax Mission recommendations.

4. Provision should be contained in the budget for an appropriate revision in government wages based upon a re-study of the situation by the National Personnel Authority.

5. No appropriations should be made for the reduction of the national debt from ordinary Japanese budget revenues. Counterpart funds for this purpose should be reduced.

6. No supplementary budgets will be authorized except for the single readjustment budget to be made effective before the beginning of the final fiscal quarter.

7. Price subsidies should be further reduced and eliminated wherever possible.

These objectives contemplate the progressive reduction of the burden borne by the Japanese people in consonance with the continuation rather than the abolition of stabilization measures, and are patterned to fit the actualities without disturbing existing equilibrium.

In general, the proposals offered by Mr. Ikeda would appear to be matters for future consideration in connection with long range planning when conditions make this possible. Indeed, they in part have been previously considered in connection with the present fiscal year's budget and found impractical of adoption in view of existing conditions. The Chief, Economic and Scientific Section will of course gladly discuss with you in fuller detail the impact which untimely adoption of such proposals would have upon the Japanese economy.

[SOURCE: SUITLAND PAPERS, Z 703–44]

11-39 LETTER FROM IKEDA TO DODGE CONCERNING THE RESULTS OF THE VISIT TO THE UNITED STATES

Letter May 31, 1950
To: Dodge
From: Hayato Ikeda

Dear Mr. Dodge:

It is beyond my description how grateful I feel to you for the wonderful and pleasant trip. Indeed I owe you everything. I was enabled by you to meet scores of important people in Washington and New York, whose acquaintance and friendship will be my valuable asset for all my life. Also for the first time in my life, you opened my eyes to a new world where the civilization has accomplished almost unbelievable things and people speak their own minds with respect and without fear. I especially appreciate your having stayed in Washington during my sojourn, being fully aware that it was a great sacrifice on the part of you and your bank.

The series of happenings which took place during the course of one week beginning at the moment I landed at Haneda Airport was not very pleasant.—The contrast was too sharp. I landed Haneda 4:40 a.m. May 22., and gave a prepared statement (enclosed) to the bunch of reporters there. So far so good. Then I was taken to Kyoto by the train that left Tokyo four hours later. I thought I should pay respect to GHQ first but Prime Minister's secretary had been kindly told from GHQ that I could go straight to see the Prime Minister in Kyoto. I reported to Mr. Yoshida about the discussions we had in Washington and as a result Mr. Yoshida made up his mind to cancel the rest of his stumping tour to return to Tokyo. I returned for Tokyo on that same night, Mr. Yoshida one day later. All the while both Mr. Yoshida and I were, I believe, very careful about what reporters called "the U.S. gift". No mention was given about it by either one of us and any mention, if any, was meant to create a negative atmosphere, although reporters were saying that "something must be hidden up my sleeve". All this movement, however, put fire into the oil of speculations and by the time Mr. Yoshida returned to Tokyo, it was a bonfire. On Wednesday morning when General Marquat suddenly cancelled his meeting with me schedulled 10:30 about fifteen minutes prior to the appointed

time, foreign reporter (Russel Brimes of A.P.—who is allegedly in alliance with Democrats and Socialists and top men of Government Section) started talking about the relation between the Occupation and J.G. being suddenly cooling down. I do not believe Gen. Marquat cancelled the appointment because of any ill intention but it nevertheless created an embarrasing situation. Prior to this scheduled meeting. Prime Minister sent a letter to Gen. MacArthur incorporating my report to Prime Minister, and requesting SCAP consideration thereof, and also asking for his authorization of a statement the Prime Minister wished to publicize giving a summary of my findings. A copy of the letter was given to Gen. Marquat prior to giving it to Gen. MacArthur. But this letter may have had something to do with the cancellation. (If you are bored of reading such tid-bits, please skip it—but such small things really sometimes mean much.) Anyway the cancellation was capitalized by the Opposition.

With the beginning of this week, the ice was broken and yesterday Mr. Yoshida in the capacity of the President of Liberal Party made an announcement after SCAP cleared it. The announcement stated that before the end of the third quarter of this fiscal year, 1951–52 budget will be drafted up, and, in connection with which 1950–51 budget may be revised. On that occasion such points (as we discussed in Washington) will be considered. Some of the points of urgent nature may be considered and realized prior to that time—This has been the basic line of the announcement. This morning I met Gen. Marquat and was given a warm congratulations from him for the success of my trip. Everybody seemed happy.

I should like to ask you to give Mrs. Dodge the best wishes of myself and Mrs. Ikeda. She is so much appreciative of the gift Mrs. Dodge gave. And also the best from my three daughters to Auntie Dodge. Please give my regard to the people I met in U.S. wherever and whenever you meet them, too, although Miyazawa is drafting letters to each of them.

Hayato Ikeda

P.S. Please accept my millions of thanks.
Dr. Reid bought me a nice sweater on your behalf, which I love so much—Keech Miyazawa.

11-40 COMPLETION OF MISSION BY MR. JOSEPH M. DODGE

Memorandum December 2, 1950
To: General MacArthur
From: W. F. Marquat, Chief, ESS
Confidential

1. Mr. Dodge completes his mission and departs Japan, as you are aware, on Monday 4 December 1950. He has devoted his time unstintingly to the purpose of analyzing the progress of implementation of the Economic Stabilization Program and of revising this program in the light of changes in conditions since the program was initiated.

2. Mr. Dodge's "final report" consists this year, as in the past, of a series of personal memoranda delineating the nature of this discussions with the various Occupation and Japanese authorities and stating his conclusions in each instance.

3. Attached is a file of these memoranda. It is my responsibility to place these in your hands prior to Mr. Dodge's departure in order that you may have at your disposal full information on any particular subject in which you may have special interest.

4. In the light of the demands upon your time imposed by the critical military issues of the moment I feel that the extent of your immediate consideration of these papers should be confined to a glance at the index which indicates the subject coverage, unless there should be some special subject in which you may have special interest. The documents will be on file for future reference in case of necessity.

5. I have followed the progress of the deliberations of Mr. Dodge to the extent that I can satisfy you of their general consonance with your budget policy upon which I have insisted. I quote from Mr. Dodge's Memorandum of 30 November 1950, subject: Budget Summary. It states "The budget policy announced in April 1950 has been followed despite the fact that this policy was established for a budget year that began one year later than the announcement of policy, that it affects the year following that latter date, and that within four months of the announcement of the policy there was a substantial and unexpected change in the fundamental conditions brought about by the Korean War." This statement indicates that the policy has been followed in spite of certain reluctance to accept it in toto and I can assure you that such is the case. My insistence upon the close adherence to the announced position was predicated upon the fact that it represented a commitment which it would have been impolitic to ignore and further that certain measures to counter the changed conditions could be taken without violating the basic precepts of the policy.

6. Some of the memoranda contain recommendations by Mr. Dodge of future action to be taken which will be followed since there is no major variance with your approved and announced policies. The recommendations contain approval of the establishment of special financing for increasing exports and for long range capital investment in Japan but otherwise the normal financing channels are adhered to. Details of the two new institutions will have to be worked out in detail later for your final approval. The major concern of the moment is the need for modernization of private banking procedures which are far from satisfactory. Detailed studies of the credit demand-supply position and the private banking procedures as they exist are being initiated. Mr. Dodge also includes some personal views on certain activities, such as his Memo of 30 November 1950, Subject: National Police Reserve, which are for the information of the headquarters.

7. Mr. Dodge's contribution of his time and profound knowledge of financial and economic subjects have been of great value to the headquarters and his deep interest in the continued progress and success of the Occupation under your masterful guidance is beyond question.

11-41 POSSIBLE REORGANIZATION OF RECONSTRUCTION FINANCE BANK

Memorandum December 3, 1950
To: Major General W. F. Marquat
From: Joseph M. Dodge

The lending activities of the RFB were stopped in 1949.

My general memorandum of Capital Funds Availability and Bank Credit highlighted the problem of long-term debt carried as short-term debt in Commercial banks and the need to refinance it on its proper terms. The same situation applies to the loan assets of the RFB where it was generally the practice to carry long-term debt in relatively short-term form.

The RFB had capital from appropriations of the general account of the budget amount to a total of ¥58 billion. Of this amount, ¥9.4 billion was repaid and taken into government revenues in JFY 49 and an estimated ¥12 billion will be similarly recovered in JFY 50.

The debentures of the RFB were retired from the Counterpart Fund to the amount of ¥62.5 billion and cancelled.

Thus, the assets of the RFB belong to the Japanese Government as a result of this capital contribution and the Counterpart Fund and/or the Japanese Government through the retirement of the debentures.

The present status of the RFB is indefinite as it is, in effect, a corporation undergoing liquidation. This is disturbing to its management and its staff and tends to disorganize both.

The assets of the RFB (to whatever extent they can be liquidated without less) as a pool of long-term capital already provided for through government appropriations and the Counterpart Fund.

There have been many proposals to reorganize the RFB and continue its operations in some form because of the capital needs of the economy. Most of these tend to replace it in its original form or even expand that.

There is some danger in a reorganization of the business in its earlier form, not only because of the demonstrated lax and political management of the lending at that time but the public bad name the corporation subsequently acquired.

However, there is the problem of the amount of long-term debt carried in the commercial banks in short-term form and long-term debt carried in the RFB in relatively short-term form. This suggests the possibility of reorganizing the RFB under a different name and giving it some permanence so it could effectually refinance the long-term debt within the RFB on the proper terms and also use its funds from the liquidation of existing loans for refinancing long-term debt now held by the commercial banks.

This would limit its operations to refinancing its own or exisiting loans held by commercial banks. If this process were followed, it would tend to free up the commercial banks to the extent that liquidation was obtainable in the assets of the RFB and in doing that provide more legitimate short-term credit to business and industry, without inflating credit.

By avoiding the possibility of engaging in direct lending, the complications incident to

past lending are largely eliminated.

By not permitting the issue of debentures and expansion of debt is avoided.

It could lend only the funds acquired from the liquidation of its assets or such other amounts as might be supplied through budget appropriations.

There is another factor. The second large pool of long-term capital lies in the Counterpart Fund loans, exclusive of grants. The time will come when perhaps under a peace treaty it will be advisable to transfer these loans to some other agency for administration and liquidation. The combination of the pool of long-term capital represented by the Counterpart Fund and the RFB and the liquidation of those assets according to the terms of the loans would provide a substantial revolving fund for the refinancing of long-term debt now held by the banks.

Any consideration of possible transfer of Counterpart Fund assets to the RFB in its revised form could be considered when an appropriate time for it arose and could be conditioned on the proof of good management of the RFB under its revised status.

Some such name as Japan Development Corporation might be used for its reorganization.

It is recommended that this place or some alternative to it be studied by your organization.

11-42 JAPANESE FINANCIAL OBLIGATIONS AND PEACE TREATY

Telegram No. Z—46314 October 28, 1951
To: Department of the Army
From: SCAP, Approved by W. F. Marquat

For SAOOA. Following for your information is press statement issued by Honorable Joseph M. Dodge upon arrival at Yokohama 28 October:

"One of the principal purposes of my visit to Japan is to review and report on the plans of the Japanese Government for meeting the financial obligations which will arise in connection with the Treaty—recently signed in San Francisco—and effective when it has been ratified by the necessary number of participating nations.

"These obligations have, in fact, existed for the past six years but, under the protection of the Occupation, have not been formally acknowledged or provided for, in the Government budgets.

"However, when Japan returns to the status of a sovereign nation these responsibilities no longer can be unfulfilled, nor would the Japanese people wish to do so.

"The claims of reparations for war damage and the restoration of Allied properties; higher domestic and collective security costs; the settlement of the pre-war foreign debt and other obligations; and any other demands arising from the Treaty itself or required by the expanding national and international responsibilities of Japan's post-treaty status will be substantial and will continue for some considerable period of time.

"Their requirements inevitably will compete with the many and pressing capital investment and rehabilitation needs of Japan in every area of the public domain and interest as well as the capital needs for the modernization and expansion of industrial production.

"To do all that is necessary to meet these additional burdens will not be easy. But with the help of a full understanding and the concentrated and cooperative effort of every element among the people of Japan it certainly can and will be done.

"What is done to satisfy these claims and meet these new responsibilities is a matter of the foremost national interest and will be watched with close attention by the rest of the world."

11-43 THE PRINCIPLES OF JAPANESE TRADE AND THE CONDITIONS OF A SELF-SUPPORTING ECONOMY

Statement[16] November 29, 1951
By: Joseph M. Dodge

No one could fail to note the visible signs of material progress made by Japan in the past year but at the same time any study of the underlying circumstances will provide just cause for concern about the firmness of the foundation upon which this higher structure has been

[16] Issued at conclusion of Dodge's visit to Japan.

built.

These circumstances, the expected ratification of the Peace Treaty and a sincere interest in the future of the people of Japan are the reasons for this statement.

Everyone should clearly understand the fundamental problem of Japan which can be expressed in these simple general terms: Too many people, too high a birth rate, too little land, too few natural resources.

This combination produces an increasing need for expanding overseas sources of food and the raw materials of production. With the need goes the requirement for payment.

It is not the production *capacity* of Japan that is the key to survival, but the supply of materials out of which the goods and products essential to the life and future development of the economy are created and the efficiency with which they are processed and converted into export products acceptable in world markets.

In the future, as in the past, the foreign exchange needed to pay for imports will have to come mostly from the exports of Japanese manufactured goods and products.

The need for exports always is especially important for any nation with substantial shortages or gaps in its basic material resources. The imported raw materials not only are needed in the production of the exportable products themselves but are just as necessary in the production of the goods and products used by the domestic consumer. Thus, in Japan, exports have to carry an extra burden.

While the economic aid provided Japan by the United States was measured in dollars, it actually was delivered in the form of food, goods and raw materials. These aid imports were a substitute for the supplies that Japan ordinarily would have had to buy for itself with the foreign exchange it earned from Japanese exports.

If grants or loans of funds or goods to Japan, or any of the other unusual or abnormal acquisitions of foreign exchange should cease, the status of its production and its standard of living or any increase of production and improvement of that standard of living clearly will depend on a close control and direction of imports and the use of other scarce materials and a determined emphasis on the increase and maximization of exports.

Production for domestic consumption will not and cannot produce the foreign exchange needed to permit Japan to pay for a steadily increasing amount of food and basic raw material imports.

An unbalanced expansion of imports which are non-essential or are diverted into production for domestic consumption to a greater degree than is necessary to provide adequate production for export will not answer the problem and will magnify it.

The same principle applies to the control of the domestic use of materials or products that could produce needed foreign exchange, if they were exported.

For these reasons, maintaining the present standard of living and of production activity and improving them primarily depends on:

1—The availability of overseas sources of food and raw materials in the amounts required for import.

2—The ability to compete in export markets, which is a matter of price and quality and not the mere ability to increase production.

3—A substantial and progressive increase in the merchandise exports necessary to provide the needed amount of foreign exchange to pay for the imports.

Unless these underlying problems are recognized more clearly than they appear to be at present, and strong and really effective efforts are made to meet them, the longer term situation of Japan is certain to become increasingly difficult.

For the past six years Japan has been living under the protective umbrella of the Occupation. In that time it has received the benefits of billions of dollars of goods and materials not provided or paid for by its own exports. To a large degree the United States Government has served as Japan's procurement agent for obtaining these imported materials and supplies, even under conditions of critical shortages elsewhere. Japan has been given unlimited technical assistance in many areas of domestic advancement and improvement. It has been able to postpone the payment of certain of its just debts. It has received a treaty with extremely favorable terms.

What these and other advantages have been when compared with any disadvantages clearly will become more apparent with time.

The question to be answered is whether Japan will gain its political independence and remain economically a dependent nation or whether it will do what is necessary to create and establish its economic self-sufficiency and independence.

At present, Japan is suffering from a plague of false legends, which include some dangerous

delusions. A few of these are:

1—That Japan is a "special case" not affected by economic events that are affecting most other nations, when, as a nation dependent on imports, it is sure to be one of the first and most deeply affected.

2—That granting progressively larger amounts of commercial bank credit for capital purposes can be substituted for the normal processes of capital accumulation, without creating current credit shortages and the possibility of later difficulties.

3—That increased production without a parallel increase in exports represents sound progress.

4—That large amounts of foreign investment capital can be attracted to Japan under circumstances which do not offer political and financial stability.

5—That any use of foreign exchange will automatically replace itself.

6—That the projects most needed to protect and ensure the future of Japan, in terms of reducing the need to import and increasing the ability to export, can be done last instead of first.

7—That any future trade with Communist China will have the same advantages as it had before the war.

8—That the Korea wind-fall will be followed by another equally good or even better fair wind.

9—That in view of Japan's progress and the unusual external sources of it, substantial amounts of foreign aid will be obtained as easily in the future as in the past.

10—That inflation is a temporary phenomenon instead of a continuing pressure in an economy short of domestic supplies of raw materials, and that inflation easily can be offset by increased production under these circumstances.

11—That the recent excessive increase in domestic prices has been caused solely by the increase in import prices.

12—That a nation that must export to live can afford to price itself out of its export markets with a domestic inflation.

13—That a rapid and excessive increase in domestic prices is inflation anywhere else in the world but not in Japan.

14—That there is anything but trouble ahead in an attempt to chase inflationary price increases with stop-gap measures which merely feed the fires of inflation.

15—That every difficulty caused by excessive debt, speculative purchasing and similar acts of bad management always is the fault of others, it is not the inevitable result of the previous mistakes of the individuals concerned, and should be borne by the government or the consumers.

The progress and the present favorable status of Japan has been the result of a series of extremely fortunate external circumstances, which cannot be expected to be repeated and continued indefinitely. But despite these unusually favorable circumstances Japan only recently has achieved an approximate balance of the foreign trade account.

It is certain that none of the fundamental problems of Japan will be met successfully by a general failure to recognize and face the facts. It is even more certain that success is unlikely if there is a continuation of the prevailing spirit of light-hearted opportunism.

Japan cannot afford to be dissuaded from the steps necessary to ensure a sound and stable future for its people or to be misled by the honeyed promises of the Pied Pipers of inflation who work to protect the speculators, the hearders of goods, and the unworthy and extended borrowers who even now are continuing their plans to milk the value from the workers' wages and the people's income and savings in the future as they have done at times in the past.

There is evidence that with the right kind of effort and direction Japan can create the essential conditions of self-support.

Much can be done to achieve this result with continued and more aggressive action to rationalize production, increase efficiency and reduce costs and prices. But with this there must be parallel action to minimize non-essential imports, to control and direct the use of imported raw materials into export production channels, to restrict the domestic use of critical materials and products that can be exported, to help develop domestic and overseas projects that will reduce the need for high-cost imports, to facilitate production for export and to limit and direct the use of credit toward these ends.

The economic stabilization program established in 1949 permitted the wholesale elimination of the coupon type of detailed controls over the economy needed during the war and immediately thereafter. This was a popular and worthy objective. But a year ago the world situation changed abruptly and Japan is directly and materially affected by it. The objective

should be to take every appropriate measure in the way of general restrictions over critical areas for the purpose of avoiding if possible any need to return to the undesirable type of controls it was necessary to use several years ago.

If these and similar related measures are taken, there should be little need for Japan to be dependent on others. If none of them is undertaken, there can be little justification for economic assistance from others.

11-44 JAPAN: POST-TREATY RELATIONSHIP

Memorandum[17] January 17, 1952

By: Joseph M. Dodge

There will be a substantial reliance on Japan for:

(1) Production of goods and services important to the United States and the economic stability of non-Communist Asia.

(2) Production of low cost military material in volume for use in Japan and non-Communist Asia.

(3) Development of its own appropriate military forces as a defensive shield and to permit the redeployment of United States forces.

Japan has:

(1) A possible increase in industrial activity of about 35 per cent without expansion of additional plant.

(2) Created a United States-Japan Economic Cooperation Council in the executive branch of the Japanese Government.

(3) The capacity in a relatively short period of time to develop its military forces to the required strength with some assistance from the United States.

United States needs:

A centralized responsibility in Washington for cooperation

(a) Able to plan and recommend with authority in this area of responsibility and mutual interests in Japan and the Far East.

(b) To determine the maximum Japanese capacity to support their own military forces as a basis for the amount of military assistance to be supplied Japan.

(c) To coordinate economic and military aid for Japan with any similar programs that can be related to Japan.

[SOURCE: DODGE PAPERS[18]]

[17] On February 1, 1952 Dodge produced a longer draft based on this memorandum and entitled "United States—Japan Economic Cooperation in the Post-Treaty Era".

[18] Unless otherwise indicated, the documents of this chapter are from JMD MSS.

12 MONEY AND BANKING

12-1 CLOSING OF COLONIAL AND FOREIGN BANKS AND SPECIAL WARTIME INSTITUTIONS (SCAPIN-74)

Memorandum September 30, 1945
SCAPIN-74 (ESS)

1. You will immediately close and not allow to reopen, except at the direction of this headquarters, the head offices, branches and agencies in Japan of the banks and other financial institutions enumerated in Inclosure 1, attached hereto.

2. You will immediately post signs on the premises declaring that the institutions are closed.

3. Guards will be posted at all premises occupied by such institutions, and access to the premises will not be permitted except as directed by this headquarters.

4. Any books, records, and papers of the institution which are not on the premises occupied by them will be taken into custody and delivered into the special custody of this headquarters.

5. You will impound all gold, silver, currency, securities, notes, mortgages, pledges and other assets of the institution which are not located on the premises occupied by them.

6. You will take such action as is required to prevent and prohibit, without the prior permission of the Ministry of Finance, any purchase, sale, transfer, withdrawal, or disposition of, or other transaction involving any assets of such institutions. No such transaction will be permitted by the Ministry of Finance without authorization of this headquarters.

7. You will discharge and summarily remove from office the chairman of the board of directors, the president, the managing directors and the advisors of all institutions listed in Inclosure 1, and all other persons holding comparable posts in such institutions; and you will forbid them to enter into or to act for institutions with which they were associated. You will cancel the authority of all persons holding powers of attorney or signing authority and will not permit any authority or power to act on behalf of such institutions to be given to any other persons without the authorization of this headquarters. All the officers, directors and other officials of such institutions will remain available and will not change their address without the authorization of this headquarters.

8. a. You will safeguard and preserve, not remove or permit to be moved from their present location, any of the following:

(1) Any plates used for printing currency and stamps other than notes of the Bank of Japan, Japanese State Notes, and stamps used solely within Japan.

(2) All stocks of manufactured currency and stamps other than notes of the Bank of Japan, Japanese State Notes, and stamps used solely within Japan.

(3) All watermarked paper intended for the manufacture of currency and stamps, other than notes of the Bank of Japan, Japanese State Notes, and stamps solely for use within Japan.

b. You will report to this headquarters by 0900 hours, 2 October 1945, the location of all of the items listed in "a" above.

9. You will report immediately to this headquarters the action taken to comply with these requirements.

10. An acknowledgement of the receipt of this memorandum is desired.

12-2 OPPOSITION TO OPENING OF NATIONAL CITY BANK BRANCH

Memorandum[1] December 2, 1945
To: Secretary, SWNCC
From: John D. Hickerson, Acting Chairman

[1] This memorandum was designated SWNCC 226/1/D, "Establishment or Re-establishment in Japan of Branches of American Banks," December 3.

In cable WARX 76093 of October 15, 1945, the War Department had sought MacArthur's views regarding an inquiry from the National City Bank of New York concerning the re-establishment of its Tokyo branch. SCAP replied in cable CA 53549 of October 19, requesting that the bank "resume Japanese operations as soon as possible", because "Japanese banks in vulnerable condition and sound bank necessary as U.S. depository to provide banking facilities for occupation needs, for import and export activities and for foreign personnel."

Confidential

I am unable to give my approval to SWNCC 226 at this time, and I would like to suggest that the paper be referred to the Subcommittee for the Far East for further consideration and a report thereon.

If the plan proposed in SWNCC 226, to permit the opening of a branch of the National City Bank in Tokyo to perform certain special functions for the American Army of Occupation, is carried into effect without granting similar permission to banks of others of the United Nations, it is certain that some of our Allies, particularly Britain, will be most suspicious of our motives and intentions. We shall be open to the accusation that we are utilizing our occupation of Japan to promote our own financial and commercial interests, while denying similar opportunities to our Allies.

Inasmuch as the State Department has taken the position that American individuals and agencies should not be given preference over individuals and agencies of other Allied countries in receiving Japanese exports or in gaining access to properties in Japan for the purpose of examination and liquidation, it does not appear consistent to permit an American branch bank to resume operations in Japan unless (a) its military necessity is unassailably established or (b) similar authorization can be given to branch banks of the other Allies.

It is appreciated, however, that prompt consideration should be given to General MacArthur's request for the early establishment of American banking facilities. Accordingly, it would appear proper that this subject should be thoroughly reviewed as to its international implications, and I recommend that this matter be referred to the Subcommittee for the Far East for study and report.

12-3 ABOLITION OF SYSTEM OF DESIGNATED FINANCIAL INSTITUTIONS AND COMPULSORY LOANS

Memorandum for the Record March 25, 1946
By: Frank Rizzo, Government Section

1. ESS/FI (Maj. Sherbourne) has submitted for informal concurrence a proposed memorandum to the Japanese Government, subject: Abolition of System of Designated Financial Institutions and Compulsory Loans wherein the Japanese Government is instructed to terminate immediately the system whereby (1) particular financial institutions are designated as the exclusive sources of credit for certain enterprises and (2) the Government directs financial institutions to make credits available to designated concerns. Paragraph 4 of the proposed memorandum further states that the "Development of a free and independent banking system adjusted to the varying needs of local communities and adhering to sound loan and investment policies is regarded as a vital step in the renewal of peacetime production and the democratization of the Japanese economy."

2. Any measures which will help to take the Japanese Government out of the banking business, restore to banks a measure of self-reliance and freedom to exercise banking judgement in the granting of loans, loosen the close ties between financial institutions and business concerns, and reduce the monopolistic control over credit exercised by the so-called "Big Five", are in accord with basic occupation policies and should be supported.

3. In a telephone conversation with Maj. Sherbourne of ESS/FI on 23 March 1946, Capt. Rizzo stated that he personally agreed with the purpose and substance of the proposed memorandum to the Japanese Government. As a matter of form, however, it was suggested to Maj. Sherbourne that if paragraph 4 and the second sentence of paragraph 2 of the present draft were combined into a new paragraph 2 and inserted before the rest of the subject matter, the directive would be more logical and forceful. Maj. Sherbourne agreed but requested that, inasmuch as the paper had been submitted informally, the suggestion be transmitted informally.

4. Accordingly the attached draft[2], revised in accordance with above informal suggestion, is being transmitted to Maj. Sherbourne.

[2] Though not printed here, this attached draft became SCAPIN-863 of April 5, 1946.

5. Since the control of financial problems under the occupation is a primary responsibility of ESS/FI, and since the proposed directive is in accord with basic occupation policies, it is recommended that the Government Section concur, leaving the determination of the final form of the directive up to ESS/FI.

[SOURCE: SUITLAND PAPERS, Z 703-12)

12-4 REOPENING OF THE JAPAN SECURITIES EXCHANGE

Memorandum March 31, 1946
To: C of S[3]
From: CW[3]

1. The Government Section concurs in the proposed memorandum for the Imperial Japanese Government, AG 371.2 (—— Apr. 46) ESS/FI, subject, Reopening of The Japan Securities Exchange, with the following provises:

a. That SCAPIN 403, AG 004 (8 Dec. 45) ESS/AG, dated 8 Dec. 45, subject: Establishment of a Schedule of Restricted Concerns, be amended so that private and over-the-counter transactions in the "restricted" securities as now permitted by paragraph 3 of that directive be prohibited altogether or, if that is not feasible, be made subject to licensing requirements no less strict than these to which exchange transactions in such restricted securities will be subject under paragraph 3b of the proposed memorandum.

b. That such withdrawal or amendment of the general authorization granted in paragraph 3 of SCAPIN 403 be transmitted to the Japanese Government prior to the date on which securities trading on the stock exchange is to be resumed.

[SOURCE: SUITLAND PAPERS, Z 703-16]

12-5 ABOLITION OF SYSTEM OF DESIGNATED FINANCIAL INSTITUTIONS AND COMPULSORY LOANS

Memo for Record undated (April 1946?)
Re: SCAPIN-863 of April 5, 1946
By: C.F.T.[4]

1. The system of designating financial institutions to finance munitions companies was inaugurated in May 1942 with the establishment of the National Financial Control Association. At the beginning, a munitions company was technically free to select one of several designated banks, but in April 1944 even this privilege was eliminated and one bank was designated for each munitions company. With the end of the war, the designated bank system was diverted to the financing of war industries converting or planning to convert to peacetime productions.

2. In effect, the designated bank system divides the banking system of Japan into two groups (a) banks for industrial financing and (b) banks for the absorption of savings. The Big Five (all but one Zaibatsu controlled) perform the financing function, the other 56 banks, the absorption of savings function. The 56 banks are assigned certain concerns to finance but their importance is so minor that the Ministry of Finance estimates that 85% of all industrial loans are handled by the Big Five and the Industrial Bank of Japan.

3. Under this system, the banks became completely subservient to the Government and also to the industrial concerns to which they extended loans, since they lacked both the authority and the mechanism for the financial supervision of the industries assigned to them. The system has operated to benefit the Zaibatsu corporations, affiliates and sub-contractors; it has frozen out independent concerns not willing to do business on Zaibatsu terms. Naturally, even today, the Zaibatsu banks give preference to Zaibatsu concerns, affiliates and sub-contractors. Complaints have been received from Japanese businessmen regarding the system and particularly the manner in which it operates to prevent smaller corporations and entrepreneurs from obtaining credit for sound and desirable business ventures.

4. In reference 1b[5] the Japanese Government states that it favors the abolition of the system in the future but opposes action now because it will butt off the supply of funds needed

[3] Probably to the Chief of Staff from Courtney Whitney, Chief of the Government Section. Cf: The related memorandum of April 15 printed below.

[4] Probably C. F. Thomas, Chief, Finance Division, ESS.

[5] Memorandum from Imperial Japanese Government, CLO No. 112 (2.1), dated January 9, 1946, subject: "Abolition of System Designated Financial Institutions."

by industries to pay wages, salaries and retirement allowances and to settle their accumulated debts. If such loans are sound loans, the termination of the system will expand the opportunity to secure such credit from one institution to all institutions operating in the area. If such loans are unsound they should not be made by any institution.

5. The system of designated banks destroyed the independence of banking institutions and made them the financing affiliates of industrial concerns. The system of compulsory loans with Government guarantees destroyed their most important functions as banking institutions because it substituted for the independent judgment of many bankers exercised freely over all of Japan, a Government blanket order issued automatically and without adequate restrictions by the Ministry of Finance in Tokyo. Such a procedure may have been necessary during the war, but its continuation cannot be justified.

6. Reference 1a[6] states that the Government proposes to abolish at once orders relating to eleven types of loans. But in truth, ten types became completely inactive with the end of the war. The action proposed is therefore merely perfunctory.

7. The abolition of compulsory loans will not mean the denial of funds for the desirable purposes mentioned in paragraph 2b of reference 1 a. It will simply mean that each loan will be considered on its merits alone and not on the basis of a flat guarantee from the Government to absorb any losses that may occur. Such unrestricted guarantees have insidiously destroyed the bankers integrity of judgment and created a further impairment of Government credit now so seriously involved as the result of abuses perpetrated during the war and even thereafter until the issuance of the SCAP directive of 24 November 1945 on the reorganization of national finances.

8. The designated banks and compulsory loan systems are to a large degree responsible for the unsound post war expansion of bank credit and the uncurbed inflationary trend that recently forced the Japanese Government to a drastic currency conversion and deposit freeze. The Government's order to finance the conversion of designated industries to peacetime production appears to have been interpreted by the subservient banks as an order to accommodate all loan requests whether sound or unsound. The insolvent condition of munitions companies therefore led inevitably (particularly in the case of Zaibatsu concerns) to such unsound practices as loans to finance payments of taxes, salaries and speculations by unconverted armament industries, completely inactive and likely to remain that way for months to come. A system that has led to such grave abuses should and must be terminated.

9. The early abolition of the system of designated banks for compulsory loans is a necessary step in the democratization of the Japanese economy.

10. The interests of USAFIK have been considered. This action does not affect the Korean area.

11. This is considered a policy matter. However, this directive requires no surveillance by the Eighth Army.

12. Concurrences: Gov't. Sec. Brig. Gen. C. WHITNEY.
AC, Mr. J. McI. Henderson.

12-6 REOPENING OF THE JAPAN SECURITIES EXCHANGE

Memorandum April 15, 1946
To: ESS
From: S.J.C., C/S[7]

1. The reopening of the Japan Securities Exchange is not favorably considered at the present time.

2. It is considered that the reopening of the Japan Securities Exchange is premature pending the settlement of such large problems as firm plans for reparations, adoption of a constitution, and the settlement of other political problems affecting the future of Japan.

[SOURCE: SUITLAND PAPERS]

[6] Memorandum from Imperial Japanese Government, CLO No. 111 (2.1) dated January 9, 1946, subject: "Compulsory Loans System."

[7] Apparently from Maj. Gen. S. J. Chamberlin, Chief of Staff. Copy sent to the Government Section.

12-7 REGULATION OF OVER-THE-COUNTER DEALINGS IN AND TRANSFER OF SECURITIES

Memorandum July 26, 1946
To: Finance Division, ESS
From: Courtney Whitney, Chief, Government Section

1. This Section does not concur in the proposed memorandum to the Japanese Government, subject as above, directing the establishment of a Commission to regulate transactions in and transfers of securities for the following reasons:

a. The protection of Japanese investors and speculators and the inculcation of business morality among securities underwriters, dealers and brokers are purely domestic matters, having little if any bearing on occupation objectives.

b. The enforcement of existing SCAP directives prohibiting or restricting transactions in certain securities does not require the establishment of a "Securities and Exchange Commission" by SCAP directive. Such enforcement is the Japanese Government's responsibility and whatever measures that Government takes to insure compliance is a purely internal administrative matter and should not be prescribed in detail by the occupation forces. If evasions or violations of SCAP directives are uncovered, the responsible Japanese Government officials are liable.

2. For the purpose of checking compliance with pertinent SCAP directives, it would appear sufficient to require the Japanese Government to render appropriate reports, leaving it to the Japanese Government to determine, as a purely internal administrative matter, what machinery it will utilize for the purpose.

C.W.

MEMO FOR THE RECORD[8]

1. The Staff study supporting the proposed memorandum states that since the securities exchanges were closed, a large volume of transactions in securities has developed in the over-the-counter market which, being unregulated, is subject to such abuses as (1) victimizing of investors by "insiders", (2) evasion of deposit blocking ordinances, (3) violation of SCAP directives prohibiting transactions in certain securities.

2. The stated purposes of the proposed memorandum are to (1) discover and eliminate transactions which contravene SCAP directives, (2) eliminate speculation, fraud, and manipulation, (3) protect investors against unfair prices and unreasonable profits, and foster just and equitable principles of trade among securities brokers, dealers and underwriters, (4) develop a free market in securities.

3. Of the purposes stated in paragraph 2 above, only item one bears any visible relation to occupation objectives. Items 3 to 4, while they may be desirable, are of no concern to the occupation forces. For the purpose of preventing violation of SCAP directives, it would appear sufficient to require the Japanese Government to gather and submit reports on all transactions in securities wherever effected. What machinery the Japanese Government chooses for this work is a purely internal administrative matter and should be left to that Government to decide.

[SOURCE: SUITLAND PAPERS, Z 703-16]

12-8 SUMMARY OF SECURITIES AND EXCHANGES BILL

Memo for File January 9, 1947
By: T. F. Adams, Money and Banking Branch, Finance Division, ESS

1. Requires the filing of certain information with a Securities Administrative Office by any corporation desiring to issue new securities. (Registration statement)

2. Provides that no one may issue, underwrite or make public sale of securities coming under the registration requirement unless such registration has been effected.

3. Provides that those persons who own 10% or more of the capital stock of a corporation issuing new securities be required to notify this fact and any increase or decrease to the Securities Administrative Office.

[8] Signed by "FR", probably Frank Rizzo.

4. Provides safeguards in the matter of use of prospectuses, advertisements or notices referring to the issuance or public sale of securities.

5. Provides that information filed with the Securities Administrative Office be available to the general public with certain limitations to protect trade secrets.

6. Determine who may be securities dealers and provides for strict licensing of persons engaged in the securities business and requires registration of all dealers.

7. Requires such persons to provide certain information to the Securities Administrative Office and specifies the maintenance of records, books and documents.

8. Gives the Securities Administrative Office power to inspect such records or to require further records; to make investigations and; to hold hearings and render decisions.

9. Requires that the assets of a dealer be always not less than an amount to be determined by the Securities Administrative Office.

10. Permits the establishment of membership securities exchanges; requires the registration of any exchanges which may be formed and provides that such exchanges file a constitution or any changes in a constitution with the Securities Administrative Office.

11. Requires that members of any exchange maintain assets in a certain amount and specifies the preferential right of a client over all other claims.

12. Provides that the Securities Administrative Office submit an annual report to the Diet relating to the business under its authority.

13. Provides penalties and civil liabilities for failure to register, misconduct, falsification, spreading of false rumors, manipulation, etc.

14. Abrogate the existing laws referring to the securities business.

15. Provides for appeal to the courts from any decision of the Securities Administrative Office.

16. In general, establishes a Securities Administrative Office with jurisdiction similar in many respects to U.S. S.E.C. Removes the government control from future exchanges which will be membership, self-regulated organizations.

Provides stringent and appropriate standards for exchanges, members and dealers.

[SOURCE: SUITLAND PAPERS, Z 703-16]

12-9 BILL FOR REVISING A PART OF THE BANK OF JAPAN LAW

Memorandum of Conference January 17, 1947
By: J. C. Smith, Money and Banking
Mr. T. E. Beplat, ESS/FI
Lt. J. C. Smith
T. Otsuki, Ass't Ch. Banking Div. Banking Bur. Min. Fin.
K. Takida, Ass't Ch. Banking Div. Banking Bur. Min. Fin.
H. Kurakawa, Liaison Office Min. of Fin.

1. Purposes of this bill were stated to be:
   a. Establish a sound budget.
   b. Impose restrictions on new loans.
   c. Increase savings.
   d. Encourage public subscription of national bonds.

2. Purposes in 1. above are to be accomplished by the following methods:

a. Establishment of a 'Board of Investigation Concerning the Issue of Currency.' A limit and ceiling will be placed on currency issue. Such ceiling to be determined by the Minister of Finance after consultation with the Board.

b. When issue exceeds the legal limit for a period not over 15 days no approval is required. If it continues for 16 to 30 days the Minister has the sole power to approve. If over 30 days the matter is referred to the Board and joint approval by the Minister and the Board will be required.

c. If excess continues 16 days or more the Bank of Japan will pay an 'excess issue tax'. Rate of tax to be determined by the Minister of Finance but the Board will set a minimum tax in advance and the Minister cannot go below this minimum set by Board. He can exceed this rate at his discretion.

d. Control of purchase and sale of securities is taken from the Bank of Japan and given to the Finance Minister. The Minister will consult with the Board but it appears from information given that the final authority rests with the Minister. This will remove the Bank of Japan from the picture as far as open market operations are concerned. The Minister will

determine both the amounts and types of securities.

e. The present law guarantees dividends and losses. That is, the Government guaranteed 4% and in addition would make good any losses sustained by the Bank of Japan. Due to the fact that the Bank of Japan will sometime in the future have to take considerable losses (estimated at about 5 billion yen and arising through operations of the United Funds Bank, funds deposited with various overseas agencies and other activities connected with the war which will inevitably result in considerable loss) this guarantee is removed in the proposed bill. This is done to give the people confidence that later hidden losses with result and further heavy demands on the government will not ensue. Also SCAP directive prohibits the Government from guaranteeing or subsidizing losses of institutions.

3. The Board is to be established by Imperial Ordinance and will be made up of about 9 members consisting of the Governor of the Bank of Japan and perhaps another Bank official, the Minister of Finance and at least one other from the Ministry plus representatives from industry and finance as well as the Diet. The chairman will be the Minister of Finance's 'Man' under present plans of the Ministry. The Minister himself will not be the chairman but it is apparent that the Ministry intends to dominate the Board.

4. It is clear from the above that this is a Ministry of Finance plan and takes considerable power away from the Bank of Japan. The Ministry stated that this was all worked out in close coordination with the Bank but the Bank professed to be suprised by both the suddeness and the content of the proposed bill. They were aware of the plan to establish a currency control commission but did not indicate they had been informed this was to be done by making some basic changes in the Bank of Japan Law. As usual the Ministry states they want immediate approval of the bill so it can be presented to the Diet 1 February 1947. The existence of such proposed legislation did not come to the attention of this Branch until an outside source made a casual remark about it. The Ministry was immediately called in and stated they intended to present the bill for our approval the following day. The Bank of Japan stated they were informed of the existence of the bill through the usual daily receipt of reports from the usual channels of the Ministry although the Governor apparently had some advance knowledge of the bill but according to information from bank officials was not fully informed as to the details.

5. As usual the purposes of the bill is said to aim at and the content of the bill seem at variance. Indirectly it might accomplish the purposes set forth in paragraph 1. above but it was understood by Money and Banking that the government was only considering some plan to control expansion of currency and this masterpiece seems to range somewhat afield.

6. *Conclusions:* This entire proposal was taken upon the initiative of the Ministry of Finance without advance notice or consultation with this Division. On the surface it would appear to be the old practice of trying to ram something through. No opinions were expressed by either representative of this division at the conference. It is suggested that Government Section be requested to inform the Legislative Bureau to shelve this entire proposal until this Division instructs them otherwise.

[Source: Suitland Papers, Z 703-15]

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12-10 ESTABLISHMENT OF COMMERCIAL AND FOREIGN TRADE BANKING FACILITIES IN JAPAN (SWNCC-226/6)

Report
SWNCC-226/6
Secret

June 20, 1947

A STUDY PRESENTED BY THE STATE MEMBER, SWNCC[9]

The Problem

1. To consider request from SCAP for authority to expand functions of foreign banks now or hereafter licensed to operate in Japan to provide services required in connection with the restoration of Japanese foreign trade on a private basis, including:

a. Use of foreign banks by SCAP as depositories of proceeds of Japanese exports;

b. Global export-import banking services for SCAP; and

c. Commercial and export-import banking services for foreign private traders, subject to foreign exchange controls and other applicable regulations established by SCAP.

[9] As revised on October 14, 1947.

Facts Bearing on the Problem

2. See Appendix "A".

Discussion

3. See Appendix "B". [deleted]

Conclusions

4. It is concluded that:

a. Foreign banks with recognized experience in foreign banking and with demonstrated ability to handle world-wide accounts, should be allowed to establish or re-establish branches in Japan for the purpose of providing banking services in connection with Japanese foreign trade;

b. Representatives of qualified and interested foreign banks should be permitted to enter Japan for the purpose of surveying in advance the desirability of establishing or re-establishing branches in Japan;

c. SCAP should be authorized to license such banks to perform normal commercial and export-import banking services, subject only to limitations imposed by the availability of physical facilities and other relevant factors;

d. Such services should be available to non-Japanese private traders as well as SCAP;

e. Branches of foreign banks licensed to operate in Japan should not, at present, be permitted to perform services locally for Japanese nationals;

f. All transactions engaged in by such branch banks in the course of the performance of their services should be subject to foreign exchange controls and any other applicable regulations established by SCAP in Japan;

g. The term "foreign banks" as used herein, shall be deemed to include banks of all countries except enemy or ex-enemy countries.

Recommendations

5. It is recommended that:

a. SWNCC approve the conclusions in paragraph 4 above;

b. After approval by SWNCC:

(1) The cable at Appendix "G"* be transmitted to SCAP;

(2) Copies of this paper be transmitted to the State, War and Navy Departments for information.

c. SCAP issue the press release quoted in the cable at Appendix "G" after advising the Joint Chiefs of Staff in order that it may also be simultaneously released in Washington by the interested departments.

APENDIX "A"
FACTS BEARING ON THE PROBLEM

1. By informal action on March 15, 1946, the State-War-Navy Coordinating Committee approved SWNCC 226/3, authorizing, under certain specified conditions and for certain specified operations, the establishment or reestablishment in Japan of branches of American banks and of banks of other Allied Powers. The principal function then envisaged for foreign banks in Japan, was the performance of certain services for the occupation forces and related to the strictly military aspect of the occupation. It was expressly provided that such banks would "not be permitted at present to engage in any ordinary commercial banking activities including provision for export-import banking facilities . . ."

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APPENDIX "C"
CABLE FROM SCAP TO WAR DEPARTMENT REQUESTING AUTHORITY TO EXPAND FUNCTIONS OF FOREIGN BANKS

FROM: SCAP Tokyo Japan
TO: WARCOS
NR: Z 48661 29 May 1947

Reurads W 82130 dated March 1946 and WAR 80830 dated September 1946 paragraph 3. Subject is licenses issued to non-Japanese banks. This radio in 2 parts.

Part 1. SCAP must now obtain War Department approval prior to permitting changes

* Appendix "G" is omitted.

in banking functions when functions are needed other than those specified in urad W 82130. Consider situation non-Japanese banking functions and facilities in Japan inadequate to support program aimed at reviving economy and reestablishment of foreign trade. Requests received from British and Dutch for reopening branches and expanding functions presently authorized by War Department. Application from Chinese expected.

Part 2. Banking and foreign trade problems required prompt solution under changing economic conditions. The time involved to effect changes through Washington by submitting requests and data to justify the changes seriously handicaps efficient operations. It is recommended that authority be delegated SCAP to provide additional banking facilities as events and attending circumstances require, and to amend licenses to permit expanding functions to meet economic developments as will be effected in expanding foreign trade. Such transfer of authority would be consistent with the revision of the trading with the enemy act which transferred control of commercial activities to SCAP, urad WCL 41001, January 1947. Request earliest approval."

APPENDIX "D"
CABLE FROM WAR DEPARTMENT TO SCAP PROPOSING EXPANSION FUNCTIONS OF FOREIGN BANKS

FROM: WDSCA ES
TO: CINCFE, Tokyo, Japan
NO: WAR 98341 17 May 1947

Reourad Mar WAR 82130 and urad Mar C 51118. Please pass copy to Lt. Col. R. F. Hartman, CAD, now on TDY SCAP.

Part 1.

1. As basis for proposed SWNCC action in connection your request authorization NCB[10] Tokyo function as depository dollar proceeds Japanese exports and render Global Export-Import Banking Services (reurad) and with view to facilitating restoration private trade Japan (reourad) request your comments earliest fol proposals:

A. That provisions Par 1 A WAR 82130 be amended to permit all non-Japanese banks now or hereafter licensed operate Japan also to act as depositories for proceeds Japanese exports and render Global Export-Import Banking Services for foreign private traders as well as SCAP when services this type needed.

B. That representatives of interested and qualified banks be permitted enter theater subject to your approval to survey in advance of decision to apply for establishment or re-establishment branches in Japan. View here restoration private trade Japan on eff basis dependent on prior existence adequate commercial banking services.

Part 2.

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[SOURCE: NATIONAL ARCHIVES]

12-11 REORGANIZATION OF BANK OF JAPAN

Memorandum May 22, 1948

To: Chief, ESS
From: Walter K. LeCount, Chief, Finance Division, ESS

1. Reference is attached paper[11] prepared by Governor Ichimada of the Bank of Japan, subject: Federal Reserve System of the United States and Policy of Reorganization of the Bank of Japan. A brief of this document follows:

2. In determining reorganization policy, the Bank of Japan believes that the U.S. Federal Reserve System, the Bank of Canada and the Central Bank of the Phillippines should be examined for pertinency to the Japanese problem.

3. *Organ to Decide Supreme Policies.*

a. Views of Governor Ichimada—Organization of a "Currency and Credit Commission" is proposed, as an organ to determine the supreme currency and credit policies for Japan. Membership of Commission to include the Prime Minister, Director-General of U.S.B., Governor of the Bank of Japan and an unspecified number or representatives of the financial

[10] The National City Bank of New York, authorized by SWNCC 226/3 to re-open its Tokyo branch. The Joint Chiefs of Staff sent this authorization to SCAP in cable WAR 82130 of March 26, 1946.

[11] Not printed here.

and industrial circles and men of knowledge and experience.

b. Views of Finance Division—Proposal is a step in the right direction. It does not however, go far enough. Responsibilities for monetary and credit regulatory policies would advisedly be divorced from direct control by the government in power, and placed by law in the hands of long-term members of a "Board of Banking and Finance" to insure continuity of national policy. Members to be nominated by the Prime Minister with advice and consent of the House of Representatives of the Diet. No cabinet officers to be eligible for membership.

4. *Number of Central Banks.*

a. Views of Governor Ichimada—Japan should not have any more than one central bank for execution of its monetary policies.

b. Views of Finance Division—In full accord with this.

5. *Number of Branches.*

a. Views of Governor Ichimada—Present branches and agencies numbering 29 and 400, respectively, should be retained as necessary due to transportation and communication deficiencies.

b. Views of Finance Division—Function of administration of government funds now performed by Bank of Japan should be transferred to Ministry of Finance, leaving Bank of Japan as depository only for government funds, thus eliminating necessity of retaining 400 agencies. Branches of Bank of Japan to be reduced to minimum number required for the adequate administration of the central bank, note issue and loaning functions and fiscal agency functions for the government.

6. *Capital Structure.*

a. Views of Governor Ichimada—Stock of reorganized Bank of Japan be owned one-half by financial institutions, one-half by general public.

b. Views of Finance Division—100% ownership by all financial institutions designated as members of a reserve system.

7. *Relations with Ministry of Finance.*

a. Views of Governor Ichimada—Proposes that control by Ministry of Finance is over:

(1) Administration of public finance, and
(2) Private finance, be reduced to the minimum.

b. Views of Finance Division—Relations should be limited to performance of fiscal agency functions for the government and to furnishing depository and fiduciary facilities to government.

8. *Reserves.*

a. Views of Governor Ichimada—Propose the establishment of a banking reserve system similar to the Federal Reserve System in the U.S.

b. Views of Finance Division—No disagreement here.

9. *Composition and Authority of Board Officers.*

a. Views of Governor Ichimada—Methods similar to those prescribed by Federal Reserve Act for selection of members of Federal Reserve Board are proposed, with the specification that the Governor and Vice-Governor be selected from among individuals experienced in central banking. Other directors likewise to be appointed on the recommendation of "Currency and Credit Commission." Directors of Bank of Japan will be of two types. One group actually engaged in operations, the other in purely an advisory capacity.

b. Views of Finance Division—This is a garbled mixture of provisions of Federal Reserve Act and Japanese traditions. No definition of authority is prescribed by Governor Ichimada.

10. *General Comments.*

Views of Finance Division are confined to reactions to views set forth by Governor Ichimada in his paper, which are speaking frankly, quite brief and very general and therefore considered extremely inadequate to the problems involving the reorganization of the Bank of Japan. Nothing is said whatever concerning the present condition of the Bank of Japan assets and its future structure. These problems are currently being worked out in considerable detail by Finance Division.

[SOURCE: SUITLAND PAPERS, Z 703-15]

12-12 PROPOSED BANKING LAW

Memorandum May 28, 1948
To: Chief, ESS
From: Walter K. LeCount, Chief, Finance Division, ESS

1. The provisions which the Finance Division is drafting as a basis for enactment by the Japanese Government of an overall banking law provide for:

a. A Board whose members are experienced in banking, finance, commerce, and agriculture, and inexperienced in politics, appointed for terms so that only one expires every two years to provide continuity. The Board will be responsible for the formulation and enforcement of all monetary and audit policies of the Government and will regulate and supervise all banks and all other credit and financial institutions, within limits fixed by law sufficiently comprehensive and definite to afford reasonable protection against undue domination or dictatorship over banks by the Government.

b. Reorganization of the Bank of Japan, with a board of directors selected from various areas of Japan and from various fields of Japanese economy and with a corps of officers and employees responsible to the board of directors. The Bank will act as banker for the Japanese Government and the private banks. It will hold reserves of the banks, rediscount loans, operate a system of check clearing collections, etc. It will handle bond issues, redemptions, and other fiscal agency operations for the Government.

c. A system of privately owned and operated banks, all required to be members of the Reserve Bank System and regulated, examined and supervised by the Board of Banking and Finance under a bank law which incorporates as far as practicable, definite provisions as to what the banks can and cannot do, leaving as little as possible to arbitrary dictation from the Government. Also, a reorganization of the so-called special banks, now partly owned and partly dominated as to the selection of management and in other respects by the Government. Each such bank will be either a private bank, or a governmental credit institution not engaged in general banking.

d. Continuation, with some necessary reorganizations, of various organizations to provide funds for distressed industrial and commercial concerns deemed to be essential to the support of the economy of Japan until present economic conditions are improved and such permanent credit institutions as are necessary can be put into effective operation.

e. Effective separation of banks of deposit from industrial, commercial and other non-banking enterprises by means of positive prohibitions against stock control or other forms of affiliation.

f. Effective separation of banks of deposit from the business of underwriting or dealing in corporate stocks and bonds.

g. Limitations and restrictions upon loans and investments of banks, with particular reference to quality of credit and amounts advanced to any individual company or group of related companies in relationship to the capital of banks.

h. Adequate capital protection to depositors, to be supplied by shareholders, and far broader and more democratic management responsibility and practices.

i. Standards of conditions and limitations to be set as definitely as practicable by law under which banks and branches may be established, operated or closed, merged, or consolidated, etc., with adequate provisions to prevent evasions of branch bank restrictions through "group" or "chain" banking systems.

j. Adequate reports and examinations for effective supervision of all banks by the Board.

k. Adequate penalties for violations of provisions of laws and regulations and for unsound banking practices, including the granting of power in the Board under stated conditions, to remove managements from office or to place banks in receivership, etc.

2. Further details with respect to the foregoing subjects are outlined below, subject to such changes in arrangement, phraseology, etc., as become necessary in the process of drafting the law itself.

Board of Banking and Finance

3. The Board would be set up along the following lines:

a. Seven members of the Board selected with a view to geographical and institutional or functional representation, appointed by the Prime Minister with concurrence of House of Representatives.

b. Positive qualifications, such as, banking, insurance, industrial, agricultural, commercial experience.

c. Fulltime service on the Board at top Government salary scale and the separation from all other occupations or business organizations.

d. Ineligibility of politicians or purgees.

e. Terms of office of initial members to be from two to fourteen years and successors for full fourteen-year terms, staggered so that one new member may be appointed each two years, thereby providing continuity.

f. The Chairman of the Board to be ex-officio, a member of the Cabinet.

g. The Chairman to be named from members of the Board by the Prime Minister for one year or until a new Prime Minister is chosen, whichever is less. If the Prime Minister fails to name a Chairman within thirty days, the Board shall elect its own Chairman who upon approval of the Diet becomes a member of the Cabinet for one year or until a new Prime Minister is chosen, whichever is less, special care to be exercised by SCAP in approving the appointment of initial members, to start off with a well-balanced Board.

h. All members to have equal voting rights with respect to all matters passed upon by the Board; restrictions to be provided to prevent undue domination by any of the political parties when or if such are clearly defined.

i. Members ineligible for reappointment, except the initial members serving the two, four, and six year terms; also ineligible to join any bank or other type of concern supervised for three years after termination of service on the Board, except after serving the full term, of at least six years for which appointed.

j. Removable from membership only by the Diet after public hearing before a committee thereof.

k. Legal authority in the Board to organize its staff, according to needs, from persons experienced in banking, finance, etc., free of political affiliations, etc.

l. Salaries and expenses of Board, or at least its staff engaged in examining and supervising banks, to be borne by institutions supervised on an equitable basis.

m. To formulate and administer national monetary and credit policies in the public interest, including loan and discount rates, margin requirements, reserves, interest rates on deposits, limits on loans secured by stocks and bonds and the rates of interest on such loans, as a means of regulating speculative securities, etc., and various open market operations.

n. To have overall responsibility for the administration of laws with respect to the regulation and supervision of the various financial institutions.

o. To counsel with the Minister of Finance and other members of the Cabinet concerning the Japanese Government finances, bond issues, etc., and to require the Reserve Bank of Japan to cooperate in the distribution and redemption of Government Bonds.

p. To coordinate with the appropriate officials of the Reserve Bank of Japan in the execution of open market and other monetary operations.

q. To collect, analyze, and disseminate economic and financial data.

r. To administer various details of examination and supervision and the collection, analysis, and dissemination of financial data through staff members with offices located in the Reserve Bank of Japan at strategic centers.

s. To report annually to the Diet with respect to:

(1) The condition and operations of financial institutions.
(2) Changes in laws and regulations during the year.
(3) Further necessary changes in laws.
(4) Changes in supervisory policies during the year.
(5) Policy actions taken and reasons therefor.

The Central Reserve Bank

4. The Bank of Japan would be reorganized in substance as follows:

a. By cleaning up numerous so-called assets in the form of advances to the Government or at its direction, distressed loans, etc., which would eliminate all present capital stock.

b. New capital stock of the bank to be subscribed by all banks in Japan in accordance with their size, measured in terms of deposits.

c. Stockholding banks to be empowered to nominate and vote for certain specified directors of the bank, one vote only to be allowed to each bank irrespective of the total amount of its holdings of shares.

d. Shares of the bank to be entitled to dividends at the rate of six per cent per annum

on the cumulative basis.

e. Surplus of the bank after allowance for estimated depreciation or losses in assets, dividends, etc., to be built up to 100 per cent of the capital stock of the bank.

f. The balance of earnings to be used to stabilize currencies or securities.

g. The general policies and practices of the bank, in accordance with the provisions of law and the general overall monetary and credit policies prescribed by the Banking Board, to be determined and administered by a competent board of directors.

h. The nine directors to be persons experienced in banking and finance, commerce and industry, agriculture, or business or economics.

i. In the nomination of directors, due consideration to be given to geographical distribution, specific provisions being made for one member for the Tokyo region and one for the Osaka region, and whenever feasible, one member from each of the following regions: Southern Honshu and Shikoku, Kyushu, Northern Honshu and Hokkaido.

j. With respect to business connections and qualifications, etc., the directors to be selected as follows:

(1) Three directors named by the Banking Board from outside banking and financial circles. One of these to be designated by the Board as Chairman and one as Deputy Chairman. Neither of these three members to have any financial interest in any bank. Each to be appointed for three years, with terms staggered for continuity whereby only one director of this class shall be appointed each year.

(2) Three directors who are not bankers but practical business men to be selected by banks, each for a term of three years, the terms to be staggered so that one new director of this group will be selected each year. One director of this class to be selected by the large banks, two by the other banks and credit institutions.

(3) Three directors who are actively engaged in banking and finance, each to be selected for a three-year term and by the different size groups of banks, etc., as in the case of (2) above.

k. Definite duties and responsibilities of directors to be included in the law.

l. Responsibility for the active administration and operation of the bank to be placed in a staff of officers.

m. Any officer of the bank to be subject to removal for violations of law and the regulations or for carrying on unsound and unsafe bank practices, under the same provisions of law as are applicable to the removal by the Banking Board of directors, officers and employees of private banks.

n. The head office of the Bank of Japan to be continued by law at Tokyo with branches at Osaka, Fukuoka, in Shikoku, at Sendai, in Hokkaido, and at such other places as the Board of Directors may decide upon with the concurrence of the Banking Board.

o. The discontinuance of any branch at the direct order of the Banking Board when in its judgment the operation of such branch is unnecessary or undesirable.

p. Functions of the Bank of Japan to be set forth in the law to include:

(1) The physical issuance and redemption of currency within the limitations and restrictions prescribed by law and the regulations of the Banking Board.

(2) Holding of reserve balances of banks.

(3) The granting of loans to banks.

(4) The maintenance of a sound and adequate system of check clearing for banks.

(5) The maintenance of a sound and adequate system of collections of drafts, bills of exchange, notes, etc., for banks.

(6) A system of money transfers and remittances for banks.

(7) Custody and safekeeping for banks which do not and cannot have adequate and safe vault facilities.

(8) Acting as depository, custodian, and financial agent of the Japanese Government, and Government agencies or corporations.

(9) Acting as depository, custodian and financial agent of prefectural governments, in cases of necessity, etc.

(10) To deal in coins and bullion, etc., foreign exchange, and other related transactions, to such extent as is necessary for its own account and for the account of the Japanese Government.

(11) To buy and sell bills and notes of industrial and commercial enterprises and Government bills and bonds in accordance with open market operations policies and regulations prescribed.

(12) To buy bonds from and make advances to the Japanese Government under limitations and restrictions prescribed by law or regulations of the Banking Board.

(13) To carry out such other monetary and credit operations as may be required by law or by orders and regulations issued by the Banking Board.

System of Private Banks

5. Various structural defects and weaknesses should be eliminated by a new banking law including definite and effective provisions relating to the following matters, some of which are covered in sufficient detail in other sections of this Memorandum:

a. Repeal the many special laws relating to various kinds of organizations dealing with deposits and credits.

b. Define a "bank" and limit the use of such term to corporations engaged in the business of receiving deposits, making loans, etc., which are chartered, regulated and supervised under this law.

c. Forbid the use of the term "bank" by securities dealers and other organizations which carry on non-banking transactions, and prohibit the receipt by them of deposits withdrawable on demand or short notice by checks or similar instruments.

d. Eliminate the Government credit granting concerns from the category of banks.

e. Change in character control and operations of various so-called special banks, either immediately or as soon as practicably consistent with economic conditions in Japan.

f. Bring under the regulation and supervision of the Board all agricultural credit cooperatives, mujins, and all other corporations, associations, etc., engaged in the business of granting credits and receiving deposits, and require them to comply with all restrictions and limitations which are applicable to banks, with certain exceptions to be provided in special chapters or sections relating to the special organizations.

g. Provide definite restrictions and limitations in the law with respect to organizing, chartering and liquidating banks, the establishment or discontinuance of branches, etc., requiring in all cases prior approval of the Board.

h. Require any bank to obtain the prior approval of the Board before it undertakes the exercise of trust powers and before surrendering trust powers.

i. Require all banks to maintain reserves with the Bank of Japan in accordance with the ratios to be set by the Board within the limitations fixed by law.

j. Prohibit affiliations with any industrial, commercial or other similar enterprises.

k. Prohibit affiliations with any securities company or securities dealer, and prohibit the dealing in securities by a bank, effective as soon as practicable.

l. Prohibit affiliation of directors, officers and employees with securities companies.

m. Prohibit interlocking relationships of directors, officers and employees with other banks and other undesirable businesses.

n. Adequate limitations and restrictions upon various classes of business and kinds of assets of banks.

o. Limitations upon classes of business and affiliations of credit associations which are brought under the banking law.

p. A system of credit unions, under special chapter of the law, for industrial workers, Government employees and others, under definite restrictions and limitations.

q. Prohibit the domination of credit unions by employers, union chiefs, etc., leaving them to be run by the employees who are members, under the supervision of the Board.

r. Special limitations and restrictions upon cooperative credit associations which are too small to be completely separated from other phases of business of cooperatives.

s. Provide special conditions relating to the use of deposit and other surplus funds of cooperative credit associations, credit unions, etc.

t. Subject all banking and bank clearing house associations to regulation and supervision by the Board.

u. Eliminate authority and responsibility of the Ministries of Communications, Agriculture, and Commerce, or any others, in respect to organizations receiving deposits and making loans, centering all under the Banking Board.

Government Credit Corporations

6. Some of these organizations are in bad condition, are not real banks and should be closed. Others should be reorganized into private banks. The remaining corporations should be taken out of the category of banks and operated as Government subsidized credit organizations, at least some on a temporary basis under a definite plan for liquidation as soon as economic conditions justify. Accordingly, the new banking law should contain provisions, and

special chapters to the extent necessary, to cover the following points:

a. Repeal the special laws relating to these various organizations.

b. Change the name of the Reconversion Finance Bank to Reconversion Finance Corporation to take it out of the category of "banks", and reorganize its management set-up and operations.

c. Industrial Bank, the Hypothec Bank, and the Hokkaido Colonial Bank to be given the option of becoming a regular bank or a private finance company. If either becomes a finance company depending upon the issuance of debentures it will be subject to limitations and restrictions comparable to those upon banks with respect to loans and the relation of capital structure to liabilities, etc.

d. The Peoples Bank and the Pension Bank which are not real banks but more nearly charity organizations to be liquidated and any of their functions with respect to distressed or other special loans or subsidies necessary to be continued in the future to be transferred to an appropriate bureau or department of the Government.

e. The Postal Deposit System to be revamped under a system of depositing funds in banks of various prefectures or branches of the Bank of Japan and its transfer functions to be reorganized.

f. The Deposit Bureau under the Ministry of Finance to be abolished, its necessary accounts to be transferred to the appropriate departments of the Government.

Separation from Industrial and Commercial Companies

7. Sufficiently definite and detailed provisions covering the following matters are set forth:

a. Comprehensive and clear definitions of a bank holding company.

b. Definition of a subsidiary of a bank.

c. Definition of an affiliate, through any other means.

d. Prohibition against affiliations in any manner, effective immediately in all cases where practicable, or not later than 31 March 1949 in any event.

e. Restrictions upon increased loan transactions with affiliated concerns pending final severance of relationships.

f. Restrictions upon financial transactions pending final steps of severance in case of affiliates which are created accidentally or to protect loans previously contracted in good faith, as where a bank is forced to acquire stock in the collection of a note, etc.

g. Permission for exceptions in definitely stated cases, as in the situation where a bank desires to operate a trust company as a corporate entity separate from the commercial banking operation, such trust company being limited in its operations to those permissible to the trust department of a bank.

h. Prohibition also against banks themselves engaging in certain types of business closely akin to but not real banking business, such as insurance, guarantee of titles, etc.

i. Authority and responsibility in the Board to prescribe regulations for clarity and definiteness, and to prevent evasions of the foregoing.

Separation from Securities Business

8. Various definitions and prohibitions against banks dealing in securities are contained in the Securities and Exchange Law. The banking law should contain the following additional restrictions:

a. No bank to be affiliated (as defined) in any manner with a securities company nor any director, officer or employee to be a securities dealer or connected with a securities company after 31 March 1949.

b. Effective 31 March 1949 no purchases of corporate stocks to be made and any stocks acquired in the liquidation of loans or otherwise in connection with debts previously contracted in good faith to be disposed of within one year. (To offset the effect of this upon the ability of companies to raise equity capital, some liberalization of restrictions upon stockholdings of other concerns and further public educational campaigns may be necessary.)

c. No bank to be permitted to issue debentures on its own credit or upon collaterals after 30 June 1948.

d. No security dealer to be permitted to receive deposits subject to check, or to carry on the business of discounting bills, notes, etc., not in the ordinary course of business of a securities company.

Loan and Investment Limitations

9. Certain situations and practices in Japan demand substantial effective changes, with respect to both the adequacy of capital and limitations upon advances, affecting both large and small banks. They should be effected either immediately or as soon as practicable in view of critical credit and economic conditions. They can be accomplished effectively only by clear and comprehensive changes in the law covering at least the following matters:

a. Loans to any one person or company to be limited to 1% of the bank's deposits, with necessary exceptions in connection with certain types of loans based upon staple commodities, etc.

b. Loans to all companies in a given group to be limited to not more than 2% of deposits, and stock of such companies to be unacceptable as collateral.

c. Strict requirements as to outside collateral on loans to affiliates, if any.

d. Loans to any one person or group collateraled by Japanese Government bonds to be limited.

e. Loans covered by guarantee or commitment to take over by the Bank of Japan or another recognized agency of this bank or of the Japanese Government to be subject to more liberal restrictions to be set forth in detail.

f. Real estate loans to be limited further as to appraisal value of property, and to be of the installment type.

g. The aggregate of real estate loans to be limited with respect to the capital and surplus of the bank.

h. No loans to be collateralized in whole or in part by the bank's own shares, except as may be necessary to strengthen a loan previously made in good faith to prevent losses, and any such stocks acquired by the bank in this connection to be disposed of within six months.

i. Loans to employees to be permitted in limited amounts, approved by at least three officers in each case.

j. Loans to officers to be limited in stated amounts and to be approved in advance by the board of directors.

k. Loans obtained by an officer from other banks to be reported by the borrowing officer to his board of directors.

l. Loans to officers and directors of other banks to be limited as to amounts individually and in the aggregate and must be approved by the board of directors of the bank making the advances and reported to the board of directors of the other bank involved.

m. Loans to directors or their companies must be approved in advance by the majority of the other directors of the bank who must also assume specific responsibility to the shareholders for such loans, and must otherwise be restricted as to rate, kinds of collateral, etc., on a basis no more favorable than granted to other borrowers in the same circumstances.

n. Loans to securities companies to be limited as to amounts, kinds of collateral and purposes.

o. Loans on securities to be limited as to amount and collateral, etc., as set by the Banking Board in regulations affecting all banks.

p. No bank, no director and no officer of a bank shall act as agent or other medium in connection with securing loans for any securities company or dealer.

q. No fees, gifts, or gratuity of any sort to be received by directors or officers for granting loans and no fees to be paid to any attorney or other person in connection with the granting of loans except upon full disclosure of the details.

r. No bank may hold stock or other securities issued by a bank premises company.

s. Any loans made by banks directly or indirectly to bank examiners or other persons in responsible positions in the offices of the Banking Board to be made only upon approval of a majority of the board of directors, to be adequately secured, and to be reported forthwith to the Banking Board with all pertinent details.

t. Penalty for making any false statements of material fact in obtaining or discounting loans.

u. Each bank's extension of credit to any corporation in the form of securities is to be limited to bonds of the investment type.

v. Define "investment securities" featuring the factor of marketability, etc.

w. Investment in any company's investment securities shall be included with the amount of advances in the form of loans to the company and loans to others collateralized by the company's stocks or bonds, within the limit of 1% of the bank's deposits in the case of advances to any one company or to 2% in the case of advances to all companies in an affiliated

group, with provision for continuing present excessive loans until they can be liquidated, not to exceed three years.

x. No such limit will be applicable with respect to bonds of the Japanese Government nor to bonds which are general obligations of a prefecture or a municipality, such as Tokyo.

y. Authority and responsibility given to the Banking Board to promulgate regulations to implement the general provisions of law and to prevent evasions.

Capital Stock Ownership and Management

10. To afford more protection to depositors and more representative managements, there is need of a drastically changed law, enforced by a competent supervisory body, covering in sufficient detail or definiteness the following matters:

a. No new bank may begin business until its capital stock is paid in full in cash to the extent of at least 5% of an average reasonable estimate of deposits for a period of three years.

b. The articles of association of the bank to state the maximum amount of authorized capital stock (which does not necessarily mean the amount outstanding or to be sold).

c. Every bank to maintain capital deemed by the Banking Board to be adequate in relation to its deposits, trust and other responsibilities, the minimum to be not less than 5% of deposits.

d. Presently existing banks which do not meet the minimum capital requirements may continue in operation, if otherwise sound or satisfactory, with the written approval of the Banking Board but will be subject to the conditions applicable to the payment of dividends set forth in the law.

e. At least 50% of the bank's capital structure shall consist of capital stock.

f. Only one class of capital stock may be issued, except in an emergency and under conditions approved by the Banking Board.

g. No certificate of stock shall be issued until the full stated par value thereof shall have been paid in cash.

h. No certificate of stock shall be offered for sale or issued except to the extent and under conditions authorized by the Banking Board.

i. No certificate of stock of the bank shall bear any statement purporting to evidence any interest in stock or assets of any other corporation.

j. No increase or reduction shall be made in the capital stock of any bank unless and until approved by the Banking Board.

k. Every bank is required to maintain an adequate stock register and shares shall not be held by or registered for any person not legally authorized to hold stock.

l. Shares may not be voted except by legally qualified shareholders or their duly constituted proxies.

m. Each share of stock is entitled to the same vote or voice in the management as any other share.

n. At least thirty days notice in writing, setting forth the various matters to be voted upon at each shareholders meeting shall be mailed to all shareholders and posted in conspicuous places in the lobby of each branch or office and published in newspapers of each city in which the bank operates a branch.

o. With each notice mailed to shareholders, there shall be included (1) a full and clear statement of the law and by-laws with respect to the rights and duties of shareholders to be present and vote their shares in person, and (2) a full and correct current report of the condition and operations of the bank.

p. At each regular shareholders meeting the Chairman of the board of directors or the president of the bank, or such other officer as may be designated by either, shall be responsible for presenting a full and correct report of the condition and operations of the bank and supply such reasonable supplemental information as may be demanded in writing by 100 or more shareholders.

q. The articles of association and by-laws of each bank shall require at least 66% of the stock to be voted to increase or reduce the bank's capital stock, to effect a merger or a consolidation, to acquire substantially all of the assets of another bank or branch, to go into liquidation, to make a substantial change in the character of its business, or make any changes in the articles of association or by-laws, and at least 33% of the stock to be voted for the election of directors and transacting other incidental or routine business at shareholders' meetings. If such quorum is not convened at any meeting, a new meeting date shall be set and new notices be sent out. If quorum fails at second and third meetings, shareholders present may proceed with voting which action may be final if approved by the Banking Board.

r. Shareholders' meetings shall be held at the head office of the bank and simultaneously at Fukuoka, Osaka, Tokyo, and Sapporo in the case of a bank having large numbers of branches and shareholders located in or near such cities.

s. Dividends may be paid only out of actual net earnings of the bank.

t. No dividend is to be paid on the stock of the bank held by or for a holding company of such bank.

u. No dividend is to be paid until capital stock is at least 50% of the total capital structure.

v. No dividend is to be paid until the total sound capital structure of the bank is at least 50% of the required amount, and thereafter until the capital deficiency is cured, dividends are to be limited to 5% on the par value of the shares outstanding, or 50% of the net earnings for the year after providing for all depreciation and losses, whichever is smaller.

w. In all cases, the directors shall be responsible for determining if the bank is legally qualified to pay any contemplated dividend, on the basis of earnings after providing for losses, etc.

x. Directors shall be held responsible for the payment of dividends on any shares registered or held illegally.

y. No dividend shall be paid while the capital stock or surplus of a bank is impaired or which will result in impairment.

z. For failure to cure impairment in capital stock or surplus the illegal payment of dividends and for any other important violation of law or regulations issued by the Banking Board, a bank may be placed in receivership or liquidation by the Banking Board.

aa. The terms "impaired capital" and "impaired surplus" shall be defined as follows: (Omit definition in this outline)

bb. The board of directors to consist of 5 to 15 persons, the exact number to be determined by the shareholders and set forth in the by-laws of the bank, not more than one-third to be officers of the bank.

cc. Directors to be elected by shareholders annually on the third Tuesday of April, to serve for one year, or until successors are appointed and qualified.

dd. Each share of capital stock except shares held by the bank may be voted once for each director to be elected, or cumulatively for one or more.

ee. If a vacancy occurs in the board of directors between shareholders' meetings, the board of directors to be required to fill it within thirty-five days, the appointment to be effective until the next annual shareholders' meeting.

ff. It shall be the duty of the board of directors of each bank to formulate, direct and review the general policies and operations of the bank within the limitations of the law and the regulations prescribed by the Board.

gg. The board of directors shall appoint annually, and at such other times as vacancies occur, and fix or approve salaries of, a president, vice president, cashier, branch managers, and such other officers as are deemed necessary to operate the bank.

hh. The directors, officers, and employees to be subject to money damages and criminal penalties and removal from office by the Banking Board for negligence, mismanagement, embezzlement, false entries, false reports, etc., violation of laws or regulations issued by the Banking Board.

Bank Charters, Licenses or Permits

11. The new law clarifies and strengthens the controls of the supervisory authority with respect to the following matters:

a. No bank to be chartered, to establish or move or close a branch, to exercise trust powers, etc., except with the prior permission of the Banking Board.

b. No change to be made in the articles of association of a bank or in the character of its business without prior permission from the Banking Board.

c. No merger or consolidation or liquidation of a bank may be undertaken without prior permission from the Banking Board.

d. No permission is to be granted by the Board for the merger or consolidation of a bank without a public hearing before the Banking Board at which a positive showing must be made that such merger or consolidation is necessary in the public interest.

e. No bank directly or indirectly may buy or own a majority of the assets of another bank or branch for the purpose of absorption without a permit from the Banking Board.

f. Prohibit the establishment of "group" or "chain" banking systems, especially as an evasion of restrictions and limitations upon branch banking.

g. The Banking Board in granting charters or permits in any of the above cases to be required to consider various factors such as needs of the community, character, financial condition, history of management, adequacy of capital, consistency with anti-trust laws and purposes, etc.

h. Emergency power to be granted to the Government to declare the existence of a national emergency and authorize the Banking Board to suspend all banks for the conservation of assets and equal protection of all depositors and to relicense or to reorganize banks which are needed and in acceptable condition.

i. To provide for some liberalization of restrictions when considered by the Banking Board to be essential during a period of national emergency.

j. Statement of conditions under which a bank may be placed in receivership or in liquidation, for the information and guidance of the Banking Board and banks.

k. Authorize the Banking Board to appoint a receiver pending determination whether to reorganize or dissolve and liquidate any bank and to appoint liquidators in all cases where necessary.

l. Receivers and liquidators shall be responsible to and operate under the rules and regulations of the Banking Board subject only to review by public courts upon the complaint of aggrieved creditors or shareholders.

m. The authority, duties and responsibilities of the receiver or liquidator set forth in the law to be implemented by such rules and regulations as may be prescribed by the Banking Board.

n. Provide for examination of assets and liabilities of any bank as a basis for determining or approving any plan of operating under a receivership, reorganizing or placing the bank in final liquidation.

o. Prohibit reorganizations under waiver of deposits unless consented to by persons representing 66% of the deposits and other liabilities.

p. Waiving depositors to be given priority with respect to all proceeds of liquidation of frozen assets, etc.

q. Trustees to be named in conjunction with or to succeed the receiver, to conserve assets of waiving depositors and creditors first, and the shareholders second.

r. Specific limitations and conditions for accepting new deposits and handling withdrawals, etc., during receiverships.

s. To fix the time limit of six months, unless extended, during which a bank must be reorganized and turned over to its directors or, if no acceptable plan of reorganization is agreed upon, to be placed in final liquidation.

t. Any receiver or liquidator to be subject to the penal and removal provisions of the banking law for misappropriation of funds, false entries, false reports, etc., in the same manner and extent as in the case of officers and directors of going banks.

u. To authorize the Banking Board to issue rules and regulations to implement this section of the law and to prevent evasions thereof.

Reports, Examinations and Supervision

12. To eliminate gross weaknesses in this regard, the new banking act should contain definite and effective provisions covering the following points:

a. Repeal any provisions of existing laws pertaining to the supervision of banks and all other credit organizations, insurance companies, securities issuers and dealers or exchanges, and place all such organizations under the supervision of the Banking Board exclusively.

b. Each bank or other financial institution covered in this act to be required to submit a balance sheet, a statement of earnings and expenses, and a statement of capital and surplus adjustments and such other reports at least annually and at such other times and in such form as may be directed by the Banking Board.

c. These reports to be submitted to the Banking Board and/or to the Bank of Japan as directed by the Banking Board.

d. Each bank to be required to report all cases of affiliation and to submit such data in connection therewith as may be prescribed by the Banking Board.

e. Special reports with respect to deposits and required reserves to be submitted to the Bank of Japan with copies to the Banking Board, in the form prescribed by the Banking Board.

f. Penalties for the submission of false or misleading reports to the Banking Board or to the Bank of Japan.

g. Penalties for false or misleading reports or statements used in or as advertisements for the purpose of selling stock, soliciting deposits or other business.

h. Each bank to be required to maintain books and records which are adequate for the conduct of its business, the compilation of reports and for examination purposes.

i. Each bank or other financial institution to submit to examination at such times as may be directed by the Banking Board, in no case less frequently than once in any eighteen months period.

j. Salaries and expenses of at least the examiners of the Banking Board to be assessed against banks and other institutions, and their affiliates, which are supervised.

k. Each affiliate of a bank to be required to submit to examination.

l. The examiner in charge of any examination of any bank or affiliate to be authorized to require directors, officers or employees to submit the data requested and to place them under oath for the purpose of questioning as to the bank's business, etc.

m. With the consent of or under regulations prescribed by the Banking Board, duly authorized representatives of the Bank of Japan may be authorized to make credit investigations of banks.

n. Examinations to be complete with respect to all operations and all departments of the bank including the trust department.

o. Reports of examination to be strictly confidential, with exceptions in the case of court subpoenas, etc.

p. Examiners to be prohibited from revealing or discussing information about banks except to courts when subpoenaed, to the Banking Board, to the directors and officers of the bank, in official relationships.

q. All banks to be further protected with respect to visitoral powers, limiting examinations or inspections to examiners of the Banking Board, duly appointed officers of certain courts and proper tax authorities who have duly executed court subpoenas or the consent of the Banking Board.

r. Books and records to be made available to responsible officials of other Ministries of the Japanese Government only upon approval of the Banking Board based upon written requests stating the purpose and extent of such access.

s. Make it unlawful for any person to reveal data with respect to loans, collateral, deposits, etc., of customers of the bank, except in the cases authorized or required by law.

Offenses, Crimes and Penalties

13. The various detailed provisions should be incorporated in each section to which they pertain. The more important general subjects are summarized as follows:

a. Members of the Banking Board to be removed from office by the House of Representatives of the Diet, after a public hearing before a committee thereof, for physical or mental incapacity, or misconduct, such as accepting bribes, violation of law or failure to enforce the law; to be prosecuted for criminal acts.

b. The members of the staff of the Banking Board subject to removal by the Banking Board for criminal violation or misconduct; to be prosecuted for criminal acts, etc.

c. Bank directors, officers and employees to be removed from office by the Banking Board upon a hearing for violation of laws, regulations, orders of the Board and for conducting unsound and unsafe practices after a warning.

d. Directors, officers and employees of banks to be subject to fines or imprisonment for criminal violations of laws and regulations.

e. Bank directors, officers and employees to be subject to damages resulting from their criminal or unsound acts or for gross negligence or failure to act.

f. Criminal violation to include misapplication of funds or other assets, making false reports, making false entries in the books and records, violating various restrictions and limitations, accepting bribes, illegally revealing information concerning bank loans, etc.

g. All trials and punishment for criminal violations to be by the public courts and in accordance with the law and penalties provided, including the failure of directors and officers of the banks or supervisory authorities to report criminal violations to the proper courts.

[SOURCE: SUITLAND PAPERS, Z 703–15]

12-13 CAGLE'S MEMO ON BANKING LEGISLATION

Memorandum December 28, 1948
To: W. K. LeCount, Chief, Finance Division, ESS
From: C. E. Cagle, Chief, Bank of Japan Unit, Money and Banking Branch

Pursuant to your request, this memorandum comments upon the proposals in part 2 of the radio from Washington, dated 17 December 1948, to the effect that "... the most practical approach would be an interim program to expand the authority of the present Bank of Japan", providing it "with controls sufficiently powerful to permit it to curb credit and thus play its part in a stabilization program". This was followed by four specific suggestions for increasing such power, which are commented upon in the order presented.

1. "To give Bank of Japan control over reserve requirements within prescribed limits." Present laws do not require that banks maintain reserves. However, the Bank of Japan requires clearing banks to maintain balances as determined by the Bank of Japan, reportedly in relation to clearing activities. Also the Bank of Japan requires borrowing banks to carry balances as determined by the Bank of Japan. This division previously had proposed that all banks be required to maintain reserves within certain limits specified by law, the exact kinds and amounts to be set by the proposed Banking Board from time to time as the economic conditions, credit conditions, and other matters affecting the public interest might require.

2. "To make Bank of Japan the principal regulating, supervising and examining authority of all banks ... the right to charter new banks to be left with the Ministry of Finance." The Finance Division had proposed that this authority be placed in the Banking Board. Washington's suggested change is practically useless because the Bank of Japan, under present laws, as vaguely worded and as applied, is already in fact just exactly what Washington proposes, and most everyone in banking circles in Japan realizes that fact. This results from the broad powers granted in the Bank of Japan law and the provisions in the laws or ordinances related to loan priorities, and the loan agreements which the Bank of Japan requires all borrowing or discounting banks to execute. This covers most, if not all, of the banks. If Washington's suggested change is to be followed there should remain no reason for the Ministry of Finance to be interested in the examining, supervising or chartering of banks and the conflicting authority and responsibility should be eliminated.

3. "To foster independence of the Bank of Japan by deleting most provisions giving control over the bank's operations to Minister of Finance ... and by giving the bank's officers more secure tenure ..." The deletions suggested might appear to be of importance to a person who only reads the words as written in the Bank of Japan law. However, to one familiar with the actual procedures and practices, the changes suggested by Washington would appear to result in but little, if any, reformation. Although Washington's suggestion is not quite clear, it is presumed not to suggest the deletion of Article 28 which provides "The competent Minister may, whenever deemed necessary for the attainment of the object of the Bank of Japan, order banks and other financial institutions to cooperate in the execution of the operations of the Bank of Japan."

4. "To grant Bank of Japan such additional powers to control money and credit as may be deemed feasible." This suggestion is difficult to understand unless it is intended to eliminate any reference to joint authority by others. The Bank of Japan practically determines in actual practice the variable loan and discount rates which it charges on credit extended to banks and others, interest on loans granted by banks and other credit institutions, and interest paid on deposits of various classes. Through its administration of the Loan Priorities Law and its credit facilitation operations, its stamped bills practices, and other credit operations, the Bank of Japan virtually dominates the credit policies and practices of all banks in Japan. In a great many cases it passes upon the eligibility of borrowers, the nature and efficiency of their management, condition, and operations, the size of loans in individual cases and the uses of funds borrowed; determines the amount of a large line of credit to a large concern which will be taken by each of the banks set up to handle the concern's loans; allocates RFB debentures and other government obligations; grants special low rate credit aids and allocates higher rate assets to inefficient banks to enable them to show profits; grants large credits of a continuous nature to certain institutions on, or in proportion to, government bonds held as collateral; supplies funds to insurance companies to enable them to expand their investments in real estate, stocks and other inflationary operations; supplies funds to selected securities dealers, call money or bill brokers, for expansion of their operations. In addition to the very powerful control over credit which the Bank of Japan is given through the aforementioned laws and operations, and which it exercises through its holding or manipulating the purse strings, the Bank of Japan is represented in an important way on at least seven of the most important monetary and credit committees in Japan, including the Reconstruction Finance Commission and the Deposit Bureau Funds Operations Committee. The power of the Bank of Japan is further extended by its operations under the provisions of the law directing that it shall undertake the management of the Government's Treasury funds. This is implemented by its network of more than 50 branches or sub-branches and over 500 agencies throughout Japan, where receipts and disbursements of hundreds of billions of yen are effected annually.

Though needing clarification in certain particulars, there are some checks and balances upon the discretionary and discriminatory authority and practices of the Bank of Japan now afforded through certain agencies of the Japanese Government charged with some responsibilities in the formulation of monetary and credit policies. They should be preserved and strengthened, rather than weakened or eliminated, as suggested by Washington. In the face of the known facts and reports as to the manner in which the Bank of Japan has exercised its policy making powers and carried out its financial and credit operations, it would seem unnecessarily hazardous to further concentrate broad policy making powers, coupled with broad and completely discretionary control over the actual purse strings, in the Bank of Japan—even if it were operated under a board of directors, as recognized in America, and as proposed by the Finance Division, but presumably rejected by Washington. This seems doubly dangerous to one who realizes that the Bank of Japan is largely a one-man institution, not inhibited by specific legal checks and controls. The Bank of Japan Law provides in part that "The Governor shall represent the Bank of Japan and control its entire operations."

5. Although the Bank of Japan has had great discretionary power to curb credit, it has extended credit in exceptionally large amounts to special banks with no expectation of repayment within reasonable periods, to enable such banks to expand their credit operations and profits. The Bank of Japan has been the principal source of credit for the vast expansion of the Reconstruction Finance Bank's credit operations. It has also extended large amounts of continuous credit to other banks, enabling them to further expand. It has been the principal source of both short-term and long-term credit to the Government in its vast deficit operations. The printing presses have been its principal source of money. These operations have contributed heavily to the existing inflated and unstabilized situation. All indications are that these developments have been determined by the Bank of Japan, other Japanese Government agencies, and SCAP officials. It is difficult to conceive of a Bank of Japan which would or could alone formulate and enforce, for any appreciable period of time, credit curbs which are not approved by the Japanese Government and SCAP officials.

6. If Washington's suggested interim program of expanding the Bank of Japan's authority should result in stabilization through its curbing of credit, it would seem that SCAP would have but little interest in more extensive changes in monetary and central banking system after the desired feat of stabilization is accomplished. It is more certain that the dominating Japanese influences would not then be interested in effecting reforms only for reform's sake unless required by SCAP.

7. The Washington radio of 27 October 1948, suggested that the Banking Board program, as proposed by the Finance Division might be jeopardized or discredited by being associated with conditions for which it was not responsible, if introduced before stabilization is accomplished or reasonably assured. It would seem that there would be far more disastrous results if the Bank of Japan were to be given at this time complete power and responsibility for curbing credit and thus accomplishing or contributing to stabilization, and then should fail to accomplish stabilization.

8. If no clear cut changes are to be effected now along the lines proposed by the Finance Division with respect to monetary and credit matters, it is believed that an alternative preferable to that suggested by Washington would be to lay down in the law some temporary restrictions and limitations with respect to reserves and other credit matters and patch up the authority and responsibility of the members of the Cabinet or other Government agencies for setting specific amounts or limitations and exercising other discretionary control features.

[SOURCE: SUITLAND PAPERS, Z 703-15]

12-14 LeCOUNT'S MEMO ON PROPSED BANKING LAW

Memorandum December 31, 1948
To: Chief, ESS
From: Walter K. LeCount, Chief, Finance Division

1. References are:

a. Memorandum for Chief, ESS, dated 28 May 1948, subject: Proposed Banking Law.

b. Washington Radio No. W 81239 dated 17 December 1948 containing comments on reference 1 a. above.

c. Memorandum for Chief, Finance Division, dated 28 December 1948, subject: Banking Legislation.

2. Part 2 of reference 1 b. above gives comments on what has developed to be the major point of difference between Washington and Finance Division's views in respect to the establishment of a Banking Control Board with supervision over all banks in Japan in contrast to the assignment of similar functions to the Bank of Japan itself. Finance Division's comments on this matter will be given in subsequent paragraphs.

3. Part 4 of Washington radio, reference 1 b. above, contains comments on paragraphs 5 through 13 of reference 1 a. above. Exhaustive consideration has been given to these comments, and except for very few minor points of difference, more particularly where reference is made to the basic point of difference as mentioned in the preceding paragraph 2 above, they can easily be resolved.

4. As stated in paragraph 2 above, the basic point of difference is the establishment of a Banking Control Board as against the assignment of bank control authority to the Bank of Japan. Reference 1 c. above outlines in detail the views of Mr. C. E. Cagle who is largely responsible for the preparation of reference 1 a. above. In preparing that paper, Mr. Cagle has been guided by an extensive background of experience, both in commercial banking and a service of about 15 years with the Federal Reserve Board in Washington, during which latter time he was largely engaged in research and administrative work on banking legislation. As emphasized by Mr. Cagle, the Bank of Japan now technically possesses through existing legislation many of the functions which we have contemplated for assignment to the proposed Banking Control Board. Some of these functions have been exercised in whole or in part and some have presumably been permitted to remain dormant. If, however, all were exercised to the utmost degree, plus such additional functions as have been contemplated for a Banking Control Board, and if the Bank of Japan retained its present setup of directorship, the ultimate result would be the creation of almost a financial octopus in Japan. Also, inasmuch as in essence the policies of the Bank of Japan stem from one man—the Governor—it would amount to a financial czardom for whoever holds that exalted position. With a strong man occupying the governorship, this factor might not be subject to too much criticism or abuse but with a weak or politically-inspired individual, there would be untold danger.

5. We still adhere to our basic recommendation for an independent Banking Control Board but as a compromise toward Washington's opinions, we would be prepared to accept in lieu of such a Board the establishment by appropriate legislation of a Policy Control Board within the framework of the Bank of Japan. This Board should be separate and apart from the bank's board of directors. It would be the determiner and be responsible for most, if not all, of the policies and responsibilities previously contemplated for the Banking Control Board and with power to direct the Bank of Japan through its Board of directors to implement its various decisions and recommendations. This Board should be comprised of not more than 7 to 9 members to include among others the Governor of the Bank of Japan, the Minister of Finance, an appointee of the Prime Minister, an appointee of the National Association of Japanese Bankers, and a representative of agricultural interests. With the exception of the first 3 named officials, the remaining membership should be chosen, appointed, or elected for definite terms of say five years, and should be on a staggered, rotational basis.

6. The setup proposed in the preceding paragraph would still leave the Bank of Japan as the keystone of the Japanese financial system, but it would remove from the operating end of the bank the establishment of policy therefor. It would also overcome the point raised by Washington in respect to the creation during the present unsettled period of an independent financial authority which might be unable to accomplish the aims for which it was created, and thereby bring discredit not only upon itself but upon the Japanese Government.

7. If this proposal meets with the approval of the Chief, ESS, in particular, and of SCAP in general, it can easily be expanded in greater detail for the benefit of Washington and of interested entities in Japan.

[SOURCE: SUITLAND PAPERS, Z 703-15]

12-15 LeCOUNT'S MEMO ON CONTROLS ON CREDIT EXPANSION

Memorandum January 7, 1949
To: Chief, ESS
From: Walter K. LeCount

1. Reference is paragraph 2c of Washington radio W 81058, 11 December 1948 requiring SCAP to assure rigorous limitation of credit extension to projects contributing to economic recovery of Japan.

2. In this connection, ESS/FIN is undertaking the following program:

a. Continuation of tight bank loan policy of the Bank of Japan.

b. Review of interest rates and rediscount rates to determine desirability of increases as a means of tighter credit control.

c. Overall reorganization of the banking laws which will bring all credit institutions under a single authority and establish a reserve system to permit more sensitive control over bank credit expansion. Establish a temporary reserve system under control of Bank of Japan pending putting into effect of new banking law. Reserves will be required in cash and bonds to any extent necessary in the accomplishment of immediately increased control of credit expansion.

d. Loan priority schedules have been revised to tighten control of flow of funds on essentiality basis.

e. All credit programs will be kept within the priority system, with special requirements such as those of foreign trade accorded top priority.

f. The loan limit plan pertaining to new deposits will be kept in effect and greatest amount possible will be diverted to support of government finance.

g. Programs will be developed to increase participation of private capital in industrial rehabilitation including encouragement of greater participation of the reorganized Industrial Bank in the equipment loan field.

h. Reconversion Finance Bank will be reorganized along lines developed in a draft plan already prepared, which provides for: (1) Future increases in capital of RFB to be provided by government appropriation; (2) More drastic limitation of total amount of funds available to RFB for loans; (3) More strict regulation of RFB loan policies, eliminating loans for operating purposes, including deficit loans; (4) Limitation of RFB loans for equipment purposes to the most urgent rehabilitation projects and requirement of participation in such loans by commercial and special banks, thus insuring more careful scrutiny of the credits; (5) Limitation of RFB lending to the industrial field, eliminating it from rehabilitation projects in other fields, such as agriculture, public works, public welfare, etc., and forcing such projects under Diet review; (6) Limitation of equipment loans to those for which adequate security can be offered.

[SOURCE: SUITLAND PAPERS, Z 703-16]

12-16 LeCOUNT'S MEMO ON CONTROLS ON CREDIT EXPANSION

Memorandum January 20, 1949
To: Chief, ESS
From: Walter K. LeCount, Chief, Finance Division

1. Reference is paragraph 2c of Washington radio W 81058, 11 December 1948, requiring SCAP to assure rigorous limitation of credit extension to projects contributing to economic recovery of Japan.

2. In this connection, ESS/FIN is undertaking the following program:

a. Continuation of tight bank loan policy of the Bank of Japan to force banks to use own funds discreetly and prevent escape from other credit controls by resort to central bank.

b. Enactment of legislation to provide for deposit reserve system. All banks will be required to maintain reserves with the Bank of Japan in accordance with ratios to be set by the bank within limitations fixed by law. This will give the central bank greater overall control of banks' lending activities and will permit tightening of their fund positions at any time in conformity with credit limitation policy. Reserves will be required in cash and bonds to any extent necessary in the accomplishment of immediately increased control of credit expansion.

c. Maintenance of present interest rates and rediscount rates for the balance of the fiscal year. Periodic review of these rates during the 1949 fiscal year to determine the desirability of increases as a means of tighter credit control.

d. Revision of loan priority schedules approved on 4 January 1949 adjusted priority classifications to meet changing conditions. Where supplies of critical materials are improving or where the items have lost importance priorities of producing industries have been reduced and higher priorities have been given where shortages are occurring. Also high priorities have been limited to specific industries eliminating or throwing into lowest class some basket classifications which existed in previous regulations.

e. Review of priority classifications at end of fiscal year to keep adjustments current.

f. Loans to exporters and manufacturers of export goods will be given highest priority in order to stimulate exports, but will be kept within the priority system. Bills arising out of manufacturing for export or originating out of transactions involving procurement of raw materials for export manufacture will be accorded foreign trade priority.

g. Loans by trust companies from specified money in trust will be made subject to loan priority regulations.

h. Temporary Money Rate Adjustment Law will be revised to make loans by trust companies out of specified money in trust subject to the legal maximum rate plus trust fees.

i. The loan limit plan covering increases of new bank deposits will be continued. This plan apportions the use of monthly increases in deposits between industry loans and government finance. Maximum amount is directed to government finance as a step in overcoming inflation. Present government portion is 40%. It will be increased as is deemed consistent with the anti-inflation program.

j. Restriction of loans by agricultural cooperative associations to members only inasmuch as the associations are not subject to loan priority regulations.

k. Encouragement of greater participation of the reorganized Industrial Bank in the equipment loan field, to relieve RFB and to bring greater lending discretion to bear on such projects.

l. Reorganization of the Reconversion Finance Bank providing for the following: (1) Future increases in capital of RFB to be appropriated by the Diet: (2) more drastic limitation of total amount of funds available to RFB for loans; (3) elimination of deficit loans; (4) elimination of operating fund loans; (5) limitation of RFB loans for equipment purposes to the most urgent rehabilitation projects and requirement of participation in such loans by commercial and special banks, thus insuring more careful scrutiny of the credits; (6) limitation of RFB lending to the industrial field, eliminating it from rehabilitation projects in other fields, such as agriculture, public works, public welfare, etc., thus forcing such projects under Diet review; (7) limitation of equipment loans to those for which adequate security can be offered.

[SOURCE: SUITLAND PAPERS, Z 703-16]

12-17 ON THE OPERATION OF JAPAN DEVELOPMENT BANK

Memorandum[12] August 6, 1951

ON THE OPERATION OF JAPAN DEVELOPMENT BANK, ETC.

1. The Japan Development Bank was established in April this year by Japan Development Bank Law and opened on May 15.

2. On the day of the Bank's establishment, two and half billion yen was paid into the Bank from the Counterpart Fund for U.S. Aid Special Account out of ten billion yen appropriated in that Account for the purpose of Government investment to JDB. On basis of this fund, the JDB has made the following amount of loans as of July 31.

(in million yen)

		Amount of loans, approved		Amount of loans, actually made
Coal	6	855	4	259
Iron & steel	2	400	2	400
Non-ferrous	1	35	–	–
Electric power (self-generation)	4	630	1	83
Chemical industry	3	328	1	29
Port facilities	2	77	–	–
Fishery	2	310	2	254
Total	20	2,635	10	1,025

3. The examination division has been set up, in addition to two business divisions, in the Bank and has been carrying out the very strict examination of the proposed loans; e.g. it took more than a month after the Bank's opening to make first loan (June 20) owing to the prudent examination, etc. Also, the above table indicates that the fund situation of the corporations to receive loans are examined carefully before the approved loans become actual, in expectation of each loan being assured proper and timely.

4. These operations of JDB are explained by the fact that they have been carried on in

[12] No indication of author (Ministry of Finance, Japanese Government?).

accordance with the Japan Development Bank Law, on a basis completely different from that of RFB, the difference being further explained in detail in attached sheets.

[Attached Sheets]

1. Underlying Economic Policy

(1) Reconversion Finance Bank

The keynote of the economic policy in the JFY 1947 and 48 during which the Reconversion Finance Bank was in active operation was that, while it should be stressed to hold price level low so as to curb the inflationery spiral, even under this low-price policy it was said to be unavoidable to increase the currency circulation to some extent so that the production standard of Japan's economy could be rapidly raised.

(2) Japan Development Bank

The keynote of the economic policy in and after JFY 1951 when the Japan Development Bank is in operation is to build up the firm groundwork of the Japan's self-supporting economy in future without disturbing the basis of the stabilized economy established in and after the JFY 1949.

To sum up, the economy in which the Reconversion Finance Bank grew up was not yet out of the period of post-war instability, whereas the Japan's economy in which the Japan Development Bank is in operation is gradually forwarding on the stabilized ground.

2. Scope of Business

(1) The Reconversion Finance Bank could finance not only equipment funds but also operation funds, whereas the Japan Development Bank can finance equipment funds only.

The Reconversion Finance Bank, as a result, financed deficit in operation funds of corporations for the purpose of increasing production under the low price policy followed at the time. On the contrary, the Japan Development Bank will never follow the same course. Furthermore the financing of equipment funds by the Japan Development Bank is being made very strictly and properly by almost the same criteria as is observed in regard to the direct investment from the U.S. Aid Counterpart Fund to private enterprises.

(2) The Reconversion Finance Bank could finance short-term loans for around six months, because legally there were no limitation on financing terms, whereas in the case of the Japan Development Bank financing for a period shorter than one year is prohibited, whereby its character as a long-term finance institution is made clear.

(3) Since the Reconversion Finance Bank, despite that its function was expected to be sound financing, did such unsound jobs as deficit financing the changes of whose redemption are not so good as they should be, it is clearly prescribed by the JDB law and strictly observed by the Japan Development Bank that it should make only those loans that are sure to be redeemed.

(4) The Reconversion Finance Bank in principle, was not supposed to finance the funds for redemption of old obligations, whereas the Japan Development Bank, as a long-term finance institution, can re-finance the long-term loan made by city banks, which re-financing is soon to be put into effect.

(5) Looking back the business operations of the Reconversion Finance Bank, its function was considerably mixed up with that of city banks, whereas in the case of the Japan Development Bank, in view of its character as a long-term financing institution, it is not to compete with city banks in its operation of business as is clearly prescribed in the law.

3. Fund

(1) The RFB procured its funds by issuing the Reconversion Finance Debenture under the legitimate authorization, in addition to its capital. Those debentures were underwritten by the Bank of Japan. This procedure brought about the economic situation called "the RFB inflation."

(2) In contrast, JDB is not authorized to issue debentures. Its fund solely comes from the Government investment, the amount of which is to be determined in view of the government fiscal balance and of the whole picture of supply & demand of industrial and other funds.

4. Organization to decide loans

(1) Until the revision of the regulations on Feb. 4, 1949, RFB had had three organizations (Council for Reconversion Finance, Managerial Conference for Reconversion Finance and the Bank itself), each of which had seperately been responsible for a decision to make each loan in accordance with the amount of the loan concerned. This method blurred the responsibility for the loaning operation, and also some-what weakened the judgement of RFB as an entire financial institution.

(2) In view of RFB's experiences, each loan from JDB is decided by the Bank itself,

in order that any doubt acount the responsibility for the loan can be cleared away and that the independent judgement of the Bank be paid due respect.

5. Budget

(1) RFB was required to present each business year its operation plan and estimate of expenses to the Council for Reconversion Finance for its approval.

(2) JDB's budget for its receipts and expenditures in each business year should be submitted to the Diet for its approval, together with the national budget.

6. Supervision

(1) Supervision over RFB was complicated. It was supervised by both the Minister of Finance and the Minister of International Trade and Industry, and also was under the direct supervision by the Council for Reconversion Finance.

(2) JDB is under the sole supervision of the Minister of Finance.

[SOURCE: SUITLAND PAPERS, Z 703-15]

13 U.S. OCCUPATION OF GERMANY

13-1 PROGRAM TO PREVENT GERMANY FROM STARTING A WORLD WAR III[1]

Sept. 1944

By: Henry Morgenthau, Jr., U.S. Secretary of Treasury

1. *Demilitarization of Germany.*

It should be the aim of the Allied Forces to accomplish the complete demilitarization of Germany in the shortest possible period of time after surrender. This means completely disarming the German Army and people (including the removal or destruction of all war material), the total destruction of the whole German armament industry, and the removal or destruction of other key industries which are basic to military strength.

2. *New boundaries of Germany.*

(a) Poland should get that part of East Prussia which doesn't go to the U.S.S.R. and the southern portion of Silesia. (See map in 12 Appendix.)

(b) France should get the Saar and the adjacent territories bounded by the Rhine and the Moselle River.

(c) As indicated in 4 below an International Zone should be created containing the Ruhr and the surrounding industrial areas.

3. *Partitioning of New Germany.*

The remaining portion of Germany should be divided into two autonomous, independent states, (1) a South German state comprising Bavaria, Wuerttemberg, Baden and some smaller areas and (2) a North German state comprising a large part of the old state of Prussia, Saxony, Thuringia and several smaller states.

4. *The Ruhr Area.* (The Ruhr, surrounding industrial areas, as shown on the map, including the Rhineland, the Keil Canal, and all German territory north of the Keil Canal.)

Here lies the heart of German industrial power. This area should not only be stripped of all presently existing industries but so weakened and controlled that it can not in the foreseeable future become an industrial area. The following steps will accomplish this:

(a) Within a short period, if possible not longer than 6 months after the cessation of hostilities, all industrial plants and equipment not destroyed by military action shall be completely dismantled and transported to Allied Nations as restitution. All equipment shall be removed from the mines and the mines closed.

(b) The area should be made an international zone to be governed by an international security organization to be established by the United Nations. In governing the area the international organization should be guided by policies designed to further the above stated objective.

5. *Restitution and Reparation.*

Reparations, in the form of future payments and deliveries, should not be demanded. Restitution and reparation shall be effected by the transfer of existing German resources and territories, e.g.,

(a) by restitution of property looted by the Germans in territories occupied by them;

(b) by transfer of German territory and German private rights in industrial porperty situated in such territory to invaded countries and the international organization under the program of partition;

(c) by the removal and distribution among devastated countries of industrial plants and equipment situated within the International Zone and the international organization under the program of partition;

(d) by forced German labor outside Germany; and

(e) by confiscation of all German assets of any character whatsoever outside of

[1] Excerpt from Morgenthau, *Germany is Our Problem* (N.Y. 1945).

Germany.

6. *Education and Propaganda.*

(a) All schools and universities will be closed until an Allied Commission of Education has formulated an effective reorganization program. It is contemplated that it may require a considerable period of time before any institutions of higher education are reopened. Meanwhile the education of German students in foreign universities will not be prohibited. Elementary schools will be reopened as quickly as appropriate teachers and textbooks are available.

(b) All German radio stations and newspapers, magazines, weeklies, etc. shall be discontinued until adequate controls are established and an appropriate program formulated.

7. *Political Decentralization.*

The military administration in Germany in the initial period should be carried out with a view toward the eventual partitioning of Germany. To facilitate partitioning and to assure its permanence the military authorities should be guided by the following principles:

(a) Dismiss all policy-making officials of the Reich government and deal primarily with local governments.

(b) Encourage the reestablishment of state governments in each of the states (Lander) corresponding to 18 states into which Germany is presently divided and in addition make the Prussian provinces separate states.

(c) Upon the partition of Germany, the various state governments should be encouraged to organize a federal government for each of the newly partitioned areas. Such new governments should be in the form of a confederation of states, with emphasis on states' rights and a large degree of local autonomy.

8. *Responsibility of Military for Local German Economy.*

The sole purpose of the military in control of the German economy shall be to facilitate military operations and military occupation. The Allied Military Government shall not assume responsibility for such economic problems as price controls, rationing, unemployment, production, reconstruction, distribution, consumption, housing, or transportation, or take any measures designed to maintain or strengthen the German economy, except those which are essential to military operations. The responsibility for sustaining the German economy and people rests with the German people with such facilities as may be available under the circumstances.

9. *Controls Over Development of German Economy.*

During a period of at least twenty years after surrender adequate controls, including controls over foreign trade and tight restrictions on capital imports, shall be maintained by the United Nations designed to prevent in the newly-established states the establishment or expansion of key industries basic to the German military potential and to control other key industries.

10. *Agrarian program.*

All large estates should be broken up and divided among the peasants and the system of primogeniture and entail should be abolished.

11. *Punishment of War Crimes and Treatment of Special Groups.*

A program for the punishment of certain war crimes and for the treatment of Nazi organizations and other special groups is contained in section 11.

12. *Uniforms and Parades.*

(a) No German shall be permitted to wear, after an appropriate period of time following the cessation of hostilities, any military uniform or any uniform of any quasi military organizations.

(b) No military parades shall be permitted anywhere in Germany and all military bands shall be disbanded.

13. *Aircraft.*

All aircraft (including gliders), whether military or commercial, will be confiscated for later disposition. No German shall be permitted to operate or to help operate any aircraft, including those owned by foreign interests.

14. *United States Responsibility.*

Although the United States would have full military and civilian representation on whatever international commission or commissions may be established for the execution of the whole German program, the primary responsibility for the policing of Germany and for civil administration in Germany should be assumed by the military forces of Germany's continental neighbors. Specifically, these should include Russian, French, Polish, Czech, Greek, Yugoslav, Norwegian, Dutch, and Belgian soldiers.

Under this program United States troops could be withdrawn within a relatively short time.

13-2 THE MILITARY GOVERNMENT OF GERMANY

Directive (JCS1067) April 1945[2]

To: Commander in Chief, United States Forces of Occupation

IT IS CONSIDERED appropriate, at the time of the release to the American public of the following directive setting forth United States policy with reference to the military government of Germany, to preface the directive with a short statement of the circumstances surrounding the issuance of the directive to General Eisenhower.

The directive was issued originally in April 1945, and was intended to serve two purposes. It was to guide General Eisenhower in the military government of that portion of Germany occupied by United States forces. At the same time he was directed to urge the Control Council to adopt these policies for enforcement throughout Germany.

Before this directive was discussed in the Control Council, President Truman, Prime Minister Attlee, and Generalissimo Stalin met at Potsdam and issued a communiqué setting forth agreed policies for the control of Germany. This communiqué was made public on August 2, 1945. The directive, therefore, should be read in the light of the policies enumerated at Potsdam. In particular, its provisions regarding disarmament, economic and financial matters, and reparations should be read together with the similar provisions set out in the Potsdam agreement on the treatment of Germany in the initial control period and in the agreement on reparations contained in the Potsdam communiqué. Many of the policy statements contained in the directive have been in substance adopted by the Potsdam agreement. Some policy statements in the Potsdam agreement differ from the policy statements on the same subjects in the directive. In such cases, the policies of the Potsdam agreement are controlling. Where the Potsdam agreement is silent on matters of policy dealt with in the directive, the latter continues to guide General Eisenhower in his administration of the United States Zone in Germany.

DIRECTIVE TO COMMANDER IN CHIEF OF UNITED STATES FORCES OF OCCUPATION REGARDING THE MILITARY GOVERNMENT OF GERMANY

1. *The Purpose and Scope of this Directive:*

This directive is issued to you as Commanding General of the United States forces of occupation in Germany. As such you will serve as United States member of the Control Council and will also be responsible for the administration of military government in the zone or zones assigned to the United States for purposes of occupation and administration. It outlines the basic policies which will guide you in those two capacities after the termination of the combined command of the Supreme Commander, Allied Expeditionary Force.

This directive sets forth policies relating to Germany in the initial post-defeat period. As such it is not intended to be an ultimate statement of policies of this Government concerning the treatment of Germany in the post-war world. It is therefore essential that, during the period covered by this directive, you assure that surveys are constantly maintained of economic, industrial, financial, social and political conditions within your zone and that the results of such surveys and such other surveys as may be made in other zones are made available to your Government, through the Joint Chiefs of Staff. These surveys should be developed in such manner as to serve as a basis for determining changes in the measures of control set forth herein as well as for the progressive formulation and development of policies to promote the basic objectives of the United States. Supplemental directives will be issued to you by the Joint Chiefs of Staff as may be required.

As a member of the Control Council you will urge the adoption by the other occupying powers of the principles and policies set forth in this directive and, pending Control Council agreement, you will follow them in your zone. It is anticipated that substantially similar directives will be issued to the Commanders in Chief of the U.K., U.S.S.R. and French forces of occupation.

PART I

General and Political

2. *The Basis of Military Government:*

a. The rights, power and status of the military government in Germany are based upon

[2] Signed by President Truman on May 10, 1945 and released October 17, 1945.

the unconditional surrender or total defeat of Germany.

b. Subject to the provisions of paragraph 3 below, you are, by virtue of your position, clothed with supreme legislative, executive, and judicial authority in the areas occupied by forces under your command. This authority will be broadly construed and includes authority to take all measures deemed by you necessary, appropriate or desirable in relation to military exigencies and the objectives of a firm military government.

c. You will issue a proclamation continuing in force such proclamations, orders and instructions as may have heretofore been issued by Allied Commanders in your zone, subject to such changes as you may determine. Authorizations of action by the Supreme Commander, Allied Expeditionary Force, may be considered as applicable to you unless inconsistent with this or later directives.

3. *The Control Council and Zones of Occupation:*

a. The four Commanders-in-Chief, acting jointly, will constitute the Control Council in Germany which will be the supreme organ of control over Germany in accordance with the agreement on Control Machinery in Germany. For purposes of administration of military government, Germany has been divided into four zones of occupation.

b. The authority of the Control Council to formulate policy and procedures and administrative relationships with respect to matters affecting Germany as a whole will be paramount throughout Germany. You will carry out and support in your zone the policies agreed upon in the Control Council. In the absence of such agreed policies you will act in accordance with this and other directives of the Joint Chiefs of Staff.

c. The administration of affairs in Germany shall be directed towards the decentralization of the political and administrative structure and the development of local responsibility. To this end you will encourage autonomy in regional, local and municipal agencies of German administration. The German economic structure shall also be decentralized. The Control Council may, however, to the minimum extent required for the fulfillment of purposes set forth herein, permit centralized administration or establish central control of (a) essential national public services such as railroads, communications and power, (b) finance and foreign affairs, and (c) production and distribution of essential commodities.

d. The Control Council should adopt procedures to effectuate, and you will facilitate in your zone, the equitable distribution of essential commodities between the zones. In the absence of a conflicting policy of the Control Council, you may deal directly with one or more zone commanders on matters of special concern to such zones.

e. Pending the formulation in the Control Council of uniform policies and procedures with respect to inter-zonal travel and movement of civilians, no civilians shall be permitted to leave or enter your zone without your authority, and no Germans within your zone shall be permitted to leave Germany except for specific purposes approved by you.

f. The military government personnel in each zone, including those dealing with regional and local branches of the departments of any central German administrative machinery, shall be selected by authority of the Commander of that zone except that liaison officers may be furnished by the Commanders of the other three zones. The respective Commanders-in-Chief shall have exclusive jurisdiction throughout the whole of Germany over the members of the armed forces under their command and over the civilians who accompany them.

g. The Control Council should be responsible for facilitating the severance of all governmental and administrative connections between Austria and Germany and the elimination of German economic influences in Austria. Every assistance should be given to the Allied Administration in Austria in its efforts to effectuate these purposes.

4. *Basic Objectives of Military Government in Germany:*

a. It should be brought home to the Germans that Germany's ruthless warfare and the fanatical Nazi resistance have destroyed the German economy and made chaos and suffering inevitable and that the Germans cannot escape responsibility for what they have brought upon themselves.

b. Germany will not be occupied for the purpose of liberation but as a defeated enemy nation. Your aim is not oppression but to occupy Germany for the purpose of realizing certain important Allied objectives. In the conduct of your occupation and administration you should be just but firm and aloof. You will strongly discourage fraternization with the German officials and population.

c. The principal Allied objective is to prevent Germany from ever again becoming a threat to the peace of the world. Essential steps in the accomplishment of this objective are the elimination of Nazism and militarism in all their forms, the immediate apprehension of war criminals for punishment, the industrial disarmament and demilitarization of Germany, with continuing control over Germany's capacity to make war, and the preparation for an eventual reconstruction of German political life on a democratic basis.

d. Other Allied objectives are to enforce the program of reparations and restitution, to provide relief for the benefit of countries devastated by Nazi aggression, and to ensure that prisoners of war and displaced persons of the United Nations are cared for and repatriated.

5. *Economic Controls:*

a. As a member of the Control Council and as zone commander, you will be guided by the principle that controls upon the German economy may be imposed to the extent that such controls may be necessary to achieve the objectives enumerated in paragraph 4 above and also as they may be essential to protect the safety and meet the needs of the occupying forces and assure the production and maintenance of goods and services required to prevent starvation or such disease and unrest as would endanger these forces. No action will be taken in execution of the reparations program or otherwise which would tend to support basic living conditions in Germany or in your zone on a higher level than that existing in any one of the neighboring United Nations.

b. In the imposition and maintenance of such controls as may be prescribed by you or the Control Council, German authorities will to the fullest extent practicable be ordered to proclaim and assume administration of such controls. Thus it should be brought home to the German people that the responsibility for the administration of such controls and for any breakdowns in those controls will rest with themselves and German authorities.

6. *Denazification:*

a. A Proclamation dissolving the Nazi Party, its formations, affiliated associations and supervised organizations, and all Nazi public institutions which were set up as instruments of Party domination, and prohibiting their revival in any form, should be promulgated by the Control Council. You will assure the prompt effectuation of that policy in your zone and will make every effort to prevent the reconstitution of any such organization in underground, disguised or secret form. Responsibility for continuing desirable non-political social services of dissolved Party organizations may be transferred by the Control Council to appropriate central agencies and by you to appropriate local agencies.

b. The laws purporting to establish the political structure of National Socialism and the basis of the Hitler regime and all laws, decrees and regulations which establish discriminations on grounds of race, nationality creed or political opinions should be abrogated by the Control Council. You will render them inoperative in your zone.

c. All members of the Nazi party who have been more than nominal participants in its activities, all active supporters of Nazism or militarism and all other persons hostile to Allied purposes will be removed and excluded from public office and from positions of importance in quasi-public and private enterprises such as (1) civic, economic and labor organizations, (2) corporations and other organizations in which the German government or subdivisions have a major financial interest, (3) industry, commerce, agriculture, and finance, (4) education, and (5) the press, publishing houses and other agencies disseminating news and propaganda. Persons are to be treated as more than nominal participants in Party activities and as active supporters of Nazism or militarism when they have (1) held office or otherwise been active at any level from local to national in the party and its subordinate organizations, or in organizations which further militaristic doctrines, (2) authorized or participated affirmatively in any Nazi crimes, racial persecutions or discriminations, (3) been avowed believers in Nazism or racial and militaristic creeds, or (4) voluntarily given substantial moral or material support or political assistance of any kind to the Nazi Party or Nazi officials and leaders. No such persons shall be retained in any of the categories of employment listed above because of administrative necessity, convenience or expediency.

d. Property, real and personal, owned or controlled by the Nazi party, its formations, affiliated associations and supervised organizations, and by all persons subject to arrest under the provisions of paragraph 8, and found within your zone, will be taken under your control pending a decision by the Control Council or higher authority as to its eventual disposition.

e. All archives, monuments and museums of Nazi inception, or which are devoted to the perpetuation of German militarism, will be taken under your control and their properties held pending decision as to their disposition by the Control Council.

f. You will make special efforts to preserve from destruction and take under your control records, plans, books, documents, papers, files, and scientific, industrial and other information and data belonging to or controlled by the following:

(1) The Central German Government and its subdivisions, German military organizations, organizations engaged in military research, and such other governmental agencies

as may be deemed advisable;

(2) The Nazi Party, its formations, affiliated associations and supervised organizations;

(3) All police organizations, including security and political police;

(4) Important economic organizations and industrial establishments including those controlled by the Nazi Party or its personnel;

(5) Institutes and special bureaus devoting themselves to racial, political, militaristic or similar research or propaganda.

7. Demilitarization:

a. In your zone you will assure that all units of the German armed forces, including paramilitary organizations, are dissolved as such, and that their personnel are promptly disarmed and controlled. Prior to their final disposition, you will arrest and hold all military personnel who are included under the provisions of paragraph 8.

b. The Control Council should proclaim, and in your zone you will effectuate, the total dissolution of all military and para-military organizations, including the General Staff, the German Officers Corps, the Reserve Corps and military academies, together with all associations which might serve to keep alive the military tradition in Germany.

c. You will seize or destroy all arms, ammunition and implements of war and stop the production thereof.

d. You will take proper steps to destroy the German war potential, as set forth elsewhere in this directive.

8. Suspected War Criminals and Security Arrests:

a. You will search out, arrest, and hold, pending receipt by you of further instructions as to their disposition, Adolf Hitler, his chief Nazi associates, other war criminals and all persons who have participated in planning or carrying out Nazi enterprises involving or resulting in atrocities or war crimes.

b. All persons who, if permitted to remain at large would endanger the accomplishment of your objectives will also be arrested and held in custody until trial by an appropriate semi-judicial body to be established by you. The following is a partial list of the categories of persons to be arrested in order to carry out this policy:

[NOTE: There follows at this point in the directive a detailed list of categories of Nazi war criminals and others who are to be arrested. Some of these have not yet been found. It is considered that to publish the categories at this time would put the individuals concerned on notice and would interfere with their apprehension and punishment, where appropriate. The list of categories is, therefore, withheld from publication for the present.]

If in the light of conditions which you encounter in Germany, you believe that it is not immediately feasible to subject certain persons within these categories to this treatment, you should report your reasons and recommendations to your government through the Joint Chiefs of Staff. If you believe it desirable, you may postpone the arrest of those whose cases you have reported, pending a decision communicated to you by the J.C.S. In no event shall any differentiation be made between or special consideration be accorded to persons arrested either as to manner of arrest or conditions of detention, upon the basis of wealth or political, industrial, or other rank or position. In your discretion you may make such exceptions as you deem advisable for intelligence or other military reasons.

9. Political Activities:

a. No political activities of any kind shall be countenanced unless authorized by you. You will assure that your military government does not become committed to any political group.

b. You will prohibit the propagation in any form of Nazi, militaristic or pan-German doctrines.

c. No German parades, military or political, civilian or sports, shall be permitted by you.

d. To the extent that military interests are not prejudiced and subject to the provisions of the three preceding subparagraphs and of paragraph 10, freedom of speech, press and religious worship will be permitted. Consistent with military necessity, all religious institutions will be respected.

10. Public Relations and Control of Public Information:

As a member of the Control Council, you will endeavor to obtain agreement for uniform or coordinated policies with respect to (a) control of public information media in Germany, (b) accrediting of foreign correspondents, (c) press censorship, and (d) issuance of official news communiques dealing with Control Council matters. United States policies in these matters will be sent to you separately and you will be guided by these in your negotiations on the Control Council.

11. German Courts:

a. All extraordinary courts, including the *Volksgerichtshof* (People's Court) and the *Sondergerichte* (Special Courts), and all courts and tribunals of the Nazi Party and of its formations, affiliated associations and supervised organizations will be abolished immediately.

b. All ordinary criminal, civil and administrative courts, except those previously re-established by order of the military government, will be closed. After the elimination of all Nazi features and personnel you will permit those which are to exercise jurisdiction within the boundaries of your zone to resume operations under such regulations, supervision and control as you may consider appropriate. Courts which are to exercise jurisdiction over territory extending beyond the boundaries of your zone will be reopened only with the express authorization of the Control Council and under its regulation, supervision and control. The power to review and veto decisions of German courts shall be included within the power of supervision and control.

12. Police:

With the exception of the *Reichskriminalpolizei* (Criminal Police) all elements of the *Sicherheitspolizei* (Security Police), e.g., *Geheimestaatspolizei* (Gestapo), and the *Sicherheitsdienst der S. S.* will be abolished. Criminal and ordinary police will be purged of Nazi personnel and utilized under the control and supervision of the military government.

13. Political Prisoners:

Subject to military security and the interests of the individuals concerned, you will release all persons found within your zone who have been detained or placed in custody on grounds of race, nationality, creed or political opinions and treat them as displaced persons. You should make provision for the review of convictions of alleged criminal offenses about which there may be substantial suspicion of racial, religious or political persecution, and in which sentences of imprisonment have not been fully served by persons imprisoned within your zone.

14. Education:

a. All educational institutions within your zone except those previously re-established by Allied authority will be closed. The closure of Nazi educational institutions such as Adolf Hitler Schulen, Napolas and Ordensburgen, and of Nazi organizations within other educational institutions will be permanent.

b. A coordinated system of control over German education and an affirmative program of reorientation will be established designed completely to eliminate Nazi and militaristic doctrines and to encourage the development of democratic ideas.

c. You will permit the reopening of elementary (*Volksschulen*), middle (*Mittelschulen*) and vocational (*Berufsschulen*) schools at the earliest possible date after Nazi personnel has been eliminated. Textbooks and curricula which are not free of Nazi and militaristic doctrine shall not be used. The Control Council should devise programs looking toward the reopening of secondary schools, universities and other institutions of higher learning. After Nazi features and personnel have been eliminated and pending the formulation of such programs by the Control Council, you may formulate and put into effect an interim program within your zone and in any case may permit the reopening of such institutions and departments which offer training which you consider immediately essential or useful in the administration of military government and the purposes of the occupation.

d. It is not intended that the military government will intervene in questions concerning denominational control of German schools, or in religious instruction in German schools, except insofar as may be necessary to insure that religious instruction and administration of such schools conform to such Allied regulations as are or may be established pertaining to purging of personnel and curricula.

15. Arts and Archives:

Subject to the provisions of paragraph 6 above, you will make all reasonable efforts to preserve historical archives, museums, libraries and works of art.

PART II
Economic

General Objectives and Methods of Control

16. You will assure that the Germany economy is administered and controlled in such a way as to accomplish the basic objectives set forth in paragraphs 4 and 5 of this Directive. Economic controls will be imposed only to the extent necessary to accomplish these objectives, provided that you will impose controls to the full extent necessary to achieve the industrial disarmament of Germany. Except as may be necessary to carry out these objectives, you will

take no steps (a) looking toward the economic rehabilitation of Germany, or (b) designed to maintain or strengthen the German economy.

17. To the maximum extent possible without jeopardizing the successful execution of measures required to implement the objectives outlined in paragraphs 4 and 5 of this directive you will use German authorities and agencies and subject them to such supervision and punishment for non-compliance as is necessary to ensure that they carry out their tasks.

For this purpose you will give appropriate authority to any German agencies and administrative services you consider essential; provided, however, that you will at all times adhere strictly to the provisions of this directive regarding denazification and dissolution or elimination of Nazi organizations, institutions, principles, features, and practices.

To the extent necessary you will establish administrative machinery, not dependent upon German authorities and agencies, to execute or assure the execution of the provisions of paragraphs 19, 20, 30, 31, 32, 39 and 40 and any other measures necessary to an accomplishment of your industrial disarmament objectives.

18. In order to decentralize the structure and administration of the German economy to the maximum possible extent, you will

a. ensure that the action required to maintain or restore essential public utilities and industrial and agricultural activities is taken as far as possible on a local and regional basis;

b. on no account propose or approve in the Control Council the establishment of centralized administration of controls over the German economy except where such centralization of administration is clearly essential to the fulfilment of the objectives listed in paragraphs 4 and 5 of this directive. Decentralization in administration should not be permitted to interfere with attainment of the largest practicable measure of agreement on economic policies in the Control Council.

19. You will institute or assure the maintenance of such statistical records and reports as may be necessary in carrying out the objectives listed in paragraphs 4 and 5 of this directive.

20. You will initiate appropriate surveys which may assist you in achieving the objectives of the occupation. In particular you will promptly undertake surveys of supplies, equipment and resources in your zone. You will endeavor to obtain prompt agreement in the Control Council to the making of similar surveys in the other zones of occupation, and you will urge appropriate steps to coordinate the methods and results of these and other future surveys conducted in the various zones. You will keep the Control Council, United States Representative on the Reparation Commission and other appropriate authorities, currently apprised of the information obtained by means of intermediate reports or otherwise.

German Standard of Living

21. You will estimate requirements of supplies necessary to prevent starvation or widespread disease or such civil unrest as would endanger the occupying forces. Such estimates will be based upon a program whereby the Germans are made responsible for providing for themselves, out of their own work and resources. You will take all practicable economic and police measures to assure that German resources are fully utilized and consumption held to the minimum in order that imports may be strictly limited and that surpluses may be made available for the occupying forces and displaced persons and United Nations prisoners of war, and for reparation. You will take no action that would tend to support basic living standards in Germany on a higher level than that existing in any one of the neighboring United Nations and you will take appropriate measures to ensure that basic living standards of the German people are not higher than those existing in any one of the neighboring United Nations when such measures will contribute to raising the standards of any such nation.

22. You will urge upon the Control Council that uniform ration scales be applied throughout Germany, that essential items be distributed equitably among the zones that net surpluses be made available for export to Allied countries, and that imports be limited to the net deficits of Germany as a whole.

Labor, Health, and Social Insurance

23. You will permit the self-organization of employees along democratic lines, subject to such safeguards as may be necessary to prevent the perpetuation of Nazi or militarist influence under any guise or the continuation of any group hostile to the objectives and operations of the occupying forces.

24. You will permit free collective bargaining between employees and employers regarding wage, hour and working conditions and the establishment of machinery for the settlement of industrial disputes. Collective bargaining shall be subject to such wage, hour and other controls, if any, as may be instituted or revived by your direction.

25. Subject to the provisions of paragraph 48 of this directive you are authorized to direct German authorities to maintain or re-establish nondiscriminatory systems of social insurance and poor relief.

26. You are authorized to direct the German authorities to maintain or re-establish such health services and facilities as may be available to them.

Agriculture, Industry and Internal Commerce

27. You will require the Germans to use all means at their disposal to maximize agricultural output and to establish as rapidly as possible effective machinery for the collection and distribution of agricultural output.

28. You will direct the German authorities to utilize large-landed estates and public lands in a manner which will facilitate the accommodation and settlement of Germans and others or increase agricultural output.

29. You will protect from destruction by the Germans, and maintain for such disposition as is determined by this and other directives or by the Control Council, all plants, equipment, patents and other property, and all books and records of large German industrial companies and trade and research associations that have been essential to the German war effort or the German economy. You will pay particular attention to research and experimental establishments of such concerns.

30. In order to disarm Germany, the Control Council should

a. prevent the production, acquisition by importation or otherwise, and development of all arms, ammunition and implements of war, as well as all types of aircraft, and all parts, components and ingredients specially designed or produced for incorporation therein;

b. prevent the production of merchant ships, synthetic rubber and oil, aluminum and magnesium and any other products and equipment on which you will subsequently receive instructions;

c. seize and safeguard all facilities used in the production of any of the items mentioned in this paragraph and dispose of them as follows

(1) remove all those required for reparation;

(2) destroy all those not transferred for reparation if they are especially adapted to the production of the items specified in this paragraph and are not of a type generally used in industries permitted to the Germans (cases of doubt to be resolved in favor of destruction);

(3) hold the balance for disposal in accordance with instructions which will be sent to you.

Pending agreement in the Control Council you will take these measures in your own zone. You will not postpone enforcement of the prohibitions contained in subparagraphs *a* and *b* and the instructions in subparagraph *c* without specific approval of your government through the Joint Chiefs of Staff except that, in your discretion, you may permit the production of synthetic rubber and oil, aluminum and magnesium, to the minimum extent necessary to meet the purposes stated in paragraphs 4 and 5 of the directive pending action by the Joint Chiefs of Staff upon such recommendation for postponement as you may make.

31. As an additional measure of disarmament, the Control Council should

a. prohibit initially all research activities and close all laboratories, research institutions and similar technical organizations except those considered necessary to the protection of public health;

b. abolish all those laboratories and related institutions whose work has been connected with the building of the German war machine, safeguard initially such laboratories and detain such personnel as are of interest to your technological investigations, and thereafter remove or destroy their equipment;

c. permit the resumption of scientific research in specific cases, only after careful investigation has established that the contemplated research will in no way contribute to Germany's future war potential and only under appropriate regulations which (1) define the specific types of research permitted, (2) exclude from further research activity any persons who previously held key positions in German war research, (3) provide for frequent inspection, (4) require free disclosure of the results of the research and (5) impose severe penalties, including permanent closing of the offending institution, whenever the regulations are violated.

Pending agreement in the Control Council you will adopt such measures in your own zone.

32. Pending final Allied agreement on reparation and on control or elimination of German industries that can be utilized for war production the Control Council should

a. prohibit and prevent production of iron and steel, chemicals, nonferrous metals (excluding aluminum and magnesium), machine tools, radio and electrical equipment, automotive vehicles, heavy machinery and important parts thereof, except for the purposes stated in para-

graphs 4 and 5 of this directive;

b. prohibit and prevent rehabilitation of plant and equipment in such industries except for the purposes stated in paragraphs 4 and 5 of this directive; and

c. safeguard plant and equipment in such industries for transfer on reparation account.

Pending agreement in the Control Council, you will put such measures into effect in your own zone as soon as you have had an opportunity to review and determine production necessary for the purposes stated in paragraphs 4 and 5 of this directive.

33. The Control Council should adopt a policy permitting the conversion of facilities other than those mentioned in paragraphs 30 and 32 to the production of light consumer goods, provided that such conversion does not prejudice the subsequent removal of plant and equipment on reparation account and does not require any imports beyond those necessary for the purposes specified in paragraphs 4 and 5 of this directive. Pending agreement in the Control Council, you may permit such conversion in your zone.

34. Subject to the provisions of paragraphs 30 and 32, the Control Council should assure that all feasible measures are taken to facilitate, to the minimum extent necessary for the purposes outlined in paragraphs 4 and 5 of this directive.

a. repairs to and restoration of essential transportation services and public utilities;

b. emergency repair and construction of the minimum shelter required for the civilian population;

c. production of coal and any other goods and services (excluding goods specified in paragraphs 30 and 32 unless measures to facilitate production are specifically approved by this Government through the Joint Chiefs of Staff) required for the purposes outlined in paragraphs 4 and 5 of this directive.

You will assure that such measures are taken in your own zone pending agreement in the Control Council.

35. In your capacity as zone commander and as member of the Control Council you will take steps to provide for the equitable interzonal distribution and the movement of goods and services essential to the purposes set forth in paragraphs 4 and 5 of this directive.

36. You will prohibit all cartels or other private business arrangements and cartel-like organizations, including those of a public or quasi-public character such as the *Wirtschaftsgruppen* providing for the regulation of marketing conditions, including production, prices, exclusive exchange of technical information and processes, and allocation of sales territories. Such necessary public functions as have been discharged by these organizations shall be absorbed as rapidly as possible by approved public agencies.

37. It is the policy of your government to effect a dispersion of the ownership and control of German industry. To assist in carrying out this policy you will make a survey of combines and pools, mergers, holding companies and interlocking directorates and communicate the results, together with recommendations, to your government through the Joint Chiefs of Staff. You will endeavor to obtain agreement in the Control Council to the making of this survey in the other zones of occupation and you will urge the coordination of the methods and results of this survey in the various zones.

38. With due regard to paragraph 4 *a*, the Control Council should adopt such policies as are clearly necessary to prevent or restrain inflation of a character or dimension which would definitely endanger accomplishment of the objectives of the occupation. The Control Council, in particular, should direct and empower German authorities to maintain or establish controls over prices and wages and to take the fiscal and financial measures necessary to this end. Pending agreement in the Control Council you will assure that such measures as you consider necessary are taken in your own zone. Prevention or restraint of inflation shall not constitute an additional ground for the importation of supplies, nor shall it constitute an additional ground for limiting removal, destruction or curtailment of productive facilities in fulfillment of the program for reparation, demilitarization and industrial disarmament.

Power, Transportation, and Communications

39. Both as member of the Control Council and zone commander you will take appropriate steps to ensure that

a. power, transportation and communications facilities are directed in such a way as to carry out the objectives outlined in paragraphs 4 and 5 of this directive;

b. Germans are prohibited and prevented from producing, maintaining or operating all types of aircraft.

You will determine the degree to which centralized control and administration of power, transportation and communications is clearly necessary for the objectives stated in paragraphs 4 and 5 and urge the establishment of the degree of centralized control and administration by the Control Council.

Foreign Trade and Reparation

40. The Control Council should establish centralized control over all trade in goods and services with foreign countries. Pending agreement in the Control Council you will impose appropriate controls in your own zone.

41. Both as member of the Control Council and as zone commander you will take appropriate steps to ensure that

a. the foreign trade controls are designed to carry out the objectives stated in paragraphs 4 and 5 of this directive;

b. imports which are permitted and furnished to Germany are confined to those unavoidably necessary to the objectives stated in paragraphs 4 and 5;

c. exports to countries other than the United Nations are prohibited unless specifically authorized by the Allied governments.

42. Both as member of the Control Council and as zone commander you will adopt a policy which would forbid German firms to participate in international cartels or other restrictive contracts and arrangements and order the prompt termination of all existing German participations in such cartels, contracts and arrangements.

43. You will carry out in your zone such programs of reparation and restitution as are embodied in Allied agreements and you will seek agreement in the Control Council on any policies and measures which it may be necessary to apply throughout Germany in order to ensure the execution of such programs.

PART III
Financial

44. You will make full application in the financial field of the principles stated elsewhere in this directive and you will endeavor to have the Control Council adopt uniform financial policies necessary to carry out the purposes stated in paragraphs 4 and 5 of this directive. You will take no steps designed to maintain, strengthen or operate the German financial structure except in so far as may be necessary for the purposes specified in this directive.

45. The Control Council should regulate and control to the extent required for the purposes set forth in paragraphs 4 and 5 the issue and volume of currency and the extension of credit in Germany and in accordance with the following principles:

a. United States forces and other Allied forces will use Allied Military marks and Reichsmark currency or coins in their possession. Allied Military marks and Reichsmark currency and coin now in circulation in Germany will be legal tender without distinction and will be interchangeable at the rate of 1 Allied Military mark for 1 Reichsmark. Reichskreditkassenscheine and other German military currency will not be legal tender in Germany.

b. The Reichsbank, the Rentenbank or any other bank or agency may be permitted or required to issue bank notes and currency which will be legal tender; without such authorization no German governmental or private bank or agency will be permitted to issue bank notes or currency.

c. The German authorities may be required to make available Reichsmark currency or credits free of cost and in amounts sufficient to meet all the expenses of the forces of occupation, including the cost of Allied Military Government and including to the extent that compensation is made therefor, the cost of such private property as may be requisitioned, seized, or otherwise acquired, by Allied authorities for reparations or restitution purposes.

Pending agreement in the Control Council you will follow these policies in your own zone.

You will receive separate instructions relative to the currency which you will use in the event that for any reason adequate supplies of Allied Military marks and Reichsmarks are not available, or if the use of such currency is found undersirable.

You will not announce or establish in your zone, until receipt of further instructions, any general rate of exchange between the Reichsmark on the one hand and the U.S. dollar and other currencies on the other. However, a rate of exchange to be used exclusively for pay of troops and military accounting purposes in your zone will be communicated separately to you.

46. Subject to any agreed policies of the Control Council, you are authorized to take the following steps and to put into effect such further financial measures as you may deem necessary to accomplish the purposes of your occupation:

a. To prohibit, or to prescribe regulations regarding transfer or other dealings in private or public securities or real estate or other property.

b. To close banks, but only for a period long enough for you to introduce satisfactory

control, to remove Nazi and other undesirable personnel, and to issue instructions for the determination of accounts to be blocked under subparagraph 48 *e* below.

c. To close stock exchanges, insurance companies, and similar financial institutions for such periods as you deem appropriate.

d. To establish a general or limited moratorium or moratoria only to the extent clearly necessary to carry out the objectives stated in paragraphs 4 and 5 of this directive.

47. Resumption of partial or complete service on the internal public debt at the earliest feasible date is deemed desirable. The Control Council should decide the time and manner of such resumption.

48. Subject to any agreed policies of the Control Council,

a. You will prohibit:

(1) the payment of all military pensions, or emoluments or benefits, except compensation for physical disability limiting the recipient's ability to work, at rates which are no higher than the lowest of those for comparable physical disability arising from non-military causes.

(2) the payment of all public or private pensions or other emoluments or benefits granted or conferred:

(a) By reason of membership in or services to the former Nazi party, its formations, affiliated associations or supervised organizations,

(b) to any person who has been removed from an office or position in accordance with paragraph 6, and

(c) to any person arrested and detained in accordance with paragraph 8 during the term of his arrest, or permanently, in case of his subsequent conviction.

b. You will take such action as may be necessary to insure that all laws and practices relating to taxation or other fields of finance, which discriminate for or against any persons because of race, nationality, creed or political opinion, will be amended, suspended, or abrogated to the extent necessary to eliminate such discrimination.

c. You will hold the German authorities responsible for taking such measures in the field of taxation and other fields of public finance, including restoration of the tax system and maintenance of tax revenues, as will further the accomplishment of the objectives stated in paragraphs 4 and 5.

d. You will exercise general supervision over German public expenditures in order to ensure that they are consistent with the objectives stated in paragraphs 4 and 5.

e. You will impound or block all gold, silver, currencies, securities, accounts in financial institutions, credits, valuable papers, and all other assets falling within the following categories:

(1) Property owned or controlled directly or indirectly, in whole or in part, by any of the following:

(a) The German Reich, or any of the Länder, Gaue or provinces, any Kreis, Municipality or other similar local subdivision; or any agency or instrumentality of any of them including all utilities, undertakings, public corporations or monopolies under the control of any of the above;

(b) Governments, nationals or residents of other nations including those of territories occupied by them, at war with any of the United Nations at any time since 1 September 1939;

(c) The Nazi Party, its formations, affiliated associations and supervised organizations, its officials, leading members and supporters;

(d) All organizations, clubs or other associations prohibited or dissolved by military government;

(e) Absentee owners, of non-German nationality including United Nations and neutral governments and Germans outside of Germany;

(f) Any institution dedicated to public worship, charity, education or the arts and sciences which has been used by the Nazi Party to further its interests or to cloak its activities;

(g) Persons subject to arrest under provisions of paragraph 8, and all other persons specified by military government by inclusion in lists or otherwise.

(2) Property which has been the subject of transfer under duress or wrongful acts of confiscation, disposition or spoliation, whether pursuant to legislation or by procedure purporting to follow forms of law or otherwise.

(3) Works of art or cultural material of value or importance, regardless of the ownership thereof.

You will take such action as will insure that any impounded or blocked assets will be dealt with only as permitted under licenses or other instructions which you may issue. In the case particularly of property blocked under (1) (a) above, you will proceed to adopt licensing measures which while maintaining such property under surveillance would permit its use in consonance with this directive. In the case of property blocked under (2) above, you will institute measures for prompt restitution, in conformity with the objectives stated in paragraphs 4 and 5 and subject to appropriate safeguards to prevent the cloaking of Nazi and militaristic influence.

49. All foreign exchange transactions, including those arising out of exports and imports, shall be controlled with the aim of preventing Germany from developing a war potential and of achieving the other objectives set forth in this directive. To effectuate these purposes the Control Council should:

a. Seek out and reduce to the possession and control of a special agency all German (public and private) foreign exchange and external assets of every kind and description located within or outside Germany.

b. Prohibit, except as authorized by regulation or license all dealings in gold, silver, foreign exchange and all foreign exchange transactions of any kind. Make available any foreign exchange proceeds of exports for payment of imports directly necessary to the accomplishment of the objectives stated in paragraphs 4 and 5 of this directive, and authorize no other outlay of foreign exchange assets except for purposes approved by the Control Council or other appropriate authority.

c. Establish effective controls with respect to all foreign exchange transactions, including:

(1) Transactions as to property between persons inside Germany and persons outside Germany;

(2) Transactions involving obligations owed by or to become due from any person in Germany to any person outside Germany; and

(3) Transactions involving the importation into or exportation from Germany of any foreign exchange asset or other form of property.

Pending agreement in the Control Council, you will take in your zone the action indicated in subparagraphs *a*, *b* and *c* above. Accordingly, you will in your zone reduce to the possession and control of a special agency established by you, within your Command, all German foreign exchange and external assets as provided in subparagraph *a*. You will endeavor to have similar agencies for the same purpose established in the other zones of occupation and to have them merged as soon as practicable in one agency for the entire occupied territory. In addition you will provide full reports to your government with respect to all German foreign exchange and external assets.

50. No extension of credit to Germany or Germans by any foreign person or Government shall be permitted except that the Control Council may in special emergencies grant permission for such extensions of credit.

51. It is not anticipated that you will make credits available to the Reichsbank or any other bank or to any public or private institution. If, in your opinion, such action becomes essential, you may take such emergency actions as you may deem proper, but in any event, you will report the facts to the Control Council.

52. You will maintain such accounts and records as may be necessary to reflect the financial operations of the military government in your zone and you will provide the Control Council with such information as it may require, including information in connection with the use of currency by your forces, any governmental settlements, occupation costs, and other expenditures arising out of operations or activities involving participation of your forces.

AMERICAN ORGANIZATIONAL PLANS FOR MILITARY GOVERNMENT OF GERMANY

Released May 11, 1945

AMERICAN ORGANIZATIONAL plans for the military government of Germany were disclosed today by Henry L. Stimson, Secretary of War.

For many months the United States Army, Navy, and Air Forces have been perfecting plans for the occupation of Germany and have been working with their British, Russian, and French Allies in putting together a co-ordinated program to impose a stern military government over all of Germany and to carry out the policies agreed upon at Yalta.

As was announced in the Yalta declaration, Germany will be governed through a Control Council on which each of the four powers will be represented. General Eisenhower will be the representative of the United States on the Control Council for Germany. Each power will administer a zone of Germany under the control of a military commander. The United

States zone will be controlled by General Eisenhower as Commander in Chief of the United States forces in Germany.

Lieutenant General Lucius Clay, United States Army, will serve as deputy to General Eisenhower, and as such will participate in the formulation of decisions affecting Germany as a whole. General Clay, as Deputy Military Governor for Germany, will also act as General Eisenhower's deputy in carrying out the administration of military government in the United States zone.

General Clay, 48-year-old West Point graduate, was deputy director for war programs of the Office of War Mobilization and Reconversion before he went to Europe in April to join General Eisenhower. Prior to joining War Mobilizer Byrnes, Clay was the Director of Matériel for Army Service Forces. He has been described as a toughminded soldier with thorough understanding and experience in the balance between military necessity and civilian requirements. He was hand-picked by President Roosevelt for the direction of the occupation of Germany.

In planning its part of the Control Machinery for Germany, the United States has formed a group Control Council which will be fitted into the Control Council for Germany. The United States group has been divided into 12 major divisions, roughly corresponding to the ministries of the German central government.

The heads of the divisions in addition to acting for the United States in Control Council matters affecting Germany as a whole, will also, under General Clay's supervision, carry out policies in the United States zone.

Names of the 12 divisions in the United States group and a description of their functions follow:

Three military divisions—Army (ground), Naval, and Air—will deal with the demobilization of the German armed forces and the disarmament of Germany.

The Transport Division will regulate traffic movements, supervise railway, road, and inland water-transportation systems, and, with the Naval Division, handle port and coastal operations.

The Political Division will deal with all foreign affairs, handle domestic political matters, protect American interests in Germany, and advise other sections dealing with control of public-information services in Germany, reporting of political intelligence, and public relations.

Tremendous tasks lie ahead of the Economic Division, which will deal with such problems as food, agriculture and forestry, fuel and mining, price control and rationing, public works and utilities, internal and foreign trade, industry, conversion and liquidation, and requirements and allocations. This division will see to it that the Germans are forced to exert all efforts to feed themselves, and also insure that the liberated United Nations are given first consideration on essential commodities.

The Finance Division will control public finance, and deal with financial institutions, foreign exchange, currency, and accounts and audits.

The Reparation, Deliveries and Restitution Division will supervise, so far as the United States zone is concerned, the execution of the policies agreed upon in the Control Council, dealing with the vital activities suggested by its title, as well as handle property control and the supervision of monuments, fine arts, and archives.

A most important division will be the Internal Affairs and Communications Division. This division will supervise public safety, including control of civil police forces, public health and welfare, post, telephone, and telegraph, military communications, civil service and local government, education, and religious affairs. The division will concern itself with elimination of the dreaded Secret Police.

The Legal Division will give legal advice to the Commander and other divisions, will have jurisdiction over prosecution of war criminals, and will exercise proper controls over Allied military courts, German ordinary and military courts, and prisons.

One of the most difficult tasks will be faced by the Prisoners of War and Displaced Persons Division. Millions of citizens of the United Nations have been held prisoner in Germany, either as military hostages or as slave laborers, and these must all be cared for and repatriated as speedily as possible.

The Manpower Division will deal with problems of labor relations and allocations, wages and labor policies, housing and labor information. This division will be charged with dissolving the notorious Nazi labor front, and laying the ground work for the normal growth of democratic labor organizations and practices.

The all-important task of purging all public agencies and important German industries of Nazis will be shared by every division, each supervising this work in its own field. However, an over-all intelligence section, answerable directly to General Clay, will maintain general

supervision over the entire denazification program. This intelligence section will also maintain surveillance over all German agencies and provide assurance that activities by Nazi underground, "Werewolves", and the like will be ruthlessly suppressed.

Also answerable directly to General Clay are the two sections dealing with control of public information and public relations. The former section will control all forms of public expression in Germany, including newspapers, radio, magazines and other publications, and motion pictures. It will deal with the dissolution of the propaganda ministry of the notorious Goebbels and the establishment of an unbiased and truthful press and radio system.

The public-relations section will deal with the issuance of press communiqués, general relations with the world press, including the accreditation of correspondents, press censorship, and press communications. Censorship in the United States zone will be solely on the basis of military security.

[SOURCE: Excerpt from, *Axis in Defeat: A Collection of Documents on American Policy toward Germany and Japan,* Department of State]

13-3 THE LIQUIDATION OF WAR FINANCE AND THE FINANCIAL REHABILITATION OF GERMANY

Outline of a Tentative Plan — April 8, 1946
Prepared by: Gerhard Colm and Raymond W. Goldsmith
(US Occupation Force of Germany)
Secret

The following plan is designed to liquidate the aftermath of Nazi war finance and to clear the decks for peacetime production within the limits determined by the Potsdam Agreement.

Details of the plan and particularly the rates applicable to the various measures can be determined only after statistical material now in preparation has become available.

The plan consists of four main groups of measures and a number of complementary actions.

I. *Elimination of Financial Overhang:*—The first group of measures is designed to eliminate the excess of currency, deposits and other monetary claims and to write down sharply the public debt. By scaling down currency, deposits, the public debt and all other monetary claims and obligations in the same proportion of X percent these measures in themselves do not impair the solvency of financial institutions. A necessary minimum of a new currency to be issued by a new German central bank of issue will be provided. Social insurance claims will be reduced only moderately. Hence, special provisions will be necessary to preserve the solvency of social insurance institutions.

The mopping up of excess currency and deposits necessitates two supplementary measures, namely, first, assurance of credit facilities for business which can no longer finance its operations by unlimited liquid funds; second, provision of relief or advance payments for those who cannot find work or are unable to work and are for the time being deprived of the use of the bulk of their savings.

II. *Equalization of Losses:*—The sealing down operation falls entirely on the owners of monetary claims. Though nothing like full equity is obtainable in the distribution of the costs of war and defeat, it is proposed to impose an equalizing burden on owners of real assets. To this and a compulsory first mortgage of substantial size—possibly as much as 50 percent, with an exemption of very small property—will be put on all real property and possibly also on all machinery, equipment and inventories, in favor of a War Loss Equalization Fund. These mortgages should bear interest starting at 1 percent and later rising to about 3 percent and should be amortized at a rate of about 1 percent a year. In the case of corporations new shares will be issued in a proportion corresponding to the rate of the compulsory mortgage.

(If the latter is e.g. 50 percent the amount of shares in circulation should be doubled.) Those shares, which may be transformed later into a funded debt, also will become assets of the Equalization Fund.

The Equalization Fund in turn will issue non-marketable and non-interest bearing certificates in favor of these who have recognized war losses. The entire income of the Fund will be used to redeem those certificates.

The definition of recognized claims is one of the major policy issues that must be resolved. It is possible, for instance, to recognize only losses resulting from the sealing down of monetary claims. If it should be the policy to take account of all or some bomb and other war damages, the same kind of compensation could be granted through the mechanism of the Equalization Fund. Finally it is possible, of course, to recognize only war damages and to exclude losses

on account of scaling down of monetary claims from the compensation scheme. (In the latter case other provisions in favor of needy owners of monetary claims, must be considered.)

The broader the definition of recognized losses, the smaller the percentage compensation that can be given in the form of certificates. If the compulsory mortgage is set at 50 percent of the value of real estate and business property and if a comprehensive definition of war losses is adopted, hardly more than 20 percent of the nominal claims could be recognized by the issue of certificates. In no case should the certificates issued to the owners of recognized claims exceed the proportion of the property not covered by the mortgage. (50 percent on the above assumption.)

The certificates issued by the "War Losses Equalization Fund" will be redeemed in accord with special regulations for each category of claims for which they are issued. Certificates issued to owners of written down monetary claims, for instance, may be redeemed under special consideration for those who owned small savings accounts or life insurance policies. Certificates issued to owners of destroyed property may be redeemed only when a priority is granted for the reconstruction of that particular piece of property. A limited amount of these certificates, however, can also be redeemed for purposes of rehabilitation.

III. *Progressive Capital Levy:*—The compulsory mortgage imposed by the equalization measure is at a fixed percentage, because it relates to specific pieces of tangible property rather than to an individual's total wealth. The progression feature is introduced into the plan by a proposed general capital levy on personal net wealth.

This levy assesses net wealth as it exists after the sealing down operation and the equalization measures have taken place. The rate of progression should, if administratively feasible, depend on the increment in property over the period of 1935 to 1946 as well as on the size of total net wealth. It should start at something like 25 percent for amounts in excess of a moderate exemption but should rise to about 80 percent for the top bracket. Payment of the levy would have to be spread over a considerable number of years and payment in kind (e.g. turning over of shares) permitted. The yield of the levy would be regarded as general budgetary receipts or could be used to redeem additional War Loss Certificates.

IV. *Adjustment of Prices and Taxes:*—Available purchasing power, even after elimination of the financial overhang, will still be in excess of supplies available for purchase. This current gap should be reduced by a moderate upward adjustment of prices while the general level of wage rates should remain unchanged. Some upward adjustment of prices will be required anyway in order to bring prices and costs into a better long-run relationship reflecting decreased productivity.

Furthermore, certain increases in excise taxes or new excise taxes (such as a tax on rents) should be considered. At the same time it should be considered to reduce the income and wage taxes in order to increase incentive to work.

The international rate of exchange is to be determined in line with the relative prices for such goods that are expected to play the main role in Germany's future industrial trade.

V. *Complementary Measures:*—Most essential among complementary measures is an agreement to stop issuing military currency and to restrict the amount of cost of occupation and of reparations on current account—if such should be levied at all—in order to keep the creation of new currency and deposits within definite limits and to prevent excessive taxation.

There are several other measures under consideration such as those related to disposal of public property or confiscation of Nazi property which should dovetail with the recommendations under the present plan.

It is proposed to adopt the plan for operation in the summer or early fall of 1946. The plan as a whole should be embodied in a general law for the liquidation of war finance and the reconstruction of peacetime finance in Germany. The elimination of the financial overhang (I.) should be executed first. This measure is so designed that it involves a minimum of administrative complications. The price adjustment (IV.) should be put into effect as soon as feasible immediately after the first step. The equalization measure (II.) and the capital levy (III.) though enacted as part of the comprehensive general plan, require more time for working out details but should be carried out as soon as feasible. The whole operation should be completed within two years after enactment.

Regarding procedure it is suggested that first quadripartite agreement be sought on the outline of the plan in general. After such agreement on the essentials is reached a special subcommittee of the Finance Directorate may consult with a group of not more than 10 or 12 German representatives from the four Zones on details. Shortly after that consultation the general plan should be enacted by the Control Committee. Specific laws and regulations with

respect to the equalization measure and the capital levy and certain complementary measures (as for instance with respect to new initial balance sheets of corporations) should be worked out in cooperation with German exports from the four Zones.

[SOURCE: NATIONAL ARCHIVES, Z 731-3]

13-4 THE COLM-DODGE-GOLDSMITH PLAN AND THE OBJECTIVES OF GERMAN OCCUPATION

undated (May 1946 ?)

Secret

1. *The Colm-Dodge-Goldsmith Plan*

The Plan For the Liquidation of War Finance and the Financial Rehabilitation of Germany, submitted to General Clay on May 20 by Messrs. Colm, Dodge, and Goldsmith, provides three major steps:

(a) The scaling down of currency, bank deposits and monetary claims and obligations by 90%.

(b) The creation of a War Loss Equalization Fund, financed by the imposition of a 50% mortgage on the owners' equity in all physical assets. The Fund will issue certificates to those who have suffered losses from the reduction in monetary claims or who have suffered war losses resulting in claims against the government (e.g. air raid damage, reparation removals, losses of property of evacuees from the eastern territories and Sudetenland).

(c) A progressive capital levy, the proceeds of which will be added to the Fund.

2. *Criticism of the Plan*

Criticism of the plan in Washington has centered on the second and third steps. It has taken two forms:

(a) *Technical*

It is maintained that the combination of 90% reduction in monetary claims, 50% mortgage, and capital levy will so deplete the assets and raise the costs of business enterprises that it will enforce a serious curtailment of economic activity.

(b) *Policy*

The occupying authorities should not undertake the responsibility for measures as ambitious and far-reaching as steps two and three of the C-D-G plan. These measures, it is argued, through their impact on the distribution of wealth in Germany, contain far-reaching social implications, which transcend the objectives of Allied occupation policy. Furthermore, by sponsoring the plan, the occupying powers will saddle themselves, in the eyes of the German people, with the responsibility for possible failure in the vast administrative task out of implementing the plan. If such a program is to be carried out at all, the Germans themselves should initiate it and assume full responsibility for its formulation and execution.

A third set of problems may be described as the constitutional issue: whether the U.S. Commander-in-Chief is authorized to sponsor such a plan under the Potsdam Protocol and JCS 1067/6. Provisions of these two documents which may be cited in support of the view that the C-D-G is *ultra vires* are the statements that:

(a) the purposes of occupation shall include convincing the Germans that "they cannot escape responsibility for what they have brought upon themselves" that their acts have "made chaos and suffering inevitable,"

(b) economic controls shall be imposed only to the extent necessary to achieve specified purposes,

(c) responsibility for any breakdown in administration of economic controls shall rest with the Germans.

On the other hand, both Potsdam and JCS 1067/6 contain other clauses which may be cited, with equal validity, as full authorization for the C-D-G Plan. Since the documents in question embody a variety of objectives which are, to some degree, in conflict with one another, certain articles of the documents may also be regarded as conflicting. It is submitted that the "constitutional" issue cannot fruitfully be discussed independently of one "policy" issue. The decision on policy will determine which of the conflicting provisions of the documents shall govern.

Of the "technical" criticism, it need only be remarked here that, although the 50% mortgage may at first glance appear a heavy burden, the interest and amortization charges proposed make it equivalent only to a property tax of 1% at the outset, rising ultimately to 2½%.

The remainder of this paper deals with the "policy" problem. It is not designed to defend the specific provisions of the C-D-G plan itself, but rather to refute the charge that the plan is

too ambitious and far-reaching in scope. It will be argued that, whatever the precise measures, some plan designed to achieve the same ambitious objectives of the C-D-G plan is essential if democratic development in Germany is to be given a reasonable chance. The discussion will review, first, the present financial situation in Germany, second, the objectives of U.S. occupation which this situation places in jeopardy, and third, the alternative methods of dealing with the situation, including the C-D-G plan.

3. *The Financial Heritage of the War*

The war has produced a vast expansion in the mark value of currency, bank deposits, and other monetary claims in Germany, while the volume of real wealth has been cut, according to the C-D-G report, by one-third, and productive capacity has suffered even more heavily. Meanwhile, the price level, in official markets, remains roughly at the pre-war level.

This disparity between "monetary superstructure and economic foundation," in the phrases of the report, entails two major consequences:

(a) The swollen volume of current purchasing power, in the form of currency and bank deposits, creates an immediate inflationary pressure which is held in check only by price and other direct controls.

(b) The large volume of claims arising from various types of war and postwar losses creates a set of difficult problems. These claims include compensation for losses resulting from Nazi persecution, air raid damage, reparation removals, and evacuation following the constriction of Germany's frontiers. To ignore them would be to impose a highly inequitable division of the costs of Nazi aggression. To pay them in full is impossible without a future inflation.

These consequences will be referred to as the *inflation* problem and the *war claims* problem.

4. *The Financial Heritage and Allied Occupation Objectives*

The C-D-G report describes the manner in which the present inflationary pressure complicates the task of occupation and endangers certain of the economic objectives of occupation, by reducing the incentive to work and by encouraging the growth of black markets and barter and the withholding of current output from the normal channels of distribution. Attention may be focussed on the relation of both the inflation problem and the war claims problem to one of the basic long-term objectives of U.S. and Allied policy: "To prepare for the eventual reconstruction of German political life on a democratic basis and for eventual peaceful cooperation in international life by Germany."

The relation of the inflation problem to this objective is two-fold:

(a) *An inflation in Germany is incompatible with the establishment and maintenance of democratic political life.*

The consequences of inflation are sufficiently well known to require little emphasis. The disorganization of production, the drastic and inequitable shifts in wealth and income, and the economic and social instability created by inflation set up political stresses which will make any orderly development of democracy, at least in the Western sense, utterly impossible.

(b) *The measures required to prevent inflation are so drastic and so controversial that no growing democratic government in Germany could take them and survive.*

Democracy in Germany will be, at best, a tender plant for some time to come. Any German government of the future will be hard put to deal effectively with the varied and complex problems that will confront it. To cope with the inflation problem, it is submitted, will be beyond its power. To secure widespread agreement on the need for some action to prevent inflation is one thing; to gain general support for any specific program is quite a different matter. The elements of any effective counter-inflation program are highly controversial, and touch directly upon basic conflicts of interest between social and economic groups. To resolve these conflicts, and still retain an effective program, is a task which taxes the capabilities of countries where democratic procedures are firmly established. It is too much to expect any German government of the near future to solve the problem in a democratic fashion. The two possible solutions are the imposition of some solution by a minority group which assumes extraordinary powers, or a stalemate resulting in no action at all. The first course involves the suspension of democratic procedures at the outset; the second, inflation.

These considerations have gained widespread recognition. Furthermore, it is recognized that no German government at all exists at present, and it is impossible, at the present juncture, to predict when one will come into being. Consequently, it is generally conceded that, if any anti-inflationary action is to be taken, the occupying powers themselves must take the initiative. Accordingly, Step 1 of the C-D-G plan is generally accepted as a necessary measure.

What is not generally recognized is that the same considerations apply to what is here described as the "war claims problem". Failure to deal with this problem will jeopardize the stability of a democratic government. At the same time, no democratic government in Germany will be capable of dealing with it. Consequently, the occupying powers must take the necessary action.

Since the war claims problem is neither so familiar, nor so obviously pressing, as the inflation problem, these statements are by no means self-evident. They are elaborated in the following paragraphs.

(a) *The need for action on war claims*

The financial losses resulting from the war fall on the German population in a most uneven and discriminatory fashion. Bombs dropped by Allied aircraft discriminate between the man whose house is destroyed and his neighbor who is spared. Territorial losses discriminate between the evacuees, who lose in many cases the bulk of their possessions, and the inhabitants of the present Germany. The reparation program discriminates between the owners of plants that are removed and those that remain. Finally, the ten-for-one currency conversion and the 90% write-down of monetary claims discriminate between the holders of monetary claims and the owners of real physical assets.

Each form of loss creates a class which considers itself entitled to compensation. The existence of a tremendous volume of unsettled claims will not only leave the claimants uncertain of their financial futures, but will also throw a cloud of uncertainty over the entire fiscal and monetary outlook for Germany. A decision to wipe out all claims would engender widespread bitterness and result in the creation of a substantial class of propertyless citizens. Furthermore, since the losses result from the war and its consequences rather than the individual actions of the claimants, an equitable distribution of war costs requires some form of compensation. It is clear that the resources of Germany do not permit anything more than partial compensation. But considerations both of politics and of equity require a comprehensive program which represents a real effort to make whatever compensation is possible.

(b) *The inability of a German government to take action*

The same factors which would prevent any democratic government of the future from taking action again inflation, and surviving, will prevent it from dealing with the war claims problem. The action required is, by its nature, so drastic and so controversial, that it would produce fatal cleavages. A situation where some action is required, but the impossibility of deciding on any given course of action results in no action at all, is one that calls for the intervention of an outside agency.

5. *Conclusion: The Possible Courses of Action Open to the Occupying Powers.*

In the light of the foregoing discussion of the inflation problem and the war claims problem, the occupying powers can choose between four possible courses of action.

(a) *They can take no action at all*

This course would leave the inflationary potential of the swollen volume of currency and bank deposits in existence, and make no attempt to settle war claims. It would sooner or later result in an inflationary increase in the price level, would complicate the economic problems of Germany, and would bar the growth of a democratic government on a stable economic base. It would, administratively, have the notable advantage that it would require no decisions or planning, since it involves allowing nature to take its course.

This course might be the logical one under certain conditions: namely, if the judgment is made that there is, in any case, little or no prospect of achieving the more positive objectives of occupation, especially the preparation for democratic life in Germany. (Even in this case, it might still be considered desirable to ease the task of occupation by averting the economic results of inflation.)

(b) *They can take Step 1, designed to eliminate the inflation potential, but omit Steps 2 and 3.*

This course has distinct advantages. Step 1 of the C-D-G plan, the currency conversion and write-down of monetary claims, is far simpler than Steps 2 and 3. Furthermore, it is sufficient to meet the more pressing problem to which the plan is addressed—the immediate danger of inflation.

But Step 1 alone, which throws the entire burden of anti-inflationary action on the holders of monetary claims, entails many of the same inequities as inflation itself. The significant difference is that, if inflation occurs, the Germans would regard it as a consequence of the war, more or less unavoidable, and would charge its inequities to the cost of losing the war. If, however, the occupying powers carry out Step 1 without Steps 2 and 3, they would, themselves, appear to be directly responsible for the resulting inequities.

Furthermore, the experience of other European countries that have carried out currency conversions clearly demonstrates the necessity for dealing with the entire financial heritage of the war in a single comprehensive program, instead of taking a piecemeal course and acting

on the inflation problem at once, and deferring other related problems to some unspecified date in the future.

(c) *They can take Step 1, designed to remove the inflationary potential, and attempt to remedy the inequities resulting from it, without dealing with the war claims problem as a whole.*

This hybrid course is designed to meet the objection to Step 1 alone that the occupying powers would be held responsible for the inequities of Step 1. It would involve some scheme of compensation, designed to equalize the burden as between the holders of monetary claims and real assets.

The advantage of this course is illusory. To rectify the discrimination between holders of monetary and real assets would require far-reaching measures of the sort contemplated by Steps 2 and 3 of the C-D-G plan. If no attempt is made to compensate for other forms of war losses, the size of the mortgage, or the rates of the capital levy, might be reduced, but the general scope of the measures, and the administrative difficulties, would be little charged.

(d) *They can deal with both the inflation and the war claims problems, by some such program as the C-D-G plan.*

If the objective of preparing the groundwork for democratic life in Germany is not to be abandoned, it is submitted that this course is clearly indicated. If democratic development in Germany is not to be abortive, it will be greatly assisted if the Allies give it a start by solving for it the inflation problem and the war claims problem.

The C-D-G plan is not the only possible solution of the problems of removing the inflation potential and spreading the cost of the war as equitably as possible. The essential point is that any other program designed to meet these problems effectively will consist of measure equally far-reaching in scope, in its social implications, and in its demands on the administrative system.

[SOURCE: NATIONAL ARCHIVES, Z 731–3]

13-5 UNITED STATES OBJECTIVES IN GERMANY

Directive (JCS-1779) July 11, 1947
To: Commander-in-Chief of the United States Forces of Occupation
From: J.C.S.

I

1. Purpose of this Directive

This directive, issued to you as Commanding General of the United States forces of occupation and as Military Governor in Germany, constitutes a statement of the objectives of your Government in Germany and of the basic policies to which your Government wishes you to give effect from the present time forward. It supersedes JCS 1067/6[3] and its amendments.

2. Authority of Military Government

a. Your authority as Military Governor will be broadly construed and empowers you to take action consistent with relevant international agreements, general foreign policies of this Government and with this directive, appropriate or desirable to attain your Government's objectives in Germany or to meet military exigencies.

b. Pending arrangements for the effective treatment of Germany as an economic and political unit, you will exert every effort to achieve economic unity with other zones.

II

3. United States Policy Toward Germany

The basic interest of the United States throughout the world is just and lasting peace. Such a peace can be achieved only if conditions of public order and prosperity are created in Europe as a whole. An orderly and prosperous Europe requires the economic contributions of a stable and productive Germany as well as the necessary restraints to insure that Germany is not allowed to revive its destructive militarism.

To accomplish the latter purpose the United States Government has proposed to the other Occupying Powers a treaty for the continuing disarmament and demilitarization of Germany and it has committed itself to maintaining a United States army of occupation as long as foreign occupation of Germany continues.

As a positive program requiring urgent action the United States Government seeks the creation of those political, economic and moral conditions in Germany which will contribute most effectively to a stable and prosperous Europe.

[3] JCS-1067/6 was issued in April, 1945.

III

4. Demilitarization

There should be no relaxation of effort to complete and effectively to maintain the disarmament and the demilitarization of Germany.

IV

5. United States Political Objectives in Germany

It is an objective of the United States Government that there should arise in Germany as rapidly as possible a form of political organization and a manner of political life which, resting on a substantial basis of economic well-being, will lead to tranquillity within Germany and will contribute to the spirit of peace among nations.

Your task, therefore, is fundamentally that of helping to lay the economic and educational bases of a sound German democracy, of encouraging *bona fide* democratic efforts and of prohibiting those activities which would jeopardize genuinely democratic developments.

6. German Self-Government

a. You will continue to promote the development in Germany of institutions of popular self-government and the assumption of direct responsibility by German governmental agencies, assuring them legislative, judicial and executive powers, consistent with military security and the purposes of the occupation.

b. It is the view of your Government that the most constructive development of German political life would be in the establishment throughout Germany of federal German states (*Laender*) and the formation of a central German government with carefully defined and limited powers and functions. All powers shall be vested in the *Laender* except such as are expressly delegated to the Central Government.

c. Your Government does not wish to impose its own historically developed forms of democracy and social organization on Germany and believes equally firmly that no other external forms should be imposed. It seeks the establishment in Germany of a political organization which is derived from the people and subject to their control, which operates in accordance with democratic electoral procedures, and which is dedicated to uphold both the basic civil and human rights of the individual. It is opposed to an excessively centralized government which through a concentration of power may threaten both the existence of democracy in Germany and the security of Germany's neighbors and the rest of the world. Your Government believes finally that, within the principles stated above, the ultimate constitutional form of German political life should be left to the decision of the German people made freely in accordance with democratic processes.

7. Interzonal German Administrative Agencies

Pending the establishment of central German administrative agencies and of a central German government, you will continue, consistent with the objectives of paragraph 6, to make arrangements with other Zonal Commanders for the creation and operation of interzonal German administrative agencies.

8. Political Parties

a. You will adhere to the policy of authorizing and encouraging all political parties whose programs, activities and structure demonstrate their allegiance to democratic principles. Political parties shall be competitive in character, constituted by voluntary associations of citizens in which the leaders are responsible to the members, and with no party enjoying a privileged status.

b. You will likewise give support to the principle that military government and the German authorities should afford non-discriminatory treatment to duly authorized political parties. Every authorized political party should have the right freely to state its views and to present its candidates to the electorate, and you will tolerate no curtailment of nor hindrance to the exercise of that right; if, however, you find that an authorized party is adopting or advocating undemocratic practices or ideas, you may restrict or withdraw its rights and privileges.

c. You will urge in the Control Council the recognition of nationwide political parties and the uniform treatment of all authorized parties in all zones of occupation. You will advocate quadripartite supervision of political activities and of elections throughout Germany as a whole.

9. Denazification

You will implement in your zone the decisions on denazification taken April 23, 1947 by the Council of Foreign Ministers, as may be agreed in ACC.

10. War Crimes

You will make every effort to facilitate and bring to early completion the war crimes program subject to the conclusions and recommendations with respect to organizations and mem-

bers thereof contained in the judgment of the International Military Tribunal.

11. Courts and Judicial Procedures

a. You will exercise such supervision over German Courts as is necessary to prevent the revival of National Socialist doctrines, to prohibit discrimination on grounds of race, nationality, creed or political belief, to enforce the application of the principles expressed in Control Council Proclamation No. 3* and compliance with the provisions of Control Council and Military Government legislation. You will foster the independence of the German judiciary by allowing the courts freedom in their interpretation and application of the law and by limiting the control measures instituted by Military Government to the minimum consistent with the accomplishment of the aims of the occupation.

b. You will maintain sufficient Military Government Courts to try persons accused of offenses involving the safety and security of United States and Allied personnel and all cases in which the interest of Military Government requires such procedure.

c. You may extend the jurisdiction of the German courts to all cases which do not involve the interests of Military Government or persons under the protective care of Military Government. Any German Tribunal established for the purpose of determining internal restitution claims may exercise jurisdiction over any person irrespective of his status who institutes a proceeding therein.

d. As a basic objective of the occupation is the re-establishment of the rule of law in Germany, you will require all agencies under your control to refrain from arbitrary and oppressive measures. Except when it clearly appears that detention is necessary for the security of the occupying forces, no person will be detained except when he is charged with a specific offense and is subject to trial by a duly constituted tribunal. You will protect the civil rights of persons detained under charges assuring them a fair trial and ample opportunity to prepare their defense. You will by regulation limit arrests for security purposes to cases where overriding considerations of military necessity require such procedure. Persons so detained will be permitted to communicate with their nearest relative or friend unless urgent security considerations require an exception, and you will review their cases periodically to determine whether further detention is warranted. When in your opinion it will be compatible with security considerations, you will eliminate such arrests without prejudice to a revival of the practice in emergencies.

12. Legislation

You will exercise your power of disapproval over German legislation only when such legislation conflicts with the legislation or other policies of Military Government.

13. Movement of Persons

a. You will implement the decisions taken 23 April 1947 by the Council of Foreign Ministers with regard to United Nations displaced persons and population transfers.

b. You will, in cooperation with IRO, facilitate the emigration to other countries of those displaced persons unwilling to be repatriated.

c. Pending the movement of displaced persons you will retain overall responsibility for their appropriate care, maintenance and protection. You will utilize the IRO to the maximum possible extent in assisting you to discharge this responsibility.

d. The term displaced persons as used above refers to displaced persons and refugees as defined in the IRO Constitution.

e. You will hold the German authorities responsible for the care and disposition of nationals of former enemy countries not otherwise provided for herein and you will continue to facilitate their repatriation.

f. You will require that persons of German extraction who have been transferred to Germany be granted German nationality with full civil and political rights except in cases of recognized disqualifications under German law. You will take such measures as you may deem appropriate to assist the German authorities in effecting a program of resettlement.

g. You will continue to permit the exchange of Germans seeking permanent residence between the United States Zone and other zones on a reciprocal basis. You will permit free movement for temporary purposes to the greatest possible extent consistent with security considerations and with interzonal or quadripartite agreement.

h. You will continue to receive those Germans whose presence abroad is deemed by your Government to be contrary to the national interest. You will likewise permit the re-entry of German and former German nationals who desire to return permanently but in view of restricted facilities you will give priority to those who are willing and able to contribute to the peaceful reconstruction of Germany.

* Department of State Bulletin, November 10, 1946, p. 861.

i. You will permit only those Germans to leave Germany who are included in categories approved by Allied agreements or your Government's instructions.

14. Prisoners of War

In carrying out the decision of the Council of Foreign Ministers of 23 April 1947, you will press in the Control Council for the earliest possible return of all German prisoners of war still located in the territories of the Allied Powers and in all other territories.

V

15. General Economic Objectives

The economic objectives of the United States Government in Germany are:

a. to eliminate industry used solely to manufacture and to reduce industry used chiefly to support the production of arms, ammunition and implements of war;

b. to exact from Germany reparation for the losses suffered by United Nations as a consequence of German aggression; and

c. to encourage the German people to rebuild a self-supporting State devoted to peaceful purposes, integrated into the economy of Europe.

Although the economic rehabilitation of Germany, within the framework of these objectives, is the task and responsibility of the German people, you should provide them general policy guidance, assist in the development of a balanced foreign trade and ensure that German efforts are consistent with, and contribute to the fulfillment of your Government's objectives.

16. Economic Disarmament and Reparation

a. Your Government continues to desire the general fulfillment of the principles of the Potsdam Agreement regarding reparation and industrial disarmament.

b. Your Government believes that the level of industry eventually agreed upon for Germany as a basis for reparation removals, while eliminating excess industrial capacity which has been used by Germany for the purpose of making war, should not permanently limit Germany's industrial capacity. The German people after the period of reparation removals should not be denied the right, consistent with continued disarmament, to develop their resources for the purpose of achieving higher standards of living.

c. Your Government does not agree to reparation from Germany greater than that provided by the Potsdam Agreement. Nor does your Government agree to finance the payment of reparation by Germany to other United Nations by increasing its financial outlay in Germany or by postponing the achievement of a self-sustaining German economy. Your Government reaffirms the principle that the proceeds of authorized exports shall be used in the first place for the payment of authorized imports.

d. You will attempt to obtain Control Council recognition of the principle of compensation for property taken for reparation or where it has been necessary to destroy property under the agreements for economic disarmament, such compensation to constitute a charge against the German economy as a whole. Except in prohibited industries, you will endeavor to ensure, to the greatest extent practicable, that no plant in which there is foreign ownership or control is removed for reparation as long as German-owned plants are available for that purpose.

e. You will continue to assist in the location of cloaked German-owned assets abroad and where possible you will assist in their liquidation.

17. Restitution

a. You will proceed, consistent with agreements on restitution reached in the Control Council, to restore such identifiable property other than gold and transport essential to minimum German economy to the government of the country from which it was taken. You will not consent to any extensive program for the replacement of looted or displaced property which has been destroyed or cannot be located whenever such replacement can be accomplished only at the expense of reparation, a self-sustaining German economy, or the cultural heritage of the German people.

b. You will turn over monetary gold uncovered in Germany to the Tripartite Gold Commission in Brussels for distribution in accordance with the terms of the Paris Act on Reparation.

c. In accordance with JCS 1570/9, you will make available for the rehabilitation and resettlement of non-repatriable victims of German action valuable personal property looted from Nazi victims which is not restitutable.

d. It is the policy of your Government that persons and organizations deprived of their property as a result of National Socialist persecution should either have their property returned or be compensated therefor and that persons who suffered personal damage or injury through National Socialist persecution should receive indemnification in German currency. With respect to heirless and unclaimed property subject to internal restitution you will designate appro-

priate successor organizations.

18. Economic Unity and Recovery

a. Your Government is desirous of securing agreement in the Control Council to the treatment of Germany as an economic unit, the formulation of common policies in all matters affecting Germany as a whole, and the establishment of central Germany administrative agencies for the purpose of implementing such common policies in the fields of finance, transport, communications, agriculture, economics (including industry and foreign trade) and such other fields as the Control Council may consider necessary and appropriate.

b. Your Government likewise desires to secure the adoption of a production and foreign trade program for Germany as a whole which should be directed toward an increasing standard of living in Germany and the attainment at the earliest practicable date of a self-sustaining German economy. Such a program should give highest priority to increased production of coal, food and export goods; provide for such allocation and distribution of German indigenous output and approved imports throughout Germany as are necessary to carry out the production program and attain the agreed standard of living; ensure full payment for all goods and services exported from Germany (other than reparation or restitution) in approved imports or in foreign exchange which can be utilized for the payment of approved imports, and provide for the pooling of all export proceeds to be made available, first to meet the import needs of Germany as a whole for such time and in such amount as may hereafter be determined, and secondly to compensate the occupying powers for past expenditures pursuant to terms and conditions to be established hereafter, priority in the latter case being given to payment of costs sustained for essential imports in direct proportion to the expenditures made by the occupying powers.

c. In cases where the restoration of normal international commercial relations between Germany and the rest of Europe would involve an increase of US dollar expenditures for the government of Germany, or a delay in the attainment of a self-supporting German economy at an appropriate standard of living, funds for German expenditures shall be increased, or the German economy compensated through provision by the US of sufficient relief monies to the country or countries so benefited to enable them to pay Germany. You will consult other European countries and international organizations representing such countries in matters of German production and trade mentioned above, and ensure that emphasis is given, in the selection of items for export, to goods needed by European countries for their economic recovery and rehabilitation insofar as these countries may provide in payment needed imports for Germany, or foreign exchange which can pay for such imports. Proposed transactions of a substantial nature which would lead to a restoration of general European trade or normal international commercial relations or restore normal trade exchanges between Germany and other European countries but which would not conform to the principles stated in this paragraph should be referred to the US Government for decision.

d. You will support the removal of existing trade barriers and will encourage the return of foreign trade to normal trade channels.

19. Finance

a. Your government views the reorganization of German finances on a sound basis and the attainment of financial stability in Germany as among the main factors essential to German economic recovery along democratic and peaceful lines. To that end, you will endeavor to have the Control Council adopt uniform financial policies in conformity with the principles and the objectives set forth in this directive.

b. Pending agreement in the Control Council, or until receipt of further directive from your government, you will continue to be guided by the following policies in your zone:

(1) you will control, within the scope of your authority, all financial transactions of an international character in order to keep Nazi influence out of the field of finance and prevent outward movements of capital from Germany;

(2) you will exercise general supervision over German public expenditures and measures of taxation in order to insure that they are consistent with the objectives of the Military Government;

(3) you will take such action as may be necessary to prevent the establishment of a centralized German banking system and an undue concentration of financial power, but will encourage the establishment of a central authority for the production, issuance and control of currency and for technical banking supervision. You will also encourage the Germans to re-establish normal banking facilities within the limitation prescribed above and within the present blocking of assets and accounts under Military Government Law No. 52;

(4) you will use the resources of the German economy to the maximum extent possible in order to reduce expenditures from appropriated funds of your government. You are authorized, as provided in the Potsdam Agreement, to use the proceeds of exports to pay for imports which you deem essential, subject to strict accounting and auditing procedures;

(5) you will continue to aid economic recovery by collection of full payment for exports of German goods and services; and

(6) you will continue to prevent non-essential imports.

c. You will press for the adoption by the Control Council of a program for financial reform which provides for a substantial and appropriate reduction in outstanding currency and monetary claims, including public and private debt; for the equitable sharing of the costs of war and defeat; and for ancillary measures including adjustments in the wage-price structure necessary to the restoration of balance between the financial structure and the economic realities.

d. (1) You will maintain such accounts and records as may be necessary to reflect the financial operations of the Military Government (U.S.) in Germany, including also such operations undertaken jointly by you with the Military Government in the British and other zones of occupation in Germany.

(2) You will take measures necessary for calculating occupation costs distinguishing those now incurred within Germany and supported by the German economy, and external occupation costs for eventual settlement with Germany. You will endeavor to agree on a definition of occupation costs of both types within the Control Council and to limit and control internal occupation costs on a quadripartite basis.

20. Agriculture

a. In accordance with the decision of 23 April 1947 of the Council of Foreign Ministers, you will ensure the carrying out and completion of land reform in your zone in 1947.

b. You will require the appropriate German authorities to adopt and implement policies and practices which will:

Maximize the production and provide for the effective collection and distribution of agricultural products.

c. You will require the appropriate German authorities to adopt and implement similar policies and practices in respect to forestry and fishing resources.

21. Economic Institutions

a. Pending agreement among the occupying powers you will in your zone prohibit all cartels and cartel-like organizations, and effect a dispersion of ownership and control of German industry through the dissolution of such combines, mergers, holding companies and interlocking directorates which represent an actual or potential restraint of trade or may dominate or substantially influence the policies of governmental agencies. You will not, however, prohibit governmental regulation of prices or monopolies subject to government regulation, in fields where competition is impracticable. In so far as possible, you will co-ordinate your action in this field with the commanders of other zones of occupation.

b. You will permit the formation and functioning of cooperatives provided they are voluntary in membership, and are organized along democratic lines and do not engage in activities prohibited under the above paragraph.

c. While it is your duty to give the German people an opportunity to learn of the principles and advantages of free enterprise, you will refrain from interfering in the question of public ownership of enterprises in Germany, except to ensure that any choice for or against public ownership is made freely through the normal processes of democratic government. No measure of public ownership shall apply to foreign-owned property unless arrangements which are satisfactory to your Government have been made for the compensation of foreign owners. Pending ultimate decision as to the form and powers of the central German Government, you will permit no public ownership measure which would reserve that ownership to such central government.

d. Pending agreement among the occupying powers, you will limit new foreign investment in your zone of Germany and will continue to ensure that all property, however owned, and all production and manpower in your zone are subject in all respects to the decisions and directives of the Control Council, and to Military Government and German law.

e. (1) You will permit the organization, operation, and free development of trade unions provided that their leaders are responsible to the membership and their aims and practices accord with democratic principles. Any federation of trade unions shall not impair the financial and organizational autonomy of member unions. You will encourage the trade unions to support programs of adult education and to foster an understanding of democratic processes

among their members. You will permit trade unions to act in the interests of their members and to bargain collectively regarding wages, hours and working conditions within the framework of such wage and price controls as it may be necessary to maintain.

(2) Trade unions may represent the occupational, economic and social interests of their members in accordance with the authority contained in their constitutions. Their basic functions may include participation with appropriate authorities in the establishment and development of a peaceful economy.

f. You will permit the organization and functioning of work councils on a democratic basis for the representation of the interests of employees in individual enterprises and will not prohibit the cooperation of trade unions therewith.

g. You will also permit the establishment of machinery for the voluntary settlement of industrial disputes.

VI

22. Cultural Objectives

Your Government holds that the re-education of the German people is an integral part of policies intended to help develop a democratic form of government and to restore a stable and peaceful economy; it believes that there should be no forcible break in the cultural unity of Germany, but recognizes the spiritual value of the regional traditions of Germany and wishes to foster them; it is convinced that the manner and purposes of the reconstruction of the national German culture have a vital significance for the future of Germany.

It is, therefore, of the highest importance that you make every effort to secure maximum co-ordination between the occupying powers of cultural objectives designed to serve the cause of peace. You will encourage German initiative and responsible participation in this work of cultural reconstruction and you will expedite the establishment of these international cultural relations which will overcome the spiritual isolation imposed by National Socialism on Germany and further the assimilation of the German people into the world community of nations.

23. Education

a. In recognition of the fact that evil consequences to all free men flow from the suppression and corruption of truth and that education is a primary means of creating a democratic and peaceful Germany, you will continue to encourage and assist in the development of educational methods, institutions, programs and materials designed to further the creation of democratic attitudes and practices through education. You will require the German *Laender* authorities to adopt and execute educational programs designed to develop a healthy, democratic educational system which will offer equal opportunity to all according to their qualifications.

b. You will continue to effect the complete elimination of all National Socialist, militaristic and aggressively nationalistic influences, practices and teachings from the German educational system.

24. Religious Affairs

a. You will, in the United States Area of Occupation, continue to assure freedom of religion. You will assure protection of religious activity and support these principles in the deliberations of the Control Council.

b. You will give freedom to the Germans to decide all questions concerning the constitution, the religious activity and the amalgamation of purely ecclesiastical bodies.

c. You will continue to take such action as may be necessary to prevent the revival of National Socialist and militaristic activity under the cloak of a religious program or organization.

25. Monuments, Fine Arts, and Archives

a. You will respect, and permit German authorities to protect and preserve, the property of all cultural institutions dedicated to religion, charity, education, the arts and sciences, historic monuments and historic archives, together with their collections and endowments. You will apply the same principle to all other property of cultural value, whether publicly or privately owned, except for institutions and monuments specifically devoted to the perpetuation of National Socialism or to the glorification of the German militaristic tradition.

b. You are authorized to make such use of German records and archives as may be appropriate.

26. Public Information

a. You will, in the United States Area of Occupation, supervise, encourage and assist in the development by the Germans of media of public information designed to advance the political and cultural objectives stated in this directive.

b. You will arrange through the Allied Control Council for the implementation of the

decision of 23 April 1947 of the Council of Foreign Ministers on the free exchange of information and democratic ideas by all media in all of Germany.

c. You will develop and maintain organizations and facilities for the operation of media of information, including those sponsored by Military Government, designed to further the objectives of your Government.

27. Re-establishment of International Cultural Relations

In furtherance of the program of the reorientation of the German people and the revival of international cultural relations, you will permit and assist the travel into and out of Germany of persons useful for this program within the availability of your facilities. You will also permit and assist, to the extent of your facilities, the free flow of cultural materials to and from Germany.

[SOURCE: *A Decade of American Foreign Policy, Basic Documents 1941–49*, pp. 552–62, Greenwood Press, New York 1968. By: Staff of the Senate Committee on Foreign Relations and the Department of State]

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