監修のことば

『昭和財政史——終戦から戦後まで——』（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、問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、日本が連合国占領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、別冊にかかげられてい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（占領政策担当官等アメリカ側関係者をふくむ）からヒアリングを中心とした共同研究会と部会を展開して研究し、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、後に後述するような在米資料をふくめて未発表、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、大蔵省の省論によって今回の財政史の編纂、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理解に留意する」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る限り発掘活用し、客観的で詳密な財政史をつく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
だから Years たこともない外国の占領下におかれた時期であり、XX 日本が新しい日本に生まれ変わらざるをえない出来事であることをおもむね、けっして長い間といえなくとも、記録されなければならぬ出来事はむしろ戦前の20年を悉く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の経済全体の復興と成長に大きな影響を与え、あくは、その原因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、ときにアメリカ合衆国との対立の歴史にも及ぶのは当然であり、そうでなくてはこのような状況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る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、従来大蔵省が編纂した財政史に比して対象期間は短期間であるが、その内容は誠に膨大であるとともに、きわめて多角的なものとなるざるをえなかったのである。しかた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充分とはいえず、占領当主は連合国占領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、近々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ことになったため、その利用が可能となった。これほど、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。それらの資料を活用できたことは、本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主導的に収集したものではないが、個人の著書を集めた全集ということのようなものでなく、全巻が有機的なつながりをもったものであり出来ようの限り客観的で、正確な史実を後世に残すものであることに筆で用いられた。そのためにも、執筆者の第一線は未定稿として省庁関係者局局に回覧されるとともに、研究会における相互討論にも供されただけである。

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、わたたくしも監修者両名が負うものである。

終りにわたったら監修に当たった両名、執筆者一同ともに、本財政史の編さん・刊行について示された大蔵省の特別な意図と理解、ならびに独自の口授による配
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: shōsen 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, the 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

ORGANIZATION OF DOCUMENTS

The documents are organized into thirteen categories and appear chrono-
logically 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 funda-
mental 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, direc-
tives, 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
AG
ADM
CAC
CAD
CIE
CINCAF PAC
CINC FE
ER OA
ESS
FEC
FI
FRUS
GARIOA
HC LC
IDAC-FE
IE
JCAC
JCS
JMD MSS
JWPC
LOF
NAC
NMA
NR
NSC
OSS
PRJ
PWC

Agriculture Division (NR)
Antitrust and Cartels Division (ESS)
Administrative Division (ESS)
Country and Area Committees (State Department)
Civil Affairs Division (War Department)
Civil Information and Education Section
Commander-in-Chief, Army Forces, Pacific
Commander-in-Chief, Far East
Economic Rehabilitation of Occupied Areas
Economic and Scientific Section (SCAP)
Far Eastern Commission
Finance Division (ESS)
State Department, Foreign Relations of the United States
Government and Relief in Occupied Areas
Holding Company Liquidation Commission
Inter-Divisional Area Committee on the Far East
(State Department)
Import-Export Division (ESS)
Joint Civil Affairs Committee (JCS)
Joint Chiefs of Staff
Joseph M. Dodge Papers, Detroit Public Library
Joint War Plans Committee (JCS)
Liaison Office (Ministry of Finance)
National Advisory Council on International Monetary and Financial Problems
Supreme Commander for the Allied Powers, History of the Nonmilitary Activities of the Occupation of Japan, 1945 through 1951.
(State Department)
Natural Resources Section (SCAP)
National Security Council
Office of Strategic Services
Supreme Commander for the Allied Powers, Government Section,
Political Reorientation of Japan, September 1945 to September 1949.
Postwar Programs Committee (State Department)
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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 Japan Government
SFE: State-War-Navy Coordinating Subcommittee for the Far East
SR: Division of Special Research (State Department)
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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

Drafted by: H. Borton

Secret

Provisional Scheme for a Handbook on:

THE FAR EAST

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 1938
   (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
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   (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.
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—

Indonesia

Formosa
General Descriptive Reference Study with Concise Summaries—Coville.
Implications of Peace Commitments and Proposals, Points of View of Other Countries,
Alternate 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—
Lushan Islands, Southern Sakhalin 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., N. American Archives

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

1-3 STATUS OF THE JAPANESE EMPEROR

Sincerely yours,

[Signature]

For the Joint Chiefs of Staff:

/\ WILLIAM D. LEAHY,
Admiral, U.S. Navy,
Chief of Staff to the
Commander in Chief of the Army and Navy.

[Signature]

SOURCE: Msg. Mil Br., N. American Archives

Report T-315
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 emperorshipship
and its future.
The empire 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 Empire

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 nationalism, 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 Empire

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 Declaration, that the disarmament of nations which threaten or may threaten aggression 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 form 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 unique racial race and 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 improvement would be obtained. No readymade 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 inheres in the institution. Superstition connected with it might be removed through more liberalized educational practice, and the influence of the exaggerated nationalism can be countered 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

[Civil Affairs Division]

[Source: National Archives]
1-5 SIR GEORGE SANSONS' VIEWS OF POSTWAR JAPAN

Memorandum of Conversation
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 stated that whenever their strength had been challenged in the past by the militarists they had 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 suffered during the years 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 1946. 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.

Political 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. He emphasized that the only things which would be more than power of "direct access" to the throne. The desire limiting those who are eligible to become the tions 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 intimate cooperation with the Japanese unless their reviews were carried through changes such as those 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 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 to 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.

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

8 British Minister to Washington D.C. and well-known Japanologist.
1-7 DRAFT DIRECTIVE FOR MILITARY GOVERNMENT OF JAPAN

Draft Directive
To: Chief, Civil Affairs Division

War Department

From: Brig. Gen. C. W. Wickersham

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 any 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 signaled 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 operating within this end the military government shall (a) relieve combat troops of the necessity of providing for civil administration; (b) restore law and order and normal conditions among the civilian 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 civilian 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 Chief 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.

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 it is necessary 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 the making 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 government or military representative 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 for determining who these 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 9.

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 Chief of Staff will furnish you a list of war criminals, will be hereafter arrested, if found within the occupied areas, and held in custody for further instruction from the Combined Chief of Staff.

11. Army 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 Chief of Staff regarding the administration of the military government, as set forth in the preceding 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 of the administrative machinery of the occupied area.

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 administration, where replacements are not necessary or only 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 superintendents or 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 therefor.

20. Claims. You are authorized to establish claims for compensation 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

4 Commandant, School of Military Government.
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 such a measure is deemed necessary 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.

1-9 PLANNING FOR RELIEF AND REHABILITATION OF LIBERATED AREAS

Letter 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 advice as you may need.

Drafted by: G.H. Blakeslee  
February, 1944

I. NUMBER OF MEETINGS:

Twentys-seven.

II. PREFERRED SOLUTIONS RECOMMENDED

The Committee unanimously agreed on the 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

2. Boundaries

3. General Problems

4. Japan's Mandated Islands

5. Korea

6. Other

PRE-OCCUPATION-GENERAL

11

SOURCE: Fawkes Papers

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

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

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.

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[Source: MOD. MIL. BR., NATIONAL ARCHIVES]
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 Northern
      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 Com-
      mittee 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 pres-
   ent, 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 interna-
   tional 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 investors in the Mandate.

6. Korea

Korea should be due course be independent, but for a time should be under
the 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. Hoey
J. C. H. Bonbright
H. S. Cumming, Jr.
R. B. Stewart
W. P. George
S. W. Boggs
A. Moffat

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

[SOURCE: DIPLO. BR., NATIONAL ARCHIVES]

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

Report CAC-116
IDAC-FE*

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
decide indispensable for security purposes.

III. ECONOMIC AND FINANCIAL OBJECTIVES
   Japan is to be permitted, within the framework of the restrictions necessary for interna-
   tional security, and having due regard to the matter of reparations, to share in the develop-
   ment of a world economy on a non-discriminatory basis, looking toward a progressively
   higher standard of living.

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

* 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 of 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-I1 DECENTRALIZATION OF JAPANESE ADMINISTRATION

Report: PWC-153

IDAC-FF

Secret

May 1, 1944

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 has proceeded 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 in some respects this will tend to reduce the military capacity of Japan, 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 demobilized 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 understandable 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 insure for them the enjoyment of a fuller share in the rewards of the economic life of Japan. With the advent of our forces in Japan there will immediately terminate the governmental 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 are of profound meaning, showing Japan of the danger of the revival of a concentration of a power in a predatory and self-seekng oligarchy and for a complete emancipation of the Japanese people from their thralldom to a vicious social, economic and political system.

Further 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 public support of a Provisional Government in Japan. 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 administration. Should there be reconstruction of the administrative system, with setting up of various local jurisdictions, it is not certain that military governemt 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 nature of the situation. It would probably be the case that any such reform 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 the highly centralizing and conclusive changes in the Japanese administrative system. The results of that reorganization, in short, would probably 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 be the recognition of certain characteristics in Japan which are not only alien to the political and social concepts of the West, but which make an interference with their own functions and thus effective cooperation with other officials is often lacking. These tendencies can, in the long run, 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 inefficiently and may fail to meet the fundamental objective of the occupation of Japan which will be to establish orderly processes at the earliest possible moment. It seems to be of the utmost importance, in the event that such tendencies are observed, that they be in time corrected, and that the authority of the central authority is not interfered with in any way. 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.

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 either barren 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 many areas 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 centralization of the productive, and relatively more productive, regions of the country will be helpful in the re-establishment of a national economy.

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 success if the above reforms were to be designed and applied in military government 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 Junta. 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 demonstrate the possibilities of 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. Paszovsky (PVC)

From: P. E. Mosley (TS)

1. Origin:

By direction of the Secretary of State transmitted by Mr. Paszovsky 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.

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 for background for policy decisions. Memoranda prepared in the Country and Area Committees are transmitted to 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, caution in transmitting 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.

[Source: Dipl. Br., National Archives]

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

Memorandum (PWC-106b) CAC-116b

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 postwar 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

* 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 by us. 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

Minutes of 67th Meeting
Dept. of State Policy Committee
Secret

Present: Mr. Berle (Presiding) Murray
Messrs. Long Savage
Shaw Taft
Rackworth Yost
Duggan Ballantine
Dunn His
Green Landis
Grew
Hornbeck

Absent: The Secretary Earhart
Messrs. Stettinius Rawkins
Acheson McDermott
Parvisky Ross
Dickery Wilson

Mr. Grew summarized document FE-7, pointing out that the Post-War Programs Committee had 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 “unneccessary” 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.

1-15 CONSIDERATION OF BOMBING THE IMPERIAL PALACE

Report R & A 2305
Office of Strategic Services
Secret

July 28, 1944

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 BOMBARDED?

1. 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 Imperial 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 nationalist reaction, 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.

2. 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:

It is believed that most documents of vital importance to the Japanese war effort would be removed to 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 to that of the sinking of the battleship Yamato, at least to such extent as the Japanese shipowners themselves disposed to conform to the desires of the United Nations. Accordingly, the Japanese shipowners have stated that even if the Japanese are induced to bring about the abdication of Hirohito through prescribed Japanese processes, the United Nations desire his abdication.

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 undermining American ability to penetrate the strongest Japanese air link 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 not agree that the mission is 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 conclusion 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 declare the emperor is in optional abdication. In short, 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 conveys 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 “presumed to have 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 overly the abdication of Hirohito: a) this step would be tantamount to giving false 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 coercion. 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 predisposed to accommodate or relieve to such extent as the United Nations themselves disposed to conform to the desires of the United Nations. Accordingly, the Japanese are opposed 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.

The Japanese Emperor Institution corresponds only in a very superficial sense to European and American constitutional practices. Although the concept of the emperor may seem to have some resemblance to the doctrine of the divine rights of kings. It is probably not given to any accidental to understand entirely the concept which the Japanese hold of their ruler, but as nearly as can be discerned the Emperor occupies the essential position that he does in the political and social order of his country and the relationship 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 have been on the outskirts of the exercise of actual power. Deposition or assassination have been the ultimate fate of many Japanese Emperors. These actions do not speak to the veneration and respect that are associated with the Shogunate’s foreign policy. 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 phenomenon is 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 “reign” or had been assassinated.

The 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 as a cultural character. It 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 contact between the British and the people of his country, 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 inferences which are publicly made 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 extraordinary 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 resignation from that function. In the theory of the emperor’s responsibility, it can be committed to the care of 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 took place, it is probable that he would have been 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 government, 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.

5. 

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 inadmissible, 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 utilize the name of the Emperor to establish a regime in Japan 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 affect 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 all actions taken by 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 legal 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 legal 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: DIPLOMATIC BAG, NATIONAL ARCHIVES

1-17 JAPAN’S EDUCATION SYSTEM UNDER MILITARY GOVERNMENT

Report PWC-2872\textsuperscript{12} November 6, 1944

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 teachers which would be required to carry on the Japanese educational system as it 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, is determined in large measure by the requirements of the nation and by the need to select the most promising students for the university. This system of selection involves the graduation 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.

The 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 government foments a spirit of cosmopolitanism and modernism 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 “subjects” or “citizens”.

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 education system where the large 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.

\textsuperscript{12} This report was first prepared and discussed by the IDAC-FE and later reviewed and revised by the PWG 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 of those of the people. Therefore the many problems which have so far preoccupanied authorities can be resolved only by introducing new methods 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.

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.

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-forming 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 religious and youth organizations, should be delegated to those Civil Affairs officers in charge of religious and nationalist organizations (See: Japan: Freedom of Worship, CAC-117b; and Japan: Political Parties or Agences, 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 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 recently developed “Taisho” readers. The “Taisho” readers read of the 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 militaristic ones.

A study of Japanese textbooks might well be undertaken 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 the CAA might choose to procure and 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. Military

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 administration and 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 authorities, should be replaced.

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. It would seem advisable that these officers be permitted to make themselves more no more obstructive 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 Japan.

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 Japanese school administrators and staffs trained in American 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 Course

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 English 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. Indocration 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 in the prefectures. Each prefecture is required to organize and maintain at least one normal school. Effective and rapid reorganization and improvement of the 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, where 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 months so as to familiarize 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, comic strips and comic books will help to remind the students of their duties as “good” Japanese subjects. This indocration program is carried on under the direction of the Bureau of Educational Reform and Social Education. The indirect guidance of the State in the education of the Japanese will be kept to a minimum.

Indocration 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. Convocations are an effective means of the dissemination of the nationalism 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.
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 subject areas and topics from a liberal perspective.

9. 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.

10. 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 the use of any part of the prescribed school curriculum any ceremony connected with the emperor’s portrait.

11. 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. Re., 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-256a—Ratification of the Imperial Proclamation Establishing 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. Blakelee reported that the Committee had given it serious 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-296a**

**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 on 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-296b**

**MEDIA OF INFORMATION**

Mr. Blakelee 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 of the 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 pointed out that this would be contrary to the principles that they had adopted. Recommendation five was revised to conform with the changes on the bottom of page six. This paper was adopted by PWC as presented.

**PWC-297**

**EQUATION SYSTEM**

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.
Mr. Blakeseley 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. Blakeseley and Mr. Ballantine pointed out that every attempt had been made to keep the two consistent. Mr. Acheson noted that these documents had been prepared at the request of the Civil Affairs Division of the War Department and that they were raw material upon which the War Department would base its directives on military government. When Mr. Pivovsky 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-296a

WORKERS' ORGANIZATIONS

Mr. Blakeseley 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 so that hostages may not be executed. It was suggested that the first sentence on page five be deleted, and that the quotation from the Rules, section 338b, 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-294a 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. Pivovsky 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. Pivovsky 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. Pivovsky stated that it now appears as though the President was anxious to avoid economic policies that would be too similar to those in Germany as we did not know what conditions we will find. Mr. Pivovsky assumed that similar consideration would be applicable to Japan and that those drafting the paper should keep this in mind.

SOURCE: DIPLO., NATIONAL ARCHIVES

1-19 JAPANESE SURRENDER AND POST-SURRENDER RESISTANCE

Report R & A No. 2022.1
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 from the Japanese population, 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 Japanese chances of ultimately regaining 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 area, supplemented by such puppet forces as remain loyal;

2. Using equipment and ammunition on hand, which are possibly sufficient to carry on for a good deal more of the 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 leaders would have 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 governments—the large industrialists, the High Commanders, the 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 cadre, 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 million, are believed to have ample stocks of war matériel (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 assure 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 the Japanese guarantee 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.
[Sources: USIR, BIB, 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
1. 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. The United States should strive to prevent a renewal of militarism and of the revival of militarism by
(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 characterized for Japan 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 against 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 terms of surrender and other measures which Japan must comply with in consequence of unconditional surrender, and (b) the general policy of the United Nations in regard to the treatment of Japan.” (PWC-84a)
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 cessation of hostilities.
A tentative plan for occupation 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 government, their willingness to carry out the terms of the surrender and of the treaty of peace, and the 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:
(a) Destruction of the military machine;
(b) Prevention of the revival of militarism by
(a) Nullification of obnoxious laws; (PWC-111)
(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 Problems of Military Government
(a) Treatment of the Emperor
“If it is recommended that the military authorities adopt 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
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.” (PCW-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.” (PCW-293c)

(12) Status of Certain Categories of Japanese Property

The following property in Japanese territory occupied by United States forces “shall 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 such convention”’ property belonging to the Imperial Family, the Imperial Rule Assistance Association and the similar organizations. (PCW-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.” (PW-292)

(14) Foreign Relations of Japan

All Japanese diplomatic and consular agents abroad should be recalled. (PCW-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. (PCW-280)

(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.” (PCW-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 Mandates, Manchuria, 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 anticipation of future behavior. Regarding the form, action is too preponderantly 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-
1-22 IMPORTANT POINTS AT INSTITUTE OF PACIFIC RELATIONS CONFERENCE ON MILITARY GOVERNMENT ACTIVITIES

Memorandum

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

January 21, 1945

(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 the government must be insisted upon. (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 Asians among the occupying troops.

(e) Techniques. Two specific devices to initiate the 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 shaping Japan to improve her status.

(f) Length of occupation. The possibility was discussed of a long period of occupation 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 projected Kurile-Kurile Islands and Sakhalin.

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 troops 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. Other. From 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.

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

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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.
I. CONSIDERATION OF JAPANESE TERRITORIAL PROBLEMS—JAPANESE CASE

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

The Committee voted 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: "As reference to the advisability of designating Southern Sakhalin 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 agrandizement, 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 reorganization 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 with 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 was analogous but that it might be more helpful if the Committee had a paper discussing the advisability of a regency in Japan. He suggested that perhaps Mr. Fearley, 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

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 these areas were being considered.

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 as a summary of basic policy under the terms of which specific plans 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 issues 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. Fearley 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 was 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. Fearley 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 unduly aggrandize the whole system of overseas protection to the detriment of other nations.

Mr. Williams added that he believed if small private holdings were confiscated in Korea, such action would be counter to international law.

Mr. Wright 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 suggested that this Article was tantamount to outright confiscation in view of the fact that the German Government was unable to repay the property owners.

Mr. Blaisdell 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 affiliated lands 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. Bsett 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 especially in view of his familiarity with the discussions on this subject at the Institute of Pacific Relations Conference, might prepare such a paper.
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 Axis 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. Doman 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 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-100) 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-100 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.

Dr. Doman 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, 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.

1-24 TREATMENT OF THE EMPEROR

Minutes, 40th Meeting
Secretary of State Staff Committee
Top Secret
Present: Acting Secretary Grew (presiding)
M. Acheson
Dunn
General Holmes
M. Mason (for Mr. Clayton)
Hick (for Mr. Passovskiy)
Meck (for Mr. Rockefeller)
Bohlen
Brown
Rothwell
Yost

March 8, 1945

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 impractical 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.

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
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 it was meant.

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 reviewing 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 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.

1-27 RESPONSIBILITIES FOR MILITARY GOVERNMENT

Telegram WARX 79282
To: Commander in Chief Army Forces, Pacific (AFPAC) in Manila
From: Joint Chiefs of Staff (JCS)

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 CINCPAC (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. CINCPAC is charged with Military Government of Japan (including the 4 main islands, about 1000 offshore islands, and Karafuto and Tushman Islands but excluding the outlying islands as defined in JCS 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.

1-28 BRITISH REPORT ON AMERICAN POLICY TOWARD JAPAN

Telegram No. 36658
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.

1. Its standpoint is 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)

2. Methods contemplated for realization of those objectives include
   (1) Exerting 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.

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8 Cf. British Foreign Office's response of July 17, 1945, which is included in this volume.
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.

Upon defeat, Japan will be in a position analogous to that in which she found herself in 1895. She will be militarily weak, financially impoverished, and her territory without any foreign trade. It might seem that her military and financial condition 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 favorable 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.

5. In these circumstances it should be possible to influence the course of events in Japan by agreement with the Allies to promote 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 a dependent rather than an independent country, and its future in no way differs from that of any other country which has been subject to a prolonged occupation by a foreign power. It may be that the events are 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 behavior.

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 organizations. She did not get rid of extraterritoriality until 1899 and did not achieve full tariff autonomy until 1911.

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 have had their fill. This may be so, but 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 have had their fill. This may be so, but 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.

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 impoverished and starved. 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. 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 under such political policies might be bright. Japan, without any burden of occupation, should be 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 Japanese population or by violent revolution with its dangerous implications for the future.

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 Commission 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 that in local and economic control of Japan as compared to the attitude and action taken 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.

I do not think 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. One 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 para. 7 above. The enforcement of these controls would be independent of 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 administrations may exist, using the economic sanctions which appear to be capable of being employed with the requirements such as the repeal of obnoxious laws, the dissolution of political societies, the reform of education, freedom of speech and worship, etc.

I feel 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 their 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]

1-36 SELECTION OF EXPERTS FOR MACARTHUR'S STAFF

Memorandum of Conversation
July 16, 1945
Participants: Brig. Gen. W. E. Crist
Drafted By: J. C. Greer

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 the invasion as political, economic and financial advisers. General Crist said that these men, 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 highly-placed 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 the man 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 about it, I said that I regarded Supreme Commander as an important part of our outstanding experts on Japan and he might be more available than others now holding official positions. I said that Mr. Doorman was now at the three-power conference at Potsdam as Chancellor of Japan and the Secretary of State on Japan's agenda. 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 referred to 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 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
July 17, 1945
To: British Embassy in Washington
From: British Foreign Office

Toph Secrep
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

"Acting Secretary of State.
"Cf.Original telegram from Washington on May 30, 1945; also reply from British delegation in Berlin on July 24, 1945."
PRE-OCCUPATION—GENERAL

1. On February 18, 1944, General Hilding and Captain Pence asked the State Department for the recommendation and advice of the Department in connection with future planning for military government in Japan 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 Hilding and Captain Pence sets of twenty-one documents approved by the Department which answered these specific questions.

3. On March 27, 1944, General Hilding 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 Hilding and Captain Pence.

5. On August 16, 1944, General Hilding and Captain Sabih 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 Hilding and Captain Sabih.

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 AMENDMENTS TO AMERICAN DRAFT PLAN

Memorandum

To: Mr. Dixon

From: “T(7)R.LR”

July 22, 1945

Reference the Foreign Secretary’s minute to the Prime Minister of July 21 P.M.45/B.T. The Prime Minister saw the President this morning and handed him the enclosure10 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

To: Mr. Dixon

From: “T(7)R.LR”

July 23, 1945

Top Secret

With reference to my minute of July 22, regarding the Foreign Secretary’s minute of July 21 P.M.45/B.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 added that he would much prefer that the appeal should be signed by the President and himself alone.

I enclose a copy11 of a minute which I am sending to Sir E. Bridges about informing the Cabinet of this.

[Source: British Public Record Office]
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

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.

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

(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 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 insured 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) Japan shall not be permitted to resell Japanese ships and machinery 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 execution 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. Essential 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 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* Secret

I. ANALYSIS OF THE POTSDAM PROCLAMATION OF JULY 26, 1945 (SEE ANNEX A)1

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

1 Inter-Departmental Area Committee on the Far East, State Dept.
2 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 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 Luchiu 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. Morton, who inclined towards Mr. Blakeslee's interpretation, asked how it was possible to have supreme authority when Article 13 specifically indicated there would 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.

[Source: Dipl. Br., National Archives]

1-38 COMPARISON OF THE POTS DAM DECLARATION WITH STATE DEPARTMENT POLICY

Report
Drafted by: Office of Far Eastern Affairs
July 30, 1945

1. **Unconditional Surrender**
   - "Unconditional Surrender of all Japanese armed forces".

2. **Terms**
   - Japan is given an opportunity to end this war on the basis of stated terms.

3. **Legal Powers of Allies in Japan**
   - Designated points in Japan to be occupied. Authority outside of these points is left uncertain.

4. **The Japanese Government**
   - The status of the Japanese Government is left uncertain.
   - It appears to be to continue and to exercise certain functions.

5. **The Emperor**
   - No mention. Since his removal is not stipulated, it may be assumed that he may remain.

6. **Objectives**
   - Irresponsible militarism and Japan's war-making power to be destroyed.

7. **Enforcement of Objectives**
   - Proclamation
   - Department Policy
   - 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.

8. **Economic Provisions**
   - Japan to maintain industries necessary to sustain her economy and pay reparations. Industries to be demilitarized.

9. **Loss of Territories**
   - Cairo Declaration. Japanese sovereignty to be limited to four main islands and "such minor islands as we determine".

10. **Withdrawal of Occupation Forces**
    - As soon as stated objectives of Allies have been accomplished and a peacefully inclined and responsible government is established.

[Source: Dipl. Br., National Archives]

1-39 BRITISH GOVERNMENT'S POLICY TOWARD POST-SURRENDER JAPAN

Report
Drafted by: S. Bennett, R.J. Campbell, Far Eastern Department, British Foreign Office
Secret
August 7, 1945

**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 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 was 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) what 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) what is the role, if any, for the Allies to press for the gradual progressive suppression of the remnant, the dissolution of political societies, the reform of education and so on?

9. It is submitted that as soon as the Far Eastern Committee is reconstituted, we ought to turn our attention to this work. It will be for the Foreign Office to advise us as to the necessary papers to be transmitted 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 Foreign 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.

1a. This Plan is formulated pursuant to directives of the Joint Chiefs of Staff contained in radiograms OK-17064/14 June 1945, and to verbal direction of the Commander-in-Chief, United States Army Forces, Pacific, 22 June 1945. It covers operations of United States Army and attached forces under CINCINPAC 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 those prescribed terms of surrender requiring immediate military action.

2. ASSUMPTIONS.

2a. 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:

<table>
<thead>
<tr>
<th>JAPAN Proper</th>
<th>KOREA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arm Ground Combat and Service</td>
<td>1,060,000</td>
</tr>
<tr>
<td>Air Combat and Service (Army &amp; Navy)</td>
<td>425,000</td>
</tr>
<tr>
<td>Naval Crews and Personnel</td>
<td>242,000</td>
</tr>
<tr>
<td>Shore Establishments</td>
<td>1,727,000</td>
</tr>
<tr>
<td>Total</td>
<td>3,245,000</td>
</tr>
</tbody>
</table>

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.

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.

3. OPERATIONS.

3a. Concept.

This Plan covers the “Occupation Period” only. During this period, control of JAPAN Proper and KOREA is established by progressive occupation of forces available to CINCINPAC and CINCPAC 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.

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 Internes without delay.

Planning purposes, it is visualized that dispatch of APEAC 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, availability of sea and air transport and are provided with adequate 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 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.

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-Omimato.

PHASE II—JAPAN: Shimono-seki-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 S 1944).

Additional points in PHASES II and III are occupied within areas as outlined above which are determined necessary by Army Commanders in accomplishment of their missions.

Direct operations permit control of the political, economic, and military life of the two countries. The forces designated in JAPAN include 60 percent of the population, 80 percent of industrial capacity and 48 percent of food production. Those in KOREA include 59 percent of the population, 16 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 of Japanese attitude are directed by CINCPAC as dictated by the situation existing 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.

2. Common Tasks.

The following tasks are common to the several operations planned in this plan and apply within areas prescribed by the Army Commanders concerned:

   a. Destroy hostile elements which oppose by military action the imposition of surrender terms upon the Japanese.

   b. Demobilize 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 coastal 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 Internes 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 coastal communications as arranged.

   [Source: MacArthur Memorial]

1. DISCUSSION AT SWNCC ON U.S. POLICY TOWARD JAPAN

Minutes, 20th Meeting

SwNCC

August 11, 1945

Top Secret

1. COMMUNICATIONS TO UNITED KINGDOM, USSR AND CHINA CONCERNING SUPREME COMMANDER

Mr. McCloy circulated draft communications to the United Kingdom, Soviet and Chinese Governments with respect to the designation of General MacArthur as Supreme Command 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 public 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, in 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 drafts 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 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.

**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 Secretaries of 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 copied and sent after transmission.

THE COMMITTEE approved this draft communication to the Japanese Government.

4. UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN

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]

4-2 DISCUSSION AT SWNCC ON U.S. POLICIES TOWARD JAPAN

Minutes, 21st Meeting
SWNCC
Top Secret
August 12, 1945

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 of the Secretaries 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 communicated by the United States, China, 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 allegedly helping his job 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.

As a result, 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 the signatures 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, Ryukyu, 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 SUPRÊME COMMANDER OF THE ALLIED FORCES

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 and to what was indicated in November wherein it was proposed that the Supreme Commander would 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 SWNCC Subcommittee for the Far East presented SWNCC 150/1, a draft prepared by it pursuant to the instructions of the Committee at its 20th meeting (Minutes, 20th SWNCC 150). The Committee approved the draft in 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 at 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, including Dutch, New Zealand and Australian 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)
I. Americal 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 play a part 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 will be subject to the concurrence of the Dominion Governments, be of the order of 4 divisions (U.K., Canadian, Australian and New Zealand) but is unlikely to be larger and may be smaller. In this paper it is assumed that the force of 4 divisions will not be larger than the force. 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 represent the dominions 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 of size indicates that there will be great disadvantage in basing the British share in political and economic control on the size of the Commonwealth forces employed in occupation duties. On the contrary, the British share in control, if it is to be effective, must be dissociated from its token contribution to the forces of occupation and should be exerted at the highest level and to a large degree independently of the Commissioner of the British Commonwealth contingent.

This discrimination disposes of the question of the creation of a British "Zone" on the lines of the American "Zone", and the question of giving a British member of the Allied Control Council the responsibility of the American Commander, as contemplated by the London Agreement, is not in fact a question of creating an "American" Zone. 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 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 the metropolitan Japan (Hokaido, 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-Ally 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 not 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 was suggested that it would enable the Four Powers to exert four-power control over Japan if an Allied Control Council of Four is established.

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.

The Supreme Commander should be the head of the Allied Control Council in character and membership. It might in fact be embarrassing to the Supreme Commander if he 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 directly to his own government. The execution of policy would be the responsibility of the Supreme Allied Commander who would exercise his control where practicable through the Supreme Commander. The control of the members of the control council would be assisted by a personal staff of such technical advisers as he might require.
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 Kunsato, the Kuriles and the Ryukyu. Quelpart Island is included 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 phases. These periods are:

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, desmilitarization and demobilization renders Japan incapable of military aggression.

c. PHASE III. The completion of disarmament, desmilitarization, and demobilization 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 conditioned 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, while the initial occupitional forces for Japan will be predominantly U.S. The Supreme Commander for the Allied Powers (SCAP) will be an American and the occupation force will be predominantly American. However initial occupation by forces of a particular nation would not prejudice the ultimate introduction 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 naval units.

6. The control machinery during Phase I for Japan will be military in character, with the supreme authority resting with SCAP. It will also 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. The forces for initial occupation of Japan are estimated to be 23 divisions with necessary service troops, 22 AAF groups and 43 Navy and Marine air squadrons, totalling 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 rapid concentration in the necessary ports and a speedy 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 50,000 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)

8. During Phase II the disarmament, desmilitarization, and demobilization 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 3,250,000 quasi-military forces in Japan must be disarmed and demobilized and 2,750,000 additional returned to the main islands.

Control machinery. In Phase II the supreme authority in Japan should continue to be SCAP. 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 SCAP. Allied policies will be recommended by a Far East Advisory Commission, approved
by the Allies and executed by SCAP. 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:

<table>
<thead>
<tr>
<th>Divisions</th>
<th>Air Group*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>8-1/3</td>
<td>315,000**</td>
</tr>
<tr>
<td>U.K.</td>
<td>5</td>
<td>165,000</td>
</tr>
<tr>
<td>China</td>
<td>4</td>
<td>130,000</td>
</tr>
<tr>
<td>U.S.S.R.</td>
<td>6</td>
<td>210,000</td>
</tr>
<tr>
<td>**Totals</td>
<td>23-1/3</td>
<td>802,000</td>
</tr>
</tbody>
</table>

*For purposes of arriving at a distribution of forces AAF groups are considered as the basic 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.

**Store-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:

<table>
<thead>
<tr>
<th>Area</th>
<th>Civilian District</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.S.R.</td>
<td>Hokkaido</td>
</tr>
<tr>
<td></td>
<td>Tottori</td>
</tr>
<tr>
<td>U.S.</td>
<td>Tokyo Region*</td>
</tr>
<tr>
<td></td>
<td>Kanagawa-Shizueto</td>
</tr>
<tr>
<td></td>
<td>Tokai-Hokuriku</td>
</tr>
<tr>
<td>China</td>
<td>Osaka Region**</td>
</tr>
<tr>
<td></td>
<td>Kinki**</td>
</tr>
<tr>
<td></td>
<td>Shikoku</td>
</tr>
<tr>
<td>U.K.</td>
<td>Western Honshu</td>
</tr>
<tr>
<td></td>
<td>Chugoku</td>
</tr>
<tr>
<td></td>
<td>Kyoju</td>
</tr>
</tbody>
</table>

*One division each of British, Chinese and Soviet forces should be present 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]

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**I-46 UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN: SWCCN 150 Series**

Memorandum
From: SWCCN Secretariat
To: Secretary, Joint Chiefs of Staff

Reference: SWCCN 150/3

1. Attached is a copy of SWCCN 150/3 on the above subject.

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 Secretary, State-War-Navy Coordinating Committee.

[Source: Dipl. Br., National Archives]

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**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.

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**I-46 UNITED STATES INITIAL POST-DEFEAT POLICY RELATING TO JAPAN: SWCCN 150/3**

Report
SWCCN-150/3
Top Secret

**Preliminary Statement**

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) The Japanese 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 or any other party 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 peace-time 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 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 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 proven 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 character to be permitted and favored, even as far as is consistent with the needs of social order, so long as the unrest is not directed at the occupation authorities and does not imperil their objectives.

3. Policy 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 honor to the people and the part played by the military people 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 group, public or private. Air and naval forces shall be dissolved and distributed and the Japanese Imperial General Headquarters, the General Staff and all secret police organizations shall be dissolved. Military and naval matériel, military and naval vessels and military aircraft, navy and civil 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 power or public or substantial private responsibility. Ultra-nationalist 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. Religious, 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 sovereignty of such other nation.

3. Encouragement of Individual Liberties and Democratic Processes.

Freedom of religious worship shall be proclaimed promptly on occupation. The people shall be free to public assembly and speech, and 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, or the 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 practically to conform to the policies set forth in Articles I and 3 of this Part III and thereafter shall be progressively improved, 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 removal of all military, naval and paramilitary 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 aircraft and atomic weapons; the institution of a system of inspection and control over selected elements in Japanese economic activity 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, 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.

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.

3. Reunion 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 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 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 loot property. No steps shall be taken, in order to effect deliveries for reparations, which are in contravention 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.


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.


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.


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]

I-47 DISCUSSION ON U.S. INITIAL POST-SURRENDER POLICY TOWARD JAPAN

Minutes, 56th Meeting
August 24, 1945
SFE
Top Secret

1. SFE 109/4 (SWNCC 70/6 and 657). 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 to 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 presented 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 control 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. 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 went 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. SWNNC 176/12D: 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. Blakely, Mr. Perry, Mr. McCune
WAR—Lt. Col. Gray, Lt. Col. Davis

4. SFE 113/4 (SWNC 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.


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 should 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, U.S. forces would have to be made available.

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’S suggestion, the Subcommittee agreed to defer action on the paper for a week.

6. SWNC 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 SWNC 150/3, and to make this revision as a Subcommittee report to SWNNC 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 the draftsmanship.

GENERAL ROBERTS mentioned that he also had an objection to the reference to “civil unrest” on page 28 of SWNC 150/3: “Changes in the form of government initiated by the Japanese people or Government, by means of notifying its futile and unauthorized attempts to be made to restore order and favor, 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.”

This was a frame of reference 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 SWNC 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 SWNNC framework.

[Source: Dep. 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.

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 and we know nothing of it here.

4. I would attach a report showing the interdepartmental Committees which are now functioning. Most of the planning for Japan is being done by SWNNC and the JGAC 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: SWNC 150/3

Memorandum: August 27, 1945
To: Secretary, Joint Chiefs of Staff
From: SWNNC Secretary

Top Secret

Reference: SWNC 150/3

1. Reference is made to SWNNC Memo on the above subject dated 22 August 1945 which transmitted a copy of reference 2.

2. Included is a revision of the enclosure to reference 1 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.

[Sources: Dep. Br., National Archives]

86 Not Printed.
87 Not Printed.
Directive
Drafted by: R.K. Sutherland, Jr., 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 38th 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 unnecessary restraint.

b. However, the Supreme Commander for the Allied Powers will issue appropriate orders to the Army and Corps commanders indicating in 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 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.

c. 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.

d. 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 and to obey all laws, proclamations, orders and regulations issued by the 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.

e. 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.

8 Chief of Staff, U.S. Army Forces Pacific.
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 reminded 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 demonstrate 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 in his 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 speech. 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 c., 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 regulations of the type to be abrogated under paragraph 4 f. above or under no specific charge whatever.”

The SUBCOMMITTEE deferred consideration of the paper in view of the fact that it had been distributed for the first time at the meeting.

LT. COL. FAHEY reported that the paper was still under consideration by the Joint Strategic Survey Committee.

t. TEMPORARY 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 such special meetings would be called when the occasion demanded.

SOURCE: Dept. Br., National Archives

I-52 MEMO ON INITIAL POST-SURRENDER POLICY FOR JAPAN

Memorandum

To: SWNNC

From: Secretary Joint Chiefs of Staff

The Joint Chiefs of Staff have considered a revision of SWNNC 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 Demobilization," to read: "Former military and naval-personnel career military and naval officers, both commissioned and non-commissioned, and all other members of the military and naval services, 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 are to be held 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 be permitted to interpret this as encouraging lawless acts or mob violence."

SOURCE: Mod. Mil. Br., National Archives

I-53 SWNNC MINUTES, 22ND MEETING

Minutes, 22nd Meeting

SWNNC

Top Secret

August 31, 1945

2. DESTRUCTION OF JAPANESE EQUIPMENT (SWNNC 58 Series)

MR. MCCLOY stated that the problem of Chinese arms rearmament 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 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 SWNNC 58/3. 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 areas over which U.S. forces exercise 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 SWNNC 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 SWNNC 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

(SWNNC 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 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 3; (2) addition of a sentence after the first sentence of Part III, Section 5; 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 SWNNC 150/3 which was deemed a preferable statement of policy. He also suggested that in the fourth line of the second paragraph of Part III, Section 3, the word "United Nations" be changed to "democracies" on the ground that the sentence as written was both indefinable and not in accord with U.S. objectives.

THE COMMITTEE:

a. Approved SWNNC 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.

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

(SWNNC 70/6—Agenda Item No. 3)

THE SECRETARY explained that this paper was placed on the agenda, although not previously reviewed, in order to be considered by the Joint Chiefs of Staff, in order to determine whether there was general Committee support for the approach in 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 upon within the U.S. government 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 would be unsatisfactory because it would give 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 the role of military control and not in accord with U.S. objectives. 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 relatives in Europe would be helped, for example, if we don't adopt an exclusive attitude with respect to Japan. Furthermore, the paper is more 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 in advance.

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 Allied Control and General MacArthur 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. Balfour of the British Embassy at the time
it was presented (subsequently circulated for information as SWNCC 70/B). 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.

SOURCE: DIPLO., BR., NATIONAL ARCHIVES

1-54 BACKGROUND OF SWNCC/SFE ORIGINS

Report January 21, 1948

SWNCC

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 1.)

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 this 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 Secretariats 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 21/10)
Basic Directive for Post-Surrender Military Government in Japan Proper (SWNCC 52/7)
United States Initial Post-Defeat Policy Relating to Japan (SWNCC 150/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 SANCC, 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. Falvey, Army
Colonel Raymond M. Cheseldine, Army
Captain H. R. Hammer, USN, Navy
Lt. Colonel A. F. Metzger, 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:

<table>
<thead>
<tr>
<th>Name</th>
<th>Service</th>
<th>Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. John C. Vincent</td>
<td>State</td>
<td>6 Sep 45—31 Jul 47</td>
</tr>
<tr>
<td>Dr. Hugh Barton</td>
<td>State</td>
<td>19 Feb 45—31 Jun 47</td>
</tr>
<tr>
<td>Mr. H. Merrell Benninghoff</td>
<td>State</td>
<td>2 Jul 45—4 Aug 45</td>
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<tr>
<td>Dr. George H. Blakely</td>
<td>State</td>
<td>19 Feb 45—25 Jun 46</td>
</tr>
<tr>
<td>Mr. Edwin O. Reischauer</td>
<td>State</td>
<td>26 Jun 46—9 Sep 46</td>
</tr>
<tr>
<td>Maj. Gen. George V. Strong</td>
<td>Army</td>
<td>30 Jan 45—3 Jul 45</td>
</tr>
<tr>
<td>Brig. Gen. Frank N. Roberts</td>
<td>Army</td>
<td>4 Jul 45—30 Sep 45</td>
</tr>
<tr>
<td>Col. Charles H. Bonesteel III</td>
<td>Army</td>
<td>1 Oct 45—14 Aug 47</td>
</tr>
<tr>
<td>Col. C. Stanton Babcock</td>
<td>Army</td>
<td>30 Jan 45—30 Sep 45</td>
</tr>
<tr>
<td>Col. James A. McCormack</td>
<td>Army</td>
<td>1 Oct 45—1 Feb 47</td>
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<tr>
<td>Maj. Gen. John H. Hilldring</td>
<td>Army</td>
<td>30 Jan 45—3 Sep 45</td>
</tr>
<tr>
<td>Brig. Gen. G. F. Schulgen</td>
<td>Army</td>
<td>4 Sep 45—16 Feb 47</td>
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<tr>
<td>Mr. Kenneth D. Johnson</td>
<td>Army</td>
<td>17 Feb 45—15 Aug 47</td>
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<tr>
<td>Brig. Gen. Wm. L. Ritchie</td>
<td>Air Force</td>
<td>15 Dec 45—17 Feb 46</td>
</tr>
<tr>
<td>Col. Royden E. Beebe, Jr.</td>
<td>Air Force</td>
<td>18 Feb 46—31 Apr 46</td>
</tr>
<tr>
<td>Col. John A. Hilger</td>
<td>Air Force</td>
<td>1 May 46—19 Feb 46</td>
</tr>
<tr>
<td>Col. C. B. Westover</td>
<td>Army</td>
<td>8 Aug 47—30 Dec 47</td>
</tr>
<tr>
<td>Capt. Lorenzo S. Sabin</td>
<td>Navy</td>
<td>1 Jun 45—6 Jan 46</td>
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<tr>
<td>Capt. R. L. Dennison</td>
<td>Navy</td>
<td>28 Aug 45—6 Mar 46</td>
</tr>
<tr>
<td>Comdr. Stephen Jurika</td>
<td>Navy</td>
<td>7 Mar 46—22 May 47</td>
</tr>
<tr>
<td>Lt. Col. Wm. R. Forbes</td>
<td>Air Force</td>
<td>20 Feb 46—15 Jan 46</td>
</tr>
<tr>
<td>Lt. M.E. McDonald (Secretary)</td>
<td>Army</td>
<td>30 Jan 45—30 Jun 45</td>
</tr>
<tr>
<td>Lt. Hugh D. Farley (Secretary)</td>
<td>Navy</td>
<td>1 Jul 45—29 Nov 45</td>
</tr>
<tr>
<td>Comdr. A. F. Richardson (Secretary)</td>
<td>Navy</td>
<td>30 Nov 45—30 Jun 46</td>
</tr>
</tbody>
</table>

[Source: Dipl. Br., National Archives]
2 PRE-OCCUPATION-ECONOMIC

2-1 JAPANESE POST-WAR ECONOMIC CONSIDERATIONS

E-155 (T-354)
Report of the Committee on Post-war Problems, State Dept.
Secret

July 21, 1943

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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 interfere 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 the machinery 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 peace-time industry and trade and the regaining by Japan of a tolerable living standard, at least equal to that prevailing before the war, is a long-term goal, if not a distant one. This view is consistent with the defense of the “Japanese menace” and turning that country to a course of peaceful and orderly development.

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 book, the American policy as it is in fact formulated, 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.

1. 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 is not sustainable by a foreign policy which has as its per contra, the goals of full employment and increased yields, has been able to absorb only an additional 6 million. The total of 20 million in agriculture, authorities agree, represents for all intents and purposes the absolute maximum which the law 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 is, however, 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 family self-sufficiency in many essential articles, would place definite limits upon the place that 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, some proposed, by surrender of her merchant marine, as minimum essential measures for the furtherance of a resolution of Japanese aggression against a resumption of Japanese aggression against China.

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 eliminated, their place in these totals, the proportions of the total production would be 28 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 with the economy imposed by the necessity for importing the country’s entire future requirements of steel and iron.

(b.) Loss of any possibility of participating in the provision of capital goods to an industrializing China, India, or Dutch East Indies.

(c.) Loss of access to a market for a large industrial base of heavy industries and the products thereof.

(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 naval 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. Four-fifths of Japan’s foreign trade has been carried on her own vessels, and practically all of the heavy goods which she has been shipping abroad by land from China are carried by her own merchant marine. Further, the foreign foreign exchange for her marine transaction has included a substantial proportion of the national 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. Japanese Aircraft Manufacturing and Shipbuilding Industry

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.

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 constructional effort of approximately 200,000 tons. At 250 yen per ton for labor, employing 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 assume that, 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 if not 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, which has a little over 50 million people, 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 people, or only five and a half million per cent, of the total, live in the cities and towns. 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 consumption. Thus, in Tokyo, 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, and its rate in 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 has slowed only slightly by the time of the outbreak of the China War. All indications then point to a minimum of approximately 800,000 a year from 12 to 15 million by 1960, the population 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 the service, losses among the armed forces, however, 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.1

The removal of existing obstacles to Japanese nativity 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 abate in the near future. Moreover, the world at the time 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 decades. 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, coal, sugar, rice, soybeans and many Japanese people are to be able to feed, cloth, 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, and these will have to be obtained from the other countries, which 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 meet the 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 is not insinuated in the possibility in 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 and favoring the industrial populations of other nations as numerous as the United States, Canada, and Australia, have already been instituted to the detriment of Japanese exports.

Following the war, the French governments of the Saar and Sicily had set up import quotas against Japanese cotton textiles, 13 against Japan's silk textile exports, 18 against her rayon textiles, 17 against her pottery and porcelain exports—and so on. Of these restrictions, only the last-named policy restriction of the type in numbers and of a severity in any way comparable to the pre-war period would likely be ready to accept. Even the most developed efforts of 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 twenty 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, not regarded by most authorities as virtually certain to take place, would be very keenly felt.

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1 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.

<table>
<thead>
<tr>
<th>Country</th>
<th>Killed</th>
<th>Wounded/Disabled</th>
<th>Lost to active forces through disease</th>
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<tbody>
<tr>
<td>China</td>
<td>240,000</td>
<td>55,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Elsewhere</td>
<td>50,000</td>
<td>20,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Total</td>
<td>295,000</td>
<td>75,000</td>
<td>90,000</td>
</tr>
</tbody>
</table>

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 large quantities of textiles, cheap metal wares, and other light, primary manufactures—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 be off quite sharply during the first and second post-war decades. Even without 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 good faith 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, and, under the development of China, India, and the Netherlands Indies, one or two is 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 Asian nations for European and American over Japanese railroad equipment, and in all but the simplest types of capital goods, the rules of the international market 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 large numbers in the Far East, and the introduction of this effective and cheap textile machinery by the 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 Asian markets in important amounts.

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 the other leading industrial nations of the world are unable to supply. It is Japan's 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 possession of the islands in the area will be of 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 changes in the population. 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 production of armament industries in Japan, “Manchuko”, 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 factor in the case is the market question, but how severe that constraint will be 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 Japan 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—We will now turn to the problem of the development of an economic base for a sound 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 World War II. Now that Japan's problems have been, for the present, reduced to a point where the question at stake is not the mildest form of war, the agrarian problem is back 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 remissible 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 most of 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 farm improvement which provides a chance for the introduction of more efficient methods of farming. A second factor tending toward the same result is the prevalence of tenancy. 85 percent of the farming land is rented combined with the fact that with yield ceilings, 32 percent of the farmers are now tenants, as compared with 8 percent a generation ago, the trend is to introduce expensive mechanical farming methods. Rent paid in kind 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.

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. This is one of the few things that must be done in order to put agriculture on a paying basis. Through such measures the millions 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.

Further, the war program has inflicted 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 paid by the person or individual of the industrialist or the manufacturer.

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 offer by way of security, were forced to rely. It is
possible that inflation, already appreciable, will do much to lighten the burden of the farming debt, but the need for improved credit facilities will remain.

Finally, support and encouragement for the cooperative farm buying and selling organizations (Négye Kamiai) would do much to eliminate a host of middlemen, speculators, and petty traders subsisting at the expense of the better organized and smaller farmers. Progress in this direction would also of village industries would help to provide supplementary employment to the farming population in at least partial replacement of the dwindling silk industry.

It is generally conceded 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 peace-time industry and trade, making possible the movement of a large proportion of the present farming 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 houses, by which these giant families are not meant), 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. Even 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 the Zaibatsu control have at first been in a weak competitive position; they have been unable to compete with these enterprises, and even with it they have been unable to provide 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.*

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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 production per capita, and a more rational 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

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 Japanese territory, Formosa, Korea, Karafuto, the South Seas Mandated Islands, "Manchuko" and Occupied China.* In recent years Japan has carried on a very large volume of trade with these territories. In 1938, she obtained 33 percent of her imports from them, and sent 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.

B. Reparation Demands

Expropriation of Japanese Property Abroad.—Japanese overseas property interests in early 1934 were estimated to have totalled the relatively large figure of 15 billion yen (approximately 2.8 billion dollars) distributed as follows:

<table>
<thead>
<tr>
<th>Area</th>
<th>Million yen</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Manchuko&quot;</td>
<td>7,000</td>
</tr>
<tr>
<td>Korea</td>
<td>1,500</td>
</tr>
<tr>
<td>North China</td>
<td>1,000</td>
</tr>
<tr>
<td>Formosa</td>
<td>900</td>
</tr>
<tr>
<td>Karafuto</td>
<td>500</td>
</tr>
<tr>
<td>South Seas Mandated Islands</td>
<td>75</td>
</tr>
<tr>
<td>Elsewhere</td>
<td>11,875</td>
</tr>
</tbody>
</table>

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 as much as a fourth of Japan's total processing (manufacturing) capacity was to be found in "Manchuko", 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 "Manchuko" and Occupied China as independent, sovereign nations, they are for all practical purpose part of the Empire.

* Recent years have witnessed the growth of a number of so-called "younger" business groups, rising in importance along with the expansion of the war industries and intensive development of the dependent territories. The most important of these newer concerns are Nagaoka (Manchuria Industrial Development Co. Ltd), Nihon, Churashima, and the Manchukuo Industrial Development Co. In 1939, the first named ranking in size, by assets, in the leading industries of Japan, and was estimated to have had at least 1.4 billion yen of gross assets, while the Nihon and Churashima together had over 2 billion yen of gross assets. However, most 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 subordinate to them. This fact notwithstanding they serve to increase considerably the degree of concentration of economic power within the country.

*While Japan still preserves the fiction of "Manchuko" 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 values 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 dividends, on their present valuation, after the cessation of the war demand and the consequent lack 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 this profit 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 at the present time, 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. The loss of private property, reparation 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 industrial economy, now largely dependent upon a large export trade. 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 Reparations:—Beside the measures described above, 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: DIPLOMATIC ARCHIVES, NATIONAL ARCHIVES.

2-2 POST-WAR ECONOMIC AND POLITICAL PROBLEMS OF JAPAN

Division of Political Studies, Department of State
Secret

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Mr. Isaiah Bowman
Mr. George H. Blakeslee
Mr. Hugh Bourbon
Mr. Robert A. Feary
Mr. M. M. Knight
Mr. Amy S. Ross
Mr. Frank S. Williams
Mr. Philip E. Mosely
Mr. C. E. Black

SUMMARY OF THE PREVIOUS DISCUSSIONS

At the request of the Chairman, Mr. Morton read the resume 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. Morton 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 Luchchi 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.

* * *

POST-WAR ECONOMIC PROBLEMS OF JAPAN

Alternative Methods of Dealing With Japan

At the invitation of the Chairman, Mr. Feary 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 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 1638 to 1854. The second school of thought believed that it was necessary only to put Japan in a condition of 'peaceful parity' and that her heavy industries, such as those of the chemical industry, could be kept in operation. The third school of thought believed in the necessity of affording Japan the opportunity to revive her economic life. The country would be disarmed but its essential industries would be left intact. Mr. Feary summed the belief that only limited restrictions of Japanese industry would be necessary in order to assure security in the Far East.

Mr. Feary 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, the 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, he pointed out that she would achieve at least a tolerable and her merchant marine within adequate security restrictions, a number of problems would arise for which solutions would have to be found. Of these 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. Feary 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

*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. Feary believed that the Japanese could gain a sufficient degree of flexibility in its export trade to adjust to changing demands in these markets. He did not think such a trade would necessarily be maintained and even increased above former levels. The third factor, and the one which Mr. Feary believed to be the most serious, was the competition 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 competition in the countries in the Far East, but 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 men reacted in justifiable discrimination against that country in the past, Mr. Feary expressed the view that while Japan had undoubtedly used dishonest methods in the past, he believed that they had been largely cleared away and exaggerated in the public discussions of the past.

Apart from the need for developing her foreign trade, Mr. Feary pointed out that certain essential reforms in agriculture and industry would have to be carried out before Japan could attain a stable economy in the war. In the case of agriculture, the essential problem was the concentration of economic life in the agricultural districts and here the number of millions of farmers into industry seemed to be the only possible 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. Feary's view that Japan would 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. Feary did not believe that the effects of the war would be serious so long as that country had equal or substantially equal economic opportunity in the rest of the world.

In conclusion Mr. Feary expressed his personal opinion that a moderate, point of view would be 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 solution, lasting peace in the Pacific could be realized only if Japan were economically healthy. If they were poverty-stricken they would represent a malignant cancer in the body of the economic life of the Far East. Mr. Feary's third reason for supporting the moderate point of 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 country might very well be less important after the war, it would nevertheless be a factor which could not be ignored. Furthermore, if groups of trading houses had been the only method by which goods were sold in Japan, it might have been possible for us to sell goods cheaply 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.

Mr. Feary expressed the opinion on the closing of his report, and remarked that rarely has a better statement been presented to the committee by a member of the research staff.

With regard to the last statement in Mr. Feary'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 that in part of the world in the years immediately preceding the war, the degree of any permanent factors. It was his impression that since Japan had played a relatively small 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 a more profitable 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 both economically and strategically, she would not have the same success in capturing the Far Eastern market. Mr. Feary 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.

With the period of Japan's greatest industrial expansion had come ten years or more after the war than in the immediate post-war period and that he was therefore inclined to agree with Mr. Feary'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 rate of expansion in Japan's industrial expansion had not come until 10 years later. Mr. Williams came on the theory of Mr. Borton and, after a discussion, they decided 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 the nature of Japanese industry, however, at present, there was a large number of Japanese goods exporters 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. Feary expressed his opinion, however, that 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. Feary 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. Pavolsky 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 offered, and asked him how this compared with that of Japan. The great market which we had served as a spur to our energy and the youth of the nation had encouraged many to enter into industry and to exercise their ingenuity in devising new methods of production. Mr. Ballantine added that the result was 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 spirit of building qualities which our 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 points.

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 restoration of the United States in part. In particular, he asked whether American influence in Japan 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 established? Finally, Mr. Borton asked the committee to consider whether there was any hope that the military oligarchy could be checked and its privileges extinguished.

With regard to the first point, 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 in which the civilian administrators had had control over the military and naval authorities. Under that system a few persons had high military and naval rank could control the Cabinet. If they were displeased with the policies they were going to order them, and not the high officials, to sign and fore 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 Emperor, 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 Emperors. Mr. Armstrong asked whether there were any measures 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
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 pursued 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. Attitude toward the Japanese Government:
   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 of all Japanese military or 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 peaceful civil use.

2. Control of Rearmament:
   (a) The establishment of control of Japanese military and naval industries and manufacturing.
   (b) The establishment of control of Japanese industrial enterprises.
   (c) The establishment of control of Japanese trade agreements.

3. Economic Policies:
   (a) The establishment of a policy of economic control over Japanese economic activities.
   (b) The establishment of a policy of economic control over Japanese trade agreements.

4. Financial Policies:
   (a) The establishment of a policy of economic control over Japanese financial activities.
   (b) The establishment of a policy of economic control over Japanese trade agreements.

5. Environmental Policies:
   (a) The establishment of a policy of economic control over Japanese environmental activities.
   (b) The establishment of a policy of economic control over Japanese trade agreements.

...
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 desparation of the Japanese people condemned by such a demand.

3. Economic Disarmament;

By this term is meant the stripping of Japan of the means of establishing autarchic independence. There are three methods which may be taken, although determination as to the details or degree of application will not be easy.

(a) The stripping of Japan of its overseas, non-Japanese possessions. With the exception of the islands acquired solely to serve as military bases, Japan's overseas territories have been acquired so that they would be assured of all needed war materials under the Japanese flag and that Japanese capital could be exploited for her sole benefit.

(b) The forfeiture of all Japanese property in the overseas possessions taken from Japan; and at a property valuation more than 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 by official sanction and subsidies.

In overseas territories taken from Japan it would seem imperative to take all Japanese property—public as well as private (except of course bona fide personal possessions and possibly certain other classifications 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 sufficiency, and will prevent the proper adjustment of the territories in their new relationships.

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.: "Manchurian") 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 during occupation or invasion of the territory; but the invasion or occupation itself 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.

It is believed that all stolen property and reparations, identical with the property acquired in the territories from which the Japanese property shall have been taken, 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 principles that Japan should not be permitted to effect an economic recovery at a speed in excess of the victims of its aggression. The amount of such reparations should depend in large part on the amount of devastation which the Japanese aggression has caused in the areas from which the Japanese property has been taken.

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. The economic future of the United States will be established a permanent post-war market on which to stages rapid recovery. Payment of cash reparations, if it would be observed, would depend on Japan's ability to acquire foreign exchange through foreign trade.

4. Control of Economic Disarmament;

It will be seen 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 ensure to Japan a place in its economic system, bring such cooperation to 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 any control or ownership 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;

Dependence at their height or even extreme discontent among the Japanese may well be a substantial factor of insecurity. The suggestion heretofore made was, it is thought, to minimize the opportunity for aggression by the Japanese—but coupled with these should be a policy of seeking to prevent the possibility of Japan's 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.

[Sources: Dipl. Br., National Archives]

24 SECURITY POLICY VISA-VISA JAPAN: ECONOMIC ASPECTS

CAC-194 Preliminary

IDAC-FF Report

Secret

May it 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 peace time use, military and naval installations, and industrial equipment specifically associated with arms production (e.g. special dies and tools). Also, it seems assured that any institution or organization, whether public or private and in any connection, 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 line of action 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 directly and in its entirety in all cases prevent Japanese aggression? Is it necessary to that purpose? A particular restriction may be highly effective in preventing 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 the balance shows years of peace 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 the development of 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 denied the security if her destruction is the result of economic and political distrust, and 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, is not made up multilaterally, imports from other areas did not make up supply, $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 war was on the whole unfavorable. 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 control. 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 island.

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 future security and prosperity depend. Her empire is composed of populations which are 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 policies concerning conditions and protection of the development of Manchuria. 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 nothing from the growing trade there and are mere sugar planters 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. More important, however, is the loss of the dependency's local currency, China, Korea and Formosa for certain vitally necessary products, particularly beans, coal and rice. Up to now her dominance of these areas and the fact that she could make all needed purchases, give the impression that the future exports to the new 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 an asset than a liability in an asset whose value would not 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

out 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 reached in the thirties was accompanied by 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, is not made up multilaterally, imports from other areas did not make up supply, $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 war was on the whole unfavorable. 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.

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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, 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 existing industries will be relatively easy and 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.

[SOURCE: DIPL. BR., NATIONAL ARCHIVES]

2-5 JAPAN: ECONOMIC POLICIES DURING MILITARY OCCUPATION

CAC-224a  
PWC-296  
IDAC-FE Report  
Secret

CAG-J 4, 1944

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.

Steps should be taken to ensure the uninterrupted movement of farm products and other consumers goods to consumers.

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 issued and central bank operations should be controlled and, if necessary, notes of large denomination withdrawn from circulation.

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 facilitate financial 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 do their part 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 imposed domestically and distributed commercially; (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 overvaluation could lead to increase occupation costs is relatively insignificant in 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 of food, 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 medical supplies and other necessary medical 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 in 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 import relief commodities will be. If Japan is cut off from continental sources of supply for a considerable period before surrender, or 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. The annual surrender and final surrender is occasioned by the loss of strategic zones well inside Japan proper, and the country is not blockaded and does not suffer extensive military destruction, primary relief needs will probably be small.

\(^4\) The title of this report changed in a later revision. CAG-224a (PWC-296) revised, November 22, 1944, appearing in this volume.
I. 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 corn output will be more than adequate to be prolonged by the war, due to the diversion of the diversified rice and 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 supplies do not become acute, arrangements must be made 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.

Clothing. It is known that considerable stocks of silk and cotton textiles were being held in reserve in Japan after 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, parts 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. The climate of the temperate climate areas and relapses, at least in certain parts of most of Japan, even a marked shortage of clothing would not present problems comparable to those likely to be faced in Europe.

Housing. Japanese dwellings, though easily destroyed, are also easily replaced. This fact 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.

Electricity, 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 local shortage.

Sanitation. Sanitation and health conditions in Japan are normally good. 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. In the event of serious damage to the sewage system, it is possible that the country's sanitation and health conditions may deteriorate to near the standard of Japan.

In conclusion it is apparent that much of the damage to the food supply will have to be met through imports, and that the damage to the electric power system will be serious enough to require the resumption of production of essential goods such as clothing and housing.

II. 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 connection it is to be noted that the United Nations must see to it that the Japanese are not precluded from the possibility of using their own resources to meet their own needs. This assistance should not be directed to the sinking of the industrial structure of Japan, but rather to the alleviation of hardships resulting from the war and the occupation.

The population of Japan is now about 100 million, and it is estimated that in the event of a widespread war the population would increase to about 150 million. The Japanese are a hardy people, able to withstand hardship and privation, but it is necessary to provide for their basic needs in order to prevent them from becoming a burden on the occupation forces.

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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 authorities. It is to be expected that the destruction of such installations and material will be carried out in accordance with the principles laid down in the occupation regulations. The destruction of military material will not necessarily be limited to the immediate post-war period, but may extend over a longer period if necessary.

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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 operation 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 possible 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.

VI. 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 return exerts without resources financial assistance by the Japanese Government should be required.

IX. Reparation

Reparations policies toward 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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[Source: Dipl. Br., National Archives]

2-6 JAPAN: ECONOMIC POLICY

CAC-1604
IDAC-PE 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, demilitarization, 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 they may 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 under 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 contribution for military agression”; (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.

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 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 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 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 recommended 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 postwar 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 broad enough to include properties under 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 postwar 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 provision of such additional reparation should be determined as promptly as possible and provision should be made for payment over a definite period of years.

3. Foreign Commerce
Japan has been greatly dependent upon foreign trade for its economic welfare. Loss of the properties of former overseas territories will add to Japan's 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, cur-}

rency 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

PGC-2904

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 fully employed population is engaged in manufacturing, mining and transportation. In more socially advanced countries,

*This report derived from CAC-254 of August 15, 1944. It later became the basis for SWNGC 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 was 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 encompass most industrial workers. The Japanese trade union movement in the past found such a 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 social, progressive, and political concepts, and it should therefore be an important instrument in the development of democratic thought and process methods for 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 cooperate wherever possible, a cooperatively attained alliance, with the workers. Such a policy should apply the tasks of the occupation authorities and help lay the groundwork for the later implementing of American long-range political, social and economic plans.

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 prominent 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 Diet. They have been recommended in particular by the International Labor Organization and its affiliates be dissolved during the period of military occupation (Japanese: Political Parties or Agencies, PWC-113; Japan: Abolition of Militarism and Strengthening of Democratic Process, PWC-125b). Therefore, the continued existence of the Patriotic Industrial Associations as now constituted would not be compatible with the democratic process.

Through the Patriotic Industrial Associations, labor has been integrated into the war economy and the totalitarian political pattern of Japan. In addition to promoting ultranationalism among the Japanese workers, these associations have been used 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 management, 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 the gratification of the workers by employers 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 associations are adaptable to their use, through the Reich that the government's role in 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 company 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 economic conditions that are comparable with employees in local industrial units. 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 Japan, 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 later develop the idea of organizing themselves into new organizations for their mutual aid and protection.

The traditional Japanese economic and social structure had its own ways and means for providing security for the workers. Aside from work-rules, the employers placed heavy 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 auxiliary facilities, etc. These were not necessarily uniform throughout the country or throughout each industry. As long as the Japanese employers employed half-salaried workers, 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 depression, severe social conditions, and industrial rationalization have vastly changed all 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 protection of their interests.

The Japanese trade union movement never achieved a position where it could exert strong influence in the 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 membership 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 II 1914-1918 enjoyed 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, have attempted to combat through joint action the Government's method of selecting the workers' representatives. Such federations of workers' federations as the General Federation of Japanese Labor (Nippon Rodo Sodomei), the Confederation of Labor Unions (Rodo Kumiai Domei Kai) on a national basis and other federations such as the Seamen's Union (Nippon Kaizai Kumiai) and the All-Japan Miners' Federation (Zen Nihon Koku Dorengokai) on an industry-wide basis.

The late twenties found the trade unions seriously weakened by the decline of economic activity, the abortive strike, and by government interference. The extension of manhood suffrage in 1925 encouraged the trade unions and the law that gave to the workers' organizations 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, and in the same time the government used these differences 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 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 Kai).

Although in the early thirties, the Japanese trade union movement attempted to set its house in order according to the rules and the spirit of the Imperial Diet, it criticized various domestic and foreign policies of the Government, it did not exercise enough political power to force the Government to modify such policies. With the onset of war, all ideas of unionizing 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

In the period of economic depression following hostilities, the Japanese economy was accelerated due to rapid industrialization. The labor market was forced 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

The feudal economy was 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 industry, although the large number of small production units which characterized 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 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 excercising 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 patriarchal 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 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.

4. Patronism

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, have provided a framework and 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 there has been a noticeable change. Over the previous decades, the surplus labor has meant easy replacement of workers. When the demand for labor is high, skilled and semi-skilled labor has been used to replace workers in factories and heavy industries. The reduction in the demand for labor meant reduced wages and long hours of work. These conditions reduce the bargaining power of the workers, 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, the multitude of workers, 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, Japanese labor has been taking place in the Japanese iron and steel industry. Despite heavy industrial production, 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 prevented an obstacle in the trade union movement. Parental influence supplemented by the worker control over the division of labor and wage rates, and the discipline expected of the working population of a “class tradition” and the “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 which to earn as much as 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 national trade union movement has experienced. Right-wing, center, and left-wing trade unions result 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 communist 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 union sponsored political parties to supplement their economic activities. No single labor party developed. By 1932 three principal workers' parties emerged in Japan: the Labor-Beauty Party (Rokuyu To—left-wing); Social Mass Party (Shakai Taishi To)—center; National Social Party (Kokka Shakai To)—right-wing. The Social Mass Party maintained a vociferous representation in the Diet, although it was the most influential of the three. It was because of such differences among Japanese workers contributed to the lack of trade union solidarity and further the 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. The 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 the general conditions available for the employment of the military government by the Japanese workers through utilization of procedures and techniques familiar to and acceptable to those workers.
4. Employees should be permitted to form, join or assist labor organizations.
5. Membership in government-sponsored 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 and hardships 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
FWC-296b revised
Secret

November 22, 1944

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 occupants, 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 prohibited, the laws in force in the country" (War Department, Rules of Land Warfare, FM27-10, October 1940, par. 202). 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 need for 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 control inflationary tendencies resulting from shortages of supply (whether from actual shortages, inadequate distribution or hoarding) or from an increase of currency in circulation from either of these sources.

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 continued, 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 are 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 activities, 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 exports and deficit financing.


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 excess imports of 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 provide available goods and services as efficiently as possible for the satisfaction of military and civilian needs" (War and Navy Departments, 22 December 1945, 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 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 equipment. However, decision on such importation must be left 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 controlled importation of goods rather than import equipment on material to assist on industry capable of making good in Japan.

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 consumer 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 that 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 SUPPLIES 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 can guarantee that production and distribution controls are firmly 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.

VI. 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 the manufacture of such items, the labor 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.

VI. 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.

2-10 ECONOMIC FOREIGN POLICY OF THE UNITED STATES WITH RESPECT TO JAPAN

Second Revised Draft
Prepared by: Far East 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, to which it has already begun to major commitment and in which some economic policy of the United States toward Japan has already been determined, it is necessary to set forth some broad principles which will guide the economic policies of the United States toward Japan. In the course of that responsibility, the economic policy of the United States toward Japan will be developed in detail, as occasion arises.

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, moreover, with the reduction of Japanese military power, while the eventual success of American policy towards Japan will rest upon Japanese acceptance of a peaceful world.
I. 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 avalued for aggressive purposes.

II. The great majority of Japan 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 thorough-going 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 aggressions and military occupation Japan has jeopardized 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 which will remain are limited and on which we cannot make a positive poverty of Japan's natural resources makes an autarchically impossible; Japan must import a fifth of her food requirements, and no matter what its economic organization, will have to pay for the food. At the present time, it would be unwise for Japan to devote all her resources for export because some of her requirements could 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 in varying proportions. Under these 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 domestic market.

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, electrical 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 economic system as the transformation 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, in the Japanese government with ready instruments of economic rewards and sanctions. Professor "Fifth Column" activity and espionage in those countries. Finally, this sort of an aggressively expanding export economy is bound to meet with severe competition or opposition from other countries, and the United States government will be confronted with increased tariffs and import 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 economies of the other Pacific countries. Japan, by importing food, raw materials and semi-processed goods, will provide a market for the other countries of the Far East, while her own return will be a market for American food, machinery, and capital goods. Since 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 exporters elsewhere, Japan's export industry is complementary to United States industries, and Japan is a market 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 interests, the United States government must be in a position to establish or to control 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 industrial 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 the United States control. However, the detailed measures which 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: a) armament, b) war industries, such as ships, aircraft, war plants, naval shipbuilding and ordnance, 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 to maintain present military and industrial production 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.

Many industries, such as chemicals, machinery, shipbuilding, 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 combine production limitations with import controls, so that all allowable production of ammonia would have to go to support essential industrial consumption. In other cases, such as merchant shipbuilding, the industry might possibly be converted to peace-time production by restrictions on specifications of products, e.g., the number of man-ship months of over 1,000 GRT. It is also suggested that Japan, besides the reduction of the merchant marine to be allowed Japan after the war, might have taken the raw materials and fuels for the orifice of a 20-year period and conditions favorable to a democratic government shall prevail.

The first objective would 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 constructing an overseas empire. In Manchuria and Korea, the zaibatsu have developed uneconomic and industrial activities. In close cooperation with the Japanese government, the zaibatsu have organized smaller business concerns into semi-official 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 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 supply, reducing 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 diverting them 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 who have been expelled from the zaibatsu 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. Compensation should be limited 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 sections.

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 (stock-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 workers 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 market industries such as clothing, furniture, 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 reconversion to meet mandatory reparations to meet expenditures or construction (F3 below).

2. Repair of housing and restoration of public services should be carried out in light industry centers such as Kyoto, Oita and Kurume. Only minimum relief aid should be permitted in Yamato, Takasagi, Nakusa, Tekaka, Hirokawa, Kasawa and other heavy industries.

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. However, the same time he has been subjected to price fixing and in agricultural income. 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 significant 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 taxes and the anarchy 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. The same time the United States should use its influence to support the 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 post-war occupation.

3. Apply an 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.

5. From the period of Military Government and under its direction, have the specially distribution monopoly, the Japanese Fertilizer Company, reduce artificial fertilizer prices.

6. 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 subsistence wages for the maintenance of the laborers is useless and injurious to the prosperity and development of the country. 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 on the establishment of a minimum wage system.

7. Dissolve all Fascist labor organizations, particularly the Patriotic Labor movement.

8. Grant and protect the right of labor to organize and bargain collectively for higher wages and better conditions.

9. Repeal the job-freezing and labor-service provisions of the National Mobilization Laws and ordinances enacted pursuant thereto.

10. Restore female and child labor provisions of the Factory and Mining Acts which have been suspended since 1937.

11. 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.

12. 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 that the payments required of Japan be of such a nature and in such a form that they will not, in the judgment of the United States, hinder Japan's ability to establish and maintain its economy. In that respect, reparations payments should be used as a means of bringing about the kind of an economic situation which will assist to the development of the economy of Japan.

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 of these payments could be completed 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 impairment of labor relations 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 will result in Japanese economic dependence on the United States and will lower the Japanese standard of living. Such reparations, while not prohibiting such reparations, will be entirely inadequate in amount. Reparations out of current production are desirable only to meet emergency needs of claimant countries.

The most fruitful source of reparations will be 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 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: multiple-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).

2. The cost of transportation should be borne by Japan.

3. The freedom of collective bargaining to the governments of the liberated areas all property owned in these areas by the Japanese government, the zaibatsu and those other Japanese business firms used as quasi-public instruments of economic aggression.

4. Transfer of civilian use, e.g., clothing shoes and medical equipment, to the impoverished areas for relief purposes.

5. 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.

6. 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 States over the post-war foreign commerce of the 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 determine the 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. The United States 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 standard 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.

5. The United States should not be undersold by any country with whom Japan has a trade relationship.

6. Japan should not be undersold by any country with whom Japan has a trade relationship.

7. Japan should not be undersold by any country with whom Japan has a trade relationship.

[Source: Henry F. Banks, University of Michigan]

2-11 JAPAN: ECONOMIC POLICIES DURING MILITARY OCCUPATION

Proposed Revision CAC-222a
March 16, 1945 and May 19, 1945
PWC-296b revised
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 fairness 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 civil unrest as would interfere with the operations of military government;
3. to arrange for relief to the United Nations and liberated areas, for restoration 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 these 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 encourage 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 occupation authorities 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 reparations 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 Command should 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 of armaments, regardless 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 these 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 necessary 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 specific 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 movables necessary to approved export and import transactions.

[SOURCE: DIP. BR., NATIONAL ARCHIVES]

2-12 POLITICAL-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)

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 recommendation for ultimate implementation.

3. The with respect to 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, 5, 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 prevail 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 above 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 Coordinating 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. Doorman, Special Assistant to the Assistant Secretary of State, Mr. Dunn.

[SOURCE: Dipl. Br., National Archives]

2-13 ECONOMIC POLICY TOWARD JAPAN: SUMMARY STATEMENT

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 destruct-

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1 Approved by and referred from the Coordinating Committee.
theless, the responsibilities which the United States will face in that regard when the war in the Pacific ceases 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, in advance of the conclusion 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 reflect the ultimate objective of an enduring peace. The Government should articulate economic policy with this objective and should at the same time provide a basis for the formulation of guidelines and directives and for their adaptation 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 assistance to among free nations, developed through peaceful trade processes, as contrasted with the system of ultranationalistic or imperialistic economic self-sufficiency; and
(c) restoration and rehabilitation, though these objectives are of subordinate importance for the long run.

Under these headings certain more immediate or specific objectives group 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 war materiel and 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 removal of surplus Japanese 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 thereby directed to war aims and by measures that will prevent reversion 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 relations with other nations;
(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 obligations 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 policies, military and economic, consequent in an 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.

2. The second period will be one of close control of Japanese economy. Its duration, probably five years. Interest will be in rehabilitation and 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 raw materials and production workmanship will be necessary to ensure that reparation 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 of accustomed consumption, it is not contemplated. It is not contemplated that Japan should be expected merely for the sake of obtaining larger reparation payment.

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 some general or regional international organization, or otherwise, will take control over the potential war power 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 the obligation to the organization to be building a position 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 control 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 brought by war, the dismemberment of the Empire as contemplated in the Cairo Decisions, and the mere fact of military occupation will have and are already in their disruptive effects on Japanese economy and industry. As indicated above, these effects must be held 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 trade, 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 consideration in determining the scope and character of the destruction of industrial facilities which 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 reparations. 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 Japanese industries as now organized were to encourage an effective control, a long step would have been taken toward opening the door of economic opportunity to all classes. It is recognized, however, that the removal of obstacles is not easily accomplished without a short span of years. This is the period in 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 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 durex 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 the claims against Japan of the respective occupying powers.

2. Reparation

The fundamental principle in all reparation should be that the requirements should support the long run objectives of United States policy, or interfere with their achievement as little as possible. Substantial reparations should not be required from 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 collective 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 collect in full the amount Japan's capacity to pay. Future studies may show that both of damages and of capacity to pay reparation, but no comprehensive estimates can be arrived at prior to assumption of conditions existing at the time of surrender both within Japan and within the areas of her aggressive action.

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 the rights to their property. It should be provided that property rights created or obtained by Japan during the war shall, so far as possible, be protected. This procedure could 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 over these areas is clearly ended. 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 that property in Japan has been destroyed, or taken under direct control, the great Japanese corporations served as the tools of imperialistic ambition that their property, as well as that under direct control, must be taken over by the occupation authorities. Moreover, there are instances of apparently private and individual holdings that are, in fact, but part of a great imperialistic endeavor that cannot be permitted to continue.

Current production in Japan may be assumed to be as an additional source of reparation. The several claimant countries are generally less developed industrially than Japan, and vary in the degree of their development and in the extent to which they can utilize capital equipment and stocks 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 may be obvious that reparation can come only from the value 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 such a standard. 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 on the basis of economic values; evidence of the possibility of maintaining the standard of living 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 national budget estimates. This amount has markedly decreased since 1914, when $17 billion (out of a total estimated national income of $19 billion) was allocated for civilian consumption. The budget 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. Thus 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 be sufficient to gather 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 to the recipient country for its own use. The recipient country may, of course, sell the goods which it receives 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 advantages. The United States does not intend to 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 military purposes. The synthetic petroleum industry should be operated under at least indirect control. Seaboard inspection of industrial establishments and production will be required, particularly if the scope of military occupation is limited. Aid in this regard might be of assistance if control of the sources and distribution of electric power, coal, and other requirements for legitimate peacetime industry can be closely estimated. The effectiveness of such controls will depend in large part 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.

VI. 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 main 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 wealth 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
Secretary's Staff Committee
Top Secret

Present: The Under Secretary (presiding)
Mr. Acheson
General Holmes
Mears, Phillips
Butler (for Mr. Rockefeller)
Flourney (for Mr. Backworth)
Stevenson (for Mr. MacLeish)
Raynor, Hayden
Bundgaard
Lewis
Yost

April 23, 1945
AGENDA ITEM

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 as 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. MR. COMMITTEE 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 more 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".

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.


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 Formosa 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.

   (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 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

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. Cowley.

Joseph C. Grew

[Source: Grew Papers, Harvard University]

2-17 UNITED STATES INITIAL POST-DEFECT POLICY TOWARD JAPAN

Letter

To: Frank Coe, Director of Monetary Research, Treasury Department

From: Edwin M. Martin, Advisor, Far East Economic Affairs, State Department

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 it was my intention 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 feel 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]
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: Dipl. 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" 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, business, 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

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 consensus 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 judgments 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
War Department Pamphlet, No. 31-10
Confidential

PRELIMINARY 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 they are the Civil Affairs Handbook, 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 used as a pattern. 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.

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FOOD AND AGRICULTURAL PROGRAM FOR JAPAN

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II. 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 more than 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 (P₂O₅), and 67 pounds of potash (K₂O) per cultivated acre must be maintained. 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, P₂O₅ and K₂O, 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 P₂O₅ and K₂O, 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 for 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
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## 2.2 CONTROL AND USE OF THE BANK OF JAPAN

August 1945

### 2.2.1 Utilization of the Bank of Japan with Central Banking Functions

The Bank of Japan is the central bank of Japan and is responsible for conducting monetary policy. The Bank of Japan is an independent central bank and is established by the Bank of Japan Law. The Bank of Japan is the central bank of Japan and is responsible for the central banking functions of the financial system.

### 2.2.2 Relationship with Government Administration

The Bank of Japan is an agency of the Government of Japan and is responsible for the central government's credit and savings institutions. The Bank of Japan is subject to the control of the Government of Japan.

### 2.2.3 Control over Credit and Savings Institutions

The Bank of Japan is responsible for the control of credit and savings institutions, such as banks and insurance companies. The Bank of Japan is responsible for regulating these institutions to ensure their stability and to prevent financial crises.

### 2.2.4 Administration of Other Foreign Exchange Control

The Bank of Japan is responsible for the administration of the foreign exchange control in the Loan of East Asia. The Bank of Japan is responsible for ensuring the stability of the foreign exchange market and for preventing speculation and black market activities.

### 2.2.5 Operations of the Bank of Japan in the "Greater East Asia Co-Prosperity Sphere"

The Bank of Japan is responsible for operations in the "Greater East Asia Co-Prosperity Sphere". The Bank of Japan is responsible for ensuring the stability of the financial system in this region and for preventing financial crises.

### 2.2.6 Administration and Personnel of the Bank of Japan

The Bank of Japan is responsible for the administration and personnel of the Bank of Japan. The Bank of Japan is responsible for ensuring the integrity and independence of its staff.
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 primary Military Government and the branch offices of the Bank in 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 institute a rapid resumption of activities on the part of the Bank of Japan, combined with an immediate imposition of control. The task will 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 discussed until the appropriate Military Government offices have been attached to the Bank. It 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 an instrument of control over other banking institutions, and (d) the availability of technical personnel with qualifications and training for the functions of control.

In general, 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, and whose activities will be subject to direct supervision by the Military Government. On this basis, some 23 to 30 Civil Affairs officers would be required—with four to six officers in charge of the head office and one officer for each branch of the Bank. In case even such limited number of qualified officers could not be obtained, two or more branches could be conveniently located 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 necessity of direct control over other banking institutions (particularly those outside Tokyo) and the number of officers required for that purpose.

2. Pre-Occupation-Economic

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 management of the Military Government. As is customary and as necessary in all such cases, 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. The central control 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 have exercised over the Bank and could determine the Bank’s policy and credit matters, subject to the overall supervision of the Civil Affairs authorities, and
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 autho-

ri ties, 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 officials of the head office to branches and agencies, to issue direc-

tives 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 ac-

tivities 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 review and analyze all acts of the branch managers and chiefs of agencies concerning amounts in excess of some-\text{-} agreed-upon sum, such as 25,000 yen, to suspend any operation or part with the law and statutes of the Bank and instructions of the Central Control Staff, and to order branch managers and chiefs of agencies to perform any operation re-

quested by the Central Control Staff;

(iii) to make available to other local Civil Affairs control organs banking and safe-

keeping 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, in addition to, and in excess of, the daily reports issued by the Bank, to prepare statements of 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:

(a) Total value of yen notes issued and on-hand—\text{with break-\text{down of}} (a) Bank of Japan notes, (b) Japanese Government notes, and (c) Occupation yen notes;

(b) Total value of outstanding discounts, loans and advances—\text{with breakdown by categories of borrowers (Civil Affairs and governmental agencies, banks, in-

dustrial corporations, and others);}

(c) Total investments—\text{with breakdown by categories of securities (Treasury bills and notes, government bonds, government-guaranteed debentures, other debentures, and stocks);}

(d) Total deposits—\text{with breakdown by depositors (Civil Affairs and government-

mental agencies, banks, industrial corporations, and others);}

(e) 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),

August 28 1945

To: Mr. White

From: Mr. White*

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 its 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 licensing policy 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 of or failure to act. We do not contend that the Emperor should not get what he wants, but we do contend that the State Department is entitled to consider the necessity of the entire package of policies, particularly the new, and, if it does not want the Emperor to act, it should be able to prevent this without having to set up a new organization 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 we are following in this supervision from the very outset of the occupation. 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 going on, he will be unable to prevent their licensing if he deems it necessary, and 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 Decla-

ration 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 ques-

*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 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-mongers would actually go untouched. They may also argue that our acceptance of the Emperor and the Japanese Government is not a federalism's channels of communication 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 foreign exchange 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 no power 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 new war unless a program 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, Onagura, etc. It is our view that the measures 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. Action through the Japanese government is the essential 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 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 requisition. 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 authorize and exclude from positions of important responsibility or influence in all private and public 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 37 of this directive. It may be generally assumed that all those persons who hold executive or administrative 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 persons have been exponents of war of war mobilization or the mobilization of control 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 China and the Bank of Taiwan;
(4) the various banks in the 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 Manchuria, 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 procedures, objections 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 purpose.

(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 moratorium or moratorium only to the extent clearly necessary to carry out the objectives of your Military occupation.

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 by reason of membership in or services to the Political Association of Great Japan, the Imperial Rule Assistance Association (Tsai E Yoku-Nen-ka), the Imperial Rule Assistance Political Society (Tsai E Soi-Ji-Kai), 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 nationalist, terrorist and secret patriotic societies and their affiliates.

(2) to any person who has been removed from an office or position in accordance with paragraphs 37 or 38 of this Directive.

(3) to any person interested in accordance with paragraph 38 of this Directive, during the term of his internment, or permanently in case of his subsequent conviction.

40. (a) Any law, 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 nationalist, imperialistic, militaristic, or anti-democratic societies of any kind will be prohibited.

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) The National Shintos;
   (3) The National Shinto, clubs or other associations prohibited or dissolved by you;
   (4) All Japanese (public and private) foreign exchange and external assets of every
       kind and description located within or outside Japan.

b. Any property which has been the subject of transfer under duress, wrongful acts of
   confiscation, disposition or spoliation, whether pursuant to legislation or by procedure
   purporting to follow forms of law or otherwise.

c. Works of art of cultural or material value of importance, regardless of ownership.

You shall take such action as will insure that any impounded or blocked assets will be
dealt with only as permitted by 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
military or 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.

You will also have and resort to the possession and control of a special agency estab-
lished 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.

You will also be granted the right to establish effective controls with respect to all foreign exchange transactions, in-
cluding:

1. Transactions as to property between persons inside Japan and persons out-
   side 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
   foreign exchange or other form of property.

4. You will provide full reports to your government with respect to all Japanese
   foreign and external assets.

5. 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.

6. 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 be-
   comes 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.

7. 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]

224 JAPAN'S ACCEPTANCE OF THE POTSDAM DECLARATION AND LABOR POLICY

Memorandum

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 yester-
day afternoon to consider the agenda of AC. The agenda concerned a draft of the execu-
tive 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 in-
structions contained within the directive has been reduced in view of the fact that a func-
tioning Japanese Government is expected to be operating a Military Government to a large
extent, therefore, will issue general orders, leaving the implementation of these orders to the
Japanese themselves.

The labor sections of the revised draft has been cut considerably, and read as follows:

"19. a. 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 docu-
   ment, 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
   quite like the sound of 19 a (4) because it mentioned legal obstacles only, and since now the Japan-
   ese 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 bargaining. In fact the whole tone of the section seemed to empha-
   size the safeguards against rather than the desirability of workers' organizations.

   Extensive alteration of the document by our Committee was deemed advisable 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.

[Source: MOD. MIL. EK., NATIONAL ARCHIVES]
3 GENERAL POLICY

3-1 ATLANTIC CHARTER

Joint Proclamation
Issued by: F.D. Roosevelt and Winston Churchill

August 12, 1941

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, they seek no annexation, territorial or otherwise;
"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

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. Shouler 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?

4. 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 Government.

2. The Soviet 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.

3. Unconditional surrender of the Soviet Government that immediately Korea is liberated, whether before or after capitulation of Japan or at the same time 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.

5. Following are our terms. We will not deviate from them. There are no alternatives. We shall brook no delay.

6. We must be convinced for all time the authority and influence of those who have deceived and misled the people of Japan into entering 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 execution 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 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 prompt and7 adequate assurances of their good faith in such action. The alternative for Japan is prompt and utter destruction.

SOURCE: Grew Papers, Harvard University Library

1 Acting Secretary of State.

3-4 POTSDAM DECLARATION

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 Government of the Republic of China, and the Prime Minister of Great Britain, representing the hundreds of millions of our countriesmen, 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 fliers 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 upon 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 uninitelligent calculations have brought the Empire of Japan to the threshold of annihilation, or whether she will follow the path of reason.

(5) We shall not fight for victory alone. We shall fight for victory against Japan. There shall be no compromise with 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.

SOURCE: Pol. Restitution of Japan, II, p. 413

6 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\(^1\) August 13, 1945
To: Gen. D. MacArthur
From: President 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 surrender 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, air and sea forces which may be allocated in accordance 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. 647-68]

3-6 GENERAL ORDER NO. 1, MILITARY AND NAVAL

To: Japanese Armed Forces and Civilian Agencies
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 Socialist 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, 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 and auxiliary forces within Manchuria, Korea North of 38 degrees North latitude, Karafuto, and the Kurile Islands, shall surrender to the Supreme Commander in Chief of Soviet Forces in the Far East.

(c) (1) The senior Japanese Commanders and all ground, sea, and auxiliary forces within the Andamans, Nicobar, Burma, Thailand, French Indo-China South of 16 degrees North latitude, Malaya, Sumatra, Java, Lombok, Sunda, (including Bali, Lombok, and Timor), Boeoe, Ceram, Ambon, Kai, Arce, Tanjir 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, and auxiliary forces within Borneo, British New Guinea, the Bismarks and the Solomon Islands, shall surrender to the Commander-in-Chief, Australian Military Forces, Pacific.

(d) The senior Japanese Commanders and all ground, sea, and auxiliary forces in the mandated islands, Bismarcks, 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 surrender 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 surrendered as a separate instrument. The members of their forces shall be held responsible for the preservation of Law and Order. The strength and arms of such Police Force will be preserved.

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, mineworks, and other obstacles to movement by land, sea or air, and the safety lanes in connection therewith.

(f) 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. The 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 verification 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
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. To this end 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.

XI. 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

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**3-7 SCAP'S PROCLAMATIONS TO THE JAPANESE PEOPLE**

Proclamations Nos. 1, 2, 3. 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

*These were withdrawn by SCAP before posted. Cfr Finance No. 104, July 1974, p. 74.*
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.

In virtue of the authority vested in me as Supreme Commander for the Allied Powers, I hereby establish military control over all of Japan, and I hereby announce the following conditions of the occupation:

ARTICLE

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 will 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 the event of any ambiguity or diversity of interpretation or definition between any English and Japanese text, the English text shall prevail.

ARTICLE VI

A military court will be established for the trial of all persons in relation to the war against the United States, the British Empire, the Chinese Nationalist Government, and the Republic of France. In the event of any ambiguity or diversity of interpretation or definition between any English and Japanese text, the English text shall prevail.

This Instrument of Surrender shall come into effect on the Second Day of September 1945.

DOUGLAS MacARTHUR

General of the United States Supreme Commander for the Allied Powers
3-8 DIRECTIVES AND THE AUTHORITY OF THE SUPREME COMMANDER

September 3, 1945
To: Gen. C. G. 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 removes 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 directive would impose upon the Supreme Commander 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

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 been written into the
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.\cite{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, or 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 by the Japanese Government to the extent that such an arrangement produces satisfactory results. This does not prejudice your right to direct Japan. 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.\"\cite{source: Fo. 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

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 on 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.

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 States desiring 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 of the 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 occupation on behalf of the principal Allied Powers acting in the interests of the United Nations at war with Japan, (b) participation of 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 execute 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 constitution of appropriate advisory bodies to establish policies for the conduct of the occupation and control of Japan which will secure the principal Allied Powers, in the event of any difference 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 in 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 to 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 favored". 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) Politics

Sections 1, 2 and 3 on disarmament, de-militarization, on war criminals and on re-education cover ground which has been covered in the U.K. "Additional Requirements to be Impossed 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* 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

   *The directive was approved by SWNNCC. 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 (SWNNCC 21/6 (J.C.S. 1467)) and the Instrument of Surrender (SWNNCC 21/6 (Annex “A” to J.C.S. 1380/5)), executed by command of the Emperor of Japan (SWNNCC 21/6 (Annex “B” to J.C.S. 1380/5)). These documents, in turn are based upon the Potsdam Declaration of 26 July 1945 (SWNNCC 149/1 (Annex 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 (SWNNCC Memo for Info No. 19 (Annex “E” to J.C.S. 1380/5)), and the final Japanese communication on 14 August 1945 (SWNNCC 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 practicable 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

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 pressure in governmental and social institutions; and the development 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 such a form of government on Japan of which government not supported by the freely expressed will of the people.

a. 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.

b. This directive does not purport to formulate long-term policies concerning the treatment of Japan in the post-war world, nor does it seek to prescribe in detail the form in which you are to take through you as to which you are to take through the power by which means to effect the surrender and the Potsdam Declaration. Those policies and the appropriate measures for their fulfillment will in large measure be determined by developing industrial, financial, social and political conditions in Japan and by you and made available to you by the Japanese 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. 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 order to all
of direct and predominant concern to the security of your troops.

b. 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 designation communicated to you by the Joint Chiefs of Staff.

5. Political and Administrative Reorganization.

a. Local, regional and national agencies of government, administration, excluding those which are actuated by the principles of the occupation, will be permitted to continue to function after the removal of officials who are unacceptable as described in paragraph 5b below, or who are ascertained to be unreliable. Such agencies and the public bodies with which they are associated 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.

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 4d 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. Except as indicated above, such responsibilities will be provided for in the Government of Japan as modified 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 come about through the lawlessness and irresponsible conduct of a minority of their population, 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 nondemocratic and democratic Japan which will respect the rights of other nations and which will meet its obligations and responsibilities to the United Nations.

f. You will provide for the gradual elimination of the militaristic and autocratic elements in the Japanese Government and for the establishment of a system of democratic government which will be consistent with the peace pact and the directives set forth in this directive. You will also aim at securing an administration that will be capable of handling the problems of reconstruction and the affairs of state.

g. You will establish such military courts as may be necessary with jurisdiction over offenders committed as a result of the occupation. You will also establish such courts as may be necessary in connection with the implementation of the surrender. You will, however, except as otherwise deemed necessary, exercise your jurisdiction in connection with such cases as those in which the Japanese courts are unable to exercise jurisdiction.

h. You will ensure that the Imperial forces of Japan and all armed forces under Japanese control 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.
6. Demilitarization.
   a. You will assure that all units of the Japanese armed forces including the Gendarmerie (Kempie) 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 treated 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. Directions are found in paragraph 7b of this directive.
   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 Naval General Staffs, the Army, Navy, Civilian Volunteer Corps and Gendarmerie, together with all reserves and other paramilitary 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 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.

   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 Naval General Staffs;
      (2) All commissioned officers of the Gendarmerie (Kempie), 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, terrorist and secret patriotic societies; and
      (4) All persons who 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 significant part in the formulation or execution of Japan's program of aggression, the activities 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 conduct of the war, or for maintenance of the military rank or position.
   c. You may, however, for a brief period of time, utilize the closely supervised services of those persons within the categories enumerated in subparagraphs 7a (1) and (2) above, and all other civilians 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 until they are held as prisoners of war.
   f. All nationalities of countries except Japan which have with 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

* SWNGC 58/9 (J.C.S. 1328/3)

GENERAL POLICY

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 protected.
   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, nationals of neutral countries may not be interned 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. 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 treated uniformly, and if you deem it advisable, may be placed in custody or restricted residence. All such nationals who fall within the provisions of paragraph 7b 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.

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. The necessary minimum of censorship will be maintained in such circumstances as to prevent the spread of subversive Communist propaganda, 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 ideas and through all available media of public information.
   b. 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 of the various objectives as necessary for the conduct of the war. Those whose activities are consistent 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, and free and fair elections to represent local governments shall 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 of political parties shall 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.
   c. 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 9a and c above, you will insure freedom of opinion, speech, press and assembly.
   d. Education, Arts and Athletics.
      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 3a 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 5f above.

c. You will, so far as practicable, cause to be preserved and protected, all historical, cultural and religious objects, against depredations by the occupational forces, or others.

II—A. Economic Objectives and General Policy 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 readjustment 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 modification 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 this authority, to the extent that the services of the Economic Director and his substancuates are not available to you, you will call upon 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.

c. 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.

b. That the standard of living will depend upon the thoroughness with which Japan rid itself of all militaristic ambitions, redirects the use of its human and natural resources wholly and solely to peaceful living, administrative, 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.

II—E. Economic Disarmament.

14. In order to effect the economic disarmament of Japan:

a. 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.

b. 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 the approval through the Joint Chiefs of Staff. Should you decide 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.

c. 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, automobile vehicles, merchant ships, heavy machines, and import of 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 Japanese nation.

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.

15. 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 require that any such conversion undertaken in a genuine move toward 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 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. In order to furnish the information necessary for further decisions concerning economic policy you will communicate those reports to the Joint Chiefs of Staff.

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 paragraphs 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 stored, finished goods, and goods in process. You will also inventory the Japanese merchant fleet.

18. You will: Develop and recommend to the Joint Chiefs of Staff controls which will prevent Japanese rearmament after termination of the occupation.

19. You will ensure 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 technical intelligence services. If you deem necessary 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 and 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 Economic System of the Japanese Economic Authority

20. 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.

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 materials, clothing and other essentials. In the event that they fail to do so, you will direct them to take such measures as are in your judgment 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, 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 activeponents of militant nationalism and aggression, of those who have actively participated in the organizations enumerated in paragraph 5 (above, Political and General) of this directive, and of any who do not direct future Japanese economic effort solely toward peaceful ends. (In the absence of evidence, satisfactory to you, to the contrary, you will assume that any persons who have held high positions of responsibility in Japan since 1937, in industry, finance, commerce or agriculture have been activeponents 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 commercial enterprises 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 satisfactory plans for reorganization have been submitted by 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 previously performed by these associations should be transferred to public agencies, approved and supervised by you.

(4) Abrogate all legislative or administrative 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 resist 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.

26. You 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

27. 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 repair or restoration.

c. Exports other than those directed to be shipped on repayment 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 proceeds of exports shall be controlled by you and made available in the first place for the payment of 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 shall 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 repayment account) shall be determined by the Japanese military, but shall be determined by you. Exports of Japanese industry to be restored or developed to an extent that might significantly contribute to Japan's war-making potential, or promote dependence by other countries on Japan for staple 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 special 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 identified Japanese property in accordance with the appropriate Allied authorities transmitted to you by the Joint Chiefs of Staff. Reparations will be accomplished:

a. Through the transfer of Japanese property located outside of the territories to be returned by Japan.

b. Through 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.

c. Restitutions 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.

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 of 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 supplies available from other Asiatic and Pacific Ocean areas. To the extent that such supplies are available in areas under the jurisdiction of governments other than the United States, or the military command of such governments, negotiations necessary to obtain such supplies 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.

You are required to: (1) take all practicable steps to obtain 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 points 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 supplies through such an agency impracticable. In order to limit direct provisions 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 are necessary will be paid for by the purchaser in local currency at prices determined by you to be consistent with the internal economy. Such supplies or other consensual supplies may be sold or otherwise disposed of 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. 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:

a. Close banks, other than those indicated in paragraph 41 above, only where clearly necessary for the purposes of internal 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.

b. 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) By reason of membership in or services to the Political Association of Great Japan, the Imperial Rule Assistance Association (Taisei Yokusanka), the Imperial Rule Assistance Political Society (Taisei Seijikai), their affiliates and agencies or any successor or similar associations, and all Japanese nationalist, terrorist 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 paragraph 40 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 expenses of your force.

38. 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 are authorized and will exclude from positions of important responsibility or influence in all public and 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 positions 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 paramout 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 objectives 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 internal 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.

b. 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) By reason of membership in or services to the Political Association of Great Japan, the Imperial Rule Assistance Association (Taisei Yokusanka), the Imperial Rule Assistance Political Society (Taisei Seijikai), their affiliates and agencies or any successor or similar associations, and all Japanese nationalist, terrorist 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 paragraph 40 of this directive.

43. You will prohibit the payment of:

a. All military pensions, or other emoluments or benefits, except compensation for physical disability, to any person whose ability to work, at rates which are lower 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 Yokusanka), the Imperial Rule Assistance Political Society (Taisei Seijikai), their affiliates and agencies or any successor or similar associations, and all Japanese nationalist, terrorist 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 paragraph 40 of this directive.

44. Any laws, ordinances and regulations or practices relating to taxation or other fields which tend to discriminate against persons engaged in military service, 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
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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.
38. A proposal for 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.
39. 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 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.
40. 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. Reversion 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. 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 Commission 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 Philippines Commonwealth.

II. Functions of the Commission

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.

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- nationalistic, imperialistic, militaristic, or anti-democratic societies of any kind will be prohibited.
- You will insure that Japanese public expenditures are consistent with the objectives stated elsewhere in this directive.
- 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, terrorist 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;
  b. Attendees owners of non-Japanese nationality including United Nations and neutral governments and Japanese outside of Japan;
  c. 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;
  d. Persons subject to internment under provisions of paragraph 7, and all other persons specified by Military Government by inclusion in lists or otherwise.
  e. All Japanese (public and private) foreign exchange and external assets of every kind and description located within or outside Japan.
  f. 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.
  g. Works of art or 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 will maintain 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 molesting 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.
- You will seek out and reduce to the possession 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.
- You will establish effective controls with respect to all foreign exchange transactions, including:
  (1) Transactions as to property between persons inside Japan and persons outside Japan;
3-14 UNITED STATES POLICY WITH RESPECT TO OCCUPIED AREAS

SWNCC Directive
Drafted by: SWNCC

Organization and Procedure for the Development and Promotion 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 operation, the Secretary of the Navy Coordinating Committee (hereafter 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 (d) above, shall be accomplished by the Assistant Secretary of State for Occupied Areas and under his direction and control through the mechanism of the Secretariat 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.
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The military purpose, which was to insure Japan will follow the ways of peace, and never again be a menace, has been, I think, accomplished.

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.

China 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.

Interim phase of 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 is possible as long as the guns were firing. Now stragglers are worse, because we have returned millions of repatriates from abroad.

No weapon, not even the atom bomb, is as deadly as in its final effect as economic warfare.

The atom bomb kills by numbers, 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 stocks and our blockade after the fall of the Philippines left 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 but not as you can lay down the framework, it has been already accomplished.

The difference must be filled by the Allies.

We need 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 political 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 surrender and control, but no economic framework can be imposed. But under strict rationing, Japan is not producing enough to satisfy her needs.

We have made Japan into a nation where the difference must be filled by the Allies.

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We have made Japan into a nation where the difference must be filled by the Allies.
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 control the government in order to get democracy to take hold?"

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 necessary.

"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 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 sources."

"Japan, 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 her up.'"

"I don'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 stockings than silk 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 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 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 foreign trade for 50 years.

Question—"What would happen if you did it?"

Answer—"There would not be anybody left alive."

Question—"What do you see as final reparations program?"

Answer—"I don't think there is any intention to take away from the industrial capacity of Japan that which would destroy it."

He noted here "disagreement" between the Pauley and the Strike reports on reparations. He then went on to say that the United States have withdrawn all military personnel working on the big problem of trying to find the proper balance on the questions.

"If reparations are cut too deeply, the United States 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 firmer line 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."
that every effort is being made to keep 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.

5. Already consideration has been given to the issuance either unilaterally or through the SCAP, of a new policy statement which would indicate a complete reversal of the economic policies established under JGS 1300/15 and other JSC, SWNCC and FEC papers. It may be recalled that 1300/15 specifically stated that the lack of a comprehensive program to supply food to 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 furthest extent to which State and Army are willing to go in redefining economic policy for this occupation. Both General Saltonstall and Mr. Rusk of the Military Affairs Division in Army desire 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 be interpreted as another piece of “reversal.” SCAP has not been withdrawn, but is here to stay in order 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. Therefore, 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 hopes that in implementation of the measure certain principles would be borne in mind, such as economic stability, economic recovery, adequate opportunity for learning and review, etc. When I left Washington this message was still awaiting final approval.

6. 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 this administration would never adopt a radical reconstruction program. We must also recognize that we felt it both in 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 methods of reconstruction the SCAP should adopt, the guidance and authority for the 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, which would be answering the growing criticism and relieving much of the pressure. This is of particular importance at this time when both departments have been presented to Congress requests for deficiency appropriations largely concerned with occupation responsibilities, and when the question of further food allocations is under consideration.

To have an effective occupation at this time, all consideration of policy must be taken 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 is considerable discussion in both State and Army of the possibility of reorganizing and reducing the occupation forces and occupation costs. It was understood early in the negotiations 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 responsibilities for occupation or other work assigned by the 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 an effective occupation 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 of initiative. 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 and occupation costs would make it easier to reconcile ourselves 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 FRC 230 or its revision, no further policy directives should be issued. It is believed that the Supreme

GENERAL POLICY

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

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 occupier nationalities are free to pursue the whole of the war in the Pacific, 2,500,000 people will be occupied.

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 other day I had the opportunity to visit 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—depends not so much on consideration for those who are occupied by the Japanese garrison in Japan, and secondary to payment of reparations to the victorious Allies for the damages inflicted upon them.

It is clearly shown by the emprise 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 evacuation of reparations...but not...enable her to receive. Access to, as distinguished from control of, raw materials shall be permitted. Eventually 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 defense, 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
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 terrorist societies, were abolished. Those who formulated the Japanese policies of conquest and the intentions behind them were isolated from important political and economic officials.

War-making industries were marked for removal and reparations. 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, and metal foundry industries. Commitments were made to other nations for payment of reparations with those plants.

Other steps followed, including those leading to the dissolution of enterprises with property exceeding $50 million. At the end of 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 'landowner' and his power to encourage war. used by 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 $5 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 this Land Reform will find its way to the political plane.

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 only one-fifth of the larger ones we have been liquidating.

The Japanese Government has been directed to prepare legislation prohibiting international cartels. Stringent anti-trust and deconcentration legislation has been prepared and passed by the Congress. A Corporation 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 of 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 people, who, at the outbreak of our war, 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 88 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. In short, Japan would be faced with widespread starvation and disease—would see her 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.

The situation in Japan has fed upon itself, and recent events have demonstrated the deep needs of the country. 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.

For this and other achievements in Japan, great credit must be given to General MacArthur and his staff. America was indeed fortunate that for this vital task it had an outstanding man who was able to bring the Japanese to a realization of their needs 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 can 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. One step to 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 an economically self-sustaining 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 distribution of land tends to produce a larger 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-supporting.

Such is our dilemma. It is clear that Japan cannot support itself as a nation of shopkeepers and craftsmen and small artisans, or even 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 border-line situation between demilitarization and economic recovery is presented in the development of the Japanese war machine. Men who were the most able and the most industrially—and 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 industrial rehabilitation of Japan, which may not be seen as an impossible situation.

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 pacifism reformation. One Senator said to me in Germany shortly after VE Day, 'I have not yet seen 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 judgment. Those decisions are not difficult to make, but for 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 London conference, and recently supplanted by a new plan called by us 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.
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 to pay 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 temporarily arrested 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.

If 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 SOCA, 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, through the supervision of SOCA, must play a part in helping to ensure that the Japanese Government and people energetically and effectively discharge that responsibility.

Great 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 burdens on the American taxpayer of supporting the Japanese economy. While the American people will continue indefinitely to subsidize the economy of Japan, the U.S. Government will show the world that 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 to stimulate Japan's production of goods required for export and to ensure that goods produced in response to demand of the U.S. Government and other countries requiring supplies from Japan: it has also provided a list of goods not desired by 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 Japan, requests favorable consideration of future policies to be presented to the Commission towards this end.

[Sources: Documents Concerning the Allied Occupation of Japan II, pp. 13-15]

3-19 MANUAL OF MILITARY GOVERNMENT IN JAPAN

Manual (Provisional)
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 25-7 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 the Japanese 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) The 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

The study and understanding by all military government personnel is indispensable to an understanding of the authority for and concepts of the occupation and, accordingly, to 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 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 organizational 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-three 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 are 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 eleventh 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 activities.
(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 efforts. By means of timely and well planned visits to these teams, the regional commander and his principal staff members will ensure that their personnel have a thorough knowledge of the problems of the area to be handled, the results to be achieved, and the best methods of attaining these results. The operational activities of the regional team should be limited strictly to dealing with regional governmental bureaus and non-governmental agencies whose actions in any given region widely extend beyond the scope of the prescribed activities of 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 supervision 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 the performance of their 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 team’s operations 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, and social affairs is the responsibility of SCAP’s military government teams, 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 operations 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 personnel should be delegated to the detachment, while military government teams should have the right of inspection. The primary responsibility for the detachment’s personnel will be the detachment commander, and for the military government teams will be the team 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 duties 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 POLICY

1. PROCEEDURES 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 programs 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, 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 to their areas. 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 bureau 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 a maximum to 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 information 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 all that prompt action is 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 activity 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 a regional level cannot be effectively determined, add recommendations to such reports from administrative headquarters which may further clarify the problem or add emphasis to its importance or seriousness, and forward it 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 any, made 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 activity. Check the effectiveness of their practical implementation of 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 laid down Specific SCAP directives will be reported to the proper Japanese authorities for correction and, when appropriate, to the next higher military government headquarters.

d. Confer frequently with local (city, town, village and district) societies, 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 local agencies, organizations and agencies and talk with responsible persons directly concerned with the 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 authorities. 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 judicious, not opinions. In no case should the civil 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 an activity file 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 the regulations do not fully cover the situation or where actions resulting from such failure in coverage would bring about conditions detrimental to the interests of the occupation.

m. Maintain close liaison 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 information 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: NUTLAM Papers]

3-20 NSC RECOMMENDATIONS WITH RESPECT TO U.S. POLICY TOWARD JAPAN (NSC 13/2)

Report NSC-13/2

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

working 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 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 interim 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, 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

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 underway. 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.)

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 situation makes such action desirable and if it is consistent with

U.S. political objectives.

6. The Japanese Police Establishment. The Japanese Police establishment, including the

coastal patrol, should be strengthened and re-equipped by 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 passed to a steadily increasing degree in the hands of the Japanese. 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.

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, SCAP should not stand in the way of the 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 those that are not only unnecessary but obtrusively 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 resort to action of such serious import. Definite background guidance embodying the above principles and indicating the United States Government's attitude 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 wishes to see 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 be purged 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 accompanied by the demobilization of United States forces in Japan 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 all the tangles of Japanese war economy. Japanese post-war 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 the close relationship with other Federal agencies already 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 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 proceed as quickly as possible by July 1, 1949. It should be the objective of the United States policy to have all property matters streamlined 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 of the broadcast media for the purpose of the maintenance of United States policy to have all property matters streamlined out as soon as possible and certainly well in advance of a treaty of peace in order that they may not hamper treaty negotiations.
   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. Information 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.
   d. 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 "A" trials from the standpoint of releasing those who can be advocated in the light of commitments already made by the United States regarding the reduction of the industrial war potential.
   e. Japanese Reparations. (Recommendations on this subject are to be submitted separately.)

[Sources: FRUS, 1948, VI, pp. 608-62]

3-21 SCAP'S SCOPE OF AUTHORITY

Telegram: C-66402

December 18, 1948

To: W. Draper, Under Sec., Dept. of Army

From: M. Arthur

Top Secret

Re: SCAP's Scope of Authority

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 CINCPAC and as pointed out in our C-63997 the international character of SCAP under the Moscow Agreement of 1945 renders him subject solely to Allied policy either formulated by the FEO or under specific limited circumstances by the United States, if transmitted as an interim directive pursuant to the proceedings set forth in the formulation of the Greater East Asia Co-Prosperity Sphere. Both such international character and the proper procedures have previously been fully recognized and followed, the latest example being in your W-8105 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 CINCPAC and SCAP is well illustrated in urad W-80599 wherein you pointed out "that because international character of SCAP this message be addressed to CINCPAC with his confidential info. Any overt acts carrying out this policy being 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 inherent, this would be understood by all United States authorities 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 rapt 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 international character.

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 actions under 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 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 SCAP's stewardship of his international responsibility.

3-22 AUTHORITY OF SCAP

Telegram: W 81792
To: MacArthur
From: Draper

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 CINCEFE as well as your executive discretion as SCAP. SCAP's position as an international officer is fully understood but there is still a considerable latitude 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 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 interdepartmental 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 of the Government of Japan. For example, Ist and most important is the agreement that SCAP shall be appointed by the President of US, 2d that the FEC should recognize the executive 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 financing all the funds but has the principal responsibility for the success of the occupation. It is our task here and yours, to find ways and means to implement US Policy as it develops from time to time but keeping within the framework of the agreements and policies of the Moscow Agreement. The US Interim Directive to SCAP through the JCS, with a copy filed with the FEC as soon as possible, is 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 prior 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

May 6, 1949.

By: National Security Council

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.

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 any peace treaty. 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 occupation mission as envisaged in this policy paper and with military security and morale, should be made to diminish to a minimum the psychological impact on the population of the occupation forces on the Japanese population. The numbers of, and especially non-tactical, forces should be minimized. In determining the location of occupation forces, there should 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.

6. The Future of the Ryukyu Islands. The United States reserves the right to recommend to the United Nations Trusteeship Council any action that it may take with respect to this island group, subject to the limitations hereinafter set forth.

7. The Future of the Nanpo Islands. The United States reserves the right to recommend to the United Nations Trusteeship Council any action that it may take with respect to the Nanpo Shoto south of 29° N, Marcus Island and the Nanpo Shoto south of Sofu Gan.

*Adapted 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 pronouncement 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 stationed therein pay 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 on 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 United States the capacity to create a base as large as possible of the type that is likely to be needed, and to the extent necessary to carry out the and that 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 United States the capacity to create a base as large as possible of the type that is likely to be needed, and to the extent necessary to carry out the 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 Regulation of**

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 future of the Government should be reduced as quickly and as speedily as possible. When its mission will consist largely of general supervisory observation of the activities of the Japanese Government and of contact with the latter at high level as necessary.

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 concluded in broad terms leaving questions of implementation and administration to SCAP. The position of the United States should be 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 policies 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 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 ch Juxtaposition 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. **Economic and Financial 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 interest oneself if the categories of authorities who have expressed opposition to 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 taking important steps to alter the implementation of the reforms. Definite background guidance embodying the above principles and indicating the United States Government's view as to the nature and extent of the adjustments 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 if the categories of authorities who have been proscribed are (1) those who have held relatively harmless positions should be made re-eligible for governmental, business and public media positions; (2) 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. **Occupational 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 a number of years, and by 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 these two objectives, the Army of Occupation of the United States, and the foreign policy of the United States, should be closely interrelated. 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 by the Foreign Economic Policy Committee, with representation of 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, the elimination of work stoppages, internal austerity, and the reduction 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. 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 maintain a wide 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 take all possible steps so as to permit 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 in 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 FEPC nations of our intended course and of the considerations underlying our position, the United States should take the following specific actions:
b. Withdraw its proposal of November 6, 1947, on reparations shares.
c. Announce to the FEPC and publicly that it has no intention of using its unilateral powers to make possible additional industrial reparations removals.
d. Announce to the FEPC 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 11 of the FEPC 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 Economic and Social Affairs of the FEPC 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.

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.
a. Submit to the FEPC proposals, regardless of likely unfavorable reception, for the rescission of the pertinent and pending FEPC reparation 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 FEPC contrary to U.S. policy.

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 such eventsuate, 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 be taken to 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 subversion.

4. Increase 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 arrangements 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 the following lines:

(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 directed toward a multiplicity of 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 of Asia and the early extension of assistance by the International Bank and the Export-Import Bank for specific key economic projects of a self-subsidizing nature, especially those directed toward increasing production of food in this area.

6. Efforts to obtain the adherence of Asiatic countries to the principles of multilateral, non-discriminatory trade embodied in the General Agreement 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 steps to secure the most-favored-nation benefits of non-Communist countries.

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. The United States should continue to provide for the extension of political support and economic, technical, military and other assistance to the democratically-elected Governments of the Republic of Korea.

f. 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.

g. (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 stance which would prompt the recognition of the United States, even in the event of such recognition. In general, it should be realized that it would be inappropriate for the United States to adopt a posture more hostile or policies more harsh towards the Communist side than towards the USSR itself. It should also be realized that the accord 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 Communist regime is granted, 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.

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 Communist influence with or without United States aid and unless such support would mean reasonable measure resistance to the Communist influence within 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 Stalins 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
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 China.

(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.

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 13/5.

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 concerned. 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. Such 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 Pacific should constitute a counter to 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, their 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. No 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 205 of the Mutual Defense Assistance Act of 1949, should be programmed as a matter of urgency.


3-26 United States Objectives, Policies and Courses of Action in Asia (NSC 48/4)

Policy Statement, NSC 48/4

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 Security 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 48/5, appropriately revised.

[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-a-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 offshore 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 offshore 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 strength of both the United States and the Soviet Union, and until such time as the United States, through its own military readiness, is 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 Objectives

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...
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 or from that area.

d. Insular 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 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 south of the Korean 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 UN forces from Korea; (4) permit the ultimate withdrawal of U.S. and UN forces.

f. Support democratic governments in 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.

7. In accordance with 5d above, one of the current and continuing actions as 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 delay these resources to the communist world.

8. While continuing to recognize the National Government as the legal government of China, the United States, with respect to Communist China, should

a. Continue strong efforts to deflate 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 influence to the leaders and people in China to oppose the present Peking regime and to seek its recreation 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 Peking regime's control, particularly in South China.

d. 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.

e. 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.

f. 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 the indefinite defense of the entire Korean peninsula by United States forces, and with the following objectives:

(1) Inflict maximum losses on the enemy.

(2) Prevent the overrunning of South Korea by military aggression.

(3) Limit the commitment of South Korean military units to the levels necessary to prevent becoming a menace to their own interests.

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 rapidly as possible and in sufficient strength 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, consult the UN Command and Korea to prevent withdrawal of 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. Take such steps as will facilitate transition from occupation status to restoration of sovereignty.

b. 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.

c. Continue efforts 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.

(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.

Establish appropriate psychological 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 6b 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 90/1.

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 offshore 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 strength 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 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 10b 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 6b above.


3-27 DESIRED REPEAL OF REVISION OF OCCUPATION LAWS AND ORDINANCES

Letter
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 commissionaires 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 advice 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 relection, 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. It is 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. The Policy System

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 the 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.

(a) To re-examine the 6-0-3-4 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.

2. The Enterprise Organization Law.

To be relaxed for the same reasons as above.

G. The Legal Procedure

(a) The Code of Criminal Procedure

Experience in the enforcement of this code has shown the need for 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 distrust 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.

III. REVIEW 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 amalgamated into a single ministry.

The Atoms of Central'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, and National Fire Defence Agency, should either be 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 advice to and 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 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.

[Sources: SUTLAND PAPERS]
3-28 UNITED STATES OBJECTIVES AND COURSES OF ACTION
WITH RESPECT TO JAPAN (NSC 125/1)

Report
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 long-term 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.

d. 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.
e. 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.
f. The United States should encourage and assist Japan to arm itself with conventional weapons.

g. 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 possess military potential far superior to that of Japan. However, it is probable that Japan will never develop that 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 offshore 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 political and economic and military self-support. In this situation Japan’s policies and actions will be determined on the basis of Japan’s concept of self-interest, and this conception may come into conflict with the interests of the United States.

d. 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 and between them and other parts of the free world.

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 pursue 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

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 sizable 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. The 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.

d. 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;

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 economies 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 principles 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.

(3) 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.

(4) Continue to maintain forces in Japan for the support of United Nations operations in Korea, so long as they are required.

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 government-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.

GENERAL POLICY

(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.*

* Defense-DOE-Commerce proposal.
4 NATIONAL SECURITY AND EXTERNAL RELATIONS

4.1 OCCUPATION FORCE IN JAPAN

Summary of Agreement

January 30, 1946

Participants: A.S. Australia, Acting on behalf of the United Kingdom, New Zealand, and India.

1. As a result of discussions 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 forces 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 is 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.E.M., of the Royal Australian Air Force, has been appointed Chief of Staff to 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 squadrons 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. The detachment is commanded by Maj. Gen. D.T. Cowie, C.B., D.S.O., M.C., Indian Army, and includes the 5th Brigade of the 2nd Division and the 268th Indian Infantry Brigade. The Australian Infantry Brigade group includes the 34th Australian Infantry Brigade, commanded by Brigadier R.H. Munro. The Commandant of the New Zealand Brigade, which is coming from Italy, is Brigadier K.L. Stewart, C.E.M., L.S.O.

6. 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 8th 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.

7. 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 in all 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 Common-
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.

[Sources: Pol. Reviiew of Japan, II, pp. 440-41]

4-2 REAPPRAISAL OF UNITED STATES SECURITY INTERESTS AND POLICIES IN REGARD TO JAPAN

Memorandum1 April 17, 1946

To: Secretary of State

From: George Atcheson Jr., U. S. Political Advisor for Japan

I have the honor to enclose a memorandum "Reappraisal of United States Security Interests and Policies in Japan" prepared by Mr. Fearay 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 brought into sharper focus the longer-range, more fundamental 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 reevaluation 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 reason the 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 Japanese 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 Emerson's comments on May 15, 1946, also published in this volume (4-3).
4.3 COMMENTS ON "REAPPRAISAL OF UNITED STATES SECURITY INTERESTS"

Memorandum
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 communist nationalism and expansion 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 militarist nationalism."
3) Development of closer cultural, educational, and tourist exchanges between the U.S. and Japan.
4) Minimum necessary restriction of Japanese peacetime industry.
6) Maintenance of adequate American armed forces in the western Pacific and elsewhere to prevent Japan's domination by another power.
7) Continuing discussion of 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 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 well if the specter were 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 goodwill still existing for us among the Japanese. Our best approach should continue to be one of positive influence 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 between ourselves and the Soviets are graver and more explosive.

A reply to Fearey's memorandum, April 23, 1946.

4.4 DRAFT TREATY OF DISARMAMENT AND DEMILITARIZATION

Drafted by Department of State
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 Marine Police (Kaikei Tai) and the Special Police (Tokiwa Ka), and all organizations auxiliary to the foregoing shall be and shall remain disarmed, demobilized and disbanded.
(b) The Japanese Imperial General Headquarters, the staffs of the Army and the Navy, and all 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 other implements 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.

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.

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

* Similar 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 quadrupartite
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 quadrupartite 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 oc-
cupation of Japan, they shall support the strict enforcement of the disarmament and demili-
tarization 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 termina-
tion 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 inspec-
tions, 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 disar-
armament 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 preven-
tion 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 quadrupartite agreements
which shall provide in the greatest practicable detail for inspection, inquiry and investiga-
tion 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 quadrupartite 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 Program, Department of State, pp. 85-88

4-5 SOVIET INTENTION WITH REGARD TO JAPAN

Memorandum
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 Japanese-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
WFU, 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 the longer term, 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 connect-
ions 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 philoso-
phy 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
Drafted by: R. E. Bacon, Spl. Asst. 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 disarmament 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, etc.

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; signatures; 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. Kiseliko, representing the Member for the Union of Soviet Socialist Republics

4-8 INTERESTS AND ATTITUDES OF F. E. C. POWERS ON QUESTIONS RELATING TO THE PEACE SETTLEMENT WITH JAPAN

Report

Drafted by: Division of Research for Far East, Department of State
Secret

February 19, 1948

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 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, 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 dominance. 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 will probably be necessary 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's "Basic Post-Surrender Policy for Japan" (see Ad Hoc Committee of Five, Appendix J), the US position will probably be sustained by most issues in care working proposals and in manner of negotiating. On many questions there will be serious difficulty in obtaining the necessary majority, since the US cannot fully support 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 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 centrally independent power but, as far as possible, also as a 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 degree of progress that has been made in the negotiations 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 United 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, reparation, and economic recovery. On reparations, the US will propose a different issue will be apportionment of economic costs to Japan and will seek an agreement that Japanese economic recovery raises before various FEC countries the specter of Japanese economic and military aggression as well as the more immediate likelihood of continuing economic problems. 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 will 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 was a voice in deciding what is to be done to Japan. India would oppose, as emperialism any arrangement that would place the US in control of Japan's economic or political future, and France and the Philippines would be opposed in principle to such arrangements. The US may feel that it is a desire to grant unitary powers to be needed for economic recovery is an aid to countries devastated by Japan. It seems likely that any proposal for such powers of unitary action would have to be made with circumspection 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.

Summary of Position of Each Power

1. Australia. Australia will pursue 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 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 the desire to avoid the cost of the war, the desire to get reparations from Japan, and the hope that an improved relationship with a reviving Japan might help the National Government to cope with its pressing economic difficulties.

Initially, 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 friendship indicates that the Philippine Government is likely to support the moderate peace treaty issues. The Philippines probably will argue for a larger reparations share and a more ambitious reparation program than that proposed by the US. It may also propose 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. USSR. The Soviet Union is concerned primarily with preventing Japanese reoccupation 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 unless it secures a veto or near veto in the deliberations. If its conditions were met at some time in the future, the Soviet delegation to the conference would be guided by the desire to maintain the Soviet Union's control over the strategic control structure of the Pacific and to secure a greater influence in the military history of Japan.

10. United Kingdom. The United Kingdom policy of limited liability in Japan is closely linked to the maintenance of US strategic interest in the Pacific and, given Britain's present economic situation, can be pursued only with American support. If the US maintains 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 interests. The interests of both the US and the UK are so closely entwined, however, that the 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.

As the conference proceeds and 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, especially those and will also seek that they be paid in American dollars, in favor of China and the Philippines. A corollary is continuation of British insistence that external assets be given full weight in computing total reparations. The UK will advocate the withdrawal of demilitarization and to a lesser extent of Allied control body during the period of tutelage until 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 "aggression". To stop "malpractices" arising from child labor, unemployment, abuse of trade-markets, and discriminatory practices against foreign firms, the UK favors writing into the treaty the obligation to conform to the requirements and regulations of (international mutual conventions 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 modifications 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 Kuril Islands (in Working Group’s draft Kunashiri, Etorofu, Shikotan, and the Habomai) would undoubtedly appear to some powers as an attempt to violate the Yalta agreement on the exchange of the USSR and in favor of Japan. Naturally the USSR would be hostile to such a suggestion, and no American concession to that aspect of talks 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 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 present on the FEG, it is possible that little opposition will arise to the proposal itself 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 it hard to agree with the Japanese government on the provisions of the new power agency for carrying out the uncompleted sentences 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.

b. Complete withdrawal of all Allied troops from Japan within six months. If the US makes this proposal, strong support may be expected from China and acquiescence from most other powers. The UK may object on the ground that American troops are necessary in Japan to insure treaty enforcement.

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 an issue that should cause major difficulties even though China will be influenced 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 FEG were written and agreed upon by the powers with whom the others concerned had only the choice of accepting or rejecting membership under those terms.

e. Broad enforcement powers for the Council of Ambassadors for Japan. Most FEG 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 having the Council in the position of the last resort, but it is not possible, 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. Australia and New Zealand, which politically favors the Philippines for the Kuril Islands, 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.

Chapter V. Disarmament and Demilitarization

a. Direct military strength. There will be strong general approval for the draft provisions 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-producing 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 on Japan and have proved less agreeable to the FEG’s proposal in the FEG may lead Chinese objections to abolition of the FEG. Further, there may be some opposition, especially from the Soviet Union and Australia, to the termination of all dual-use industries by present dual-use powers who might propose that present dual-use industries be maintained in force until changed or terminated by the new authority set up to enforce the treaty.

c. Separate treaty on Japan’s disarmament and demilitarization. The proposal of the Working Group to bring such a treaty into effect, in which the US would 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 treaty to join eleven powers greatly weakens the chance of getting Soviet support and reduces China’s interest in the treaty. The US recommended it by Mr. Byrnes in 1946, as a way to end the war, 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 expect to be able to support the US in pressing for a strong eleven-power treaty on this point. 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. Clauses Arising Out of the Interim Agreement

a. Reparations. There is as yet insufficient evidence of willingness to retreat from positions taken in the FEG on 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 agree 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 the legal and moral asset claims, and compensation for eleven-power losses. 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 FEG powers on restitution questions relates primarily to property known to have been looted but not identifiable as to source. The majority of the powers declare 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 manner that will reflect 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 formerly 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 threat 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.


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 principle 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 as a settlement, as initially and presently constituted, 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. Admissibility 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 program, 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. Re., National Archives]

4-9 POLICE REFORM

Telegram: W29921
To: CINCFE
From: CSCAD
Top Secret
1. Re Para 7 of NCS 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 disarmament to Japan may have effective police protection. Recognize that responsibilities for internal security problem through improved training of police forces and through steady realization of provisions of Maritime Safety Authorization Bill will devolve upon you. In this connection, early shipment from ZI of Cal. 36 revolvers contemplated.
3. Under the new 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 "GUNPOWER", 2ND, EDITION

Memorandum
April 12, 1949
From: General Headquarters Far East Command
To: Distribution List, Far East Command
Top Secret
1. Staff Study "GUNPOWER", 2nd Edition, prepared pursuant to directives contained in JCS 1299/27 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 "GUNPOWER", 2nd Edition is also distributed to the Joint Chiefs of Staff, Commanding General, Strategic Air Command; Commandant-In-Chief, Pacific; Commandant-In-Chief, Alaska and Commander, United States Naval Forces, Western Pacific.
3. Owing to the character of the emergency to which Staff Study "GUNPOWER", 2nd Edition applies, strictest security measures will be taken to prevent knowledge of its existence 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 "GUNPOWER", 2nd Edition will be strictly limited by addresses 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 addresses to nor to any foreign national.

b. Plans prepared by the recipients of "GUNPOWER", 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, AEF, and U. S. Task Forces of U.S. Naval Forces, Far East as designated by COMMAVE. Such plans will be complete in themselves and will not refer to "GUNPOWER", 2nd Edition by title.

* This formula would of course be modified in the event of the inclusion of Pakistan or any other Far Eastern state.
c. Plans, or extracts of plans, prepared by command as 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; Ryukyu Command; Marianas-Bonins Command and United States 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

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ORGANIZATION OF FORCES (See Paragraph 5 and Annex "A")

a. FAR EAST AIR FORCES
   (1) U.S. Air Forces assigned Far East Command.
   (2) U.S. Army Air Forces (ARWAF) in the Far East Command.

b. NAVAL FORCES FAR EAST
   (1) U.S. Naval Force assigned Far East Command.
   (2) U.S. Naval Forces afloat assigned Naval Forces Western Pacific.

b. EIGHTH ARMY
   (1) U.S. Army Forces in Japan.
   (2) U.S. Army Forces in Korea.

b. MARIANAS-BONINS COMMAND
   (1) U.S. Army Forces in the MARIANAS and VOLCANOES-BONINS.
   (2) U.S. Army Forces in the PHILIPPINES.
   (3) U.S. Army Forces in the RYUKYUS.

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: (1) enumerates the demarcation 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 possessions. 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 MUNCHURIA and MONGOLIA and as far as the Great Wall of CHINA in the vicinity of KALGAN, CHENGTE and CHIN HAI prior to D Day. From these points, the USSR could move into 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 points and 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 resistance by D+20 days. Such action would then attack JAPAN and OKINAWA and bring these areas within range of Soviet fighter aircraft based in KOREA and CHINA.
   (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. For the purpose of sabotage may be expected and an invasion of HOKKAIDO by air and sea is possible 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. Offshore 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 Soldiers and Saboteurs can be landed in JAPAN and OKINAWA to support the Communist Fifth Column.

**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.

**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 coordinate the following activities:
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 the Pacific, Alaska, and Strategic Air* commanders in their missions.
4. Make plans and preparations within the resources assigned to him and predispositionally 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.
   e. The above missions have been assigned by the Joint Chiefs of Staff, except those starred which are derived.

**GENERAL CONCEPT**

The general area of operations of the Far East Command includes the Sea of OKHTOKSK, JAPAN, YELLOW and EAST CHINA Seas, and the land and water areas of JAPAN, KOREA and MANCHURIA, CHINA, the USSR FAR EAST, the RYUKYUS, PHILIPPINE ISLANDS, MARINAS-VOLCANOES-BONINS.

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.

The general scheme of operations includes:
1. 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 CINCPAC. The evacuation of U.S. Forces from KOREA is effected as practicable and in accordance with instructions from SCAP. 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.
2. 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 mining the Soviet submarine menace at sea and for the mining of bases.
3. 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.
4. Upon declaration of a general emergency Naval Forces afloat affecting CHINA report to CINCPAC and are passed to the command of COMNAVFE.
5. 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.

**MAJOR COMMANDS**

1. **FOUR EAST AIR FORCES**
   a. Tasks
      (a) Conduct active air defense of the Far East Command.
      (b) Conduct such air defense missions 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.
   b. 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: (1) 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 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.
   b. The air defense of AAA is of prime importance to the security of JAPAN and the RYUKYUS. It is a continuous and ever-riding requirement.
   c. Fighter elements not required for defense, light bombardment units, and medium bombardment units as available, are employed in an immediate offensive initially against enemy airfields basing aircraft, the performance characteristics of which permit strikes against U.S. installations in JAPAN and against the RYUKYUS, or against troop evacuation in KOREA.
   d. 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 expected.
   e. 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.
   f. During the initial phase of the conflict, all available medium bombers with supporting elements are based on Okinawa and are available to CG, FEAF; employment in accordance with plans approved by the Joint Chiefs of Staff. Thereafter, these bombers, the VLR reconnaissance 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 CINCPAC for mining and other missions in support of his plans.
   g. The coordination and integration of mining operations in the Pacific, including the air support thereof, is a CINCPAC responsibility. CINCPAC 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 CINCPAC, will radiate 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
NATIONAL SECURITY AND EXTERNAL RELATIONS

B. Memo 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

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4-11 UNITED STATES OBJECTIVES AND PROGRAMS FOR NATIONAL SECURITY (NSC-68)

Report To: The National Security Council
By: The Executive Secretary

NOTE TO THE EXECUTIVE SECRETARY TO THE NATIONAL SECURITY COUNCIL ON UNITED STATES OBJECTIVES AND PROGRAMS FOR NATIONAL SECURITY

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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 fusion 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 fusion

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 fusion weapons—viewed in the light of the probable fusion bomb capability and the possible thermonuclear bomb capability of the Soviet Union.

The moral, political, and psychological questions involved in this problem would need to be taken into account and be given due weight. The outcome of this reexamination would be of crucial importance, for there would 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."*

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 masses of the people, and consciousness of people" (Vishinsky, "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 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 it is not the ends toward which the policy is directed which 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 conscious expediency. The single-mindedly violent, pugnacious, and intolerant attitude that is a leading factor: relative cost, risk, and employment of violence, subversion and deceit, and rejects moral considerations. In any event, the Kremlin's conviction of its own intransigence has made it devoted to theory so subjective that past or present pronouncements as to doctrine offer no reliable guide to future actions. This approach to war, and to war preparations in particular, is consistent.

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 resist or forcibly stop 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 confidence of this country and in the rest of the free world, on which our power is based. In this it has both adhered to 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 but can, if required, less to keep it functioning and its military machine operates efficiently 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 strategy of total and unqualified world conquest, because the inherent movement becomes total conquest, and because the Communist Party 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. The Communist Party, the Kremlin, and its 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 police force able to subdue the masses and to ferret out dissenting or subversive tendencies. 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 conscious might of the Soviet military machine 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 sympathy, if not cynicism, by the oppressed totalitariats 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 in the so-called "third world" countries which, 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 versatility sufficient 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 intrinsically 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 emotion-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 thrust it encounters a superior force which hails 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 rot.

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. The Kremlin has not yet been given real reason to fear and may 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 state. The material welfare of the totalitarian is seen as subservient 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:

<table>
<thead>
<tr>
<th>Product</th>
<th>U.S.</th>
<th>U.S.S.R.</th>
<th>European Orbit</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ingot Steel</td>
<td>20.4</td>
<td>21.5</td>
<td>28.0</td>
<td>37.9</td>
</tr>
<tr>
<td>Primary aluminum</td>
<td>61.6</td>
<td>130-135</td>
<td>140-145</td>
<td>230-235</td>
</tr>
<tr>
<td>Crude oil</td>
<td>410</td>
<td>72</td>
<td>112</td>
<td>176</td>
</tr>
<tr>
<td>(million metric tons)</td>
<td>(million metric tons)</td>
<td>(million metric tons)</td>
<td>(million metric tons)</td>
<td></td>
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</tbody>
</table>

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 capability 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 of Soviet 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 is not, its forces, the greater capabilities of the U.S. are to that extent ineffectual 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 arms production, although the margin of scientific research of the U.S. superiority is uncertain, 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 an additional 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:

c. 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;

c. To launch massive 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 in such targets in Alaska, Canada, United States, and the U.S.S.R. and the British Isles; and

c. To launch limited sea operations against British Isles;

b. Invasions of the Iberian and Scandinavian Peninsulas;

c. Further operations in the Near and Middle East;

c. Air and sea operations against the North American continent, and air and sea operations against the Pacific and Atlantic lines of communication;

c. Reciprocal exchange of atomic weapons.

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 these areas of its own and its satellites’ territories which can oppose but cannot prevent allied air operations against these areas.

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 so doing can 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-
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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 likely than 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 in the intervening years 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, assigned 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 time and the degree of accuracy of their delivery on targets. It is believed they are in a position to 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 sorted. For planning purposes, therefore, the United States assumes an atomic stockpile of 250 bombs with a 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 long waste to the British Isles and thus depriving the Western Powers of their use as a base;
- Destruction of the vital centers and of the communications of Western Europe, thus precluding effective defense by the Western Powers; and
- 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 capability, would result in tremendously increased threat.

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 defense guided missiles.

C. Military

The United States now possesses the greatest military potential of any single nation in the world. The 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 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. Our relationship to the strength of 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 coping with a reasonably effective measure of protection to the Western Hemisphere, bases in the Western Pacific, and essential military lines of communication; and an adequate measure of protection to vital military bases in the United Kingdom and in the Near and Far East. We will have the capability of conducting powerful offensive air operations against vital elements of the Soviet Union 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 aggregate threat, if any, 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.

In certain countries, such as Turkey, actively advanced 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, thus the United States could be 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. In such a course of increasing our military strength, we 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.

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 204 (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 supersonic atomic attack on the United States. We have substantially increased general air, ground, and sea power 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 shock and go on to 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 204, 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 its 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 the U.S.S.R. and our own."

"16. The risk of war with the U.S.S.R. is sufficient to warrant, in competent prudence, timely and adequate preparation by the United States."

Even though the present estimates indicate a significant Soviet military capability, 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 development, important among which are:

a. Serious espionage, subversion and sabotage, particularly by concerted and well-directed communist activity.

b. Inadequate 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 showering 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 1946 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 in time of war, are still valid, as are the aims and measures stated therein (para. 20 and 21). Our current security programs and strategic plans are based upon these objectives, aims, and measures:

"19. "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.

"20. 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 eradicating the myth by which people remove 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 instill among the people of nations a realistic 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 peace-time 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 them 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 all free peoples in vigorous and effective programs 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 the 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 aim must be 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 will have to light the path for the world which depends 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 with 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 national purpose and our objective in the world—will require that 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.

Concerning the relationship 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 in which the United States must be prepared to resist aggressive negotiations with the Kremlin—on the terms of agreements on important pending issues would reflect real realities and would therefore be unacceptable, if not disastrous, to the United States and the rest of the free world. The only reasonable solution to this problem is a steady and urgent deepening of our political attitude toward the U.S.S.R., 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.
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 United States and the Atlantic powers, prevent the Kremlin from achieving by force of arms what it cannot achieve by negotiation. This 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 nonpartisan 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 implement 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 convinced that the strategic interests of the United States would be seriously jeopardized if Formosa were to be made ilegitimate host of 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 west coast of 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 Formosa bases are 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 these installations currently available on Formosa could increase by 100 per cent the air effort which could be directed against Okinawa and operations based in China. It could at the same time could direct damaging air attacks against fighter type aircraft against our installations in the Philippines which are currently beyond the range of fighters based on the Mainland.

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 counterterrorist 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 "fleets" 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 agree to by both Washington and Tokyo military intelligence agencies satisfy me that the Russians have the capability to expand 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 military requirements either by improvisation or by the import of critical materials from Europe is being demonstrated daily by military activities extending from Tientsin to the southern border of China. The interest of the USSR in the southwest displacement of this fleet has been well documented.

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 invasion 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 campaigns in the South China Sea. The main body of the Japanese forces were landed on the southern coast of Luzon on January 1945 and formed the invasion group to Formosa. After the invasion of Formosa from Luzon in January 1945, the Formosa was considered to be a staging area 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 of the Philippines. After the invasion of Luzon in January 1945, the United States carrier forces withdrew to Formosa to freshen up and take 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 Ryukyu 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 the economy of the Far East. Under the Depression and the war it was able to maintain its economic importance. Today its imports are estimated to be about 600,000 metric tons annually. No one could tell precisely the importance of the economies of these two Oriental nations, which are fairly self-sufficient and of the two powers have a maximum utility of from three to five years, whereas people under occupation become even more dependent upon United States assistance.

8. Formosa represents a political area of no less importance to western ideology than any other region in the Orient. The Chinese are a homogeneous racial group as individuals who as individuals have resisted the intrusion of foreign blood. Although Formosa was promised to China as a part of World War II this promise was given in consonance with a political situation in which 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.

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 people or into the hands of a power which will try to use Formosa to 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 Command-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. This recommendation I approve fully as I have indicated 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 number of the Chinese Nationalists in Formosa and the equipment to either the political or military 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 of such an event. The Chinese are not averse to the idea of maintaining Formosa as an independent power. 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 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 acted upon as a basis for United States national policy with respect to Formosa.

[Source: MacArthur Memorial]

1950

1950

4-13 MacArthur’s Memo on the Peace Treaty Problem

Memorandum

June 14, 1950

O’Hare, 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 treaty conditions. Since then I have had occasion to consider the question from the viewpoint of the Allied Powers and in particular the United States. I have come to the conclusion that it is necessary to have a maximum utility of from three to five years, whereas people under occupation become even more dependent upon United States assistance.

2. Since then the issue of a peace treaty has been constantly upon the agenda of international discussions existing in the several Powers from time to time. Following upon their Basic viewpoint of their respective requirements, however, it should be noted that the Powers have found in 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 conference—the Soviet insisting that it involved a matter which should first go before the Council of Foreign Ministers of the United States and the other United States, adhered to the position 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 conference because of its aim to contain all of the Powers as the United States 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 Commonwealth have held three recent meetings hoping through an exchange of ideas to crystallize a firm Commonwealth peace policy. More recently, the United States 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. In the general confusion and unfounded charges that the Soviet has massed all of its 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 treaty policy because of continued disagreement between the Departments of Defense and State Departments, giving emphasis to the idea that the peace treaty 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 question and reaffirmed their belief that certain conditions must be present to warrant our entry into treaty negotiations. All of such conditions may be described as offering no unanswerable difficulties with the exception of one which requires that the Soviet and Communist powers sign the preliminary treaties of Paris. In other words, the signing of the final treaty 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. I, therefore, neither agree nor disagree with the SCAP nor do I agree with the JCSC. If SCAP has long been deeply concerned over the psychologically adverse effect upon the Japanese people of protracted delay in moving toward such a treaty, and as CHICOM I have observed that the grave misgivings of the Japanese people as to the potential under the impact of political and military reversion on the mainland of Asia, with concomitant pressure upon vital segments of our strategic island frontier off the Asian coast. In fact, my observation of passing events in Asia and understanding of Oriental psychology have long convinced me that there has been a fundamental error in dictating suspending 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 is clear that 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 blight upon the world. For this reason and in the interests of peace, a new set of policy objectives, we should not allow ourselves to be deterred from moving inevitably 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 peace formula which it cannot gainsay, assume the full onus for any further consequences. 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. Japan and all of Asia would witness the emergence 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 the pattern of Oriental psychology to respond to follow aggression, to produce 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 eyes of the whole world in such a peace conference or in such a conference by which the United States sought to secure peace in Eastern 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.

8. To safeguard against such an eventuality and to compose the situation in Japan resulting from the slapstick nationalist sentiment, existent in Japan, the United States Government must be permitted to 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 that the United States Senate has now moved to enter into this, providing reason to hope that there is no irreconcilable point of difference.

9. It is my understanding that both Departments agree that the United States policy as expressed in NSC 1/3 is a "guiding principle". In view of the agreement which we have developed among the interested nations regarding the procedure and substance of a Japanese peace treaty and in view of the serious international situation created by the Soviet Union's participation in Communist aggression, in its present form and in our view as shown in the negotiations for the current Chinese compromise, the United States Government has been "overpowered by events", although it appears to be the view of State that such events have not made it mandatory that the United States now press for a peace treaty, while Defense expresses the view that these events should be interpreted in a way which would make it possible for the United States to proceed to a peace conference. While the situation is not entirely clear, it would appear that the Japanese for the present at least are not desirous of a peace settlement, even if only based upon partial representation of the Allied Powers. It would be impossible to expect any semblance of sincerity or validity the failure to grant the United States due place in the negotiations, and it would be unreasonable for the United States to take the initiative in this matter until more is known as to the extent to which the Japanese are desirous of a peace treaty. 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, in addi-

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 a Japanese based 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 largely met by the reservation of such military bases to the United States would be a move toward the consolidation of the United States as an aggressive threat against the mainland of Asia. In these circumstances, while such a joint agreement is entirely possible of legal consummation, its value to the United States would be limited by the bitterness and resentment which would thereby dominate the Japanese mind.

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 world peace 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 has been destroyed, points in Japanese territory to be demilitarized 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 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 a fuze in the wake of predatory forces embarked upon military conquest. However, Japan and its “new order of peace, security and justice” in effect 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 need for surrender “as irreparably lost to the Sovereignty and the territorial integrity of Japan” 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 power would not be a factor in the world 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 peace and security 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 this is a failure 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 lose sight in the existing international tension 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 possibilities of the future, but to ignore the realities is to plan unsoundly for either period. Such an effort to reverse Allied policy toward 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. Such steps would be accompanied by complications in Japan itself where the people with unfaltering 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 cannot stand on her own defences. Allied occupation 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 alignment, in the state of neutrality, both with the Soviet and Japan 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 a 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 and occupy “points in Japanese territory” until “irresponsible militarism is driven from the world” 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 occupation. It would place and retain jurisdiction 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 execution.

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, it provision should be made for the establishment of a UN Trusteeship to, 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 continuing occupation.

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 would provide the basis for international pressure for the Soviet acceptance. 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 reaction, and in the event of a Soviet refusal, is merely more evidence to the effect that the so-called unicity vis-a-vis Japan, whereby 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 be acceptable within our own government and will accord with 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 structure made for 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

Concerning the defense of a land area necessitates only reservation of pre-determined 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 formulation may be stated: 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 dispositions as may be necessary to adjust defense plans adequately to cope with any changes in the potentiality of external threat and in the event of hostilities to take such tactical dispositions as the military situation may require from time to time require. Thus, by avoiding emphasis upon any specific points to be resolved 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 imminent threatened hostilities no major change in the composition 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 integrated to a size and character adequate for internal security.

3. Such a concept would be fully 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 would avoid arbitrarily the $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

"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 enforcement 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 the police a major national rural police force of 30,000 men. It then was 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 elimination 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 the much lower police strength in relation to population is to be found in most of the other democratic states and the general post-war impoverishment and other adverse conditions usually conducive 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 safety 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 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 for the General Account of the National Budget toward retirement of the public debt. The appropriate sections of this Heading will be available, as heretofore, to advise and assist in the technical aspects of these measures.

[Source: SUTLAND PAPERS]

4-16 STAFF STUDY "INCREASE IN JAPANESE SECURITY AGENCIES"

Memorandum

From: General Headquarters Far East Command

Top Secret

AG 253 (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 aspects of 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... "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.


7. A copy of this Memorandum (less Inclusion 1) has been forwarded separately for action to CO, 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 sheet)

File No: Subject: Increase in Japanese Security Agencies
Note No: From: DC/\S, SCAP To: Chief of Staff Date: 10 July 50

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)


3 Incls:
   1. Tab 1—National Police Reserve
   2. Tab 2—Coast Guard Augmentation
   3. Tab 3—ESS Financial Estimate

A. P. F.

AD HOC COMMITTEE
(DcOs, SCAP, G-2, G-3)

Brief of Tab 1—"National Police Reserve"

The organization, equipment, 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 Jima School Command should be used as required in training Japanese cadre 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 assign the selection of key Japanese ex-military, non-purge personnel for command, staff and technical positions in the force.

 Concurrently with processing of recruits at the six (6) National Police Reserve regional schools, concentration and training areas should be selected and organized to receive trainees in groups of 1,000 from the reception centers (National Police Reserve 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 (Y8,405,000,000). This sum 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
(DcOs, 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 CINCEFE 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 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 outlaw 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 training division/G-2 should be utilized. The employment of any reasonable 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 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 the 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 units, 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 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 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. Movement of divisions from 1,000 man units through the program will be 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 directed 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 recommendations in paragraph 10 above be approved.

b. Annex "P": 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"**

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.

b. The JACPOW 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.

c. The metropolitan police forces of Japan total 95,000 men. These forces perform metropolitan and civil tasks which restrict them to a civil and limited functioning as 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 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 force to which it will be attached which might ultimately prevent the exercise of any force 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.

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 personnel and methods already established, and an established police force centralized and central 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 disadvantage and the addition of limitations so established lines of communication. The 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 serious 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 the past the NYK Building or the Japanese 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 and further that, except that the further guidance and training schedule of SCAP, 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
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 purgese 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 1,000; the Japanese battalion is slightly less. The latter is less adequately organized and equipped than a United States battalion. This is because the battalion 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 the eventually individually 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, administrating, 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 establish them if necessary, where processed personnel of the six schools may be relocated. Only by this effort may the 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 training troops. The former geographical division 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 security that the four divisions be established in conjunction with these areas. As the 1,000-man units are formed in the regional schools they should be dispatched to those areas for further training.

The Japanese Army, now two infantry divisions, is capable of fielding 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-built 30-cal. M-1. On order from Zama are 5,000 serviceable, 10,000 unserviceable. The former are 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, 60-mm and 105-mm howitzers, and light tanks, 105-mm howitzers, and other equipment. The armament is the present status 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 weapons. The recruit would be armed with individual weapons as rapidly as possible and the 1,000-man units should be augmented progressively until these men have received the degree of fire power necessary and in accordance with their ability to absorb and master required techniques.

The SCAP agency assigned this responsibility must commence immediately training of unit cadres; must select, screen, organize and assist headquarters and offices for the National Police Reserve. Already available to aid this training are facilities available at the Eighth Army Service School at Zama, Japan. 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 quickly purged in fulfilling quotas it excludes skilled, educated and highly trained group. A happy medium therefore is to accept any applicants other than purges 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 training 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).

To: 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 8,625, and all majors (with the exception of 47) numbering 8,011 were purged. Research further shows that 7,914 captains were purged; 7,315 were not purged; 3,635 first lieutenants were purged and 59,092 were not purged; 5,243 second lieutenants were purged and 91,986 were not purged. The non-purged officers were formerly special reserve officers of candidates, warrant officers and non-commissioned officers. All of those purged were graduates of the Military Academy. For a comprehensive view of how purged and non-purged, see Tab 1.

2. The officer replacement system of the Japanese Army is entirely different from that prescribed by the Army of the United States. A junior officer must be graduated from the Military Academy or a Military Academy Officers’ School. Officers, purged or not, were purged or not, held an appointment for a period of months or years. The two were re-coded 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. The duration of their limited training was non-negligible, 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 become qualified to perform the duties of general. 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 duties 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 or on graduation from the 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 and non-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 are 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 Reserve 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 1530, 8 August up to 1030, 9 August, showed that of the 972 non-purges 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 Reserve and more than 95% showed no interest. These inquiries were made to the local Assistance Bureaus in the forty-six Prefectures of Japan. (See Tab 4).

15. 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 Communist 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.

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 Reserve Police Force, the 800 responsible 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 obtaining the information, as its mission was to infiltrate the National Rural Police Headquarters, the Special Investigation Bureau and the Municipal Police Headquarters are disunited, and with no coordination between them in matters pertaining to information and activity. (See Tab 6).

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, along with several listed 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).

13. At a secret meeting of the Liberal Party, Chief Secretary OKAZAKI stated on 2 August 1950, that there was a need 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 borders, and that the Police Reserve was 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 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 purge officers in the Police Reserve.

4-19 YOSHIDA LETTER ON CHINA

Letter

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 toward 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 territories, and which maintains diplomatic relations with most of the members of the United Nations. To that end my Government on November 17, 1951, established the 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 China, 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. The Japanese Government is prepared as soon as legally possible to conclude a peace treaty 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 a bilateral treaty shall, in respect of the Republic of China, be applicable to all territories which are now, or 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 as being an aggressor and in consequence, the United Nations has recommended certain measures against that regime, in which Japan is now concurred and expects to continue to concur when the multilateral Treaty of Peace comes into force pursuant to the provisions of Article 5 of the Charter, 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 Communist Party in its program of subversion against 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.

Sigeru Yoshida.

[SOURCES: John Wheeler-Bennett and Anthony Nicholls, The Sandbox of Peace, pp. 615-16.]

4-20 ASSISTANCE FOR SELF-DEFENSE FORCES AND TRADE

Japanese Memorandum
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 definite nature on the problems embodied in the agreed agenda. The Japanese representatives feel more confident today than they ever have been before that as a result of the discussions they will be enabled and encouraged by their government so that their mission may end fruitfuly. The present paper is designed to summarize the resulting decisions reached and (points which are) as yet to be agreed upon, in the order of the agenda.

1. The legal restriction and an assistance

(i) 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.

(ii) The legal restriction is one of the constitution. The Japanese Constitution reads in its Article 9 that: "Abandonment 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 of the Constitution so as not to do any damage to the cause of Japan's peaceful 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 to take up arms no matter what may happen, and those who were mostly affected by this education are the 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 peace time expenditure of the defense cost out of the national income for terms of each 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 community atmosphere which is the cause of concern. The Japanese are very sure that the youths will not direct their guns towards Japan. All this means that a speedy 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 Japanese representatives have recognized these restrictions and have agreed that the Japanese share in the "mutual defense cost" should decrease as the cost of her own defense program increases.

October 19, 1953
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.

Within the Japanese 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 the businessmen 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. It is Japan's intention.

The U.S. representatives expressed their anxiety as to an inflationary trend that the Japanese economy is taking or likely to take.

The Japanese representatives 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: Irving H. Blass, Ministry of Finance]

4-21 ASSISTANCE FOR SELF-DEFENSE FORCES

United States Memorandum

Ikeeda—Robertson Consultation

Confidential

October 21, 1953

The following United States comments upon the Japanese paper of October 19 are conceived as internal and do not stand independently of one another.

Paragraph number correspond to paragraphs of the Japanese paper.

1) The United States representatives recognize the existence of the four limitations upon the use 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) 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 require. 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.

3) The adequacy of Japan's 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 conferences 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 JPY 1955, Yen 235 billion.

4) It is suggested that the conferences tentatively accept an objective for the ground force of approximately 950,000 to 950,000.

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 255 billion can be most wisely expended for the defense force over the next two Japan fiscal years.

It is noted that Mr. Ikeeda's study of Japan's defense program does not provide for any increase in the NSF ground element in the current fiscal year.

1 is the recommendation of the United States Conferences 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
NATIONAL SECURITY AND EXTERNAL RELATIONS

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 the United States 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 Japan in completing the equipping of Japanese forces in being and to assist in training the personnel, including air.

(ii) The United States would regard it as proper for Japan’s consumption on the support of United States forces should diminish as, of justified by the development of Japan’s own forces.

(iii) United States Conferences 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.

4. The United States has given a Japanese defense 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 on 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 quantity of procurement. As of now, the United States agencies involved have a tentative target figure of $200 million in mind.

The United States believes that $50 million is a reasonable target figure for sales of United States products to Japan under the criteria of the Mutual Security Act, including the necessity for demonstrating that such sales and purchases will aid Europe and other friendly forces in the Far East. The $100 million off-shore procurement procurement estimate given in the preceding 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 sales could be used to help develop the Japanese economy, and 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.

1. The United States is prepared to help the reparations settlements through its diplomacy if it shall prove useful. The Japanese understand that such 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 the reparations settlement.

2. The United States recognizes the important benefits which can result from increased trade between Japan and the southeast Asia area. The United States is prepared to discuss any specific ideas which the Japanese government may develop with respect to the role which the United States should 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 stricter controls than those of European countries, is now consulting with the Japanese Government on the removal from the embargo list of certain items that are available in Japan, and is reviewing other items for possible deletion. A number of such depletions 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 important 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 $2.5 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 2 percent in 35 annual installments with approximately $43 million of the $750 million to be settled on surplus prosperity terms.

It is suggested that the United States and Japanese representatives meet in Tokyo about November 15 to finalize the necessary documents.

5. It is the understanding of the United States Congress that the Japanese Government intends to permit full exclusive 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 conferences would like to emphasize that they regard milder 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 steps to stop production of goods for export;
3) Adequate procedures to direct the flow of investment into productive enterprises, especially export enterprise;
4) Adequate 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 off-shore procurement will diminish; 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

Ikeeda-Robertson Consultation

Is now made to United States Memorandum dated October 21, 1953, which reached us on October 22.

1. Japanese conferences 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. The United States conferences have expressed their willingness to assist Japan in developing a defense program 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.

3. The fiscal year 1954 it is the opinion of the U.S. conferences that it will be difficult to defend U.S. military bases and economic 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 F.Y. 1954 and by the same time $235 billion yen for F.Y. 1955.

Information available to the U.S. conferences suggests that $250,000,000 is a reasonable objection for Japan and the proposed Japanese conference will meet the ground force of 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 conferences 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 mine-sweepers and mine layers.

The conferences 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.

They 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. conferences 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 conferences 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. conferences 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. conferences 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. conferences 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. conferences that $50 million is a reasonable target figure for sales of agricultural products to Japan under the criteria of Section 509 of the Mutual Security Act, including the necessity for demonstrating that such products are in addition to usual marketing. 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 conferences 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. conferences 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 ways to 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 conferences recognize the important benefits which can result from increased trade between Japan and the Southeast Asian area. The U.S. conferences 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. conferences believe that it is important to maintain a high level of control over trade with Communist China. However, the conferences agree as a matter of principle that no stricter controls should be requested of Japan than European countries.

IV. Japanese conferences understand the importance attached by the U.S. conferences to the settlement of GARIAO 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. conferences 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 conferences state that the above approach overlooks the fact that the reparations is not such a complicate problem for West Germany as in the case of Japan. The attention of the U.S. conferences is also called to the fact that West Germany has been the recipient of EC Aid, while Japan has not received economic aid since GARIAO was terminated.

V. The U.S. conferences suggested that some liberalization of the Japanese law and regulations pertaining to foreign investments will result in a greater investment. Japanese conferences 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. conferences 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

Top Secret

September 12, 1945

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).

ENCLOSED

REPORT BY THE STATE-WAR-NAVY COORDINATING COMMITTEE 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 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 "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 or 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. War crimes. 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.

APPENDIX "A"

DISCUSSION

1 This is a revision of SFE 106/8 and 106/9. Cf. also: SWNCC 57 series, JCS 1023/10; JCS 1349.
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 area subject to your jurisdiction, take all practicable measures to identify, apprehend, and detain all persons whom you suspect of having committed war crimes, as defined in paragraph 1, subparagraphs B and C above, or 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 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 charg- ing under paragraph A above 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 report to the United Nations all suspected war criminals in close concert with the press or other media of public information, and without distinction as to rank or position, as belfs of 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 the authority by which it is constituted will 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 military courts and (b) the power of enforcement of the sentence described in paragraph 1 A above. Un- til further authorization by the Joint Chiefs of Staff, no international court for the trial of war criminals will be constituted for the Far Eastern area until after the conclusion of the trial on the charge of the Japanese Emperor, as prescribed in paragraph 1 A above, and the Japanese Emperor should be taken as the first priority for the establishment of international military courts, the trial before which should be completed by the end of 1946. After the Japanese Emperor, the Emperor of Germany, the Emperor of the Hapsburg Empire, and the Emperor of Russia will be the next priority for international military courts, the trials before which should be completed by the end of 1947. After these trials, the trials of other persons of greater importance will be considered.

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 or persons charged or convicted elsewhere, if in your judgment such their trial in such courts is desirable. Courts which are to be held under paragraph 1 A above shall be subject to the Supreme Commander as to the jurisdiction of the courts and the nature of the coordination of the plans of the United States, Great Britain, and the United States. The courts shall have the power to impose sentences of death, life imprisonment, and other penalties as authorized by law. The courts shall have the power to impose sentences of death, life imprisonment, and other penalties as authorized by law. The courts shall be established in accordance with the laws of the United States and shall be under the control of the United States.

8. Subject to the provisions of paragraph 1 A above, you will promptly comply with a request by the Governments of any one of the United Nations or Italy, or persons acting under such requests, to deliver to the United States, Great Britain, or the United States, persons suspected of having committed war crimes, in accordance with the laws of the United States and the laws of the United States. The courts shall have the power to impose sentences of death, life imprisonment, and other penalties as authorized by law. The courts shall be established in accordance with the laws of the United States and shall be under the control of the United States.

9. Compliance with any request for the delivery of a suspected war criminal shall not be delayed on the ground that other requests for the same person are anticipated.

10. The delivery of a suspected war criminal to a requesting government shall be sub-
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 (Keisshi-cho) is under a Superintendent-General (Keisshi-nakan) directly responsible to the Police Bureau of the Home Ministry, rather than to the Tokyo-to authorities.

6. 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 that are discharged by separate government bureaus in other countries. Police functions in Japan range from the enforcement of criminal law to arbitrary control of dissent by 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 full development 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 free expression of the will of the 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 (SWNC 150/4/A, publicly announced 22 September 1945) establishes specific policies with regard to Japanese public order and methods. It calls for the rapid 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 designed for the enforcement of such laws; and the replacement of the present police as 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 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 extent to which the Japanese authorities will cooperate with 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 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 the Japanese authorities will cause a deterioration in public order below the necessary level 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 inquiries and requests on the authorities to 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 permanent 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: U.S. Department of State, 1945]

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 steps and 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. In regard to Japan, 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. 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.

   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.

   d. In regard to Japan, 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. 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.

   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.

   d. 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.

   e. 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.

   f. 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.

   g. 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.

   h. 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.

   i. 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.

   j. 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.

   k. 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.
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. Orientatlon of Japan, II, p. 796]

5-4 EMPEROR’S POSSIBLE ABDICATION

Telegram: CA 53136
To: War Department
From: Advance echelon, General Headquarters, Army Forces, Pacific, Tokyo Secret

From SCAP to WARCOS pass to SEGSTATE from Atchenso 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 any time of his own choosing. This source feels that reform of the Japanese constitution should come about in a manner now provided, that is, through initiative of Emperor and that 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) would provide a firm basis for launching and establishment of an organic law of government.

[Source: Med. Mil. Br., National Archives]

5-5 TREATMENT OF EMPEROR

Minutes, 27th Meeting (Excerpt)
SWNCC
Top Secret

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.

“d. The tone of the discussion (Appendix B, paras. 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, 5, c 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 Institute of the Emperor 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 reflected the Emperor’s guilt, which would be inadmissible 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.

[Source: Dipl. Br., National Archives]
5-6 ADMINISTRATION OF THE EDUCATIONAL SYSTEM

Memorandum
SCAPIN-178 (CIE)

October 22, 1945

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 militaristic 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, reoriented, 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 reappointments.
      (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.
   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 designated 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. 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* 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 of the "Conclusions", page 2, and the reference to decentralization of the government in paragraph 5 of the "Conclusions", page 2, where only one clarification 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 was 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 Emperor system was adopted because the Emperor would have no power to override the 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 list 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 of 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 if 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 communications with Konoye and other Japanese governmental representatives, approve any proposal they might make in the direction of the "Conclusions", suggest

* Cf.: SWNCC 209/D and SFE 141 series.
any points that were not being adequately considered, and only as a last resort issue an
tis-bell.

Mr. Martin objected to the paper on the grounds that it proposed constitutional re-
forms by the same group of Japanese who had been in power before the war, with no re-
ferendum 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. SWGC 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 the will of the people. 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 govern-
mental reform to be definitive without a decision on the institution.

Mr. Martin added that the reorientation paper could not properly be retained with-
out 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. AsSir George Sansom, Mr. Martin suggested Dr. Reinshauer, as
such an authority. Objecting to Capt. Dennison’s reference to the need for a de-
finitive paper, he felt that it was impossible to arrive at a definitive conclusion at this
time, and that the purpose was for a useful paper for discussion 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 cite the changes in form that would be required for either all-
territorial conquest or for restoration of the institution, or (b) if the institution were retained, (b) if the institution were retained.

Capt. Sabin supported this view and suggested that SFE 142 would be a better paper
if SWCC 209/D were written first.

Mr. Penfield said that there was no need of a scholarly paper in order to con-
clude that the Japanese should not be allowed 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
perhaps encourage many changes by the Japanese in that direction.

Mr. Vincent would avoid any delay in forwarding SFE 142 to the
SWCC 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 be dropped from the agenda at the instigation of a letter to the Secretary.

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 that we were the same ones that had been in power 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 Insti-
tution 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

58 Governamental Reform in Japan

Memorandum

To: J.C. Vincent

From: F.H. Horton

Secret

In recent reports from Mr. George Acheson 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 Supreme Commander and his advisors “wish if possible to keep the
State Department out of this matter”. [The question of constitutional 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,
categorialization of feudalistic and totalitarian practices, and further development of occupation
policies”.

While it is realized that the Supreme Commander has final responsibility for all activi-
ties within his theater of command, the problems involved in the reforms of the Japanese
constitution 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 governamental
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 of the appropriate channels of any plans or contemplated action by the Supreme Commander on matters of political reform;
2. The paper on "Reform of Japanese Government 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 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 judgment, 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. Bourne suggested that parts of Max Bishop's draft paper dealing with the preceding 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. Seabold suggested that there might be hidden problems in the paper such as that of the Emperor's advisors. Mr. Borton answered that SWNCC No. 223 provided that the Emperor was to act only on the advice of the cabinet which was responsible to the Diet. Dr. Blakeslee suggested that such a phrase might be added to 4 a was agreed to by the committee.

Mr. Johnson opposed 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 eagerness for the institution of the Emperor, the Supreme Commander should in accordance with SWNCC No. 223 transform the institution into a Constitutional monarchy.

Mr. Johnson questioned the relationship of f to the subject matter of this paper. Mr. Reischauer suggested 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. Seabold 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. Seabold's suggestion to delete all of f, after "such a move"; also, to break e and f into three parts; to deal with a general statement of principle relating to our 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. Perlo's suggestion to leave out the adjective "extreme". The committee accepted e 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 established 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, terrorist, or secret paramilitary service agencies or affiliates.
   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 Chokin 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 Chokin (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 associations and other organizations of the Government or any of their agencies that have a financial interest representing actual or control or supervision.

5. The term “remove from public office,” as used in this directive, shall mean to discontinue the person from 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 for screening purposes. 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 therein 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 persons 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 appointments 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 those persons who are absolutely required to be in a certain position (e.g., officers of the military, the police, the Navy, the Finance Department). Also, certain officials in the outlying theaters or out of the provisions of this directive. When their assistance is no longer absolutely required they will be dismissed. The names of such individuals will be remade so that their temporary retention will be promptly reported to this Headquarters. The time of their final dismissal 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 paragraph 5 of this directive. Persons shall thereafter be excluded from government service by the Imperial Japanese Government, or otherwise, 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 would be necessary to obtain an appointment, 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 application will be considered 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 described 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 recommended for removal 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 Questionnaire which will provide for:

a. Distribution.

b. Collection.

c. Revisions.

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 shall be approved by the Minister or other head of the 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 the influence of those who have deceived and misled the people of Japan into embarking on world conquest, any person who commits any one within 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 prefectoral Government or Municipal elections or for any other elections. This person will be 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 notices, and 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. Reports required by paragraph 11. This Headquarters may direct revision of any of these Plans if they are not considered adequate.

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 Imperial 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. The classification 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.,  
Ass. Adjutant General.

Inclusions:
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 (Kempf-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

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 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 territories, 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.
   - Governor General.

2. Formosa:
   - Governor General.
   - Governor General.

3. Kwangtung:
   - Governor General.
   - Governor General.

4. South Seas:
   - Governor General.
   - Governor General.

5. Netherlands East Indies:
   - Governor General.
   - Governor General.

6. Malaya:
   - Governor General.
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.
Officer 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.

[Sources: Pbl. Reviatuation of Japan, 11, pp. 402-85]

**5-11 REFORM OF JAPANESE GOVERNMENT (SWNCC-228)**

Report, SWNCC-228
Drafted by: SWNCC
Top Secret
January 7, 1946

**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 Japan-
       ese 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;
   b. A legislative body, fully representative of the electorate, with full power to re-
      ducce, increase or reject any items in the budget or to suggest new items;
   c. No budget shall become effective without the express approval of the legislative
      body;
   d. Guarantee of fundamental civil rights to Japanese subjects and to all persons
      within Japanese jurisdiction;
   e. The popular election or local appointment of as many of the prefectural officials
      as practicable;
   f. The drafting and adoption of constitutional amendments or of a constitution in
      a manner which will express the free will of the Japanese people.
   g. 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.
   h. 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 legisla-
          tive 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.
      a. 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 repre-
                sentative 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 Govern-
      ment 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
      and strengthening representative government in Japan.
   7. This paper should not be released for publication. The eventual release of a state-
      ment 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:
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 ensure that the reforms are lasting in strengthening representative government in Japan.

In 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


5-12 CONSTITUTIONAL REFORM

Memorandum
To: Gen. MacArthur
From: Whitney

The question of constitutional reform of the Japanese governmental system is rapidly approaching a climax. Several proposed reforms 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.

I have authority from the Allied Powers to proceed with the fundamental constitutional reform required by 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 to pursue policies in accordance with the freely expressed will of the Japanese people of a peaceably 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.

I 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 necessary to carry out your mission. (Table 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," (para. 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 autho...
5-14 SCAP AUTHORITY ON CONSTITUTIONAL AUTHORITY

Telegram: WAR 80049
To: CINCPAC, Tokyo
From: War Department

It is understood that in view of Moscow and certain members of Far Eastern Commission may question your right to approve new Japanese constitution without directive from Committee. Accordingly State Department is informally asking War Department to ascertain basic of your approval.

View in War Department had been that if Japanese Government were to proceed with constitutional reform prior to action in F.E.C., 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.

5-15 U.S. EDUCATION MISSION TO JAPAN

Digest of Report

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.

* Submitted to SCAP on March 30, 1946.
The Mission recognizes the necessity for the original negative directives, such as those eradicating militarism and nationalist 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 ultranationalistic reform, is endangered by the evils that accompany centralization. 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, responsible citizens.

To that 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 different careers and abilities. It should therefore be set up through cooperative action involving teachers, calling on their experience and releasing their creative talents.

Moral, which in Japanese education occupies a separate place, and have tended to promote submissiveness, should be differently construed and should interpenetrate all phases of a 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 support in the 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.

Proposing that some form of Romaji be brought into common use, it is proposed that a language commission be 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 should 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; (3) to study the nature 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.

POLITICAL AND SOCIAL REFORM

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. The substitution of ceremonial in the reading of the Imperial Rescript and obeisances to the Imperial Portrait in the schools is regarded as undesirable. The Ministry of Education, under the proposals of the Mission, would have important duties to perform in preparing 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 of representatives 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 school budgets, the hiring of teachers, the selection of textbooks, and 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 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 of 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 profession should be brought about 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 kind of teachers needed. They should provide a course in the field of studies only after completion of a course in the field of education. In addition, a program in the field of teaching should be offered to normal schools of the elementary level. The teaching profession should be extended to the elementary level, and not remain confined to the elementary schools.

Other institutions for preparing teachers for certification, whether private or tax-supported, should provide training in teaching methods equivalent to those of the reorganized normal schools. These teachers should be trained in the elementary schools to the extent that they may become instructors in the elementary schools.

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ADULT EDUCATION

During this period of crisis for the Japanese people, adult education is of paramount importance.
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 fulfill 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 broadened 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 the revised plan. Some governmental agencies 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 and its ability 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 access, 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 medical and public health.

[SOURCE: U.S. Department of State, Occupation of Japan: Policy and Progress, p. 156-63]

5-16 REFORM OF THE JAPANESE WRITING SYSTEM AND LANGUAGE PROBLEM

Report
Drafted by: Working Group, State Department

POLITICAL AND SOCIAL REFORM

MEMORANDUM FOR

Dr. E. O. Reichsauer, S-2586, Room 432, State Dept.
Major M. Mitchell, W-71940, Room 419401, Pentagon.

Condr. Stephen Jurek, N-63068, Room 86141, Navy Bldg.

Reform of the Japanese Writing System and Language Problem.

Enclosure: 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. Reichsauer, Chairman.

2. There will be a meeting of the Working Group to consider this paper at 1500, 2 May 1946, Room 4346, 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 kanji, 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 SWSCC, 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 East 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: Depl. Br., National Archives]

5-17 REFORM OF LOCAL GOVERNMENT

Memorandum

To: Chief, Government Section
From: C.G. Tilton, Chief, Local Government Branch

April 30, 1946

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 be necessary 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 area 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 central authorities 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 of organizations for local purposes. Variations from the standard 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 opportunity 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. Herefore 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.

2. The basic law of the three echelons of the civil government has an organic law of some 150 articles which provides its basic structure; the Law concerning the Organization of Prefectures, Law No. 68, 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. 68, 1911 with amendments.

b. Supplementary organizational elements as well as other matters for each of the echelons are provided for in Imperial Ordinances: the Chihkankanrei or Regulations Governing the Organization of the three levels of local government, the Budakenshienrei or the Regulations Concerning the Appointment of Civil Officials and the Yainaishikan 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 curtailing 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**
      b. Home Ministry Draft: Poplar 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 elected 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.
   b. Local Government Branch: Poplar 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.
   c. **City Mayor**
   d. **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 is performing the 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 issue and sell rent, 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.
   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. **Village and Town 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.

3. **Duties of Executives in Respect to Elections.**
   a. Present Law: 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 to the budget, and the Assembly is not permitted to increase 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.
      b. 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.
      c. 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 election of the 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.
      d. The Home Ministry also proposes that when the Assembly has adopted a resolution of non-confidence the Governor may request the Home Ministry 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 Home Affairs upon the initiative of 1/50 of the electorate, or 10,000 persons, whichever is smaller.
   b. **Village and Town Councils**
      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 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 Governor 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 without limit, except 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 referring 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 Aldermen, 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 change.

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. (Disused by Dr. Gradjdanzev and Mr. Masland.)

2. City

a. City Assembly.

i. Present Law: The law in respect to the city assembly follows closely the law of prefectures, except that the dependence upon superior government is greater, “the City Assembly may submit . . .”, “the city assembly shall submit . . .”, etc.).

ii. Home Ministry Draft: The proposed changes closely follow the prefectural pattern.

iii. Local Government Branch: The Local Government 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.

b. Present Law: The present law provides for a city board of aldermen similar in composition and functions to the prefectural board of aldermen.

c. 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.

d. 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

b. 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.

POLITICAL AND SOCIAL REFORM

ADDITIONAL PROVISIONS

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 councillors and committees on his own authority.

b. The mayor has coordinated jurisdiction or talon 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.

3. Towns and Villages

A. Town and Villages sections and staff.

b. Present law for administrative control and organization of towns and villages is the same as the city law in essential elements.

c. Home Ministry plan similar to its recommendation in the city law.

d. 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 Provisions

Local units of government should possess home rule authority, enabling them to write their own charts 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: HUBBY PAPERS, UNIVERSITY OF MICHIGAN)

5-18 SUMMARY OF ACHIEVEMENTS DURING THE FIRST YEAR OF OCCUPATION

Statement 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 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 war-making 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 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 untrammeled right, individually or collectively, with his fellow workers, to demand justice, with a further million of allied 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 enfranchising 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 the history of Japan. 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 preceded 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 the economic challenge 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 Far Eastern Commission September 21, 1946

REPRESENTATIVES PRESENT

Major General Frank F. McCoy (United States) (Chairman)
Major J. Plimso (Australia)
Dr. George S. Patterson (Canada)
Dr. S.H. Tan (China)
Mr. Paul Guerin (France)
Mr. Jamshed Vezudia (India)
Dr. A.A. de Kat Angelino (Netherlands)
His Excellency Sir Carl Berendri (New Zealand)
Mr. Leonides S. Virata (Philippines)
Rear Admiral S.S. Ramalvili (U.S.S.R.)
Sir George Sason (United Kingdom)

SECRETARY GENERAL

Mr. Nelson T. Johnson

ITEM 3 DRIFT CONSTITUTION (FEC-007/1)

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 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 in 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 determine its defects or inadequacies, it can properly be deduced that the inability of this body, and the other two former Imperial Parliaments 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 of 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, if left such 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).

(2) It will be recalled that my Delegation has had 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 FCO-087/3, which paragraph in part reads as follows: The Committee considers, therefore, that 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 the consistent opinion of the Commission 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 to afford the opportunity to study them and scrutinize them.

(3) 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 as to the extent of Representatives of Japan that it is capable of an interpretation which may permit the maintenance by Japan, 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 of this Article. Whether, as a matter of policy, Japan will 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 if the Chairman or the other members of this Assembly would give some light on these points.

The Chinese Delegation would like to request that the Chairman write General MacArthur inquiring into the underlying cause as to why this Article has been so modified. The revision of policy whereby Japan shall 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', Japan would be allowed to maintain an armed force for purposes of "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 clear that the question of Article 9 of the Draft Constitution 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."
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. He added that the revision of Article 9 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 any elements in 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 said that the Supreme Commander should 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 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 assuming that the interpretation 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-0876.

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 their 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. If 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, he could not for the change in Article 9, that 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 Plimso's motion.

THE COMMISSION unanimously agreed to postpone further consideration of FEC-0876.

[Source: SOTILAND PAPERS]

520 ROSTER OF PERSONNEL IN GOVERNMENT SECTION

Announcement

GOVERNMENT SECTION

Name

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
Masao Matsuoka ................................................Research Analyst
Selahib M. Hayes ................................................Adm. Asst. to Chief of Section
Ruth Hays ......................................................Adm. Asst.

Executive Group

Name

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 Baranati, T/S ..............................................Asst. Chief Clerk
Louise P. Perzel ................................................Personnel Clerk
Ruth M. Grabalzlaw ..............................................Personnel Clerk
Anne Vennett ..................................................Chief Clerk
Jane E. Baker ..................................................Clerk Steno
Enid S. Peterson ..............................................Clerk
Ages T. Chadwell ..............................................Chief File Clerk
Harry M. Scollins ...............................................File Clerk
Richard Barta, Pfc ..............................................File Clerk
Masako F. Sato ..................................................Clerk-Steno
Fred A. Daniel, Pfc. ...........................................Supply Sgt.
William Roach, Pfc ............................................Supply Clerk
Michael Urephalt, Pfc ..........................................Supply Clerk

Interpreter Pool, Administrative Division

Raymond Y. Aka ..................................................Chief, Interpreters' Pool
Mituyu Matsumoto ...........................................Translator A
Takao G. Shingushi ...........................................Translator A
Yoshikiko Shigemura .........................................Translator B
Kenji Morinaka ................................................Translator B

Governmental Powers Division

Alfred R. Hussey, Jr. ............................................Chief of Division
 Wallace E. Monagan, Jr. ......................................Deputy Chief
Ann M. Massingill ............................................Adm. Asst.
5-21 HUSSEY'S MEMO ON LOCAL AUTONOMY

Memorandum
December 12, 1947

To: Chief, Government Section
From: H.R. Hussey

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

*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 laws. This is in order that this principle of local administration of public affairs 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 officers 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 national interest.

4. There is, however, a conflict between the American principles of democratic government and the democratic principle of local autonomy. As between the United States and the several states, the federal constitution devotes 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 on 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 greater centralization, a movement no one will deny. 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 conducted by national officials and local matters by local officials and that the nation at large must have the sole power of determining the national interest, must not be confused with the principle of national interest 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.

7. The remedy for failure to apply such standards lies in court action, the check to be within the power of the courts to require the administration of national interest 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 to be within the power of the courts to require the administration of national interest upon uniform practices and procedures in the administration of local affairs.

8. Where the national interest is in proper administration or observance of standard provisions, the federal government should require local officials to observe the provisions of the laws. But where the national interest is one of substance, where the nation at large requires direct action which may affect local areas unequally, where the national interest does or may conflict with the local interest, efforts must be made by the national government to make local officials responsible to the nation at large. Furthermore, the test must be applied by the local legislature. This question is a purely political one and not open to judicial determination.

9. It is well recognized that the trend in Japan for the past 75 years has been toward centralization of government, and in the past 50 years it has been toward complete centralization. This was not only not an expression of 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 reinstatement of the national interests, the Occupation commander has recognized the need for re-establishing 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 of national interest, and what local interests are to be considered as national interests. We cannot, however, interpret these national interests to mean that 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 localities.

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 in this matter. It is further recommended that in all future consultations with other Staffs Sections of SCAP on problems involving local autonomy the foregoing principles be borne strictly in mind.

[Source: House Papers]

5-22 MODIFICATION OF PURGE

Telegram: W80053

To: CINCJE

From: CGPO

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 made re-eligible for government business and that the number of persons selected each time 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 and implementation of Part 1. Request comments.

Part 3.

A. Following categories of persons purged or barred by virtue of offices held should be freed from all further purges or barred 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 Seijiki, and affiliated organizations.

Category 5, Paragraph 1, directors, advisors and auditors of designated concerns.

Category 7, Subparagraph 8 of remarks, recommended candidates for 1942 elec-
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 "activeponents 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
To: Gen. MacArthur
From: Prime Minister Yoshida

August 6, 1949

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 Minister's 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: SUTLAND PAPERS]

5-24 POLICE PROBLEM AND PUBLIC SECURITY

Letter
To: Yoshida
From: Gen. MacArthur

August 8, 1949

I am in receipt of your letter of August 6th pointing out what you believe to be exist-

[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.
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 inducement 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-
6 ECONOMIC REFORM

6-1 THE OCCUPATION AND JAPANESE AGRICULTURE
(October 1945—April 1952)

Summary Statement
By Wolli. 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 restraint. 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. Schenck, 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: Science Papers, Hoover Institution]

6-2 ESTABLISHMENT OF ECONOMIC AND SCIENTIFIC SECTION
Telegram No. 2A 6291 October 1, 1945
From: CINCPAC, Advance (Tokyo)

ZA 6291 from CINCPAC 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.

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 ZAIATSU

Telegram No. CA 53860
To: War Department
From: CINCPAC, Advance

On matter of Zaiatsu 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 Zaiatsu corps 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: Misc. Mil. Br., National Archives]

6-5 AGRARIAN REFORM IN JAPAN

Letter of Transmittal. No. 30
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
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. The period of 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 propagandas. 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 Shokudai 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 do the 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 pro-

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ECONOMIC REFORM

Data Paper
Prepared by R. A. Fearay

JAPAN: AGRARIAN REFORM

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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
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I. EXPLOITATION OF FARMERS BY MIDDLEMEN IN THE MARKETING OF THEIR CROPS

II. MEASURES OF AGRARIAN REFORM

1. THE JAPANESE AGRARIAN PROBLEM

Industralization 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 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 provide 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 per capita official 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. 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

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*Not enclosed in JCS 1565*
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 the overpopulation of the land. About 125 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 farthest west coast in Canada. Many Japanese farmers, particularly in the south, cultivate only much less than 2.7 acres. In 1888, 33.8 percent tilled less than 1 ton (1.2 acres) and 65.5 percent tilled less than 1 cho (2.5 acres).

The yield of the cropland cannot be expected through expansion of the arable land area, as a consequence of war casualties, or barring revolutionary advances in the science of fertilizer, 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 is accomplished since 1892 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 labor 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, wasteful and unfavorable 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 rented. The proportion rapidly increased. Today, the proportion of cultivated land in 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 due to the fact that landowners then charged more than they could themselves cultivate could earn a larger return by renting to tenants than by operating with hired labor, were important factors which favored the growth of tenancy. By the end of the 19th century, the proportion of farm households in Japan who rented all or part of their land was 55 percent, with an additional 35 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 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 tenant's responsibility and must be deducted from his share. 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 farms an average of 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, 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 from borrowed funds, and 20 percent must contribute at least 50 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 farthest west coast in Canada. Many Japanese farmers, particularly in the south, cultivate only much less than 2.7 acres. In 1888, 33.8 percent tilled less than 1 ton (1.2 acres) and 65.5 percent tilled less than 1 cho (2.5 acres).

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ECONOMIC REFORM

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 of the average farm household, 10,000 yen, had increased 1000 times. By 1940, 4 percent of the debt was at that time (1937) held by money lenders, 14 percent by the Hypotheek 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 amount of capital thus 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. D. Mulford.

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

<table>
<thead>
<tr>
<th>Income</th>
<th>Payed by Farm Landowners</th>
<th>Payed by Business Proprietors</th>
</tr>
</thead>
<tbody>
<tr>
<td>(in Yen)</td>
<td>Total: National: Local</td>
<td>Total: National: Local</td>
</tr>
<tr>
<td>1,000</td>
<td>270</td>
<td>63</td>
</tr>
<tr>
<td>2,000</td>
<td>530</td>
<td>143</td>
</tr>
<tr>
<td>3,000</td>
<td>874</td>
<td>239</td>
</tr>
<tr>
<td>5,000</td>
<td>1,395</td>
<td>457</td>
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<tr>
<td>10,000</td>
<td>3,435</td>
<td>1,187</td>
</tr>
<tr>
<td>20,000</td>
<td>8,084</td>
<td>2,717</td>
</tr>
<tr>
<td>100,000</td>
<td>52,603</td>
<td>19,327</td>
</tr>
</tbody>
</table>

*The landlord's return averaged 4.4% for paddy fields and 3.7% for upland fields during the pre-war decade. (Shinriku Nani, Aspects of Japanese Agriculture, 1941, p. 130)

**The yen had an average value of 28.5 cents during 1928.

***The percentage of 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.
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. Exported 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 economic distress 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 wildly 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 Composition 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, suffering the full effect of a price drop during years of good crops, has never compensated by higher prices during short years. Weig 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 Agriculture

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 drop was due to business conditions in five countries account for 70 percent of the total, but the most 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 farm families in the silk farming class, which 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 result of experiments from soils all over Japan, indicate that 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 rates. As artificial fertilizer industry is a monopoly, prices, as a result of the monopoly, have risen high, and prices which have 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 form of public control have, as far as is known, failed. A similar situation prevails in the case of chemical disinfectants. The high prices of these chemicals, which cost only a small 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.

I. Exploitation of Farmers by Middlemen in the Marketing of Their Crops

Middlemen, speculators and petty traders have long used their stronger bargaining position sister to the individual peasant to extract excessive commissions for their services. Farm market middlemen, who are a combination of members of several cooperatives and often 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 for the farming class. It is true that this has a temporary effect back to 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 those of 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 is virtually the only section of society. 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 wildly 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.

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 otherwise. The 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 by no means an incomplete list. 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 of (a) widespread tenancy highly unfavourable to 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 the urban family businesses. The prices of Japanese farm products have been particularly low for the tenants, who in addition can be evicted by the landlord with relative ease.

The problem can be approached either with the idea of improving the conditions of the tenants or of improving the conditions of the landlords. 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 a certain percentage of the market price of the product. Such a law might also require that tenants have the right to evict their landlords if the latter do not maintain in good repair the buildings which they let, or if 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 landlord to give a certain amount of the produce to his tenants have not been proved satisfactory. If the landlords' right, 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 obviously follow if the landlord decided to cultivate the land himself, and would be scarcely less certain to occur if the landlord decided 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 farmers, 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 changes in landlord-tenant relationships (i.e. for the tenant who were not evicted), the landlords, because of the continuing scarcity of land and multiplicity of farmers 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 Renting 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 renting 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 equivalent value would be issued. If this should not be done 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 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 net annual 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 6.6 million acres of renting farm land in Japan with a total productive value of approximately 8 billion yen:

<table>
<thead>
<tr>
<th>LAND TILLED BY TENANTS, 1939</th>
<th>Acres</th>
<th>Average Market Value Per Acre (Yen)</th>
<th>Estimated Average Productive Value Per Acre (85% of market value)</th>
<th>Total Productive Value (million yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Irrigated Fields</td>
<td>4,071,000</td>
<td>2520</td>
<td>1440</td>
<td>5,862</td>
</tr>
<tr>
<td>Dry Fields</td>
<td>2,745,000</td>
<td>1680</td>
<td>920</td>
<td>2,424</td>
</tr>
</tbody>
</table>

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 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. The main point in Japan would be to 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 Interest on Farm Loans

While the emancipation of the tenant class would be the principal change 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 find themselves faced with 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 have been 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 28 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 reform may not only do much to reduce the high interest rates, but also to clear up the large amount of debt which has been accumulated. The new credit policies of the bank would 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 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 the property tax, 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 international connotation, 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 nations.
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, of course, are beyond Japan's power to control. Also, the cost of raising the quality of silk is too high for the farmer to adjust his crop to the demand. The government has attempted to stabilize prices by controlling the release of stocks from storage, but this system is not effective. Probably the only way to stabilize the market for silk would be for the government to purchase the surplus and sell it at a lower price. This would probably require a large investment of government funds and would not be practical in the short run.

b) The Competition of Korean and Formosan Rice

Japanese farmers would benefit greatly from a tariff on Korean and Formosan rice, which is sold in Japan at a low price. 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 position in the world market. Any reduction in rice prices would be offset by 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 situation is either not being 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 reasonable prices. Joint purchasing has 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 expanded to include the less well-to-do farmers. At the same time the activities of private traders should be subjected to closer regulation.

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 pro-

portion 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

SCPIN-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
- Mitsubishi Honsha
- Sumitomo Honsha
- Yasuda Hozensha
- Kawasaki and Co.
- Nissan and Co.
- Ason Honsha
- Fuji Industrial Co.
- Shibusawa Dozoku and Co.
- Nippon Nitrogenous Fertilizer Mfg. Co.
- Furukawa and Co.
- Okura and Co.
- Noma and Co.
- Ricken and Co.
- Nisso Co.

6-7 LIQUIDATION OF ZAIBATSU

JCS-1556 (JCAC-64/2)

Report by the Joint Civil Affairs Committee

November 1, 1945

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

To: Joint Chiefs of Staff

From: CINCAPAC, Advance

October 20, 1945

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

* 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, 3 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 holding company will resign.

E. Officials will be appointed to succeed resigned officials who have risen in 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 right 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 "D"

JCS 1565 (continued)
Teleg. No. W 79135 (extract)
To: CINCPACFAC, Advance
From: War Department

October 26, 1945

1. No objection to your proceeding in accordance with plan outlined in reference cable GA 53350 (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.

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 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 will 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 paragraphs 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 specie 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 character that would confer authority with persons now in government industry and finance. 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 the Japanese public with full explanation of reasons calling for reform.

6. State Department believes that in general imposition of basic reforms, such as this one, by Japanese 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 Potemkin Declaration and the President's Policy Statement of December 9, 1945, to replace by the democratic administration of the Allied Powers. It is believed that present leaders are subject to removal under provisions of the directive cited above. In fact, many of them are believed to be subject to removal under 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.


Memorandum through Central Liaison Office
LOF-2
To: Keizo Shibusawa, Minister of Finance for the Imperial Japanese Government

The financial stability of the Japanese people is an essential factor in the economic reconstruction of Japan. In order to achieve this goal, it is necessary to cleanse the financial system of all factors that may undermine its stability. To this end, the Holding Companies Law, adopted by the Allied Powers, imposes strict controls on the activities of holding companies in Japan. This law is designed to ensure that all financial enterprises in Japan are owned and controlled by the Japanese people themselves. It is the aim of the Government of Japan to cooperate fully with the Allied Powers in implementing this law and to bring about a new era of economic prosperity for the Japanese people. The Holding Companies Law is an important step in the right direction, and the Government of Japan is determined to see that it is carried out effectively. The success of this law will depend on the cooperation and support of all citizens of Japan. In this context, the Government of Japan expresses its gratitude to the Allied Powers for their assistance and guidance in the formulation of this law.
ECONOMIC REFORM

Allied Powers, within fifteen days of the receipt of this memorandum, a report listing:

a. All movable or immovable 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 movable or immovable property, including securities and other evidences of ownership, indebtedness and control by any member of the Mitsui, Iwasaki, Yasuda and Sumitomo families since January 1st, 1944.

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.

7. 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.

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. 161-163]

6-10 REMOVAL OF ZAI BATSU PROPERTY

Letter

December 5, 1945

To: General of the Army Douglas MacArthur, SCAP
From: Edwin W. Pauley
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 Zaitatsu 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 evade finding their way back, through dummies and otherwise, into the control of the same people who previously held them.

One of the concrete steps in the direction of implementing the policy of breaking up the Zaitatsu will be our program designed to deprive the Zaitatsu, 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

* 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: Suguitan papers]

6-11 RURAL LAND REFORM

Memorandum

SCAPIN-411 (CIE)

December 9, 1945

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 ill 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 ill 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 to such extent that 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. The Japanese Imperial 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.

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 Mission on Japanese Combines

To: The Department of State and the War Department

Top Secret

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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; it controls substantial financial institutions as well as substantial industrial or commercial ones; 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.

4 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.

5 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 than the aggregate of two billion yen; that a concern or combine doing business in several unrelated fields be regarded as excessively 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. Zaiatsu 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) Dissolution of the non-financial enterprises which are operating companies, divestiture of all securities held in other companies, including companies not believed to be part of any zaiatsu combine.

c) Prohibition of further 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 zaiatsu 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 zaiatsu combines, specifically arrangements for communal office services, interchange of personnel, exclusive agency, and preferential or exclusive trading rights.

g) Requirement that enterprises which have been members of zaiatsu combines shall grant licenses on non-discriminatory terms to all applicants irrespective of patents which they now hold and 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 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.

b) 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 as 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 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 various companies involved should be attacked first and decision about the ultimate scope of the program should await experience.

3. Business communities of interest based upon zaiatsu family ties should be broken. For this purpose:

a) Members of zaiatsu official families (including the individuals who exercise controlling power in certain zaiatsu combines) and persons close to them by blood, marriage, adoption, or clan loyalty should be divested of all their corporate security holdings and liquidated as soon as feasible.

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 zaiatsu 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 45% 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 changes. The quantity should, of course, be adjusted to the change in value of the yen to the extent that corporate book values reflect such change."

* Defined as "perhaps a decade."

* The recommendations stated that "the first companies attacked should be those which aggregate size in degree of monopoly power are most clearly objectionable."

* The Commission was not unanimous on this point: "Two courses of action appear to be practicable. One is the dissolution of their stockholding and offices in most companies, but one, so long as the latter is limited to control of a single corporation. The other is to extend such divestiture 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."

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this end:

a) Policies which facilitate the conveyance of zaiatsu property to new owners should not be modified by any effort to obtain fuller compensation for the zaiatsu.

b) The maximum compensation for any seized property should be 25% of the net proceeds from its sale; but a tax of any amount by which such net sale price exceeds the August 1945 market price (in the case of securities having a market value in the case of other securities or property).

- If possible the level of bids for zaiatsu property should be reduced by substantial windfall tax upon the buyer whenever 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.

- If sums realized by sales under these policies are so large as to make probable a revival of zaiatsu power, outright partial confiscation should be used to whittle them down.

- Sums credited to the zaiatsu as compensation should be frozen in government bonds for ten years from the completion of the sale of zaiatsu 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.

- Before the freeze is terminated, succession by the owner’s heirs should be required, coupled with payment of succession taxes at steadily graduated rates.

- Liquidation of zaiatsu 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-zaiatsu 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. The bids should be two-thirds for the zaiatsu and one-third for the government, which is given an option to buy the zaiatsu’s share of the sales and_to suppress 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 of zaiatsu employees and companies, persons wishing to go into business for themselves, persons driven from ownership by government policy during the war, workers, in the case of certain public utility enterprises, the state itself.

- Certain principal officials of operating companies should be removed because of clan links or other personal relationships with zaiatsu 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 not been displaced by military destruction and reparations policy.

- Zaiatsu control over credit should be broken. To this end:

  a) In dissolution and reconstitution of zaiatsu financial enterprises (other than insurance companies) which are insolvent, stock held by zaiatsu holding companies and zaiatsu individuals which are part of the same combine should be subordinated to that of other stockholders. Zaiatsu insurance companies which are insolvent should be neutralized by cutting back the face amount of outstanding policies.

  b) Policy holders in zaiatsu insurance companies should be aided in buying the stock of those concerns which is now owned by the zaiatsu. 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 zaiatsu 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 zaiatsu should be permitted to re-establish their old enterprises by forced divestitures.

10. If this expedient proves insufficient, other devices should be used also—possibly a
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) Alliances between trust companies other than large corporate 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 shall 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 shall 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 underwriting or in default of loans, but any such exemption shall 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 registered capital stock thereof, should be ineligible to hold any office or directorship in another company 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 shall be allowed to re-deposit more than 10 percent of its deposits 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 one 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 should not be allowed to engage in any operations outside of their special purpose.
   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 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.
   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 business 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 has, with SCAP's approval, that allocation and control are necessary as emergency measures in the reversion period, the powers now exercised under control laws should be temporarily preserved in a reversion statute, which, however, should have a 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 reversion. Where temporary allocations and price control are to be undertaken, the old control associations or similar quasi-private new bodies should exercise delegated authority from the government. Such decisions are made by the government and rights and duties of appeal to the government against abuse of powers are provided. All bodies exercising such delegated functions during the reversion 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 functions which should be temporarily continued by a reversion ordinance, in accord with the foregoing recommendations. Certain other special companies which perform governmental functions should be temporarily continued, until arrangements are 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 entities should be terminated. This special period of smuggling, 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.

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 rates and types of industrial growth or intercorporate connection which are particularly likely to lead to monopoly or excessive size. 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 producers which are not coercive or monopolistic; for labor activities other than the restriction of commercial competition; and for natural monopolies and public utilities so far as they are closely regulated by government.

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 reasonable and non-discriminatory terms, and that if any licenses are granted within the restricted field of activity, all applicants shall be licensed on non-discriminatory terms. Assignments and licenses not publicly recorded shall 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) Prohibitions on 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.

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a) The law concerning excessive size "should prohibit mergers of concerns which are in competition with one another (possibly comprising 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."

b) In measuring excessive size "the standard of corporate size which should be used...should not rest upon a mechanical weighing of 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. Insiders and outsiders should begin 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 household 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 activities 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. 
S) 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: SUTLAND PAPERS

6-13 ZAIBATSU POLICY RECOMMENDED BY THE UNITED STATES REPARATIONS MISSION TO JAPAN

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 precluded as complete an investigation as the Edwards staff. The Edwards recommendations, therefore, are not considered 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 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.

Conclusions:

10 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 commission of the committee and thereafter should refrain so far as possible from guidance or censorship.”

14 Reference 7-6, “Pauley Report”, April 1, 1946.

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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. Take up in SCAP the office of Custodian of Japanese 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) of all other property, in every name whatever (whether joint, sole, or otherwise), denominated in the custody of the Holding Companies that may be held or possessed by them. In the custody of the holding company shall be held for the President of the holding company.

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 Instrumant of Surrender or the Purposes of Occupation, and to liquidate such properties as 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 large Holding Companies then forthwith be surrendered to the Japanese Government and cancelled 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 usual 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 and on the 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 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 Custodian, 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 any disposal on 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 public debt retired, or currency debt retired, or any foreign indebtedness; any foreign 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 person or persons, and in such capacity and capacity thereupon receive the custody of 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 shareholders 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 the top loan or mortgage 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.

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: SCUTTLEBUTT, 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)

For: Chief, ESS

5. A/C DIVISION STAFF STUDY REPORT FOR CEIL, 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 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 constitute 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 pulping unit would produce considerably 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以外 of wood. The small pulping unit could therefore be 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 is owned by the two principal uses.

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. This circumstance introduces a new element of flexibility into corporate management and has often been responsible for saving the entire enterprise.

It is reiterated 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 economic activity 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 of the pyramid 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:

1. By preventing against any corporation holding shares of another corporation which itself owns any corporate securities.

2. A requirement that equity capital (common stock) must represent at least 50% of the total capitalization of any company which wishes to issue additional (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 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 companies 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 owning 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 and they may have some measure of control over the business 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 control."

The staff believes that the 5 percent limitation would include all stock and securities held by the bank either as an owner of record or as a holding of a beneficial interest, or both. If this proposal is accepted, we feel easions 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: SCOTLAND PAPERS, Z 708-12]

6-15 TRANSMITTAL OF REPORT OF EDWARDS MISSION ON THE ZAIATSU

Memorandum
To: Joint Chiefs of Staff
From: W. F. Marquart, Chief, ESS
Secret

May 17, 1946

2. War Department Message No. WO 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 pending action by FEC pending receipt of Edwards Report with your comments."

4. It is my opinion that the Zaiatsu subject may incite debate of a controversial nature among the SWNNC 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 SWNNC. In consequence the initial comments from me 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 as 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 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: SCOTLAND PAPERS, Z 708-12]

6-16 ON THE REPORT OF THE EDWARDS MISSION

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 that are in a constant state of flux and imbalance.

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 of the governmental structure must be made in the Occupation Forces. This conflict immediately conflicts 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: DIPLO. BR., NATIONAL ARCHIVES]

6-17 FUNCTIONS OF ANTI-TRUST AND CARTELS DIVISION, ECONOMIC AND SCIENTIFIC SECTION

Administrative Memorandum No. 23
From: W. F. Marquart, Chief, ESS

March 7, 1947

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:

   i. Strengthen democratic processes and tendencies in economic institutions.

   ii. Prevent regrowth of monopoly in agriculture, commerce, finance and industry.

Transmitted to Washington on May 17, 1946 (see preceding document) and later appended to SME 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.

ECONOMIC REFORM 349
3. DUTIES
The duties and functions of the Division are to:

- Maintain surveillance over industrial and financial combines until reorganized.
- Maintain surveillance over dissolution of control associations and other forms of private economic control to prevent their reestablishment in some other form.
- Maintain surveillance over the public agency established to reorganize Japanese business structure.
- Advise Japanese in drafting and enforcement of legislation referred to in paragraph 2, above.

[Source: SUTLAND PAPERS]

6-18 POLICY ON EXCESSIVE CONCENTRATIONS OF ECONOMIC POWER IN JAPAN

EGC-2307
Report by the United States Government (Excerpts)
May 12, 1947
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 (EGC-014), and it is reaffirmed in Basic Initial Post-Surrender Directive to SCAP for the Occupation and Control of Japan (EGC-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 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 have already 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

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The first U.S. policy document dealing specifically with the economic concentration program was SFE 162, August 1, 1946 based on the Edwards Report and SCAP's comments. Referred to SFE 102/1 on December 19, 1946, after additional SCAP comments, it was then forwarded to SWNC to become SWNC 302/2, dated January 22, 1947. SWNC 302/2, as amended by SWNC 302/3 and SWNC 302/4.
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 defini-
tions 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
premised, 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 officer-ship between operating companies; or from the sale of shares 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 physically and technologically
that they do not in fact have a common 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 4 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 (auditors are to be considered officers and directors of those operat-
ing units, and of operating units in the financial field as well, should surrender all offices
and, where directors of those in the company in which they are principally engaged 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 contractual and service arrangements between the units into which these
excessive concentrations have been dissolved should be terminated, including arrangements
for personnel, services, inter-change of personnel, etc. Among these contracts should be
considered to be excessive concentrations. The determination of what is an excessive concentration 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
initiated.
b. Mergers of 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 concentra-
tion of economic power, whether as creditors, stockholders, managers, or in any other capacity,
should:
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 in subsidiaries of the Zaiibatsu families, but it should also be
taken to refer to persons otherwise associated with the Zaiibatsu 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
property in the amount of any significant value; and divested of all corporate security holdings
in any excessive concentration of economic power and corporate security holdings represent-
ing an interest of more than 1% in any other major private enterprise;
b. forbidden from purchasing corporate security holdings, or from acquiring positions in business or government which might be used to
favor Zaiibatsu interests;
c. forbidden from purchasing corporate security holdings, or from acquiring positions in business or government which might be used to favor Zaiibatsu 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 any place of power in the Japanese economy. In order to bring about this
act, it is essential that certain measures be taken in the dissolution of excessive concentrations and in
the disposal of the assets of these persons. Thus, the assets are set out at market value, 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 been covered on the basis of existing 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
initiated.
b. Mergers of portions of divested or dissolved concerns should be prohibited,
except when permission is granted after an affirmative showing of public interest.
c. forbidden from purchasing corporate security holdings or from acquiring positions of
business or governmental responsibility at any time during the next ten years.
Third Indemnification: The 90% tax described in Article 41 of the Patent Law.
Fourth Priority: All Zaiibatsu 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).
Fifth Priority: The 90% tax described in Article 41 of the Patent Law should be paid in full.
Sixth Priority: All Zaiibatsu 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 the shareholders who would be so excluded from the 90% tax, and still retain their
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 50% 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 3 as a result of the sale of assets divested from such individuals.

b. Tax should be levied on any gain realized through resale 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 which will amount to a rate of interest that will not exceed the interest rate being paid by comparable government bonds. Such bonds should not be 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 amounts required for accustomed living expenses. However, no such taxes may be a 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 company other than those specified in paragraph 4 (and in some cases to financial institutions which own the holding company’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. No person shall be allowed to act as the holding company’s agent in any of the processes of liquidation, and no person shall have a right of action against the liquidation commission.

8. Sale of Divested Holdings

In the sale of securities 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 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 purchasers’ present ability to pay.

a. Broadening holdings in excess of 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 concomitant purchase of non-Zaibatsu equity holdings in that concern.

b. In connection with non-governmental 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 development of financial assets necessary to take advantage of the conditions under which such divestiture is being provided, 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 will further the democratization of the economy. The liquidation commission may give 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 well as 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 re-creation of a concentration of economic power in the hands of one person or enterprise (or group).

d. The purchase of divested holdings in ex-Zaibatsu concerns by the employees of such concern should be encouraged only if a vigorous effort is made to dispense ownership widely through the working force in question, rather than to concentrate it in a few top executives.

e. All sales should be screened to exclude clouses for Zaibatsu and for other groups who fall outside of any of the purge directives or purge parerges. The criteria specified above should be adhered to regardless of the wishes of non-Zaibatsu stockholders in the enterprises concerned.

9. Sources of Credit

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 able to buy back certain of those contracts 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 from the government. Such loans should be protected by the court as a form of security as well as by the value of policies. Zaibatsu insurance companies which are insolvent should be neutralized by cutting back the face amount of outstanding policies, where sufficient assets still exist to render this procedure practicable. In the re-establishment of insolvent financial enterprises, stock held by Zaibatsu holding companies and Zaibatsu individuals should be subordinate 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 risk necessary to banking stability. 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 should be encouraged to re-establish such enterprises as financial cooperatives or the like.

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 commissions should not be permitted to hold, either as an owner of record or as the holder of a beneficial 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 in any financial 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.

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 one billion yen) should be set on the total amount of deposits which will be insured for a single bank. A limit should also be set on 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 in at least 50% of what it pays out in national or local governments in the 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 redemption of national or local government securities.

c. Legislation should be introduced to improve the standard of commercial banking and to prevent banks from undertaking business considered unsafe for commercial banks. (Performance of investment banking functions by commercial banks should not be prohibited, however, unless it is specifically forbidden by law for such functions.)

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 abolished, repealed, and the assets of such bodies transferred to the Zaibatsu companies. The future assumption, by governmental agencies, of any governmental agencies, of any governmental agencies, of this type or kind, and of any other similar governmental agencies, should also be prohibited.

b. Necessary governmental functions formerly performed by control associations or special companies should be transferred to appropriate governmental agencies, whose responsibility should be created where they do not now exist. In cases where SCP 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 govern-ment to private companies, to special commissions or to special bodies, provided that final decisions are made by the government and that the 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 are transferred to appropriate government agencies, or at such sooner time as SCP 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 reclamation purposes, their performance could be terminated upon the expiration of the reclamation 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 SCP 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) the special or economic reasons for the exclusive use by Zaibatsu, to the detriment 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, 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 change in the substantive law, but also by providing giving aggrieved persons the right to attack in the courts any discriminatory subsidy, preference, or other practice.

14. Anti-Trust Law

A new 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 or production 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 or to excessive size, including mergers (i.e., acquisition of a substantial portion of the corporate 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 development 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 agency 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 public as well as representatives of the business 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 of cooperatives of genuine cooperatives. Similar exemptions 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 fraud and deception connection with such sales should be strictly regulated. The government should be given a power to veto the sales if the public interest would be injured.

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 understand 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. Interlocking directorships should be prohibited, and officers of one concern should be prohibited from becoming directors of another. Interlocking directorships should be prohibited if the director is found to be engaged in the management of a business or business dealings with the corporation, and person having a beneficial interest in or control of any equity interest of a corporation in excess of one percent of the total issue should be required to report their holdings.

17. "Tax and Inheritance Laws"

In connection with current and impending revisions of Japanese tax law, every effort should be made to prevent the growing concentration 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 of the income or estate tax 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 insular status of other members of the house.

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 made to function as independent corporations. In this connection, 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 no member should be penalized 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 made to serve the economic needs of other public enterprises and legal non-profit organizations.

b. Co-operative Societies Law should be revised to provide for registration of co-operative societies. The minimum number of members required for registration and 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 made to serve the economic needs of other public enterprises and legal non-profit organizations.

c. Small enterprises desiring to purchase dividend holdings should be given all possible technical and financial assistance so that they may compete on more advantageous terms with large scale businesses. Small enterprises may be required under a Ministry of Commerce which the Ministry will establish for this purpose, to devote a large portion of their income to small business. This bureau should give special support to the performance of joint activities of an unrestricted character by such mutual-aid organizations.
of small entrepreneurs as manufacturers' 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 forced 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 to as far as the more important issues related to private enterprises 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. 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 such private enterprise in an amount which would represent more than 5% of the officer's total wealth, or more than 1% of the enterprise'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, any private enterprise 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 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: Dept. Br., National Archives]

6-19 DISSOLUTION OF TRADING COMPANIES

Memorandum

SCAPIN-1741 (ESS/AC)

July 3, 1947

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-242), dated 6 November 1945, subject: Dissolution of Holding Companies.


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 Mitsubishi 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, and after 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.

c. 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.

d. Certificate of Liquidation or other such agencies shall be granted only if it shall conclusively appear that a possibility of reformation 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 name Mitsubishi Trading Company or Mitsubishi 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

To: Japanese Government

Forwarded by: E. C. Welbus

July 18, 1947

1. The purpose of this law shall be to ensure 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.

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 restraining competition, eliminating competitors, consolidating competitors, or restricting access to domestic or international markets.

c. Concentrations of ownership 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 as 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 which 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 production.

c. Participation of any enterprise in or the existence 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, 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 which 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 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.

7. 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.

8. 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.

9. 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 or enterprise conversion with the purpose of compliance with this law. It shall be the duty of HCLC to exercise such 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. Proposals of the FTC or 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 in its discretion, it may propose changes in proposed order which shall have been deemed appropriate. Transmission of the proposed order may be by public notice.

9. A plan of reorganization shall not be approved by HCLC unless it shall accord fair and reasonable treatment to creditors, security holders, and shareholders, and the plan of reorganization shall 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. If HCLC may make such findings of fact (6) days after issuance of the final order or providing of fact or such finding shall be made unless such finding shall have been specifically raised at the hearing, provided for in Article, or if such facts shall have been willfully 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 determination has been made.

9. Definitions:

As used in law:
ECONOMIC REFORM

Supplementary Provisions
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: MTBHO Papers, Ministry of Finance]

6-21 HOLDING COMPANY LIQUIDATION COMMISSION BILL

Memorandum (ESS)  
To: Brig. General W.F. Marquart  
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

1. 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.
2. 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 E.S. Nasser Government Section added another draft. Mr. Welch has been pressing the Japanese Government for enactment in the present Diet Session, which begins on 10 August. The Japanese Government, which was considering some such measure on its own, does not like the bill in its present form, but apparently with talk if pushed.
3. 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 represents a new statement 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 SGRIN.
4. 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 by the Prime Minister. 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—disolution, separation of companies, termination of arrangements etc.—which it (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 is 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 breaking 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. It 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 wargage 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 with ESS to insure that the missions of the various ESS divisions are not jeopardized.

14. 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 new powers 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 a 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.

(EClosure: 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 that the following be added in line 2 of Art. 4:

"Specific standards determining concentrations of economic power shall be established by Cabinet Order in accordance with the following considerations: (1) 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 "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 action arising out of rulings of the Holding Company Liquidation Commission shall be taken to the High Court in the first instance."

[Source: SCOTLAND PAPERS Z 703-12]

6-22 ESP'S REPORT ON ELIMINATION OF EXCESSIVE CONCENTRATION OF ECONOMIC POWER

Report
Economic Stabilization Board
August 22, 1947

DESIGNATION OF ENTERPRISES AND STANDARD FOR ELIMINATION.

1. Enterprises to be exempted. a. 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 a position to designate certain of these enterprises as an exception to the rule when deemed specifically necessary. b. Concerns of which the authorized capital has not amounted to ¥1,000,000 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 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 controlling 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 as to not to impair the entirety of the plant. Remarks: A plant is an organic unit in which various producing processes are intertwined. Examples given: Kurozuki Plant of Mitsubishi Kasei & Mikke Plant of Mitsui Kagaku.

b. Business operations are regarded as related when, (1) same equipment is in use (such as aluminum 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 incomparable, ex-
c) Any enterprise of monopolistic or potential monopolistic characteristic having excessively expanded its business activity by means of mergers, expanding or purchasing facilities or others during the period from 1937 to July 31st, 1945, will be dismembered in principle, its employees separated, even if they are related activity.

Exceptions, however, will be set for such cases as coming under any one of the following items and deemed it to be reasonable.

1) In case of the fair competition being secured as having powerful competitors, a large scale of enterprise of 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., 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 provided it is 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 neither highly 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 are no 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.

So long as present conditions continue in Japan I believe it inadvisable to make any 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. Yet this phase of the occupation has not been successful, much in spite of several hundred Russians who are attached to the Soviet Embassy in Tokyo and who are willing and waiting for the economy of Japan to collapse.

Herein lies the purpose of an occupation was to democratize the occupied country, restore order and freedom, and conserve property until a peace treaty was concluded. Democratization 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 the effort was decided that democratization included the political and ideological aspects of its ideology. One of the means for bringing that about is the imposition of an economic theory which is, I believe, no counterpart anywhere else in the world. It is not Communist and certainly it is not that practiced in our country. It probably approaches more closely the socialist ideal than anything else. Japan has now become the great economic experiment which has attracted many Americans who were formerly employed in bureau 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 general the officer's training has so far been limited to military. If one has some real single concept, he is fortunate. Gen. Marquart 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 has the power of 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.

I am not familiar with many positions in S.C.A.P. more remunerative than their Majory or Colonels, 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 the former instructors of the Army who have also served some years in one of the many bureaus in Washington, or recent graduates from college. Few of these men have a 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 Japan they have also have also served some years in one of the many bureaus in Washington, or recent graduates from college. Few of these men have a practical experience. 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 followed upon which 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 “for this end, it is desirable that Japanese economy be reorganized and concentrations

6-23 REPORT ON CONDITIONS IN JAPAN AS OF SEPTEMBER 6, 1947

Private Report\textsuperscript{19}
Prepared by: James Lee Kaufman
September 6, 1947

\textsuperscript{19} Usually known as the "Kaufman Report".
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 the nation among workers, farmers and small traders through the medium of taxes, sales of valuable properties at nominal values, financial assistance, regulation, and regulation of the economy. 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 secret. The letter of transmission stating the distribution 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" can 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. In view of this, the following are recommended:

(a) Income and inheritance taxes should be much more steeply graduated than they are at present.

(b) Diffusion of inherited wealth should be assured.

In providing for the disposal 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 disposal, the types of purchasers, the purchaser’s financial resources, any potential 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 owners and tenants, 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 that 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 cut up if, by the whim of some court in Japan, or by some court 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 menace and 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 be 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 opportunities 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 document provides: “Where units in question are held by 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. It is obvious enough that the abrupt change to democracy 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 Exchange Discretion 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 promulgate on the first of January, 1947, a Law which would completely replace the previous law known as the “Enterprise Restitution and Reorganization Standard Act.” The Enterprise Reorganization and Reorganization Law is also to be amended in several important respects. The policy has been further implemented by an instruction issued by instructions, directives, and regulations under the Act by the 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. and “The Oriental Economist” of March 29, 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 disparity in bargaining powers, etc., it places restrictions on 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 per cent of the stocks of any company other than a company which is in the same kind of business or to acquire stocks in more than three companies simultaneously. It sets up the Act under the Anti Trust and Fair Trade 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 unknown in any 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, that is, the restrictions on any companies other than those which are acquiring shares in another company without the permission of the Fair Trade Committee of the Act. Such permission can only be requested if the shares are to be acquired in circumstances that are not inconsistent with the conditions set forth in the Act. These conditions have been met the Fair Trade Committee 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 because must be made directly from the company of the company that holds the shares of the company being acquired. 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 that “any company” means just what it says and it is any company, not only companies 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 Cartel Division of SCAP, says “any company” means only corporations 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
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pleased 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 and organized by the 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 are held and farmed need reform after the war. Large tracts were in the hands of absentee landlords and farmed by tenant farmers under leases which in many cases did not permit, rates on loans to farmers to keep 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 of agriculture lands owned by American and foreign landlords the property 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 of his holdings in condition that the tenant plants it. Any purchase by the purchaser 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 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 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 exception case but one illustrating the usual way in which the law is being administered. While this 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 Attene in all her beauty came into this world via Zeus' forehead, so The Labor Standard Law was born from Mr. Cohen's or Mr. MacArthur's brain. The 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 strengthening it and Mr. Cohen was surprised to see the law clamped and being removed as head of the Labor Section. He is now one of the chief advisors to General Marques, Chief of the Economic Section of SCAP where he will have the opportunity to fulfill his business what he did to labor. I am told that Mr. Cohen is a fairly recent graduate of New York University and that 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, and working conditions; pay for miners from "pit-mouth" to "pit-mouth," child labor, general forbiddance of employment of persons under 16 years of age; medical treatment, compensation for injuries; sick leave; accidents and disease; and so forth. 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 without preparation. The miners were unprepared by experience either to understand 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 American labor 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 undermining. Giving of extra food as an inducement to work has not proven successful. Some of the mines have tried to give the workers a leg up 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. Extra food which is sold in the black market helps to supplement the income and reduce the days of work.

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, ex-
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 raise taxable income. The black market rate of exchange is currently about 1,000 yen to the dollar; this means that the black market is 25% lower than the official rate. Theoretically, the inheritance tax is based on taxable income, but actually the tax is levied on the sales of assets at death or at the dissolution of an enterprise. The tax rate is highest on gains from capital transactions, ranging from 50% to 75%

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 Reorganization Law, as it is now 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.

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 "undesirable concentration of economic power" the Anti Trust and Cartel Division of the Economic and Scientific Section of SCPA has the power to destroy any single Japanese company. This is true even though the Zaibatsu has no connection with such corporation.

I 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 Zaibatsu. For years, those persons popularly termed "machi" who made meetings, two of those 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 what was good for the Japanese people.

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 purging of the intelligentsia and the evasion of the issue, is not by the 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 results will be any better than the disease. At any rate, the new ones are not healthy.

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 mining for the economic power 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 is submitted by SCPA to the Japanese Government) states: "1 The purpose of this law shall be to insure that measures for Japan's reconstruction are concentrated with peace-time 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 specifies the means by which these can be applied for discovering its existence. Paragraph 5 sets up the procedure for eliminating it. This paragraph provides as follows: "The Holding Corporation Liquidation Committee (a committee of Japanese puppets controlled by SCPA) shall take such action in regard to the elimination of concentrations of economic power under the law as it finds appropriate to accomplish the purpose thereof, including dis solve, liquidation or reorganization of enterprises or associations; prohibiting juridical persons or natural persons from engaging in such activities or performing such acts as might prejudice concentrations of economic power; cancellation of obligations of companies, syndicates, 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) Collect, 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 disadvantage of enterprises, etc.

Nevertheless, the provisions of this law are in contradiction with the provisions of the new law on enterprise reorganization, which has been enacted 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 access to raw materials or make marketing of the product extremely difficult.

To separate unimportant 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 management.

No combination should own raw material supplies or raw material capacity substantially in excess of the needs for production for the final product.

Consequently, horizontal combinations will generally not be justifiable.

This economic condition is allowed to continue, the general principle should be non-ownership of the source of raw materials.

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 capacity of the entire company.

Thus the great experiment, noble in purpose is reborn in Japan but still at the American taxpayer's 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 another 100,000 are still to be purged. This purge will be wide it will be able to be continued for a long time, but there is no indication that it will end.

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 over any excessive concentration of economic power whether as creditors, stockholders, managers, or in any other capacity and all other persons likely to be 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 Kagawa, a man of seventy years of age, a graduate of an American college, and considered to be America's greatest friend in Japan was purged. Count Kagawa 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 aware of his dealings with the 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 Kagawa 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 property values. The second class are permitted to retain an economic interest in the occupation 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 business or financial interests. The first echelon are forbidden both of personal property holdings or from acquiring positions of business or Governmental responsibility at any time during the next ten years. The next echelon are forbidden from doing any of these acts for the next five years and for the next three if they are in business in 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, who held the key positions and positions of power. The former most competent men are working, sincere and intelligent but lack experience and working knowledge in Governmental affairs which is so desperately needed at this time.

The purge is for those who come under it. I talked with two or three of the purges 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 offer of employment is met with a refusal and fear to employ them. They are required to make voluminous reports to S. C. A. P. including minute estimates of their expenses. 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 he would be doing 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 that it would be a fatal blunder to have war with America. So long as it was possible he said Japan had decided to prevent war, but once the decision was made he would be infinitely happy to play his part. 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, Japan could have created the knowledge and experiences which are now needed.

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 no 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 an unexplained reason control was put back and the vegetables disappeared. The farmers are beginning to show some reluctance selling their produce on the condition that it will be purchased by the consumer and thus not be offered for sale. Because of inflation in wages of the white-collar employees and in the number of yen per month are not 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 consumer's 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 the 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 purging of practically all experienced businessmen, the separation of businesses 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 institutions and I might like, but the Japanese businessmen cannot plan for the future. 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 fifty years. By raising 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 future by forming a counterattack as a matter of course as is the case of America. 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 serve as 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 present system with one that will provide the sort of opportunity which has been shown in our own system and which, in my opinion, is the only way Japan can be made to play a significant role in the world 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 firm friend.

James Lee Kauffman

[Source: Text distributed by the Ministry of Finance]

6-24 CRITICISM OF KAUFFMAN

Memorandum

To: The Under-Secretary of the Army

Prepared by: Charles L. Kades

James Lee Kauffman first came to Japan two years after graduating from law school in 1911 and became 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 practice law in Tokyo as a partner in the firm of McVey, Kauffman, Smith and Yamamoto. It is understood that this was the senior partner of this firm. He continued to practice in Japan for one year and about 1927 when he returned to the United States to conduct a New York branch of the Japanese office represented locally, among other U.S. companies, by Libby-Owens, Ford Glass Company, Ford Motor Company, National Cash Register Company, Western Electric Company, as well as many other 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 with 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 holding company also owns, among other things, and the Zaitauchi family which controls 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 Walsh) which is charged with breaking the control of the Zaitauchi 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 the Emperor to confer upon him the Order of the Sacred Treasure.

As to Kauffman's specific charges, the following comment is made:

(f) Kauffman's report is critical of Theodore Cohen, described as General Marquart's "economic advisor." Cohen is an analyst of the economic 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 to head the economic analysis with the U.S. Army, and was also associated with the Sherman Anti-Trust Act of 1890 and the Clayton Act of 1913 on which the Japanese laws are patterned as equally socialistic.

(g) Kauffman's report is critical of the activities of the Foreign Economic Commission, the U.S. policy of encouraging collective bargaining, and the recently adopted Japanese Constitution. The Trade Union Law enacted during the occupation is a blank sheet with an anti-cartel question, work in a closed shop is no longer considered 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 imposed, and the existing Cabinet, largely臣民派, was replaced by that 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 from 453 men used to operate machines to collect 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 t and are charged 50 t per day for hotel accommodations. There are no restaurants, Allied or Japanese, operating in Japan and no private facilities for serving meals to Allied residents of hotels and apartments. Furthermore, throughout the Occupation, the military 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 t per day fixed by the War Department is made. As to the hotel accommodations, Army officers meeting separate establishments receive no commutation of quarters whatever, the government being reimbursed from being deducted from their pay. Civilians living in billets and hotels do not have normal hotel accommodation but live in small 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) Kaufman'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 jeep type, 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 Kaufman's major grievances to the policy decisions of the United States and Far Eastern Commission, by which this headquarters is bound, and to executive action taken here in implementation thereof. In fact, the implementation of all basic directives received has been and tempered to avoid undue dislocation in the political and economic life of Japan.

The activity of Kaufman 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: RUTLAND PAPERS, Z 721-12

6-25 CONTINUED IMPLEMENTATION OF DECONCENTRATION PROGRAM (EXCERPTS)

Telegram No. C 56312
To: Dept. of the Army (CSCAD PL)
From: CINCFE, Tokyo (MacArthur)
Confidential

October 24, 1947

1. Reuras W 886824 and W 89748. 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.

2. The alternate procedure 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, 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 and 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 maximum of direct responsibility in carrying out Allied decisions.

3. Although I had no part in the formulation of the original US Government policy enunciated in SWGCC 140/4A, 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 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 full completion of the program in conformity with US and Allied policy which I had every reason to believe was fixed and determined.

4. 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.

5. 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 surveillance of the movement of capital, monopoly power was widespread. 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 pillage abroad. As early as 1930 Japanese industrial combines veered in the direction of armaments production and geared the country for war.

6. The alliance of the Zaibatsu with government was close and their influence on governmental policies was inordinate.

7. But besides those personal fortunes and positions are affected, the opposition has been joined by those who, being ideologically committed to a Socialist or collectivist pattern for Japan's future, sense that this program, if successful in transforming a small number of very large enterprises into a number of competing units and in lessening the 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 democracy 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.

8. 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, or a political establishment that forces economic power to give the appearance of being exercised over the Japanese authorities by those adversely to be effected, is no guarantee that the program will succeed. Indeed, more than likely, it will result in the highest degree of corruption possible under our present system of administration and will tend to retard or prevent the achievement of the program.

9. 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 than 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.
ECONOMIC REFORM 383

6-26 GRAY'S MEMO ON JAPANESE ECONOMIC SITUATION

Memorandum
To: The Secretary of the Army (Kenneth C. Royall)
From: Gordon Gray, Assistant Secretary of the Army
Confidential

November 14, 1947

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 facts 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 in favor of bringing about reforms in all, or some, of those aspects and that the policy which I have in mind is one of conciliation 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 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 security system and in which the government itself is 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 direct negotiation or by court decision?
   c. Is there a middle course that can be followed?

5. Under consideration is a policy paper, SWNCC 3022/2, which has been submitted to the Department of State and has not yet been promulgated by SCAP. We have attempted to analyze it fully, the policy seems to be stated in an atmosphere of social planning. It goes into considerable detail; for example, with respect to the disposition of divested holdings, the paper classifies the 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 price but what the purchaser is able to pay; and that the government lend all technical and financial support 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 D. Edwards, currently teaching at N.Y.U. Edwards 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 debated. The request from Washington is for a series of basic principles, 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 pushed hard and that he should be notified of any action taken 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, the Pacification Committee (JCS 160/4A), the starting point for all subsequent legislation and directives, this policy has guided all actions taken by me and 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 U.S. 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 what, 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
To: Kenneth C. Royall (Secretary of the Army)
From: H. L. Stimson* Private and Confidential

November 21, 1947

I read your note 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 expropriation. The holding companies in their turn are not necessarily evil concentrations and 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 social justice, law 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 method of statement, it was suggested that for this last purpose she should be allowed to build up her own trade.

In the development of the first three of these steps General MacArthur has apparently made good 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 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.

* 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

November 25, 1947

Telegram Draft
Approved by W. F. Marquart
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 financial 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 defendants 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 reimbursable basis by the Department of Army and loaned to SCAP for an initial period of 2 years. Personnel selected by the standards mentioned provides SCAP with a competent professional review authority. Its selection by Washington assures that both 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 affect 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 envisages the submission by the AC Division, ESS, to the Review Board. A list is then returned by the Review Board to SCAP which lists the companies 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 would be provided with 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.

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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 made 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 Draft 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 made 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 divergences between the two Departments in this regard do not 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 prejudice the review of the program. It therefore uses, as in its first sentence, language of characterization to the effect that the policy in SWNCC 352/2 "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 precludes 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 in and agreeing to review the whole program as set forth in FEC 290. The State Department is preparing its own revision and your letter to Mr. Russell 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 not be 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 prejudice 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 not been raised in 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 prejudice the much larger issues but 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 exercising 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 the 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 the agreement whereby General MacArthur is to be Commander in Chief of 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. Rossell 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

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.

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"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 or 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 April 1937 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 significant 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 1946.

Article 5.

When the HCLC has made designation provided for by Article 3, it shall transmit such designations to the Japanese Government, and be made public to the interested persons. The designation of the same 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 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 separate parts or combination of separate parts in 1937.
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 information; 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 of enterprises the 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 Items 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 5, 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 term persons includes a person and legal entity or organizations). 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 omission of evidence shall have been specifically raised at the hearing or if such substantial evidence shall have been willfully 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 omission is such a substantial character as to render the order arbitrary.

In case the Prime Minister deems such omission 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 omission.

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 perpetuation 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. Any person 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. Any person 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. Any person 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 previous 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 proviso 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
6-31 MacARTHUR'S SUPPORT FOR THE LAW FOR THE TERMINATION OF ZAIBATU FAMILY CONTROL**

Telegram No. 34745

To: CSCAD PL (Under-secretary Draper)
From: CINCFFE (MacArthur)

Subject: W-93500 January 7th and W-93500 January 8th, the Law for the Termination of Zaibatu Family Control is 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 capitalist 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-91731 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 interlocking directorates, but also the relationships which exist by virtue of securities holdings in one company by shareholders who own the stock of other companies, although they may be in different industries or perhaps even in different countries. The problem faced in Japan was the而且not only concentration of economic power within industries, but also across the whole economic structure. The dissolution of Zaibatu Family Control, which affects the holdings of over 2,000 subsidiaries, is a critical step in addressing this issue.

The law for the Termination of Zaibatu Family Control is designed to terminate the influence over Zaibatu enterprises which Zaibatu families have exercised and are still exercising by virtue of securities and offers held by members of the Zaibatu family itself and by others who have been appointed by and having represented the interests of Zaibatu families, may be expected to continue such influence if permitted to remain as, or become, officials in enterprises affiliated with the Zaibatu. Its purpose is to avoid defeat of the deconcentration program through the use of "fronts" related to the Zaibatu by ties of blood or by feudalistic alliance, 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 consequences of persons affected by this law are (1) the immediate family members of the 56 Zaibatu family heads designated under Imperial Order No. 233, and (2) non-family members who, as officials in Zaibatu-controlled companies, have owed them resignation to, and have represented the interested of such Zaibatu in the companies in which they have been associated.

Persons in the first category, i.e., the immediate family members of the 56 Zaibatu family heads, are prohibited under the law for one year from holding or assuming any positions of business or restricted company or their subsidiaries and affiliated as defined under Imperial Order No. 567 of 1946. They are, however, free to become 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 appointed to the Zaibatu, are prohibited for ten years from holding or assuming any positions of business or restricted company or their subsidiaries and affiliated as defined by the law for any of the restricted concerns identified with the Zaibatu family of which such persons are designated as appointees. They are, however, free to hold or assume positions in other companies outside the restricted list. Even within the restricted category, they may serve as officials in companies not identified as under control of the particular Zaibatu whom they represent. They are not divested of any of their securities and they are not excluded from any public office.

The 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 Zaibatu 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 dereliction of duty, be designated as a Zaibatu appointee. In addition, the law provides special exemptions under certain circumstances.

These are (1) the event all the officials of a company are subject to retraining 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 replacement is not obtainable and whose services are indispensable to the management of a company which is engaged in activities essential for 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 Appellate 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 fear of designation for exemption from designation for or retention in or assumption of office have been disapproved, have the right to appeal for re-examination. The requests for re-examination will be referred to a re-examination committee which submits its reports, findings and recommendations to the Prime Minister.

The information provided by the law has not as yet been appointed nor began 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 our hands, in order to retain the capacity of our author's to exercise 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 exception even before their cases have been considered by the Committee, I would indeed be considered as prejudicing 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 have been shown in the Japanese Government.

Subject law was prepared by the Japanese Government in implementation of the requirement of SWNGC 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):

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.
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into account. (The phrase "past personal relationship" is used in the previous sentence in reference to persons who have been placed in positions of substantial responsibility in holding companies or their subsidiaries. But it would also be taken to refer to persons otherwise associated with the Zaibatsu whom SCAP may consider to be acting in a non-combative role.) 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 a concentration of economic power and corporate security holdings representing an interest of more than 5% 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 it is impossible to determine 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.84

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. 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 5% 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. The result is a drastic treatment contemplated in that paper was considered neither necessary to attain the desired objective, nor desirable in view of the practical situation. Under the law, however, the Zaibatsu appointees are not deprived of the opportunity to invest in the security of companies not related to their own enterprise, and that they are left free to utilize their abilities and talents in non-Zaibatsu enterprises, service in government, or in any other field of endeavor. As for the Zaibatsu appointees, since the only purpose of their removal is to prevent the continued exercise of Zuibatsu family influence through the "fronts," it has not been deemed necessary here to divest these persons of their securities, as contemplated by the American policy. It was, however, in order to promote stability in the Japanese economy, that the provision for divestiture was maintained, and it was in order to avoid a repetition of the experiences of the Zaibatsu enterprises with respect to the concentration of economic power in heavy industries in the pre-war period. The Zaibatsu enterprises are in no better condition than the Zaibatsu enterprises were at the war's end, and the Zaibatsu enterprises have not been able to meet the situation as it developed here.

As a result of this, the law for the Termination of Zaibatsu Family Control as it now stands provides for a considerably more broad and comprehensive approach 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 control 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 who should be divested of all such power and should be prevented from re-establishing such controlling power. Further, any such an individual or person acting therefor should be prohibited and prevented from exercising and significant power in business and governmental affairs prior to 1950, unless otherwise provided in international agreements hereafter provided."

It is to be noted that 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 comparability 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 a effective control upon the continuance of Zaibatsu influence exercised through "fronts." It is probable that, in view of the broad field for elimination provided in the law, and due to the discipline of this body, 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 unfounded. The basic deterrent, of course, is the lack of raw materials essential to industrial production and the food deficiency essential to sustain working capacity. Solution of this problem is 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 astounding 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. For 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 businessmen 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 the manufacture of material resources in the Japanese pre-war era, in gearing the country for war, and later in persecuting war with maximum violence. Measures taken to reorient the Japanese economy are hampered by the unco-operative and unco-operative nature of the companies, the government, and even the local government. The government's new policies have been met with resistance by press and public, and even the government is forced to retreat from its promise of strong, vigorous action. The government is overwhelmed by the massive problems facing it, and has little choice but to accept the status quo.

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 competitive enterprise through adequate access to raw materials and world markets in an atmosphere of peace.

MacARTHUR

SOURCE: HENRY 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.

I paid a periodic courtesy 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 needed to be done and how to do it.
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 flood the market with goods for commercial gain. 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 American viewpoint of the occupation. He was disappointed to have the American press, with the exception of the Tribune and few other papers. I needed 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 capitalist 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 circle 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 staff. Their report was passed by Gen. Hillding, Peterson, and Sullivan, representing state, war, and navy departments. Apparently these men didn’t realize the dynamite contained in the report, minded for them, they passed it on to the Far East Commission without change. It was then designated as FEC-230.

MacArthur said he had 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 that the Zaibatsu were pretty well wrecked by the war. He denied that the concentration of industry bill that forced through the diet here in December. (The bill is a mass of generalities; the administrative standards, have been referred to Washington, also he said, “now say”

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 Washington correspondent, apparently got his information from an unconfirmed source (it isn’t 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 over 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 engineered 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.)

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 Marquart, Chief of the E. S. A. and MacArthur much more often than formerly, and Marquart is much more cordial to the press than he used to be.

[SOURCE: Melting Paper, Ministry of Finance]

**6-33 DETERMINING DE-CONCENTRATION OF EXCESSIVE ECONOMIC POWER AND THE DE-CONCENTRATION REVIEW BOARD**

Telegram No. 260453* January 26, 1948

Approved by: W. F. Marquart
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-9710 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 enterprises.

2. Standards for designation and reorganization will be issued by HCLC for each of the four categories or 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 and expenditure, and payments of the Financial Institution Law will be considered. Financial modernization and production 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 within the same degree of public announcement except 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 later a slightly longer period. 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 Supreme Command Headquarters’ 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 to be 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 supervision of the Supreme Commander’s Headquarters. Procedures essentially 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.

* 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. 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 remains 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 Deconcentration 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 efficiency 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.  

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.
   b. The company may be reorganized as per plan without drastically reducing operating efficiency with manifest impairment of the economy.
   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, although without designating the deconcentration 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 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 released 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. Appeals 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 designated list. This 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 to terminate appeal action.


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.
   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 he may be induced to redevelop as to conceal or neglect the deconcentration concentration of economic power.
   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 indications of the duties to be performed. The board is to perform their duties in reviewing 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 be 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.

1. 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: SUTLAND PAPERS]
6-34 RURAL LAND REFORM (SCAPIN-1885)

Memorandum

SCAPIN-1885 (NR/A)
February 4, 1948

Reference is made to:


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, 20 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 redistribu-
tion 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 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 implementa-
tion 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

Prepared by Ormond Freile, ESS, SCAP
April 17, 1948

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 was processed by HCLC and the companies exempted from further action.
Under the Deconcentration Law, names deleted from the List of Designated Com-
panies 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 com-
panies in four categories totalling 32 companies, which could be removed from the "De-

centrination 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 there 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

6-36 OPERATING PROCEDURE REGARDING LAW NO. 207

Memorandum

To: Deconcentration Review Board

From: W. F. Marquat, Chief, ESS
June 10, 1948

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:

   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

   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 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, Commis-
sions would be delighted with the present situation and the reorganizations planned 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 con-
   centration 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 produc-
   tion 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: SOUTLAND PAPERS, Z 703-12]
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.

3. 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.

4. 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.

5. 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.

6. 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.

7. 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.

8. 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.

9. 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.

10. 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 data, to the Antitrust and Cartels Division, ESS, so that the procedures of General Headquarters’ analysis and coordination can be carried out again on this changed order.

11. 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 prior to the expiration of such period.

12. 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.

13. 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 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 Cartels Division, ESS, unless such persons, petitions, etc. have been requested by the Deconcentration Review Board or by any member thereof.

[Source: SUTCLIFF PAPERS, Z 703-10]
ECONOMIC REFORM

6-38 REQUEST BY WESTINGHOUSE ELECTRIC INTERNATIONAL COMPANY ON BEHALF OF MITSUBISHI ELECTRIC MANUFACTURING CO., LTD.

Summary of Letter

To: Decentralization 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 Marquart, Chief E.S.S., SCAP
CC: Mr. W. S. Vaughn, Chief Industrial Division, E.S.S., SCAP
CC: Mr. E. C. Welsh, Chief Anti-Trust & 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: MITUBISHI DENKI K.K.'s REORGANIZATION

This report is submitted at the request of General Marquart 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 licensees.

The Westinghouse Electric International Co.'s position in the matter may be stated as follows:

1) 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.

2) The company's name, MITUBISHI DENKI, and trade marks, particularly , should be retained as:
   a) any other procedure would constitute an unjust discrimination against the company;
   b) the name of the company from the quality standards of the company and not from any non-legal "cumulative influences";
   c) the dissolution of MITUBISHI HONSHA effectively renders impossible illegal practices;
   d) the name MITUBISHI was used before the war by companies in no way connected with the HONSHA and thus said to stand for ZAIKATSU;
   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.

3) In the dissolution of the Setagaya-MITUBISHI DENKI ties, care should be exercised so 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 company be distributed to the old shareholders.

J. P. BOYER
Special Representative

6-39 FOUR POINTS OF GUIDANCE REGARDING DECONCENTRATION

Memorandum of Meeting


Present were:

General Marquart, Chief, ESS
ESS Antitrust & Cartels Divn.
Mr. Welsh
Mr. Bush
Mr. Scheier
Deconcentration Review Board
Mr. Campbell
Mr. Burger
Mr. Robinson
Mr. Woodruff
Mr. Hutchinson

Holding Company Liquidation Commission
Mr. T. Tatsuyama, Chairman
Mr. I. Noda
Mr. G. Kashiwa
Mr. U. Kurumata
Mr. Ichikawa
Mr. K. Morikawa
Mr. Y. Wakimura
Mr. R. Minobe

SCAP Legal Section
Mr. Carpenter
Mr. Strassf

The meeting was opened by General Marquart 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 spokesmen for the HCLC.

General Marquart continued:

The Decentralization 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 Decentralization 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 Decentralization Review Board have expressed great satisfaction with the efficient manner in which the HCLC has performed its duties to date.

The finding of the Decentralization 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 fields of operation. The Board believes that the administrative policies and procedures under Public 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".

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 disregarded if the fact 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 questions that you would care to submit in further development of consonant operating procedures.

At this point I would like to emphasize that nothing has been presented to you which 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 Marquart replied that these recommendations had been accepted by GHQ 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 asked if the procedures to be followed by HCLC were understood 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 further that 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. 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.

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 would like to be given an opportunity to study out any change occurring in their orders as if they were to remain in the Japanese public that a change 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 Marquart 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 given enough time 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.

Mr. Noda asked if HCLC could have copies of the 4 points, and these were furnished by the Deconcentration Review Board.

Mr. Noda 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 chance to get in touch with the Board.

General Marquart advised Mr. Noda that the Board would 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. There had been no change in policy. 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 Marquart 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 the Deconcentration Review Board, a similar statement was in order. Lastly, that he would like to express his own personal appreciation.

[Source: Scotland Papers, Z. 705-10]
6-40 INITIAL REPORT OF THE DECONCENTRATION REVIEW BOARD

Telegram No. C-65098
To: Dept. of Army (Draper)
From: SCAP (MacArthur)
Approved by: W.F. Marquart

Personal for Draper. Reference your WAR 91333, following is the initial report of the Deconcentration Review Board covering the period from organization through 30 October 1949:

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 function 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 3 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 subject.

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 memorandrum 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 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.

ECONOMIC REFORM

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 Marquart, acting as chairman, announced that the companies remaining on designation should be examined in the light of the above four principles. The purpose of the re-examination was to remove from designation those companies where the evidence did not indicate that they were excessive concentrations of economic power.

9. To remedy by 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 altered 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. On 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 Marquart, 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 20 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 for reorganization for the companies enumerated below:

- NIPPON SODA COMPANY
- KOBE STEEL COMPANY
- FUSO METAL COMPANY
- NIPPON STEEL TUBE COMPANY
- JAPAN IRON AND STEEL COMPANY
- NISSAN CHEMICAL COMPANY
- OJI PAPER COMPANY
- MITSUBISHI ELECTRIC COMPANY

(Received 2 October 1948. No Board action taken.)

(Received 5 October 1948. No Board action taken.)
ECONOMIC REFORM

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 efforts. For example, the assets of the 56 persons who comprised the heads of the 15 major zaibatsu families and the assets of the 83 holding companies controlled by these persons have been acquired by the Government and are in the process of being sold to the Japanese public. The sale of these 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 it is well advanced, to eliminate all Japanese trust companies and governmental banking institutions, making possible the emergence of a significant number of new commercial banks, to compete with and supplement the large existing banks by 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 ensure that the operation 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; by limiting 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 management of their enterprise.

Moreover, many existing laws which tended to centralize the control of Japanese industry within a few large combines 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 banking reform 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 in some cases to dissolve control associations and in others to convert these combines into a large number of smaller combines. As these 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. The rapid growth of the daily business of the Japanese government to enforce its 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 are reflective of the changing status of Japan, which 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

Recapitulation

13. RE: Present Status of Industrial & Service Companies designated under Law No. 207

Designated

Originally designated

Removed from designation prior to 4 May 1948

Companies in which it was determined no physical break-up

was required—action taken prior to 4 May

Same as above—action taken after 4 May

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

Cases on which action has been taken by the Board

Action is being taken or has been taken by the Board

Total either removed from designation or process of being

examined

Balance requiring disposition

The next report of the Deconcentration Review Board will be submitted inclusive of 30

January 1949. Signed

M. ARTHUR

[Source: Scotland Papers, 2703-10]

6-41 Excessive Concentration of Economic Power in Japan

FEC-230/3

United States Statement on FEC-230

To: The Far Eastern Commission

Note by the Secretary General

December 9, 1948


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 put into effect by the Post-Surrender Directive issued December 6, 1945 and on the Far Eastern Commission's Post-Surrender Directive of December 30, 1945, 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
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 outdated 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 determinateness 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 outmode 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 obstacles which exist may constitute a competitive enterprise either is not 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: SUTLAND PAPERS

6-42 REEVALUATION OF CORPORATE ASSETS, AS STABILIZATION MEASURE

Memorandum

To: W.F. Marquart, Chief, ESS

From: Edward C. Welch, Chief, Antitrust and Cartels Division

January 6, 1949

1. Question: Would re-evaluation of corporate assets, at this time, have a net advantageous effect upon prompt stabilization of the Japanese economy?

2. Answer:

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 of the various assets involved 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 not been given plans submitted on the basis of re-evaluation of such assets, the delay in our effort to establish financially sound companies would most certainly affect adversely efforts at stabilization. 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 those companies.

d. Re-evaluation of assets might well be grossly unjust to creditors and stockholders who 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 re-evaluated post facto. As reorganization under the ER&R Law cannot be made to include all details may be required to amend 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 to the already long legal suits which would develop from non-uniform treatment of creditors and stockholders.

e. 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.

f. 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 cooled by this action and would hence undoubtedly discount an apparently more favorable financial position of some companies for credit whose companies' books suddenly appeared in a remarkably improved condition.

g. The effect on the economy of 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 was no longer in the same hands and controls and that such company has additional assets which it had prior to re-evaluation. The illusion of solvency would then be dissolved.

h. In the financial reorganization of special accounting companies re-evaluation of assets would mean the withdrawal of the call for consideration 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 and warranted foreign 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 method the company was now in a position more promising.

i. Actually re-evaluation of assets would not in itself contribute to the stabilization of the price level or as a deterrent to further inflation. If the price level is not stabilized, re-evaluation would at this time tend to establish an expectation of further revaluations at 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.

j. The re-evaluation of assets would not only not contribute to the elimination of the effects of 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. Likewise re-evaluation of assets would not result in 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 probably only 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.

k. The 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 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 profits 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 possible 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 tectonic effect upon some companies in light of higher equity values on the books, larger allowable 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 impede if not absolutely necessitate increases in prices, tend to discourage investment until after reappraisals and financial reorganizations could be 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: SCOTLAND PAPERS, Z 703-20]

**643 ECONOMIC AND SCIENTIFIC SECTION TELEPHONE DIRECTORY**

as of June 1, 1949

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<th>Chief of Section</th>
<th>Maj. Gen. W. F. Marquat</th>
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**ECONOMIC REFORM**

- **Foreign Investment Board:**
  - (Forestry Bldg.)
- **Occupied Japan Export-Import Revolving Fund:**
  - (Forestry Bldg.)
- **Director, Bank Operations Branch:**
  - PFO Representative:
- **Administration Division:**
  - (Forestry Bldg.)
- **Administrative Branch:**
  - Personnel Branch:
  - Supply-Services Branch:
- **Anti Trust and Cartels Division:**
  - (Empire House)
- **Controls Branch:**
- **Reorganization Branch:**
- **Securities Branch:**
  - Trade Laws Branch:
  - **Finance Division:**
  - (Pacific Bldg.)
- **Executive Officer:**
  - Miss S. Lamb (Secretary)
  - Capt. J. P. Lowe
- **Money & Banking Branch:**
- **Insurance Securities:**
- **Financial Institutions:**
- **Credit Policy:**
  - Mr. J. R. Phillips
  - Mr. W. Goodhue
  - Mr. G. E. Waller
  - Mr. E. Donegan
  - Mr. C. D. Yeomans
  - Mr. J. M. Jordan
  - Mr. C. S. Ishimoto
  - Mr. E. M. Reed (Chief)
  - Mr. S. T. Baron (Asst Chief)
  - Miss M. Mabbert (Secretary)
- **Public Finance Branch:**
- **Financial Administration & Customs:**
- **Budgets, Local Gov’t Finance, Fiscal Policy:**
- **Foreign Exchange:**
- **Executive Officer:**
  - Miss S. Lamb (Secretary)
  - Capt. J. P. Lowe
  - Mr. H. J. Robinson (Acting Chief)
  - Mr. W. N. Rogers (Asst Chief)
  - Mr. J. P. Reymont
  - Mr. H. J. Robinson
  - Mr. H. S. Lahman
  - Mr. J. J. Henry
  - Miss A. Harrington
  - Miss H. R. Shelden
  - Mr. J. R. Phillips
  - Mr. W. Goodhue
  - Mr. G. E. Waller
  - Mr. E. Donegan
  - Mr. C. D. Yeomans
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<td>Mr. T. Yamane</td>
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<td>Mr. H. C. Bradshaw</td>
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<td>Shoup Mission:</td>
<td>Mr. A. Edridge</td>
<td>57-8612</td>
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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 proposed partition of the big enterprises in Japan has been enabled to maintain the stability of their management through handling both coal and metal and the necessity of having unified management of multiple industries of this kind is expected to become less in future. The proposed partition if it were carried out would make it impossible for partitioned enterprises to maintain in 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, therefore, that due with regards for the above consideration the both companies be allowed to continue as they are without partition.

[Source: Etsu Seigo Shigyo, vol. 18, Economic Planning Agency]

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-30542 of 26 January 1948. The primary function of the Board as outlined by SCAP was to recommend a plan 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 additional recommendations with respect thereto.

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 Provision of 26 July 1945, the Basic Initial-Post-Surrender Directive to the Supreme Commander for the Allied Powers, 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 board 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 FEG 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 subjected 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 Zaiatsu holding companies had been earmarked for dissolution and their ownership and control of large portions of the Japanese economy terminated. The so-called Zaiatsu 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 Zaiatsu

6-44 PARTITION OF MITSUI AND MITSUBISHI COAL MINING COMPANIES

ESB No. 269
June 20, 1949

Memorandum
To: Mr. J. Robinson, 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

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Memorandum
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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 FEG 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..."

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had been designated for dissolution 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 Division Subsidiaries and had been designated as "restricted enterprises" and subject 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, in the event of a conclusion of agreement by the companies with the government 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 offices 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 Cartel Division, Economic Section, 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 concern" and as such 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 branches. Others, not identified with the 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 them, as large operating companies, the Act, pursuant to the provisions of the law. 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 dissolution 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 discretion in recommending to SCAP at the request of the Department of the Army, to SCAP for 47 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 to be able to give to facts and circumstances where industries involved. The remaining 111 companies were removed from designation under the law without referral to the Board.

8. Of the 168 companies referred to in paragraph 6, the Board has reviewed the detailed files of 123 propositions of reorganization, and made its 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 to be able to give to facts and circumstances where 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 directive 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 the Board's finding the Board would then advise the Supreme Commander when in its opinion the company's inherent right to intervene for the purpose of reorganization, 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 reor-
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 November 19, 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 FFC for specific action recommended by DRB 1
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. Marquist, 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 for your valuable contribution 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

ECONOMIC REFORM

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<tr>
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<td>2</td>
<td>2</td>
<td>2</td>
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<td>Heavy Industries</td>
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<td>Can</td>
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[SOURCE: Shiland Papers, Z 703-10]

6-16 JAPANESE LAND REFORM PROGRAM

Report No. 127th
Presented by: Laurance I. Hewes, Jr.
Natural Resources Section, SCAP

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Introduction
Formation and Negotiation of Land Reform Program
The Land Reform Law
Administrative Role of Land Reform Program
Other Land Reform Policies
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 shrank from 46 percent to about 12 percent of the total cultivated area. Absence landlords as a class have completely disappeared. Owners, only 35 percent of the total number of cultivators at the beginning of the program, have increased to 70 percent. Tenants, who among 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 tenure 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 1920s and 1930s. 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.

* 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 and practices. In pursuit of this goal, the Supreme Commander for the Allied Powers, General the Duke of MacArthur, issued a formal Memorandum to the Imperial Japanese Government. This document briefly reviewed the problems confronting farm tenants and instructed the Japanese Government to present its plans for a new system of farming ownership among farm tenants. Simultaneously, and apparently quite independently of General MacArthur's Memorandum, the Japanese Government enacted legislation implementing prewar tenure law and tenure legislation, bearing the name of its principal sponsor, Chuma (prewar). This legislation, a major innovation, was designed to effect a complete reorganization of farm tenancy and create two complementary statutes, the Farmer Tenant Establishment Special Measures Law and the Agricultural Land Adjustment Law. These were known collectively as the Land Reform Laws.

4. These two laws required that almost all agricultural land in Japan was owned by non-cultivating landlords, who must sell their land to tenants, paying them a fixed price plus a small yearly increase. The tenant was then required to purchase the property in 10 years, when the land was to revert to the landlord. These provisions were designed to prevent the concentration of land in the hands of a few large owners. The tenant, in turn, was granted the right to sell his land to others, who would then become tenants under the same conditions. In addition, the legislation provided for the creation of tenant cooperatives, which were to undertake the management of the land and to provide technical assistance to the tenant farmers. The land reform laws were designed to provide a considerable amount of official time and energy. Landlords were assured of their rights and the government was assured of a steady flow of income. Thus, the legislation was designed to benefit both the government and the tenants.

5. The execution of the Land Reform Law required an extensive administrative structure. The organization of land reform was under the supervision of the Land Reform Commission, which was established in 1946. The commission consisted of representatives from various government agencies, including the Ministry of Agriculture and Forestry, the Ministry of Finance, and the Ministry of Commerce and Industry. The commission was responsible for the implementation of the Land Reform Law and the administration of the tenant cooperative system.

6. The operation of the Land Reform Law was complex and involved a large number of agencies and individuals. The government issued detailed regulations and guidelines to ensure the proper implementation of the law. The tenant cooperatives were responsible for the management of the land, including the allocation of land to tenants, the provision of technical assistance, and the collection of rents. The government also provided financial assistance to the tenant cooperatives, including grants and low-interest loans. The tenant cooperatives were also required to pay taxes on the land they operated.

7. The operation of the Land Reform Law was fraught with difficulties. There were many problems, including the lack of suitable land for distribution, the reluctance of landlords to sell their land, and the lack of funds to finance the implementation of the law. These problems were compounded by the fact that the government was also responsible for the reconstruction of the agricultural economy, which was in ruins after the war. The government was therefore forced to make difficult choices, and the results were often controversial.

8. The Land Reform Law was an important step in the modernization of Japan's agricultural economy. It helped to distribute land more equitably and to provide a more stable basis for agricultural production. However, the law was also flawed, and the problems it created were exacerbated by the inadequacy of the implementation. The government was therefore forced to make difficult choices, and the results were often controversial.

9. The operation of the Land Reform Law was quite inadequate, resulting in extremely low prices to landlords and an unjustified windfall to tenants. This effect, not intended in original plans, was due to a poor price-fixing procedure and an agricultural policy too insensitive to reflect the revolutionary tide.

CONCLUSION

For the 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 summary 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 dangers involved and the importance of technical assistance for the execution of the administration of the machinery for executing the program and 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 analyzed. This concluding section summarizes 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 clo of cultivated land and the sale of all but 76,492 clo to 3,000,000 eligible purchasers were accomplished in the two-year period ending on 31 March 1949. In addition 220,373 clo of pasture land was acquired, of which 97,626 clo 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 335,450.2 clo has been requisitioned since 1 January 1945, and 97,500 clo 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 ¥7,267,500,164, composed of ¥1,055,357,033 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 clo. 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 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 clo (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 clo. Even here, changes in cultivators probably have occurred only on units larger than three clo which formerly were cultivated by the owner. Holdings of more than three clo 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:

<p>| Table N—Estimated Changes in Distribution of Owner households Owning to Land Reform (percent of owner households) |
|---|---|---|---|---|---|---|---|---|---|</p>
<table>
<thead>
<tr>
<th>Scale (cho)</th>
<th>1 Aug 47</th>
<th>31 Dec 48</th>
<th>Net Change</th>
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<td>0.0—0.5</td>
<td>48.1</td>
<td>49.2</td>
<td>1.1</td>
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<td>0.5—1.0</td>
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<td>0.6</td>
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<td>0.0</td>
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<tr>
<td>Over 50</td>
<td>2.7</td>
<td>0.7</td>
<td>-2.0</td>
</tr>
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</table>

| Source of Data: Ministry of Agriculture and Forestry |

Table N indicates 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 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 | 30.0 | -6.5 |
| Part owner a) | 23.0 | 22.5 | 0.5 |
| Part tenant | 16.9 | 2.0 | -14.9 |
| Tenant | 36.6 | 5.5 | -31.1 |


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, (c) development of a national educa-

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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 state 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 landlord, 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 individual 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 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 assessment 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 nonentities. 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.

Figure 7

LAND REFORM—CHANGES IN TENURE STATUS
BEFORE 2 SEP 1945

OWNERS 26.7%  PART TENANT 36.6%

5.5%  TENANTS 36.6%  PART OWNER 36.6%

OWNERS 70%

PART TENANT 24.5%

OWNERS 70%

PART TENANT 24.5%

PART OWNER 24.5%

OWNERS 70%

PART TENANT 24.5%

PART OWNER 24.5%

SINCE 1 JAN 1949

[THE SOURCE: SCOTTLAND PAPERS]

* Japan—Enemy or Ally, pp. 143, 144.
7 ECONOMIC DISARMAMENT AND REPARATIONS

7-1 PRINCIPLES OF REPARATION POLICY

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 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 the 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 accountability 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

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1 This document bears no indication of its author.
<table>
<thead>
<tr>
<th>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</th>
<th>Estimated Value Expressed in United States Dollars of Corporate, Individual, and Government Assets Other Than Military and Naval, by Area</th>
<th>Military and Naval Assets by Area</th>
<th>Total Assets by Area and Combined</th>
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<tr>
<td><strong>C. China</strong></td>
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<td>1. Central &amp; South China (Including Hong Kong)</td>
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<td>3. Manchuria</td>
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<td>1. France</td>
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<td>5. Combined Areas</td>
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<td>2. East of Greece</td>
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<td><strong>F. Italy (South of Genoa)</strong></td>
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<td><strong>G. Poland</strong></td>
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<td>1. Poland</td>
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<td><strong>H. Siam</strong></td>
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<td>1. Siam</td>
<td>11,311,329,000</td>
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<tr>
<td><strong>Total: Siam</strong></td>
<td>$11,311,329,000</td>
<td>$11,311,329,000</td>
<td>$6,616,752,291</td>
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<tr>
<th>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</th>
<th>Estimated Value Expressed in United States Dollars of Corporate, Individual, and Government Assets Other Than Military and Naval, by Area</th>
<th>Military and Naval Assets by Area</th>
<th>Total Assets by Area and Combined</th>
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<td><strong>J. United States of America</strong></td>
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<td>1. Caroline Islands (Occupation)</td>
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<tr>
<td>2. Gilbert Islands (Occupation)</td>
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<tr>
<td>3. Korea South of Parallel 38 North Latitude (Occupation)</td>
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<td>4. Mariana Islands (Occupation)</td>
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<td>5. Marshall Islands (Occupation)</td>
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<td><strong>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</strong></td>
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<tr>
<td>1. Austria</td>
<td></td>
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<td></td>
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<tr>
<td>2. Bulgaria</td>
<td>25,000</td>
<td>25,000</td>
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<td>3. Czechoslovakia</td>
<td>40,000</td>
<td>40,000</td>
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<tr>
<td>4. Denmark</td>
<td>63,000</td>
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<td>5. Germany</td>
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<td>8. Rumania</td>
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<td>9. Yugoslavia</td>
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<td>10. The Netherlands</td>
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<tr>
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<td>c. Molucca Islands (Colony)</td>
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<td>d. South Borneo (Colony)</td>
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<tr>
<td>e. Sumatra (Colony)</td>
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<tr>
<td>f. The Netherlands</td>
<td>530,000</td>
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<tr>
<td>g. Timor Archipelago (Colony)</td>
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<tr>
<td>h. (West) New Guinea (Possession)</td>
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<td></td>
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<td>i. Combined Areas</td>
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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 industry which will eliminate its threat or challenge to world peace for generations to come. To 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, ammunition, 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 people who have 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 the concentration of national economy within standards of living, and the will of the controlling nations to perpetuate their supervision.

Japan's Psychology Must Be Adjusted

The Japanese attack upon Pearl Harbor and the war of conquest in the Pacific was the fruit of not only military 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 judgment of defeat. This perversion may and must be eliminated from Japan 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 had been. With these ambitions, Japan has subjected 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 early consideration. With respect to both the seizing and the exposure of war materials, various nationalities or districts have been inter-related, and each new situation will present problems involving market outlets, employment, means of obtaining necessary supplies, and pre-

[Source: Soutland 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 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 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:

   (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:

      a. Iron and Steel
      b. Coal
      c. Other mining
      d. Light Metals
      e. Other non-ferrous Metals
      f. Shipbuilding
      g. Machine Tools
      h. Railroad Equipment and Rolling Stock
      i. Automotive Machinery
      j. Electric Machinery
      k. Other machinery
      l. Electrical Power
      m. Chemicals
      n. Food Processing
      o. Petroleum (natural and synthetic)
      p. Forest Products
      q. Cement and other building materials
      r. Rubber and Products (including synthetic)
      s. Textiles and Leather
      t. Fisheries products
      u. Ceramics
      v. Communications and Communications Equipment
      w. Handicraft, cultured pearls, tea, and other items of export significance

   (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 Japanese companies, 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.

3. 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 munitions and internment expenditures in Japan other than pay of troops. This material may be arranged in any way most convenient for you.

4. 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.

5. 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.

General of the Army Douglas MacArthur
Supreme Commander for the Allied Powers

Dear General: 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 repartitions policy and interim removals from Japan on reparations account.

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.

Accordingly, I am recommending to our Government that plants and equipment be made available 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 manufactory 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 the entire aircraft industry of Japan. It is estimated that this should bring in 220,000 machine tools.
   b. In all plants manufacturing ball and roller bearings.
   c. In all plants manufacturing aircraft engines.
   d. 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.)
   e. 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.

3. A recommendation on pig iron will be sent to you later.

4. All facilities for the production of magnesium, for the preparation of aluminum 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.

5. All contact process sulfuric acid plants, except those necessary to recover waste gases from zinc, lead, copper, and other heavy metal smelters.

6. The modern Salvy process soda-ash plant in Japan. (According to the Japanese information made available by the Economic and Scientific Section, there are four of these from which to choose.)

7. 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 hearing 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 by the rebuilding of heavy industries is going forward with an apparent expectation of [or] 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 the reparations become fully necessary—a situation which could create a great disturbance and Japanese workers feel that we are destroying peaceful industry—the sooner the reparation 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, 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 definitive measure. If this happens, the effect 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 which 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.

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.

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 STATES 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, in his address to the members of his staff, 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 last war generation consisted of plants for the purpose of waging wars of aggression. It was further over-expanded 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 bomb-damaged areas is [this easy view. The fact is that Japan's industrial equipment was overwhelmingly designed for war. Despite all the destruction, Japanstill 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 de-
industrialization 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 re-

placements, to be begun as soon as appropriation and shipment can be supervised by Allied observers. These interim removals will probably be below the total 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 manufacture 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 engine parts. I estimate that the interim plan will remove from Japan between 350,000 and 400,000 machine tools.

**Shipyards**

1. All equipment and accessories in 20 shipyards to the extent it is not needed for the repair of shipping essential to the occupation.

**Steel**

1. 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**

1. 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**

1. All contact process sulphuric acid plants, except those necessary to recover waste gas, nitrogen fixation, and copper and other heavy metal smelters, the major part 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**

1. All capacity for producing magnesium and aluminium, and for the reduction of alumina to aluminium, except facilities for processing scrap, and all strip mills, rolling mills, extrusion presses, etc., used in finishing magnesium and aluminum.

2. I have also made several other recommendations to President Truman, listed below:

- **External assets**
  - To seize 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**
  - 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 for occupation costs, imports, reparations, or restoration.

- **Silver**
  - 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 enterprises. 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 something 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 realease 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.

My Recommendations are summarized in one page as follows:

Page 15 and 16 of the Interim Report

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 Principles
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 aids, 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 removal 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 removal 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 definitively 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 reparations 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 them.

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 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 of the machinery 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 200,000 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.)

ECONOMIC DISARMAMENT AND REPARATIONS

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 aluminum 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 generating 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
Gold, silver 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, deficits, reparations and restitutions.

d. Use Reparations Program to Help Destry Zaibatsu
One concrete step in the direction of implementing the policy of breaking up the Zaibatsu 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. Activities of Mission
My staff which accompanied me to Japan was composed of 21 men besides myself. In addition to 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 South 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, Formosa and North China, after which the Japanese Government agreed to sign a mutual security treaty with the United States.

My primary purpose in visiting the Philippines was to assess the total needs of industrial equipment and plants that will be required to keep the economy running in the event of a Japanese invasion. It is important to note that the heavy industries of Japan are now going forward with an apparent determination to maintain a level of industrial capacity that will be increased in the future as Japan becomes more efficient in the use of its natural resources.

Observations by my staff and myself in various parts of Japan, confirmed reports from other members of my staff, that indicate that not only the consumption of all essential commodities, but also the need for critical industries, is now going forward with an apparent determination to maintain a level of industrial capacity far beyond that which we and our allies will be willing to permit.

The Japanese Imperial Government, under General MacArthur's Headquarters, which directed the Japanese Imperial Government to "stimulate and encourage the maximum production of all essential consumers commodities", the military authority responsible for this, had been directed by General MacArthur's Headquarters) are permitting conversions of Japanese war industries to peacetime production on a large scale.

The statement of fact is not presented as a criticism of our occupation policies in Japan, but as a basis for the impossibility of proceeding consistently with a reparations policy which has not been stated. Particularly in dealing with industrial conversion programs, GHQ in Tokyo must not know only the broad principles of the reparations program, but also the practical implications of these programs, as defined 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 has been at war. Official studies by General Army, General Navy, and General Staff, which have been made by the Ministry of Agriculture, Industry, 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) The food being held on the farms and in the local storerooms as a hedge against further declines in the purchasing power of the yen.

(3) Black market (or "open market") channels, for which no statistical data are available, provide the bulk of the food for the urban people.

The food shortage, based on government estimates, has been limited 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 troops. Including the pay of the 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.

Japanese 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 prisoners of war 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 activity which was estimated in advance, and the Japanese 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 to 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 majority of the 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 by 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
to install and use plants and equipment received by them as reparations from Japan.

Edwin W. Pauley


7.4 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, decolonization 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 industries 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 encourage 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

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-
dation 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

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GENERAL STAFF OF THE UNITED STATES REPARATIONS MISSION

(MAY TO SEPTEMBER, 1946)

EDWIN W. PAULEY

Ambassador of the United States

and

Personal Representative of the President on Reparations

MARTIN TOSCAN BENNETT*

Chief of Staff

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Secretary

SGT. JOHN MATLES†

Interpreter

* Accompanied Ambassador Pauley into Manchuria

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 payments 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 in search 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, Puchun, Liaoyang, Amahan, Penchhu, Kunghwan, Chinhow, Chimau, Peipiao, Fushun, Helian, Kaiyuan, Suilingchich, Halian, Changchun, Kirtin, Harbin and Mutanchang. 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 the 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 could 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 increased productive capacity to low wages. However, the 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 Manchuria Railroad 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-Asianic 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 Manchuko Government assisted the Zaibatsu in their exploitation with preferential treatment and subsidies. This policy was no altruism in these actions, but the driving force at Manchuria was not 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 as the backbone of Asia. It is one of the few areas where coal in Japan 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 the 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 1944. The area had expanded from 1942 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 addition to this estimate, figures obtained by the British Mission cited by the Chinese Industrial Advisory Commission, the British Ministry of Economic Warfare, the U.S. Foreign Economic Administration, Japanese sources were also consulted. The Chinese compilation is appended, this report as Source File 201-X-10 in Appendix B.

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 economic structure that will provide 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 which situated in Japan proper or in occupied areas should be expropriated. To claim as allied reparation loss of the territories 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 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. This realignment should be accomplished in two important steps: to turn over to local non-agency governments control of the Japanese assets in those countries, and, to transfer surplus capacity from Japan to regions where it can be best used to process the natural resources so as to satisfy the needs of the Far East at a price. This plan has a double advantage: it will help to meet needs for normal rice requirements, the U.S. policy would reduce this surplus and capacity and place it near sources of iron ore and coal mining. 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 present is great. This Mission made its survey of the condition 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 or 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 blow 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 landings August 18, 1945
Japane delegation arrives in Manila to receive orders August 19
Unopposed Soviet air landings August 20
Unopposed Soviet air landings at Kirin and Changchun August 21
Eighth Army advance party landed at Atagoo Airdrome, Tokyo August 23
General MacArthur leaves Tokyo August 23
Formal signing of surrender terms in Tokyo Bay September 2

Upon their arrival in the industrial areas of Manchuria, the Soviets began a systematic conquest of food to stop the relief. 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 stocks of prime importance to industrial operations, the Soviets took all functioning power generating and transforming equipment, electrical 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 two-thirds 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 for the steel and other plants to operate. Water pumps 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 means of salvation for those who fled 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.

The will of the war had driven the Manchurian industrial complex occurred during the Soviet occupation and was primarily due to Soviet removal 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.

The Soviet forces confiscated approximately three million U.S. dollars worth of gold bullion stocks and over a half billion Manchurian yuan from Manchuko banks. They also circulated nearly ten billion yuan in occupational currency, almost doubling the total Manchurian note issue. In addition to the reparations, mentioned above, the Soviets also took control of trade in order 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 in Manchuria by the Soviet Government. In the case of 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 reparations 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 halt in all industrial activity, 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 create a steady, peaceful, 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 in 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.

ECONOMIC DISARMAMENT AND REPARATIONS

7-10 DELAYS IN COMPREHENSIVE REPARATIONS PROGRAM

Letter

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 2 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 that a copy of this report had been given to the Chinese authorities and the 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 SWNNC and for expediting its approval in order that I might submit it to the Board with SWNNC concurrence with the object in view of its being used as a basic statement of policy.

By letter of August 25 Clair Wilcox, Acting Deputy, reported that "...the State Department has prepared in form for presentation to SWNNC 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 SWNNC, as was done with my Interim Reparations Program of 18 December 1945. That is not now the case, and the Department does not intend to submit to SWNNC the comprehensive report in its entirety. Instead, I am advised the Department has drafted and proposes to sponsor in SWNNC 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 statement does not refer 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 plants. 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 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 Japan reparations issue 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, and in the event the President is 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]

7-12 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 in which 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. The second paragraph 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 a delay in my program 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 EFC.

In addition to this, the second and third paragraph of my report points out that the information on which it was based 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 judgement of well qualified members of my Mission. The decision on any matter may be made more exactly and surely at a later time, I believe sufficient qualified judgment 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, considering present uncertainty as to participation in world trade and the attitude of other countries. 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

[Source: Dipl. Br., National Archives]
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 program would be to make some ships larger than 5,000 gross tons (which SCAP agrees should be prohibited in Japan) available as reparations as soon as salvage and repair activities would permit. This would be an important settlement of the shipyard capacity question which the island also wishes to delay. Both these items are needed to reparations and the claimants are entitled to know what to expect.

Some comments emphasize the necessity for exporting sufficient products to pay for reparations, and this plea is made on the grounds that 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 unavoidable unless it 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 so 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 all fill this vacuum by restoring the subsidized industrial economy of Japan or by 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 Asisatic 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". Herefore, in the interests of the Japanese textile capacity was inadequate for home needs. As I urged early last summer, the best help that can be given is the development of the situation in Japan 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, and have covered almost any great distances and sold at any available 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 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 goods.

Delays in the reparation program, I share SCAP’s concern. However, with physical and economic conditions as they are in Japan, I am far from seeing a surplus greater than the production that could be obtained by moving facilities from Japan if prompt action is allowed to follow. 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 respect, 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 replacement parts 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 in 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, sufficient to suppress the manufacture of machine tools in the recipient countries. We should remember furthermore that copies of some German machines, which 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 agree 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. For that matter I can 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 would be counted at 61%, if I may, 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 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 unsatisfactory location. Some iron production was concentrated in a small number of plants. All of this tended to leave a portion of the iron 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 with SCAP’s comments on woolen textiles, rayon fiber and cellulose 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 it is no valid reason for assigning a fixed specific limit to install machine tools in all industries at the discretion of the decision which will influence the size and development of Japanese metal working industries have been made and it is now advisable to leave a large margin of error as I did in arriving at the ceiling of 2,575,000 for machine tool installations.

The industries involved in the machine tool installation 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. It, 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 submission of their remarks. For example, my statement that sugar 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 work in the Far East of some of the members. I early realized how important a maximum food production to the reparations program and that meats will represent the largest category of imports. Increasing food production in Japan should do more than bring about a balance of imports and exports from 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.

On the levels of operation actually achieved by industries in Japan will not be limited by lack of capacity for reparations. This is true, of course, in the cases 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 by a comprehensive assured retention program is adopted. While many SCAP comments can be taken as a word of caution, they do not 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 agree with many of them for the reasons I have expressed above, but at this point I am concerned more with the delays than I am over a move to shelve the quantities of goods to be available for reparations.
7-13 COLONEL CHESELINDE'S REPORT ON REPARATIONS POLICY

Memorandum

To: General MacArthur
From: R.M. Cheseldine, Deputy Chief, E & S Branch, Civil Affairs Division, War Department Special Staff

February 17, 1947

1. Pursuant to Letter Orders, The Adjutant General, War Department, dated 22 January 1947, 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 Department's Committee on Reparations...". The attached brief summary report of my visit to Japan with the 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 further detail as may be requested and conclusions drawn.

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 various sections of General Headquarters, in the Eighth Army Officers, and in addition, have visited many plants in Tokyo, Yokohama, Osaka, and Kobe. They have been completely disinterested, sincere and thorough in presenting the facts, as 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 high degree of professional 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 of 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, both in writing and in oral presentation, and with the best 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 infallible on a subject of such magnitude and of such historic importance and implications 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
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 the 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 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 re-establish Japan's war economy and 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 efficiency and strength of our capitalist 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 point 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 existence, and 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 Japan can 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 "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 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 great financial burden upon any 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 reparations 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. For political purposes, decision should be reached at once regarding disposition of excesses. For 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.

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 excesses. For 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. This 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 heavy reparations payments. The only reasonable policy would be to take the reparations "gold pot" 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, and 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 machinery now in Japan, 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 which would impose upon 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. In all staff studies, briefs and proposed directives on all phases of reparations now being processed by the War Department in SWNCN and FECA should be withdrawn for restudy in the light of these conclusions and the following recommendations.

E. Conclusions and Recommendations

1. The War Department immediately propose to SWNCN 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. "Gold Pot" as outlined in the SCAP radio 60424 and in the paper "Industrial Disarmament and Economic Control of Japan", dated 22 January 1945, 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 plant and machinery catalogs.

5. For the time being, the "gold pot" be designated 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 Japan.

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 funds 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.

United States economic policy should specify disapproval of reparations from current production.

[Source: MACARTHUR MEMORIAL, RG-5]
ECONOMIC DISARMAMENT AND REPARATIONS

The uncertainty which has existed as to the exact nature of the reparations program has had a retarding effect on reversion 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 observed the work which is in progress 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 Linter 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 unsolved 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 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 50% greater than 3,500,000 metric tons should provide flexibility. A further study should be made of the advisable proportion of open-hearth and electric-furnace melting capacity under certain conditions relating to the avail-
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 availability to claimants of power equipment from this source over new equipment will be limited.

The Committee reviewed in some detail the project of the work in the other branches of the Chemicals—Japan, under her war program, greatly enlarged her heavy chemical industry which no doubt now contains a surplus over historical peace-time needs, but these needs are examined in the light of changed post-war 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 10%) nearly all of which is used for growing fertilizers. Japan is large producer of rice, corn and sweet potatoes 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 those markets to lowforeign exchange. Therefore, if any reparations are to be paid in cotton imports and may have to produce in part at least, rayon cottons in her extensive textile industries, requiring large amounts of sulfuric acid and caustic soda in production of yarn. Another suggested means of getting foreign exchange, not under consideration, is the enhancement 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 carbonate and cyanamide capacity and all chamber production of all acid plants. It would also favor retaining all contact process sulfuric acid plants, all soda ash, caustic soda and chlorine plants until the law of supply and demand is proven that some of this production is surplus.

Shipbuilding—An estimate of a $500,000,000 tonnage in 1946 has been made by SCAP assuming requirements of the Japanese merchant marine of 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 or the absence of a final settlement of certain economic needs. In the absence of a new shipping fleet, 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 reduced sufficient for 550,000 gross tons of new construction annually and 5,900,000 gross tons for current repairs.

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 tools made available for reparations are not very old, and to the extent to which replacement tools, trucks, bicycles and other such products useful in the peace-time economy and, where such conversion is possible, these tools should be retained. The estimate of Japanese requirements for new machine tools appears to be 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 shipbuilding industries designated as available for reparations, should be declared free of control and not subject to reparations.

ECONOMIC DISARMAMENT AND REPARATIONS

Japan must of necessity continue to be a trading nation. Before any level of indus-

try 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.
ECONOMIC DISARMAMENT AND REPARATIONS

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 operations. The Committee and the military command included in it, such as the Eighth Army, the government agencies, including the War Department, have all been involved in the process. The military government operated under the principles of requisitioning, labor adjustment, and labor control. The issues of reparations were handled in a way that was consistent with the overall goals of the occupation.

The work done by the Eighth Army in supervising the movement, storage, preparation, and restocking of the reparations has been commendable. The Committee feels that the administration of the framework of the reparations program, including the major areas of supervision, is very important for the economic recovery of the country.

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 Plants for Reparations—While no appraisal has been made of the actual value of plants and facilities available for reparations, based upon information obtained in the field, the Committee believes that the value of a very small fraction of the external Japanese assets, consisting of industrial installations located in former conquered territories and which are now in the possession of the liberated countries.

B. Office of the Executive for Reparations

The function of this office in the handling of claims, making evaluations and allocations, and directing the handling of shipping plants, while being a considerable importance in the whole program, is the kind of an operation which can be programmed as a separate office with the exception of 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 and facilities of industry under Economic and Scientific Control, and the Committee 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 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 to avoid a backlog of claims. Such a date could be cleared for repatriation 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.
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: SUTLAND PAPERS, Z 703-I]

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: SUTLAND PAPERS]
7-16 INTERIM DIRECTIVE REGARDING ADVANCE TRANSFERS OF JAPANESE REPARATIONS

Telegram No. WAR 95604
To: Gen. MacArthur
From: Joint Chiefs of Staff
Confidential

"The following Interim Directive, Serial Number 75, received from the State, War, and Navy Departments, is 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 shall 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 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 judgment 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 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 disproportionate 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]

7-18 REPORT ON INDUSTRIAL REPARATIONS SURVEY OF JAPAN TO THE UNITED STATES OF AMERICA (SECOND STRIKE REPORT)

Report
To: The Secretary, Department of the Army
From: Overseas Consultants, Inc.*

February 26, 1948 (transmittal date)

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

* 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.

7-17 POLICY REGARDING AVAILABILITY OF JAPANESE PLANTS AND EQUIPMENT FOR REPARATIONS REMOVAL

Memorandum
To: ESS, REP*
From: Chief of Staff**, SCAP

July 25, 1947

1. The following policy with reference to the availability of Japanese plants and equipment for reparations removal is effective immediately:

* Reparations Section, SCAP
** Maj. Gen. P.J. Mueller
<table>
<thead>
<tr>
<th>Industry</th>
<th>Unit</th>
<th>Annual Productive Capacity Designated</th>
<th>Value of Facilities Designated for Reparations (1959 ym)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>for Retention</td>
<td>for Reparations</td>
<td></td>
</tr>
<tr>
<td>Fig Iron</td>
<td>Metric tons</td>
<td>2,000,000</td>
<td>1,600,000</td>
</tr>
<tr>
<td>Steel Ingots</td>
<td>Metric tons</td>
<td>3,500,000</td>
<td>2,900,000</td>
</tr>
<tr>
<td>Steel Rolling</td>
<td>Metric tons</td>
<td>2,650,000</td>
<td>1,550,000</td>
</tr>
<tr>
<td>Sulphuric Acid</td>
<td>Metric tons</td>
<td>3,510,675</td>
<td>1,245,675</td>
</tr>
<tr>
<td>Nitric Acid</td>
<td>Metric tons</td>
<td>30,255</td>
<td>106,945</td>
</tr>
<tr>
<td>Electrolytic Calcium Soda</td>
<td>Metric tons</td>
<td>65,520</td>
<td>46,900</td>
</tr>
<tr>
<td>Soda Ash</td>
<td>Kiloliters</td>
<td>453,000</td>
<td>—</td>
</tr>
<tr>
<td>Synthetic Oil</td>
<td>Kiloliters</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Synthetic Rubber</td>
<td>Metric tons</td>
<td>10,000</td>
<td>900</td>
</tr>
<tr>
<td>Ball and Roller Bearing Systems</td>
<td>Kilowatts</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Mainly generated without boilers.*

This amount is sufficient to service 3,017,000 g.t. per yr.

**ECONOMIC DISARMAMENT AND REPARATIONS**

Economic disarming for 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 quite evident that a large part of the internal economy, over and above that 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 peace-time industries were destroyed, and the development 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 plagues of mechanization do not have a degree of development that the United States could experience.

In Japan, there is a serious internal problem 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 85,300,000 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-agricultural population problems in finding the 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 279,000,000 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 revenues paid 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 and Japanese claims in foreign securities held abroad, and it is estimated that, if it continues, it will pay for the services of Japanese goods which were shipped in 1936, invisibly 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 foreign capital 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 invisible income will decrease 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 1937 is estimated to be about 500,000,000 or about 149,000,000 yen.

As pointed out elsewhere, 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 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:

<table>
<thead>
<tr>
<th>Industry</th>
<th>Unit</th>
<th>Capacity</th>
<th>Value (1939 yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nitric Acid</td>
<td>Metric tons</td>
<td>107,000</td>
<td>9,640,000</td>
</tr>
<tr>
<td>Synthetic Rubber</td>
<td>Metric tons</td>
<td>100,000</td>
<td>10,230,000</td>
</tr>
<tr>
<td>Shipbuilding</td>
<td>Gross tons</td>
<td>385,000</td>
<td>118,130,000</td>
</tr>
<tr>
<td>Aluminum and Magnesium Fabricating</td>
<td>Metric tons</td>
<td>50,000</td>
<td>21,680,000</td>
</tr>
<tr>
<td>Magnesium Reduction</td>
<td>Metric tons</td>
<td>180</td>
<td>12,550,000</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td></td>
<td><strong>172,269,000</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Primary War Facilities</strong></td>
<td></td>
<td><strong>1,475,887,000</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>1,648,156,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

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 1935 domestic requirements plus repairs for exports at the 1937 level. Silk exports in 1935 probably will amount only to a small fraction of such exports in 1937. Power requirements in 1935 will far exceed present capability. The only industries not recommended for reparations in Section B, which appear to have capacities for producing goods in excess of 1935 domestic requirements plus exports at the 1937 level are aluminum, ball and roller bearings, and sulphuric acid (by producing ammonium sulphate for fertilizers). Such excess production 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 in invisible income since that date is big. Not only can Japan afford 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 buildings and equipment removed in Section A were removed, the buildings and non-removable equipment remaining in Japan, which would be difficult to adapt to other purposes, would have a value over and above the removalable items of more than 1,500,000,000 1939 yen. It is what property would be salvaged and utilized by Japan for other purposes and 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 a value permanent loss of the facilities having a value approximating 1,500,000,000 1939 yen. It is difficult to state the equivalence 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 provision of loans, utilities, and accessories 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 peace-time 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.

Conclusion

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 to 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.

Recommendations

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 296/43

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. 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, 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 3,000,000 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 con-travened thereby reparations removals in the chemical industry will be accomplished as hereinbefore presented.

   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 limitations:

   1. 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

Projects 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 $2,500,000 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 hydrocarbons derived from coal), including all straight 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 alkylization 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 aluminum, 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, carrying 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 limitations:

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.

[Sources: SOUTHERN PAPERS, Z 721-7 and 8]
7-19 COMMENTS PERTAINING TO OVERSEAS CONSULTANTS
RECOMMENDATIONS RELATIVE TO INDUSTRIAL
REPARATIONS FROM JAPAN

Memorandum

To: Chief, Industrial Division, ESS
From: H. B. Overton, Chief, Raw Materials and Requirements Branch, Industrial Division

March 18, 1948

I. 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:

<table>
<thead>
<tr>
<th>Steel Type</th>
<th>Annual Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pig Iron</td>
<td>2,000,000 M.T.</td>
</tr>
<tr>
<td>Steel Ingot</td>
<td>3,500,000 M.T.</td>
</tr>
<tr>
<td>Rolled Steel</td>
<td>2,650,000 M.T.</td>
</tr>
</tbody>
</table>

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 Hirobata, Hyogo Prefecture, plant of the Nippon Seittetsu (Japan Iron and Steel Company). This plant was installed between 1938-39, 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. 90, which OCI was not bound by, and which states first consideration to removals will be given to Zaiibatsu 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.

ECONOMIC DISARMAMENT AND REPARATIONS

(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 doubling of 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:

<table>
<thead>
<tr>
<th>Steel Type</th>
<th>Annual Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction</td>
<td>25,000 M.T.</td>
</tr>
<tr>
<td>Fabricating</td>
<td>None</td>
</tr>
</tbody>
</table>

(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:

<table>
<thead>
<tr>
<th>Steel Type</th>
<th>Immediately Available Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>OCI</td>
<td></td>
</tr>
<tr>
<td>Nippon Light Metals Co.</td>
<td>36,000 M.T.</td>
</tr>
<tr>
<td>Shimizu Plant (alumina)</td>
<td></td>
</tr>
<tr>
<td>Suzuki Seittetsu</td>
<td></td>
</tr>
<tr>
<td>Nihama Plant (alumina)</td>
<td>27,000 M.T.</td>
</tr>
<tr>
<td>Nippon Light Metals Co.</td>
<td></td>
</tr>
<tr>
<td>Kambara Plant (alumina)</td>
<td></td>
</tr>
<tr>
<td>Nisbin (Sumitomo) Kagaku Co.</td>
<td>52,000 M.T.</td>
</tr>
<tr>
<td>Nihama Plant (alumina)</td>
<td></td>
</tr>
</tbody>
</table>

* 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

<table>
<thead>
<tr>
<th>Steel Type</th>
<th>Immediately Available Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nisbin (Sumitomo) Kagaku</td>
<td>36,000 M.T.</td>
</tr>
<tr>
<td>Nihama Plant (alumina)</td>
<td></td>
</tr>
<tr>
<td>Nisbin (Sumitomo) Kagaku Co.</td>
<td>25,000 M.T.</td>
</tr>
<tr>
<td>Nihama Plant (alumina)</td>
<td></td>
</tr>
</tbody>
</table>

* Capacities 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 Nisbin Kagaku Nihama 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 SWNC 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 in and demand in the Far East and world market.

(2) All objections with respect to 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) SWNC 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 supply could provide approximately 1,000 tons of semimetal and by-capacity.

NICKEL SMELTERS

(1) The definition of nickel smelters, as stated in SWNC 236/43, is "all plants and establishments primarily engaged in the smelting of nickel from its ores." All large nickel plants engaged in the smelting of nickel from its ores have been large experimental nickel smelters, therefore the Committee has no objection to the recommendation of the United States.

SYNTHETIC OIL

Part A

(1) SWNC 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 mainly of coke ovens (impractical to move) can be used to good advantage in the economy with a minor auxiliary coal supply (semi) coke (coal tar) and by-capacity. Certain portions of the synthesizing equipment can be and should be converted to fertilizer and other production.

(2) The condition of the equipment, the impracticability of removal, valuelessness 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—Toko Kagaku Kogyo (Toko Chemical Industries Co.), a combination refinery and synthetic plant is in consideration of the Allied Command D-F, Nagoya Branch, and as an arsenic property. As such this plant should be made available for reparations under definition of primary war facilities.

Part B

(1) Agree with refinery capacity as stated by OCI and relative inefficiency and poor condition. Available capacity comes within SWNC 236/43 limitation of 40,000 barrels per day, which capacity should be removed for reparations.

(2) SWNC 236/43 limits storage capacity to 10,000,000 barrels. Above ground storage as stated by OCI consisting of steel tanks in units of 50,000 barrels or more in condition to move and re-install amounts to 7,252,000. 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 SWNC 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: Committee

From: Committee

April 26, 1948

Johnston Report

Perce H. Johnston

Paul G. Hoffman

Robert F. Loomis

Sidney H. Scheuer

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Raw Materials and Foreign Trade

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Position and Prospects of Foreign Investment

Budget and Foreign Trade Policy

Concluding Comments

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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 laws 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 Mariana 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.
Japanese industrial products are needed throughout the Far East, where nations also need Japan as a market for their potential exportable production—thick, rubber, copra, wool, cotton, iron ore, bauxite, sugar and rice. Japanese industry is operating at a very low level—less than 40 per cent of the 1930-1934 average. Shortage of needed raw materials is not a major reason. However, despite the upheaval of war and the disruption of supply, Japanese industries are better than other nations in the Far Eastern region in not being too far removed from their original location in the home market. 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 in what quantities will be left to them, so within the industries thought to be subject to reparations, incentive to restore and reconstruct is small. Plants which are in the process of 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 current dependence of Japan on the sterling areas, and on the Far Eastern and East European 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 bounties 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.

The major internal problems of 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 rigorous control of governmental expenditures, the maintenance 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 be the 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, and in reducing costs of doing business are all 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 struggling populations.

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-sustaining economy. In our opinion the 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 integration of their country, 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 were destroyed in 1950 and could be supplied by rail only if Japan were to be invaded by the North Koreans. 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 especially short of machinery; anything other than the simplest machinery is imported from Japan. 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 Hodges, our Military Commander, that reasonable assistance should be given to finance incorporation 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, an opportunity to learn what an independent nation can do. The Committee therefore recommends an interim aid program to be administered and executed by our Government of the suggested recovery program at the earliest possible date.

[SOURCE: SUTTEN PAPERS, 2:721-9]

7-21 CONCERNING THE "REPORT ON INDUSTRIAL REPARATIONS SURVEY OF JAPAN" AND THE "REPAIRS OF THE UNITED STATES OF AMERICA" BY THE OVERSEAS CONSULTANTS, INC.

Memorandum, R.B. No. 41 (GS)

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.

Noted is the fact that 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 labs 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 reformation of our efforts 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 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: SUTTEN PAPERS, 2:703-1]
CONCERNING LETTER FROM REPAIRATIONS BOARD, JAPANESE GOVERNMENT, COMMENTING ON OCI REPORT

Memorandum (draft)  
To: Chief, ESS  
From: W.S. Vaughan, Chief, Industry Division


2. These two papers are the attempt of the Japanese Government to further reduce reparations 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.

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 drastic recommendations of the 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 removed 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, 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 290,000 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
   Special Fishing Boats 60,000 GT
   Misc. (Tugs, Ferries, Dredgers) 15,000 GT
   Total 655,000 GT

(2) Repair Capacity
   Cargo and Passenger 6,000,000 GT
   Fishing Boats and Misc. 1,200,000 GT
   Total 7,200,000 GT

ECONOMIC DISARMAMENT AND REPARATIONS

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 Electric 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: SETTLING PAPER S, Z703-1]

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)  
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 restrictions with respect to the speed and size of the future Japanese merchant shipping. As this problem is vital to the sea-bound 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 SWNW 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-knot speed.

Therefore, we would be grateful if you could be good enough to take into consideration the development of events which has been achieved for the past years as stated heretofore and modify the limitations on the speed and size of the Japanese merchant vessels.

When 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 ZABATSU (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: Sculand Papers, Z 703-1]

7-24 PROPOSED ACTION BY STATE DEPARTMENT ON INTERIM REPARATIONS PROGRAM

Letter (SWNCC-236/2/D)  
To: Dean Acheson, Acting Secretary of State  
From: Edwin W. Pauley  
December 18, 1948

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
SCAPIN-47
September 22, 1945

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 dis-
   tributed.
   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 alloca-
   tion 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 con-
   cerned.

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 incorpora-
   tion 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 incorpora-
   tion 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
ECONOMIC CONTROLS AND PLANNING

II. Estimate of the Inflation Situation in Japan

A. Developments up to the Present

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

3. Probable Effects of a Substantial Inflation in Japan

4. Economic Effects

5. Effects on Particular Groups

   a. Farmers

   b. The Zaibatsu

   c. Professional Classes

   d. Industrial Labor

   e. Small Business and Industry


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 percent 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 deposits 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 people 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 been transferred 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 statistics indicated 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 on any considerable portion of these claims would 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 which could be available over the value of goods and services currently produced and imported. This inflationary force will be of great importance 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 government, for reconstruction, reorientation, 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 increased as inflation progresses. Destruction has already taken place in Japan's industries and employed the productivity and taxing power of the Japanese economy. In addition there will be large outlays by the occupying forces, including expenditures by individual troops. 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 result of such inflation will be to cause deflation 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 more rapidly than other prices. On the other hand, food and clothing prices may rise more rapidly than prices of other goods. Inflation will suffer as their real income shrinks.

If inflation does occur, it may have some of the effects of a military occupation. 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 Zabihata may suffer as a result of limitations on large-scale industry, and their losses from bombs and fires may be represented by insurance claims shrunk in value with rising prices.

**8-3 CONTROL OF FOOD AND AGRICULTURE IN JAPAN**

**ECONOMIC CONTROLS AND PLANNING**

**Report**

**SWNC**

**October 11, 1945**

**SWNC**

**Report 98/1**

**THE PROBLEM**

1. To determine the policy of the United States with respect to food supply in Japan with particular relation to agricultural production.

2. See Appendix "A". (Not Printed)

3. See Appendix "B". (Not Printed)

**FACTS BEARING ON THE PROBLEM**

**CONCLUSIONS**

4. It is concluded 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 not productive, 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 factor in fertilization of cultivated crops. Survey 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 remanufactured should be distributed to areas most dependent on animal power.

   f. Steps should be taken to assure an equitable distribution of farm output. 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 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, 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 Department 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 the conclusion of the war of which our Allies may be terminated, of which their respective governments will be requested to forward this report to the Secretariat of the United Nations, and the United Nations Children's Emergency Fund;

      (4) this report be classified "Restricted" until such time as it is released according to paragraph 5 above.

**SOURCE:** FRUS, 1945, vol. VI, pp. 748-49
8-4 BOGDAN'S INSPECTION TRIP ON FINANCIAL PROBLEMS

Report: On Trip through 6th Army Area
To: W. F. Marquart, Chief ESS SCAP
From: Norbert A. Bogdan, Financial Adviser
January 6, 1946

I. MISSION:
To study financial problems, with particular reference to:

a. reparations
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 seem 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 deplore 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.
(6) There seems to be increasing uneasiness among Japanese as to the number of reports required from subordinate regional authorities. There is obviously a limit to what these people can turn out, in view of past training and inadequate communications. One
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

ECONOMIC STABILIZATION BOARD

Memorandum

To: Commander Hussey, GS
From: C. H. Peake, Public Administration Division, Government Section
Date: March 26, 1946

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 the 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. Abern 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 Price Minister to order them to be executed by competent ministers, except in the case of the 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 is 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: Henry Papers, University of Michigan]

FOOD CRISIS IN JAPAN

Letter No. 337

To: The Secretary of State
From: Max W. Bishop, Office of the United States Political Adviser, GHQ, SCAP
Date: March 26, 1946

Sir:

I have the honor to enclose a copy* of a brief, informal memorandum prepared by Mr. Charles J. Shubert, 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 more detailed and will be submitted perhaps before this dispatch 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]

JAPANESE TEXTILE INDUSTRY (MISSION REPORT)

Report

To: The Secretary of State
By: Fred Taylor, Chairman

March 31, 1946

I. JAPAN'S TEXTILE CAPACITY (deleted)
   A. Cotton Textiles
   B. Rayon
   C. Woolens and Worsted
   D. Silk
   E. Other Clothing Fibers
   F. Stock Position

II. OPERATIONAL PROBLEMS OF THE JAPANESE (deleted)
   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

*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 textile from Japan over this short-run period of world shortage, with particular emphasis on the 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 Nehemiah, 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, Tsinagto

India

Bharat Ram, Managing Director, Delhi Cloth and General Mills, Ltd.

United Kingdom

Frank S. Winderbottom, British, 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 Japanese Textile Association, with various persons in the Japanese Government, and with officials of textile concerns. The Mission has recognized 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 Research and Statistical 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 Statistical 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 spindles 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 spindles will increase by January 1947 to 2,800,000 of which an estimated 2,000,000 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 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 is 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’s 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 120 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 producing. A spindles available for producing 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 should be carefully considered along with that for other fibers.

4. In the Mission’s survey of Japan’s stocks of clothing raw materials, yarn, cloth, and cotton, it has been estimated that by the end of February, Japan had on hand a total of 575,000 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 Japan’s total production, have the capacity of producing between 295,000 and 300,000 square yards and loomage in 1946 by 290,000 and 11,300 respectively. In 1947 they will be able to produce over 785,000 square yards and 16,800 looms. The peacetime reconversion of Japan’s textile manufacturers is complicated by the problems of reparations and by the need for the Japanese to return to normal production.

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.

8-10 AN ECONOMIC PROGRAM FOR JAPAN (BODGAN REPORT)

Report (draft) May 3, 1946

To: W. F. Marquart, 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 and to be 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.

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, too, has 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.

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 accepted as representing the views of the division but not checked as to facts and figures owing to their pre-occupation with other problems at this time.

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 many figures used therein will be necessary.

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.

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:

- Prepare the paper in mimeograph form.
- Circulate it among all interested Staff Sections and Divisions for comments and suggestions.
- 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.
- 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.
- When such additional research is completed, have the Statistics and Research Division prepare charts and other graphic illustrations, to the extent desired.
- Prepare paper in final form as an agreed SCAP proposal for submission to Washington authorities.

NORBERT A. BOGDAN
FRANK M. TAMAGNA

ECONOMIC CONTROLS AND PLANNING

SUMMARY

CHAPTER I
- INTRODUCTION (delet ed)
- POPULATION (delet ed)
- AGRICULTURE (delet ed)
- FISHERIES (delet ed)
- FORESTRY (delet ed)
- MINING (delet ed)
- INDUSTRY (delet ed)
- TRANSPORTATION (delet ed)
- FOREIGN TRADE AND BALANCE OF PAYMENTS (delet ed)
- EMPLOYMENT (delet ed)
- FINANCE (delet ed)
- GOVERNMENT CONTROL OF THE ECONOMY (delet ed)
- CONCLUSION

Summary

1. This paper proposes a blueprint 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 Korea and other neighboring countries through the export of heavy machines. Such views do not 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, 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 undue demands by industry outside Japan on Japanese replacement, technical skill or engineering data.

2. The pressure of inflationary trends will continue for some time to come but can be held in check, and eventually stabilized, through coordinated measures.

3. 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 1937. 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:

- make the new Economic Stabilization Board the top central authority for all allocation and economic planning;
- bend every effort toward immediate and continuous increase in production, especially of foodstuffs, coal and fertilizers as well as consumers goods;
- require the immediate reporting of all stockpiles of merchandise and raw materials throughout the country;
- 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;
- dispose of problem of war indemnities and compensation for reparations without delay along the lines suggested in this paper and accomplish prompt dissolution of Zaitaku combines without affecting production in operating subsidiaries;
- dissolve Industrial Control Associations and reduce government control over distribution just as necessary to:

1. assure fair distribution of staple foods
2. control prices of scarce and basically essential articles
3. allocate scarce raw materials
1. Summary

a. In the preceding chapters a blueprint for the peacetime economic structure of Japan has been indicated. Japanese officials and economists contend that the reconstruction of Japan should provide an environment 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 the control factors, as limited 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, with the understanding that nothing should be done to disturb Allied control over imports, exports and 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 to leave Japan. In view of its broad political and economic implications it is a decision for consideration by the Joint Allied Governments.

b. Prohibitions 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 lasting effective, these limitations must, however, be consistent with the aim of not only keeping the Allied control on 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 overall 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 reform, changes in the 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 will 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 substantial stability attained.

(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 a part of consumer 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 and have the lines of credit suggested in this paper and accomplished prompt dissolution of Zabatsu combines without affecting production in operating subsidiaries;
(f) dissolve industrial Control Associations and reduce Government control over distribution except in cases of emergency; and
(g) provide a reformation of the banking system with a view to mobilizing sources of credit for productive purposes and restoring financial solvency.

(1) assure fair distribution of staple foods
(2) control prices of scarce and basically essential articles
(3) import scarce raw materials
(4) proceed with a reform of the banking system with a view to mobilizing sources of credit for productive purposes and restoring financial solvency
(5) confine public expenditures to direct productive purposes and exercise strictest economy in servicing essential services
(6) promote peaceful labor relations, through prompt and fair consideration of reasonable labor demands, encouragement of responsible unions, introduction of a modern social insurance program.

3. Responsibility of the Japanese People:

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 the Japanese who wish to keep Allied cooperation and continue peace-time development 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. Orders again are prone to take an attitude that “this shall 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;
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: Scotland Papers, Z.721-6]

8.11 INFLATION AND ITS THREAT TO OCCUPTIVE 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 recoinversion, 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 35 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 lifted. Either alternative is premised on the view that inflationary pressures will not be substantially reduced by the present fiscal measures.

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 the tax 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 would undoubtedly meet with stubborn resistance by the present Japanese bureaucracy. 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 the necessary funds 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 witnessed in Japan, financial chaos, the wiping out of all savings, and widespread suffering for all except a few规格ulators.

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, Japan will take at least two years to attain the prewar production level.

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. Furthermore, 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. Whether or not possible, the Japanese authorities are attempting to maximize government output. 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 to the extent of fiscal measures, as in the capital levy, but also to the ever closer scrutiny of cash accounts and the operation of any emergency 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 ¥500 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 defects have 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 apparently effected by various political and economic pressures, and have not been made 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. In the case of a salaried earner, the effects of a major 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. The effects will be proportioned by these elements in Japanese society, the 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 be affected 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 channeling of post-war business to existing large companies the concentration of industrial production and economic power in the hands of the wage earner relatively greater than before the war.

c. 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.

d. Uncertainty as to the future value of the yen is leading industrialists to concentrate on the rehabilitation of plants and other 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.

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.

14. The remedy lies in an emergency 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.

8-12 LIVING STANDARD AND THE FUTURE ECONOMY OF JAPAN

Report

December 25, 1946

Prepared by: Section III, Research Bureau, Foreign Ministry, Japanese Government

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I. Introduction
II. Scope of Peace Economy
III. Necessary Scale of Foreign Trade
IV. Living Standard and Foreign Trade (dealt)
V. Contents of Export Trade (dealt)
VI. The Future of Japanese Economy as Viewed from Employment (dealt)
VII. The Future of Japanese Economy as Viewed from National Income (dealt)
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IX. The Future of Japanese Economy as Viewed from Foreign War Damages (dealt)
X. Economic Difficulties of Present Japan (dealt)
XI. Ambassador Pauley’s Final Plan for Reparation and the Japan’s National Economy (dealt)
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 the 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 capitalist 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.

*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, instead of relying purely on its national living standard, 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 the world's economy under a world economy radically 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 colonial sources, is left with a regrettable and unbalance in the supply of materials for her heavy industries, particularly of such key materials as iron and steel, aluminium, petroleum, etc. on the other, it is simply incomprehensible 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. Industries for this purpose should be established throughout the whole nation and 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 in the fever of war and the aeroplane was a popular pursuit. Taking the aeroplane as a point of departure, the results of calculation 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, that of 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 stagnation. In that year, as compared with 1930—when the Japanese people enjoyed the most prosperous living in the past, the proportion 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 finer 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 by the Japanese in Japan Proper, is taken as the basis, (for instance, 9 kilograms of rice, 17 kilograms of soy 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 Y2.7 billion.

| Item            | Quantity
<table>
<thead>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Food materials</td>
<td>Y222 million</td>
</tr>
<tr>
<td>Clothing materials</td>
<td>924 &quot;</td>
</tr>
<tr>
<td>Others</td>
<td>1,571 &quot;</td>
</tr>
<tr>
<td>Total</td>
<td>2,717 &quot;</td>
</tr>
</tbody>
</table>

To pay for these imports, as the exports manufactured from the meager domestic resources will not suffice, the articles manufactured from imported raw materials will have to be exported. Besides, for the anticipated disappearance of receipts derived from shipping, immigration 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 Y5.5 billion (U.S. $900 million at 1936 price level) will become necessary, as the particulars shown below:

<table>
<thead>
<tr>
<th>Payments</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import of necessaries</td>
<td>Y2,700 million</td>
</tr>
<tr>
<td>Import of raw materials for export industry</td>
<td>700 &quot;</td>
</tr>
<tr>
<td>Adverse invisible trade balance</td>
<td>130 &quot;</td>
</tr>
<tr>
<td>Total</td>
<td>3,530 &quot;</td>
</tr>
</tbody>
</table>

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 1936 is to be maintained. Consequently she must have export industries of a corresponding scale.

The above-mentioned Y5.5 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 Y400 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 Y4.1 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").

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
economic controls and planning

5. The Japanese policy has been to avoid importation of finished petroleum products as much as possible and to import crude petroleum—foster ing the growth of the Japanese Petroleum Industry by refining in Japan. Thus, the refining industry expanded rapidly in Japan. 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 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 imports from Korea, then coming about one-fifth (1/5) of total demand. However, through government subsidy of marginal mines, output of domestic ore increased from three and a half million metric tons in 1934 to 1.4 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 ore reserves in Hokkaido and the Tono-Ishiohe Mining Zone and the Northern Mining District are estimated at 9.8 billion metric tons.

7. By 1936 domestic production of pig iron was nearly double the 1930 output. However, notwithstanding the increase of commercial production, importation of pig iron rose more than doubled during the same period. In 1929 and 1930 domestic supplies of iron and steel scrap were about 1.4 million tons, or 3 percent of total consumption. In 1929 and 1930 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 the production of pipe and Japanese iron rails; in 1931, Wire and rods, after 1926, 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 iron and steel 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 taste of the Japanese to succeed in their heavy industries and in armament industries in spite of sufficiency of raw materials.

It is obvious that war industries are dependent upon the circulation of petrole um, 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, tooled products 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 and the largest and most complex heavy industrial equipment to the Orinoco. 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 oil output included more than 5 million tons of naphtha, 2.5 million tons of aromatic chemicals 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 ship all or nearly all of the products of her industries in 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 was the 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 an economic control of Japan is concerned, the above premises are recognized in current proceedings for dissolution of the militaristic emphasis, elimination of the segmentation 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:

- Pig Iron—2 million tons per year.
- Steel Ingots—2.5 million tons per year.
- Steel Rolling Capacity—27.5 million tons per year.
- Ball and Roller Bearings—about 1 million units per year.
- Sulphuric Acid—8.5 million tons per year.
- Steel Scrap—100,000 gross tons per year.

14. Reparations have, in addition, reduced other non-so basic categories of industry and have eliminated arsenals and the aircraft industry. Sufficient to say that the levels established under either disarming or industrial disarray or industrial disarmament will, in each case depend on 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 those items now included or to stockpile a war potential in itself or to stockpile in order to prevent supply and distribution to other nations.

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 is believed that the 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 all the important basic industries to remain unrestricted.

16. In limiting and restricting industrial and other economic activities, the limitations applied would have to be as broad as the very nature of the product would permit. 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 selecting and administering control as to minimize the reaction.

17. 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 leave 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 victim, yet strong enough to be effective.

18. 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.

Efficiency of Control Over Basic Commodities

19. While the commodities used in modern warfare embrace probably every article known to man, the theory of control over all such items can only be broken 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.

20. 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.

21. Control over all war supporting industries would be somewhat more feasible, but again would involve complex determinations of allowable capacities in a host of industries, many of which are easily turned out products and more easily diverted from war production to peaceful end uses. Such control would furthermore exercise an unduly restrictive influence over economic development and normal business operations in the country being controlled.

22. 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 technologic change. The size of plant, the transportability of products, 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 disarray be accomplished substantially as outlined in Washington radio WX 9937 and in our radio C 69/24. Subject to the recommendations made above, 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 of the following classes of goods:

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.

3. Both products are bulky and most difficult to stockpile or to transport clandestinely.

4. Steel uses large quantities of coal in its manufacture, an additional easily inspected check on petroleum.

5. 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.

b. 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.

4. It is 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.

ECONOMIC CONTROLS AND PLANNING

8-14 PROGRAM FOR ECONOMIC STABILIZATION (B) (SUMMARY)

Report 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 the country 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.

The objectives of the program are: (1) control of 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 excessive 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 blackmail 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 these materials and price criteria which can be determined for all can commodities whose 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 interfederal 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 necessities of living, 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 future developments during the period of emergency economic controls must be provided.

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 a repeat of the export commodities being shipped in the Japanese controlled territories. It is further necessary 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 arrangements during the period of certain Japanese liquidation agreements, 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 development of the economy, the economic and administrative planning, administration and enforcement of all programs must 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: SUTLAND PAPERS, Z 703-21]

8-15 A POSITIVE ECONOMIC PROGRAM FOR JAPAN

Memorandum

March 12, 1947

To: General Hildreth, Assistant Secretary of State for Occupied Areas
From: E. M. Martin, Chief of the Division of Japanese and Korean Economic Affairs

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-
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, F, P, TTP, 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 possibly the Vice President, and to develop a program and, in particular, the proposal to allocate to Japan a billion dollars.

I am told he is in talks 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 concurrence 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 on 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 these 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 would 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 defense and other purposes.

It has been estimated by the Research Sub-Committee of the Japanese Reparations Policy Commission that certain specified and available increased rice 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 until Japan possesses domestic self-supporting agriculture. Available problems sure to arise as will continue to deteriorate due to the cumulative effects of food shortages and the exhaustion of domestic raw material stockpiles.

It has been estimated that increased 1948 and 1949 imports would so stimulate Japanese exports during these years that the Japanese 1949-50 trade deficits would not be greater if “cranked 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 self 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 statistical evidence in an unfavorable direction the cost of unfavorable balance as well 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 appropriations, 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 develop Japanese economy until early in the calendar year 1949.

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 made. 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 credit for Japanese exports, and most of Japan's imports, 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 reparations 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 repay the full amount of its advances for the Japanese civilian supply program. Payment can only be made in gold or dollars. The amounts are large, the world shortage of dollars is and promises to continue to be acute, and the U.S. gold 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 claims. Most of these claims are in such a disarray of credit that their ability to assimilate quantities of complicated capital equipment into their industrial structure is very limited, particularly equipment likely to be in 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 the 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.

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 take positive steps to move in to step in and make decisions, even if he is not in economic policy. He may 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 firm 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 1949 and 1949 on the scale necessary to drive 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.
ECONOMIC CONTROLS AND PLANNING

8-17 A POSSIBLE PROGRAM FOR A BALANCED JAPANESE ECONOMY

Report
March 27, 1947
Prepared by: Research and Statistics Division, ESS, SCP
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 SCP. 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 minimal standard of living. The norm of living per capita level 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 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 military 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 past 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 Japan's 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

*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 the 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 comparison with levels of 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 6 and 6A, it is believed that there is inherent logic and necessity in the overall 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 35 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 uses. (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 tables show instances of the former which are railroad rolling stock, non-ferrous metal refining, several chemical industries, chief instances of the latter being 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 3)

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. There is also need of further research by 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 balanced economy. This is defined to mean a real 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 relation 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 account. At present restorable capital capacity (after Interim Reparations) is about 25 percent above base period production. (See Table 3) Over-all requirements however call for a 35 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 restorable capacities in many industries at levels considerably lower than these suggested in this report. Such differences in appraising Japan's present restorable industrial potential need to be threshed out if reparation decisions are to be realistically arrived at and executed.

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8-18 ACJ'S VIEW ON STABILIZATION OF WAGE-PRICE RELATIONSHIPS

Statement

By: Allied Council for Japan: Office of the Member

April 14, 1947

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*Text continues on next page.*
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 inefficiently, 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 taxes 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, 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 to prevent excessive charges.

[Source: SUTLAND PAPERS, 2:703-23]

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 excess peasant purchasing power, particularly from the "new rich" 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. Development funds sufficient to provide initial raw material imports and permit flexibility and ingenuity in promoting sound foreign trade ventures will be made available.
12. Licensing 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 be applied singularly. 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 drafted. 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 1945-47 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 needed goods at official prices, will be combated 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 assured to provide incentives, and other non-basic goods, and (b) the expansion of the link system to assure consumer goods at official prices in exchange for food deliveries.

4. Price control. The rapid rise in key commodity prices must be drastically slowed down and the effective commodity prices must be lowered by progressive elimination of purchases at blackmarket prices. Public 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 hand, simultaneously providing sufficient incentive for production. This will be accomplished by 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, wage freezes are justified by the need to maintain purchasing power in the face of anticipated price increases. 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 through the use of a parity formula for agricultural commodities, a parity formula for industrial commodities, a parity formula for agricultural commodities, and a parity formula for industrial 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.

6. Government expenditures. Government expenditures must be restricted to the amounts necessary to carry out appropriate and authorized government functions. A government may not be a government in name only, but must be a government that is capable of providing the necessary services, including the regulation of supply and demand in the economy. This will be accomplished by (a) the reduction of government expenditures to the level of the official budget, and (b) the imposition of a freeze on government wages and salaries. This will be accomplished by (a) the reduction of government expenditures to the level of the official budget, and (b) the imposition of a freeze on government wages and salaries.

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 eliminated. This will be accomplished by (a) the reduction of government expenditures to the level of the official budget, and (b) the imposition of a freeze on government wages and salaries. This will be accomplished by (a) the reduction of government expenditures to the level of the official budget, and (b) the imposition of a freeze on government wages and salaries.

8. Industrial credit. 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. Credits will be granted only upon presentation of a legitimate need for the funds, as determined by the government.

9. Business reorganization. Business reorganization on the basis of peacetime industry and genuine competition must be completed. This will be accomplished by (a) the reduction of government expenditures to the level of the official budget, and (b) the imposition of a freeze on government wages and salaries. This will be accomplished by (a) the reduction of government expenditures to the level of the official budget, and (b) the imposition of a freeze on government wages and salaries.

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 revolvs 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-priviote 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, offenders.

The above program must be explained thoroughly to the Japanese people 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: Sutland Papers, 2, 703-20]

8-20 ECONOMIC CONDITIONS IN JAPAN*  
Report  
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:

* 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 9 months of 1947 were at a rate approximately 8 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 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 cannot 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 task is arduous and its political strength is 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: Hinsley Papers, University of Michigan]

8-22 THE POSSIBILITY OF A BALANCED JAPANESE ECONOMY10 (GREEN BOOK)

8-21 REGARDING THE ESTABLISHMENT OF KODANS

Informal Memorandum September 3, 1947

To: Mr. Hiroo Wada, Director-General, Economic Stabilization Board
From: W. F. Marquart, 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. Cotton.
   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:

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.

b. In any such enforcement activity is the danger of unreasonable petty investigations and searches.

c. 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.

d. 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 circumstances there is a genuine danger that the function which the Government intends the kodans to perform may in fact be perverted by selfish special interests.

e. 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.


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 Bread Political and Economic Objectives".
ECONOMIC CONTROLS AND PLANNING

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 currency exchange rates, 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 several fundamental bases: the first, 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 reasonably 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 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 25 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 shown in the table below.

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 countries.

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 on additions to the industrial raw materials shown in the table below.

While the table gives the total requirements for importation, 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 more than the consumption level is desired; 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 prevail living standard.

Forecast of Trade and Production Levels in the Future Economy

When reasonably acceptable levels of production are attained, under the assumptions of Condition "B" in 1955, 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 difference 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:

<table>
<thead>
<tr>
<th>Articles</th>
<th>1930–34</th>
<th>1947</th>
<th>1953 Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Exports</td>
<td>1827</td>
<td>350</td>
<td>164</td>
</tr>
<tr>
<td>Textiles</td>
<td>1200</td>
<td>288</td>
<td>900</td>
</tr>
<tr>
<td>Machinery and Metal Products</td>
<td>140</td>
<td>10</td>
<td>325</td>
</tr>
<tr>
<td>All Other</td>
<td>487</td>
<td>42</td>
<td>415</td>
</tr>
<tr>
<td>Total Imports</td>
<td>1640</td>
<td>423</td>
<td>1540</td>
</tr>
<tr>
<td>Textile Fibers</td>
<td>612</td>
<td>91</td>
<td>462</td>
</tr>
<tr>
<td>Ore, Metals, and Minerals</td>
<td>242</td>
<td>41</td>
<td>214</td>
</tr>
<tr>
<td>Foodstuffs</td>
<td>498</td>
<td>229</td>
<td>530</td>
</tr>
<tr>
<td>All Other</td>
<td>488</td>
<td>62</td>
<td>334</td>
</tr>
</tbody>
</table>

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 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 Appropriated 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 non-essential 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, the budget for appropriation for repayment 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 is largely dependent on the ability to obtain 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 problem is solved, then Japanese production will be dependent on United States appropriated funds—under Condition "B" by 1951—under Condition "A" by 1953.

Balance of Payments and Problem of Foreign Exchange

The net balance of international payments for Japan, i.e., the net trade position in all
ECONOMIC CONTROLS AND PLANNING

1. REVIVAL OF THE JAPANESE ECONOMY (SANCC 381/1)

The STATE MEMBER said that the State Department was of the opinion that SANCC 381/1 covered the substantive points in SWNCC 384 and suggested that SANCC 381/1 be tentatively approved and that the Army withdraw SWNCC 384 from consideration by the Committee.

The ARMY MEMBER pointed out that President’s four basic principles had been approved for the control of Japan, namely, disarmament, democratization, democratization, and economic security. 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 a primary objective of the occupation of Japan.

He went on to say that it would be extremely difficult to revive Japanese economy and that it probably would be more difficult to continue to secure substantial funds from Congress for purposes of the occupation. Should SANCC 381/1 come up with a paper which indicated that the economic recovery of Japan was a primary objective of this Government and that SCAP would be notified, he felt that it would be much easier to get funds from Congress. Mr. CLAXTON suggested that the Conclusions of SANCC 381/1 could be modified to indicate the Government’s acceptance of the principle of economic recovery being a primary objective of this Government, and that it would be satisfactory to the Army Member if SANCC 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 SANCC 381/1; that he would like to have a slightly modified SWNCC 384 acted upon by the Committee, sent to SCAP for information and released to the press, leaving SANCC 381/1 for later discussion by the Committee as a more detailed paper.

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 substantive points in SWNCC 384, and that the other country’s representations as the United States had been received by the other countries 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 SANCC to work it out.

THE COMMITTEE agreed to defer consideration of SANCC 381/1 and SWNCC 384 pending further discussions between Departments of State, Navy, and Army.

[Source: DEPL. B. NAVAL, ARCHIVE]

8-24 THE ECONOMIC RECOVERY OF JAPAN (SANCC 384/1)

Report
SANCC 384/1

Secret

Memorandum by the Army Member of SANCC

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 increasing 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

[Source: SITTLAND PAPERS, 2:703-6]

8-23 SANCC MINUTES ON THE REVIVAL OF THE JAPANESE ECONOMY

Minutes
SANCC, 61st Meeting
Top Secret

October 23, 1947

[State Army-Navy-Air Coordinating Committee, redesignation of SWNCC]
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.

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, subject to the policies of the United Nations, the Kuril Islands, as may be determined by the economic recovery of Japan.

b. Japan will be completely disarmed and demilitarized. The authority of the militarists and the influence of militarism will be totally eliminated. All institutions and activities of the spirit of militarism and aggression will be vigorously suppressed.

c. It is desirable that there be the development of 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 execution 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 practicable. Every effort should be made to maintain a high level of 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 remain a menace to the peace and security of the world. In implementing the objectives of the Basic Post-Surrender Policy of 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 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 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.

The fourth of the four principal means of 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 the policy to be set forth hereunder, in order to develop the economic recovery of Japan 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 SCAP’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 the policy hereafter, 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: DEP. BR., NATIONAL ARCHIVES}

8-25 MAINTENANCE OF PRESENT PRICE LEVELS

Memorandum

January 21, 1948

To: Direct, M. Fine (ESS)

From: H. J. 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. During the period of 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 rationing—being met in full—At this time last year ration delays had already occurred in the major cities.

* Not Printed.
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% increase per month which began with the food crisis of May through July 1947.

e. Excessive control of black market prices—In the period from 1 December 1947 through 10 January 1948 black market 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 with 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 black market goods. The planned expansion of this system to all 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 months contain several important favorable factors including:

- Electrical power—Improved electric power supply, within the next 30 to 60 days, will relieve an impediment to industrial production.
- Increased coal allocations—Continuing high coal production will soon begin to show up in substantially increased allocations to industrial users.
- 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 its inflationary effects) for the first time since the Occupation began.
- Consumer goods sales—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 the shortages on these lines. Further increases on the pressure of a black market prices in Tokyo are likely to be met in 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 cannot be secured in much larger volumes. On the other hand, it is still burdened by the debt remaining from the war, both in the form of imports from the United States, 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.
- Increased industrial production—The above favorable factors combined with seasonal improvement will show a substantial increase in industrial production beginning in March.

5. These favorable conditions are temporary and there are, of course, serious negative factors still prevailing which are tending to offset the present economic stability, these include:

a. Government controls—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. Liquidity 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. Price increases—Unless the present price of stability is maintained, labor will demand drastically increased wages which will precipitate another sharp movement in the wage-price 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.

The decision to hold 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 increase 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 railways 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 size 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 possible (probably until April-May) Specifically, in view of the risk 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: SHUETLAND PAPERS, 5, 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. In December the index reached a new postwar peak of approximately 110% 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 volumes. On the other hand, it is still burdened by the debt remaining from the war, both in the form of imports from the United States, 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% 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 the 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 the purchase of 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 expanding markets and concluding satisfactory financial arrangements.

The price level, after a rapid rate of advance during the summer months, began to slow down with the onset of severe food shortages and rationing 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 been achieved in the efforts of the Government to maintain a distribution 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 44.3 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 2.3 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.

<table>
<thead>
<tr>
<th>Index of Industrial Production</th>
<th>1946</th>
<th>1947</th>
<th>Points Contribute to Change in Total Index</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Industrial Production</strong></td>
<td>1946</td>
<td>1947</td>
<td>32.46</td>
</tr>
<tr>
<td>Major Increases</td>
<td>65.34</td>
<td>87.37</td>
<td>+2.24</td>
</tr>
<tr>
<td>Coal mining</td>
<td>22.00</td>
<td>34.00</td>
<td>+1.49</td>
</tr>
<tr>
<td>Machinery, n.e.c.</td>
<td>11.16</td>
<td>23.23</td>
<td>+1.97</td>
</tr>
<tr>
<td>Cotton yarn</td>
<td>7.45</td>
<td>20.41</td>
<td>+0.98</td>
</tr>
<tr>
<td>Cotton woven goods</td>
<td>12.37</td>
<td>16.75</td>
<td>+0.99</td>
</tr>
<tr>
<td>Raw silk</td>
<td>191.21</td>
<td>117.81</td>
<td>+0.66</td>
</tr>
<tr>
<td>Lumber</td>
<td>29.53</td>
<td>34.62</td>
<td>+0.65</td>
</tr>
<tr>
<td>Chemical group</td>
<td>36.88</td>
<td>44.68</td>
<td>+0.23</td>
</tr>
<tr>
<td><strong>Major Decreases</strong></td>
<td>1896.44</td>
<td>1252.43</td>
<td>-0.65</td>
</tr>
<tr>
<td>Motor trucks</td>
<td>59.25</td>
<td>23.13</td>
<td>-0.51</td>
</tr>
</tbody>
</table>

**ECONOMIC CONTROLS AND PLANNING**

**8-27 SELF-SUPPORT OF THE JAPANESE ECONOMY (SANACC 381,2)**

**Report**

SANACC 381/24

**February 12, 1948**

**Confidential**

**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".

**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 revision of the Plan should be reviewed and approved by SCAP and the U.S. Government, in the manner provided above.

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.

* See SWNCC 381, July 22, 1947; and SWNCC 381/1, October 16, 1947, "Revival of the Japanese Economy."

**Not prioritized.**

* 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".
(c) 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 promoting 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.

(b) 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 these 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)*
   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

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* This section only included.

**ECONOMIC CONTROLS AND PLANNING**

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11. Expenditure of Convertible Assets (4f)
12. Far Eastern Cooperation (4g)
13. Import Procurement and Financing (4h)
14. Effect of a Peace Treaty (4i)

II. Economic Recovery Plan

15. SANACC Action (5a)
16. FEC Action (5b)
17. SCAP and U.S. Government Action (5b)

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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 portions 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.

[Sources: SCUTLAND PAPERS]

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**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,”7 The Supreme Commander has on frequent occasions declared that primary responsibility for carrying out his directives and instructions rests with the Japanese Government, that he looks to them as a matter of course to establish a responsible government, a free economy and a peacefully inclined Japan. (Tab “B”)8

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 concern. Particularly in the economic, welfare and agricultural areas. Particularly in the economic, welfare and agricultural areas. Particularly in the economic, welfare and agricultural areas. Particularly in the economic, welfare and agricultural areas.

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7 Tab not printed.

8 In this respect, the Plan will be of particular value to the U.S. Government in facilitating its overall export planning 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 case of food and rationing, the United States government, through its representatives, has actually directed and controlled 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. It must be made fully clear that the military shall not participate in that any aid from the United States to the Japanese population is voluntary and that no reparation, occupation, or reparation, occupation, or war indemnity shall be accepted.

6. 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 been directed to undertake and supervise the specific measures. All Japanese agencies shall have an opportunity to do so. The Japanese Government has 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 have blamed the failure on the Allied Powers.

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, equality of access to materials, equal opportunity, and distribution of monopoly 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. However, it must be left to the Japanese to determine when and how to plant, how to cultivate, what tools to use. If the occupation authorities permitted to decide these questions for themselves and are required to assume full responsibility for their decisions, they will never have the incentive to make the best of what is available.

8. Recently, members of the Diet informed this Secretary that a representative of ESS that immediate provision of revenue to pay the 0.6 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 present government in the fall of last year. In conclusion, I wish to stress that the present government is a far better government than any of the previous governments and that its work is far better than any of the previous governments.

Memorandum18

By: W. F. Marquart, Chief, ESS

May 6, 1948

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 administrative deficiencies of essential industrial raw materials, food and other products along with remaining imperfections in control of legal distribution channels, another factor must be considered. The 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 and it is essential that control of labor be imposed. Where is the effectiveness of distribution controls over all essential raw materials and manufactured producer. Thus, it becomes imperative that realistic attention be directed to the formulation of a labor regulation policy that will stabilize the labor market and thus control 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.

ing the current wage-price relationship.

a. A new wage frame will be announced with appropriate upward adjustment to accommodate 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 permission prevailing of conventional differentials upon demonstration of adequate cause. Collective bargaining on issues other than wages will not be impaired.

b. 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 the establishment of a formal wage frame but would not be inflationary per se since additional output would accompany increased wage payments.

c. Utilizing Japan's success 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: SUTLAND PAPERS, 2.703-23

3.03 ESSENTIALS OF ECONOMIC STABILIZATION PROGRAM

Memorandum

By: W. F. Marquart, Chief, ESS

Confidential

In order to fulfill the requirements incidental to insuring the continued 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 the elimination of the black market.

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 formal and flexible wage stabilization program.

6. Acceleration and strengthening of tax 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. Complete elimination 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: SUTLAND PAPERS, 2.703-20

3.04 JOINT RECOMMENDATIONS AS TO STABILIZATION POLICY

To: General Marquart

From: Henry 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 persistence 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 Postwar Planning 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 accepted.

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 which there is adequate evidence that there is a demand so great that there is danger of its exceeding supply. Furthermore, it is considered that the formulation 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 decided and understood in which there is a high degree 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 Japanese economy is concerned, wages payments are used in determining wage payments and, as 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, reprisal 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" paths set on by the ineffective 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 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 RPB or other government sources 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 go higher than they can if agreement cannot be reached with management. If agreement will be permitted to cease operations and go through bankruptcy in the event of inability 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 price of and the method of wage 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, according to 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 the new policy. However, it is our considered opinion that such costs 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 is unlikely that any group of labor will be able to carry out a concerted strike over such a long period. 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 lack of such 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 below capacity. This low level of capacity is due in a large part to 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 disinterested 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 trade relations in the Far East are based on an existing structure of 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 trade 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 be undeniably 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 ESP through the Japanese Government with management, sitting on the sidelines as an interested party and with labor having no voice. Such conditions will work to the material benefit of the workers and management for the exercise by the government 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. By 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: SUTLAND PAPERS, Z.703-29]

8-32 PROGRAM FOR A SELF-SUPPORTING JAPANESE ECONOMY

Report: ESS, SCAP
Prepared by: ESS, SCAP
November 1948

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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-sufficiency and self-reliance. The program presented herewith indicates the ways and means to be employed to achieve this goal by fiscal year 1953. Instead of the general considerations is the fact that the program must be implemented in its entirety and according to the time phasing proposed that the ultimate goal is to be met. Appropriations

Altho much of 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 trade 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 needs of the fiscal years 1949 and 1950 are critical in which industrial production must experience the 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 desirable to maximize the dollar earnings. After 1950 a steady movement of the economy 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. Altho many 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 are demanding. In the absence of a complete list of available materials, Japan must supply 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 imports of 1.5 billion dollars in the latter year. The expected savings and receipts from the development of potentially sizable visible exports are estimated to make up the apparent trade deficit. Hence, the flow of goods 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 needs of the countries of this region for transportation equipment, electric power equipment and industrial machinery of all types. These industries products must be 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 the maximum amount of the supplies Africa 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 of Japan. The financing 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. For example, American aid will be required for an industrial program of $4.1 billion, the economic and financial 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) Japan’s government will proceed at 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 on the part of her freedom to engage in world trade.

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 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) Japan’s government will proceed at 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 on the part of 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 adds almost 6 million people to the population in 1950. This is 31 per cent of the total and represents a growth rate of 1.3 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 1,500 calories a day in 1953 for the average consumer is only 87 per cent 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 be severe.

The program presented clearly states that to attain 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

19 Commonly known as the “Blue Book”, this report reprinted with slight change by the Dept. of the Army, under the same title in January, 1949.
20 This section only printed.
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 a sacrifice, the willingness to contribute to the overall good. The Japanese must make this contribution. They must realize that if only they do so will further American aid, already so generous, supplemented by private foreign investment, enable them to achieve the industrial, economic, and social goals for which our people have been fighting so long. It is their duty to do so. It is their part to make the sacrifices. 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 United aid needed to make their efforts effective. One cannot overemphasize the fact that both domestic and foreign effort can be the way cleared for the development of a stable, democratic, self-supporting Japan. [Source: SUTLAND PAPERS, 2:703-31]

ECONOMIC CONTROLS AND PLANNING

8-33 ESS MEMO ON ECONOMIC STABILIZATION

Memorandum

To: W.F. Marquart, 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.

November 8, 1948

1. Within the general principle 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 industries 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 program. We are now faced with a major work stoppage by 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 policies with the utmost of speed and adopt the light of their 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 the 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 reductions in the earned income tax, which, 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 32% 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 arbitration in order to avoid a strike of the electric workers in late June. It has now been proposed by the Japanese government that the CLRB award for the electric workers be effective on August 1, 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 Appendices 1 and 2) 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 of many products of such basic commodities as fertilizer, cement, textiles, caustic soda. This would inevitably be reflected in the parity index necessitating a revision of food prices. The result would be particularly exaggerated because of the high degree of interdependence of many products. Any 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 principle of the full cost of the CLRB proposal on the electric industry, that the rate increase 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 these courses of action can be implemented within present ESB 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 for a month for workers, 4,600 yen for 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 6,138,000,000 yen within the current fiscal year. This increase is said by ESB to be equivalent to 80.72 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 per ton, and further, that the 5,670,000 yen to 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 6,138,000,000 yen to the fiscal year. This would amount to approximately 15% of 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 over 2.5% of the total increase in this fiscal year. Since the fiscal year was started 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 supplies more than 20% of the energy requirements of government special users to whom coal is presently furnished at a reduced price the 45% 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. The Ministry of Finance is vigorously examining methods of subsidizing the coal used by so-called special users (key industries) down to its present consumer price to be allowed the increase in producer price to be passed on to all so-called general users including the government railways. While this proposal would result in a price increase, the government would 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 the United States and the other occupying powers.

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 last two paragraphs we have discussed the implications of a 42% wage increase for electric workers and coal miners. It was pointed out in paragraph 2 that the appropriate application of statistical data would probably result in an increase in approximately a 15% wage increase for coal miners and electric workers. Such an increase would be uneconomic to the same extent as 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 productive 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

31 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 so on. 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 wages-price relations 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, employment, 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 relationship within which the ordinary enforcement 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 the payment to government workers, the postponement of the enactment 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 ESB of the proposed basic stabilization program recommended in paragraph 8a above. In the event that 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 the necessary wage increases for the electrical 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 3,000 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: SUTLAND PAPERS, 2 703-20]
(1) Scale of exports and imports.

The targets of exports and imports and the balance of international payments are estimated as follows:

<table>
<thead>
<tr>
<th></th>
<th>FY 1950</th>
<th>FY 1951</th>
<th>FY 1952</th>
<th>FY 1953</th>
</tr>
</thead>
<tbody>
<tr>
<td>Imports</td>
<td>1,220</td>
<td>1,358</td>
<td>1,477</td>
<td>1,575-1,600</td>
</tr>
<tr>
<td>Exports</td>
<td>810</td>
<td>1,050</td>
<td>1,250</td>
<td>1,250-1,450</td>
</tr>
</tbody>
</table>

(2) Development of electric power resources.

The target of electric power resource development program is set forth temporarily as below:

<table>
<thead>
<tr>
<th>Hydro-power</th>
<th>FY 1949</th>
<th>FY 1950</th>
<th>FY 1951</th>
<th>FY 1952</th>
<th>FY 1953</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existing plant</td>
<td>5,908.1</td>
<td>5,939.5</td>
<td>6,169.5</td>
<td>6,308.5</td>
<td>6,336.4</td>
</tr>
<tr>
<td>New construction</td>
<td>31.4</td>
<td>261.4</td>
<td>404.4</td>
<td>428.3</td>
<td></td>
</tr>
<tr>
<td>Thermal-power</td>
<td>1,820</td>
<td>2,029</td>
<td>2,162</td>
<td>2,162</td>
<td></td>
</tr>
<tr>
<td>(average of maximum generation)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Existing plant</td>
<td>1,775</td>
<td>1,934</td>
<td>1,901</td>
<td>1,941</td>
<td>1,941</td>
</tr>
<tr>
<td>New construction</td>
<td>45</td>
<td>95</td>
<td>221</td>
<td>221</td>
<td></td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Ordinary rainfall</th>
<th>Supply at generating end</th>
<th>% of loss</th>
<th>Supply at consuming end</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 1951</td>
<td>35,283</td>
<td>28.5</td>
<td>25,227</td>
</tr>
<tr>
<td>FY 1952</td>
<td>36,917</td>
<td>27.0</td>
<td>26,945</td>
</tr>
<tr>
<td>FY 1953</td>
<td>37,500</td>
<td>25.5</td>
<td>27,927</td>
</tr>
</tbody>
</table>

(b) High and low water seasons (FY 1953)

<table>
<thead>
<tr>
<th>Ordinary condition</th>
<th>Supply at generating end</th>
<th>% of loss</th>
<th>Supply at consuming end</th>
<th>Ratio to A</th>
</tr>
</thead>
<tbody>
<tr>
<td>water-A</td>
<td>37,500</td>
<td>25.5</td>
<td>27,927</td>
<td>100</td>
</tr>
<tr>
<td>High water season-B</td>
<td>39,703</td>
<td>26.5</td>
<td>29,241</td>
<td>B/A106</td>
</tr>
<tr>
<td>Low water season-C</td>
<td>35,131</td>
<td>24.5</td>
<td>26,524</td>
<td>C/A94</td>
</tr>
</tbody>
</table>

(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 1955:

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 of steel.

The target of production in steel is set forth temporarily as below:

<table>
<thead>
<tr>
<th>FY 1951</th>
<th>FY 1952</th>
<th>FY 1953</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,500-4,000 thousand tons</td>
<td>3,700-4,200 thousand tons</td>
<td></td>
</tr>
</tbody>
</table>

Investigation will be made concerning the purchase conditions of materials.

(5) Production of textiles.

The targets of production increase in textiles are under investigation.

(6) Production of rice and wheat.

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:

<table>
<thead>
<tr>
<th>1934-1936</th>
<th>1950</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>80</td>
</tr>
</tbody>
</table>
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.

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.


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) The 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 rearrangement 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 (1951=100): JFY 1951 83, 1952 86, 1953 89.

(e) Population will increase as follows: JFY 1951 85,571 (Unit: 1,000), 1952 86,082, 1953 88,204.

8-36 JAPAN'S INDUSTRIAL POTENTIAL

Report on Japan's Immediately February 20, 1951
Available Production Resources 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 considerable capacity to produce 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 people 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.

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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-faced 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 rearrangement 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 its 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 nation 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 and capable economy the making of 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.

* Portions of this section are deleted. Subsequent sections are omitted.
ECONOMIC CONTROLS AND PLANNING

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 for either type of aid or a total military defense would place a serious strain on the limited economic resources of Japan. It is to be noted, however, that 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 objectives are likely to be defeated. The obvious line of reasoning would have 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 not the industrial capacity to meet the total requirement of American and European and Asian defense through a realignment of its productive power and man-power, is for determination in the United States. There is no question that Japan could provide the rephenums on non-defensive economic lines which over the long stretch of time can be acceptable. It is germane to the issue, however, that the United States is vitally concerned with the maintenance of 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 has that 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 unemployment latent capacity, once ignored, was to be used a means of ingrass of subversive influences should Japan be faced with economic deterioration following attainment of independence.

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 Japan is a nation whose domestic production of strategic materials is small and which 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 it is inevitable that a precipitous decline in industrial activity with a consequent demand for outside aid if the nation is to be kept vital to perpetuate a national and plasticity adjusted to anti-Communist doctrines.

The matter of justification for the immediate participation of Japan in military construction and operation in view of the 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 permit after ratification of the United States, Medical, and other needs. It is appreciated that substantial economic efforts and 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 risks. 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. The plan of Japanese military potential immediately after the termination of the Occupation by acceptance of the peace treaty may result in the imposition of sanctions definitely contrary to the best interests of Japan and possibly of America. Further, it is possible that such a shortage of raw materials might be accompanied with a shortage of 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 hereafter. 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 continued 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 the military defense pact now under discussion. It is contemplated here that safeguards be introduced to ensure 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 paragraph (b) of the United States in the pre-peace treaty agreements. 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 final financial 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 maintenance 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 and non-ferrous 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, Army Quartermaster, Military and Medical 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 instruments leading to the accomplishment of the procurement 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. It will be necessary to restrict certain military and other purchases to the extent that Japan has to keep this excess capacity to produce a limited number of military items which can be marketed economically and satisfactorily while at the same time permitting manufacture of certain domestic consumption and non-military exportable production 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 that the United States is vitally interested in the extent ultimately required. It must be apparent that since Japan is now engaged in depleting its industrial stockpiles for military purposes 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 made, the military needs of Japan will not amount to an actual order for the production in order to make it certain the limited raw materials available for normal economic utilization.

In summation the basic assumptions for the economic mobilization program contemplated are:

The economic conditions acceptable for the Occupation, which is a matter of concern to the Western Powers.

The United States is vitally interested in the amount of economic aid or military aid which will be committed to consider for Japan after the peace treaty.

Given access to the necessary raw materials, Japan can retain a good economic level without United States economic aid.

The right to access to raw materials, basic as well as strategic, 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 quantities 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 material 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 under-estimation.

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, unemployment by reason of exclusion from available military exports market, the probability of attractive offers by the Communist area after the peace treaty is not entirely remote. Under the capitalist system the profit motive is difficult to control.

The present准备 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 requirements is for determination after joint analysis by the Munitions Board and the Occupation. 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 order to avoid the large peace慈like Commander is no longer an issue. The Delegate of the United Nations is now the commander in高兴 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 loan terms are through the Korean War Occupation concept as sole basis for this action.

The manufacture of military export items is a basis of economic necessity is supported by the measure, but not open to the challenge in future policy actually used by Japan and will not be disregarding to financing or entreprenuer efforts.

Safeguards, such as foreign title to special purpose tools, will furnish adequate revaluation to the United Nations MEM nation of pre-peace treaty violation of the Poudsum 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 registration of industry. The nature and extent of certain demands of the occupied country are controlled by world conditions directly influenced by the acceptance or rejection of the proposed long range participation by Japan in military production programs.

In order to properly consider the problem is recommended that a procurement agency under auspices 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 Japanese 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.

**ECONOMIC CONTROLS AND PLANNING**

**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>
<thead>
<tr>
<th>Industry Group</th>
<th>Calendar Year</th>
<th>Dec 1950 Production</th>
<th>Dec 1950 Percent of Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial Activity</td>
<td>209</td>
<td>207</td>
<td>188</td>
</tr>
<tr>
<td>Utilities</td>
<td>152</td>
<td>130</td>
<td>111</td>
</tr>
<tr>
<td>Industrial Production</td>
<td>219</td>
<td>204</td>
<td>95</td>
</tr>
<tr>
<td>Mining</td>
<td>131</td>
<td>140</td>
<td>110</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>227</td>
<td>211</td>
<td>95</td>
</tr>
<tr>
<td>Durable</td>
<td>422</td>
<td>324</td>
<td>48</td>
</tr>
<tr>
<td>Non-Durable</td>
<td>48</td>
<td>139</td>
<td>76</td>
</tr>
</tbody>
</table>

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, 126 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. Capacity = Capacity Activity Index = Production + 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 also be noted that the overall measure of industrial capacity is a combination of the capacity to produce 65 representative, or controlling, industrial groups 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 1.4." For purposes of this study, capacity to produce is related to annual production for the years 1932-1936=100. Thus, as defined above, over capacity 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 similiar to the capacity in the works 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 products of 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 B. PRODUCTION AND CAPACITY—SELECTED ITEMS

<table>
<thead>
<tr>
<th>Production Item</th>
<th>Unit</th>
<th>Production Actual 1950</th>
<th>Production Dec. 1950</th>
<th>Annual Capacity End of 1950</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity</td>
<td>Billion KWH</td>
<td>45</td>
<td>32</td>
<td>50</td>
</tr>
<tr>
<td>Coal</td>
<td>Million MT</td>
<td>39</td>
<td>45</td>
<td>90</td>
</tr>
<tr>
<td>Crude Petroleum</td>
<td>Thousand KL</td>
<td>300</td>
<td>353</td>
<td>300</td>
</tr>
<tr>
<td>Refined Petroleum</td>
<td>Thousand KL</td>
<td>1,65</td>
<td>2,310</td>
<td>3,435</td>
</tr>
<tr>
<td>Pyrite</td>
<td>Thousand MT</td>
<td>446</td>
<td>466</td>
<td>550</td>
</tr>
<tr>
<td>Iron Ore (Metal Content)</td>
<td>Thousand MT</td>
<td>40</td>
<td>43</td>
<td>50</td>
</tr>
<tr>
<td>Copper Ore (Metal Content)</td>
<td>Thousand MT</td>
<td>112</td>
<td>12</td>
<td>13</td>
</tr>
<tr>
<td>Steel</td>
<td>Million MT</td>
<td>1,911</td>
<td>2,134</td>
<td>3,400</td>
</tr>
<tr>
<td>Pig Iron</td>
<td>Thousand MT</td>
<td>2,277</td>
<td>2,379</td>
<td>5,600</td>
</tr>
<tr>
<td>Ferro Alloys</td>
<td>Thousand MT</td>
<td>466</td>
<td>69</td>
<td>214</td>
</tr>
<tr>
<td>Crude Steel</td>
<td>Thousand MT</td>
<td>5,960</td>
<td></td>
<td>9,900</td>
</tr>
<tr>
<td>Finished Steel</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary Products</td>
<td>Thousand MT</td>
<td>3,184</td>
<td>4,569</td>
<td>10,473</td>
</tr>
<tr>
<td>Secondary Products</td>
<td>Thousand MT</td>
<td>1,152</td>
<td>1,627</td>
<td>4,506</td>
</tr>
<tr>
<td>Cast Iron Products</td>
<td>Thousand MT</td>
<td>103</td>
<td>130</td>
<td>422</td>
</tr>
<tr>
<td>Copper Products</td>
<td>Thousand MT</td>
<td>78</td>
<td>106</td>
<td>160</td>
</tr>
<tr>
<td>Aluminum, Primary</td>
<td>Thousand MT</td>
<td>25</td>
<td>31</td>
<td>114</td>
</tr>
<tr>
<td>Ship Construction</td>
<td>Thousand MT</td>
<td>234</td>
<td>262</td>
<td>802</td>
</tr>
<tr>
<td>Railroad Locomotives</td>
<td>Units</td>
<td>118</td>
<td>156</td>
<td>744</td>
</tr>
<tr>
<td>Freight Passenger, Cars</td>
<td>Thousand Units</td>
<td>247</td>
<td>340</td>
<td>1,900</td>
</tr>
<tr>
<td>Industrial Equipment</td>
<td>Units</td>
<td>30</td>
<td>32</td>
<td>76</td>
</tr>
<tr>
<td>Trucks, Passenger Cars and Buses</td>
<td>Thousand Units</td>
<td>32</td>
<td>43</td>
<td>53</td>
</tr>
<tr>
<td>Three-wheel Vehicles</td>
<td>Thousand Units</td>
<td>35</td>
<td>44</td>
<td>40</td>
</tr>
<tr>
<td>Industrial Machinery</td>
<td>Thousand Units</td>
<td>473</td>
<td>602</td>
<td>1,346</td>
</tr>
<tr>
<td>Bearings</td>
<td>Thousand MT</td>
<td>4</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Internal Combustion Engines</td>
<td>Thousand MT</td>
<td>40</td>
<td>45</td>
<td>80</td>
</tr>
<tr>
<td>Machine Tools</td>
<td>Thousand MT</td>
<td>3</td>
<td>6</td>
<td>14</td>
</tr>
<tr>
<td>Electric Motors</td>
<td>Thousand Units</td>
<td>277</td>
<td>239</td>
<td>320</td>
</tr>
<tr>
<td>Storage Batteries</td>
<td>Thousand MT</td>
<td>12</td>
<td>11</td>
<td>18</td>
</tr>
<tr>
<td>Vacuum Tubs</td>
<td>Million Units</td>
<td>18</td>
<td>13</td>
<td>18</td>
</tr>
<tr>
<td>Sheet Glass</td>
<td>Million Cases</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Cement</td>
<td>Million MT</td>
<td>5</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Lumber</td>
<td>Billion Bd Ft</td>
<td>4</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Plywood</td>
<td>Million Sq Ft</td>
<td>391</td>
<td>477</td>
<td>900</td>
</tr>
<tr>
<td>Raw Silk</td>
<td>Thousand Bales</td>
<td>151</td>
<td>188</td>
<td>170</td>
</tr>
</tbody>
</table>

### Notes
- 33 Capacity depends upon type of products produced.
- 32 100 sq. ft. 2 mm. thick.

### ECONOMIC CONTROLS AND PLANNING

Output in the calendar year 1950 plus an allowance for power spoiled 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 capacity. 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, seasonal 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.

**Iron Ore.** Japan has three sources of indigenous iron ore. First, there is some hematite 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 molybdenum.

**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, 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 steel. The industry as a whole is capable of large expansion over present operations. This, however, will require more iron ore, for more, in fact, than is provided 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 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, programed 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, refining and blowing down of additional furnaces have yet not to be scheduled to step up steel production, and upward revision of present plans will only be made if the presence of adequate equipment 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:

<table>
<thead>
<tr>
<th>Type</th>
<th>Number</th>
<th>Annual Capacity (1,000 MT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pig Iron</td>
<td>37</td>
<td>5,594</td>
</tr>
<tr>
<td>Large blast furnaces</td>
<td>37</td>
<td>5,594</td>
</tr>
<tr>
<td>Small blast furnaces</td>
<td>11</td>
<td>84</td>
</tr>
<tr>
<td>Charcoal furnaces</td>
<td>6</td>
<td>86</td>
</tr>
<tr>
<td>Electric furnaces</td>
<td>150</td>
<td>213</td>
</tr>
<tr>
<td>Total</td>
<td>204</td>
<td>5,926</td>
</tr>
<tr>
<td>Steel Ingots and Castings</td>
<td>198</td>
<td>7,147</td>
</tr>
<tr>
<td>Open hearth furnaces</td>
<td>198</td>
<td>7,147</td>
</tr>
<tr>
<td>Thomas converters</td>
<td>6</td>
<td>325</td>
</tr>
<tr>
<td>Electric furnaces</td>
<td>700</td>
<td>4,119</td>
</tr>
<tr>
<td>Total</td>
<td>904</td>
<td>11,291</td>
</tr>
</tbody>
</table>

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 determination of the overall current requirements, is not a matter for the facilities required for the production of finished steel products, which 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 1 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 cutting and grinding tools, and 44 thousand of the other categories listed above. Of the 295 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 tools, a certain percentage 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 other tools mentioned in the preceding paragraphs 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 total number of machine tools which are 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 estimated by the Japanese Ministry of Machine Industry, and for obvious reasons is markedly conservative. Moreover, it should be recalled that reparations seizures were limited to plants in certain industries with many important tool using industries remaining untouched.

The total number of 530 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 99,500

**Units**

- Increase since 1946: New manufacture 25,000
- Net reduction 64,500

The indicated supply is 614.5 thousand units, i.e., 550 thousand 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 as of March 1950 was about 30 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 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 550 thousand at the end of 1949 indicating a slightly larger reduction than the most recent 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 output available.

The following table shows the minimum number of machine tools believed to be in Japan: **Machine Tools in Japan (S.L.)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Tools</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946-1950</td>
<td>550,000</td>
</tr>
<tr>
<td>1946-1950</td>
<td>514,000</td>
</tr>
<tr>
<td>1946-1950</td>
<td>57,000</td>
</tr>
<tr>
<td>1946-1950</td>
<td>12,500</td>
</tr>
<tr>
<td>1946-1950</td>
<td>20,000</td>
</tr>
<tr>
<td>1946-1950</td>
<td>25,000</td>
</tr>
<tr>
<td>1946-1950</td>
<td>545,000</td>
</tr>
</tbody>
</table>

The Japanese government under SCAP direction is preparing to conduct a machine tool survey in the near future.

**Military Articles.** At this time, it is impossible to determine what may be required in Japan in the way of end products to support the United States, United Nations, and other military activities. The Japanese Ministry of Machine Industry has not a specific list 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, sleeping 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 1.06 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, the 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 (39.9 square yards), this provides for an output of 260 thousand units annually. Alternately, the 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 juvenile 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, maps, brooms, and insecticides. Such specialized items as large fork-lift trucks, which are required in relatively limited quantities, are not suitable for production under SCAP direction.

**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 cyanamid companies will be producing fixed nitrogen at an annual rate of about 525 thousand tons, which is
TABLE II. SUPPLY CONTRACT AWARDS BY ARMED FORCES AND ECONOMIC COOPERATION ADMINISTRATION 25 June 1950-28 January 1951

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Value</th>
<th>Commodity</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grand Total</td>
<td>$145,491</td>
<td>Chemicals and Drugs</td>
<td>6,310</td>
</tr>
<tr>
<td>Food and Beverages</td>
<td>3,864</td>
<td>DDT</td>
<td>956</td>
</tr>
<tr>
<td>Biscuits and Rations</td>
<td>3,697</td>
<td>Dressings</td>
<td>623</td>
</tr>
<tr>
<td>Oil</td>
<td>167</td>
<td>Fuel</td>
<td>1,022</td>
</tr>
<tr>
<td>Textiles and Products</td>
<td>33,295</td>
<td>Drugs and Biologicals</td>
<td>3,709</td>
</tr>
<tr>
<td>Yarn and Thread, Cotton</td>
<td>2,468</td>
<td>Non-Metallic Min. and Prod.</td>
<td>6,300</td>
</tr>
<tr>
<td>Cotton Fabric</td>
<td>4,594</td>
<td>Glass</td>
<td>589</td>
</tr>
<tr>
<td>Blankets</td>
<td>4,833</td>
<td>Cement</td>
<td>684</td>
</tr>
<tr>
<td>Sleeping Bags</td>
<td>2,274</td>
<td>Coal</td>
<td>4,609</td>
</tr>
<tr>
<td>Wool and Rayon Yarn</td>
<td>1,504</td>
<td>Other Non-Metallic Mineral</td>
<td>624</td>
</tr>
<tr>
<td>Clothing</td>
<td>4,002</td>
<td>Metal Products</td>
<td>36,991</td>
</tr>
<tr>
<td>Sandbags</td>
<td>6,720</td>
<td>Barbed Wire</td>
<td>4,455</td>
</tr>
<tr>
<td>Rope and Net</td>
<td>655</td>
<td>Barbed Wire Posts</td>
<td>6,299</td>
</tr>
<tr>
<td>Other</td>
<td>6,223</td>
<td>Drums and Containers</td>
<td>6,729</td>
</tr>
<tr>
<td>Wood and Paper</td>
<td>18,147</td>
<td>Buildings</td>
<td>3,865</td>
</tr>
<tr>
<td>Lumber</td>
<td>4,620</td>
<td>Rail and Track Materials</td>
<td>2,474</td>
</tr>
<tr>
<td>Ties and Poles</td>
<td>2,364</td>
<td>Structural Steel and Sheet</td>
<td>2,758</td>
</tr>
<tr>
<td>Plywood</td>
<td>770</td>
<td>Pipe and Fittings</td>
<td>1,846</td>
</tr>
<tr>
<td>Bom Wood</td>
<td>2,164</td>
<td>Other Iron and Steel</td>
<td>1,750</td>
</tr>
<tr>
<td>Pallets</td>
<td>1,944</td>
<td>Wire and Cable</td>
<td>1,650</td>
</tr>
<tr>
<td>Tires and Frames</td>
<td>2,802</td>
<td>Tools and Kits</td>
<td>1,973</td>
</tr>
<tr>
<td>Prefab Bldg Parts</td>
<td>3,816</td>
<td>Other</td>
<td>3,432</td>
</tr>
<tr>
<td>Charcoal</td>
<td>600</td>
<td>Machinery and Equipment</td>
<td>37,346</td>
</tr>
<tr>
<td>Other (Inc Paper)</td>
<td>1,707</td>
<td>Rail Equipment</td>
<td>9,297</td>
</tr>
<tr>
<td>Rubber Products</td>
<td>2,482</td>
<td>Trucks and Trailers</td>
<td>15,101</td>
</tr>
<tr>
<td>Tires</td>
<td>565</td>
<td>Electrical Equipment</td>
<td>2,319</td>
</tr>
<tr>
<td>Canneback</td>
<td>979</td>
<td>Batteries</td>
<td>4,429</td>
</tr>
<tr>
<td>Rubber Footwear</td>
<td>344</td>
<td>Other</td>
<td>4,410</td>
</tr>
<tr>
<td>Misc Rubber Products</td>
<td>544</td>
<td>All Other</td>
<td>690</td>
</tr>
</tbody>
</table>

In 1944, 2 million of $ million persons engaged in manufacturing in Japan were engaged in the production of aircraft and aircraft parts. This compares with 486 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 accessories for use in aircraft. Further, it should be possible for Japan to produce aircraft parts for the installation of American engines. Finally, if required, Japan could produce scouting and liaison planes in considerable volume.

The high 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 Custodians. The ability of the 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, may 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

<table>
<thead>
<tr>
<th>Item</th>
<th>Unit</th>
<th>1946</th>
<th>1947</th>
<th>1948</th>
<th>1949</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PHARMACEUTICALS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mapharen</td>
<td>kg</td>
<td></td>
<td></td>
<td>149</td>
<td>47</td>
</tr>
<tr>
<td>Bl. Subsal. Inj.</td>
<td>liter</td>
<td></td>
<td></td>
<td>445</td>
<td>51</td>
</tr>
<tr>
<td>Salzthionale</td>
<td>kg</td>
<td></td>
<td></td>
<td>6,017</td>
<td>7,651</td>
</tr>
<tr>
<td>Sulfadialine</td>
<td>kg</td>
<td></td>
<td></td>
<td>11</td>
<td>252</td>
</tr>
<tr>
<td>Penicillin</td>
<td>1,000,000 I.U.</td>
<td></td>
<td>1,152</td>
<td>24,752</td>
<td>149,859</td>
</tr>
<tr>
<td>Erythromycin</td>
<td>kg</td>
<td></td>
<td></td>
<td>301</td>
<td>1,228</td>
</tr>
<tr>
<td>Capsule</td>
<td>1,000,000</td>
<td></td>
<td></td>
<td>499</td>
<td>5,077</td>
</tr>
<tr>
<td><strong>BIOLOGICS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cholera Vaccine</td>
<td>1,000 cc</td>
<td>1,011</td>
<td>531</td>
<td>67</td>
<td>23</td>
</tr>
<tr>
<td>Diphtheria Antitoxin</td>
<td>1,000 cc</td>
<td>112</td>
<td>61</td>
<td>92</td>
<td>29</td>
</tr>
<tr>
<td>Diphtheria Toxoid</td>
<td>1,000 cc</td>
<td>175</td>
<td>472</td>
<td>1,991</td>
<td>152</td>
</tr>
<tr>
<td>Smallpox Vaccine</td>
<td>1,000 dose</td>
<td>2,596</td>
<td>2,174</td>
<td>1,149</td>
<td>6,713</td>
</tr>
<tr>
<td>Typhoid Vaccine</td>
<td>1,000 cc</td>
<td>1,164</td>
<td>11,465</td>
<td>2,955</td>
<td>738</td>
</tr>
<tr>
<td>Typhus Vaccine</td>
<td>1,000 cc</td>
<td>0</td>
<td>221</td>
<td>100</td>
<td>141</td>
</tr>
<tr>
<td><strong>TEXTILE SANITARY MATERIALS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Absorbent Cotton</td>
<td>1,000 lb</td>
<td>29</td>
<td>214</td>
<td>321</td>
<td>396</td>
</tr>
<tr>
<td>Gauze</td>
<td>1,000 lb</td>
<td>38</td>
<td>58</td>
<td>105</td>
<td>142</td>
</tr>
<tr>
<td>Bandage</td>
<td>1,000 lb</td>
<td>46</td>
<td>40</td>
<td>100</td>
<td>63</td>
</tr>
<tr>
<td>Rubber Medical Goods</td>
<td>kg</td>
<td></td>
<td>49,999</td>
<td>69,871</td>
<td>71,950</td>
</tr>
<tr>
<td>Surgical Instruments</td>
<td>1,000 pcs</td>
<td>1,302</td>
<td>2,121</td>
<td>3,165</td>
<td>3,057</td>
</tr>
<tr>
<td>Dental Instruments</td>
<td>1,000 pcs</td>
<td></td>
<td></td>
<td>326</td>
<td>477</td>
</tr>
<tr>
<td>Glass Syringes</td>
<td>1,000 pcs</td>
<td></td>
<td></td>
<td>399</td>
<td>382</td>
</tr>
<tr>
<td><strong>X-RAY &amp; ELECTROTHERAPY EQUIPMENT</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>X-ray Machine</td>
<td>each</td>
<td>163</td>
<td>175</td>
<td>312</td>
<td>341</td>
</tr>
<tr>
<td>Ultra Shortwave</td>
<td>each</td>
<td>47</td>
<td>48</td>
<td>89</td>
<td>39</td>
</tr>
<tr>
<td>Molybden Ray</td>
<td>each</td>
<td>15</td>
<td>35</td>
<td>92</td>
<td>93</td>
</tr>
<tr>
<td>Infra-red Ray</td>
<td>each</td>
<td>21</td>
<td>29</td>
<td>14</td>
<td>37</td>
</tr>
<tr>
<td>Luminous Screens</td>
<td>each</td>
<td></td>
<td>56</td>
<td>140</td>
<td>161</td>
</tr>
<tr>
<td>Incinerating Stove</td>
<td>each</td>
<td>145</td>
<td>268</td>
<td>450</td>
<td>450</td>
</tr>
<tr>
<td>Electro Surgical Instruments</td>
<td>each</td>
<td></td>
<td></td>
<td>12</td>
<td>10</td>
</tr>
<tr>
<td><strong>X-RAY FILM</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>25 x 35</td>
<td>doz</td>
<td></td>
<td>967</td>
<td>247</td>
<td></td>
</tr>
<tr>
<td>45 x 64</td>
<td>doz</td>
<td></td>
<td></td>
<td>1,048</td>
<td>148</td>
</tr>
<tr>
<td>5 x 7</td>
<td>doz</td>
<td></td>
<td></td>
<td>892</td>
<td>396</td>
</tr>
<tr>
<td>65 x 65</td>
<td>doz</td>
<td></td>
<td></td>
<td>2,016</td>
<td>2,016</td>
</tr>
<tr>
<td>8 x 10</td>
<td>doz</td>
<td></td>
<td></td>
<td>3,692</td>
<td>1,057</td>
</tr>
<tr>
<td>10 x 12</td>
<td>doz</td>
<td></td>
<td></td>
<td>22,986</td>
<td>27,094</td>
</tr>
<tr>
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<td>Coolidge</td>
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### ECONOMIC CONTROLS AND PLANNING

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 capacity can be viewed only in relative terms. For example, the Japanese apparel industry is probably as readily convertible 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 more 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 nearly so great 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 the manufacture of each other's products, and electric furnaces now used in the manufacture of calcium cyanamide and ammonia can be used for the manufacture of carbide are equally suitable for the manufacture of electro-chemicals and alloying materials. In these cases, and in many others, the characteristics 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 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 machine tools, and even such 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 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.

**8-37 NOTES REGARDING UTILIZATION OF THE JAPANESE ECONOMIC POTENTIAL**

Memorandum

April 17, 1951

To: General Marquart, 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.

1. 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 offensive.

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. That some of the peace treaty together with the end of the Occupation arouses the latent instincts of SCAP personnel to begin to plan for more permanent employment. It will be difficult if not impossible to replace individuals as they resign. To prevent the US-Japanese cooperation to be handled on behalf of the US by SCAP it will become increasingly difficult.

5. Immediate and aggressive action toward developing a program of cooperation therefore appears to be imperative. This is so for three reasons:

a. 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.

b. The balance between Democracy and Communism is a delicate one which could be very seriously upset by a program which would take the energy and resources of a program which would take the energy and resources needed to fight a war.

c. The economic strength of friendly nations in the Far East should be used as effectively and as fully as possible. This can be done only if there is a single policy.

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 a single policy.

7. So long as full-scale war can be avoided and 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. The basic work which would be involved in the development 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 very basic data is necessary 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

ly 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 dangerously 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 would radically involve a radically different pattern of production, and it is not apparent to me that the pattern of power use were changed it could be increased by 50 percent by 1953. However it appears impossible to contemplate an increase in output of 50 percent without a substantial increase in production capacity or otherwise taking the heavy risk of wrecking every capability 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 procurement" as such. Japan could and should provide substantial quantities of goods required by the military forces in this area. Moreover 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 mobilization.

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 be subject to the consequences of their actions? And what sort of 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 officials' misunderstanding of all the details of Japan's precarious economic situation), upsetting the economic "apparatchik".

10. My personal opinion is that a top level mission of great competence and prestige is needed here to work the problem through effectively with the military forces in this area. I believe 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.

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 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 Japan's effective productive capacity 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 here, is set out 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.

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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 controls may be accelerated.

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 repositioning of controls. (A big selling job is needed here to assist in educating the people to the value 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 implementation of 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 out;

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 clearly approximate 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
Visiting Expert

[Source: Sullett Papers, 2:705-51]

8-38 UNITED STATES-JAPAN ECONOMIC COOPERATION

Statement

May 10, 1951

By: General Marquart (ESS Chief)

Released by Public Information Office, SCAP

Major General William F. Marquart, 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.

As stated by General Marquart in a report released today 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 general economic and private departmental interest in the area of United States financial and economic assistance to the United States 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 extreme heavy demands upon his time. It 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 Aften; 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, Chairman of the International Finance Corporation, T.S. Treasury, Governor, Federal Reserve System; William McChesney Martin, 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 Majz and John Christmas, and Brig. Gen. Omsted, and a long list of other government agencies and commercial and industrial firms.


[Source: Eikun Songs Shiryu, Vol. 27, Economic Planning Agency]

8-39 MARQUAT'S STATEMENT ON U.S.-JAPAN ECONOMIC COOPERATION

Press Release

May 16, 1951

By: W. F. Marquart

From: Public Information Office, SCAP

The following is a detailed press release prepared by Maj. Gen. William F. Marquart, 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-
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 disruption of export expansion. The adoption of a responsible national 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 the event of defaults there is no likelihood that the policy may not be adopted. Normally this type of financing may be considered only when United States interests are included in the mutual benefits of the transaction contemplated.

Priorities for the loan for the Allied Powers are in 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 acceptance of 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. Expenditure of the U.S. procurement program is progressive as funds are made available and purchases are made on an order to basis. There is no single overall program contemplated wherein long-range assignment of priorities is involved, and it has been the policy of the U.S. to recognize the responsibility of the U.S. industry to assume the burden of increased production, and it is the obligation of U.S. industry to make adequate provision for current procurement. On the other hand, it is the responsibility of the Japanese to make adequate provision for the purchase of manufactured items in the interest of world industrial development it is essential that the placement of orders be made on the basis of successive contracts predicated upon competitive bidding. The 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 most critical 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 stage. The measures although available capacity is being fully employed. Agencies have been directed for the national effort through essential elements by means of allocations controls and other recognized methods. It is obvious that if the other countries provide the necessary shipping measures to adjust domestic prices of manufactured items to international levels Japan must consider similar action of the she in order to avoid the need for export restraints. For any reason, Japan is not able to contribute to the international program her claim for raw materials and food to maintain a stable standard of home consumption will be affected. Japan should endeavor through existing agencies to the fullest extent possible for adequate Japanese for the Occupation's full assistance in this respect. Some of the prerequisites for membership in international financial bodies are:

Adoption 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 protect the production of goods which 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. Execution of plans for the economic development of the occupied territories. The execution of plans for the economic development of the territories occupied by the United States is essential to the success of the occupation. Economic development is necessary to provide the Japanese with the means to support themselves, and to provide them with a sense of purpose and direction. Economic development must be based on sound economic principles and must be carried out in a way that will be acceptable to the Japanese people.

4. The establishment of a just and equitable system of compensation for the occupation forces. The establishment of a just and equitable system of compensation for the occupation forces is necessary to ensure that the occupation forces are adequately compensated for their services. The system of compensation must be fair and just, and must be based on sound economic principles. The compensation must be adequate to ensure that the occupation forces are adequately compensated for their services.
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 assistance 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 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 relationships. Members of the SCAP-PEC Mission, in addition to General Marquart were: Mr. Terrance O. Kennedy, Dr. Sherwood M. Fine, Mr. Kenneth D. Morrow, Brig. Gen. Urban Niholo, Colonel Maylon Scott, Colonel Calvin M. Bryan, Capt. William P. Peters, USN, Capt. Raymond O. Bruyns, USN, Lt. Col. Marcus S. Griffin, Lt. Col. Robert N. Bond and Lt. Col. Leslie L. Motz.

[Source: MORIHAGA PAPERS, MINISTRY OF FINANCE]

8-40 JAPAN’S INDUSTRIAL POTENTIAL

Report (Vol. III) Prepared by: Programs and Statistics Division, ESS, SCAP

February 20, 1952

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5. The United States Programs

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 countries 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 not now present in the U.S. and West Europe.
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 defense. Also 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 level of 80 per cent or more of pre-war production, it is not yet near 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 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 included a suggested distribution of Japan's potential factory output calculated to obtain the optimum benefits for the free world.

The purpose of this paper, Volume III of "Japan's Industrial Potential," is to analyze Japan's capacity as of 31 December 1951.

1. Describe Japan's industrial potential in terms of its ability to produce military end-items.
2. Analyze Japan's trade patterns.
3. Evaluate Southeast Asian resources and note problems related thereto.
4. 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 overproduction. One year later, on 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 other industries have taken place. The most startling increases in capacity from December 1950 to December 1951 were: the blast-furnace cases to 8 million cases; 6.8 million metric tons to 8.8 million; cotton yarn, 720 million pounds to 972 million pounds; calcium carbide, 369 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 to one of the aluminum processes begun conversion to nickel sulphate 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 recompilation 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 1. 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 2,260,000. These figures include all types of ships in 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 2,235,000 gross tons. Expansion will continue as rapidly as funds permit. Table 1 shows how the fleet fared during the year.

<table>
<thead>
<tr>
<th></th>
<th>In Service</th>
<th>New Construction</th>
<th>Purchases and Conversions</th>
<th>Scrapped or Converted</th>
<th>As of 31 Dec. 1950</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of ships</td>
<td>1,679</td>
<td>124</td>
<td>52</td>
<td>60</td>
<td>1,795</td>
</tr>
<tr>
<td>Total tonnage of ships</td>
<td>2,037,637</td>
<td>419</td>
<td>291</td>
<td>127</td>
<td>2,260</td>
</tr>
<tr>
<td>Merchant fleet</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of ships</td>
<td>944</td>
<td>70</td>
<td>52</td>
<td>49</td>
<td>1,017</td>
</tr>
<tr>
<td>Tonnage</td>
<td>1,711,443</td>
<td>387</td>
<td>291</td>
<td>106</td>
<td>2,233</td>
</tr>
<tr>
<td>Cargo</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of ships</td>
<td>600</td>
<td>55</td>
<td>50</td>
<td>31</td>
<td>724</td>
</tr>
<tr>
<td>Tonnage</td>
<td>1,240,317</td>
<td>317</td>
<td>270</td>
<td>84</td>
<td>1,743</td>
</tr>
<tr>
<td>Semi-cargo</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of ships</td>
<td>60</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>52</td>
</tr>
<tr>
<td>Tonnage</td>
<td>112</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>94</td>
</tr>
<tr>
<td>Passenger</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of ships</td>
<td>116</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>108</td>
</tr>
<tr>
<td>Tonnage</td>
<td>78</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>73</td>
</tr>
<tr>
<td>Tanker</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of ships</td>
<td>116</td>
<td>15</td>
<td>2</td>
<td>0</td>
<td>133</td>
</tr>
<tr>
<td>Tonnage</td>
<td>201</td>
<td>70</td>
<td>21</td>
<td>0</td>
<td>372</td>
</tr>
<tr>
<td>Fishing fleet</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of ships</td>
<td>403</td>
<td>12</td>
<td>0</td>
<td>11</td>
<td>404</td>
</tr>
<tr>
<td>Tonnage</td>
<td>165</td>
<td>20</td>
<td>0</td>
<td>20</td>
<td>163</td>
</tr>
<tr>
<td>Special type fleet</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of ships</td>
<td>332</td>
<td>42</td>
<td>0</td>
<td>0</td>
<td>374</td>
</tr>
<tr>
<td>Tonnage</td>
<td>163</td>
<td>11</td>
<td>0</td>
<td>0</td>
<td>174</td>
</tr>
</tbody>
</table>

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 barges, 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 since 1951.

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 740,000 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...
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 million 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 increased 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

<table>
<thead>
<tr>
<th>Year</th>
<th>Hydro</th>
<th>Thermal</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>3,542</td>
<td>5,589</td>
</tr>
<tr>
<td>1951</td>
<td>3,542</td>
<td>5,589</td>
</tr>
<tr>
<td>1952†</td>
<td>3,542</td>
<td>5,589</td>
</tr>
<tr>
<td>1953†</td>
<td>3,542</td>
<td>5,589</td>
</tr>
</tbody>
</table>

### Table 2: Railway Rolling Stock (Government and Private) (In Units)

<table>
<thead>
<tr>
<th>In Service</th>
<th>New Con</th>
<th>Added by Conversion</th>
<th>Retired or Converted</th>
<th>In Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>1950</td>
<td>1950</td>
<td>1950</td>
<td>1950</td>
</tr>
<tr>
<td>Total locomotives</td>
<td>5,391</td>
<td>50</td>
<td>0</td>
<td>14</td>
</tr>
<tr>
<td>Steam, including</td>
<td>4,862</td>
<td>21</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Electric</td>
<td>529</td>
<td>29</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>Passenger cars</td>
<td>11,329</td>
<td>360</td>
<td>42</td>
<td>1,666</td>
</tr>
<tr>
<td>Freight cars</td>
<td>106,199</td>
<td>5,191</td>
<td>55</td>
<td>1,049</td>
</tr>
<tr>
<td>Electric cars</td>
<td>11,281</td>
<td>478</td>
<td>66</td>
<td>350</td>
</tr>
</tbody>
</table>

(suburban & municipal)

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 availability, Japan can produce substantial and progressively larger quantities of military end-products. Japanese steel production is currently indicated as follows: 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 wastefulness of the domestic economy and the Korean demand 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 making, 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.

The relatively wide dispersion of orders also is 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 Japan can produce virtually a most satisfactory situation in terms of the U.S. procurement program in Japan, particularly so if that program is to be expanded.

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 item of products available from production and stocks from Kobe 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 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.
ECONOMIC CONTROLS AND PLANNING

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 manufacturing industry.

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 $650 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 $130.0 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 Logistic 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 MDAF 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, and a number of other important details regarding each plant.

Ordnance GHQ has reviewed ILC 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, grenadier; projecor, pyroehand; rifles cal 30 and pistol 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; pistol and submachine guns cal. 45; howitzer 105 mm; rifles 57 and 75 mm; grenades, hand and rifle; flares, trip; mines, personnel and antitank.
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 and Southeast Asia, and there has been established a Center for Southeast Asian Studies, in which the Department of State has joined, to study the economic, social, and cultural conditions in that area. The Center is designed to aid the United States in considering policies affecting the Far East and Southeast Asia, and to aid the United States in understanding the problems of that area.

The Center has been established to provide a place of cooperation between the various agencies of the United States government, to facilitate the exchange of information, and to provide a central location for the study of the problems of the Far East and Southeast Asia. The Center will be a place where experts from various agencies can come together to discuss the problems of the Far East and Southeast Asia, and to study the economic, social, and cultural conditions in that area. The Center will be a place where the United States government can come together to study the problems of the Far East and Southeast Asia, and to develop policies for dealing with those problems.

The Center will be a place where the United States government can come together to study the problems of the Far East and Southeast Asia, and to develop policies for dealing with those problems. The Center will be a place where the United States government can come together to study the problems of the Far East and Southeast Asia, and to develop policies for dealing with those problems. The Center will be a place where the United States government can come together to study the problems of the Far East and Southeast Asia, and to develop policies for dealing with those problems.
9 AID AND TRADE

9-1 POLICY WITH RESPECT TO RELIEF IN JAPAN (SWNCC 107/1)

Report SWNCC 107/1

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.
   b. 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.
   c. 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.
   d. 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.
   e. 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.
   f. Distribution of supplies should be made through Japanese public supply agencies or such other consensuses 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.
   g. 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.

AID AND TRADE

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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 prepare to 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.

The existing disposition 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 for 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: MAC

Re: SWNCC 107 and 107/1, 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 importation 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 68184, 25 September 1945, provides for importation only where payment can be made by exports. Pending your decision on export policy and financial procedures queries have been forwarded to U.S. forces this theater regarding important 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 all commodities available for export will follow. Urgent 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

April 8, 1946

SCAPIN 941-A (ESS/IE)

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
AID AND TRADE

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-Chō (Board of Trade). Foreign firms and governments deal with SCAP. Boeki-Chō turns exports over to SCAP. SCAP turns imports over to Boeki-Chō.

3. Under this arrangement separate accounts are maintained. Boeki-Chō 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 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 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-Chō in accordance with yen cost of production plus a 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 found satisfactory for stabilization.

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 30-1. The black market yen-dollar rate has gone from about 60-1 in March 1946 to about 120-1.

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 merchandising methods or retire his 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 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 yen prices continue to rise, tied in dollars 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 imports could gradually reduce 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 completely rolled up in labor costs or because encouragement prices 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 abroad would be with a view to the world market and the low cost items would be practically at no cost; moreover, 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 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 amounted to US $150,000,000 while imports amounted 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 available. This would mean for stabilization of the yen a considerable increase in foreign credits for stabilization. Stabilization in turn would mean that the Japanese government would 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 halt of inflation in Japan. This in turn would mean an 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 enhancing the available balance. 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 rate. The support price in the market would be reduced and the rate of exchange 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 for that purpose 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.

12. For realization 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 exporting dollars 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 channeled 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 I) 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.

AID AND TRADE

In the interim SCAP will receive and pay out dollars and other acceptable foreign currencies incident to private transactions, while the Japanese Government through Bocki-Chô (Board of Trade) will handle yen payment for Japanese businesses 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: SCUTLAND PAPERS, Z.703-7]

9-5 RESTORATION OF PRIVATE TRADE WITH JAPAN (SFE 194/2)

Report

SFE 194/2
Confidential

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.

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 re-establishment 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.

III. ENTRY OF PRIVATE BUSINESSEMS

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.

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 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)

Issued by: SCAP

August 15, 1947

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 moneys upon 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 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 imported 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 and CCC accounts) derived from the sale of textiles manufactured from cotton imported under CCC and CCC 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 used, 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.

5. The Fund shall be used for the payment of the following:

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 be 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 e, and 4 f, above.

e. Monies borrowed and interest and other charges in connection therewith.

f. Service or other charges arising out of any transaction specified in Paragraphs 5 a, 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 thirty percent (30%) of the initial value of the assets specified of Paragraphs 4 a, 4 e, 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 the Fund deems it necessary to export and sell any of the assets referred to in 4 a to obtain current currencies to 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 such withdrawals 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 market value of goods at these export sales value.

b. Liabilities shall include, but shall not be limited to, the initial value of Paragraphs 4 a, 4 e, 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 the monthly statement is rendered. Copies of such statement will be made available to such parties as the Supreme Commander for the Allied Powers, or the Controller, 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. 276-279]
AID AND TRADE

9-7 ESS'S REPORT ON YEN EXCHANGE RATE

Report

January 10, 1948

Contents:

Part I—Summary and Explanation of Recommendations
Part II—Proposed Modified Single Rate Exchange System
Part III—Statistical Appendix

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 establishing 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 a 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:

<table>
<thead>
<tr>
<th>Month</th>
<th>Yen per Dollar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov. 1946</td>
<td>100</td>
</tr>
<tr>
<td>Dec.</td>
<td>117</td>
</tr>
<tr>
<td>Jan. 1947</td>
<td>120</td>
</tr>
<tr>
<td>Feb.</td>
<td>131</td>
</tr>
<tr>
<td>Mar.</td>
<td>148</td>
</tr>
<tr>
<td>Apr.</td>
<td>150</td>
</tr>
<tr>
<td>May</td>
<td>176</td>
</tr>
<tr>
<td>June</td>
<td>194</td>
</tr>
<tr>
<td>July</td>
<td>235</td>
</tr>
<tr>
<td>Aug.</td>
<td>236</td>
</tr>
<tr>
<td>Sep.</td>
<td>238</td>
</tr>
<tr>
<td>Oct.</td>
<td>265 (estimated)</td>
</tr>
</tbody>
</table>

5. If, however, OJEIRF can be effectively implemented, if other funds now being sought can be used to have a 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 been taken 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 unemployment, national income, standard of living, prices, the movement of foreign capital and investment, invisible exports such as tourist trade and remittances, and have a direct impact on 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 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:

<table>
<thead>
<tr>
<th>Percentage of Commodity Exports</th>
<th>Percentage of Commodity Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yen per Dollar within 20 Yen</td>
<td>Yen per Dollar within 40 Yen</td>
</tr>
<tr>
<td>80</td>
<td>25.32</td>
</tr>
<tr>
<td>100</td>
<td>37.76</td>
</tr>
<tr>
<td>120</td>
<td>34.14</td>
</tr>
<tr>
<td>140</td>
<td>25.14</td>
</tr>
<tr>
<td>160</td>
<td>12.04</td>
</tr>
<tr>
<td>180</td>
<td>5.51</td>
</tr>
</tbody>
</table>

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 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 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

*These sections omitted.
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.

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 by the Japanese and foreign speculators purchasing foreign property and coming to Tokyo to buy up and bid up 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 time this program 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.

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 times as great in 1948 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. This rate would attract highly desirable that within the limitations of the regulations governing foreign investment, the maximum amount of the inflow of foreign capital should be encouraged.

The inflationary trend in Japan has 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.

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 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.

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 when warranted by specific justification indicated that the price of materials or goods is subject to fluctuation under this system.

When rates of exchange fluctuate 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 war production, and second, since the end of the war, by the process of reparation and occupation. This dislocation of the economy and its disorganization have been accompanied by a drastic and radical breakdown of the economy, and the Japanese economy, without a major intervention, would have continued to exist.

b. The primary economic justification for a single rate at this time is that it would tend to result in a uniform price level throughout the country, and reduce the inflationary pressures throughout the country. For example, if a rate of ¥250 per dollar is established, and if the rate remains at ¥250 per dollar, both the export and import prices of goods will be the same. The result is that the economy will be controlled by the central government, and the Japanese economy is thus controlled by the central government.

The committee has carefully considered the possibility of a single system under which all imports and exports now under the single rate would be permitted or required to come up to a single rate, but which would provide for maintaining exports above the rate by allowing explicit subsidy payments. This alternative implies the inflationary effects of the necessary subsidy payments or alternative price rises described in (b) above would not be avoided by this proposal.

c. Therefore it is concluded that, as long as the present conditions are not alleviated, a single rate is necessary to prevent the continuation of inflationary pressures throughout the economy.
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 obtained) 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, a temporary condition and provides certain immediate Japanese interest, 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: Scotsman 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 the Japanese exchange rates with respect to the dollar.

The other members of the technical mission, in addition to yourself, are as follows:

Orrville John McDermid Department of State
Arthur Waters Stuart Treasury Department
Lt. Col. Paul Alfred Feyerisen 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 view of the recommendation 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 recommend 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.

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**9-9 YEN-DOLLAR PRICE RELATIONS AND THE PROBLEM OF AN EXCHANGE RATE**

Memorandum

By: W.V. Turnage, Research and Programs Division, ESS

June 6, 1948

The problem is whether it is now advisable to institute a uniform rate of exchange between the yen and dollar. The yen-dollar prices of 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 United States (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 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 around 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.)

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**AID AND TRADE**

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 remain 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 values consistent to a uniform rate.
   c. It assures maximum exports with a minimum reliance upon government subsidies.

3. 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.)

(Not: 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.)

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**9-10 REPORT OF THE SPECIAL MISSION ON YEN FOREIGN EXCHANGE POLICY (YOUNG REPORT)**

June 12, 1948

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PRELACE 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. Marquart, Chief of the Economic and Scientific Section of SCAP, and Colonel H. S. Cuth, Fiscal Director of CINCPAC. Every opportunity was provided for individual and Mission discussions of the technical aspects of our assignment with these officers and their staff. 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 general 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 stabilization program and financial 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 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 support 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 of a general rate's introduction, 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 the 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 adjustments in the general yen exchange rate when the latter program 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.


Paul A. Feyerisen, Lt. Col. Michael Lee
Arthur B. Hersey Orville J. McDermid
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 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 inquiry movement 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

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**9-11 Japanese Exchange Rate**

Memorandum

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 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 feudal characteristics of 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 deficits, 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 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 grey 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 100 billion yen is indicated. The forecast has been made that a rate of 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

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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 due to the combined influence of factors which inhibit Japanese import substitution and their prices are now as well as by the limited availabilty of raw materials prices and the disruption of normal production incentives by inflation. Among the factors limiting imports, in addition to shortages of raw materials, are the presence of a vigorous and protectionist 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 product have been lagging 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 in part to the small scale of industrial plants at varying levels of production and fluctuating, 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. Thus, 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 price-fixing 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 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 SCAP staff have given considerable thought, would enact a measure which would perpetuate many of the 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 system. Moreover, a multiple rate system would be a barrier to the curbing of inflationary tendencies, in that it would allow excessive output of yen to insensitive exporters, and tend to preclude the use as a deflationary device of larger import payments to the foreign trade fund for imports. Any attempt to compress the range between high and low rates, 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 Mission recommended an administrated or controlled multiple rate yen-dollar exchange rate, applicable to all transactions including those to which the present military rate applies, to be established as administratively possible, with target date on or before October 1. The Mission did recommend the basis of allowing 80 percent of foreign exchange goods 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, in order to achieve the specified range of yen-dollar price stability.

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 could be borrowed and paid, and into which would be paid the yen general export rate, applicable to all transactions including those to which the present military rate applies, to be established as administratively possible, with target date on or before October 1. The Mission did recommend the basis of allowing 80 percent of foreign exchange goods 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, in order to achieve the specified range of yen-dollar price stability.

4. Volumetric Supply of Commodities and GHQ Staff

In 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 additional burden 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 excessive recourse would have to be made to subsidies to prevent the elimination of essential exports and to check “unfair competition.”

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 stated the existing domestic levels of production and foreign trade in Japan as indicating the difficulties of imposing, concurrently with establishment of the rate, the 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 further that one of the prior 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, in coincidence with the production index.” Other determinants, in his view, would be the strengthening and establishment of stabilization mechanisms which would “ensure the establishment and maintenance of the controlled rate of exchange.”

5. Review of the Arguments

SCAP’s belief that establishment of a single, general rate of exchange should wait on substantial recovery in domestic production and 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 the export procedures if a single rate is not adopted. The reactions of other countries trading with Japan are likely to be unfavorable. A multiple rate system of exchange 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 derive from their wages. There is little likelihood of this real level of consumption as determined by domestic production and imports will be adversely affected by a stabilization program embracing four staple fiscal measures and other measures recommended by the Mission. Moreover, the underemployment which may be occasioned either by temporary cutting off of high-cost exports or by rationalization induced by economic conditions could not cause a serious 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 rate system 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 and export trade goods. However, providing official direct pricing established a level 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 distortions. Smallish price increases 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 our present system of price stabilization. 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 preferably 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 financial interests 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 Japan's 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 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. Recommendations

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) The desirability of a single exchange rate for the yen, applicable to all types of transactions including those for which a military conversion rate would be used, and for 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 S. Young (Chairman), Special Mission of Yen Foreign Exchange Policy, Visitor
Mr. Arthur B. Hersey, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. William W. Stuard, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. Michael Lee, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. Orville J. McDermid, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. Franklin H. Strom, Special Mission on Yen Foreign Exchange Policy, Visitor
Mr. William 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 Dembits, Board of Governors, Federal Reserve System
Mr. William McC. Martin, Jr., Export-Import Bank
Mr. Herbert E. Gaston, Export-Import Bank
Mr. Paul H. Hoffman, Economic Cooperation Administration
Mr. Wayne C. Taylor, Economic Cooperation Administration
Mr. August Maffly, Economic Cooperation Administration
Mr. George F. Luthringer, International Monetary Fund
Mr. John S. Hooper, International Bank
Mr. Walter C. Louchheim, Jr., Securities and Exchange Commission
Mr. Frank A. Southard, Jr., Treasury Department
Mr. John J. Hauser, Treasury Department
Mr. William W. Parsons, Treasury Department
Mr. Elting Arnold, Treasury Department
Mr. Robert A. Dillon, Treasury Department
Mr. John O. Halley, Treasury Department
Mr. John W. Gunter (Secretary)
Mr. Allan J. Fisher (NAC Secretary)

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 policy was to approve in principle the findings of the Mission on the desirability of establishing a 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 by the Special Mission on Yen Foreign Exchange Policy 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 it deplored the absence of 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 action 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 end the extraordinary measures 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.
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 that the United States would have to import 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 not been asked to provide a date. The Department of the Secretary of the Treasury could be agreement on a specific date which would be somewhat later. The recommendation would leave open the Army, after receiving General MacArthur's recommendations, the putting into effect of the exchange at such time as the Army elected. The Army would interpret as soon as practicable to mean as soon as its condition would allow by 1948, which would merely fix the rate of exchange for dollars which are 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 yen to the dollar as compared with the existing rate of 30 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 publicly.

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 more difficult and our pressure on them not to adopt multiple rates and to go to the International Monetary Fund less persuasive if we continued in the areas in which we have expressed the hope. The State Department did not believe that anything like a year or two-year period would be a reasonable time. They would like to have a period 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 States and the Treasury thought that further delay might make early action 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 measures were taken 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 policy 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 that 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 conceded. 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 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.

The matter was in development 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 that matter before the lesson and discussion with the State and Treasury Departments and that the latter could clear it with the Council if they desired.

Mr. Cabe 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.

With two of a broad program the recommended action was unanimously approved.

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 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. Treas., p. 732-1]

9-13 THE ECONOMIC REHABILITATION OF JAPAN

Report October 15, 1948
Prepared by: Reports and Analysis Branch, Civil Affairs
Division, Department of the Army

Precwarz 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 other minerals and a geography which favored the incorporation with the areas 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
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 United States has appropriated funds "for goods and services 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...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 of the largest category was grain and flour), and 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.

The food situation in Japan was critical in 1948-49. 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 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 a position of self-sufficiency. SCAP, or its successor, 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 1945, 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 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 advance the seller's foreign exchange funds.

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 and prices. 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 it 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 forwards the foreign exchange to the foreign exporter in accordance with the contract.

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 or the U.S. import duties and other regulations apply as do other 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 are restricted to items essential to the Japanese economy. Individual producers selling commodities to Japan may be reimbursed for the 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 following procedures:
   a. Direct Negotiation with SCAP: SCAP solicits bids for needed commodities on a competitive basis. The contracts are then written and executed directly with the Japanese producers.
   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 dictate the desirability 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 of 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 the Department of the Army, under its supervision.

2. Transactions Involving Appropriated Funds (GARIOA): By Public Law 793, 80th Congress, funds were appropriated to finance the procurement of minimum supplies for the civilian population of Occupied Areas as might be essential to prevent starvation, disease, and unrest prejudice to acceptable foreign exchange objectives and any 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 Rynokys, 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):

<table>
<thead>
<tr>
<th>Type</th>
<th>Number</th>
<th>Value (in dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import</td>
<td>264</td>
<td>$45,612,000</td>
</tr>
<tr>
<td>Export</td>
<td>2,655</td>
<td>$45,378,000</td>
</tr>
</tbody>
</table>

Occupied Japan Export-Import Revolving Fund (OJEIF): On the basis of a Far Eastern Commission policy decision in July 1947, SCAP established an Occupied Japan Export-Import Revolving Fund, based upon Japanese-owned precious metals valued at $137,000,000. OJEIF 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 Schroeder Banking Corporation. The Bank of America National Trust and Savings Association was also a party to the agreement.

**Congression Appropriation:** 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 $57,000,000 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:

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### ESTIMATED VALUE OF JAPANESE FOREIGN TRADE BY AREAS OF ORIGIN AND DESTINATION

1 January through 31 May 1948 (In U.S. Dollars)

<table>
<thead>
<tr>
<th>Area of Origin</th>
<th>Value of Imports</th>
<th>Value of Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(CIF Japanese Port)</td>
<td>(FOB Japanese Port)</td>
</tr>
<tr>
<td>Total, All Areas</td>
<td>$282,645,792</td>
<td>$62,911,716</td>
</tr>
<tr>
<td>North America—Total</td>
<td>206,609,508</td>
<td>13,722,380</td>
</tr>
<tr>
<td>U.S.</td>
<td>205,044,936</td>
<td>13,512,792</td>
</tr>
<tr>
<td>Others</td>
<td>5,564,572</td>
<td>295,538</td>
</tr>
<tr>
<td>Asia—total</td>
<td>35,202,785</td>
<td>40,628,362</td>
</tr>
<tr>
<td>Europe—total</td>
<td>6,908,622</td>
<td>6,416,297</td>
</tr>
<tr>
<td>South America—total</td>
<td>2,805,473</td>
<td>34,192</td>
</tr>
<tr>
<td>Africa—total</td>
<td>1,446,567</td>
<td>1,550,336</td>
</tr>
<tr>
<td>Oceania—total</td>
<td>301,687</td>
<td>560,299</td>
</tr>
<tr>
<td>Others—total</td>
<td>27,030,750</td>
<td>27,030,750</td>
</tr>
</tbody>
</table>

### ESTIMATED VALUE OF MERCHANDISE IMPORTS TO JAPAN, BY COMMODITY GROUPS

1 January through 31 May 1948 (In Dollars; CIF JAPANESE PORT)

<table>
<thead>
<tr>
<th>Commodity Group</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$282,645,792</td>
</tr>
<tr>
<td>Animals and Animal Products</td>
<td>4,968,136</td>
</tr>
<tr>
<td>Vegetable Products</td>
<td>120,547,016</td>
</tr>
<tr>
<td>Grains and Preparations</td>
<td>51,739,920</td>
</tr>
<tr>
<td>Sugar and Related Products</td>
<td>33,557,959</td>
</tr>
<tr>
<td>Others</td>
<td>33,239,177</td>
</tr>
<tr>
<td>Vegetable Products, Inedible*</td>
<td>18,830,299</td>
</tr>
<tr>
<td>Textile Fibers and Manufactures</td>
<td>87,033,611</td>
</tr>
<tr>
<td>Cotton, Manufactured</td>
<td>67,276,384</td>
</tr>
<tr>
<td>Cotton, Other</td>
<td>1,282,194</td>
</tr>
<tr>
<td>Other Textile Products</td>
<td>19,375,123</td>
</tr>
<tr>
<td>Nonmetallic Minerals</td>
<td>27,897,363</td>
</tr>
<tr>
<td>Metals and Manufactures*</td>
<td>4,911,049</td>
</tr>
<tr>
<td>Machinery and Vehicles</td>
<td>192,331</td>
</tr>
<tr>
<td>Chemicals and Related Products</td>
<td>17,707,237</td>
</tr>
<tr>
<td>Miscellaneous Commodities</td>
<td>73,699</td>
</tr>
</tbody>
</table>

* Includes estimated value of goods procured with U.S. Government appropriated funds and estimated value of surplus military stocks transferred to Japanese Government.

† Includes imports from Australia and Guam; Exports to Australia.

‡ Imports from Cuba.

§ Includes estimated value of goods procured with U.S. Government appropriated funds and estimated value of surplus military stocks transferred to Japanese Government.

¶ Excludes wood and paper.

‖ Excludes machinery and vehicles.
ESTIMATED VALUE OF MERCHANDISING EXPORTS FROM JAPAN, BY COMMODITY GROUP
1 January through 31 May 1949
(In Dollars, FOB Japanese Port)

<table>
<thead>
<tr>
<th>Commodity Group</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$62,911,716</td>
</tr>
<tr>
<td>Animals and Animal Products</td>
<td>5,528,653</td>
</tr>
<tr>
<td>Vegetable Products</td>
<td>2,719,760</td>
</tr>
<tr>
<td>Textile Fibers and Manufactures</td>
<td>37,392,300</td>
</tr>
<tr>
<td>Cotton Manufactures</td>
<td>31,245,851</td>
</tr>
<tr>
<td>Others</td>
<td>16,602,439</td>
</tr>
<tr>
<td>Wood and Paper</td>
<td>1,755,595</td>
</tr>
<tr>
<td>Nonmetallic Minerals</td>
<td>6,200,242</td>
</tr>
<tr>
<td>Metals and Manufactures</td>
<td>5,127,866</td>
</tr>
<tr>
<td>Machinery and Vehicles</td>
<td>2,555,003</td>
</tr>
<tr>
<td>Chemicals and Related Products</td>
<td>1,547,454</td>
</tr>
<tr>
<td>Miscellaneous Commodities</td>
<td>2,043,823</td>
</tr>
</tbody>
</table>

*Excludes machinery and vehicles.*

[Source: SUTLAND 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: Kumatoki 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 traditional 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 sense of the word; it may rather 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, it 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 swelling-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 humiliation 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 "ministry of 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. Jumonose 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 realises 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 nothing 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 staked, and would con-

Most respectfully yours.

[Source: SUTLAND PAPERS, Z 703-7]

9-15 COMMENTS ON THE EXCHANGE RATE PAPER OF JANUARY 11, 1949

Memorandum

By: Seimour J. Janow, Foreign Trade and Commerce Div. ESS, SCAP

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."

[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 accounting methods.

e. Whether the rigidities that will be associated with the fixing of an exchange rate have been made clear.

The necessary position of the Japanese Government in the exchange rate problem has been explained.

a. Specific data used in this paper. It is believed that the ratios shown in Table 2 are subject to a random lag in time, and are not representative of existing export or 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. Machinery and metals, rubber products, machinery is a Japanese industry, rubber products, machinery, and rubber products, machinery is in the same broad category as machinery and metals, rubber products, and machinery in the general category of machinery.

Compilation of most recent data on this subject is relatively easy and straightforward. 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, there are such things as trading ships, now not considered. 550 to one, and automobiles, now being manufactured at an adjusted 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 450; electric apparatus at 600; and communication equipment at 510.

A forecast which 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 same figure which could be used in this study. Steel products fall into the following major categories: Primary products, secondary products, ship's, rolling stock, textile machinery, communication equipment, light machinery, light metal manufacture, enamel ware, miscellaneous machinery, plants, electric machinery, locomotives, industrial machinery, hardware. The data presented in the study is a 2 year average of current year in examining an export data to that representing the total for 1949 and indicates a single ratio for the entire machinery and metals output. Moreover, a weight in terms of dollars of $125,000,000; whereas the sum anticipated may reach $125,000,000. A rough indication of what weights have been used in arriving at your total average figure. In short, it is not believed that 500 is to one is the proper ratio of this entire 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, and are not adequate for determining future effects based on current circumstances, and are not appropriate for common use. 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 economy. This is purposely left to reports currently available for the Japanese economy. There is no direct or indirect price index that can be used for Japanese exchange rates. There is no Consumer's Price Index for Japan and the United States and other countries equally related to a common base. There is no reference to the 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 data 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 difficulties of determining the commodity and price indices 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 United States and other countries in that it does not relate the rate of change in the dollar against the yen to the 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 details proposed is certainly 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 had no guarantee of food, coal, salt, or petroleum products will 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. Similarly, food imports in the past were largely from Asia and Near East 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 United States coking coal shipped in American flag vessels to Japan cannot be done. Japan must consider a "necessary price adjustment" and pay for the streamlining 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 that go into steel production, coal, iron ore, and steel products, are a Japanese industry, and in the trade agreement with China, the government and industry associations in the United States, the agreement associates in the United States, the United Kingdom, Philippines, Australia, South Africa, Egypt and others would not object to a special 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 internationally will be confined to reductions in the cost of production. Per favorable to a system of direct subsidy in price is the fixing of an export rate at a level sufficient to cover the full cost of production in the United States. There is no assurance that the price received in yen will remain at the same rate. In the proper proportion, the incomes of machinery and metal 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 complete advantage 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 never reached a production capacity that will allow it to compete in the United States. General textile capacity available for further expansion is the prospect 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 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 even 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 requirement.

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 West. Import, tariff, and the United Kingdom. During the last year it may be due to the lowering of dollar and sterling prices of metals and machinery exports. Such reduction in export prices is very likely to be greater than savings resulting from lower costs of production. The subsidy payments in your paper may have a double insufficiency; they may be low because of 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, paper 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 invidious. 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 and systematically applied, will eliminate exchange rate system except in the absence of imports, which is unlikely, and until such time, the effects of the adjustment in the exchange rate system must be anticipated and anticipated.

c. Rigidity 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 for a revision of the yen. This aspect by itself suggests that this rate is too low to be fixed and to anticipate the future rather than being fixed on past and possibly already outdated data. A year ago an exchange rate of 200 to one might very well have been fixed on the principles proposed in this paper.

d. The level of fixed rates is not adequate to meet requirements it will be difficult and perhaps impossible to change 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, the Japanese Government will act as if it were a law passed by the General Headquarters and at what rates the yen 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 reasonsings 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 rate must be established in condition of relative economic dampening. 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 would be possible to fix a single exchange rate and establish and administer it with confidence and knowledge.

[Source: Scotland Paper]

8-10. APPLICATION OF EXCHANGE RATE PROPOSALS

Memorandum (Draft)

February 19, 1949

By: W. F. Marquart, Chief, ESS

1. Reference is ESS memorandum, subject: Exchange Rate, dated 15 January 1949. The recommendations 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 prices, 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.

(3) Such temporary measures 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 products could not be exported at all. 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 and restored. In the case of raw silk, a temporary subsidy is essential during the period of adjustment of present high cocoons prices to world competitive prices to avoid sharp curtailment of cocoon production. To effect this the following measures should be immediately implemented.

a. The list of priorities 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 farmcyclists. No silk subsidy is recommended beyond JFY 1949-50.

c. It is estimated that total yen costs of the above two subsidies would amount to about 7.2 billion yen.

3. Import.

a. It is recommended that during JFY 1949-50 the only imports 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 cotton processing, textile materials for the producing 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 yen in JFY 1949–50 be allowed to move without subsidy. Of this total, import items totalling 290 million yen in JFY 1949–50 have therefore been subsidized in part to continue their movement at rates lower 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 in each case the advantage gained in price stability far outweighs the burden on the public treasury. Conversely, the drastic inflationary impact which would result from abrupt termination of these subsidies would be even greater.

If, for example, raw cotton consumed for domestic textile industries 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 price index and the price of food. Imports of raw materials, i.e., coking coal, iron ore, copper, magnesium, cinder and graphite, were not subsidized, the price of steel ingot had 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 items were allowed to move at their international levels, the rate which could not be maintained. The import subsidies recommended herein are therefore minimal.

4. Domestic Price Adjustment Funds:

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 productivity 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 depression and imminent changes in the collection of excess rate of interest 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 continue to exceed 1 billion yen in JFY 1949–50, would be eliminated by a 120 percent passenger 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 45 percent increase in total funds is believed necessary to cover a 100 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 subsidy.
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 contained in the first draft budget for JFY 1949–50 has not been reduced from that of JFY 1948–49. Consequently, it will be necessary to revise the nature of the public works program to function more effectively as unemployment relief rather than otherwise.

7. Subsidies and International Relations

(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 125.3 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 the 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, and an increase of this magnitude in such a basic material would completely disrupt the stabilization effort and reduce 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: unbalanced long haul of iron ore and coking coal from abnormal supply sources, very high dollar transportation charges on both raw materials 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. Japanese 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, 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 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 parity concealed subsidies as follows:

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 sales of the sale of Jßerdem exports, with specified dollar sales, purchased with U.S. government funds and the dollar and EIROA. On the basis of estimated sales during JFY 1949–50 of 400 million dollars of GARIOA imports and $130 million dollars of the government fund, the Counterpart Fund revenues would amount to about 116 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 EIROA import proceeds. The yen proceeds of the sale of $420 million of commercial imports (imports purchased with export proceeds) will amount to 138.6 billion yen compared to 181.5 billion yen needed for the purchase of imports.

b. 102.4 billion yen for subsidizing import prices to stabilize the cost-of-living. (See para 3b above)

c. 21.1 billion yen for subsidizing import prices to stabilize the general industrial price level. (See para 3c above)

d. 12.2 billion yen for selected public works which contribute directly to economic rehabilitation. The equivalent amount saved from the general revenue fund would be transferred to the domestic price adjustment fund for subsidizing the production of selected exports. (See para 2d above)

E. The following procedures are 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 or for 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. The exchange rate recommendation should continue to be made on a monthly basis. A general outline of the Budget should also accompany the exchange rate recommendation.

b. SCAP should, at all times, retain control over specific releases from the counterpart fund.
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 EGA 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. Marquart, Chief, ESS
Secret

1. Recommend approval general foreign exchange rate for Japanese yen of 300 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 rates 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) contemplate export subsidies.
   b. Rate together with import subsidies which budget can absorb (see Dodge to Voorhees 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 absorb effective rate change on price and cost structure including exports.
   d. Balance achieved consolidated budget including provision for Counterpart Fund (Dodge to Voorhees April 2)
   e. Since Japanese fiscal year begins April 1 and necessity adjust certain prices conform reduced subsidies included in budget in light of exchange rate consider desirable announce exchange rate at the 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 obtained by Washington agencies will provide basis your consideration this recommendation.

If Telecom deemed necessary expedite matter please request.

[Source: Sutland Papers, 2, 703-53]

9-19 PROPOSED SINGLE RATE FOR JAPANESE YEN AND RELATED MEASURES

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 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 the military governor.

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, a reduced import subsidies, at a reduced rate is considered necessary to offset this 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 April 1949, in a strong sense, suggest, however, that the level selected was at the higher end of the range. Thus, a level at 330 yen per dollar 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 appreciation 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 the requested 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.

3. Balance achieved consolidated budget including provision for Counterpart Fund (Dodge to Voorhees April 2)

4. Since Japanese fiscal year begins April 1 and need adjust certain prices conform reduced subsidies included in budget in light of exchange rate consider desirable announce exchange rate at the 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 obtained by Washington agencies will provide basis your consideration this recommendation. If Telecom deemed necessary expedite matter please request.

[Source: Sutland Papers, 2, 703-53]

4. Proposed single rate for Japanese yen and related measures

Memorandum
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 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 the military governor.

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The special mission on yen foreign exchange policy recommended that the final rate selected within the requested 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.

3. Balance achieved consolidated budget including provision for Counterpart Fund (Dodge to Voorhees April 2)

4. Since Japanese fiscal year begins April 1 and need adjust certain prices conform reduced subsidies included in budget in light of exchange rate consider desirable announce exchange rate at the 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 obtained by Washington agencies will provide basis your consideration this recommendation. If Telecom deemed necessary expedite matter please request.

[Source: Sutland Papers, 2, 703-53]
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 deceive a degree which would require substantial 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 Japan economy. SCAP’s 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 set should be 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 strong importance of Japanese exchange limits 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:

(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 350 yen and 330 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 as 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 350 yen per dollar.

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 DEP’T Z 732-1]

9-20 PROPOSED SINGLE RATE OF EXCHANGE FOR JAPANESE YEN AND RELATED MEASURES

Meeting No. 122
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 350 yen per dollar.

[Source: U.S. TREASURY DEP’T Z 732-1]
9-22 YEN COUNTERPART OF GARIAO\(^{11}\) AND EROA\(^{12}\) IMPORTS (SCAPIN-1908)

Memorandum

SCAPIN 1908 (ESS/EEX)

April 1, 1949

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 the same amount as the dollar cost of 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.

The Secretary of the Treasury 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 thereafter 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.

The Japanese Government will be permitted to draw from the Fund only such amounts and only for such purposes as may be approved by the Supreme Commander.

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 a proposal 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.

The Secretary of the Treasury for the Allied Powers and appropriate agencies of the Japanese Government within the scope of this memorandum is authorized.

9-23 ECG’S REPORT ON LOCAL CURRENCY COUNTERPART FUNDS

Report

Prepared by: Division of Statistics and Reports and Fiscal and Trade Policy Division, Economic Cooperation Administration

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STATUS OF 5% FUNDS

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\(^{12}\) Economic Rehabilitation in Occupied Areas.
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, 79th 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.
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.

<table>
<thead>
<tr>
<th>Total</th>
<th>(dollar equivalents in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>U.K.</td>
</tr>
<tr>
<td>Jan.</td>
<td>120</td>
</tr>
<tr>
<td>Feb.</td>
<td>259</td>
</tr>
<tr>
<td>Mar.</td>
<td>215</td>
</tr>
<tr>
<td>Apr.</td>
<td>232</td>
</tr>
<tr>
<td>May</td>
<td>452</td>
</tr>
</tbody>
</table>

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 — 100,000,000 Deutsche Marks
- Netherlands — 345,000,000 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 billion at the present rate) in May under the program submitted by the French Government in March, and discussed in the preceding 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:

<table>
<thead>
<tr>
<th>Millions of Schillings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal railways</td>
</tr>
<tr>
<td>Postal and telegraph systems</td>
</tr>
<tr>
<td>Federal forests</td>
</tr>
<tr>
<td>Federal printing office</td>
</tr>
</tbody>
</table>

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 $1,633 million had 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 $36 million, primarily for purchases of strategic materials.
## 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)

<table>
<thead>
<tr>
<th>PURPOSE</th>
<th>TOTAL</th>
<th>PUBLIC LAW 472</th>
<th>PUBLIC LAWS 84 AND 389</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>APPROVED FOR PROGRAM USE</td>
<td>WITHDRAWALS</td>
<td>APPROVED FOR PROGRAM USE</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$2,203.9</td>
<td>$1,682.9</td>
<td>$1,690.8</td>
</tr>
<tr>
<td>MONETARY AND FINANCIAL STABILIZATION</td>
<td>682.1</td>
<td>682.1</td>
<td>609.6</td>
</tr>
<tr>
<td>Debt Cancellation</td>
<td>682.1</td>
<td>682.1</td>
<td>609.6</td>
</tr>
<tr>
<td>PROMOTION OF PRODUCTION</td>
<td>1,319.1</td>
<td>920.4</td>
<td>884.6</td>
</tr>
<tr>
<td>Raw Materials Extraction</td>
<td>289.3</td>
<td>125.5</td>
<td>218.2</td>
</tr>
<tr>
<td>Agriculture, incl. land reclamation and irrigation</td>
<td>171.9</td>
<td>15.3</td>
<td>135.0</td>
</tr>
<tr>
<td>Forestry</td>
<td>1.3</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Coal Mining</td>
<td>116.0</td>
<td>116.0</td>
<td>82.0</td>
</tr>
<tr>
<td>Other Mining and Quarrying</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>24.8</td>
<td>24.8</td>
<td>3.4</td>
</tr>
<tr>
<td>Primary Metals</td>
<td>4.9</td>
<td>4.9</td>
<td>...</td>
</tr>
<tr>
<td>Stone, Clay and Glass Products</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Fertilizer</td>
<td>1.4</td>
<td>1.4</td>
<td>...</td>
</tr>
<tr>
<td>Chemicals and Allied Products</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Petroleum and Coal Products</td>
<td>10.4</td>
<td>10.4</td>
<td>2.7</td>
</tr>
<tr>
<td>Machinery</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Miscellaneous Manufactures</td>
<td>1.5</td>
<td>1.5</td>
<td>...</td>
</tr>
<tr>
<td>Transportation, Communication and Utilities</td>
<td>750.0</td>
<td>579.1</td>
<td>413.9</td>
</tr>
<tr>
<td>Railroads</td>
<td>329.5</td>
<td>217.4</td>
<td>210.2</td>
</tr>
<tr>
<td>Waterways and Harbors</td>
<td>14.0</td>
<td>5.1</td>
<td>9.6</td>
</tr>
<tr>
<td>Merchant and Fishing Fleet</td>
<td>70.5</td>
<td>37.4</td>
<td>49.8</td>
</tr>
<tr>
<td>Roads and Misc. Transportation Facilities</td>
<td>10.3</td>
<td>3.1</td>
<td>9.7</td>
</tr>
<tr>
<td>Communication Facilities</td>
<td>4.7</td>
<td>4.7</td>
<td>2.9</td>
</tr>
<tr>
<td>Electric, Gas Light and Power Facilities</td>
<td>394.2</td>
<td>394.2</td>
<td>137.3</td>
</tr>
<tr>
<td>Water Systems</td>
<td>3.4</td>
<td>3.4</td>
<td>3.4</td>
</tr>
<tr>
<td>Exploration and Development of New Sources of Wealth</td>
<td>39.1</td>
<td>39.1</td>
<td>39.1</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>2.7</td>
<td>2.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Loans to Industry (not elsewhere classified)</td>
<td>14.7</td>
<td>14.7</td>
<td>14.7</td>
</tr>
<tr>
<td>Undistributed Promotion of Production</td>
<td>196.5</td>
<td>139.1</td>
<td>192.6</td>
</tr>
</tbody>
</table>

### 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.
- * Exclusive of temporary deposits required to match conditional aid.
- * Exclusive of $1.2 million advance deposit.
## OTHER PURPOSES

<table>
<thead>
<tr>
<th>Other Purpose</th>
<th>Grant Aid</th>
<th>Counterpart Deposits</th>
<th>Transferred to U.S. Accounts</th>
<th>U.S. Obligations</th>
<th>Admin. &amp; Materials</th>
<th>Statistic Materials</th>
<th>Other</th>
<th>Total U.S. Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction of Public Buildings &amp; Housing Facilities</td>
<td>202.7</td>
<td>71.4</td>
<td>196.6</td>
<td>67.0</td>
<td>6.1</td>
<td>4.4</td>
<td>4.4</td>
<td>634</td>
</tr>
<tr>
<td>Housing</td>
<td>34.1</td>
<td>25.0</td>
<td>29.7</td>
<td>20.6</td>
<td>4.4</td>
<td>4.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Buildings</td>
<td>27.0</td>
<td>18.3</td>
<td>27.0</td>
<td>18.3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Special Relief Projects</td>
<td>7.1</td>
<td>6.7</td>
<td>2.7</td>
<td>2.3</td>
<td>4.4</td>
<td>4.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health and Sanitation</td>
<td>66.3</td>
<td>44.3</td>
<td>64.6</td>
<td>46.3</td>
<td>1.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Care of Refugees</td>
<td>14.5</td>
<td>1.4</td>
<td>16.5</td>
<td>1.4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous Social Services</td>
<td>46.7</td>
<td>39.5</td>
<td>46.7</td>
<td>39.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transportation of Relief Packages</td>
<td>3.7</td>
<td>2.9</td>
<td>2.0</td>
<td>2.0</td>
<td>1.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tourism</td>
<td>14.3</td>
<td>3.0</td>
<td>14.3</td>
<td>3.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan Capital (not elsewhere classified)</td>
<td>20.0</td>
<td></td>
<td>20.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Undistributed Other Purposes</td>
<td>68.0</td>
<td>1.8</td>
<td>68.0</td>
<td>1.8</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 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

<table>
<thead>
<tr>
<th>Country Mission</th>
<th>5% of Total Grant Aid Furnished</th>
<th>5% of Total Counterpart Deposits</th>
<th>Transferred to U.S. Accounts</th>
<th>U.S. Obligations</th>
<th>Admin. &amp; Materials</th>
<th>Statistic Materials</th>
<th>Other</th>
<th>Total U.S. Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>$169,252</td>
<td>$120,022</td>
<td>$38,936</td>
<td>$55,814</td>
<td>3,106</td>
<td>3,439</td>
<td>5,457</td>
<td>$37,080</td>
</tr>
<tr>
<td>France</td>
<td>45,025</td>
<td>37,927</td>
<td>6,097</td>
<td>14,029</td>
<td>3,106</td>
<td>33,439</td>
<td>5,457</td>
<td>5,788</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>36,121</td>
<td>30,604</td>
<td>18,078</td>
<td>25,727</td>
<td>3,443</td>
<td>24,827</td>
<td>17</td>
<td>24,727</td>
</tr>
<tr>
<td>Italy</td>
<td>14,946</td>
<td>11,726</td>
<td>11,726</td>
<td>10,348</td>
<td>923</td>
<td>5,600</td>
<td>3,225</td>
<td>6,748</td>
</tr>
<tr>
<td>Austria</td>
<td>12,604</td>
<td>10,377</td>
<td>1,200</td>
<td>982</td>
<td>65</td>
<td>802</td>
<td></td>
<td>882</td>
</tr>
<tr>
<td>Belgium</td>
<td>10,145</td>
<td>9,437</td>
<td>854</td>
<td>102</td>
<td>55</td>
<td>132</td>
<td>17</td>
<td>182</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10,298</td>
<td>6,514</td>
<td>668</td>
<td>3,637</td>
<td>130</td>
<td>3,506</td>
<td>1</td>
<td>744</td>
</tr>
<tr>
<td>Greece</td>
<td>7,396</td>
<td>5,447</td>
<td>2,000</td>
<td>1,477</td>
<td>1,302</td>
<td></td>
<td>115</td>
<td>1,477</td>
</tr>
<tr>
<td>French Zone</td>
<td>3,594</td>
<td>2,700</td>
<td>52</td>
<td>17</td>
<td>17</td>
<td></td>
<td>115</td>
<td>17</td>
</tr>
<tr>
<td>Denmark</td>
<td>3,506</td>
<td>2,800</td>
<td>130</td>
<td>125</td>
<td>110</td>
<td></td>
<td>13</td>
<td>122</td>
</tr>
<tr>
<td>Trieste</td>
<td>2,896</td>
<td>2,410</td>
<td>172</td>
<td>150</td>
<td>141</td>
<td></td>
<td>9</td>
<td>150</td>
</tr>
<tr>
<td>Belgium</td>
<td>429</td>
<td>480</td>
<td>78</td>
<td>26</td>
<td>21</td>
<td></td>
<td>5</td>
<td>26</td>
</tr>
</tbody>
</table>

### 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 $1,271 thousand advance deposits.
### STATUS OF ITALIAN COUNTERPART FUNDS
#### MAY 31, 1949

<table>
<thead>
<tr>
<th>PUBLIC LAW 472</th>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Billions of lire)</td>
<td>(Millions)</td>
</tr>
<tr>
<td>Deposits in Special Account</td>
<td>134.9</td>
<td>$254.5</td>
</tr>
<tr>
<td>5% Reserved for United States</td>
<td>6.7</td>
<td>11.7</td>
</tr>
<tr>
<td>Balance of 95% for Italy</td>
<td>129.2</td>
<td>222.8</td>
</tr>
<tr>
<td>ECA Approvals for Program Use of 95%</td>
<td>250.0</td>
<td>434.8</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Approved for Program Use but not yet Withdrawn</td>
<td>250.0</td>
<td>434.8</td>
</tr>
<tr>
<td>Promotion of Production</td>
<td>195.6</td>
<td>342.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>70.9</td>
<td>121.7</td>
</tr>
<tr>
<td>Railroads</td>
<td>70</td>
<td>121.7</td>
</tr>
<tr>
<td>Waterways and Harbors</td>
<td>5.1</td>
<td>8.9</td>
</tr>
<tr>
<td>Merchant and Fishing Fleet</td>
<td>15.0</td>
<td>26.1</td>
</tr>
<tr>
<td>Roads and Misc. Transportation Facilities</td>
<td>4.1</td>
<td>7.2</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>0.5</td>
<td>0.9</td>
</tr>
<tr>
<td>Undistributed</td>
<td>31.9</td>
<td>55.5</td>
</tr>
<tr>
<td>Other Purposes</td>
<td>53.4</td>
<td>92.8</td>
</tr>
<tr>
<td>Housing</td>
<td>3.8</td>
<td>6.7</td>
</tr>
<tr>
<td>Health and Sanitation</td>
<td>7.6</td>
<td>13.1</td>
</tr>
<tr>
<td>Tourism</td>
<td>8.0</td>
<td>13.9</td>
</tr>
<tr>
<td>Undistributed</td>
<td>34.0</td>
<td>60.1</td>
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</table>

<table>
<thead>
<tr>
<th>PUBLIC LAWS 84 AND 389</th>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT*</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECA Approvals for Program Use</td>
<td>53.0</td>
<td>92.2</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>28.0</td>
<td>48.7</td>
</tr>
<tr>
<td>Purpose of Withdrawals:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotion of Production:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Railroads</td>
<td>28.0</td>
<td>48.7</td>
</tr>
<tr>
<td>To be Withdrawn</td>
<td>25.0</td>
<td>43.5</td>
</tr>
<tr>
<td>Promotion of Production</td>
<td>24.0</td>
<td>41.8</td>
</tr>
<tr>
<td>Agriculture</td>
<td>20.0</td>
<td>34.8</td>
</tr>
<tr>
<td>Merchant and Fishing Fleet</td>
<td>4.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Other Purposes:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Misc. Social Services</td>
<td>1.0</td>
<td>1.7</td>
</tr>
</tbody>
</table>

* 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

<table>
<thead>
<tr>
<th>PUBLIC LAW 472</th>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Billions of drachmai)</td>
<td>(Millions)</td>
</tr>
<tr>
<td>Deposits in Special Account</td>
<td>1,169.4</td>
<td>$116.9</td>
</tr>
<tr>
<td>5% Reserved for United States</td>
<td>58.5</td>
<td>5.8</td>
</tr>
<tr>
<td>Balance of 95% for Greece</td>
<td>1,110.9</td>
<td>111.1</td>
</tr>
<tr>
<td>ECA Approvals for Program Use of 95%</td>
<td>1,300.0</td>
<td>130.0</td>
</tr>
<tr>
<td>Withdrawals—Total</td>
<td>925.5</td>
<td>92.5</td>
</tr>
<tr>
<td>Temporary Advances</td>
<td>18.2</td>
<td>1.8</td>
</tr>
<tr>
<td>For Country Use</td>
<td>910.3</td>
<td>91.1</td>
</tr>
<tr>
<td>Purpose of Withdrawals:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotion of Production</td>
<td>272.4</td>
<td>27.2</td>
</tr>
<tr>
<td>Agriculture</td>
<td>38.0</td>
<td>3.8</td>
</tr>
<tr>
<td>Forestry</td>
<td>5.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Railroads</td>
<td>10.2</td>
<td>1.0</td>
</tr>
<tr>
<td>Waterways and Harbors</td>
<td>6.8</td>
<td>0.7</td>
</tr>
<tr>
<td>Road and Misc. Trans. Facilities</td>
<td>25.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Water Systems</td>
<td>34.4</td>
<td>3.4</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>1.4</td>
<td>0.1</td>
</tr>
<tr>
<td>Undistributed</td>
<td>144.8</td>
<td>14.5</td>
</tr>
<tr>
<td>Other Purposes:</td>
<td>637.9</td>
<td>63.9</td>
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<tr>
<td>Housing</td>
<td>183.0</td>
<td>18.3</td>
</tr>
<tr>
<td>Public Buildings</td>
<td>23.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Health and Sanitation</td>
<td>13.9</td>
<td>1.4</td>
</tr>
<tr>
<td>Care of Refugees</td>
<td>394.6</td>
<td>39.5</td>
</tr>
<tr>
<td>Misc. Social Services</td>
<td>19.6</td>
<td>2.0</td>
</tr>
<tr>
<td>Transportation of Relief Packages</td>
<td>1.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Tourism</td>
<td>2.6</td>
<td>0.3</td>
</tr>
<tr>
<td>To be Withdrawn:</td>
<td>389.7</td>
<td>38.9</td>
</tr>
<tr>
<td>Promotion of Production</td>
<td>3.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1.3</td>
<td>0.1</td>
</tr>
<tr>
<td>Forestry</td>
<td>1.5</td>
<td>0.2</td>
</tr>
<tr>
<td>Misc. Manufactures</td>
<td>3.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Waterways and Harbors</td>
<td>4.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>1.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Other Purposes</td>
<td>360.6</td>
<td>36.6</td>
</tr>
<tr>
<td>Housing</td>
<td>20.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Public Buildings</td>
<td>4.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Care of Refugees</td>
<td>71.9</td>
<td>7.2</td>
</tr>
<tr>
<td>Tourism</td>
<td>6.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Loan Capital (n.a.c.)</td>
<td>200.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Undistributed</td>
<td>85.6</td>
<td>8.9</td>
</tr>
</tbody>
</table>

* Rate: 100,000 drachmai to U.S. dollar.

**Exclusive of $3 billion drachmai transferred from PL 84 and applied to withdrawals (less than $50,000).
### Status of U.K. Counterpart Funds

**May 31, 1949**

<table>
<thead>
<tr>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Thousands of pounds)</td>
<td>(Millions)</td>
</tr>
<tr>
<td><strong>Public Law 472</strong></td>
<td></td>
</tr>
<tr>
<td>Deposits in Special Account</td>
<td>150,850</td>
</tr>
<tr>
<td>5% Reserved for United States</td>
<td>7,544</td>
</tr>
<tr>
<td>Balance of 95% for United Kingdom</td>
<td>143,346</td>
</tr>
<tr>
<td>ECA Approvals for Program Use of 95%</td>
<td>113,983</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>113,515</td>
</tr>
<tr>
<td>Purpose of Withdrawals: Debt Cancellation</td>
<td>113,450</td>
</tr>
<tr>
<td></td>
<td>Technical Assistance</td>
</tr>
<tr>
<td>Other Purposes: Transportation of Relief Packages</td>
<td>48</td>
</tr>
<tr>
<td>To be Withdrawn: Promotion of Production</td>
<td>438</td>
</tr>
<tr>
<td></td>
<td>Strategic Materials</td>
</tr>
<tr>
<td></td>
<td>Technical Assistance</td>
</tr>
</tbody>
</table>

¹ Rate: $1.03 per £1.

### Status of Austrian Counterpart Funds

**May 31, 1949**

<table>
<thead>
<tr>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Millions of Schillings)</td>
<td>(Millions)</td>
</tr>
<tr>
<td><strong>Public Law 472</strong></td>
<td></td>
</tr>
<tr>
<td>Deposits in Special Account²</td>
<td>2,075.6</td>
</tr>
<tr>
<td>5% Reserved for United States</td>
<td>103.8</td>
</tr>
<tr>
<td>Balance of 95% for Austria</td>
<td>1,971.5</td>
</tr>
<tr>
<td>ECA Approvals for Program Use of 95%</td>
<td>400.0</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>400.0</td>
</tr>
<tr>
<td>Purpose of Withdrawals: Debt Cancellation</td>
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</tr>
<tr>
<td>Promotion of Production</td>
<td>275.0</td>
</tr>
<tr>
<td>Forestry</td>
<td>4.3</td>
</tr>
<tr>
<td>Mines &amp; Minerals</td>
<td>2.0</td>
</tr>
<tr>
<td>Railroads</td>
<td>110.8</td>
</tr>
<tr>
<td>Communication Facilities</td>
<td>26.6</td>
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<tr>
<td>Loans to Industry (n.e.c.)</td>
<td>120.3</td>
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**Public Laws 84 and 389**

<table>
<thead>
<tr>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Millions of Kroner)</td>
<td>(Millions)</td>
</tr>
<tr>
<td><strong>Public Law 472</strong></td>
<td></td>
</tr>
<tr>
<td>Deposits in Special Account</td>
<td>288.9</td>
</tr>
<tr>
<td>5% Reserved for United States</td>
<td>14.1</td>
</tr>
<tr>
<td>Balance of 95% for Norway</td>
<td>265.0</td>
</tr>
<tr>
<td>ECA Approvals for Program Use of 95%</td>
<td>210.0</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>210.0</td>
</tr>
<tr>
<td>Purpose of Withdrawals: Debt Cancellation</td>
<td>210.0</td>
</tr>
</tbody>
</table>

¹ Rate: 10 schillings to U.S. dollar.

² 50-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

<table>
<thead>
<tr>
<th>PUBLIC LAW 472</th>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Millions of DM)</td>
<td>(Millions)</td>
</tr>
<tr>
<td>Deposits in Special Account¹</td>
<td>377.5</td>
<td>$188.7</td>
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<tr>
<td>5% Reserved for United States</td>
<td>18.9</td>
<td>9.4</td>
</tr>
<tr>
<td>Balance of 85% for Bizon</td>
<td>259.6</td>
<td>179.3</td>
</tr>
<tr>
<td>ECA Approvals for Program Use of 95%</td>
<td>2.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Other purposes: Trans. of Relief Packages</td>
<td>2.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Purpose of Withdrawals:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total:</td>
<td>2,1</td>
<td>1,1</td>
</tr>
</tbody>
</table>

¹ Temporary rates: 2 Deutsche Marks (DM) to U.S. dollar.
² These deposits were €43.6 including 63.6 conditional aid.

STATUS OF TRIESTE COUNTERPART FUNDS
MAY 31, 1949

<table>
<thead>
<tr>
<th>PUBLIC LAW 472</th>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Billions of lire)</td>
<td>(Millions)</td>
</tr>
<tr>
<td>Deposits in Special Account²</td>
<td>5.5</td>
<td>$9.6</td>
</tr>
<tr>
<td>5% Reserved for United States</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Balance of 95% for Trieste</td>
<td>5.4</td>
<td>9.2</td>
</tr>
<tr>
<td>ECA Approvals for Program Use of 95%</td>
<td>7.4</td>
<td>12.9</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>5.2</td>
<td>9.0</td>
</tr>
<tr>
<td>Purpose of Withdrawals:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotion of Production</td>
<td>5.2</td>
<td>9.0</td>
</tr>
<tr>
<td>Misc. Manufacturing</td>
<td>3</td>
<td>.5</td>
</tr>
<tr>
<td>Merchant &amp; Fishing Fleet</td>
<td>.6</td>
<td>8.5</td>
</tr>
<tr>
<td>Other purposes: Trans. of Relief Packages</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To be Withdrawn:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotion of Production: Undistributed</td>
<td>2.2</td>
<td>3.9</td>
</tr>
</tbody>
</table>

¹ Rate: 575 lire to U.S. dollar.
² Includes 700 million lire advance deposit.
³ Less than 0.05 billion lire.

STATUS OF DANISH COUNTERPART FUNDS
MAY 31, 1949

<table>
<thead>
<tr>
<th>PUBLIC LAW 472</th>
<th>LOCAL CURRENCY</th>
<th>DOLLAR EQUIVALENT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Millions of Kroner)</td>
<td>(Millions)</td>
</tr>
<tr>
<td>Deposits in Special Account</td>
<td>231.2</td>
<td>$48.2</td>
</tr>
<tr>
<td>5% Reserved for United States</td>
<td>11.6</td>
<td>2.4</td>
</tr>
<tr>
<td>Balance of 95% for Denmark</td>
<td>219.7</td>
<td>45.8</td>
</tr>
<tr>
<td>ECA Approvals for Program Use of 95%</td>
<td>.1</td>
<td>*</td>
</tr>
<tr>
<td>Withdrawals</td>
<td>.1</td>
<td>*</td>
</tr>
<tr>
<td>Purpose of Withdrawals: Technical Assistance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total:</td>
<td>231.4</td>
<td>48.4</td>
</tr>
</tbody>
</table>

¹ Rate: 4.79991 Kroner to U.S. dollar.
² 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 Docher Mission policy for the use of the Counterpart Fund is that it is a stabilization fund to be used (1) to relieve the stingency 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 is for private investment that there is plenty of capacity to meet such demands. The use of the fund for these purposes is subject to some reluctance as it was felt that the Japanese economy is not characterized by a general shortage of capacity and that any need 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 Docher 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 Docher 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 held 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 work, railway and other lines of development as are 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 highly 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 Distributions and Labor Division, it appears that it is the consensus 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 deflationary 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 become evident. 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. Government obligation 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. Further borrowing of bank funds or for private financing. If the funds in the economy may require for and financing exports under any program of delayed payments for exports.

d. Investment in critical private enterprise. $25 billion

Electric power 10 billion
Shipping 4 billion
Iron and steel 2 billion
Coal 4 billion
Miscellaneous 5 billion

In connection with Mr. Morrow’s recommendation for use of funds for financing exports it is pointed out that $60 billion of capital subscription to the Foreign Trade Fund is included in this year’s budget which will be used in part for that 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 and 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 reducing the fund into operation on a basis 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 purposes the program be announced as SCAP policy to relieve the uncertainties in the minds of Japanese business men as to when the fund will play in their own or competing enterprises.

SOURCE: SUTLAND PAPERS, 2,720-2

9-25 GOVERNMENT AND RELIEF IN OCCUPIED AREAS ECONOMIC REHABILITATION IN OCCUPIED AREAS FISCAL YEAR 1950

Report

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 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 Law 17 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 stability and military necessity, 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 developed by war, with no wartime trade contracts, and with extremely limited means to procure 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 achieve economic recovery and thereby achieve effective recovery and thereby to achieve effective recovery.

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 benefited for the first time to recover with the passage of the Economic Cooperation Act of 1948. P.L. 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 purpose 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 is yet 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 economies independent of 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, for purposes of administrative purposes, as a separate purpose of the funds such as those appropriated to the Department of the Army for Government and Relief in Occupied Areas might be expended “for the purpose 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.”

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 Bizon 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 for the minimum obligations of the occupation 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 power, 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
AID AND TRADE

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 in the administration of the Fiscal Year 1949 ECA aid 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 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, which in primitive barter arrangements took the place of the normal methods of exchange, flourished. Nearly every type of good domestic crops and a sizable accumulation of coal stocks due to unusually mild winter were the only bright spots in an otherwise discouraging economic outlook. The change in the Bizonal economic prospects of the country was clearly demonstrated 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 means to carry it out.

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 inhabitants of the area. At the beginning of the occupation 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 materials required to promote economic recovery. While support 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 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.

The drastic currency reform was announced in June 1948. The new currency unit, the Deutcher Mark, was fixed at an average rate of 1.1 to the old Deutsch Mark 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 essential goods, passed into law, and in the following month the way for an increase of the minimum food rations was opened by the fact that the price received for each 100 Mark rose to 80 percent of the price which was paid for each Mark. The new currency and the currency reform were the immediate cause of a noticeable acceleration in the rate of increase of industrial production in July and August. 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 $1 billion of the aid for Fiscal Year 1949 for ECA aid. This estimate included the $550 million for the Bizonie 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 1948 GARIOA request to $587 million. Subsequent revisions in both the GARIOA and ECA programs in September and December of 1948 could take into account the impressive revival of Bizonie industrial production and exports and the actual harvest of the 1948-1949 season, so that the revised 1949-1950 request of $537 million for ECA aid is only $61 million above the original estimate or nearly $200 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. The Japanese economy had 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, is providing minimum relief assistance. It has been furnishing food and other relief supplies to keep the Japanese people alive. These costs amount to nearly $400,000,000,000 for the fiscal year ending March 31, 1949.”

As noted previously the Congress subsequently approved the use of part of the total funds ($1.5 billion) appropriated to the Department of the Army for relief and recovery in the occupation area. A recovery program in Japan was not, however, initiated until the Fiscal Year 1949 aid was available. 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. Japan’s share has been in fact about $74 million on the allowance of the Industrial production data was provided by the United States, which was calculated by the International Labor Organization. The improvement in the Japanese economy was reflected in a noticeable acceleration in the rate of increase of industrial production in Japan since the inception of the EROA program. The index of industrial production for the first quarter of 1949, which was below the 1930-34 level during the last quarter of calendar year 1948, increased by 56 percent over the average for the first quarter of the year. Preliminary estimates indicate that the increases have been more than have been observed in the Bizone. The increase was a result of the fact that the dollar aid received or a rapid increase 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 1948, 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 twice those reported for the first quarter of the year (a monthly average of approximately $30 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 ($160 million).

The progress achieved in Japan in the past year, limited as it was by inadequate total funds

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and the lateness of the 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 are available in the United States 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 implements, medical supplies), for the transportation thereof, for administrative costs connected with the supply program and 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 66 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 2 and 4 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 crops will be paid for from non-GARIOA funds, expenditures for agricultural supplies will decline from 10 percent of the total budget in FY 1948 to less than 2 percent in FY 1950. The foods requested for Japan will be spent approximately as follows: food 50 percent, clothing 33 percent, medical supplies and POL 17 percent, with the balance going to reorientation projects, military 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 Ryukyu 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 occupation 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 than the reduced 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 Ryukyu), 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 resources to furnish the 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 commodities to other Asiatic countries and even to the Latin American and West European markets of the Western Hemisphere. Earnings from these exports, supplemented by those from her merchant fleet, more than sufficient 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 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-sufficiency 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, concepts which most Asiatic countries lack. The reduction in market outlets for her textiles and consumer goods can be made up through expansion of her heavy industries. Subsequent expansion, of course, be subject to the limitations on prohibited and restricted industries which have been imposed to curb her war potential.

Last year the Congress approved the inauguration of a recovery program in Japan, Korea, and the Ryukyu Islands, when it granted the Army Department permission to use funds appropriated for the Korean program. This program, if continued, 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 Bizonale could be fully appraised, an additional $50 million was transferred to the recovery programs of the Pacific zone. Japan’s share was raised to $188 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 orderly. Economic conditions during the past year have not 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 million tons for the past six 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 75% of the 1930–1934 level. Experts during FY 1949 should be about $400 million in value, more than double the amount in the previous year. The economy is, however, and will continue to be, characterized by lack of raw materials, special consumer goods, and other industrial goods. Further improvement in this critical material can be made available—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 on 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 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 on the assurance that materials purchased therewith will aid in 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 useful 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 inputs.

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 presence 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 anxiety towards Japan and Japanese products has been dispelled 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, while consuming only a minor part 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, FLR loans, and proceeds of exports) total $39 million.

Based on the premise that it is a needed Measure, the $116 million authorized 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 provide (a) an abundance of employment to export industries of Japan and (b) continue to provide for the original output in raw materials, and (c) the initiation of a regular cycle of import-export activity.

The objectives here set for FY 1950 are attainable. Their achievement would mean more stability and political and economic conditions within Japan and a substantially increased measure of self-support and security. 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 Ryukyus

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 750 miles in a northeast-southwest direction between Formosa and Japan. The group comprises some 150 of the archipelago which only 30 are inhabited. Okinawa, the largest of these islands, contains approximately 60 percent of the estimated 900,000 native population. Most of this 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.

Before statistics on Ryukyu export trade and other external receipts cannot be completely separated from those for Japan proper. It appears, however, that the Ryukyu 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 sea foods 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: DoD Papers, Detroit Public Library]

9.26 ESS Memo on Use of Counterpart Fund

Memorandum

By: ESS

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-62899, Dodge to Voorhees, 22 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 are 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:

"Believe SCAP procedures 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 (a) attainment by Japanese Government and bank 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."

"II. Counterpart Fund is included in budget in sum of 175,000 million yen of which 27,000 million yen is recommended for public investment (railways 27,000 million yen and communications, 12,000 million yen). Of the balance of 148,000 million yen is recommended for public investment (railways 27,000 million yen and communications, 12,000 million yen)."

*The author is not indicated.*
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In order to achieve a disinflationary impact in Japan, it is necessary to utilize the SCP (Special Committee on Price Stability) to control the general economic situation and to achieve a disinflationary impact. The main purpose will be to achieve a disinflationary impact by reducing the yen's value in the exchange rate. The yen's value is currently at around 150 yen to the dollar. If the yen were to be reduced to the level of 100 yen to the dollar, this would result in a decline in the yen's value by about 30%. This would allow for a more competitive export sector, which is currently suffering from a lack of competitiveness due to the strong yen. The reduction in the yen's value would also lead to an increase in the competitiveness of the Japanese export sector, which would help to boost exports and stimulate economic growth. Overall, reducing the yen's value is a necessary step to achieve price stability in Japan.

9-27 BOJ'S VIEWS CONCERNING FOREIGN EXCHANGE RATE

Letter of Opinion
October 8, 1949

Submit to: W. J. Logan and General Marquet
By: Bank of Japan

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 considered 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 equilibrated budget based upon the Dodson Plan and the establishment of the single foreign exchange rate. The rationalization was, therefore, 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 currency with minimum volume of each expenditure will have to be made by the Japanese Government to SCAP.

Radio C-6855, SCAP to DA, 7 May 1949:
"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 1980 (1 April) to establish a U.S. Aid Counterpart Fund for Japanese Stabilization which would be administered under strict SCP control for the general purpose of debt retirement, investment in government enterprises and public critical 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 controls.
b. Achievement by recipients of funds of scheduled production goals and improved efficiency levels.

Although present intent is to utilize the recipients potential to achieve a disinflationary impact its main purpose will be to provide the SCP with an instrumentality of control of the general economic situation as the situation may dictate advisable.

b. 27 billion yen will be used for self-sufficing investments in government enterprises (15 billion yen for railroads and 12 billion yen for communications).

Radio C-6855, 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 SCP supervision for investment in government enterprises, such as railways and communications, private industries, and debt retirement. The initial volume of each expenditure will have to be made by the Japanese Government to SCAP."
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 specifically as possible.

[Source: Dodge Papers, Detroit Public Library]

9-28 RECOMMENDATIONS AND FINDINGS OF THE ADVISORY MISSION FOR INTERNATIONAL TRADE (FREILE REPORT)

Report* 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. Immerse 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 from 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 communities from 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. Marquet 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.

Accordingly, the following personnel was designated to constitute the Mission:

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Michael Lee</td>
<td>Department of Commerce</td>
</tr>
<tr>
<td>Norman P. Davis</td>
<td>Federal Reserve Bank of N.Y.</td>
</tr>
<tr>
<td>Edward W. Doherty</td>
<td>State Department</td>
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<tr>
<td>John F. Shaw</td>
<td>State Department</td>
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<tr>
<td>Arthur W. Stuart</td>
<td>Treasury Commission</td>
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<tr>
<td>Patrick Henry</td>
<td>Tariff Commission</td>
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<tr>
<td>Derek Brooks</td>
<td>Department of Commerce</td>
</tr>
<tr>
<td>John Judge</td>
<td>Department of Commerce</td>
</tr>
<tr>
<td>Mabel Eads</td>
<td>Department of Commerce</td>
</tr>
<tr>
<td>Eleanor Crosby</td>
<td>Department of Commerce</td>
</tr>
</tbody>
</table>

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.

As a result of the activity of the Mission, the Chairman requested Major General W. F. Marquet, 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 cumbersome documentation.
3. Maximization of foreign exchange earnings, with due regard to flight of capital and problems of dumping.
4. Stabilization of export prices.

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, much 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.

The 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.
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

It is recommended that Government participation in foreign trade operations 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 a report of the Department of Finance, June 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 Government departments and carried on Governmental stock, and is not available 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 the 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 import licenses for Government account should not be adopted. The proponents of these measures argue that the function of the Foreign Exchange Funds Divisions 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.

One 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, 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 deprecation of raw materials and foreign exchange.

EXPORTS

The present export procedures were efficient and safeguarded 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. Governmental 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.

3. 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 admirably 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 two 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 records of foreign exchange will be required since a 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.

TRADE PROMOTION

The most important requisite to expansion of Japanese foreign trade is its transfer from Government control to the private sector. 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.

In summary, if from the viewpoint 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, the Japanese government can be made in analysis of markets, sales promotion, and acquisition of industrial techniques for the time being.

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 to be certified by the United States Price and 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
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.

**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 its 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 unsalable merchandise, loss of foreign exchange proceeds therefrom, myriad claims and counterclaims, and mounting retenue 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.

**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 importers, barter (bilateral), 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 procedures are such that a given commodity on condition that a given commodity is imported by a given importer will be released for payment.

*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 the contract has been approved and a letter of credit has opened. The letter of credit will be 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 carth 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 of credit 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 transaction the bank is paid for export credit that is held by the bank in effect, the recipient purchases the currency to which it is entitled by the beneficiary’s exporting purchase. Egyptian cotton is also an example of a commodity purchased under escrow.

*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

**REPLACEMENT OF FOREIGN TRADE PAYMENT CERTIFICATES WITH YEN**

The inflexibility and inconvenience of the Foreign Trade Payment Certificate has led to...
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 restablished commonwealth SCA P opens a letter of credit which is credited or debited to the appropriate SCA P commercial account in accordance with normal banking procedures. An example of a trade arrangement providing for handling 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."

**Exhibit to which Various Trading Methods are Used:** An analysis of SCA P'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 SCA P 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 sent atton one SCA P account provided for by the arrangement is the second most widely used. 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 limited because trade is conducted outside a planned plan. The following table sets forth an analysis of the contracts let under these various methods.

### Table 1

**ANALYSIS OF SCA P'S TRADING METHODS AS A PERCENTAGE OF THE VALUE OF APPROVED CONTRACTS**

<table>
<thead>
<tr>
<th>TRADE METHOD</th>
<th>UNDER TRADE ARRANGEMENTS IMPORTS</th>
<th>EXPORTS</th>
<th>WHERE NO TRADE ARRANGEMENT EXISTS IMPORTS</th>
<th>EXPORTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Back to Back</td>
<td>4.3%</td>
<td>1.5%</td>
<td>1.6%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Escrow L/C</td>
<td>3.4%</td>
<td>2.2%</td>
<td>20.2%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Open Account</td>
<td>33.3%</td>
<td>20.5%</td>
<td>78.2%</td>
<td>96.1%</td>
</tr>
<tr>
<td>Cash/Ltr of Credit</td>
<td>58.9%</td>
<td>75.8%</td>
<td>78.2%</td>
<td>96.1%</td>
</tr>
</tbody>
</table>

1. This does not include purchases exercised by U.S. appropriated funds.

**Recommendations:** The trade methods which are being utilized by SCA P 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 current policy objectives of the United States may assist those individuals who are responsible for the future conduct of the foreign trade of Occupied Japan.

As a result of continuing study, the Mission has prepared a table with the assistance of SCA P to bring its foreign trade operation into closer conformity with the commercial policy of the United States. The table can be expected to help 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.

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9-29 REPORT ON EXCHANGE AND TRADE CONTROLS IN JAPAN

November 18, 1949

To: General MacArthur
From: J. V. Mlake 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 Mission has been to assist the authorities in establishing exchange and trade controls in Japan.

As a result of its study, 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 Forces for the invitation to visit Japan. It also wishes to express its appreciation to Major General W. F. Marquart and his staff for their cooperation and assistance which have greatly facilitated the work of this Mission.

Sincerely yours,

JAN V. MLADEK

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1. 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 has been emphasized that the Mission would present 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 resulted from these decisions 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 concerning 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 details in 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 best suited 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 underwritten 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 that the Mission have recommended 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-sustaining economy, the Mission has taken the position that system of exchange controls is needed in Japan. It feels that the system of foreign exchange controls in 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 the system is well run. 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 system.

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. It should provide a special fund which might be used in the event of any new 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 sterling and other hard currencies 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 amount may be, and 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 for Japan to have a system of foreign trade. However, it is felt that full consideration should also be given to the fact that it may become necessary to exchange certain payments 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 effectively in many ways with or without such arrangements.

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 its current obligations. It is recommended that the authorities should give serious thought to the general field of investments on the balance of payments and make a strenuous effort to avoid the danger of promoting a balance of payments policy which would not be consistent with the earning power of the foreign exchange of the country in the immediate future.

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 domestic 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 ministers overstepping the budget or other jurisdictional limitations. It is suggested, in this respect, 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 applying for licenses and import quotas, and the principle of the payment of a fee by the importer, guaranteeing in effect that appeal of 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 it may be given to the recipients of the report in a confidential manner.

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.

The Mission has already indicated in the course of discussions with various SCAP officials that it favors 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 possible that the functions of some of the 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.

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 Ministry should rest with the President of the Ministry. The Mission feels that this would be most desirable, and that 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 Ministry, 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. Practically all countries the central banks are governmental agencies and is responsible to the Ministry of Finance. It has been suggested on the SCAP side that FECC should assume the responsibilities for the operations of the exchange control system. Again the question of ministerial jurisdiction arises. FECC 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 responsibilities of the Prime Minister.

It is the impression of the Mission that FECC 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, devoted to watch the moral aspect of the exchange controls, would be worth having in Japan. However, such an agency should not be an operative agency. If the FECC is a controlling and auditing body, then it's 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 market and of the export 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: John W. Dodge

In considering the particular consideration of the FY 51 appropriation for Japan, I believe the following basic factors deserve particular consideration:

1. Present, Japan is the focal point of our established Far Eastern interests. While some point 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 an amount of aid nearly four times 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. I do not know the substantial progress that has been made in Japan in 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. However, a substantial increase in exports and economic recovery has proceeded at a heartening pace and is now at almost the least of the Prime Minister.

It is the impression of the Mission that FECC 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, devoted to watch the moral aspect of the exchange controls, would be worth having in Japan. However, such an agency should not be an operative agency. If the FECC is a controlling and auditing body, then its jurisdictional responsibility and straight line of report to the Prime Minister is justified.

6. 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 market and of the export 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

AID AND TRADE 663
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.

11. The present Japanese government is in the process of implementing policies to increase 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 consumption. The government is of the view that an increase in the purchasing power of wages would control the situation, to insure political stabilization, labor stabilization, and a continuing economic and democratic reconstruction. Invariably, the reply came for some increase in food and cotton goods availability.

12. 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 believed that a full substitution could be made. The present indications are that this cannot be done as the official ration plus other purchased foodstuffs which, on the average absorb 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 food 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 30 per cent of pre-war in fiscal 51. The pre-war domestic cotton consumption of Japan was approximately seven pounds per capita, whereas the budget proposal brings this up to 3.4 or about half that level.

13. To summarize, the internal stabilization, politically and economically, depends substantially on effectively increasing the real value of wages and reducing black market prices which would drive wages down and thereby drive wages up. The pressure on wage increases and drive 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 found in the stabilization of the economy. To reduce the adoption below the amount finally submitted for your consideration would be to run a serious danger of defeating the stabilization of date, to which have been carried out in 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. Marquet

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 as follows:

1. Providing U.S. dollars for developing projects in Southeast Asia with or without the earmarking of such funds for the purchase of Japanese goods.

2. Diverting GARIOA funds for aid in Southeast Asia countries, probably by using counterpart funds for such purposes.

3. Substituting for GARIOA an authorization to permit Japan to purchase U.S. goods with yen which, if approved, would be appropriated by the U.S. Congress for aid to Southeast Asia.

4. All four of the suggestions are workable, provided appropriations are of adequate 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, the Japanese aid from OPAIOA aid for the fiscal years 1953-54 has a strong impact on the country from both the standpoint of dollar aid and yen aid. Moreover, if the five billion yen aid were increased and repaid by the countries of Southeast Asia. Third, it is a minor modification of the present American aid program for Japan, providing only for the extension of yen credits to Southeast Asia countries. What is most important is the ability of the present aid program, and on the basis of the present aid program and program 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. Plan 3 has 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 goods can only increase the yen credits, building long-range projects and such 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. 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 international 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 international 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 show that the credit will be a future source of increased in future Government and can be repaid within a period of time definite in terms of 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 SCAPs encouraging the U.S.) approval for each counterpart 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 need for a fairly intensive collaboration between the Washington, SCAP, the Japanese Government, and the Japanese supplier. Plan 3 would in fact be consistent with SCAPs delegated authority and thus facilitate the handling of the situation.

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 Plan 1 or 2 under appropriate conditions. In fact, the same project in Southeast Asia could have been similarly used to purchase Japanese aid. Thus, the need for Plan 3 in the latter case could be turned in Plan 4 in the case where Plan 2 being used to provide funds for consumer goods from external sources. Very large development projects carry the threat of inflation in a country with limited supplies of consumer goods and capital. Indirect inflation 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:

Plans 1, 2 and 4 shift the focus of attention from Japan to Southeast Asia, while the U.S. should direct a greater portion of its overall aid to other areas. While Japan must be considered as a vital ally in the Far East, Japan's war reparations should be taken into consideration.

It is very important 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 the United States, British, and European countries for the former to buy from the latter and to buy from the latter on the basis of buying more than they need, including shares 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 with less restrictive Japan might reestablish Manchurian and Chinese trade. The Chinese themselves are strong American trade. The primary difficulty is that Plan 4 puts in Japan’s hands the key decision—of the quantity of goods to be procured in the U.S.—even though it provides for U.S. appropriations of amounts tailored for American goods.

It is probably 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, 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 $1 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 financial 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. The Plan 4 should be prepared for the later, post-treaty period. The adoption of Plan 3 should include 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: SUTLAND 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. Indeed, the export surplus, not only of certain consumption and semi-consumption products but also of exports of equipment and heavy machinery that will help fulfill the productive 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 credits to exporters of capital equipment subject to the possible delay 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.

In this regard, the Japan Government (JGF) has agreed to the establishment of an Export Finance Bank. The JFY 1950 Supplementary Budget will provide a Y2.5 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 Y5 billion will be established for the Bank.

It is planned to appropriate Y5 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 Y15 billion.

The Bank will not have access to the private banking system 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 functions 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 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: SUTLAND PAPERS]

9-33 FOREIGN ECONOMIC POLICIES (GRAY REPORT)∗

Report to the President

Prepared by: Gordon Gray, Special Assistant to the President

Published by: U.S. Government Printing Office

November 10, 1950

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 our 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

∗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.

The events, well under way when conditions were drastically changed by the aggression in Korea and the subsequent decision 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; the over-all economic problem is not to achieve any specific objective with respect to 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 programming in the foreign economic field. In view of the uncertainties which entered into the picture and the time available to me, I was impossible to arrive at final judgments with respect to many program matters, particularly those requiring a quantitative estimate.

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.

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 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.

Staff
Felix Belair, Jr.
Theodore W. Braun
Kermit Gordon
G. Griffith Johnson
H. H. Kaufmann
Raymond F. Mikkelsen
Walter S. Salant
Ralph N. Stoul
Philip H. Trezise

E. JAPAN

The economic position of Japan is analogous, in many of its aspects, to that of the United Kingdom and some other Western Europe. A relatively highly industrialized na
tion 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 United States aid 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 one of the highest in the world, and industrial activity in general is flourishing; while in 1951 the energy level was at 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 1).

Aid and Trade

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 market
ing and production problem rather than a market problem. In Japan's case economic recovery in the past, 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 in the market. The problems were all available; although the 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 in 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 pertinent 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. At the same 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 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 78 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 a growth of 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. Furthermore, Japan could therefore be 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 primarily be of benefit to the large 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 consumer goods needed for economic 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 the necessary economic resources and giving maximum use to her industrial potentialities, 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 benefit.

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 mechanization 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 the process of becoming more concrete and thus will demand further clarification 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 the important social factors a sound living condition can engender. The existence of a suspicion that Japan's economy might dump its cheap labor in the international market.

3) A well-balanced operation of national economy.

Any attempt 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 fall order from breaking the harmonious operation of Japan's national economy and ensure its continuous and ever-growing contribution.

4) About the economic control.

The 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. In tolerable hardship of life and other various unpleasant measures, there remain any margin in public mind, while they are faced with the frightful fact that the post-war economic stabilization has disproved the communist agitation when shops are flooded with goods as a result of progressive decontrol measures. Hence it is not surprising 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, 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: Eiken Sengo Shugi, Vol. 20 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 temporary 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 the 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 is fostered. 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.


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 summary of shipments which were prepared.

The major components making up United States postwar economic assistance to Japan are set forth in the tabulation below. OPLC 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) 129,173,671.00
Diverted Military Stocks 59,972,515.00 $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 40,555.080.00
Less Reacquisition and Storage 15,548,368.50 25,110,698.50

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. On May 29, 1954, the Japanese representatives submitted a detailed questionnaire concerning the data presented by the United States.

3. On July 1, 1954 the United States representatives replied to the Japanese questionnaire explaining the method of obtaining the GARIOA figures.

4. 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.

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.

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 principle should be $500 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 relanced 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.

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.

On August 28, 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.

On May 6, 1955, Ambassador Allison, in a letter to Minister of Foreign Affairs Momoru 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 payment 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 2½/3 per cent, in twenty-five annual installments, beginning July 1, 1955.

A copy of Ambassador Allison's letter is attached.

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: Ghoso Suido Papers, Finance Ministry]
10 FINANCE

10-1 IMPERIAL HOUSEHOLD PROPERTY (SCAPIN-300)

Memorandum
September 1, 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
By: Public Finance Division, ESS, SCAP
January 1946

Table 2

<table>
<thead>
<tr>
<th>Type of Asset</th>
<th>Appraised Value*</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>¥ 33,043,900</td>
<td>Cash 2</td>
</tr>
<tr>
<td>Bonds, Stocks &amp; Debentures</td>
<td>311,096,377</td>
<td>19</td>
</tr>
<tr>
<td>Land</td>
<td>393,974,669</td>
<td>23</td>
</tr>
<tr>
<td>Standing Timber</td>
<td>592,850,099</td>
<td>35</td>
</tr>
<tr>
<td>Buildings &amp; Structures</td>
<td>312,239,475</td>
<td>19</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>33,075,671</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>¥1,675,265,675</td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

*September 1945 yen value.

[Source: NAMA (§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

Concurrence: 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.
   e. Total food supplies, particularly rice, are considerably short of estimated requirements.
   f. The government has not been able to insure an equitable distribution of existing supplies to all ration card holders.
   g. Prices have continued to rise steeply until rice is presently quoted at five thousand yen per koku against an official price of one hundred and fifty yen per koku.
   h. 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.
   i. The savings, accumulated food stocks, and bargainable goods of increasing numbers of people are being exhausted.
   j. 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.
   k. Strong opposition to the use of the police powers is evident from newspaper reports in statements of leaders in the rural areas.

1 Only Table 2 is printed.
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/FT.

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 which 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 the Japanese Government 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. 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 considerably 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 surpluses 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 circula-

tion 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 inflation 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 measures which will assure 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 permitted. 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. Contents:

   (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 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.

(3) Under Section 2 of Article 7 of the Ordinance and Article 20 of the Regulations, deposits in financial institutions are permitted to earn interest. It should be stated that such interest will be subject to the same restrictions as the principal.

(4) All earnings 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 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 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 is an underlying an easy matter. It should be reserved to only if unavoidable because of scarcity of materials or facilities or absolute lack of time for printing new notes.

(2) 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 circulation. 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: SUTLAND, PAPER] 10-4 JAPANESE GOVERNMENTS 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 combating 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 (proposals four above), are incised as Tabs "B" and "C" and an analysis of these measures, prepared in Government Section, is incised as Tab "A".

3. It is hoped 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.

FINANCE

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, financial 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. In its factual form, 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 the Supreme Commander the responsibility for taking measures to curb the inflation.

[Source: SUTLAND, PAPER, 7-703-23] 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

"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 occupying forces in Japan for occupation costs 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 provision 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.

[Source: 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: DIPLO. BR., NATIONAL ARCHIVES]

10-6 THE EXTRAORDINARY JAPANESE POST-WAR TAXES

Memorandum

To: SCAP
From: Leo M. Cherns, Tax Advisor to SCAP

May 14, 1946

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% penalty 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 on 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 these extraordinary taxes should accomplish.

5. The inflationary pressure exerted by yen and bonds must be reduced sharply.

6. The major tax revenues must come from those individuals whose wealth has most contributed to Japan’s economic, political and social problems.

7. A redistribution of national wealth should be accomplished, directed particularly to the strengthening of Japan’s middle class.

8. The Japanese Government should be enabled to secure the revenue needed for occupation expenses, social and economic rehabilitation and the industrial and fiscal reorganization which SCAP directives will require.

9. 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 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 repaid, thereby accomplishing the effect of a 100% tax upon these Government indemmites 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 captured 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 on 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 5% for 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 goals.

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:

<table>
<thead>
<tr>
<th>Taxable Amount in Yen</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 40,000</td>
<td>10%</td>
</tr>
<tr>
<td>40,000 - 50,000</td>
<td>15%</td>
</tr>
<tr>
<td>50,000 - 60,000</td>
<td>20%</td>
</tr>
<tr>
<td>60,000 - 70,000</td>
<td>25%</td>
</tr>
<tr>
<td>70,000 - 80,000</td>
<td>30%</td>
</tr>
<tr>
<td>80,000 - 100,000</td>
<td>35%</td>
</tr>
<tr>
<td>100,000 - 200,000</td>
<td>40%</td>
</tr>
<tr>
<td>200,000 - 300,000</td>
<td>45%</td>
</tr>
</tbody>
</table>

12. Delayed payments are to be discouraged and permitted 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 (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 revaluated valuation and make restitution in the form of government bonds whenever it deems the 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 or recipient answers 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 "informers" 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. Copies of the various Immovable Property Tax directives are attached herewith. The list to be appointed by the Ministry of Finance; local electees to be used only in an advisory capacity.

21. All members responsible of the various Real Estate Tax Estimation Committees are to be appointed by the Ministry of Finance; the work of these committees will be centralized and coordinated 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 ordinary 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 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 amount of 18,000 yen.

2. The tax was increased property to be taxed at the same rate, but where the particular asset (except stock) has been held by the same taxpayer continuously throughout the 1940-1946 period no tax would be assessed. The purpose of this provision is to prevent 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 asets 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. The tax would be imposed if the increased value of property is less than 30,000 yen.

2. No preferential treatment shall be afforded to deposits, savings, or other forms of credit.

3. The capital a portion of increased property is to be eliminated for purposes of this tax and, accordingly, will be regarded as class A, under the property.

4. 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 classification, filing date, and collection date established for the Capitation Levy Law will also be applicable for the Increased Property Tax.

Memorandum for the Record
By: T. A. Bison, Government Section, SCAP

May 20, 1946

1. President at the meeting:

Finance Division: Mr. LeCount, Colonel Jennings, Mr. Cherne, Major Brentlinger, Mr. Segal, Lt. Col. McDiarmid, Lt. Comdr. Aulis, Mr. Burns, Major Sherbourne, Capt. Hertzmark, Major Wood, Lt. Rickel.

Anti-Cartels: Mr. Henderson, Mr. Pearce, Lt. Comdr. Nos, Capt. Cooper, Mr. Ziff.


Civil Property Custodian: Major Ware.

Government Section: Mr. Bison.

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 war industries. Copies of the proposed 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 ESB people. The Division hopes to have the directive approved by SCAP and sent to the Japanese government within a week. Thereafter, within a period up to June 15, will be devoted 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, exceeding ¥100,000.

(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, the capital levy upon property would be necessary 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 "phony" 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 historic instances. It was rejected in favor of a program levied entirely against individuals, including of course the corporate securities owned by individuals.

Finance Division hopes the bill will be passed by June 25, that is within 10 days after the Diet recess, that the capital levy be enacted, that the bill is due and payable August 25, the second (Class B) September 25, and the third (Class C) October 25.

Total yield estimated by Japanese Government at 80 billion yen, but by Finance Division at 50 billion yen, of which 60 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 billion yen) would reduce it to 90 billion yen.

9. It is proposed that this Section follow developments of this program.

[SOURCE: SCAP PAPERS, 2:703-4]
10-9 A MEMO ON LOCAL GOVERNMENT FINANCIES

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.)

<table>
<thead>
<tr>
<th>Year</th>
<th>National</th>
<th>Local</th>
</tr>
</thead>
<tbody>
<tr>
<td>1932</td>
<td>1,477</td>
<td>1,625</td>
</tr>
<tr>
<td>1933</td>
<td>2,163</td>
<td>2,243</td>
</tr>
<tr>
<td>1937</td>
<td>2,582</td>
<td>2,717</td>
</tr>
</tbody>
</table>

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 1955. 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

<table>
<thead>
<tr>
<th>Category</th>
<th>In million yen</th>
<th>Percentages of total</th>
<th>Per inhabitant (in yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prefectures</td>
<td>1,472</td>
<td>41.4</td>
<td>20.1</td>
</tr>
<tr>
<td>Cities</td>
<td>1,427</td>
<td>40.0</td>
<td>48.1</td>
</tr>
<tr>
<td>Towns, villages</td>
<td>664</td>
<td>18.6</td>
<td>15.3</td>
</tr>
</tbody>
</table>

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 50 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

<table>
<thead>
<tr>
<th>Category</th>
<th>In Million Yen</th>
<th>Percentages of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pref. Cities</td>
<td>146</td>
<td>24.7</td>
</tr>
<tr>
<td>Pref. Cities</td>
<td>439</td>
<td>73.6</td>
</tr>
<tr>
<td>Pref. Cities</td>
<td>91</td>
<td>1.7</td>
</tr>
<tr>
<td>Pref. Cities</td>
<td>266</td>
<td>71.2</td>
</tr>
</tbody>
</table>

Rich Prefectures

Osaka

[Source: Henry Papers, University of Michigan]
In the prefectures with large cities almost three-quarters of expenditures are passing through the city budgets, and only one-quarter through the prefectoral budgets, leaving practically nothing for the towns and villages; in the poor prefectures the prefectoral budget is the base (50-60 per cent of the total expenditures). Thus poor prefectures are more interested in strengthening prefectoral budgets. As to the differences among the prefectures, while in 1943 the total per capita expenditures for Osaka prefecture were 98 yen, for Osaka 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**

<table>
<thead>
<tr>
<th>Prefectures</th>
<th>City</th>
<th>Villages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>29.2</td>
<td>12.0</td>
</tr>
<tr>
<td>Health</td>
<td>2.0</td>
<td>6.7</td>
</tr>
<tr>
<td>Social Welfare</td>
<td>1.0</td>
<td>2.3</td>
</tr>
<tr>
<td>Encouragement of Industry</td>
<td>14.0</td>
<td>1.7</td>
</tr>
<tr>
<td>Police</td>
<td>10.6</td>
<td>1.7</td>
</tr>
<tr>
<td>Engineering &amp; Works</td>
<td>14.9</td>
<td>5.9</td>
</tr>
<tr>
<td>City Planning</td>
<td>2.4</td>
<td>6.2</td>
</tr>
<tr>
<td>Public debt</td>
<td>11.7</td>
<td>17.2</td>
</tr>
<tr>
<td>Water Works</td>
<td>0.1</td>
<td>8.8</td>
</tr>
<tr>
<td>Gas &amp; Electricity</td>
<td>1.0</td>
<td>7.9</td>
</tr>
<tr>
<td>Salary &amp; offices</td>
<td>8.3</td>
<td>24.9</td>
</tr>
<tr>
<td>Others</td>
<td>14.1</td>
<td>20.0</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total in million yen</td>
<td>1,472</td>
<td>1,427</td>
</tr>
</tbody>
</table>

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 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 50 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, additional 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 general government debt 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 4,356 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**

<table>
<thead>
<tr>
<th>Source</th>
<th>1944 Percentages</th>
<th>1945 Percentages</th>
</tr>
</thead>
<tbody>
<tr>
<td>From taxes</td>
<td>597</td>
<td>3,333</td>
</tr>
<tr>
<td>From other sources</td>
<td>2,167</td>
<td>2,230</td>
</tr>
<tr>
<td>Total</td>
<td>2,763</td>
<td>3,563</td>
</tr>
</tbody>
</table>

The most important of these non-taxation sources were:

**FINANCE**

<table>
<thead>
<tr>
<th>Source</th>
<th>1943 (Percent of Total Revenue)</th>
<th>1943 (Percent of Total Revenue)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commissions, fees, payments</td>
<td>10.5</td>
<td>12.0</td>
</tr>
<tr>
<td>for joint use</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government subsidies</td>
<td>10.6</td>
<td>17.0</td>
</tr>
<tr>
<td>New debts</td>
<td>30.7</td>
<td>13.4</td>
</tr>
<tr>
<td>Carry-over from the preceding year</td>
<td>9.7</td>
<td>1.0</td>
</tr>
<tr>
<td>Revenue from property</td>
<td>1.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Transfers</td>
<td>1.9</td>
<td>3.4</td>
</tr>
<tr>
<td>Sale of property</td>
<td>0.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Others</td>
<td>13.0</td>
<td>11.7</td>
</tr>
<tr>
<td>Total</td>
<td>78.4</td>
<td>62.6</td>
</tr>
</tbody>
</table>

The revenue of prefectures in 1943 was composed of the following items:

**Surface taxes 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) 36.1 million yen
- Other taxes 16.8
- Total from taxation 576.2
- From other sources:
  - Subsidies and grants-in-aid from the National Government 418.7
  - Fees and similar receipts 14.4
  - 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, 12.8 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**

<table>
<thead>
<tr>
<th>Source</th>
<th>1943 Percentages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apportioned taxes</td>
<td>35.1</td>
</tr>
<tr>
<td>Surtaxes on national taxes</td>
<td>235.5 million yen 146.6</td>
</tr>
<tr>
<td>(land, house, business, mine)</td>
<td>18.1</td>
</tr>
<tr>
<td>Surtaxes on provincial taxes</td>
<td>54.8</td>
</tr>
<tr>
<td>Cities' (towns'-villages') own taxes</td>
<td>54.2</td>
</tr>
<tr>
<td>City planning tax</td>
<td>62.3</td>
</tr>
<tr>
<td>Other taxation receipts</td>
<td>39.5</td>
</tr>
<tr>
<td>Total</td>
<td>415.9</td>
</tr>
<tr>
<td>Fees, rents</td>
<td>31.2</td>
</tr>
<tr>
<td>State and pref. subsidies, etc.</td>
<td>14.2</td>
</tr>
<tr>
<td>New debts</td>
<td>263.0</td>
</tr>
<tr>
<td>Sale of property</td>
<td>22.0</td>
</tr>
<tr>
<td>Receipts from property</td>
<td>39.7</td>
</tr>
<tr>
<td>Carry over from 1942/43</td>
<td>66.3</td>
</tr>
<tr>
<td>Others</td>
<td>131.6</td>
</tr>
<tr>
<td>Grand Total</td>
<td>1,426.9</td>
</tr>
</tbody>
</table>

**Towns & Vill.**

<table>
<thead>
<tr>
<th>Source</th>
<th>1943 Percentages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apportioned taxes</td>
<td>10.6</td>
</tr>
<tr>
<td>Surtaxes on national taxes</td>
<td>24.0</td>
</tr>
<tr>
<td>(land, house, business, mine)</td>
<td>18.1</td>
</tr>
<tr>
<td>Surtaxes on provincial taxes</td>
<td>54.8</td>
</tr>
<tr>
<td>Cities' (towns'-villages') own taxes</td>
<td>54.2</td>
</tr>
<tr>
<td>City planning tax</td>
<td>62.3</td>
</tr>
<tr>
<td>Other taxation receipts</td>
<td>39.5</td>
</tr>
<tr>
<td>Total</td>
<td>415.9</td>
</tr>
<tr>
<td>Fees, rents</td>
<td>31.2</td>
</tr>
<tr>
<td>State and pref. subsidies, etc.</td>
<td>14.2</td>
</tr>
<tr>
<td>New debts</td>
<td>263.0</td>
</tr>
<tr>
<td>Sale of property</td>
<td>22.0</td>
</tr>
<tr>
<td>Receipts from property</td>
<td>39.7</td>
</tr>
<tr>
<td>Carry over from 1942/43</td>
<td>66.3</td>
</tr>
<tr>
<td>Others</td>
<td>131.6</td>
</tr>
<tr>
<td>Grand Total</td>
<td>1,426.9</td>
</tr>
</tbody>
</table>
Let us now compare the sources of revenue for the prefectures, cities, towns and villages:

Composition of revenue of local governments, 1943

<table>
<thead>
<tr>
<th></th>
<th>Prefectures</th>
<th>Cities</th>
<th>Towns-villages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentages of total</td>
<td>39.1</td>
<td>29.2</td>
<td>51.9</td>
</tr>
<tr>
<td>Taxes</td>
<td>6.3</td>
<td>21.8</td>
<td>3.4</td>
</tr>
<tr>
<td>Fees, Rents</td>
<td>28.4</td>
<td>9.9</td>
<td>23.5</td>
</tr>
<tr>
<td>National pref. subs.</td>
<td>12.3</td>
<td>18.5</td>
<td>4.8</td>
</tr>
<tr>
<td>New debts</td>
<td>2.1</td>
<td>1.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Sales of property</td>
<td>1.8</td>
<td>2.8</td>
<td>3.2</td>
</tr>
<tr>
<td>Receipts from property</td>
<td>1.9</td>
<td>4.6</td>
<td>4.2</td>
</tr>
<tr>
<td>Carryover from 1942/43</td>
<td>8.1</td>
<td>11.7</td>
<td>8.7</td>
</tr>
<tr>
<td>Others</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

This table shows that 28.4% of the revenue of the prefectures and 23.5% of the towns and villages come from subsidies from the superior echelons; this shows their great dependence upon the favor of the center and the instability of their own fiscal base. If this is so we add the receipts from centrally administered taxes, the dependence upon the national treasury in case of prefectures would amount to 33.2% of total revenue in case of prefectures and to 41.5% per cent in case of towns and villages. Moreover, 12.3% of total revenue in the case of prefectures comes from loans.

This brief survey of local finances shows that (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

<table>
<thead>
<tr>
<th></th>
<th>1945/46</th>
<th>1946/47</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes</td>
<td>6,660</td>
<td>5,865</td>
</tr>
<tr>
<td>Rents, fees</td>
<td>402</td>
<td>854</td>
</tr>
<tr>
<td>Subsidies</td>
<td>3,142</td>
<td>2,247</td>
</tr>
<tr>
<td>New Loans</td>
<td>1,500</td>
<td>1,500</td>
</tr>
<tr>
<td>Carry-over</td>
<td>797</td>
<td>510</td>
</tr>
<tr>
<td>Others</td>
<td>819</td>
<td>754</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>8,632</td>
<td>10,967</td>
</tr>
</tbody>
</table>

Expenditures:

<table>
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10-10 RECOMMENDATIONS REGARDING THE MINISTRY OF FINANCE

Memorandum

To: Chief, Governmental Powers Branch

July 18, 1946

FINANCE

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 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 zabatsu 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 bureaucracy 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 Ministry's control 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 main problems of policy concern: (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 investigatory, control and questioning. But in the event that the pattern of decentralization of police functions is carried out the Finance Ministry policy will have to be given serious 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

To: Mr. H. Borton, Division of Japanese Affairs
From: Mr. R. Feary, Division of Japanese Affairs

October 14, 1946

It would be well for JA to be acquainted with at least the following facts brought out in the attached reports:

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

*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 those 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 made to make the 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 hammering recovery.
4. SCAP has long favored general cancellation, but as in other matters possessing important political implications and relatively little related to Japanese democratization and reform, has been reluctant to issue a specific directive. Pressure was exercised 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) abolition 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 uncanceled 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 result. These would include a three-year moratorium on bank debts, 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 thoroughly, less than any other in 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 repair losses and removals and abandonment 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 and present it to the Diet." Therefore, to make such an order on the Cabinet that it present 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 commenced upon the responsibility of the Diet to be subsequently approved by the Diet" indicating that, as stated, 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" included in 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 Diet is merely to authorize the budget. To this argument is baseless is indicated by Article 85 of the Constitution which states that the power to administer national finances shall be exercised as the Diet shall deter-
executive 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.

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 resign 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 establishment 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: SUTCLIFFE PAPERS, 2/69/17]

10-13 NEW FINANCE LAW

Memorandum for the Record
By: Frank Rizzo
February 17, 1947

On 15 February 1947 Mr. Noda of the Budget Bureau of the Ministry of Finance together with Mr. Fujiyaki 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 the Diet, the Cabinet has set up a new Board of Audit. This body will include representatives of all interested agencies, and as a result, the 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 will be discussed between the Minister of Finance and the Cabinet 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.

Mem. Noda and Fujiyaki 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

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 one of the highest administrative organs in the government.

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 of the administrative officials of the constitution and by the office of the Committee.

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 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.

10-14 NEW FINANCE LAW

February 17, 1947
By: Helen Loeb

Memorandum for the Record

On 15 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. Hayas, 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.

1. 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 that the Minister of Finance and the President of the Board of Finance and the Cabinet of the Board of Audit, that the Cabinet shall be subject to revision by both the Finance Ministry and the Diet, 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 Constitution 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 be protected.

c. The above suggestion has been discussed by representatives of the Finance Ministry and the Cabinet.

2. It is their opinion that if the Cabinet should 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 independent or discretionary faculties of their respective offices. The representatives were also informed that the Cabinet would transmit to the Diet for its consideration the original requests of the three organs.

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 the right of reserve power over 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 incorporated in the budget, with the final decision to be left to the Diet.

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 together with the final draft of the Budget and the revised figures in its final form. Since these previous discussions have entirely been 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.

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, it 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 Diet 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. He then proposed that the differences between the particular amounts included in the Cabinet’s budget are not likely to be great, there is little reason for not accepting the original budget requests.

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 a member of 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, since it does not have the authority to modify the budget. 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 prejudiced use of such independence, he suggested the establishment of a committee affiliated with the Supreme Court to audit the budget figures 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.

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, 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 fact that had but been discussed in complete detail within the framework of the party interest, 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, 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 expertise 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, the Diet 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 legislative body, and he hoped that the Diet would become so in actuality.

[SOURCE: SUTLAND PAPERS, Z.767-17]

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 steps to be taken. To give a complete picture of the tax revision 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 for 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 serious inflationary situation continues, with sharp changes in the levels achieved in the production of income and rapid changes in price levels, the Ministry should be required frequently—or perhaps quarterly—to reappraise the situation and revise its tax goals. This is particularly the case for personal and corporate income taxes whose yield is geared to the current price levels.

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 objectives.

3. In the present fiscal year actual tax collections, particularly of personal income tax, are low relative to budget targets. As it is not so well realized the budget targets themselves are quite contingent upon the net income tax limits set by the national income figures and total national income from all sources 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.
withholding 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 explicitly revised when government-wide salary increases are granted. The budget allows for an additional 2.0 billion yen received from withholding 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 take of 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 central collection of taxes thus far, the Finance Ministry's policy 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: SUTLAND 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 by the Administrative Research Bureau which is a temporary agency attached to the Cabinet. A draft 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 refers to a central agency for 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 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: SUTLAND PAPERS, Z 703-77]

10-17 PLACE OF THE BUDGET BUREAU IN THE JAPANESE GOVERNMENT

Memorandum
March 6, 1948

To: General Marquart
From: Eugene Reed

1. Attached 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 should 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 Committee Note on this subject welcome the proposed consolidation with them in order to discuss the best and most effective 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 Committee and take the technical advice of the Finance Division on 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: SUTLAND 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
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 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 dependents 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 complete operating, management, or manufacturing service, such as the operation of commissaries, laundries, bakeries, transportation, automotive maintenance and repair shops, stevedoring, etc.

f. PUBLIC SERVICE:
   (1) 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 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) Domestic service: (For Japanese Fiscal Year 1948—29,000 Japanese Nationals). This type of labor operates and maintains dependent housing. It does not include personal servants, such as nurserymaids, 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, billots and other entertainment 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, billots, housing, residences, and operational facilities.

i. ADJUSTMENTS: (1) EXPORTS (Other Areas). Covers the cost of materials, exported to areas outside Japan, of the military forces in such areas and transportation costs when shipment is made in SCAJAP shipping.

j. REIMBURSEMENTS: Covers reimbursement for rail transportation for

unofficial purposes; automotive maintenance for vehicles of other areas; and the payment of expenses 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.

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 in the current estimate.

3. There is attached as requested, Inclosure No. 1, a copy of the summary used in the presentation made by Lt. Colonel Dyckman.

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**FINANCE**

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**ESTIMATED JAPANESE GOVERNMENT BUDGET EXPENDITURES FOR SUPPORT OF OCCUPATION FORCES**

(In Millions of Yen)

<table>
<thead>
<tr>
<th>Year</th>
<th>Troop Housing</th>
<th>Dependent Housing</th>
<th>Operational Facilities</th>
<th>Maintenance and Repairs</th>
<th>Supplies and Services</th>
<th>Public Services (Communication)</th>
<th>Licenses</th>
<th>Rentals</th>
<th>Adjustments:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946</td>
<td>9,874</td>
<td>8,899</td>
<td>2,175</td>
<td>1,918</td>
<td>5,014</td>
<td>2,581</td>
<td>3,716</td>
<td>678</td>
<td>34,873</td>
</tr>
<tr>
<td>1947</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>70,595</td>
</tr>
<tr>
<td>1948</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>69,936</td>
</tr>
</tbody>
</table>

Adjustments:

- Exports (Other Areas) 875
- Reimbursements 15

Total: 34,873

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**10-19 JAPANESE GOVERNMENT 1948-49 BUDGET**

Memorandum

By: Theodore Cohen, Special Assistant to the Chief, ESS

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 activity 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 2200 yen average of the March 1948 government workers wage settlement).

c. An increase of 25% in rail freight and passenger fares and 30% 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 personnel in light of the principles noted in paragraph one above. In every case of reasonable doubt, the double was resolved in favor of the Japanese Government’s estimates. In particular, the feasibility of increasing official prices by 10%, 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. 5.7 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 proposed. The Japanese Government, of course, is cognizant of the fact that 25 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 Headquaters, 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 13 billion yen, of which 12 billion yen is the food item. (This would increase the preceding parage to 102 billion yen of which 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 accredited 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: Scuttlebutt Papers, 2-703-17]

10-20 TAXATION PROGRAM

Memorandum

I. SUMMARY OF PROGRESS TO DATE

January 6, 1949

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:

- Recruitment of qualified tax experts in U.S. and establishment of Internal Revenue Division, ESS.
- Recruitment of temporary mission to conduct survey of tax structure. (Dr. Carl Shoup of Columbia University agreed to accept chairman of this mission.)
- August 1948—Internal Revenue Division of ESS established.
- August 1948—8th Army directed to establish tax surveillance on permanent basis and intensify program.
- August 1948—Attorney General, as a result of ESS pressure, appointed 63 special procurators in all prefectures to specialize in tax prosecution.
- 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.)
- 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 Tsyo Lache Net Co., Osaka, is set for 22 January 48).
- 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).
- December 1948—Attorney General commended 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:

- 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 principal 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 for temporary adverse tax collection drive.

- Prosecution of Tax Evasion:

- Expanded 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.

- 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 Internal Auditors 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.

- 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.

- 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.

- 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.

- 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.

- 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:

- 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 result 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 Law: 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 1949 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.

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Collections (billion of ¥)</th>
<th>National Income (billion of ¥)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946-47</td>
<td>37.9</td>
<td>500.0</td>
<td>7.6%</td>
</tr>
<tr>
<td>1947-48</td>
<td>190.0</td>
<td>1,156.0</td>
<td>16.4%</td>
</tr>
<tr>
<td>1948-49</td>
<td>2,393.0</td>
<td>1,272.4</td>
<td>14.7%</td>
</tr>
</tbody>
</table>

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 15.3% 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 play an increasingly important role in Japan’s fiscal system. (For a comparison of U.S. and Japanese tax collections with national income see figure, 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:

<table>
<thead>
<tr>
<th>Year</th>
<th>National Taxes (in millions of yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946-47</td>
<td>12,713</td>
</tr>
<tr>
<td>1947-48</td>
<td>12,713</td>
</tr>
<tr>
<td>1948-49</td>
<td>12,713</td>
</tr>
</tbody>
</table>

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 165.8 billion yen, or 22.4% of the 1948-49 budget goal of 360.1 billion yen. (The actual percentage is approximately 34%, 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 1949 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.)

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10-21 TAX DATA FOR ECONOMIC MISSION

Memorandum* Prepared by: Internal Revenue Division, ESS
January 27, 1949

1. Introduction: A drastic reform 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 subject to the influences of the United States 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:

*No tabs printed.
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)

TAX:
- Income
  - Withholding
    - Self-assessed
      - Total
        - Corporate: 22.0
        - Residual: 52.0
        - Total: 264.0
  - Liquor: 40.0
  - Tax on Textile: 3.0
  - Commodity: 23.0
  - Miscellaneous: 30.0
  - Total: 170.5

Monopoly Bureau (tobacco)
- Gasoline: 5
- Tobacco: 546.5

New Levies:
- Monopoly Bureau (tobacco): 541.5

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 1949, an official of the United States Treasury Department, Internal Revenue Service, was recruited for the purpose of investigating the tax situation. 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 the Ministry of Finance 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 which is 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 power 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 agency, 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 present 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 to have very personal contact with every prefecture of 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 evasion. During the first 34 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 encouraging, and it is expected that their combined efforts will result in numerous criminal tax 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. False claim of income tax returns;
   b. Failing to file income tax returns;
   c. Failure to keep honest records of income and expenses.

16. Military Government Tax Surveillance: In January 1949, Military Government tax surveillance stations were established in all regions. MO Headquarters and every prefecture to assist in the task 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 year and noted the progress of tax collections, setting goals for collections falling below established goals. During their first full month (February 1949) 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 appears to have been the sense of moral guilt which was imposed upon 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 training program for both 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 reminders in presentation in an appealing fashion, giving details of the more important tax levies. Present employee training programs have been and are being drastically expanded. Increased emphasis is to be given to intensive courses for larger numbers of employees rather than long courses for a small number of individuals.
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: Dodgen Papers, Z.711-1]

10-22 REORGANIZATION OF NATIONAL TAX ADMINISTRATION OF THE JAPANESE GOVERNMENT (SCAPIN-2001)

Memorandum SCAPIN-2001 (ESS/IR) May 4, 1949

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 ensure 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 those 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 Ministry 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?) Prepared by: Parliamentary and Political Division, Government Section May 18, 1949

Members of the Urawa (Saitama-ken) Tailors and Vegetable association testified as follows yesterday before the H.R.3 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. *Probably "House of Representatives".

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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 protests heard, bribery is necessary.

6. The leaders of the associations and various 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.

Testimony was emphatically made to the effect that in Saitama prefecture the tax offices have more power over the people than the police. [Source: Sultand Papers, Z.700-6]

10-24 NATIONAL ADVISORY COUNCIL* 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.**

[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 recommendation 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 mere 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 become 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 that the latter 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


**Other enclosures omitted.
attractive prices, if provided with the necessary imported materials, 
(3) to avoid any tendency toward establishing a 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 reduction 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. Doubles these political demands go beyond tax reform (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 mentioned 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 food-stuffs?
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 would be retained 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 paragraphs (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 alone?

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 be more than offset by reduced subsidies eventually fall on traders and the lowest income groups in the cities, rather than on the majority of 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. Total tax policy listed as "proportionate". Is it not 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 of the burden be paid for in the form of lower prices of raw materials and equipment purchased by farmers 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 of which has hitherto been reinvested in higher prices, or has not been reinvested in higher prices?

6. How should the effect of decreased subsidies on industrial materials be appraised? Is it not true that the burden of the voluntary contributions to public works is very heavy for the consumer? If so, is it not an oversimplification to speak of "no net relief for the Japanese consumers"?

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 an increase in the number of useful 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, for example, by bringing a larger number of taxable persons in the categories of income subject to 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 rule, 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 prosperity of local autonomy is to be maintained. However, the government has included the so-called voluntary contributions collected in 1950–51 in the tax revenue, to be mainly used for school buildings, or to supply other local services. If 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 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.

In light of 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. The reduction in real public expenditure, 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 5 billion in yen. The local taxes and contributions are assumed to total 65 billion yen. 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 readjustment in expenditures.

Both of these 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. As a result of increases in the value of the yen, the local governments are therefore not assumed to have 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 total decrease is 225 billion yen to 340 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 even greater in 1950 than in 1949, even if business activity merely levels off, and assuming no rises 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 assessment rates in force the present rates in force. The present rates are 75% of the surplus revenue, and 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 undertake any more of 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 3.5 of 1 cent per cent on that part of his net worth that is in excess of 5 million yen. The rate would rise, until it reached 3.5 per cent on the part of his net worth in excess of 10 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 true that the very top rates of the income tax do not add much to revenue, at least under present conditions, where the top rate of income tax 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. The present rate of corporation tax, as well as the other rates of tax recommended by the mission, have been progressively decreased and are now at a minimum that will ensure the extraction 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 complex and too complicated, as at present, to be administered consistently at the base of 17.5 per cent.

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 less in 1950 than in 1949, and this would be the case in 1951. 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 the tax. It is expected that the tax on corporate income, which is 6 per cent of the personal income tax on corporation income, will also be reimposed after a temporary suspension in 1950. The total yield from the corporation tax may drop from 12 billion yen in 1949 to 10 billion yen.

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 reaping 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 national government, 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 taxes are on necessities of life. Some part of the expenditures on textiles are of a somewhat secondary nature, but it is difficult to measure that part; moreover, the producers of silk are undergoing a severe readjustment and should not be further imperiled by a continuation of the 40 per cent tax on silk. The tax is recommended for repeal as of 1 March 1950, except in the case of raw silk, where some 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 their revenue from the local property tax as the central government. The property tax on the real estate of 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 recommended that the local property tax be changed from a tax to a broader base, known as "valuedd, to be explained, as follows:

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 to the present 150 per cent to 100 per cent, whereby the yield would drop from its current estimated level of 14 billion yen.

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 helps 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.

The mission recommends that the land and house tax, under the mission's recommendations, would be extended to becoming a tax on 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 rate tax. The more important of those recommendations are given here.

For the purpose of income tax, the mission recommends that one does not get the benefit of the increase in the dependent allowances. 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 yen, the tax falls from 64,250 yen to 54,200 yen. At 1,000,000 yen the income tax falls from 573,000 yen to 486,000 yen, but this person would be subject to the net worth tax.

A single wage or salary earner with no dependents, net income 100,000 yen, would have his tax reduced from 15,000 to 14,000 yen. This relatively smaller reflection reduces the tax mission's view that compared with other types of income tax, the single wage earner with no dependents 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. At 200,000 yen net income the tax 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 of one's recommendations is related to all the others that we are recommending is a tax system, not a number of isolated measures having no connection with one another.

A number of other changes are recommended for the income tax including: a liberalized death tax; a reduction of the flat-rate income tax on the full income of farmers and other unincorporated businesses; a special additional exemption of 12,000 yen for the blind and others with extreme physical handicaps; and deduction of medical expenses in setting up the price level of more than 15 per cent, so that the purchase tax will not be taxed, and merchants will not be allowed to deduct the capital gains and losses, with 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 are 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 exceptions) of the individual's tax should not prove an important barrier to the industrialization 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 pay the tax. Individuals with net worth of more than 5,000,000 yen would not pay the tax. 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.

The tax rates are 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.

Net worth over 5,000,000 yen is 0.5 per cent.

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) of that part. For the 10 million yen to 20 million yen bracket the rate would be 0.75 per cent; for the 20 million to 50 million bracket, 1.0 per cent; for the part above 50 million, 1.50 per cent.

At these rates it would hardly ever pay the taxpayer to try to evade the tax by hiding his

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FINANCE

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Table 1: Schedule of Income Tax Rates

<table>
<thead>
<tr>
<th>Taxable Income Bracket</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 50,000</td>
<td>20%</td>
</tr>
<tr>
<td>50,000 - 80,000</td>
<td>25%</td>
</tr>
<tr>
<td>80,000 - 100,000</td>
<td>30%</td>
</tr>
<tr>
<td>100,000 - 120,000</td>
<td>35%</td>
</tr>
<tr>
<td>120,000 - 150,000</td>
<td>40%</td>
</tr>
<tr>
<td>150,000 - 200,000</td>
<td>45%</td>
</tr>
<tr>
<td>200,000 - 300,000</td>
<td>50%</td>
</tr>
<tr>
<td>over 300,000</td>
<td>55%</td>
</tr>
</tbody>
</table>

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 as described in 6, below.

(5) A few illustrations will indicate the extent of the tax reduction recommended under 1 to 4. A married couple with two dependent children, whose income from a business of a corporation or a farm, with a net income of 100,000 yen before deducting the personal allowance or the allowance for dependents, will pay 8,000 yen income tax, instead of 17,850 yen as at present. 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 dependents.

A tax-payer with the same family, but an income of 200,000 yen would have his income tax reduced from 38,850 yen to 8,000 yen. If his income is 1,000,000 yen, the tax falls from 567,000 yen to 467,000 yen; but such a tax-payer 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 1 million yen individual might own little or no property, hence not be subject to the net worth tax.
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 pays 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 be quite hazardous.

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 received, 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 to earnings made in 1950 and later years, as its surplus already accumulated before 1950.

A number of problems common to the corporation income tax and the personal income tax are treated in the mission. Among these, the essentials 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 rise in price following the abolition of subsidies.

Third, net losses should be carried over to other years to be offset against the income of those years. 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, strict enforcement of the provisions that capital expenditures on buildings and other improvements, and capital outlays all in one year are urgent, 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-rate per acre tax on a homestead element, not a property element on a farm; a percentage addition to the homestead should be made and a property tax on 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.

The income tax 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.

Assessments under the mission's recommendations will be performed 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 determined solely for the purpose of the 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 favor 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 the emphasis on the greatly improved administration of the tax law. Its recommendations for a fair and economically beneficial tax system cannot 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 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.

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.
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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 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 citizen. 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 1945, the Young Mission, the Dodge Mission and the Shoup Mission. The Nine-Point Economic Stabilization Directive of 10 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 EVASERS."

In SCAPIN 2001 dated 4 May 49, which required the Japanese Government to reorganize its tax administration as being 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, the authorized tax personnel in 20%, it gave no consideration to the actual needs of the service, and deftly ignored both the Nine-Point Directive and SCAPIN 2001. This decision 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 Ministry 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 to 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 undesirable and incompetent. As to the restorations, it was desired that authority to restore the personnel be granted under an order not to be jeopardized or September 1, 1948. It is to be assumed that this fiscal year, as well as the tax reform; new employees hired after November 1947 of little value to the tax service this fiscal year.)

In 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 noting 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 ad-

ministration 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 "battled" man for the Occupation Government. It is said that he cannot insist upon 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 administration.)

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 Shoup Mission of an ambitious program of major tax reform. In the circumstances, it is probably impossible to reduce the personnel now.

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 assessments 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 reinforced by sudden personnel provided 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 446 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 the tax personnel. It is a "waste and void" 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 tax and personnel objectives are selected, 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."

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 not historically equipped to an unsympathetic with such ideas as 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: SUTLAND PAPERS, 2-703-4]

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 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 rigorously 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 retrenchment measure, 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: SUTLAND PAPERS, Z 703-4)

**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 proposals is the requirement that revenue of the municipalities be adequate to provide essential public 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 Municipal 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.

Applying the Shoup recommendation of the revised local tax laws becoming 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: SUTLAND PAPERS, Z 703-4)

**10-29 JAPANESE GOVERNMENT BUDGET FOR FISCAL YEAR 1951–52**

**Memorandum**

**April 24, 1950**

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. Appropriations 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.

2. The delay in submitting the budget this year is due to the complications caused by the troubles in the Diet. The Japanese Government was permitted to submit the budget for the FY 1951–52 annual budget to the House of Councillors on 1st February 1951.

4. The timing of budgetary consideration 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.

5. The allocation and utilization 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.

6. 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.

7. 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 distinct necessity for both the U.S. and Japanese Governments to reorganize and to simplify the structure of their respective governments. 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.

8. Further and more detailed instructions regarding the reductions in personnel within General Headquarters will be issued separately.

9. A timetable which will govern the formulation, review and submission of the Japanese Government budget has been established and is attached hereto as enclosure 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. Marquart 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.

10. The Chief of the Economic and Scientific Section is charged with transmitting to the Japanese Government the timetable set forth in Enclosure 1 and the pertinent provisions of
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**

To: Henry Shavel
From: M. Bronfenbrenner, Tax Economist

June 3, 1950

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 lobby 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, it 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. In the case of losses, however, a firm will run the risk of shifting this year's tax burden to 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 movement 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 tax in an attempt to do too close to gross income for my particular purposes.

5. In advocating delay in setting the standard rate for the value-added tax, I wonder whether Dr. Shoup did not overlook temporarily the use of these standard rates in determining allowable movements in 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-barreling. 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 tax 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

* The private railway lobby, in particular, claims to have defeated the Local Tax Bill through its influence with the Ryokufudai 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.

**FINANCE**

**10-31 DR. SHOUP'S PRESS STATEMENT**

**Memorandum**

To: Major General Marquart
From: Harold Moss, Chief, Internal Revenue Division, ESS

September 17, 1950

1. Transmitted herewith is a draft of Dr. Shoup's comprehensive press statement scheduled to be delivered at a CSLIE press conference at 1900 hours next Thursday, 31 September 1950.

2. During 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/FF, ESS/PD, ESS/LA, NRS, GS, ALS, 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: 8 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 progressiveness of the tax rate scale in the low and middle income levels and an increase in the 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 Grant.

   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, he 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 Promotion 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 Government, 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 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

To: SCAP
From: J. 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 stands today, 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 can be expected to it is a question which cannot be answered definitively until after the Occupation has been lifted, but 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 government of the more complicated or controversial issues, even as long as it does not run contrary to the basis assumptions 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 not 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 increases 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, nothing more happens, the tax system may well develop into a taxed and taxpayer 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 severe damage to the equity elements of the system as finitistic 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 present 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 we are not as yet sufficiently positive about such a new requirement and file a system; our answer rests 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 Eaters

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 choice that can be made difficult.

They will then be in danger of reassessment 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 or cannot do anything about it. But, under present circumstances, those who are 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 is not done, there is little 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 payments are reassessed as of January 1, that were not reassessed as of January 1, and so on. The new assessment system 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 ignore 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 incomes 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 Income Tax 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 provisions against assessment applies even though the taxpayer was not assessed as of January 1, and that the overpayment due to the 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 statutory provisions 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 filed, whichever is later. This statutory prohibition should not, however, apply in the case of penalties or special assessments.

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 the 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 banks in filing the information return is likely to be wholehearted. All those observations lead 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
To: SCAP
From: Carl S. Shoup, Chairman, Shoup Tax Mission
September 21, 1950

Submitted herewith is a statement of conclusions and recommendations covering our survey of the Japanese income 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 systems had been enacted by the Diet only the day before. Even under the national tax system, there had been no 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 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 evidence, 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 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 independent 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 200,000 yen). Extending the credit to other self-employed persons is recommended 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.

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 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 less than 3 billion yen, though 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 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 to at least 12 billion yen, so as to accommodate up to 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 officials and taxpayers are to be induced 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 in the past twelve months has been substantial as we last year had expected it would be. The greater part of the job is 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 forgone in the interest of price stabilization. Barring such a development, we recommend a reduction in personal income tax.

But in reducing the personal income tax it is necessary to decide whether to emphasize basic exemption and dependent allowances, 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 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 earnings—would in fact encourage him from working more, 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 brackets correspond 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 about 4 per cent points—28 per cent, altogether. Provisional figures of tax paid on actual income indicate that the combined rate is probably about 30 per cent with 5.4 per cent on 100,000 yen, 35.7 per cent on 150,000 yen, and 39.5 per cent on 200,000 yen. This marginal rate is close to, if not beyond, the point at which it may be determined in practice that a lower-wage earner (in the group of 100,000—120,000 yen) no longer feels that additional income is worth the extra effort of working more. Provisional figures also show that 45.3 per cent in the 120,000—150,000 bracket, 47.2 per cent in the 150,000—200,000 bracket.

The impact of these 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 businessmen are found in these ranges. The question here, rather, is the effectiveness of the rates, or to work toward high enough positive incentives. Many believe that these 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 to the recipients.

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 those 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 elsewhere. Consequently, if one worker decides to indulge in forgoing 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.

For substantial rate 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 reflect the 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, especially those founded in tradition, of what the taxpayer thinks is reasonable. But taxpayers' complaints on this score can scarcely be taken at face value. If those Japanese taxpayers who represent, say, the top 10 per cent of income of 1951, 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 and after 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 remove all of the cost of these services from local taxes. The result is that 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 of 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 reparation activities, which has discouraged him from doing more business. For example, the proponent of the system whereby the local governments in local paid one-third the cost of such reparation activities. 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 about 20,000 employees in 1951—52. Article 13 (c) of the 1947 Basic Law of the Local Taxation 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 obligated to do so. The proposed increases in wages alone would add 5 billion yen to local expenditures (teachers, policemen, and firemen, 11 billion yen; others, 6 billion yen).

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 rendered. For these reasons, we believe that, if inequitably and economically harmful levels of local tax rates are to be avoided in 1951—52, the national government must forego some of the reduction in the cost of repair activities, and (1) reduce the cost of repair activities to that which would result from the localities' obligations to the localities, the cost of disaster rehabilitation; 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 the size of the grants would further 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 would be affected by the amount of reduction in national taxes foreseen. 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 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 local financial supports can be 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 proceed with the accounts.

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. It is not surprising, therefore, that the 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.

This problem 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 administration to taxpayers. Our Mission has studied this 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 of the implementation of 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 Fukuoaka, 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.
The present law provides that for the first year of the new tax certain businesses may use 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 need for them. 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 76 of the present law be repealed or substantially restricted in scope.

d. 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 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.

i. Rate-Regulated Enterprises and Government 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 prefectoral highway expense might appear not 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: SHUTLAND PAPERS, Z 703-3]

10-34 DR. SHOUP'S CONFIDENTIAL MEMORANDUM

Memorandum

To: General Marquart

From: Harold Moss, Chief, Internal Revenue Division, ESS

September 26, 1950

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 in 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 ease 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.

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.

3. 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: DOODGE PAPERS, DETROIT PUBLIC LIBRARY]
11 THE "DODGE LINE"

11-1 THE GENERAL ECONOMIC AND POLITICAL PROBLEM AND ITS RELATIONSHIP TO BANKING

Statement
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 socialist 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
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 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 shown:

1. Correction of present price disparities in export and import yen-dollar relationships.
2. Creation of conditions in which efficient direct price subsidies and tax levies 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. Disparity in the present effective yen-dollar price ratios 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 their income 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 to determine quantities 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 the prewar level. The yen price of woolen cloth in the prewar period was over 30 yen per hundredweight. While the industrial index is about 45-48 per cent of 1930-34, exports are about 14-14 per cent of 1930-34. Yen price equalization with world prices has not been forced as the deliberate and comprehensive choice has been made by the Japanese to try to restrain the general price level without causing wage and price advantages to the labor, alternative employment, alternative cost of living price structures and the day to day life of the Japanese. Thus 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 position of the wage earning classes. It is believed that a joint price 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 disparities in export 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 on 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

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1 Subsequent sections deleted.
in this situation, of course, result in additional note issue.

c. 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 $175,000,000. The value of exports in 1930-34 adjusted to 1947 prices was $1,800,000,000, and therefore, in terms of past values, 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 a 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 $175,000,000 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 unwise 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 GAKO imports and the economic imports for export industries. Raw material imports brought into Japan for export industries, directly or indirectly, can presumably be changed in a rate comparable to the change of the rate applying to the specific export industries. By this method price modification 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 export industries, 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 will and will narrow existing price distributions. Such trends of prices for economic 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 substitution 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 action. A line of 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 not 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 export taxes 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 is 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 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 Kayatama 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 drain 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.

**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).

- **Improved employment and 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 business towards a condition of relative price stability.

- **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.

- **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.

- **Improved public finance.** Better management of public finance is to be expected as Japanese policy towards government, and the Occupation, both make important changes in the price control and mechanization 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.

**Conclusion.** In sum, this Committee feels that three major considerations: (1) present price dispersion in foreign trade commodities, (2) existing political difficulties which prevent an efficient system of taxation and legislatively enacted subsidies for foreign trade and the Government, both made toward stabilization and (3) the nature and mechanism 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.
THE "DODGE LINE"

11-3 THE JAPANESE RECOVERY PROGRAM

Memorandum
To: The Under-secretary of the Army
From: R. Reid
Confidential
P.L. 795, 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 time of achievement. Such a state will be expected to:

1. Fulfill Potsdam Declaration guarantee that Japan would be assured a viable economy;
2. Create the most favorable economic 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:

a. The above aims were not in conflict with the controlling aim of the Occupation:
   1. To ensure that Japan would never again be a menace to the peace of the world; and
   2. To guarantee to Japan a freely constituted and democratic form of government; and
b. 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.

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, 35% 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.

Subsequent sections deleted. This paper runs to 32 pages, double-spaced.

An attached comment reads: "Mr. Dodge notes that the figures mentioned herein should be checked before 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 provisions proposed will require for stabilization.”

He asks the question: “Why do we not do it now?”

7. Japan’s economy is now only some 35% of 1934. Germany’s is, 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. Diplomatic 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 rather 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 force on this problem in Japan unless there were the full realization on the part of all concerned of 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.”

13. Recommendations on any changes or additions necessary to accomplish desired result.

14. 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.

15. 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 should see 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.
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 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."

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."

II-7 SCAP COMMENT ON STABILIZATION DIRECTIVE

Telegram No. C66296
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 in their own economic rehabilitation and when the maturity 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 gauge. 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 will most 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 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. R & 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.

It was very much appreciated 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, both of which Mr. Lovett was 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 Security Resources Board, the Treasury Department, the Labor Department, and the Department of Commerce, each of which were represented 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 help 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 advise General MacArthur in meeting the problem, and that he hoped to have the opportunity to come so that 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 him 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. He told me he 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 with the thought might be the necessary action was taken, probably in the interests of 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 responsibilities for a number of instances 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 detached from their necessary responsibilities. He said he would be and that he would have the support of every Department of the Government and any necessary assistance would be made available.

Then from a 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 about them and also why he had given me the Medal, the button of which I was wearing.

I told the President that 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 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 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.

Letter morning also a personal cable was received by Secretary Royall from General MacArthur, a copy of which is also attached.

Because of the nature of the action taken at the highest level in Washington, and the inevitable flow of personal communications with the SCAP Commander, this is 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 to discuss it in my absence. 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 here. 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.

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 we met privately here, Dr. Fine was extremely helpful in giving you to know 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 you will accept the President's request but, if for some reason you should not, I would like 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 we have 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 you accept, 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 I am sure you will give 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 which 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 1.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 coordination with other SCAP Sections and other Divisions of ESS. 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 81059 will strengthen SCAP in clarifying to Japanese the continuing interest of the U.S. in supporting such controls as are necessary to ensure 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 uncontrollable 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 standards computed by the cost-of-production method. Improved policy has resulted in ability to maintain given price levels over comparatively long periods.

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 inducements to the extent that no unemployment or underemployment 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 on this will be imposed.

b. Radio, newspaper, and other types of campaigns are acquainting consumers with official prices and rationing procedures to decrease black market 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 determine certain items, and it is expected that the list of such items can gradually be extended. In exceptional cases some decontrol items may have to be recontrolled.

3. Reference 2g. Seventy percent of representative Japanese family expenditures is for food, including thirty percent per cent being spent on eating out, and the other thirty percent being spent on clothing, shoes, light and fuel, transportation, etc., each of these items comprising a small percentage of total family expenditures.

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 clear misrepresentation of population, rationing has been much 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 standard should have important stabilizing effects as it is being applied to all prefectoral officials. Fuel 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 which tends to reduce the amount of excess foods 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.

c. The material contained in paragraph 4 above was furnished to this Division by NRS, which is responsible for food collections. [Source: SUTLAND 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.

   c. 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.

   d. 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.

   e. 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 be contrary to the FEC 16 Principles which specifically guarantee the right to strike.

   f. Require a degree of surveillance and enforcement which is beyond the present capacity of the Japanese Government.

   g. Give ammunition to Communists in their current propaganda campaign to convince the Japanese people that the United States is pursuing a policy of imperialism to dominate the Japanese nation and complete suppression of the Japanese trade union movement.

   h. 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: SUTLAND PAPERS, 2, 703-23]

11-13 SCAP'S EXPLANATION OF STABILIZATION PROGRAM TO JAPANESE GOVERNMENT

Letter

December 19, 1948

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.

The objectives, which are listed as an enclosure 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 Government, so long as it is called upon to undertake existing deficits in the indigenous resources required to sustain Japanese life are entitled to the maximized industry of the Japanese people and the minimized losses incident to the distribution 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 the Allied intervention may be seen as a benefit to the Japanese Government.

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 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 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.

Now 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-
ment must be curbed as menacing the general welfare.

In keeping with my long established policy, if 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, how 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 hit 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
December 20, 1948
To: W. F. Marquart, 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 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. Renormalize 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 use. 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. Deregulate 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 25-30 different associations.

11-16 HEPLER’S MEMO ON WAGE STABILIZATION
Memorandum
January 8, 1949
To: Chief, ESS
From: Chester W. Hepler, Chief, Labor Division

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 officials, that no one employer will receive increases in “three principles” 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 appropriation 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 increases. 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 a fair share through collective bargaining. In case of disputes in any 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.

The copy of this memorandum printed here does not appear to be complete.
11-17 PLANS OF THE PRICE AND DISTRIBUTION DIVISION FOR IMPLEMENTATION OF NINE-POINT PROGRAM

Memorandum

To: Chief, ESS
From: Floyd L. Whittington, Acting Chief, Price and Distribution Division, ESS

January 8, 1949

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 implementation of 2a,
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 corres-
dents, and (3) the implementers for the implementation of this program, the implementers
attached to 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 2a. 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 to avoid the possibility of 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 since the impact of the initiation of a single rate of exchange and the substantial wage advances since the last general price revision in June-July 1948 are as follows:

- 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
prospective inflation and distortion of production, wages, and prices despite 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.
- 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.

a. 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 current wage commitments, even after the current 2.4 billion yen 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 profits, (b) by wage increases, and (c) by additional income from which to meet (a) increases in unit subsidies, (b) capital expenditure commitments, and (c) entrepreneurial returns.

b. Miscellaneous price increases: Of the estimated 54-56 billion yen GJR deficit to occur in FY 1949, approximately 24 billion is said to arise from wage increases. In view 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 approaching 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 composed of those which will have but minor effects on costs of living or on the general price level.

c. Indigenous subsidies: It was originally contemplated that present unit subsidies would be continued for the stabilization program, and at a cost based on production figures, of approximately 118 billion yen. In accordance with studies of other divisions, especially the 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:

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Billsions of Yen</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pig Iron &amp; Steel</td>
<td>50</td>
</tr>
<tr>
<td>Cotton</td>
<td>4</td>
</tr>
<tr>
<td>Fertilizers</td>
<td>10</td>
</tr>
<tr>
<td>Soda Industry (Soda Ash &amp; Caustic Soda)</td>
<td>1.5</td>
</tr>
<tr>
<td>Coal to special industries</td>
<td>26.5</td>
</tr>
<tr>
<td>Total Projected Stabilization Band</td>
<td>100.0 Billion</td>
</tr>
</tbody>
</table>

(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 transport is already disproportionately high, it is not considered advisable to raise water transport rates.

d. 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 wage increases 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.Wages: Recent wage disputes, especially those among the electrical, coal,
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(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 $98,0,10 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 greater competitive advantage in profits from which to make capital expansion, pay disproportionate wages, etc. Moreover, the effect of a price increase of this price increase of this nature is, in effect, inflationary.

(2) Where the world market price is lower than the indigenous cost of production. In some cases where indigenous production is insignificant and no adverse economic effects would occur if the world market price is adopted, no action would be needed. In many cases (i.e., petroleum), it will be dangerous to establish the world market price as the official price since such action would tend to discourage indigenous production. On the other hand, there is danger that to raise the world market price to a level competitive with the indigenous levies. A preferable method, in selected industries, will probably be to effectuate a price pooling mechanism. 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 inefficient. The practice 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 for more and better food are felt through a program for the rationalization, Price and Distribution Division will refer such problems to the Industry and Labor Division 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 price increases being prepared to attack these problems. 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 food to the workers who contribute to the maintenance of the Ministry of Agriculture, and to the groups which 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 the misclassification of self-suppliers as non-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 has as one of its planks of its platform the abolition of fish and vegetable rationing. Although SCAP has insisted on the continuation of the rationing of certain fish and vegetables the effectiveness of the rationing system has been thus far insufficient. 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. Violation of the Nine-Point Program 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. The recent charred 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 types 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 and 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 agencies, in cooperation with the procurators' offices, to improve relations with the procurators' offices, and clearer instructions to Japanese police agencies.

Reference paragraph 2i. Actions taken or anticipated by ESS/PD and NRS to improve the effectiveness of the food collection program, in addition to those already mentioned, follow:

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 contribute to the administration of food collection programs. 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 program with food collection officials and Military Government teams.

c. The incentive goods and distribution programs 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 program. 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 Agrimize the collection of these oils for rationing purposes. A campaign to increase substantially collections of oil is presently in progress.

f. Vigorous 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.
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 ELDEST 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 #2. ASSURE RIGOROUS LIMITATION OF CREDIT EXTENSION TO PROJECTS CONTRIBUTING TO ECONOMIC RECOVERY IN JAPAN.

The Bank of Japan 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 to consider production programs and materials supplies. Particular consideration was given the following:

- Export Industries
- Essential industries (coal, fertilizer, etc.) and those closely related to them
- Industries which make best use of imported materials
- Industries producing daily necessities

The Reconversion Finance Bank January-March (Fourth Quarter) Program was reduced after review of 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 sum 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 during 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.

The Board should have completed its coordination work, promulgated its regulations, cause to have amended the Foreign Exchange Control Law and be reasonably effectively operated by 30 April 1949 and in full effective operation by 31 July 1949.

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.
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 stand-
point 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 budget, 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 Govern-
ment workers since 1945 and the effect on the budget of these increases.

THE "DODGE LINE"

FINANCIAL

11-21 JAPANESE GOVERNMENT BUDGET

Memorandum

Summary of Meeting 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 prior to 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. 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 state-
ment that if this tax was repealed if this would be the only way to get it repealed and it
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 inappropriate one. In FY 49 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 control the tax. It is controlled by the Communists in 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

2 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 of FY 49 could only be collected by force of law. Mr. Ikeda hoped 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 10 billion in accumulated savings. He said that the added amount in FY 49 was 9 billion, and that 1 billion was borrowed in March 1949. The tax income was expected to be 24 billion. He believed the latter increase would far exceed 10 billion in FY 49 because the government was intending to strengthen the insurance per policy from 20,000 to 30,000 to 50,000. He said the Deposit Bureau would invest only in bonds to 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 systems.

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 the tax on tobacco and the sugar tax, the result of which might prove to be clear. He said that the sugar tax was 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 for new investment was 4 or 5 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 the freight rate was 11% or 12% of cost and now only about 4% which justified the present rate.

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 to be reduced because passenger trip service is reported as profitable but the commuter service loss is 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 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.

Mr. Ikeda said that the conclusion was a reduction in passenger trains 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. He believed the communications system was interested in passenger traffic and was proposing 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.)

The communications system had asked for 45 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. He said 20 billion borrowed with 22 billion added to surplus 22 billion and in FY 49 it was proposed that the railroads borrow 20 billion with no subsidy. In FY 49 the communications system borrowed 14 billion and had a 64 billion subsidy. In FY 49 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 accounts.

5. The next question was the financing of the prefectures.

He said that the net savings increase from April 1948 to March 1949 was 28 billion excluding the 10 billion in accumulated savings. He said that the added amount in FY 49 was 9 billion, and that 1 billion was borrowed in March 1949. The tax income was expected to be 24 billion. He believed the latter increase would far exceed 10 billion in FY 49 because the government was intending to strengthen the insurance per policy from 20,000 to 30,000. He said the Deposit Bureau would invest only in bonds to 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 systems.

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.

The "DODGE LINE"
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 to be his budget and not a SCAP budget and he intended to take the full responsibility for it 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

To: General Marquart
From: Sherwood M. Fine, Director, Economic Planning, ESS

March 6, 1949

1. The attached study, prepared by Mr. A. O. Hirschten 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 production and industry, no effective stabilization 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 dangerous 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 expanding economy, may very well be largely neutralized by appropriate fiscal policies and effective direct controls, such inflationary threat is always a possibility during periods 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 incident to new investment.

5. Thus the moral would appear to be that the uncritical wooling 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: SUTLAND PAPERS

11-23 DRAFT SUPPLEMENTARY BUDGET RECOMMENDATIONS OF DODGE MISSION

March 7, 1949

By: Labor Division, ESS

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 would also 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 whole and in the time context of the 1949-50 budget, the Recommendations are too severe and seem to have disregarded dangerous social, political, and economic consequences inherent in them.

1. 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 retraction 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

Distinctly 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, uninhibited, 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 changes in incomes, 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 Measure

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 overall rehabilitation and an implied reduction on the use of unemployment funds. No increase in funds available for direct relief, all of which are indicated in the Recommendations, and a potentially dangerous political and social situation of large-scale unemployment.
become 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 language of the ESF 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 SCA considerably in the labor objective, as 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

By: Joseph M. Dodge

Summary of Meeting* 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 that he had agreed 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 elimination of subsidies and that he recognized that to cut down subsidies would bring upward pressure on certain prices.

2. He pointed out that the contention of some sections of ESF 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.

3. He spoke of the need for continuing or establishing agencies to finance housing and 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. He also noted that 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 he would not go over the limit as yet to meet this. He said this was being tentatively considered as six months plus one months pay for each year of service. On the Kodos, which were fairly recently established agencies, he thought it might be three months pay. There is no unemployment insurance applicable to government workers.

I would suggest 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 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 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 repayment and that to stop them for those desirous of 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. Dodge contended that all the unemployment would be absorbed by export industries or in the development of new 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 so compensated. He said that a minimum of 70 billion yen was the value of the land reclaimed, improvement of harbors beyond present, present or immediate future use. We found these municipal authorities had firm ideas to do 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 lower the maximum revenue and the maximum amount of purchasing power. He was told that was the position but that it was not directly applicable to any 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 $2 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 it 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 unions to stand together.

*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 membership, but the reporting 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 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".

The President 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 SCP. 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. The foreign trade fund was 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 exchange fund 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 lower the maximum revenue and the maximum amount of purchasing power. He was told that was the position but that it was not directly applicable to any 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 $2 billion in taxes.

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*Held March 9 from 1430 to 1600.
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 would be upheld. 

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 income resulting from increased prices of goods and services even from the inflation marking us down. As a result of the inflation 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 proposition to reduce taxes had even been 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 of 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 revenue.

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 the 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 day is not lost in waiting for 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 budget appropriation and was referred to Mr. Reuther to discuss the matter.

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 16th at the minimum, and 26th at the maximum so he believed they would have to make very 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 as a provision of the budget. Such a recommendation that the debt service be paid.

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.
THE "DODGE LINE"

11-26 JAPANESE BUDGET

Memorandum

March 25, 1949

Summary of Meeting with Finance Minister Ikeda

The objective of Mr. Ikeda's interview was 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. Ikeda insisted the abatement of a reduction in the income tax; that he believed it a mistake to prejudice 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 point of time had come for them to pay for some of the 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, 1946, and the dependent reduction from 408 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, 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 any taxes 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 conditions remained about the same.

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, the heavy tax burden was necessary and the Ikeda Government had done its part in 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 the Japanese Government had done its part to date and has contributed to the high taxes.

Mr. Ikeda said that there is no question but what the patient was ill and not yet dead but he believed a token reduction in the tax would serve as a sedative to relieve the shock on the budget 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 what he saw as the practice of the Japanese Government. It was suggested that if the Japanese Government 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 no assurance and could give every assurance that this was true. He was told that it was understood that any concession was but a precedent for future 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 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 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 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. Ikeda.

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 worse. He said he viewed in this light the necessity of strong medicine and strong stomach. 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 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 Mission members which were expected to arrive in 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 the existing 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 in his view a slight change in the basic taxation 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 that the 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
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 excusable, under the conditions of the present budget state would not bc consistent with the position of the SCAP mission, which was that the budget should not be opened. The last was that the president would approve 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 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 discussed 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 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. Mr. Ikeda 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

By: J. M. Dodge

March 31, 1949

Summary of Meeting10 with Finance Minister Ikeda

1. There was a demand from certain elements within the party at a party meeting that the Finance Ministry should require a directive from SCAP for 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 stance they wanted positive assurance that this position would not be upset.

3. 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 em-

10 Held March 30 from 1015 to 1045.
and economic 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 increased by repatriation and concentrated to its homeland. There is a large net gain in population as a result of these factors. 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 sagacity and loyalty of the people. The economy has traveled the early part of this road in a damaged and unrepairable 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 its 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 have been had it been withdrawn on the early part of the road.

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 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 can 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. Herefore, the budget must take the past and not adequately served this purpose. The two principal reasons for this are that the facts have not been made clear by the budget itself and that the discussion and publicity has always centered around only one part of the budget, the general account. 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 very large one. Combined, as they should be, in a consolidated budget the total 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 United States 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.
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 transaction accounts 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 the removal 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 fictitious 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 pays this part of what he pays out. The proceeds are paid by all of the people, and except for subsidies granted to hold down the price of basics 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.

There are many cases where some amount of subsidies 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. In principal uses will be for the retirement of government debt and for capital investment purposes which will be directed and quickly to economic reconstruction. It will be a logical and quick economic activity.

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 fulfillment 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 be 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.

THE "DODGE LINE"

Memorandum

April 15, 1949

Summary of Meetings* 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, again 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. Ichinomada 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 Ichinomada 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 to 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 country and the prestige attached to a position created by agreement 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 ratio 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 have not 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 guarantee.

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 April and May and to bridge the near-term requirements. He believed 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 it was 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

* 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 Fiscal Year. Thus there was a backlog of goods on the way which came from the U.S. Fiscal 49 appropriations which would arrive in Japan during the Japanese Fiscal Year 49 and that also the proceeds from some of the US FY 50 appropriations would arrive during the Japanese Fiscal Year 49.

It was 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 ESH, 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 Ministry of Finance 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 a high 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 ESH 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 take the plan of the immediate and coordinated plans of the ESH, particularly such as might have included to 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. It would not be easy money for anyone to reach and obtain. 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 this fund would be expended only on fully justified specific cases and projects which had been carefully studied and Finance Ministers determined to be constructive and not wasteful. He was warned that he had better establish in the Diet now the idea that this was in fact, to avoid later trouble and complications. The basic questions would be the productivity of the use of funds and whether or not they were consistent with the plans 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 cause local disturbance.

Mr. Ikeda referred to the immediate increase in the price of rice of about $3 per hundredweight and said that there would be somewhat a deflating 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 the best they can do is 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 was an astonishing statement, and asked if he did not know the figures of the Japanese budget which showed 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 was 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 $35 billion. He was also told that 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 noted that he had 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

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 problem of the budget and 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 were needed to keep the timing of the increase in the budget. It was of some concern as to the timing of the extent of the change which would be caused by the budget and believed it was too drastic and there would be much skepticism over the 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 ESH 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 more in revenues than were estimated for the FY 48 year. He hoped most of this 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 utilized 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.
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 properly directed to the production of consumer goods. He pointed to the problem of the issue of the 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 yen, a margin of seven billion yen available from this source if the debenture issue was increased to ten. This could be added to by a further 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 10 percent. In 1943 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 monopolies. 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 than in Japan, 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 become apparent for the first time as a result of our action in exposing them in the budget. We anticipate there would never be a right time to stop inflation. This is the kind of action which everyone tries to put off and putting off 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 it. There may be less yen in circulation in Japan than the U.S. but we have not 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 the areas of the world, as well as in Japan.

3. 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 giving of grants and not with the giving of grants and not with the debt level not and would not be as easy to obtain credits from banks as it had been to do business with politicians freely dispensing the tax revenues obtained from the people.

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 to 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 suggested 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 in addition to U.S. 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 problem of the debt burden is a national war and economic problem and others or banks or other banks be turned into a substitute for the discontinued RBF loans and we could not afford to replace a budget inflation by a credit inflation. While there might be some argument to the proposition that lending power for reconstruction should not 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

11-32 THE STABILIZATION PROGRAM: PROBLEMS AND RESULTS (DODGE TO IKEDA)

Letter

To: Hayato Ikeda, Finance Minister
From: Joseph M. Dodge, United States Minister and Adviser
Dear Mr. 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 that Japan stabilize and control 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.

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.

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 progressive and unbalanced situation.

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. Manpower was formerly dispersed to a great extent into defense, and government policies to prepare for a great, have been largely continued to be learning to supply themselves. This leads to trade restrictions intended to protect their own development. Other countries are following the belief that their future welfare also depends on greatly increased domestic production.

The demand for goods from abroad is 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 finance. This is recognized as the lending power for reconstruction must 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 the 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.

In the United States, for example, increased prices, held at artificially low levels under a grotesque subsidy structure, were unceremoniously removed and overnight most of the basic food stuffs went up as much as one hundred per cent.

With this year’s budget, the British have added to bring to an end the rise in government subsidies. Belgium has had to take similar action.

Other governments have had to take drastic action. In Italy one of the government agencies providing subsidies or relief funds to industry, the Fondo Industria Addestramento, has now been terminated.

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 in 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.

The need for 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 hand-outs in the form of government subsidies and bank and government credit, to any more normal level can not be accomplished without some temporary embarrassment, and it can not be accepted and met as necessary and inherent to the situation, or avoided by a continued inflation with unquestionably disastrous results.

It is no exaggeration 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 near avoidance of 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 stabilizing 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 substantially reduced credits in 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 as the price 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 the prices under retail food items, 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 value.

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 carelessly 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 commerce. Again, this is a problem common to most of the rest of the world. But real capital either must be created or supplied from some outside source.

Unfortunately, in Japan its industrial production operations have tended to displace capital and not create it. The inflation process undermined both the incentives and capacities of Japanese industry to attract such capital by providing temporary earnings in large quantities that could not be expected to persist into the future.

The real advances of public funds to industry and trade, obtained by the use of government credit, were depleting as fast as they were 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 public 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 now provided both in 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.

The government of Japan has been aware of the need for meeting the crisis and 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, the Japanese public and the government of Japan would be in a position 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 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 production or the assessments 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. There is 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. McDermid 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 changes or of changes in local import controls. 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 rationalization in production in export enterprises. 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 Japan by the spiraling consumer goods prices proves destructive. The tendency 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 of short war itself could have been more damaging to the viability of the Japanese economy and the welfare 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 needs to the consumer through legitimation 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 there will be paid in a currency, the value of which does not continue to shrink, is an incentive 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 lack of understanding of the 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.

The 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 served to postpone the inevitable. The inevitable is no longer posturable.

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: South Pacific Papers]

11-33 BANK OF JAPAN'S OPINION ON FINANCIAL ISSUES

Letter of Transmittal
November 14, 1949
To: Major General W. F. Marquart
From: Hisaio 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
Hisaio Ichimada

[Enclosure]

I. MATTERS DESIRED FOR IN CONNECTION 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 enterprise rationalization, and it is expected that 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 possible to prevent the occurrence 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 critical for loans which the Bank of Japan has finished examination and sent to the Ministry of Finance amount to 29 cases, Y$800 million, but the cases approved to date are only 2 cases, approximately Y$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, special consideration is requested for their speedy handling.

Finally, 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 of great importance for 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 in the field 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 to ensure that any measures that may affect the effects of depositors' psychology and eventually the increase of depositors 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 supplied 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 by financial institutions. Further, the major part (90% or about 75% at present) of deposits in this country are interest-bearing deposits and they are considered to be of great importance 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 they 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 decision of the Deposit Inscription 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 exercised in the inspection of deposits by such measures as limiting them to cases where tax evasion is strongly suspected, so that the depositors' willingness to maintain deposits will not be impaired by their necessity for financial support and their economic difficulties.

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. This is to hasten the first recommendation so that it will be carried 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 enforced is to be extended to six months and 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 develop the 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 required funds mainly through the issuance of debentures. However, real estate mortgage finance is very unsound 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 Y500 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 order to improve the banks and local government banks, as well as in government bonds and local government bonds, this 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 the Deposit Bureau funds as of 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 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 present condition, for the Deposit Bureau to adopt a method of supplying funds to industries indirectly through financial institutions by the underwriting 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 at a high rate and that such special market troubles are in the making, 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.

1134 DODGE-IKEDA TALKS

Monetary Bill 43, Meeting Between Dodge and Finance Minister Ikeda

By: Joseph M. Dodge

May 3, 1950

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 number of subjects were 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 was arguing that the rate was too low and the debt requirement too high. This will cause deflation instead of disinflation. It is substantiated by increasing bad debts, 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 employment. The General also believed that a wage increase to be followed by a wage increase for government workers would add fuel to the fire of other wage demands.

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 General's economic program. He believed any wage increase would be built on a spiral of wage increases taken in connection with government workers due to the decline in black market prices and other prices, and that the factors now were more wage continuation 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 180 thousand. In FY 1950, the budget provides for 600 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 state of Japan employees. Thus the net government workers is 430 thousand.

The present basic 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 basic 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 get 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-personal costs due to price declines.

It was considered important that this wage adjustment be made so as to be related to the increased productivity expected 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 1/2 of the FY 50 fiscal year, and 1 1/4 of the 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 recommendations, 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 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” wage savings. This proposal was for a continuing higher level of budget expenditures in this category and would absorb and greatly exceed any budget savings of non-personal 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 productivity.)

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 would have paid the tax 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.

The provisions for debt retirement in the FY 50 budget and counterpart fund total 128 billion yen. In the FY 50 budget the amount is from current revenue and 28 billion is mandatory debt retirement as a result of FY 49 surplus.

There is the 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.

A very preliminary forecast of the FY 51 budget (to be effective April 1, 1951) indicates total expenditures at 5.256 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 revenues are expected to be 72 billion in the FY 51 fund and 58 from the budget, comparable to FY 50, with the substantial saving in deficits and transfers of 7.8 billion and in subsidies of 42 billion.

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 of coal, particularly coking coal. In Japan coking coal is about twice the price per ton ($5000 yen) as Pittsburgh. This problem can be met by importation 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 Kyouyu mines claim that an investment of 1 billion 700 yen will enable them to save 1500 yen a ton. This is a reasonable cost to get a bargain in coal and shipbuilding.

Mr. Ikeda believes the counterparty 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 none 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 GOA at the end of 1949 against 1948. In this there was no indication of a marked deflationary reduction, particularly when related to the increased government debt, postwar dislocation of domestic savings and the price of the GOA debt 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 GOA and the public forum of 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 were discussed and their inflationary effect in the short run. It was greatly excess that they were not suggested as an important element in the relationship between the accumulation of private savings and domestic capital investment, including capital investment made and financed by the government.

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 any or 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
To: General MacArthur
From: Joseph M. Dodge

May 8, 1950

Dear General MacArthur,

When I was in Tokyo it was my province 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 memorandum, there is another, classified as Secret, about a discussion of the Japanese Treaty problem which will have to be sent on by courier.

I know you will understand that I do my best to report these as simply as 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 preparation 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 Minister Ikeda 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 as to what we were going to talk about I said, "Anything you like!". 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 "political gifts".

I have devoted a great deal of my time to listening and 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 it may come from my own notes 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 be not disclosed to anyone, other than Major General Marquart 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 proposals, and I would prefer to be wrong although, at least at the moment, I believe I am more nearly right than wrong.

18 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 realization of Tracy's responsibility within the Department. Major General Magruder is acting in his place. Tracy has offered to continue his work in the Occupied Areas problems, but no action has 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 study and documents on his appointment. They recall 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 turn out to have some integration of the two, but not enough for 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 with our comparable emphasis on the requirements and responsibilities of the foreign Nations receiving the assistance.

Frank Pace is 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 discontinued, disbanded, or allowed to drift away because of the recent changes in the Army Administration. I believe the loss of Tracy's long experience on leave it all the more necessary to retain the others who retain the same level of 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 as much assistance I thought necessary.

I am sure he would welcome any of these men—if any of these men—or, for that matter, Mr. 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.

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 be found in 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 portion of the money that is to be on the move toward much larger scale), it seems to be a very complex problem.

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 good enough 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 only what the Congress provided by law, he would do all he could to help Japan and that if opposition in the first opportunity he would 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 guaranty 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.

Obviouly 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 a 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. Without 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 management remains 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 we 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 Detroiter is sending 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
To: General MacArthur
From: General MacArthur
May 22, 1950

Dear Joe:

Thank you so much for your full letter concerning Ikeda's visit to the United States and for the book which you 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 severe constraints 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 as present Yoshida and the Liberal Party are so embossed in the political fight that their economic balance is not entirely rational. 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
To: General MacArthur
From: Prime Minister Shigeru Yoshida
May 22, 1950

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.

The "DODGE LINE"

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 7,500 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 payroll.

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 businesses.

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 purposes. 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 Government will be able to meet the Government's fiscal year-end deficits and 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) Property Tax
To work out a formula whereby the tax rate will be determined prior to the payment of the third and final installment 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 implementation 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 the same year 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: Scotland Papers, 2.784-34]

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 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 achievements achieved thus far. This attitude was particularly noticeable during Mr. Ikeda's recent visit to the United States. Japan's budgetary position was most favorably commented upon. Nothing could be more inappropriate at this time which would reduce the already weakened international reputation, such as revision to previous inflationary policies whose ill effects are now just remaining 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 high for the month. Without inflation, 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 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 Y50 billion less than last year and tax relief has been advanced requirements of lost government 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 fiscal headquarters prior to the next session of his Headquarters prior to the next session of the United States.

[Source: Scotland Papers, 2.784-34]

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 was delighted by the way Washington and New York, whose acquaintance and friendship will be my valuable asset for all my life. Also for the first time in your life, you opened my eyes to a new world where the civilization has accomplished almost unbelievable things and people speak with their own minds with respect and without fear. I especially appreciate your having stayed in Washington with my sejour, 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 Hickam Airport was not very pleasant. The contrast between Washington and Tokyo was so sharp that I had to keep my hat in my hand. 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 Tokyo by the train that left Tokyo four hours later. I had to give press 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 Tokyo. 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, 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 in my sleeve". All this movement, however, put fire into the oil of speculations and by the time Mr. Yoshida returned to Tokyo, it was on fire. On Wednesday morning when General Marquart suddenly cancelled his meeting with me scheduled 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. Marquart cancelled the appointment because of any ill intention but it nevertheless created an embarrassing situation. Prime Minister General, Mr. Noda, was also wondering about it. Prime Minister General also had second thoughts after receiving a written reply from Gen. MacArthur. But he might 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, General MacArthur 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 SACP 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. Marquart and was given a warm congratulations from him for the success of your 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 appreciate 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—Keich Miyazawa.

11-40 COMPLETION OF MISSION BY MR. JOSEPH M. DODGE

Memorandum

To: General MacArthur
From: W. F. Marquart, Chief, ESS
Confidential

December 2, 1950

1. Mr. Dodge completes his mission and departs Japan, as you are aware, on Monday 4 December. 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 these 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 covered unless there should be some special subject on which you 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.

"Availability of 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 economic situation. The expectation was obtained that wages in the "Red Wares" industry would show a significant increase. This expectation has not 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 in the light of his views on the 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 recommendations are in line with your views and 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 has 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.

11-41 POSSIBLE REORGANIZATION OF RECONSTRUCTION FINANCE BANK

Memorandum

To: Mr. General W. F. Marquart
From: Joseph M. Dodge

December 3, 1950

The lending activities of the RFB were stopped in 1949. My general memorandum of Capital Funds Availability and Bank Credit highlighted the problem of the long-term debt carried as short-term debt in Commercial banks and the need to refinance it on a longer-term basis. 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 balance of long-term capital of the general government budget account amounted to a total of Y$38 billion. Of this amount, Y$9.4 billion was repaid and taken into government revenues in JFY 49 and an estimated Y$12 billion will be similarly recovered in JFY 50.

The duties of the RFB were transferred to the Counterpart Fund to the amount of Y$2.5 billion and cancelled.

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. It has been suggested that whatever extent they can be liquidated without loss 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 also 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 the short-term form and long-term debt carried in the RFB in relatively short-term form. 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 existing loans held by commercial banks. If this process were followed, it would tend to free up the commercial banks to the extent that their resources were available for other uses in the Japanese economy. The RFB would 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

To: Department of the Army

From: SACAP, Approved by F. F. Marquat

October 28, 1951

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 will be clearly spelled out, and the Japanese people will be expected to bear them.

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

By: Joseph M. Dodge

November 29, 1951

No one could fail to note the visible signs of material progress made by Japan in the past year 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

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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.

For Japan to 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 exports.

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 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 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 rate 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 imports is 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.

4. The problems of understanding, the recognition of these problems by the people of Japan in the 1950’s and 1960’s and the receipt of real assistance from the United States and other sources of 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
THE "DODGE LINE"

11-44 JAPAN: POST-TREATY RELATIONSHIP

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 now 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 our 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

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*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."

*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)
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 Inclusive 1, attached hereto.
You will immediately post signs on the premises declaring that the institutions are closed.
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.
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.
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.
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.
You will discharge and summarize remove from office the chairman of the board of directors, the president, the managing directors and the advisors of all institutions listed in Inclusive 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 such authority or power to act on behalf of such institutions to be given to any other persons without the authorization of this headquarters.
The all 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 instructions.

An acknowledgement of the receipt of this memorandum is desired.

12-2 OPPOSITION TO OPENING OF NATIONAL CITY BANK BRANCH

Memorandum December 2, 1945
To: Secretary, SWNCC
From: John D. Haldeman, Acting Chairman
1 This memorandum was designated SWACC 226/1/D, "Establishment or Re-establishment in Japan of Branches of American Banks," December 3.
2 In cable WARK 7609 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 35095 of October 19, requesting that the bank "resume Japanese operations as soon as possible", because "Japanese banks in a vulnerable condition and sound bank necessary as U.S. desires to provide banking facilities for occupation needs, for export and import activities and for foreign personnel."
3 Though not printed here, this attached draft became SCAPIN-803 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: SUTLAND PAPERS, Z-703-12]

12-4 REOPENING OF THE JAPAN SECURITIES EXCHANGE

Memorandum

To: C of SS

From: CW*T

The Government Section concurs in the proposed memorandum for the Imperial Japanese Government, AG 571/2 — Apr. 46 — ESS/FI, subject, Reopening of The Japan Securities Exchange, with the following changes:

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: SUTLAND PAPERS, Z-703-16]

12-5 ABOLITION OF SYSTEM OF DESIGNATED FINANCIAL INSTITUTIONS AND COMPULSORY LOANS

Memo for Record

Re: SCAPIN-563 of April 5, 1946

By: C.F.T.4

1. The system of designating financial institutions to finance munitions companies was inaugurated in May 1940 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 of which are controlled by Zaibatsu) perform the financing function and 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 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.

In the Japanese Government states that it favors the abolition of the system in the future but opposes action now because it will but off the supply of funds needed 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 sound they should not be made by any institution.

1. The termination 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 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.

Reference 1a 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.

The abolition of the system of compulsory loans will mean the denial of funds for the desirable purposes mentioned in paragraph 2b of reference 1a. 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 insistently 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 uncured inflationary trend that recently forced the Japanese Government to a drastic money 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 the Zaibatsu 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 USAFIX 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.


AC, Mr. J. McL. Henderson.

12-6 REOPENING OF THE JAPAN SECURITIES EXCHANGE

Memorandum

To: ESS

From: S.J.C., C/S*

The reopening of the Japan Securities Exchange is not favorably considered at the present time.

1. 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: SUTLAND PAPERS]


12-7 REGULATION OF OVER-THE-COUNTER DEALINGS IN AND TRANSFER OF SECURITIES

Memorandum

To: Finance Division, ESS
From: Courtney Whitney, Chief, Government Section

July 26, 1946

1. This Section does not occur 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 elimination 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.
   b. 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

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 "insider" 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 unscrupulous profits, and foster just and equitable principles of trade among securities brokers, dealers and underwriters, (4) develop a fair market in securities.
   3. Of the purposes stated in paragraph 2 above, only item one bears any viable 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 submit reports on all transactions in securities whenever so requested. 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: SCOTTLAND PAPERS, Z 703-16

12-8 SUMMARY OF SECURITIES AND EXCHANGES BILL

By: T. F. Adams, Money and Banking Branch, Finance Division, ESS

January 9, 1947

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.

*Signed by "FR", probably Frank Izzo.
determine both the amounts and types of securities.
c. 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.
Th[e]e passage will give the people confidence that later [bills] 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 surprised by the suddenness 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 that they want immediate approval of the bill so it can be presented to the Diet I 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 report of receipts 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: SCUTLAND PAPERS, Z 703-15]

12-10 ESTABLISHMENT OF COMMERCIAL AND FOREIGN TRADE BANKING FACILITIES IN JAPAN (SWGCC-226/6)

Report
SWGCC-226/6
Secret

A STUDY PRESENTED BY THE STATE MEMBER, SWGCC

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.

2. See Appendix "A".

3. See Appendix "B". [deleted]

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. SWGCC approve the conclusions in paragraph 4 above;
b. After approval by SWGCC:
   (1) The cable at Appendix "G" be transmitted to SCAP;
   (2) Copies of this cable be transmitted to the State, War and Navy Departments for information.
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.

APPENDIX "A"

FACTS BEARING ON THE PROBLEM

1. By informal action on March 15, 1946, the State-War-Navy Coordinating Committee approved SWGCC 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 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 . . . ."

APPENDIX "C"

CABLE FROM SCAP TO WAR DEPARTMENT REQUESTING AUTHORITY TO EXPAND FUNCTIONS OF FOREIGN BANKS

FROM: SCAP Tokyo Japan
TO: WARCOS NR.: 210105 dated March 1946 and WAR 8030 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.19

APPENDIX "D"

CABLE FROM WAR DEPARTMENT TO SCAP PROPOSING EXPANSION FUNCTIONS OF FOREIGN BANKS

FROM: WDSCE ES
TO: CINCFE, Tokyo, Japan
NO: WAR 98941
17 May 1947
Recurred 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 NCBA Tokyo function as depository dollar proceeds Japanese exports and render Global Export-Import Banking Services (reurred) and with view to facilitating restoration private trade Japan (reurred) request your comments earliest full 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.

...[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 paper4 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 Philippines 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

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 ideally be divorced from direct control by the government in power, also pleased by law in the hands of long-term members of a "Board of Banking and Finance" to assure 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 have no 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.


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: SUTLAND PAPERS, Z 703-15]
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 administration, and in securities in particular, appointed for terms 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 discretion 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 the diversified 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. Stabilization 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 securities as a business.
   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 broader and more democratic management responsibility and practices.
   i. Stands 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 "grouping" 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.

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. Full-time service on the Board at top Government salary scale and the separation from all other occupations or business operations.
   d. Ineligibility of politicians or purges.
   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 being taken by the 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
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limitations and restrictions prescribed by law or regulations of the Banking Board.

5. Various structural defects and weaknesses should be eliminated by a new banking law including definitive and effective provisions relating to the following matters, some of which are covered in sufficient detail in other sections of this Memorandum:

(a) Define the many special laws relating to various kinds of organizations dealing with deposits and credit operations.
(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, munis, and all other corporations, associations, etc., engaged in the business of granting credits and receiving deposits, and require them to comply with all the 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 dealings of a bank, effective as soon as practicable.
(l) Prohibit affiliation of directors, officers and employees of securities companies.
(m) Prohibit interlocking relationships of directors, officers and employees with other banks and any considerable 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 about by 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.

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 Hypothebank, 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 will be liquidated and any of their funds and assets will be transferred to the board of directors, 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 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 have been liquidated 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. Moratorium 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, the 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., or

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.

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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 1/3 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 collateralized 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 as 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 officers or 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 favorably than 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 secured loans for any securities company or dealer.

q. No bank may hold stock or other securities issued by a bank premises company.

r. 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.

s. 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” for 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 or to bonds which are obligations of a prefecture or municipal corporation, 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 evasion.

Capital Stock Ownership and Management

10. To afford more protection to depositors and more representative management, 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 shall 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 which will be subject to the conditions applicable to the payment of dividends set forth in the law.

e. At least 50% of the book's capital stock 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 purchase price 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 any asset or liability of the 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 office, 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 right of all holders of stock 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 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 attained at any meeting, the new business and any adjourned meeting shall be adjourned until a quorum is reached.

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 paid not in excess of 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 regulation 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.

c. 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 share to be elected or cumulatively for one or more directors.

ee. If a vacancy occurs in the board of directors between shareholders' meetings, the board of directors is 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 punishment 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 of 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 reorganize or 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. To avoid the information and guidance of the Banking Board and regulations prescribed by the Banking Board, duly authorized representatives of the Bank of Japan may be authorized to make credit investigations of any person.

k. Authorization of the Banking Board to appoint a receiver pending determination whether to reorganize or dissolve 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 at a time for determining or approving any plan of operating under a receivership, reorganizing or placing the bank in 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. Trusts 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.

1. 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.

m. 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 financial institutions, insurers, 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. The Banking Board is hereby authorized to submit reports to the Banking Board and 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 reports 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 report to examination at such times as may be directed by the Banking Board, in no case less frequently than once in every eighteen months.

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.

1. 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 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. Directors and officers 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.

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 of banks 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: SCOTLAND PAPERS, Z703-15]

12-13 CAGLE'S MEMO ON BANKING LEGISLATION

Memorandum

To: W. K. LeCount, Chief, Finance Division, ESS

From: C. E. Cagle, Chief, Bank of Japan Unit, Money and Banking Branch

December 28, 1948
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 proposal 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." Professor Naoro’s report has banks maintain reserves. However, the Bank of Japan requires clearing banks to maintain balances as determined by the Reserve Bank of Japan. This is 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 not proposed that all balances be required to maintain reserves within certain limits; the required balance, and 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. The principal regulatory 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 in Japan. 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 security... the suggestion might appear to be that the bank 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 little change in practice.

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 suggestion that the Bank of Japan was not to have full control over its own operations. The Bank of Japan law actually provides that the Bank provides all necessary banking services and that the central bank in Japan is the Bank of Japan. The suggestion would require, in actual practice the variable loan and discount rates which it charges on credit extended to banks and other institutions, on loans granted by banks and other credit institutions, and interest paid on deposits of various types. Through its administration of the Loan Priorities Law and its credit rate, facilities operations, its stamp bail 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, concrete  operation of the Bank of Japan, and the size of loans in individual operations. The Bank of Japan may determine 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 RBFB debentures and other government bonds; grants special low rate credit aids and allocates higher rate assets to insufficient banks to enable them to show profit; grants large credits to a continuous nature to 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 investment operations; supplies funds to selected securities and 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 this proposal would not touch, the Bank of Japan is represented in an important way on at least seven of the most important managerial and credit committees in Japan, including the Reconstruction Finance Commission and the Deposit Bureau Funding 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 discretion, in the Bank of Japan—even if it were operated under a board of directors, as envisioned 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 unsatisfactorily stabilized 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 execute 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 had little interest in more extensive credit operations, and would presumably have opposed them 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 the on-going occupation, for which it was not responsible, if it were approached before stabilization is accomplished or reasonably assured. It would seem that there would be far more desire to accept such a program 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 it.

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 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.

[Sources: Scuttlebutt Papers, 2709-15]

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 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. 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 be easily 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 as recommended by the Finance Division. 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, the Bank of Japan would be able to fulfill these functions because of its status and power. Moreover, there is a strong case for the belief that if the Bank of Japan were to assume all the functions of a Banking Control Board, it would be able to perform them because of its existing organization, structure, and powers.

5. We still adhere to our basic recommendation for an independent Banking Control Board, not to be used merely as a convenience of policy, but as a means to bring about the accomplishment of the objectives of Washington's opinions, which we believe are exactly the same as those of Mr. Cagle. Moreover, we believe that the establishment of such a Board would be more easily accomplished than by any means short of a majority vote, and would impose a far greater responsibility on the Bank of Japan for the exercise of its power.

6. The setup proposed in the preceding paragraph would still leave the Bank of Japan as the ultimate ultimate authority in 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 also upon the Bank of Japan. It would also avoid the problem of the relationship of the Bank of Japan to the policy of the government, and would overcome the point raised by Washington in a note on the question of the independence of the Bank of Japan.

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.

[Sources: SUTLAND PAPERS, 2,703-15]

12-15 LECOUNT'S MEMO ON CONTROLS ON CREDIT EXPANSION

Memorandum

January 7, 1949

To: Chief, ESS

Fro: 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:


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. To improve 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 public 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 of such rehabilitation projects 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.

[Sources: SUTLAND PAPERS, 2,703-16]

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:


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.

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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 public 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 of such rehabilitation projects 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.

[Sources: SUTLAND PAPERS, 2,703-15]
12-17 ON THE OPERATION OF JAPAN DEVELOPMENT BANK

Memorandum 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'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.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Amount of loans, approved (in million yen)</th>
<th>Amount of loans, actually made</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td>855</td>
<td>239</td>
</tr>
<tr>
<td>Iron &amp; steel</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td>Non-ferrous</td>
<td>35</td>
<td>1</td>
</tr>
<tr>
<td>Electric power (self-generation)</td>
<td>630</td>
<td>183</td>
</tr>
<tr>
<td>Chemical industry</td>
<td>338</td>
<td>29</td>
</tr>
<tr>
<td>Port facilities</td>
<td>77</td>
<td>2</td>
</tr>
<tr>
<td>Fishery</td>
<td>310</td>
<td>254</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,635</strong></td>
<td><strong>1,025</strong></td>
</tr>
</tbody>
</table>

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 receiving these loans has been 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 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 FY 1947 and 48 during which the Reconversion Finance Bank was in active operation was that, while it was planned to hold price level low so as to curb the inflationary 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 FY 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 FY 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.
   (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 prescribed by the JDB law as they prescribed by the JDB law, it is clearly for the better. Furthermore the financing of equipment funds by the Japan Development Bank being made very strictly and properly by almost the same criteria as is observed in regard to the direct investments through the U.S. Aid Counterpart Fund to private enterprises.

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 separately 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 somewhat 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,

No indication of author (Ministry of Finance, Japanese Government?).
in order that any doubt account 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, 703-15]
13 U.S. OCCUPATION OF GERMANY

13-1 PROGRAM TO PREVENT GERMANY FROM STARTING A WORLD WAR III

By: Henry Morgenthau, Jr., U.S. Secretary of Treasury

Sept. 1944

1. Démilitarization 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 disarmament of 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 13 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, Württemberg, 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 present industries and then weakened and controlled so 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 restoration. 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 objectives.

5. Restitution and Reparation.
   Reparations, in the form of future payments and deliveries, should not be demanded. Reparation and restitution 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 property 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).

(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.

(a) 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:

(i) Dismantle all policy-making officials of the Reich government and deal primarily with local government officials.

(ii) 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 experiments separate states.

(iii) 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.


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 thus 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 in order to prevent 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.

(a) All large estates should be broken up and divided among the peasants and the system of primogeniture and should be abolished.

11. Punishment of War Crimes and Treatment of Special Groups.

(a) The punishment of crimes, including 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 uniform military 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.


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.

Directive (JCS1067)
April 1945

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 directives and statements by the United States, that 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 issued 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 have responsibility for military government of the United States zones assigned to the United States for purposes of occupation and administration. It outlines the basic principles which will guide you in those two capacities after the termination of the combined command of Supreme Commander, Allied Expeditionary Forces.

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 clearly understand that it sets general principles and that you, as military representative of the United States, will interpret and apply them in a manner consistent with the governmental, industrial, financial, social and political conditions within your zone and that the results of such surveys and other such 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

Signed by President Truman on May 10, 1945 and released October 17, 1945.
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 have 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 and other 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 agreements entered into in August. 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 toward 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 utilities, communications, (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, any agreements 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 the movement of civilians, no civilian will be permitted to leave or enter your zone without your authority, and no German within your zone shall be permitted to leave Germany except for specific purposes approved by you.

f. The military Government in each zone 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 authority over the whole of Germany affecting 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 government and important Allied objectives. In the conduct of your occupation and administration you shall be but firm and aloof. You will strongly discourage fraternization with the German officials and population.

h. 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 civilians and comfort necessary for maintenance of good order and security required to prevent 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 your zone on a higher level than that existing in any one of the neighboring United Nations.

5. Economic Controls:

a. As 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 requirements for the maintenance of good order and security required to prevent 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 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 such 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 discrimination may be transferred to 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 laws purporting to impose a regime of regulations which may be in inconsistent with the laws of the Control Council, or to impose controls 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. No person who has been more than nominal participant 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) commercial undertakings, 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 so designated as more than nominal participants in Party activities or as 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 crime other than the so-called political crimes or the so-called political crimes committed by a member of the Gestapo or the Criminal Police, or (3) by their actions or statements 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 participants in its activities, shall be confiscated or otherwise disposed of in accordance with 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 instruction, or which are devoted to the glorification of Nazi 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 ends or propaganda.

7. Demilitarization:
   a. In your zone you will assure that all units of the German armed forces, including para-military organizations, are 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 shall proclaim, in your zone you will effectuate, the total disarmament of para-military organizations, including the General Staff, the German Officers Corps, the Reserve Corps and military academies, together with all asociations 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, withhold from publication for the present.]

   a. 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 decisions 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 of 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 Activity:
   a. No political activities of any kind shall be countenanced unless authorized by you.
   b. You will be assured that your military government does not become committed to any political group.

10. Public Relations and Control of Public Information:
   a. 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) access to publications, correspondence, (c) press censorship, and (d) coordination and supervision and regulation of communicies 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 courts 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:
   a. With the exception of the Reichskriminalpolizei (Criminal Police) all elements of the Sicherheitspolizei (Security Police), e.g., Geheime Staatspolizei (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:
   a. 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, Napolis 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 specifically to eliminate Nazi and militaristic doctrines and to encourage the development of democratic ideas.

15. Art and Archives:
   a. Subject to the provisions of paragraph 6 above, you will make all reasonable efforts to preserve valuable 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 administration, individuals, organizations, institutions, principles, features, and practices.

18. 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.

19. 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 fulfillment 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.

20. 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.

21. You will initiate appropriate surveys which may assist you in achieving the objectives of this directive. In particular you will get underway 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.

22. 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, and resources and personnel will be taken from the activities set forth in paragraphs 2 and 5 of this directive, and such 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 military 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 assure 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.

23. You will urge upon the Control Council that uniform ration scales be applied throughout Germany. Such equipment items would be distributed equitably among the zones that surplus would be made available for export to Allied countries, and that imports be limited to the net deficits of Germany as a whole.

24. 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 influences under the conditions or the continuation of any group hostile to the objectives and operations of the occupying forces.

25. 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 such wage, hour and other controls, if any, as may be instituted or revived by your direction.

26. Subject to the provisions of paragraph 48 of this directive you are authorized to direct German authorities to maintain or re-establish non-discriminatory systems of social insurance and poor relief.

27. You are authorized to direct the German authorities to maintain or re-establish such health services and facilities as may be available to them.

28. 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 transmission of agricultural output.

29. You will direct the German authorities to utilize large-sized estates and public lands in a manner which will facilitate the accommodation and settlement of Germans and others or increase agricultural output.

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) 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. in those cases in which they are 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. keep the balance for disposal in accordance with instructions which will be sent to you.

Pending agreement in the Control Council you will take those measures in your own zone.

You will carry out the prohibition 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 specified in paragraphs 2 and 5 of this directive, and take such 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 the production of steel and iron, excluding pig iron and steel, and other non-ferrous 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 the decision in the Control Council, you will put such conduct 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.
21. 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 joint control products, 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 conversion 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. Limit all cartels or other private business cartels 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 control 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 consult with the Joint Chiefs of Staff in the making of this survey in the zones of other occupation and you will urge the coordination of the methods and results of this survey in the various zones.
38. With respect 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 adopt the fiscal and financial measures necessary to that 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, Information, 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 in 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 foreign trade controls are designed to carry out the objectives stated in paragraphs 4 and 5 of this directive.
42. Imports which are permitted and furnished to Germany are confined to those unavoidably required in the product mix stated in paragraphs 4 and 5 of this directive.
43. Exports to countries other than the United Nations are prohibited unless specifically authorized by the Allied governments.
44. 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.
45. 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 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 outlined 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 circulation in Germany will be legal tender without distinction and will be interchangeable at the rate of 1 Allied Military mark for 1 Reichsmark. Reichskreditkassen- scheine 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 to 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.
   a. 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.
   b. 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 to 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.
   a. 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.
   b. 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 to the cost of such private property as may be requisitioned, seized, or otherwise acquired, by Allied authorities for reparations or restitution purposes.
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 5, 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 the 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.

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 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 deem proper, but in any event, you will report immediately to the Control Council the facts to which this paragraph applies.

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 may require, including information in respect of 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

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 preparing plans for the occupation of Germany and have been working with their British, Czech, 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.
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.

Lieutenant 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 the Office of Production Management. He has been described as a tough-minded 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 Finance Division will deal with all foreign affairs, handle economic, political, military, and financial problems of the Economic Section, and a number of complementing actions.

The Division will see to it that the Germans are forced to exert all efforts to feed themselves and 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 trade, labor 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 nationalization of industries, firms, 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, 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 Prisons of War and Displaced Persons Persons Division. Multiple sections 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 divisions 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, Asia 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

Prepared by: Gerhard Colla and Raymond W. Goldsmith

(U.S. 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. This information will be kept as secret as possible.

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 and the bank shares, deposits, the unemployment compensation fund, deposits, the national debt, and all money 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, necessary to establish confidence in 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 wages.

II. Equalization of Losses:—The scaling 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 end 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. 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 those 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 scaling 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 compensatory 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 scaling 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 allocated to additional claims and the additional claim thus so created. The creation of 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 wages and salaries is increased in an orderly way 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 monetary currency and to restrict the amount of cost of occupation and of reparations to be paid—not such as are put into effect in the event of creation of new currency and deposits within definite limits and to prevent excessive taxation. There are other measures under consideration such as those related to disposal of public property or compulsory nationalization 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 (L) should be executed first. This measure is so designed that it involves a minimum of administrative complexities and is put into effect 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 possible. 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, of course, may consult with 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

Secret

1. The Colm-Dodge-Goldsmith Plan

The Plan for theLiquidation of War Finance and the Financial Rehabilitation of Germany, submitted to General Clay on May 20 by Mears, 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 due to evacuation). The creation of War Loss Certificates:—

(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% mortgages and capital levy will destroy the productive and commercial life of Germany.

(b) Policy

The occupying authorities should not undertake the responsibility for measures as ambitious as the 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 responsibility for its successful 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 plan is constitutional 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 use 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 2%.

The remainder of this paper deals with the "policy" problem. It is not designed to define 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 are currently 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 resulted in a large 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, productive capacity has suffered even more heavily. Meanwhile, the price level, in official markets, remains roughly at the pre-war level. To guard against the creation of "monetary superstructure and economic foundation," in the phrase of the report, entails two major consequences:

(a) The swollen volume of current purchasing power, in the form of currency and bank deposits, creates immediate inflationary pressure which is held in check only by price and other direct controls.

(b) The large scale 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 damages, reparations, and evacuation following the confiscation 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 focused on both of these problems and on the need for a comprehensive program to address them, 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 resulting 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 controversial that no growing democratic government in Germany could take them and survive.

The problem is not likely to be a temporary one 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 the capacity of the Allied forces. To secure widespread agreement on the need for some action to prevent inflation is one thing; to gain general support for a specific program of any kind is quite a different matter.

The elements of any effective counter-inflation policy 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 to the problem of control 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, the C-D-G plan is designed as a 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.

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 provinces of the defeated Reich in whose territory 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 from 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 against inflation, and surviving, will prevent it from dealing with the war claims problem. The problem itself is unlikely, 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 the occupying 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 a rebirth of the C-D-G plan, at least in the minds of the leadership 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 run its course. It 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. (But 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 has the advantage of leaving in place a financial framework of support of the G-4 plan, and the 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.

(c) They can take Step 1, with Steps 2 and 3. This plan has the disadvantage that it selects for special treatment the holders of monetary claims, 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.

(d) They can take Step 2 alone, which would involve the occupiers in an anti-inflationary action on the holders of monetary claims. This plan has the disadvantage that it selects for special treatment the holders of monetary claims, 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.
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 latter 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, apart from 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 ground 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 measures 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.

1. Purpose of this Directive

This directive is 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) and its amendments.

2. Authority granted

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.

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 able to receive its destructive influence.

To accomplish the latter purpose the United States Government has proposed to the other Occupying Powers a treaty for the continuing disarming and demilitarization of Germany and it has committed itself to maintaining a United States army of occupation as long as foreign occupation 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.

4. Demilitarization

There should be no relaxation of effort to complete and effectively to maintain the disarmament and the demilitarization of Germany.

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 tranquility 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 honest 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 (Lander) and the formation of a central German government with carefully defined and limited powers and functions. All powers shall be vested in the Lander 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 be absolutely firm 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 formation of German political life should be left to the decision of the German people made freely in accordance with democratic processes.

7. Inter-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 quadrupartite 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-
been thereby 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, 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 the 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 in 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 interest 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. In your opinion it will be compatible with your requirements and the public interest, 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 policies of the United Nations or other Military Government.

13. Movement of Persons

a. You will implement the decisions taken 23 April 1947 by the Council of Foreign Ministers with respect 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. You will maintain the displaced persons camps until such time as you will determine that the displaced persons can return to their homes or until the IRO is able to maintain the camps.

d. 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.

e. 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 disloyal activities under German law. You will take such action as you may deem appropriate to assist the German authorities in effecting a program of resettlement.

f. 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.

g. 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.


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 framework of international cooperation.

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 reparations 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 reparations 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 compelling the achievement of a German economy consistent with German conditions that affirms the principle that the proceeds of authorized exports shall be used in the first place for the payment of authorized imports.

d. Your Government 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 extent possible, 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 essentially national 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 lost or displaced property which has been destroyed or cannot be located whenever such replacement can be accomplished only at the expense of Germany, 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 1570/3, you will make available for the rehabilitation and resettlement of non-reparand property of German action valuable personal property looted from National Socialists 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 and property losses as a result of National Socialist persecution should receive indemnification in German currency. With respect to heirless and unclaimed property subject to internal restitution you will designate appro-
U.S. OCCUPATION OF GERMANY

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 economic unity, and the establishment of central German authorities 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 may be considered 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 of 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 any 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 countries or territories benefited to enable them to pay Germany. You will consult with 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 programs, and that it may be possible for the German economy to develop these exports to the benefit of all. Proposed transactions of a substantial nature which would lead to a restoration of general European trade or normal international monetary relations or restore normal exchange rates and transactions 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 stabilization of Germany as essential factors in the establishment of an organized 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 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 a speculative character in order to keep 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;

(c) 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 the establishment of a central German 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.

(d) 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 Potdam Agreement, to use the proceeds of exports to pay for imports which you deem essential, subject to strict accounting and auditing procedures; and

e. You will continue to aid economic recovery by collection of full payment for exports of German goods and services; and

f. You will continue to prevent non-essential imports.

c. Your Government will consider the adoption of a program of 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 revolutions; 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 (US) in Germany, including also such operations undertaken jointly with you by 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 quadrilateral 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: (1) facilitate 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. Control Council 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 development of free enterprise, or restore normal international trade relationships or restore normal exchange rates and transactions 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.

b. You will permit the formation and functioning of cooperatives provided they are voluntary in membership and governed along democratic lines and do not engage in activities prohibited under the 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 remain free of interference in this directive. 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 in accordance with the central 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 are in conformity with the principles and objectives of the Control Council. Any federation of trade unions which is controlled by national or 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.

23. 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.

24. 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.

25. You will also permit the establishment of machinery for the voluntary settlement of industrial disputes.

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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 Land 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 1966. By: Staff of the Senate Committee on Foreign Relations and the Department of State]