The Domestic & Occupational US Policies Aiding Post-War Japanese Economic Recovery

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Japan’s defeat in World War II left the empire in tatters economically from massive destruction to its industries and labor force. Under the Supreme Commander of the Allied Powers (SCAP), the United States took on the role of the occupation and administration of Japan and its imperial possessions. SCAP would in the years following 1945 to the Treaty of San Francisco in 1952, where sovereignty was returned to Japan, would enact numerous policies to at first, prevent future Japanese aggression then in light of the Cold War reverse this stance to helping the Japanese economy recover as a bastion against Communism in Asia. This paper seeks to first, provide a brief history of the post-war Japanese economic situation under the aegis of American occupation, then investigate how the change in economic policy by both SCAP and the American government resulting from the escalation of tensions in the Cold War had an positive effect on the *zaibatsu* conglomerates, steel industry, camera industry, and cotton textile industry in the recovery and growth of the post-war Japanese economy.

**Brief History: 1945 Defeat to Regaining Sovereignty in 1952**

After Japan’s surrender, the United States provided copious amounts of humanitarian and economic aid, totaling $1.95 billion between 1946-1950, to alleviate the consumer goods and food shortages across the country (Ohno, 2005; see Table A1 for yearly US credits and grants to Japan from 1945-1960). In the first years of the occupation, it was said that the Japanese economy was barely surviving on two artificial supports, subsidies and US aid, partly due to SCAP restricting Japan’s foreign trade by prohibiting private trade and all international transactions necessitating SCAP approval (Ohno, 2005). Initially, the USA sought the demilitarization of Japan, which meant a policy towards crippling the economy especially heavy industries so it would never produce military goods again (Ohno, 2005). Several of SCAP’s democratic reforms highlight this policy ranging from the breaking up of the *zaibatsu* conglomerates (large family-owned conglomerates with huge influence in a variety of Japanese industries which in the aftermath of WWII, were accused of supporting Japanese militarism), new labor laws (workers’ rights, organization of labor unions, collective bargaining, etc.), land reform (confiscation of land of absentee landlords, which lead to the rise of small-scale family farming in lieu of large-scale productive agriculture in Japan), and a new constitution (limiting the Emperor’s power as a mere symbol and most importantly Article 9, the renunciation of war) were implemented in the hopes of a peaceful and democratic Japan (Ohno, 2005).

**Dodge Line of 1949**

In 1948, President Truman asked Joseph Dodge for help in reconstructing Japan’s economy amidst the backdrop of an imminent Communist victory in China due to Dodge’s successes in rebuilding post-war Germany (Nakamura & Odaka, 2003). Joseph Dodge focused on austerity measures to stop Japan’s rampant inflation and called for a “super-balanced budget” by strengthening taxation, cutting expenditures and abolishing subsidies (Ohno, 2005). Dodge’s plan called for the introduction of strict control on domestic demand to reduce excess consumer purchasing power and allowing for the growth of exports, unifying the different exchange rates for different commodities into a single rate of 330 Yen to the dollar, abolishing subsidies and advancing rationalization policies, and finally expanding production through the utilization of both government savings and foreign aid funds for investment into private enterprises (Nakamura & Odaka, 2003). As will be seen in later discussions of various industries, the Dodge exchange rate was important in that it slightly undervalued the yen and helped the Japanese economy due to its reliance on US imports and being able to generate more foreign exchange through Japanese exports from the favorable exchange rate (Ohno, 2005). Dodge’s policies were adopted in 1950 and although it was successful in stopping inflation as well as setting the foundation for the Japanese tax system it caused severe adverse economic shocks resulting in a large decline in output (Ohno, 2005).

**The Korean War: 1950-1953**

However, the Korean War was the saving grace for Japan as there was a large increase in external demand resulting in an export boom which lead to a quick end to the recession and rapid growth of the economy (Ohno, 2005). The impact of the Korean War cannot be understated, with an increase of industrial output by more than 50% between 1950 and 1951 and a 53% increase in the value of exports and 84% increase in the total value of foreign trade (Dingman, 1993). Throughout the war, America spent 3 billion dollars into Japan for war-related goods and services, which was around 60% of the amount invested into the numerous nations of non-Communist Europe in the aftermath of World War II (Dingman, 1993). The huge influx of US dollars into the economy allowed for investment into many different sectors of the Japanese economy to modernize and improve efficiency in factories (Dingman, 1993).

It was only in 1951, that the Treaty of San Francisco ended US economic assistance and political sovereignty was returned to Japan (in effect 1952), while a US-Japan Security Treaty was signed in its place cementing Japan’s place as a US ally in the Cold War (Ohno, 2005).

**US Policy Shifts Concerning the Japanese Economy**

Even with the initial American policies seeking to limit Japanese heavy industry and democratizing the country, beginning in 1947 however, there was a profound about-face in American policy regarding Japan. In the immediate aftermath of the war, MacArthur and SCAP focused on the promotion of trust-busting in relation to the zaibatsu, the large family-owned conglomerates with enormous influence in vast varieties of industries in the Japanese economy (Kingston, 2010). Within a general trend of deconcentrating power in Japan, this was due to the fact that these companies had taken a very large in the military industrialization of Imperial Japan and profited from its expansions and war procurements, MacArthur especially believed that having such a large concentration of power in the hands of a few would allow this small faction to influence national policy for its own ends (Kingston, 2010).

William R. Castle was a diplomat with many ties to Japan through his posting as an Ambassador and Undersecretary of State through the 1930s (Schonberger, 1982). In the aftermath of Japan’s defeat he emphasized his prewar claim that Japan’s strength as a capitalist country was necessary as a bulwark against Soviet expansion in Asia in that a strong Japanese economy would provide an economic containment of Russia and negate the need for a long-term and expensive American military containment strategy across the Pacific (Castle, 1990). He also proclaimed that Japan would not be so eager to change its socio-economic institutions, what he called the “aristocratic social organization” and that the economic idealism and liberalization policies sought by SCAP and MacArthur would destroy the Japanese economy with no better alternatives in place (Castle, 1990).

American policy-makers on the other hand, preoccupied with a variety of economic issues such as the post-war recession and a mix of surpluses and shortages across industries, saw the growth of Japan as a solution to America’s domestic problems, a country that could become independent from direct US aid and play a major role in the post-war global capitalist trading structure (Schonberger, 1982). Starting in 1947, from the escalation of Cold War tensions, worries over Japan’s future defensive and economic capabilities along with discomfiture over the extremeness of MacArthur’s socio-economic reforms, politicians such as George Kennan of the Policy Planning Staff in the State Department started a movement to encourage the strengthening of the Japanese economy and form a US-Japan security alliance (Miller, 2011). George Kennan and Army Undersecretary William Draper worked together to emasculate the *zaibatsu* dissolution reform “FEC-230” and other SCAP policies (Schonberger, 1982). In their revision of the reform program, which they modelled after the Marshall Plan, they argued that 2 years of increased aid appropriations for the start of industrial raw material shipments and relief goods would increase Japanese exports and thereby the foreign exchange for imports for necessities which they believed would result in Japan not needing US aid by 1953 (Schonberger, 1982). MacArthur and SCAP refused to cooperate with this about-face in government policy as they believed that *zaibatsu*, were basically “socialism in private hands” and in response Draper and Kennan drummed up support for their reform program through the publication of speeches and articles regarding the dangers of *zaibatsu* dissolution and SCAP interference (Schonberger, 1982).

MacArthur himself strongly supported Japanese economic recovery but considered the *zaibatsu* as militarists, led by elderly incompetents and wanted to dissolve the current economic system to allow for better and new people to run the Japanese economy (Schonberger, 1982). Eventually in the summer of 1948, MacArthur acquiesced and the dissolution program only completed the breaking-up of 19 of the planned 324 firms and Japanese banks were completely exempted (Schonberger, 1982). The dissolution program was also hampered by Japanese circumstances in that there were very few trustbusters available and most Japanese lawyers and policy-makers had a lot of experience and skill defending big businesses (Schonberger, 1982). Perhaps more importantly, the big businesses had the support of the conservative political elite, who believed that slowing economic recovery and prolonging the suffering of workers would aid the rise of communism in Japan (Schonberger, 1982). Also, large US corporations with pre-war ties to *zaibatsu* took to lobbying congress by emphasizing the left-wing policies of SCAP and the tax-payer burden of prolonging US aid to Japan by dissembling the *zaibatsu* companies (Schonberger, 1982). The results of Kennan and Draper’s plan, which was quickly approved by Congress, can be seen in the gradual decline in US foreign grants/credits to Japan by 1953 and the amount in subsequent years not coming close to pre-1953 figures (See Table A1). In the end, most *zaibatsu* were modified into *keiretsu*, which were bank-centered, industrial conglomerates who were still strongly linked to the pre-war *zaibatsu* companies (Kingston, 2010).

**The Steel Industry**

The steel industry was one of the primary industries targeted following the policy shift to revitalize Japan’s ailing economy, at first SCAP provided subsidies to reduce the raw material prices for both coal and steel (Elbaum, 2007). Beginning in 1946, SCAP allowed for the importation of a small number of goods and from negotiations following a discussion by the Japanese government on which imports to prioritize, there was an agreement for the importation of heavy oil in return for Japanese production target of 30 million tons of coal (Ohno, 2005). Heavy oil was chosen as it was a vital input for steel production, which in turn was necessary for coal mining, coal was important for Japan as it was the country’s only domestically available energy source (Ohno, 2005).

At the same time, SCAP created the Economic Stabilization Board which organized a centralized economic planning scheme for Japan (Fletcher, 2006). Due to the shortage of coal and steel, these industries became prioritized for production in the “policy for sloping production” (Fletcher, 2006). Coal and steel were seen by the Japanese government as vital due to the fact that it was a valuable input for many other industries and as such, an increase in the production of these industries would supply the economic expansion of Japan (Fletcher, 2006). The rationale for the system to prioritize production for coal and steel was the belief in the cycle of increased coal output would lead to increased steel manufacturing, leading to increased allocation of steel to coal production for, in turn increased coal output. Following the end of the World War II, steel production slowly began to rise back up to pre-war levels (See Figure B1).

This increased production in steel was also augmented by the concept of “*gorika”* or “rationalization” wherein productivity was improved through investments in technology and machinery and/or reorganization of production and management (Ohno, 2005). This concept was spurred on by the Korean War, wherein the profits from US military procurement was used as investment by the government for reinvestment into the steel and other prioritized industries and led to the steel industry contributing heavily to overall productivity gain and becoming more competitive (Ohno, 2005).

**The Camera Industry**

The camera industry was one of the first to recovery following WWII. This was mainly due to the ease at which Japanese cameras could be exported to America and other countries (Nelson, 1998). The camera companies in Japan were one of the earliest to receive permits to resume production by SCAP (early 1946) and Japan already had the raw materials on hand to produce cameras (Nelson, 1998).

For Japan to import critical goods there was a necessity to export goods for foreign exchange to pay for them, The sales of cameras through the American military post exchanges (PX) allowed for a large influx of dollars to be allocated by the Japanese government to import basic necessities and shift investment into prioritized industries (capital equipment and licensing fees) (Nelson, 1998). Both the American involvement in the Korean and Vietnam War had positive influences in camera and lens sales due to demand from American soldiers in East Asia by 1960 over 40% of total sales value came from the US market (Nelson, 1998). These PX sales were important for Japanese photography firms as it allowed their products and brand names to seep into the American market through returning US personnel (Nelson, 1998; as can be seen the rise in USA imports from 1953, the end of the Korean War, in Appendix C).

Export promotion from 1949 as part of the economic recovery policy set by SCAP allowed for the expansion of the camera industry. US market open up for Japanese exports due to Japan’s balance of payment problems led to increased shares of Japanese cameras in the US market through sales to US armed forces in Japan and other parts of East Asia (Nelson, 1998). Acknowledging this the Dodge Line set the official exchange rate at a slightly undervalued rate of 360 yen to the dollar allowing for Japan to take advantage of US imports (Nelson, 1998). Domestic American producers created a lobby in response to this however were unsuccessful due to government foreign policy prioritizing Japanese economic recovery to strengthen an anticommunist ally (Nelson, 1998). The Japanese government fully took advantage of US security fears in East Asia by stymying domestic American pressure to revalue the Japanese export favorable exchange rate (Nelson, 1998). This policy did not shift until the beginning of friendly relations with China resumed in the 1970s wherein criticism of Japanese export practices were acknowledged (Nelson, 1998). By this time, however, the Japanese camera industry had become a worldwide phenomenon and did not have to rely solely on the US market that had helped the industry in its post-war infancy.

**The Cotton Industry**

Following Japan’s defeat in World War 2, the loss of the empire’s overseas territory also had an effect on production of materials. In terms of the cotton industry, with the loss of China and Manchuria, Japan lost 2.75 million cotton spindles and another 210,000 in Korea (Fletcher, 2006). However, with the USA’s help, the Japanese cotton industry became the principal export industry from 1946-1960 (taking up around 59.4% of dollar value of total Japanese exports, see Figure D1 for rapid rise of Japanese textile exports), which was not only necessary for food and raw material imports but an important factor in the revival and then rapid growth of the Japanese economy (Fletcher, 2006; Sugihara, 1999). The United States’ involvement stems back from the accumulation of raw cotton from New Deal policies during the Great Depression (Abe, 2005). The raw cotton came from the Commodity Credit Corporation, exporting to Japan had the effect of increasing American government revenue and help domestic farmers raise their prices, a similar program was initiated in occupied Germany (Fletcher, 2006). These efforts were spurred on by senators from cotton states who urged the War Department that the CCC program use at least 70% of the total raw cotton shipped to Japan come from American producers, their constituents (Fletcher, 2006). The American government also believed that increased Japanese textile exports would relieve American taxpayers the burden of paying for the massive Japanese imports of food, therefore, to provide for the revival of the Japanese cotton industry, America found a ready customer and started shipments as early as mid-1946 (Abe, 2005). At around the same time, SCAP began to allow spinning companies to use their spinning and weaving machines, while controls on textile exports were relaxed as the Trade Bureau was permitted to directly negotiate with foreign buyers in some cases (Abe, 2005). Furthermore in 1948, SCAP allowed textile companies to produce goods under their own trademarks and allow them to receive 25% of export revenue above the SCAP-set price floor (Fletcher, 2006).

Due to the aforementioned shift in US policy regarding *zaibatsu* companies, the Deconcentration Investigation Committee in 1949 only dismantled one spinning company and the removal of the limit on the number of spindles due supply demands from the outbreak of the Korean War all lead to the quick development of the textile industry (Abe, 2005). All of these developments created a circular relationship of America providing raw cotton and being an export market for Japanese textiles to support the recovery of the Japanese economy (through allocation of textile export revenue as investment into prioritized industries) and by 1951, Japan had become the largest exporter of cotton textiles in the world (Abe, 2005; Sugihara, 1999). From 1955-1970 Japanese cotton fabric production was kept at over 2900 million square yards, of which a growing percentage of exports were directed to the USA from the 1950s (Abe, 2005; See Figure D3). The shrink in textile exports (in terms of million square yards) to the USA from 1955 onwards can be attributed to pressure from the domestic American textile market which lead to voluntary restrictions by the Japanese government as well as an quota agreement in 1957 (Sugihara, 1999; See Figure D2). As a result the share of Japanese cotton exports (in dollar terms) to the United States fell from 72% in 1957 to a mere 20% in 1960, however the emergence and entry of other Asian countries into the American market made the policy shift meaningless in the context of the domestic American textile market (Abe, 2005). Regardless of the decline in cotton exports, the cotton textile industry in Japan contributed greatly to the initial growth and recovery of the Japanese economy as a whole and by the 1960s began to focus on other industries, most famously the automobile industry.

**Conclusion**

The Japanese economic situation looked bleak following the empire’s defeat in WWII. Most industrial centers were devastated from Allied bombing and many of its people displaced or killed. During the American occupation however, the discourse and debates over what was necessary for Japan between SCAP and the American government back home evolved within the growing tensions of the Cold War (such as the Communist victory in China and the Korean War), leading to policies that would in effect restore and grow the Japanese economy. The sectors of the economy that were affected by both the initial SCAP policies and the later revisions include the steel, camera, and cotton industry along with the *zaibatsu* conglomerates that controlled most of these companies. By studying the effects of different American policy in this case study of Japan after WWII, we can gain clues to the challenges, successes, and failures in rebuilding economies in other war-devastated areas of the world.

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Appendix A

US Aid to Japan (Net Grants & Credits, Millions of Dollars)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Year | 1945/1946 | 1947 | 1948 | 1949 | 1950 | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 | 1957 | 1958 | 1959 | 1960 |
| US Aid to Japan | 388 | 487 | 423 | 550 | 247 | 279 | 64 | 5 | 23 | 9 | 88 | 46 | -4 | 42 | 17 |

(Source: For 1945/1946-1953 see *Statistical Abstract of the United States 1954*, pp. 902, for 1954-1960 see *Statistical Abstract of the United States 1960*, pp. 906.)

Appendix B

(Source: *Statistical Abstract of the United States 1962*, pp. 925.)

Appendix C

(Source: Nelson, P.A. (1998). Rivalry and cooperation: How the Japanese photography industry went global, pp. 14, 74.)

Appendix D

Figure D1

(Source: Sugihara, K. (1999). International circumstances surrounding the postwar Japanese cotton textile industry, pp. 15)

Figure D2

(Source: Sugihara, K. (1999). International circumstances surrounding the postwar Japanese cotton textile industry, pp. 16.)

Figure D3

(Source: Sugihara, K. (1999). International circumstances surrounding the postwar Japanese cotton textile industry, pp. 15-16.)