Which Factors Created the Impetus for Economic Recovery in Occupied Japan?

— Focusing on the Effects of Economic Distress and American Pressure Groups —

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要 旨
戦後のアメリカの対日占領政策の究極目的は、日本を二度と国際の平和と安定を脅かす存在にしないことであった。この目的を達成するために、日本を再編する懲罰的措置が採用され、対日占領の初期段階で、実施されていた。だが、1948年初頭になると、懲罰的措置は、日本の経済復興に資するような、より穏和なものにとって替えられた。多くの歴史学者は、こうした対日占領政策の変化を、米ソ間のイデオロギー対立と迫り来る冷戦状況の結果だと評価している。すなわち、アメリカの対日占領政策は、トルーマンドクトリンやマーシャルプランに代表されるような、アメリカのグローバルな対ソ封じ込め政策の一環と捉えられ、変容されたのだ。

ここで、冷戦の影響のみが、対日占領政策の唯一の要因であるかという疑問が生ずる。本稿では、対日占領政策の他の要因として、次の二点、つまり、(1) 日本の経済窮状、(2) 対日占領政策に批判的なアメリカの圧力団体を指摘する。本稿では、この二つの要因が、賠償問題と財閥解体政策に与えた影響を検証する。本稿は、上記の二つの要因が占領期日本の経済復興政策の推進力となり、そして冷戦状況の激化により日本の経済復興政策が強化されていく過程を明らかにするものである。

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I Introduction

Post-surrender policies for Japan, their establishment, and the reasons behind the policy changes are all well-known subjects that were analyzed by many researchers. Regarding these, much scholarly work was published in the 1980s after many primary sources were made open to the public. During this period, the Revisionist historians left their mark upon the literature. They drew attention to the phenomenon of “reverse course,” a unilateral and politically reactionary “shift of emphasis” from reform policies to economic recovery.¹

What Revisionist historians did was link the changes in the occupation policies with the U.S. strategic interest and foreign policy. They explained that policy changes were made under the looming Cold War to protect U.S. national security. According to the revisionists, Washington shifted its emphasis from democratization and demilitarization policies to economic recovery and establishment of limited defense forces in Japan after: (1) the Truman Doctrine and the Marshall Plan deepened the ideological rift between U.S. and the Soviet Union, (2) the consecutive communist gains against Kuomintang (KMT) in the Chinese Civil war pushed the U.S. to reconsider its choices of allies, and (3) the possibility of a spill-over of the communist influence in the South East Asia and the Far East increased concerns in Washington. As a result, the economic democratization policies, such as the deconcentration of excessive economic power and the reparation policies that crippled the economic recovery and “self-sufficiency” of Japan, were shelved. Instead, a new set of policies to stabilize the Japanese economy and revitalize the trade relations between Japan and South East Asian countries were put into motion. To achieve the new goals, Washington sent Dodge Mission to implement austerity measures to curb spiraling inflation in Japan and establish a single exchange rate to revitalize its trade. According to revisionist historians, all these steps were taken in order to create a strong ally in the Far East which could prevent the spread of communist influence in the region.

This interpretation which focuses on the macro level explanations of U.S. national security is persuasive and plausible. It goes without saying that the Cold War dynamics played the role of a catalyst in the change of occupation policies to protect the core interests of the United States. Having said that, the Cold War dynamics were not the only factor affecting the occupation policies. I claim there are two more factors that explain why the policy reversal occurred: (1) Economic distress in Japan raised concerns over the feasibility of the democratization of Japan, and (2) the American pressure groups and Congress criticized the occupation policies which beaconed an intervention by Washington.

In this paper, I argue that these two factors created the impetus of economic recovery, causing a reversal of occupation policies. As early as 1946, policy-makers in Washington and GHQ started recommending an economic recovery program for Japan to prevent civil unrest and to strengthen democratic tendencies. They mentioned that radical right or radical left could emerge and destroy all the achievements of the occupation unless the problems underlining the civil unrest were solved. They stressed that the Japanese economy should be brought to the self-sufficiency levels to assure that the democratization program would succeed, and Japan would not become a menace to the world order again. Meanwhile, American business-
men and pressure groups criticized punitive economy program of the Occupation. American businessmen saw Japan as a great market for their businesses. But the Japanese economy was not performing well because of the stern reform policies, such as the purge of the business leaders, and deconcentration of excessive economic power. Uncertainties over reparations and dissolution of Japanese companies in which American businesses had great shares and interests furthered these concerns. Therefore, American pressure groups started criticizing the ongoing reform program and recommended changes in the policies to create a suitable environment for conducting business in Japan.

As the result of these factors, the economic recovery program gained utmost importance in late 1947. William Draper of the Army Department and George Kennan of the State Department went to Japan to stimulate a reversal of occupation policies. They confirmed the need for economic recovery and drew attention to make Japan a strong ally in the Far East under the conditions of looming Cold War. In other words, the intensification of the Cold War did not bring forward the idea of economic recovery, rather it fortified the already existent arguments of the policy-makers and the American businessmen who desired the economic recovery.

However, this doesn’t mean that the Cold War did not play a role in the policy reversal. Moreover, by no means, this paper rejects or criticizes the revisionist interpretation. The main premise here is that revisionist interpretation could be buttressed by analyzing the economic distress in Japan and the influence of the American pressure groups. We believe that a detailed examination of the developments in 1946 and 1947 would enable us to grasp how the arguments for economic recovery surfaced and then gained utmost importance by late 1947. For these reasons, following questions will be answered as clearly as possible in this paper: How did the punitive measures for occupation occur? To what extent, the economic distress in Japan affected the policy formulation in Washington? Were there any pressures to Washington by American pressure groups/businessmen to revive Japanese economy? If so, did they utilize the threat of communism in Japan to justify their purposes? Did American ex-businessmen/bureaucrats play a role in reversing the course?

The paper is going to examine the developments and changes in the policies of the Japanese occupation from December 1943 to December 1949. This timeframe will be divided into three parts. In the first part, a historical background of economic policy formulation within the State Department between 1943 and 1945 will be touched upon to enhance our understanding. Next, punitive measures for the zaibatsu and strict reparations policies will be examined. An effort will be made to understand how the directives from Washington were utilized by the GHQ personnel, particularly by “New Dealers,” to draw comprehensive dissolution policies for zaibatsu. In the second part, I will look into the concerns raised by “Japan Lobby” and American businessmen over the SCAP economy policies under the framework of economic distress, spiraling inflation, and escalating Cold War. The role of the members of “Japan Lobby,” such as James Lee Kauffman and Harry Kern in challenging the Occupation programs will be analyzed. In the third part, I will mainly explore two critical missions –Draper/Johnston and Kennan mission– sent by Washington to Japan in early 1948, and try to explain how they helped the entrenchment of economic recovery. In the last part, I will present the findings of this paper and draw up conclusions.
II Economic Planning for Occupied Japan, 1943–1947

Japan’s perilous walk into a war which started when she closed her eyes and “jumped from the veranda of the Kiyomizu Temple,” came to an end when Emperor Hirohito announced the surrender of Japan on August 15, 1945. Following the Hirohito’s radio broadcast, Instrument of Surrender was signed on U.S.S Missouri on September 2 and the occupation of Japan started. The main objective of the U.S. occupation of Japan was never to let Japan become a menace to the world peace and order ever again. To achieve this security-oriented objective, the U.S. decision makers thought that reforming the political, economic, and social structures of Japan was necessary.

A. The Framework for Policy Formulation

The policy formulation for the post-surrender period started long before the termination of hostilities. Shortly after the United States became embroiled in Pacific War in December 1945, Roosevelt directed the State Department to carry out the necessary proceedings required for the creation of post-war order. By starting the policy formulation early, Roosevelt administration tried not to repeat the ill-preparedness of the Wilson administration after the WWI.2 Accordingly, a proposal of a work schedule was released on December 1, 1942, by Far East Section of Special Research Division. Thereupon, many reports on a wide range of topics, such as the status of the Japanese Emperor, territorial limitations of the Empire, political structure of the Japan, were prepared by the State Department.3

The policy formulation process was carried out by a set of labyrinth-like organizations. First, the State Department took the initiative and created Advisory Committee on Post-War Foreign Policy (ACPFP) in the wake of the Pearl Harbor attack. ACPFP had five committees, dealing with economic, territorial, political, international organization, and security matters. The formulation of postwar policies for Japan started in those committees. In the meantime, George H. Blakeslee, Hugh Borton, Robert A. Fearey, and Joseph W. Ballantine of the State Department played crucial roles in this process. Secondly, in summer 1943, the State Department created Country and Area Committees (CAC) to formulate specific policies for specific countries and regions. In October, Inter-Divisional Area Committee on the Far East (FEAC) headed by George Blakeslee was established under the CAC to coordinate the policies among various committees within the State Department. Thirdly, Committee on Postwar Programs (PWC) was created in January 1944 which replaced the ACPFP and its roles. Recently created Inter-Divisional Area Committee on the Far East (FEAC) then became a subcommittee of the Committee on Postwar Programs (PWC). PWC and the FEAC, therefore, became the central committees that formulated the prototype plans for the occupation policies.

Meanwhile, Department of Navy created Occupied Area Section (OAS) in January 1943. Department of War followed this move by establishing Civil Affairs Division (CAS) in March 1943. Both committees were in charge of making preparations for the postwar policies. However, this situation complicated the policy formulation process. Every major department had their own committees, working on the postwar policies for Japan. A heap of uncoordinated policies by State, War, and Navy Departments ensued as a result. To
overcome this problem, State-War-Navy Coordinating Committee (SWNCC) was created in December 1944 to coordinate the views of three Departments on matters particularly those involving the foreign policy and relations with foreign nations. SWNCC held its first meeting on December 19, 1944, and “the State-War-Navy Coordination Subcommittee for the Far East” (SFE) was established on February 16, 1945. Sub-committee for the Far East (SFE) created the most important documents, namely “Basic Directive” (SWNCC 52/7), and “Initial Post-Defeat Policy Relating to Japan” (SWNCC 150/4/A) for the occupation of Japan.

Going back to 1943, the formulation of the policies for the post-war Japanese economy started around June, under the Advisory Committee on Post-War Foreign Policy (ACPFP). The early discussions underlined the differences among the three distinct schools of thought which deliberated over to what extent Japanese economy should be reformed. The first group argued that the Japanese foreign policy which leads to aggression is fueled by her industrialization. Therefore, they recommended that all modern industries of Japan should be stripped from her, and U.S. should enforce a reversion of Japanese economy to a dominantly agricultural one. Close to this point of view, the second group proposed the liquidation of all of Japan’s heavy industries, or their transfer to China, followed by the surrender of the Japanese merchant marine. This idea forced Japan to be cut from international trade, and to have an economy based on domestic markets. Disagreeing with those ideas, the third group proposed preserving the essential industries of Japan to give her the opportunity to revive its economy. They argued that the liquidation of ship-building and aircraft manufacturing industries that were used for war-making potential was enough to prevent Japan from becoming a menace to world order.

The primary sources do not specifically mention the members of these groups. But, we can argue that first and second schools of thoughts were dominated by “the China Crowd” or their supporters who wished a “weak Japan” to nurture a “strong China” in the Far East. The China Crowd supported the transfer of production capabilities from Japan to China to tip the balance of power in favor of China. They rooted for stern occupation policies and reforms for Japan to prevent future aggression. The China Crowd wished for a “hard-peace” and recommended punitive measures to be implemented during the occupation. Therefore, it is appropriate to say that the China Crowd influenced the first two groups’ way of thinking.

On the other hand, the third group was dominated by “the Japan Crowd,” who recommended moderate policies for the Occupation. They believed that a weak Japan would represent a “malignant cancer in the body of the economic life of the Far East.” Robert A. Fearey one of the members of the Japan Crowd, argued that it would not only cause one-quarter of the Japanese population to starve to death but also would cripple the Japanese economy permanently if the plans of the China crowd were to be implemented. Dismantling all of Japan’s industries meant that Japan would be cut off from foreign trade, depriving Japan the “opportunity to restore her economy and achieve at least a tolerable standard of living.” In the light of these, Fearey favored the moderate plan of the third school. He rejected the plans that would make many Japanese people suffer greatly and underlined that “lasting peace in the Pacific could be achieved only if Japan were economically healthy. Further, Fearey argued that “a healthy Japanese economy would offer important opportunities for American business.”
Fearey’s recommendations influenced the discussions. In a report in September 29, 1943, titled “General Principles Applicable to the Postwar Settlement with Japan,” Blakeslee underlined that “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.” (Emphasis added.) In other words, moderate economy policies for Japan found more support within the State Department.

Another focal point for the discussions was the topic of the monopoly control in Japanese industry, commerce, and finance structure. Curiously, there was a near consensus that reforming the Japanese economy was needed to prevent the future aggression. The near-consensus stemmed from the opinion that zaibatsu (money-clique) and the gunbatsu (military-clique) cooperated and encouraged Japan’s war of aggression. Both groups gained immense profits by invading Far Eastern and South East Asian countries and exploiting their natural resources. Thus, zaibatsu leaders and firms were considered as warmongers which fueled the aggression over neighbors of Japan. On top of that, policymakers in Department of State thought that removal of the zaibatsu from the Japanese industrial scene “would in no way decrease the efficiency of production in Japanese industry,” and more importantly, would pave the way for strengthening the small and medium scale businesses, as well as the labor sector. In short, the existence of zaibatsu predominance was perceived as nothing but a danger to U.S. interests in the Far East. Removing them from Japanese economy was considered to be a basis for democratization policies.

Parallel to the monopoly controls, there was a major agreement that substantial reparation should be required of Japan. Reparations were just, because, it was Japan who started the aggression against her neighbors and inflicted great damage to them. Japanese actions justified the reparations which were thought necessary to heal the wounds of ravaged counties. That’s being said, the Japan Crowd considered that reparation policies should not interfere with long-term objectives of U.S. policy. It was stressed that Japan does not have the economic capacity to pay the maximum amount of reparation that was demanded by the countries she waged war against. In addition, it is thought that economic burdens of the reparations might cause a failure in Japanese economy which directly influences other reformation plans devised by the U.S. To prevent such failure, the Japan Crowd argued that reparation policies must be given secondary importance and the punitive conceptions should be avoided. However, no comprehensive estimates to decide the amount of reparations could be done during the early planning stage. Therefore, the Secretary’s Staff Committee decided that detailed studies would be done once Japan surrendered.

In conclusion, the early reports prepared by the State Department stressed the prerequisite that Japan must be prevented from being a menace to the United States and the other countries of the Pacific area. However, these reports did not envision stern and punitive measures for Japan. Rather, they recommended moderate policies to ensure that Japan could recover and become rehabilitated after democratization and demilitarization reforms achieved success. This situation did not change much up until April 1945 because the Subcommittee for the Far East (SFE), main policy formulation committee, was chaired by Eugene Dooman, and joined by George Blakeslee, Joseph Grew (Under Secretary of State), and Joseph Ballantine.
(Director of Far Eastern Affairs). All were the members of "the Japan Crowd" who were sympathetic for a "soft-peace" for Japan, thus favored moderate occupation policies.

When Roosevelt died and Harry Truman became the president in April 1945, the influence of the Japan Crowd started to fade. The replacement of the Secretary of State Stettinius with James Byrnes heralded the start of stern policies for Japan. Joseph Grew, undersecretary of the State Department resigned on August 15, and replaced by his "arch-adversary" Dean Acheson. Eugene Dooman, chairman of the Subcommittee for the Far East, was replaced by China specialist John Carter Vincent, who also took the Far Eastern Affairs Division of the State Department from the Japan Crowd member Joseph Ballantine. Another China specialist George Atcheson was dispatched to Tokyo as the Political Advisor (POLAD) for the Gen. MacArthur. Meanwhile, individuals such as Owen Lattimore and Andrew Roth who were the supporters of a "hard-peace," started influencing the top decision-makers after many of the Japan Crowd were replaced by China specialists. Hatred towards the Japanese aggression was strong enough to justify punitive measures put forward by the China Crowd. Therefore, the supporters of the punitive measures against Japan started to affect the direction of the occupation policies after August 1945.

B. Post-Surrender Plans for the Occupation

When the occupation started, the Supreme Commander for the Allied Forces (SCAP) Gen. Douglas MacArthur had two guidelines to follow: "Potsdam Declaration" and the summary of "Initial Post-Defeat Policy Relating to Japan" (SWNCC 150/4/A). The former emphasized that militaristic tendencies which deceived and misled the Japanese people into embarking on a world conquest should be eliminated, war criminals should be punished, and all obstacles to the revival and strengthening of democratic tendencies should be removed. In addition, the declaration mentioned "Japan shall be permitted to maintain such industries as will sustain her economy, but not those which would enable her to re-arm for war. To this end, access to raw materials shall be permitted." In other words, Potsdam Declaration of July 26, 1945, gave an opportunity for Japanese people to build its peace-time industry and allowed them to import the necessary raw materials for industrial production. In this sense, the international document emphasized stern justice for militarists and ultra-nationalists but favored a moderate peace and productive lives for the Japanese people.

The latter document, "Initial Policy," was prepared by the State Department and sent to SCAP on August 29. The document branched out the objectives mentioned in the Potsdam Declaration and laid out the ultimate objectives – democratization and demilitarization – of the occupation. Initial Policy, since its inception, had similar objectives as the Potsdam Declaration but it was a more detailed document. It touched upon various matters such as the authority of the SCAP, political demilitarization, war criminals, freedom of speech, freedom of religious worship, and so on. Part IV of Initial Policy banned all factories that were related to war-making power and limited the size and character of Japan's heavy industries to meet its future peaceful requirements. Furthermore, it recommended MacArthur to favor the programs that would ensure the democratic development of organizations in labor, industry, and agriculture. To fulfill this goal, a program for the dissolution of the large industrial and banking combinations which had exercised control.
of a great part of Japan’s trade and industry was favored. Lastly, a reparation policy, through the transfer of Japanese property located outside of the Japanese mainland, and through the transfer of tools, equipment, and facilities that were not necessary for the Japanese economy, was encouraged. The Initial Policy was later approved with minor changes by Far Eastern Commission and became the official “Basic Post-Surrender Policy for Japan.”

These two documents shaped two of the three pillars of the occupation policies that were built upon. They both encouraged the democratization and demilitarization of Japan and implicitly suggested a moderate peace. Both documents permitted Japan to keep her peacetime industries and gave Japanese an opportunity to recover her economy as Fearey wished for. However, the United States assumed no responsibility for the economic recovery of the Japan. Initial Policy entrusted the responsibility for economic recovery to the Japanese government.

During the first weeks of the occupation, no reform measures were carried out by SCAP. This situation caused some assumptions of the so-called “soft policy” to appear in the press. However, on September 14, 1945, MacArthur rejected the assumption of soft-policy and explained that “the surrender terms are not soft and they will not be applied in kid gloved fashion.” SCAP explicitly said that “when the first phase [demobilization] is completed the other phases as provided in the surrender terms will infallibly follow.”

Yet, the two documents were very general in nature and did not offer concrete measures on how to progress the reforms. To provide such measures, the last pillar of the occupation policies – “Basic Directive for Post-Surrender Military Government in Japan Proper” known as Joint Chiefs of Staff (JCS) 1380/15 or “Basic Directive” – was sent to MacArthur on November 3, 1945.

JCS 1380/15 had a different tone than the previous two documents. First of all, it contained more severe and punitive provisions. In this sense, it was similar to the famous JCS 1067, the governing statement of policy for the occupation of Germany that reflected the drastic Morgenthau concept of severely limiting the level of the losing country’s industrial production. To sum up, it underlined two stern principles related to the operation of Japanese economic system:

1. SCAP would assume no obligations to maintain, or have maintained, any particular standard of living in Japan.
2. SCAP will direct the Japanese authorities to make every feasible effort to avoid serious inflation. However, prevention or restraint of inflation shall not constitute a reason for limiting the removal, destruction, or curtailment of facilities in fulfillment of programs for reparations, restitution, demilitarization, or economic disarmament. (Emphasis added)

In other words, MacArthur was given the authority by JCS 1380/15 to reform the economic, social, and political structures of Japan without assuming any responsibility for Japanese economic recovery. The demilitarization and democratization programs were favored even in the times of distress with only one exception: If the strikes or other work stoppages interfere with military operations or directly endanger the security of the occupying forces.

Secondly, JCS 1380/15 was a more detailed directive, being three times longer than the Initial Policy. It recommended plans for dissolving large Japanese industrial and banking combines or other large concen-
trations of private business control. Moreover, different from the previous documents, JCS 1380/15 provided the details needed for implementing the democratization of Japanese economic institutions. It recommended MacArthur to direct the Japanese government to establish a public agency responsible for reorganizing Japanese business in accordance with the military and economic objectives of your government.27

Lastly, JCS 1380/15, contrary to the Potsdam Declaration and Initial Policy, was not made public. It remained undercover until the latter phase of the occupation. This “how-to” guide for translating the principles into action, was regarded as the “bible of the occupation.”28 The GHQ personnel, especially the “New Dealers”29, treated it as the main framework for the occupation reforms and formulated policies based on this directive. Thus, in time the support for moderate plans for the occupation weakened and punitive measures to reform Japan gained utmost importance in the eyes of the occupiers.

C. The China Crowd and Influence of the New Dealers

Shortly after JCS 1380/15 directive, President Truman appointed Edwin Pauley as his advisor on reparations. Pauley, an independent California oil baron, yearned for punitive and retributive policies for Germany and Japan, as well as preventing their hasty revival.30 In November, Pauley went to Japan with his aides, including a longtime member of the China Crowd Owen Lattimore, and recommended removing surplus Japanese plants as war reparations for other Asian nations. They argued that Japan should not be allowed to maintain a higher living standard than her war victims.31 Pauley recommended that Japan will not be left with any plant which represents a key phase in the processing of the raw materials of any of her neighbors. The heavy industries, such as steel, should be limited greatly, and the excess production capabilities should be transferred to her neighbors to stimulate economic growth there. To sum up, Pauley underlined that “reparations is a problem of contributing to the economic stabilization and to the political stabilization of East Asia as a whole.” He told, “in a rehabilitated Asia there will be a place for Japan, though no longer a place of leadership or control.”32 Accordingly, the interim Pauley report of December 6, 1945, recommended transferal of a huge chunk of Japanese industry machinery to achieve those goals.33

Around the same time, staff sections34 were created within the GHQ to formulate specific policies that were necessary for the occupation. On September 15, 1945, the Economic and Scientific Section (ESS) was established to control Japan’s economic affairs and formulate policies on zaibatsu dissolution, labor reform, and reparations (until May 1947 when a separate Reparations Section was formed).35 Raymond C. Kramer became the chief of the ESS on October 2. Yet, the policy formulation did not start immediately. The ESS was understaffed and the necessary subsections, such as Antitrust and Cartels Division which handled the zaibatsu dissolution, was not established until January 1946. Even by then, Antitrust and Cartels Division had only 2–3 staff to analyze tremendous amounts of data.36

Lacking the necessary workforce and specialists, the ESS chief Kramer advised Japanese companies to submit voluntary dissolution plans to get dissolution reform going.37 On November 6, 1945, one of the big four zaibatsu, Yasuda Hozensha, proposed a voluntary reorganization plan after being advised by Watanabe Takeshi, a Finance Ministry officer.38 Yasuda Plan proposed to dissolve the top-holding companies at the apex of the zaibatsu organization. MacArthur, being not sure of the program, telegraphed the Washington
for approval. After Washington’s approval, Yasuda Plan became the first step in the dissolution program. Thus, on November 6, the ESS sent SCAP Instruction No. 244 (SCAPIN 244) to the Japanese government and called for the creation of a Holding Company Liquidation Commission to dissolve the top holding companies and the zaibatsu-controlled firms. Washington also proposed to send an expert team to prepare comprehensive guides for the dissolution program. With the State Department’s permission and MacArthur’s affirmative response, Assistant Secretary of War John McCloy and Assistant Secretary of State for Economic Affairs Will Clayton sent Corwin Edwards to Japan to further examine the economic democratization program.

The Edwards Mission, officially “The Mission on Japanese Combines,” remained in Japan from January 6 to March 15, 1946. The State-War joint mission perceived zaibatsu as “a type of industrial organization that tends to hold down wages, block the development of labor unions, and destroy the basis for democratic independence in politics.” Thus, the mission argued zaibatsu prevented the rise of interests which could be used as counterweights to the militaristic ambitions of small groups.

On March, the mission forwarded a report to Departments of State and War. To eradicate the influence of zaibatsu in Japanese economy, the report interpreted the term zaibatsu as widely as possible: “Any private enterprise conducted for profit, or combination of such enterprises, which ... 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 brief terms, Edwards report supported a dissolution program, not necessarily limited to the top-holding companies, but also inclusive of interlocking directorates, contractual and service
arrangements, procedures for opening up combine patents, oversized operating companies, and removing zaibatsu families and those close to them from business for a 10-year period.44 In this sense, the program for dissolution of the zaibatsu became far more thorough and punitive than the Yasuda Plan.

However, MacArthur did not share the views of the Edwards mission. SCAP’s comments on May 17, 1946, underlined that “the objectives of the report are admirable in purpose, but the practical execution of [it]… is beyond the size and organization of the Occupation Forces.” It further questioned, “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 ensure the disability of Japan to make future war.” Chief of the ESS, William Marquat also stressed that recommendations of the report might penalize the industry.45 Therefore, MacArthur and the ESS favored a plan which introduces democratic methods to Japan, and regarded the report merely as “a guiding study.”46

Meanwhile, Japanese Imperial Order No. 233 was finally promulgated on April 20, 1946, five months after the SCAPIN 244 instructed the Japanese government to implement the Yasuda Plan. Order No. 233 established the Holding Company Liquidation Commission (HCLC), a Japanese organization to dissolve the zaibatsu holding companies. The HCLC started the dissolution but limited it to the “top holding companies” and ignored the dissolution of “zaibatsu-controlled enterprises.”47 In other words, the objective of JCS 1380/15, which stressed the need for “striking the head of the ‘octopus’ (top holding companies) and severing its ‘legs’ (zaibatsu-controlled enterprises) to eradicate the influence of the zaibatsu from the Japanese economy, was disregarded by HCLC.48

As mentioned before, the ESS and MacArthur were content with an introductive plan that was put into motion by the Japanese government. Therefore, they did not order Japanese government to change the direction of the policies implemented by the HCLC. However, the New Dealers within the GHQ, such as Eleanor M. Hadley was against such a plan. Hadley sent a memorandum on June 12, 1946 to the Government Section and criticized the Imperial Order No. 233. She recommended to change the HCLC plan and implement the measures drawn up in the JCS 1380/15 instead.49 Hadley memo convinced the Government Section to implement the punitive measures and forced the Economic and Scientific Section to change its position. On July 23, forty days after the memo, the ESS sent SCAPIN 1079 “Ordinances and Regulations Affecting the Holding Company Liquidation Commission” and ordered the HCLC to dissolve both the top holding companies and their controlled enterprises.50 Even though MacArthur and the Economic and Scientific Section favored a mild-reform program, the New Dealers pushed for comprehensive economic reforms and influenced the policy formulation. New Deal thinking was so influential that a famous New Dealer and the Deputy Chief of the Government Section, Charles Kades called SCAPIN 1079 as “Hadley Directive.”51

Yet, why did MacArthur, who is definitely not a New Dealer, agree to implement these policies in the first place? Was it because he was a military man who was obligated to follow the orders of Joint Chiefs of Staff, or were there any other reasons? The short answer to these questions lies in the decision-making process of the occupation.

During the occupation, MacArthur was the decision-maker which meant every part of the reform plan
had to be approved by him before becoming a SCAPIN to the Japanese government. However, considering the massive amount of reports and time restrictions, it was not possible for MacArthur to digest every piece of information flowing through Special Sections to his office. For this reason, MacArthur chose to delegate freely to his section chiefs. He made decisions after reading a one-page abstract or summary prepared by staff officers. This meant that not only the Chiefs of the Special Sections but any officer had a chance to influence the reform programs if they can create plausible arguments based on the objectives mentioned in JCS 1380/15 and convince their superiors. Therefore, JCS 1380/15—a product of Franklin Roosevelt’s New Deal era—programmed the operations of GHQ with respect to the Japanese from top to bottom and influenced the policy formulation progress. As Theodore Cohen of the Economic and Scientific Section mentioned, everyone referred to the JCS 1380/15, he recalled: “I cannot remember anyone in GHQ ever referring to the State Department’s policy paper [SWNCC 150/4/A].”

New Dealers who rooted for comprehensive reformation of Japanese economic, social, and political structures, could succeed to influence the policy formulation process. After their intervention on July 23, 1946, the Holding Companies Liquidation Commission designated 83 firms as holding companies which were composed of ten zaibatsu head companies (honsha), their related holding companies, and local holding companies. By the end of 1947, forty-two companies were dissolved, and the remaining forty-one were reorganized and their activities were severely restricted.

On top of that, New Dealers continued pushing for other reforms. The Capital Levy Law, No. 52 which devised a graduated tax on individuals—especially the wealthy population—, was imposed on November 11, 1946. On January 4, 1947, economic purge which purged the officials of the 250 designated companies from any position in public service and from the directorship in any formerly zaibatsu-connected companies, was issued. Then, on April 14, 1947, Anti-Monopoly Law was enacted by Japanese Diet to prevent the reappearance of any tendencies toward monopolies. On July 3, Edward Welsh, the New Dealer head of the Antitrust and the Cartels Division of the ESS, prepared SCAPIN 1741 which dissolved two giant zaibatsu companies, Mitsui Co. and Mitsubishi Trading by direct action by the Occupation authorities.

The last of these measures was the “Elimination of Excessive Concentration of Economic Power Law, also known as “Deconcentration Law.” On December 18, 1947, Deconcentration Law—based on the recommendations of the Edwards report of March 1946—passed the Diet under strong pressure from the Occupation authorities. The law ordered a comprehensive “breaking-up” of all big companies in Japan to allow small-medium businesses to compete in the market. With the promulgation of the law, nearly all of the punitive measures were put into motion before the end of 1947. However, around the same time, many American businessmen started showing discontent for the economic policies of the SCAP. The economic distress in Japan and the concerns by American pressure groups over the economic policies sparked discussions for changing occupation policies.

III The Criticism of the SCAP Economic Policies under the Looming Cold War

The social, political, and economic reformation of Japan made a sound start in late 1945. By the end of 1946, the ultra-nationalists and militarists were purged, the new Constitution, the Labor Standards Act, and
the Farm Land Reform Law were promulgated. The vast socio-political reform agenda was devised and implemented within a short time span and achieved remarkable success.

Despite its success in the socio-political reforms, the occupation was not without criticism. During 1947, Japanese economy did not show any promise of economic recovery or self-sufficiency. Industrial production was low, the raw materials were scarce, and the reparations were still incomplete. Civil unrest, labor strikes, and the unprecedented inflation worsened the situation. Without recovery, Japanese economy became more and more dependent on American Government Aid Relief in Occupied Areas (GARIOA) to survive. The low prospects of the future Japanese economy raised eyebrows in the American business world which eventually beckoned an intervention by Washington.

A. Economic Distress in Japan

In 1947, the Japanese economy was in an abysmal state. GNP in 1947 was only slightly over 50 percent of the 1937 level. The index of real income stood at 54.9 percent (61.1 according to some sources) in 1947, as against 100 in 1934–1936. All raw materials were in extremely short supply, and by October 1947 the total production of coal and electricity fell below the level considered the critical minimum. Japanese people lingered on the line of semi-starvation since the food supplies had fallen very low to support only 1,042 calories per capita per day for the urban consumer.60)

On top of these, the inflation rate, which was uncontrolled during the early years of the occupation, ballooned and averaged 700 percent through mid–1946.61) The value of yen dropped drastically as a result of unchecked inflation. According to a prominent scholar, 1 dollar was equal to 2 yen before the war. However, by 1947, 1 dollar became equal to almost 270 yen.62) Japan had never before experienced an inflation as extreme as that.63) In the meantime, the foreign trade suffered greatly. Japan’s exports crashed to a mere 3.9 percent and its imports 8.8 percent of prewar levels. (Table 1) The production output was nowhere near the prewar levels, yet the population steadily increased after around 6 million repatriates return to Japan.64)

<table>
<thead>
<tr>
<th>Table 1 Postwar Economic Index (1934–1936 Levels=100 percent)</th>
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<tr>
<td>1934–1936</td>
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<tr>
<td>Real National Income</td>
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<td>Standard of Living (Urban)</td>
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<td>Population</td>
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<td>Export Volume</td>
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<td>Import Volume</td>
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<td>Production (Mining &amp; Manufacturing)</td>
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<td>Production (Farm, Forestry, and Fishery)</td>
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In light of these, SCAP directed Japanese government to establish the Economic Stabilization Board (ESB) to coordinate the economic planning in May 1946. The newly established board found out that Japan had a massive demand and an insufficient supply. Therefore, Japanese government tried to increase the production levels to meet the domestic demand. To achieve this, the ESB recommended a “priority production” (Keishaseisan) strategy and encouraged Japanese companies to produce more. However, Japanese companies did not have any capital to replace the old and broken equipment or buy new machinery that was required to increase their production levels. To overcome this problem, the Japanese government set up the Reconstruction Finance Bank (RFB) in October 1946. The bank issued 44 billion yen in loans through 1947 to these companies. The actions taken by the Japanese government helped increase production but also fueled inflation since Japanese government had to print out and pump more bills into the domestic market.

Economic distress in Japan led to the so-called “October offensive.” In October 1946, an extremely left-wing Sanbetsu (All-Japan Congress of Industrial Unions, also called as the National Congress of Industrial Unions) started a series of strikes and production control tactics. The union demanded a basic minimum wage plus the abolition of the income tax on labor and stressed that the demonstrations would not stop until their demands were met. Later, Sanbetsu called for a general national strike in February 1947, but it was banned by SCAP’s orders to prevent the crumbling Japanese economy further paralyzing itself. Even though the general strike was banned during its inception, its rippling effects were imminent. SCAP realized that the civil unrest could cause other occupation reforms to fail. Thus, reconsideration of the liberal/New Dealer reform programs has started. As early as 1948, some of the rights that were given to unions by reforms, were restricted to contain the civil unrest.

Under these circumstances, the economic recovery and “self-sustainability” plans for Japan surfaced. To begin with, George E. Blakeslee wrote a report after his visit to Japan between December 26, 1945 and February 13, 1946. In his report, Blakeslee underlined that to achieve the democratization of Japan, “it is essential to prevent economic distress for Japanese.” He thought that the immediate problem in Japan was economic and argued “a sane democracy cannot rest on an empty stomach.” Blakeslee recommended that “to safeguard the American type of democracy in Japan … the United States should prevent acute food shortage and should help the Japanese revive their industries and their export trade.” He further stressed that as pre-requisites, the stabilization of Japanese currency and especially an initial decision on reparations will be almost necessary.

In addition, T.A. Bisson of the Government Section (GS) wrote a memo for Courtney Whitney, Chief of the GS on October 23, 1946. In his report, Bisson stressed that the Japanese authorities were intentionally pursuing policies – priority production strategy and Reconstruction Finance Bank loans – that invites inflation rather than averting it. Bisson warned that unless the runaway inflation was brought under control, civil unrest would cause the emergence of extremist control which will eventually impede the reform policies. Echoing the recommendations of Blakeslee, Bisson advocated a comprehensive program of price stabilization to solve the inflation problem and get rid of its threat to occupation objectives.

Furthermore, Edward M. Martin, Chief of the Division of Japanese and Korean Economic Affairs of the
Kurtulus: Which Factors Created the Impetus for Economic Recovery in Occupied Japan?

State Department, wrote a memorandum to General Hilldring on March 12, 1947. Martin considered that economic recovery plans for Japan would create the impetus of nurturing a peaceful and democratic Japan. Martin argued that if Japan were provided with food and raw materials in 1948 and 1949, Japan could be "cranked up" to the point where she might be self-supporting in 1950. He pointed out that with enough food and raw materials aid, Japanese industries could produce more and export the excess to other Far Eastern countries. By doing so, Martin continued, Japan might break out from the vicious cycle where the food and raw material shortages deteriorate Japanese economy and culminate in a more dependent Japan to the U.S. aid. Research and Statistics Division of the Economic and the Scientific Section prepared a report on August 1, 1947 and echoed the same point of view. The report underlined that Japan would become more dependent on U.S. aid unless Japanese industrial output and foreign trade volume were increased.

Shortly after Edward Martin memo, MacArthur hinted the possibility of an early peace during an interview with press correspondents on March 19, 1947. He divided the occupation into three phases – military, political, and economic – and claimed that the first phase is already completed and the political phase is approaching completion. However, MacArthur continued, the economic recovery of Japan cannot be achieved by the occupation authorities as long as Japan economically blocked by the Allied Powers. Therefore, he recommended to allow Japan to trade with the world, without restrictions applied by the occupation apparatus, and to restore Japan's production to self-sufficiency levels. In regard to the reparations, MacArthur implicitly suggested that reparations burden should be reduced unless the United States was prepared to support Japan economically for many years to come.

In the meantime, the U.S. stance against reparations policy started to change. In the spring of 1947, War Department sent the Overseas Consultants Incorporation (OCI), headed by Clifford Strike to Japan. On paper, Strike mission's objective was to provide technical assistance to SCAP officials on reparation removal levels. However, in reality, Strike was in favor of reducing the reparations while increasing the retention levels of the Japanese industry. During his stay, Strike recommended limiting the reparations to primary war facilities category, while keeping the non-war related industries intact. As an expected result, OCI sent a report to MacArthur on February 18, 1947 and recommended higher retention levels for Japanese industries to achieve self-sufficiency levels. Only a month and a half later, SWNCC 236/43 established new reparation levels for Japanese industries. The new figures were far more lenient towards Japanese industry than the Pauley recommendations of 1946.

Another supporter of the economic recovery was Under Secretary of the State Dean Acheson. On May 8, 1947, Acheson stood before the Delta Council in Cleveland and made an epoch-making speech about the "workshops in Europe and Asia." Acheson pointed out that "until the various countries of the world get on their feet and become self-supporting there can be no political or economic stability in the world and no lasting peace or prosperity for any of us." He buttressed his point with the argument that the total volume of U.S. exports will not increase until the U.S. accepts increased imports from the world. To achieve economic recovery around the world, Acheson recommended reconstructing the "two great workshops of Europe and Asia – Germany and Japan – upon which the fate of the two continents largely depends."
Acheson linked the recovery of Japan to the recovery of the international economy and favored changes in occupation policies.

Complementing the Acheson’s point, Political Advisor to Macarthur (POLAD), George Atcheson wrote to Truman on June 19, 1947. Acheson warned Truman of the situation in Japan: “Japan, whether we like it or not, has become an economic responsibility of the United States .... It is to our interest to assist in the process of getting the country on at least a minimum self-supporting basis.” The report also underlined that self-supporting Japanese economy cannot be achieved unless a foreign exchange (U.S. dollar) to finance the essential imports is secured and adequate imports of essential raw materials are obtained. Atcheson’s comment was integral since his opinions were close to the China Crowd’s. However, the worsening situation in Japan paved the way for Atcheson to conform, at least, regarding punitive economic measures that were being taken in occupation.

All of these arguments amounted to an action by State and Army Departments to review the occupation policies and change their direction. By October 9, 1947, both State and Army Departments agreed to make Japan self-supporting. Although the implementation of the recovery program remained disputed, State and Army Departments reached an agreement to put more emphasis on the economic recovery. On the one hand, the State Department backed SWNCC 381 – prepared by Edward Martin – which favored the revitalization of Japanese economy based on the Acheson’s speech in May. The State Department rejected unilateral action on the issues of reparations and deconcentration (FEC–230) and rooted for achieving consensus on Far Eastern Commission on these issues. The State Department employed this deliberate approach not to irk the Far Eastern Countries which dreaded the resurgence of Japanese aggression.

On the other hand, Under Secretary of the Army, William Draper was considering to bypass the Far Eastern Commission and the involvment of other nations. Draper thought about making further cuts in reparations levels designated in SWNCC 236/43 and revising the FEC–230 policy by sending unilateral directives to MacArthur. After his return from a trip to Japan in September 1947, Draper launched a campaign for an overhauling reorientation of American Occupation policy. He directed the Army Department to formulate a new policy which would make “economic recovery the main objective and ... give SCAP the authority to interpret other existing directives [FEC–230 and SWNCC 236/43] in light of this primary objective.” On October 3, SWNCC 384 titled “The Economic Recovery of Japan,” was completed and ready for consideration by other Departments.

Even though the means for economic recovery remained disputed among the Departments of State and Army, one thing was crystal clear: The economic democratization, including the deconcentration and reparation programs, lost its vigor little by little and eventually became bogged down in late 1947 while the economic recovery gained utmost importance. The economic distress in Japan combined with the civil unrest, became the driving force for recovery plans within Washington and GHQ. In addition, the concerns over international economy pushed the decision-makers to fortify the Japanese and German economies to overcome the probable future problems.
B. The Role of American Pressure Groups on Policy Reversals

Howard Schonberger, a prominent scholar, stressed the role of the American pressure groups – or “Japan Lobby” – in providing a major impetus behind the reorientation of reform policies for the Occupied Japan. According to Schonberger, “the reorientation of policies was … aided by Newsweek magazine, led by old Japanese hands of the State Department [Joseph Grew], and backed by major corporations with investments in Japan and friends among the zaibatsu.” (Emphasis added) Its program included the ending of reparations, the suppression of reform in the name of recovery, and the reinstatement of the zaibatsu leaders purged by MacArthur. The Japan Lobby was a small and loosely connected group of individuals who operated behind the scenes most of the time. But that doesn’t mean their impact on the policy changes was minuscule.

One of the most influential groups in the Japan Lobby was the Newsweek magazine. Newsweek was founded in 1937 with the funds and encouragement of Averell Harriman, heir to the Union Pacific Railroad fortune and partner in the Wall Street investment house of Brown Brothers. Three key players used Newsweek as a platform to raise concerns over occupation policies. The brains of the operation was Harry Kern, a young Harvard graduate. Kern joined Newsweek in 1937 and rose to the position of the foreign editor after Pearl Harbor. Two other players, Compton Pakenham and James Lee Kauffman, were included to the team later on. Pakenham fed news from Japan to Washington as a correspondent, while Kauffman contributed sensational reports and insights. All three took part in challenging the U.S. Occupation policies by contributing to the articles published in Newsweek.

The scoops about the occupation policies started when Kern appointed Compton Pakenham, a former journalist of New York Times, and an ultra-conservative who has connections with the high-level Japanese officials, as the Tokyo correspondent for Newsweek. After his dispatch to Tokyo in the spring of 1946, Pakenham tried to contact with his prewar Japanese friends who were high-ranking officials in the government. However, he learned that members of the old-bureaucracy (nationalists and militarists) were purged by January 1946. In addition, Pakenham was unhappy with the SCAP’s decision to permit Japanese communists to return to the public life. Discontent with the conditions in Japan, Pakenham sent a message to the Kern on July 24, 1946, telling him that “the occupation is failing, failing, failing.”

Some high-ranking American bureaucrats, too, were unhappy with the situation in Japan. One of these people, Averell Harriman, the new secretary of commerce, met frequently with Kern in the fall of 1946. During these meetings, Harriman emphasized that the economic democratization policies delayed the Japanese economy’s ability to reach self-sufficiency levels, and hindered her role as an anti-Communist bastion in Asia.

After many meetings with Harriman and hearing from Pakenham about a SCAP plan for the economic purge of business executives, Kern decided to put a story in Newsweek on January 27, 1947. The story criticized the economic purge and claimed that purge program disposed of the capable “brains of the entire Japanese structure.” In addition, it strengthened the socialistic tendencies while undermining the American capitalist principles in Japan. Kern claimed that 30,000 businessmen were to be purged after the SCAP’s directive. However, the economic purge affected only 1,555 business people, a far less figure than the
Newsweek report claimed.\textsuperscript{88} Regardless, the report heralded the future criticism of the occupation policies.

The report that James Lee Kauffman published in Newsweek was more sensational than Kern’s. Kauffman, a founding member of the American Council of Japan, had represented virtually every major American corporation in Japan, including General Electric, Standard Oil, Libby-Owens-Ford, and Dillon, Read & Company. Before the war started, Kauffman worked as a lawyer in Japan, representing these companies and protecting their interests. In August 1947, he came to Japan as a member of the Second Strike Mission on reparations, and while in Japan, acquired a copy of top-secret policy document FEC–230 from an officer in GHQ.\textsuperscript{89} After his trip, Kauffman published a report on the December 1, 1947 issue of Newsweek, in which he claimed that reform policies would make Japan a less attractive place for American investment because the economic democratization policies were stripping the Japanese economy of older men of ability and experience.\textsuperscript{90}

Kauffman further argued that FEC–230 and the Deconcentration Bill was standing on a “socialistic ideal,” and if fully implemented, would lead to the collapse of the Japanese economy. Kauffman was anxious that Deconcentration Bill not only dissolves the holding companies at the apex of the combines but also split all big businesses into smaller businesses. He described this situation as “radical reformists were using Japan as a ‘laboratory’ for their ‘experiments’ and pushing for an anti-American economic system in Japan.”\textsuperscript{91} Kauffman thought that if Deconcentration Bill was enacted, it would discourage the Japanese business, lower the production levels, worsen the economic prospects, and undermine Japan’s potential as America’s “Far Eastern bastion” against the Communist threat. Most importantly this situation would make the conduct of American business in Japan impossible.

In addition, the “burdens of the occupation” for American taxpayers, became a hot topic of the public debates in the wake of the Kauffman report. Kauffman argued Japan was costing the American taxpayers millions of dollars a year in form of payments for food and other necessities to Japan (Table 2). Kauffman hinted that American taxpayer will continue to pay for these payments unless Japan gets out of the economic quagmire. Yet, in reality, the financial burdens of the occupation were being assumed by the Japanese government (Table 3). Moreover, the financial burden of aiding Japan was not overwhelming for

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\hline
208 & 294 & 357 & 530 \\
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\end{tabular}
\caption{U.S. Apportioned Aid (Million Dollars; U.S. Fiscal Years)}
\end{table}

\begin{table}[h]
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\begin{tabular}{|c|c|c|c|}
\hline
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39,600 & 64,121 & 107,062 \\
\hline
Percent of the Total Budget & 33\% & 30\% & 23\% \\
\hline
\end{tabular}
\caption{Japanese Costs for the Support of the Occupation Forces (Japanese Fiscal Years)}
\end{table}
Curiously, some argued that Kauffman was criticizing SCAP policies not because there was a serious socialistic tendency or a particular communism threat in Japan. Rather he was employing such a jargon to protect their clients’ interests. One of the skeptics, Theodore Cohen, argued that “Kauffman was a lawyer for the Libby-Owens-Ford Company, which had a substantial interest in Nippon Sheet Glass Company, a monopoly then being broken up by the Occupation.” A report prepared by Charles Kades, Deputy Chief of the Government Section, too, criticized the Kauffman report and underlined that the Libby-Owens-Ford Glass Company was the second largest stockholder (42,000 shares) in Nippon Sheet Glass Company. Kauffman’s comments about a serious drop in industrial output as a result of the economic purge were also baseless. Cohen argued that the industrial output showed an increase between 1946 and 1948, contrary to the Kauffman’s claims. Parallel to these, Eleanor Hadley argued that the Japanese Communist Party (JCP) expressed discontent with the SCAP policies, especially the Deconcentration Bill which Kauffman vigorously labeled as “socialistic.” While Kauffman claimed that the deconcentration of Japanese businesses would become a hindsight for the foreign investment, the JCP saw the legislation as a means of inducing foreign capital.

Even though it is highly debatable, the influence of communism in Japan was not a daunting problem in 1947. The only exception of this was the general strike in 1947 which was nipped in the bud by a SCAP directive. The reason behind this argument is that Japan was not as important as China or Korea for the Soviet policy-makers. Effectively barred from taking an active role in the occupation, Soviets recognized that further efforts to increase their influence in Japan would have little effect. Therefore, the Japanese Communist Party was allowed to function without any attempt at systematic guidance and control from Moscow, at least until 1950.

Apart from these, Senator William Knowland of California obtained a copy of “top-secret” FEC-230 from Undersecretary of the Army, William Draper on December 15, 1947. Four days after, he made a speech in the congress and claimed that “FEC-230 and other policies being followed in Japan go far beyond the breaking up cartels and trusts.” After Deconcentration Law was promulgated by the Japanese government in mid-December 1947, Knowland attacked this policy for a second time on January 19, 1948. Knowland stressed that “FEC-230 and certain other policies go far, very far, beyond trust-busting … It seems to me that in both Germany and Japan, our policy should be to eliminate trusts and cartels, but not to promote socialism…” Knowland, similar to Kern and Kauffman, was concerned that Japan was drifting into socialism little by little under the Occupation reforms. What is not mentioned by many is that the Republican member of the Senate, William Knowland was one of the “cotton senators.” He was also a member of the Senate Appropriations Committee and was lobbying the Pentagon to develop the Japanese textile industry as a major foreign purchaser of the American cotton.

Japanese textile sector whose revival was desired by Knowland was not performing well after the war. The scrapping of the textile machinery for war effort reduced the output capacity of the industry. Cotton mills had one-fifth of the number of spindles they had in 1937, while rayon capacity dropped to one-third of the 1938 level. The silk industry capacity was hit hardest, its capacity dropping to one-seventh of the
prewar levels. The general economic distress and scarce raw materials caused the textile output to plummet, while the high inflation levels prevented the necessary repairs for the machinery. Moreover, the reparations problem was hanging over the textile industry – especially the rayon industry which was suspected of having a war potential – like a sword of Damocles. Unlike the heavy industry, the textile was not a main target of the deconcentration program. Yet, some textile firms were marked as potential targets for the deconcentration, furthering the uncertainties over the textile sector.

For these reasons, Knowland attacked the deconcentration program in Congress. Like Kauffman, Knowland denounced the deconcentration plan as “socialistic,” and employed the fear of expanding socialist influence to achieve personal goals. He openly criticized these policies to create the conditions that were necessary to sell excess American cotton to the Japanese market. However, arguments of Kauffman and Knowland were biased and based on false information. The Deconcentration plan aimed to break up Japanese business into small but highly competitive units. But, according to Kazuo Kawai, it was hardly socialistic. Also, the New Dealers within the GHQ were not “experimenting” or going beyond trustbusting and promoting socialism. New Dealers were just following liberal reform programs drawn by 1380/15 which was prepared in Washington and directed as the occupation policy.

In short, economic distress, civil unrest, numerous strike movements, and inflation problems in Japan created deep concerns among American businessmen. Starting from 1947, three leading figures in the Japan Lobby, tried to clear the ambiguities over the economic democratization program of the Occupation. They favored revitalization of the economy and drew attention to the problems in Japan while employing Cold War terminology to fortify their arguments.

The reports published in Newsweek triggered vigorous debates in American congress and among top decision makers. First, Knowland joined their ranks and targeted FEC-230, and then William Draper confirmed the accuracy of the Kauffman report to Secretary of Defense James F. Forrestal (a former partner in Dillon, Read&Co.). Draper agreed to the conclusions by Kauffman because he had similar impressions after visiting Japan in September 1947. Consequently, Draper proposed a revision of the deconcentration bill and “the need for carrying out the zaibatsu program in such a way as to promote rather than hinder Japanese recovery.” To achieve these goals, Draper was sent to Japan to study and make recommendations on economy policies in Japan.

IV Entrenchment of Economic Recovery, 1948–49

The year 1948 marked maybe the most critical year of the occupation. Liberal reform programs of the Occupation were canceled or reversed unilaterally by Washington. The Draper-Johnston mission and their findings minimized the reparation levels while the Deconcentration Review Board mitigated the impact of the deconcentration program. Meanwhile, other nations, especially the ones in Far Eastern Commission expressed strong disapproval of the actions of the United States. Yet, they were completely disregarded by U.S.

The Secretary of Army Kenneth Royall speech on January 6 signaled the first drastic changes in the U.S. stance against the economic democratization policies. In San Francisco, Royall told “new conditions have
arisen-in world politics and economics … [and] these changes must now be fully taken into account in determining our future course [of Japan].” What Royall was trying to say is that U.S. officials were facing a dilemma. In this dilemma, the United States could not afford to leave the Japanese war-making system intact, but they could not afford to sterilize the business ability of Japan either. Royall mentioned that “the dissolution policies did not present a serious economic problem,” he went on, “but extreme decentralization of industry, while further impairing the ability to make war, may at the same time impair manufacturing efficiency and reduce the overall production and the exportable surplus of Japanese industry. Therefore, this situation might postpone the day when Japan can become self-supporting.” To clear the ambiguities over the direction of the occupation policies, Royall claimed that the deconcentration program could be modified to ensure the Japanese economic recovery in line with the interests of broad U.S. objectives. In other words, Royall implied the need for the reversal of deconcentration policies to make Japan self-supporting and prevent her from becoming a financial burden to the United States.\(^\text{103}\)

The other harbinger of the reversal of policies was Maj. Gen. Frank R. McCoy, the U.S. representative and the chairman of the Far Eastern Commission. In his speech on January 21, 1948, McCoy used a tone similar to the Royall’s and explained that the economic chaos in Japan has been prevented by the U.S. financial aid. He thought an early revival of the Japanese economy on a peaceful, self-supporting basis was needed to eliminate the burden on the American taxpayers. Moreover, bits of the McCoy’s speech resembled the Acheson’s, repeating the need to make Japan self-sustainable to contribute its part to the rehabilitation of world economy.\(^\text{104}\)

Meanwhile, Gen. MacArthur was planning to propose the establishment of a board to review the ongoing economic reform programs in Japan. As early as November 25, 1947, MacArthur prepared the draft of such proposal upon receiving criticism on the economy policies.\(^\text{105}\) After the speeches by Royall and McCoy, MacArthur thought that the time was ripe to send a radio message to the Department of the Army. On January 26, 1948, MacArthur requested a group of five outstanding individuals to review the decisions of the Holding Companies Liquidation Commission on excessive concentrations of the economic power. The authority of the board was limited to prepare reports for the SCAP and decide whether the decisions of HCLC have good or bad effects for the Japanese economy.\(^\text{106}\)

MacArthur tried to clear the criticism leveled against the deconcentration program by making such a proposal. However, this did not necessarily mean that MacArthur was against “breaking-up” of the excessive economic power. In February 1948, SCAP directed the Holding Companies Liquidation Commission to designate 257 mining and manufacturing companies, in addition to 68 distribution and service companies (325 at total) as excessive concentrations.\(^\text{107}\) This last move raised the concerns over the Japanese economy and eventually led to an intervention by George Kennan and William Draper to investigate the situation in Japan.

A. Draper – Johnston Mission and the Changes in the Reparation Policies

William Henry Draper, Jr., was one of the most important figures that helped to change the occupation policies to ensure the economic recovery in Japan. After the end of WWII, he worked as the chief of
Economics Division, Control Council for Germany, where he vigorously fought against the Morgenthau Plan. From the start, Draper criticized the de-industrialization of the German economy and supported the plans for recovery. After his return from Germany, he was appointed as the Under Secretary of War for Kenneth Royall in 1947. Shortly after the War Department’s transition to Army Department in 1947, Draper became the first Under Secretary of the Army.\textsuperscript{108}

Prior to his dispatch, Draper did not possess much knowledge about Japan. However, Draper had become convinced from what he had known in Germany that the orders concerning the economy of Japan had to be changed. The campaigns to break-up excessive concentration of the economy disturbed him the most during a visit to Japan in September 1947. Therefore, he wanted to make sure that deconcentration policies would cease and Japan would be revitalized. Draper invited a group of businessmen to join his envoy to buttress his own recommendations to the President and the Secretary of State and the Congress to change the instructions to MacArthur in Japan. Thus, it became clear that Draper was not going Japan just to investigate the general economic situation, rather, he was planning to alter the reparations and the deconcentration plans.\textsuperscript{109}

The group of businessmen who joined the Draper was known as the Johnston Committee. The Johnston Committee consisted of Percy H. Johnston, chairman of the Chemical Bank and Trust Co., Paul G. Hoffman, formerly president of Studebaker, who had been named administrator of the European Recovery Program, Robert F. Loree, chairman of the National Foreign Trade Council and formerly vice president of the Guaranty Trust Company, and Sidney H. Scheuer, senior partner of Scheuer and Co. The mission stayed in Japan between March 20 and April 2 and compiled a report for the Secretary of State. It was later published as the Johnston Report on May 18, 1948.\textsuperscript{110}

The Johnston report laid out that there are three obstacles to achieve economic recovery in Japan: (1) lack of raw materials, (2) bad condition of existing factories, and (3) the poor state of transport. It underlined that these obstacles weigh down the desire to produce, work, plan, and invest more in Japan. Furthermore, the threat of removal for reparations hangs over much of Japan’s industry, especially heavy industry, worsening the economic situation. Jerome B. Cohen explained the arguments of the committee as follows:

Insufficient essential raw materials result in insufficient production; insufficient production results in insufficient exports; insufficient exports result in insufficient foreign exchange to pay for the necessary raw materials. Until this circle is broken Japan’s economy will remain prostrate and dependent upon a food dole [GARIAO] such as the United States is presently supplying. The best way to break the circle is to supply sufficient dollar exchange to enable Japan to purchase the initial foreign raw materials.\textsuperscript{111}

In addition to the raw materials scarcity issue, the Johnston committee criticized the reparations policies as well. The committee warned that reparations cannot be made without damaging the peacetime industrial potential of Japan. Which meant that, as long as the reparations continued, the Japan’s ability to self-sustain was postponed. And if done as a punitive measure, the committee claimed that the United States would have to pay the real price of the reparations, because it was the United States which extended relief
to Japan and would be doing so for a long time unless Japan became self-sufficient.

The logic behind these warnings was simple; increasing the production was the sure method to induce industrial recovery. Therefore, to assure the recovery of the Japanese economy, the report argued that reparations must be minimized and concluded in a rapid manner. Johnston Committee recommended to retain the Japanese industries and remove only the excess capacity. Most interestingly, the committee proposed further cuts in the reparation levels proposal of the Overseas Consultants Incorporated\(^{(12)}\) (2\(^{nd}\) Strike Mission Report) and extended these cuts to the primary war facilities for the first time (Table 4). Hence, the main belief and the objective of destroying the war-making capacity of Japan to prevent her from becoming a menace to the world order started eroding. In other words, the hatred against the ex-enemy started to soften and evolve into benign relations.

| Table 4 Recommended Removals for Reparations (millions of yen in 1939 prices) |
|---------------------------------|-----------|-----------|-----------|
| Pauley Report (April 1946) | 990       | 1,476     | 2,466     |
| 2\(^{nd}\) Strike Report (March 1948) | 172       | 1,476     | 1,648     |
| Johnston Report (May 1948)  | 102       | 560       | 662       |
| Actual Removal (Up until Spring of 1949) | 160 |


Johnston report also mentioned the perils of the deconcentration program. Similar to the reparations issue, the committee perceived the deconcentration program as a big uncertainty for Japanese businesses that crippled the economic recovery process. The report recommended that “the period of uncertainty caused by this economic reform should be made short and the area of uncertainty lessened as rapidly as possible.” Moreover, they recommended that reorganization of big companies “must be limited to the minimum necessary to ensure reasonable competition.” Therefore, an overhauling deconcentration program was not favored by the Johnston Committee.

Recommendations of Johnston report tremendously mitigated the reparations levels in accordance with the Draper’s objectives. Total reparations levels that were designated in Pauley Report dropped to one-tenth for industrial equipment, and one-quarter for military equipment in the wake of recommendations by Johnston committee. After the realization of this first step, Draper toiled for removing the second obstacle for economic recovery. For this reason, he sent the Deconcentration Review Board to Japan to devise a reversal of the deconcentration program.

B. Deconcentration Law and Its Moderation
The promulgation of the Deconcentration Law indicated that the economic democratization programs
nearly reached completion. However, by that time, the dissenters of the program and their active criticism in the printed media and the congress started casting a shadow over the feasibility of deconcentration. After consecutive criticism by American pressure groups and speeches by Kenneth Royall and Frank McCoy, MacArthur finally decided to send a telegram to Washington, proposing the establishment of a Deconcentration Review Board (DRB). But this did not mean that General was trying to reverse the deconcentration policies. On the contrary, MacArthur tried to create a suitable environment for reform policies by reducing the criticism over the deconcentration. Hence, MacArthur proposed establishing a Deconcentration Review Board to examine the outcomes of that program.

As expected, SCAP directed the Holding Company Liquidation Commission (HCLC) for execution of the law shortly after the telegram. The Holding Companies Liquidation Commission designated 325 firms as possible excessive concentrations of economic power subject to reorganization. The designated companies in February 1948, represented nearly 75 percent of all Japanese industry and commerce. The programs for the economic democratization of Japan were about to be completed after two-and-a-half year the occupation started.

Meanwhile, the direction of the occupation policies greatly changed with the Draper-Johnston mission. After the Johnston report’s recommendations of limiting the reparations and minimizing the deconcentration scope, the Chief of Economic and Scientific Section William Marquat convened a meeting on April 17, 1948 to review the lists for designated companies under the Deconcentration Law. During the meeting, Edward Welsh (New Dealer) of the Anti-Trust and Cartels Division presented a new “List of Designated Companies” reducing the total number of companies from 325 to 293. However, Marquat was not satisfied with the minor changes and stated that nearly 200 companies should be identified as not excessive concentrations of power, and be removed from the lists.

Under these circumstances, Deconcentration Review Board (DRB) arrived in Japan on May 4, 1948. Team of five individuals, hand-picked by Draper, were: Roy S. Campbell, chairman, president, and general manager of the New York Shipbuilding Corporation; Joseph B. Robinson, industrial engineer and owner of the Robinson Connector Co.; Edward J. Burger, vice-president of the Public Service Co.; Walter R. Hutchinson, former Assistant U.S. District Attorney from north Iowa; and Byron D. Woodside, assistant director of Corporation Finance, Securities Exchange Commission. The members of the board represented big American companies but ironically, their mission was to examine the influence of deconcentration of big Japanese companies. Obviously, the DRB was sympathetic towards the big corporations and aimed to reverse what the Deconcentration Law started since their first day in Japan. This was the reason why William Draper chose these individuals and sent them to Japan.

In the meantime, the National Foreign Trade Council, representing the largest American corporations, sent the heads of General Electric, International Telephone and Telegraph, and Standard Oil to advise Draper and Walton Butterworth, head of the Far East division of the State Department, on July 26-27, 1948. The president of General Electric, which had significant investments in the prewar Japanese electrics industry, said that American corporations were anxious to reinvest in Japan, but that SCAP’s deconcentration policy, the purge, and the economic controls created an unfavorable business climate. Under these
conditions, the corporations feared for the profitability of their affiliates. The move by the National Foreign Trade Council further fortified the arguments of the Draper.

As a result, Draper’s team in Japan started putting a spoke in deconcentration law’s wheel. In July, Deconcentration Review Board started examining its first case, Nippon Soda, and decided to exclude the company from the deconcentration lists. DRB did not settle for small changes in the deconcentration process and altered the procedures for deconcentration. After the examination, DRB enunciated “four principles” in August to guide the Holding Company Liquidation Commission. The principles introduced “obstructing procedural points” and complicated the process of determining whether a company was excessive economic power or not. However, according to Hadley, DRB had no authority to determine what companies were excessive concentrations; it had been invited to Japan to determine the effect of the proposed organization plan of companies. Regardless, with the new principles introduced by the board, the number of designated companies were gradually decreased.

In its final report to SCAP on July 15, 1949, the Deconcentration Review Board claimed that the deconcentration of excessive companies was finished. The report said, out of the originally designated 325 companies, 50 were removed from designation prior to board’s arrival; 38 were removed by board’s recommendation; 179 were removed as a result of application of “four principles”; 2 were closed before deconcentration; and 37 were classified as requiring no physical breakup. Therefore, the Board successfully designated 19 companies out of 325, to be decentralized. Among 19 companies, 11 (Japan Iron and Steel, Mitsubishi Heavy Industries, Mitsui Mining, Mitsubishi Mining, Sumitomo Mining, Oji Paper, Teikoku Fiber, Daikin Industries, Toyo Can, Dainippon Beer, and Hokkaido Dairy Coop.) were ordered to be divided into smaller corporations while 8 companies were required to dispose/liquidate certain plans and securities. More than two-thirds of the designated companies were excluded from the deconcentration lists by direct involvement of the Deconcentration Review Board. After a year-long effort in Japan, DRB managed to lower the number of the companies just under the 6 percent of what was intended in the first place.

DRB did not favor radical reforms and wanted to make sure that the industrial structure in Japan remains intact. At the end, they succeeded in that. With the moderation of the reform program and drastic cuts in reparations, Draper mission achieved great success in the reversal of the economic policies of the Occupation. However, the reversal of the course was not finished yet. It was George Kennan and his report “Policy Planning Staff 28” (PPS-28) that completed the reversal of policies. Based on PPS-28, a broad framework of U.S. national policy was established and completely changed the U.S. stance towards the occupation of Japan. In the next part, the key points of Kennan mission will be touched upon briefly.

C. Kennan Mission and the Entrenchment of Recovery

George F. Kennan was the foremost authority on the policy toward the Soviet Union. His long telegram in 1946, fundamentally changed how the Soviet Union and the threat of communism were perceived in the United States. His article “On the Sources of Soviet Conduct” – published in Foreign Affairs journal in 1947 – provided a realist approach to follow in dealing with the communist nations. Kennan was appointed as
the head of the Policy Planning Staff that was established by Secretary of State George Marshall in 1947.\(^{121}\)

One of the first tasks of the Policy Planning Staff was to examine the prospects of an early Peace Treaty with Japan. The Early Peace Proposal made by MacArthur during a press conference in March 1947, prodded the State Department to make necessary preparations. Taking part in these preparations, Kennan was skeptical about the MacArthur’s proposal. Kennan considered Western Germany and Japan as the "theaters of greatest dangers, greatest responsibilities, and greatest possibilities" of the United States in late 1947. He thought that the two industrial complexes – Germany and Japan – were the centers of Europe and East Asia, and their recovery was essential to the restoration of stability in those regions.\(^{122}\) Moreover, Japan was the sole great potential military-industrial arsenal of the Far East. Hence, unlike China, Japan was a potential factor in world political developments.\(^{123}\) However, Kennan stressed that occupation policies did not reflect the realities of recent developments, rather showed "evangelical liberalism, punitive enthusiasm, and unreal hopes for great-power collaboration in the postwar period." These issues restricted the potential of Japan and crippled the democratic prospects in the country. Meantime, civil unrest and numerous economic problems raised the concerns over the future of Japan. For these reasons, Kennan concluded that Japan was neither stable enough nor ready for a peace treaty.

Yet, Kennan did not confine himself with that conclusion. He decided to pay a visit to Japan to grasp the situation better and persuade MacArthur to change the current policies of SCAP. Just before his departure, he handed out a detailed paper to Secretary of State Marshall. The paper mentioned that U.S. objective for the coming period should be to "devise policies toward Japan which would assure the security of that country from Communist penetration and domination as well as from military attack by the Soviet Union," and "permit Japan’s economic potential to become once again an important force in the affairs of the area, conducive to peace and stability."\(^{124}\) Hence, similar to Draper’s way of thinking, Kennan was constructing policies for economic revival even before he arrive in Japan.

Following these developments, Kennan departed for Japan.\(^{125}\) He was aided by Marshall Green, a Foreign Service officer who had been private secretary to Ambassador Joseph Grew in Tokyo, during his journey. Marshall Green provided invaluable help to Kennan who had no knowledge about Japanese Affairs.\(^{126}\) Even though we do not know to what extent Marshall Green influenced Kennan’s way of thinking, we can argue that the Japan Crowd was making a comeback to the political scene after the punitive measures for Japan started to lose supporters in early 1948 while the moderate policies gained momentum once more. Kennan arrived in Japan on March 1, 1948 and throughout his stay, he met three times with MacArthur to discuss the situation in Japan.

During the first meeting, MacArthur performed a two-hour long monolog, telling that Japanese were thirsty for both democracy and Christianity. MacArthur continued and said “for the first time in their history the Japanese were now tasting freedom … Peoples who once learned what freedom and democracy meant would never willingly return to slavery.” For that reason, he argued, Japanese would never willingly accept Communist domination. In other words, MacArthur claimed that the Japanese communists were no menace.\(^{127}\) The first meeting proved unproductive and ended without any discussions on occupation policies.
Kennan requested a personal meeting with MacArthur to find some answers to the questions he had in mind. In their second meeting on March 5, Kennan discussed the leading problems of occupation policy with MacArthur. MacArthur agreed with the plan of the State Department that the economic recovery should be made the primary objective. However, MacArthur was concerned that changes in the occupation policies, especially on the development of foreign trade, would be criticized by the representatives of the Far Eastern Commission. Far Eastern countries were suspicious of economic empowerment of Japan because they feared that Japan would establish an economic dominance in the region that is similar to the pre-war era. MacArthur mentioned these problems should be solved first to get Japan started again as a processing and trading nation. As a solution for the economic problems, MacArthur suggested establishing a “revolving fund” which would provide loans for Japan to be used to buy the necessary raw materials for her industries.  

George Kennan and the MacArthur convened the third meeting on March 21, 1948. Draper, too, joined the discussions to represent the views of the Department of the Army. The trio focused on mainly two topics: establishment of a small defense force in Japan and the reparation policies. Laying out straight, Draper expressed that there was a general trend in Army toward building a small defensive force in Japan before the occupation ends. When asked about his opinions, MacArthur said he was unalterably opposed to any such plan because: (1) it would contradict with U.S. primary objectives of demilitarization and alienate the Far Eastern nations; (2) it would further retard the economic recovery in Japan; and (3) it would contradict with the article 9 of the new constitution. Rebuked by MacArthur, Draper changed the topic to reparations. MacArthur said Japan has already paid over fifty billion dollars by virtue of her lost properties in outside of her homeland. Together with the destruction that Japan faced, MacArthur believed that Japan has suffered enough. According to him, the continuation of the reparations program was just making Japan more and more dependent on American taxpayers and foreign aid. He insisted that there was a critical need in Japan for every tool, factory, and practically every industrial installation to increase the production and balance the Japanese economy. Thus, MacArthur argued that reparations of the industries, which have no place in the future Japanese economy, should be completed while the thought of further reparations of other industries should be abandoned entirely.  

In light of this discussion, George Kennan prepared his famous report PPS-28 on March 25, 1948. First and foremost, the report stressed that the United States should not press for a peace treaty at this time. Then, it touched upon various topics including U.S forces in Japan, future of Okinawa, strengthening of the Japanese police, reform programs, economic recovery, reparations, and war crimes trials. Relevant to our topic I should mention three crucial recommendations by Kennan. 

To start with, Kennan favored keeping the Far Eastern Commission intact but recommended that the United States should not hesitate to use unilateral directives whenever they failed to obtain prompt action in the FEC. Probably influenced by MacArthur’s criticism of Far Eastern Commission, Kennan supported the unilateral actions to overcome the gridlock over reparations and economic recovery program. In other words, Kennan recommended that U.S. should be in charge of the policies –such as reparations and economic recovery– that were not settled by the FEC. This approach constituted a distinct demarcation
between the implementation of early and late occupation policies. While early occupation policies were implemented under a watchful Far Eastern Commission, the latter policies were directly initiated by Washington and disregarded the multilateral organizations in the process.

Kennan report also urged to moderate the purge policies, paving the way for many bureaucrats, businessmen, and public workers to return to the public life. More importantly, the report underpinned that economic recovery should be made the prime objective of the U.S. policy in Japan and reparations should be done in accordance with the levels proposed by second Strike mission. However, Kennan mentioned that both changes should be implemented after consultation with the findings of Draper mission.131)

The recommendations of the Kennan mission (PPS-28) later produced the broad framework for U.S. policy toward Japan. It became the source that U.S. national policy built upon. The PPS-28 was discussed in National Security Council and after two revisions and small adjustments, it was accepted as NSC 13/2 on October 7. Two days later, President Truman approved it as the new U.S. approach toward Japan. With this policy, U.S. aimed to draw a non-punitive peace treaty for Japan and decided to reverse punitive reform policies. The document underlined the importance of Japan for the U.S. security and depicted an economically strong Japan which trades extensively with her neighbors for her economic recovery.132) Curiously, the document was not explicit about the termination of the reparations program. Departments of the Army and State both agreed that reparations were a hindrance to the economic recovery and should be ceased immediately. But the termination of the program dragged on until May 12, 1949. Only then, both departments agreed that the implementation of the reparations was impossible under the FEC decision. This was followed by a unilateral announcement by U.S. representative to FEC, Frank McCoy. McCoy explained that there was little or no prospect of the Far Eastern Commission agreeing on a reparations share schedule. Moreover, McCoy said Japan had already paid substantial reparations through the liquidation of her former overseas assets.133) In the light of these, McCoy announced that reparations were terminated unilaterally by the United States.

Following the NSC 13/2, Joint Chiefs of Staff sent a telegram to MacArthur on December 11, 1948. The telegram ordered MacArthur to take the necessary actions to implement “Nine-Part Interim Directive on Stabilization.” The interim directive ordered implementing an economic stabilization program to achieve fiscal, monetary, price and wage stability in Japan and to maximize production for export.134) With stabilization plan directive, the period of policy development for the economic recovery had finally ended.135) To achieve economic recovery goals, Truman appointed Detroit banker, Joseph Dodge who arrived in Japan on February 1, 1949. Dodge took the role of an “economic czar,” and swiftly applied austerity measures to curb the inflation problem. By April 25, 1949, the single exchange rate (360 yen to a dollar) was established and the last obstacle to the economic recovery of Japan was cleared out. The financial stabilization program of Dodge stopped the inflation immediately, but brought some economic setbacks, too. The famous Dodge Line created convoluted unemployment problems, reduced the budgets of various government sectors, including education, and increased the unrest within the Labor unions. Moreover, it could not increase the production output of the industries and failed to create an impetus for economic recovery. On the contrary, numerous scholars argued that Dodge Line introduced deflation rather than stabilization to Japan.
## Table 5  Chronology of the Change of Occupation Policies

<table>
<thead>
<tr>
<th>Year</th>
<th>Punitive Measures</th>
<th>Recommendations for Economic Recovery</th>
<th>International Events</th>
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| 1945 | **August 29, Basic Directive**  
**November 3, JSC 1380/15**  
**December 7, Pauley Interim report on reparations** | **January 28, First Strike Mission for surveying the reparations policies**  
**May 8, Acheson’s “workshops of democracy” speech**  
**September 18-21, Draper’s first visit to Japan**  
**December 1, James Lee Kaufman criticized the deconcentration policies in a report published in Newsweek magazine**  
**December 19, Senator Knowland criticized the deconcentration policies (FEC-230)** | **February 4-11, Yalta Conference**  
**July 26, Potsdam Declaration**  
**August 8, USSR entered the war against Japan**  
**December 12-27, Moscow Foreign Minister Conference and the establishment of international bodies of FEC and ACJ** |
| 1946 | **March, Edwards Mission report on zaibatsu**  
**April 1, Pauley final report on reparations**  
**April 20, Holding Company Liquidation Commission was created**  
**June 12, Hadley memo** | **January 28, First Strike Mission for surveying the reparations policies**  
**May 8, Acheson’s “workshops of democracy” speech**  
**September 18-21, Draper’s first visit to Japan**  
**December 1, James Lee Kaufman criticized the deconcentration policies in a report published in Newsweek magazine**  
**December 19, Senator Knowland criticized the deconcentration policies (FEC-230)** | **March 5, Churchill’s “Iron Curtain Speech”**  
**February 26, Far Eastern Commission’s 1st meeting**  
**April 5, Allied Council for Japan’s 1st meeting**  
**May 3, Tokyo Tribunal proceedings started** |
| 1947 | **January 4, Economic Purge of zaibatsu families and top-businessmen**  
**April 14, Anti-Monopoly Law**  
**May 12, Revised Edwards report sent to FEC, which later became FEC-230**  
**July 3, SCAPIN 1741, Dissolution of Mitsui Trading and Mitsubishi Trading**  
**December 18, Deconcentration Law** | **January 6, Royall Speech underlined the need for policy reversal for Japanese self-sufficiency**  
**January 19, Senator Knowland again targeted Deconcentration Law**  
**March 9, 2nd Strike Mission recommended drastic cuts in reparations**  
**March 20-April 2, Draper-Johnston Mission explicitly underlined the need for a change in SCAP economy policies**  
**June 12, Young Mission urged the need for a single exchange rate for Japanese economic stabilization**  
**July 15, SCAP directive of “ten point economic stabilization plan”**  
**October 7, NSC 13/2** | **March 12, Truman Doctrine**  
**June 6, Marshall Plan**  
**June 30, Chinese Communists launched the counterattack against KMT; scales of war started to change in favor of communists** |
| 1948 | | **January 21, US representative to FEC, McCoy, made a speech to stress the new U.S. position on economy policies for Japan**  
**April 1, Berlin Blockade**  
**August 15, North and South Korean governments were established, divided by the 38th parallel**  
**November 12, Class A war criminals’ punishments were concluded by Tokyo Tribunal** | |
| 1949 | **February 1, Dodge arrives in Japan to stabilize Japanese economy**  
**April 25, 360 yen exchange rate was established.** | | **April 4, NATO established**  
**May 12, US representative to FEC, McCoy, announced the termination of the reparations**  
**May 12, End of Berlin Blockade**  
**August 29, USSR successfully detonated their first atomic bomb.**  
**October 1, “Loss of China”** |
V Conclusion

The liberal reform policies that started in early 1946, were weakened by the numerous economic problems in Japan. Unhappy with the situation in Japan, domestic pressure groups within the United States started criticizing occupation policies and requested their reversal. The domestic pressures – combined with dissenters of the occupation programs in Washington– beaconed an intervention by Washington in late 1947. This process gave birth to the dispatch of two high-ranking officers, namely William Draper and George Kennan, of the Departments of the Army and State. Consecutively, Draper and Kennan missions recommended unilateral U.S. action to stop the reparations and deconcentration program in spring of 1948. The reversal of the punitive measures and the entrenchment of the economic recovery were molded into their official shape in October 1948 with the adoption of NSC 13/2. As a result of the new U.S. foreign policy toward Japan, U.S. publicly announced in May 1949 that reparations were terminated; while two months later, the hand-picked team of Draper –Deconcentration Review Board– announced that deconcentration of excessive economic power was successfully completed.

The above-mentioned order of events explains the process that resulted in the implementation of economic recovery in the occupation period. However, it does not offer or provide concrete answers to the questions that we have previously enquired. Here, let us go back to the questions that were laid out in the introduction part and answer them accordingly.

How did the punitive measures for occupation occur? The policy formulation for the occupation started in late 1942 within the Department of State. Until the last phase of the Pacific War, moderate policies –under the influence of the Japan Crowd– dominated the policy formulating committees. However, after the death of Roosevelt, Harry Truman became the president and the endorsers of "soft peace" were replaced by the China Crowd. In the meantime, Washington sent the "Initial Policy" (JCS 1380/15) to SCAP which envisioned stern and punitive principles related to the operation of Japanese economic system. New Dealers within the GHQ regarded Initial Policy as the "bible of the occupation." Accordingly, they started formulating and implementing comprehensive liberal reform policies without paying much attention to the economic situation in Japan. In the light of these, the punitive measures gained support and eventually were implemented in the first phase of the occupation.

To what extent, the economic distress in Japan affected the policy formulation in Washington? At the end of World War II, Japan was torn apart; her factories were lying in ruins while her people were surviving barely with the Government Reliefs by the United States. Although the occupation authorities accomplished much success in a short-span of time, Japanese economy did not show any indication of recovery. GNP in 1947 was just slightly over half of the 1937 level; exports and imports plummeted to abyssmal levels and the inflation went out of control. These problems resulted in civil unrest that strengthened the right and left wing extremists and endangered the nurture of democratic values in Japan.

Starting from February 1946, many American officials in Washington and Tokyo argued that to safeguard the American type of democracy in Japan, economic recovery was a must-do. Based on these arguments, State and Army Departments prepared policies for making Japan self-supporting and agreed to make eco-
nomic recovery the top priority of U.S. occupation policy by October 9, 1947. Therefore, the economic distress in Japan enormously affected the policy formulation in Washington. Without economic problems, Washington might not have started the policy formulation for economic recovery and achieve a consensus on policy changes in such an early phase. Without economic problems in Japan, the formulation of the recovery plans might have been delayed until the “loss of China,” and or even Korean War where the Cold War between the capitalists and socialists became apparent more than ever.

Were there any pressures to Washington by American pressure groups/businessmen to revive Japanese economy? If so, did they utilize the threat of communism in Japan to justify their purposes? Short answers to these questions are: “yes” and “probably, yes.” In retrospect, the role of the American pressure groups on policy reversal is not studied by many. However, based on the arguments of Howard Schonberger –the leading scholar on the topic–, we see that “Japan Lobby” played a crucial role in the reversal of policies by enabling printed media. The Newsweek magazine, its foreign editor Harry Kern, and the contributors of the articles – Packenham and Kauffman – stood against the punitive measures and favored a moderated approach that encourages the economic recovery of Japan. They acquired top-secret policy documents and leaked their contents; and stressed the burden of the occupation on American taxpayers to catch Washington’s attention. By doing so, they even influenced the Eightieth Congress which was very skeptical of increasing the foreign aid to Europe and Japan. Standing on the congress floor, Senator William Knowland attacked the deconcentration policies twice and accused FEC–230 and the Deconcentration Bill for going beyond the original goals and being “socialistic.”

Both Japan Lobby and Senator Knowland employed a jargon that was heavily influenced by the Cold War dynamics. In every opportunity, they claimed that Japan was becoming more and more “socialist” and did not shy away from using forged evidence to fortify this approach. However, the crux of the problem remains disputed. There is some evidence that Japan Lobby used false information and aggravated the facts. Kern’s estimates of the number of people affected by economic purge; Kauffman’s estimations about a serious drop in industrial output as a result of purge policies; the argument that underpin the burdens of the occupation on American taxpayers; the claims of Kauffman and Knowland that anti-American capitalist system was under construction in Japan were all debunked by scholars and officials of the occupation such as Kazuo Kawai, Theodore Cohen, Eleanor Hadley and Charles Kades. They out that members of the Japan Lobby had vested interests in Japan, thus they wanted to stop the deconcentration and reparations policies. For this reason, we can argue that the dissenters of the occupation policies utilized the threat of communism in Japan to justify their purposes. However, the evidence mentioned above is not exhaustive, therefore should be taken with a grain of salt until further evidence becomes apparent.

This brings us to the last question: Did American ex-businessmen/bureaucrats play a role in reversing the course? Without any doubt, they played a great role in reversing the course. Many ex-businessmen and high ranking officials in Washington yearned for a strong Japanese economy. Founder of the Newsweek magazine and the Secretary of Commerce Averell Harriman; cotton producer/lobbyist and Republican Senator William Knowland; the president of Dillion & Read, Co. and the Secretary of Defense James F. Forrestal; the vice-president of Dillion & Read, Co. and the Under Secretary of the Army William Draper
were the vocal supporters. They thought that the liberal reform policies under the influence of New Dealers were crippling the business opportunities in Japan. That was why Draper went to Japan and brought a group of prominent businessmen with him to buttress his own recommendations to the President, the Secretary of State, and the Congress. He pushed for limiting the reparations and ending the deconcentration program, a process in which he emerged victorious. Arguably, Draper played the most important role in the reversal of occupation policies.

The other bureaucrat who played a central role was George Kennan of the Policy Planning Staff in the State Department. Kennan was not an ex-businessman and had a different reasoning for policy changes. He approached the problem in Japan from a geostrategic viewpoint and argued that Japan was too valuable for the U.S. national security. Therefore he thought Japan should not fall to communism. To prevent such a calamity, he agreed with Draper’s proposal of strengthening Japanese economy. His report, Policy Planning Staff – 28, became the milestone in the U.S. foreign policy toward Japan. In October 1948, Joint Chiefs of Staff adopted NSC 13/2 – a revised version of the Kennan’s paper – and the formulation for the reversal of policies have ended.

In light of these developments, this paper concludes that economic distress in Japan and the American pressure groups ignited the debates over the occupation policies and created the impetus for a reversal of the policies. They eventually triggered an intervention by Washington which unilaterally changed or stopped the ongoing reform programs. In other words, the intensification of the Cold War solely did not cause the "reverse course." Rather the Cold War dynamics fortified the already existent arguments of the policy-makers and the American businessmen who desired the economic recovery. Therefore, the influence and the importance of these two factors should not be dwarfed and underestimated by the macro-level explanations of policy reversals.

Notes
5) The Basic Directive was revised fifteen times by the Joint Chiefs of Staff and became JCS 1380/15 after its approval. Some scholars argued that JCS 1380/15 became the most important document for the occupation and called as "bible of the occupation" by GHQ staff. After its approval, JCS 1380/15 was sent to MacArthur on November 3, 1945. The directive recommended punitive liberal reforms for Japan and disregarded the concerns over the economic recovery policies.
7) Fearey was the personal secretary to the Ambassador to Japan, Joseph Grew who was one of the most prominent
supporter of the moderate policies for Japan. He fought vigorously against the people who were in favor of abolishing the emperor system.

9) Ibid., p. 7.
10) Ibid., p. 86.
13) When presented with the report titled “Economic Policy Toward Japan” dated April 17, 1945, Secretary’s Staff Committee criticized it that the recommendations were too general and that detailed studies of Japanese industry and trade should be utilized to make concrete suggestions and recommendations. Ministry of Finance, op. cit., pp. 129–130.
14) Ibid., pp. 17–18. Memorandum of May 4, 1944, “Post-war Objectives of the United States in Regard to Japan.” Also see Ministry of International Trade and Industry, op. cit., p. 11.
18) Ibid., pp. 73–78.
19) Ibid., pp. 78–79.
20) Ibid., p. 80.
22) Ibid.
23) Ibid., pp. 428–439.
26) Ibid., p. 436.
27) Ibid., p. 435.
29) New Deal was the liberal relief, recovery, and reform policies of the Roosevelt administration in the wake of the Great Depression of 1929. The liberal policies favored strengthening of the labor unions and the middle class, as well as providing a better distribution of wealth. These policies later became the impetus behind the economic democratization – zaibatsu dissolution, labor reforms, and land reform for occupied Japan.
31) Ibid., p. 66.
33) Half of the capacity for the manufacture of machine tools; All tools and equipment in army and navy arsenals, except for the ones useful solely for making arms, ammunition, and implements of war; All tools in the entire aircraft and shipbuilding industry; All steelmaking capacity in excess of 2,500,000 tons per year; Half of the thermal electric

34) Most important Special Staff Sections were Government Section, Legal Section, Civil Information and Education Section, Economic and Scientific Section, Civil Intelligence Section, and Reparations Section. Establishment of most of the sections were completed by October 2, 1945.


39) Yasuda Plan essentially was a superficial plan which aimed to dissolve only the holding companies at the apex of the zaibatsu organization, leaving other interlocking companies within the organization intact. Sugita, *op. cit.*, p. 23. Therefore, comprehensive plans were need to further economic democratization.


50) Government Section, *op. cit.*, p. 567. To further implement the program of deconcentration of economic power, the Imperial Japanese Government is directed to take following immediate actions: (a) the elimination of the influence of listed families or family members through security ownership, (b) limitation on intercorporate security holdings, (c) prohibition of multiple directorates, (d) prohibition of contractual, service or patent arrangements which restrict competition or restrain trade and commerce.


56) *Ibid.*, p. 9. Tax was imposed on individuals who owned real and tangible assets exceeding 100,000 yen.


60) Yamamura, *op. cit.*, pp. 20–21.

61) Borden, *op. cit.*, p. 70.

Another prominent scholar estimates that the theoretical exchange rate was 1 dollar to 200 yen by December 1947, see Cohen, op. cit., p. 465. The official single exchange rate (1 dollar to 360 yen) was established in April, 1949.


66) Sanbetsu (産別) was an extreme left-wing union movement that was founded in August 1946.


70) Ibid., pp. 515–518.

71) Government Section, op. cit., p. 765. In addition, MacArthur mentioned that there was no “clear-cut economic framework outlined for Japan or Germany” which slowed the pace of the necessary preparations.

72) MacArthur quoted Winston Churchill and told “Our problem is [not to keep Japan down, but] keep Japan up.” Ibid., p. 766.


76) Delta Council is an area economic development organization representing the eighteen Delta and part-Delta counties of Northwest Mississippi. Started in 1935 by a group of far-sighted citizens to provide a medium through which the agricultural, business, and professional leadership of the area could work together. http://www.deltacouncil.org/ last accessed on 28 June 2016.


80) Department of State, Foreign Relations of the United States, 1947: Volume VI the Far East, Washington: United States Government Printing Office, 1972, pp. 302–304. Both programs were put forward by two departments (SWNCC 381 and SWNCC 384) recommended to revitalize Japan’s economy. However, there was a disagreement between Departments. The State Department put forward SWNCC 381 to revitalize the economy of Japan by achieving consensus among FEC countries. On the other hand, Army Department endorsed SWNCC 384 and proposed to foster Japanese recovery by issuing unilateral directives.


82) Ibid., p. 134.

83) Ibid., p. 135.

84) Ibid., p. 136.

85) Ibid., p. 136.


87) Schonberger, op. cit., p. 138.

91) Ibid.
95) Hadley, *Antitrust in Japan*, pp. 140–141. On January 22, 1948, the Central Committee of the Japan Communist Party issued Directive no. 198 in which the Deconcentration program was described as a plan mapped out by the Government to colonize Japan by inducing foreign capital. This directive called on all labor unions to fight this program because it is a scheme of a traitorous, monopolistic capitalists.
108) William Draper received B.A. and M.A. in economics in New York University. After the Great War, he worked as a banker. In 1927, he joined the Dillon & Read, Co., an investment bank, and rose to the rank of vice president by 1937.
112) Jerome Cohen points out an interesting point of the Johnston Report in his article. According to him it is not clear how a group of businessmen, without a staff of engineers, in a three-week survey which included travel time to and from the Far East, and a diversionary trip to Korea, could conclude that primary war facilities available for reparations were only forty percent of that favored by a group of engineers [Strike Mission] who had spent five months studying the question. Jerome B. Cohen, *op. cit.*, p. 140.
116) Borden, *op. cit.*, p. 84.
117) On August 28, DRB sent a memorandum to SCAP recommending four principles to be followed in determining the excessive companies under the Deconcentration Law: (1) A *prima facie* case is needed to determine whether the company restricts or impairs the competition in business; (2) Possession of non-related lines of business is not in itself sufficient to confer upon the HCLC authority to issue deconcentration; (3) Submission of a voluntary plan for reorganization by companies is not in itself sufficient to confer upon the HCLC authority to issue deconcentration; (4) HCLC orders for deconcentration should be directly related the three factors stated above. Ministry of Finance, *op. cit.* Vol. 20, pp. 408-410. “Initial Report of the Deconcentration Review Board.”


120) Finn, *op. cit.*, p. 201.

121) The Policy Planning Staff's mission was to take a longer term, strategic view of global trends and frame recommendations for the Secretary of State to advance U.S. interests and American values.


123) “Deterioration of the situation in China did not strike us as fatal, in itself, to American interests. China was not a strong industrial power. She showed no promise of becoming one and she could not become in any short space of time a strong military power. She had no ability to develop amphibious power on any serious scale. [However] what it [deterioration of the situation in China] did do was to heighten the importance of what might now happen in Japan.” Kennan, *op. cit.*, pp. 373-374.


125) Originally, Kennan did not plan to visit Japan by himself. He thought that a higher ranking official (such as George Marshall) should visit Japan and convince MacArthur about the policy changes. However, Kennan was aware that there was a friction between the two generals. Therefore, he undertook the mission.


127) Department of State, *Foreign Relations of the United States, 1948: Volume VI the Far East and Australasia*, Washington: United States Government Printing Office, 1974, p. 697. Actually this was not the first time that SCAP disregarded a communist threat in Japan. In a reply to a question raised by Mr. Shen on the topic, W.J. Sebald (Political Advisor to MacArthur) responded in behalf of MacArthur. Sebald said “communism, the extreme left is equally as bad as the extreme right... The Japanese already thrown out the extreme right... I am convinced that Japanese will likewise refuse to accept Communism as a system.” Ibid., pp. 668-669.


129) Ibid., pp. 706-711.

130) Ibid., p. 693.

131) Ibid., pp. 694-695.

132) Ibid., pp. 858-862.


