

Without hesitation, SCAP picked up a bid for 729 bales of Australian wool. The selection was not made because Australian wool was particularly preferred to South American but because it was the only bid offering immediate shipment which was desperately needed to keep the Japanese mills operating.³¹

Although this amount was far from adequate to meet the immediate predicament in the Japanese industry, SCAP accepted no further bids from US firms. A bright opportunity emerged in negotiations with the Mission of the Australian Wool Realisation Commission, which supervised postwar sales of Australia's surplus wool. Informed via the US State Department of SCAP's frustration with Australia's firm stance against wool sales to Japan, Canberra agreed to sales of some better types of wool.³² At the early stages of the negotiations in Tokyo, in August 1947, SCAP officials gained the impression that 'principal previous obstacles to business may be virtually eliminated'. In the light of these developments, it was considered advantageous not to rely on bids from private firms because firstly this could cause a situation whereby more than two firms might be bidding against each other to buy wool for Japan at the same auction, and secondly, outright purchases through an agent appointed by SCAP would give 'greater latitude for Japan'.³³ SCAP was also informed by Washington that Australia had changed its policy to permit shipment of high grade merino wool to Japan, but at the same time Japan was required to include a certain percentage of a low quality crossbred wool in its bid.³⁴

Despite this, the Mission of the Australian Realisation Commission did not allay SCAP's suspicion that Australia was uncooperative in supplying wool to Japan. SCAP understood Australia's policy that wool procurement should be made at auctions using brokers, and duly presented a list of twelve brokers identified by the Japanese wool traders. However, SCAP found difficulty in accepting the Mission's claim that payment should be made in cash, which SCAP understood to be dollars, on terms similar to regular private trade. It insisted that purchases of Australian wool should be financed in the currency used

³¹ Foreign Trade Division, 'Memorandum for Record', 29 August 1947, *ibid.*

³² Rix, 1986, p.61.

³³ 'Teleconference', 16 August 1947, SCAP, 6090(4), ESS(D)00808.

³⁴ Foreign Trade Division, 'Memorandum for Record', 19 August 1947, *ibid.*

by the markets for Japanese wool textile exports.³⁵ The problem of financing of the trade had to be settled before Australian wool could be shipped to Japan.

PROBLEMS OF FINANCING WOOL PROCUREMENT FROM AUSTRALIA

After the Australian wool mission left Japan in September, the Foreign Trade and Commerce Division began to lose its desire to procure wool in the Australian market. The Division found the prices at Australian auctions to be too high, and the type and quality offered by the Mission limited. It even seemed conceivable that 'rigging of the market and combined actions against the Japanese purchasing' might happen. Australia's insistence on controlling the types of wool to be used in Japan was regarded as 'exercising unfair discrimination against Japan'. Hence, it was recommended that the most scrupulous and 'careful analysis' had to be made when purchasing wool at Australian auctions, furthermore, increased effort should be made to explore wool of suitable quality at lower prices from alternative sources of supply.³⁶

While the procurement of Australian wool again faced a deadlock, negotiations were proceeding between the Foreign Trade and Commerce Division and the Government of Hong Kong for a sort of wool processing contract. In late September, the Division proposed to procure wool through a Hong Kong firm named Scott and English in return for the future export of Japanese textiles and general merchandise to the Hong Kong Government.³⁷ Apart from the fact that the firm had been long acquainted with SCAP through its Tokyo offices, Scott and English was favoured because it had been SCAP's largest customer in wool products and had the capacity to 'readily absorb the finished products in SCAP's programme'.³⁸ By late November, Scott and English had concluded a contract to purchase, on SCAP's behalf at the Australian auctions, 50,000 bales of Australian wool which was to be financed through sterling credit to be provided by the

³⁵ Radiogram from SCAP to Washington, C-55768, 27 September 1947, SCAP, 6090(4), ESS(D)00807; Pickelle to Wrigley, 'Purchases of Australian Wool', 20 September 1947, SCAP, 6709(38), ESS(C)05438.

³⁶ Foreign Trade Division, 'Memorandum for Record', 20 September 1947, *ibid.*

³⁷ Pickelle to Marquat, 29 September 1947, SCAP, 6709(38), ESS(C)05438.

³⁸ Max B. Laupheimer, Chief of Wool Procurement, Foreign Trade and Commerce Division, to Australian Wool Realisation Commission, 'Scott and English', 14 April 1948, SCAP, 6747(19), ESS(A)05537.

Hong Kong and Shanghai Bank.³⁹ The Hong Kong firm, however, faced strong objection from the Australian government which wished to receive payments for its wool export directly from SCAP through a channel to be established by the ongoing Anglo-American negotiations for Japan's sterling trade.

On 15 August 1947, the resumption of Japanese private trade was permitted within a limited scope. While SCAP was to maintain tight controls on trade, especially importation and foreign currency holdings, Japanese private exporters were allowed to enter into negotiations for deals directly with foreign private buyers. It gave trading opportunities to the British Commonwealth countries especially those in East Asia, which had revealed a strong appetite for Japanese manufactured goods, particularly cotton textiles. On 20 August 1947, however, Britain suspended convertibility of the pound sterling into dollars due to the continuing dollar drain. Since the United Kingdom and the Commonwealth countries had to save dollars wherever possible to reimburse their dollar liabilities, they lost the financial means to purchase most demanded Japanese textiles. The British government duly entered into negotiations with the US administration on financial facilities for reopening private trade with Japan.

The Interim Sterling Payments Agreement was concluded between SCAP and the sterling area countries on 14 November 1947. Under the Interim Agreement, Japan's private trade with the United Kingdom and its colonies, Australia and New Zealand, was to be conducted on a sterling basis through SCAP's account opened with the Bank of England. SCAP had the right to convert its sterling surplus accrued from trading activities into dollars at six month intervals. Since Japan had a heavy deficit with the United States and most of the imported foodstuffs and raw materials were financed by US appropriated funds, SCAP could not afford to accumulate inconvertible sterling earned from the exports of goods made from dollar-financed raw materials, while at the same time asking the Congress for funds to finance Japan's overall trade deficit. The dollar convertibility provision forced the sterling countries to regard Japan as a hard currency source, imports from which were put under tight controls.⁴⁰ Cotton textiles were excluded from payment in sterling because Japanese cotton textiles had to be sold in dollar markets to fulfill the

³⁹ Cable from Australian Government, Canberra, to the Secretary of State for Commonwealth Relations (Crosec), United Kingdom Government, London, no.314, 24 November 1947, AA, A609, 317/20/4.

⁴⁰ Cable from Crosec to Canberra, no.183, 21 August 1947, AA606, R40/1/42.

obligation to reimburse the US dollar loans for raw cotton purchases, though Washington showed preparedness to include cotton textiles in sterling trade in the event that Japan's standing liabilities were liquidated and raw cotton became available from non-dollar sources.⁴¹

While SCAP thought it 'essential' for Australia to join the Interim Agreement obviously in an attempt to facilitate wool procurement, Australia's debt to Japan was on a dollar basis since it had purchased 7,000 bales of raw silk from Japan in a government-to-government deal in the previous year. As the Interim Agreement excluded financing government trade, Australia's standing liability was left unsettled. This was one of the reasons why Australia had sought dollar payments for Japanese wool purchases. However, the need to impress SCAP with a conciliatory attitude towards the sale to Japan led Australia to endorse the agreement. In view of the political difficulty in granting credit to the former enemy, it was logical to facilitate Japan's wool import by switching to financial settlement on a sterling basis.⁴²

The wool procurement plan of Scott and English bypassed the Interim Agreement, for Hong Kong was not a party to the Interim Payments Agreement.⁴³ Australia raised strong objection to the Hong Kong deal and took the position that payment for any Australian wool shipped to Japan should be made directly from SCAP's account where its sterling earnings from trading activities under the Interim Agreement would be saved.⁴⁴ Scott and English might try to export to Australia its stocks of Japanese goods which would be subject to far more relaxed import licensing than in the case of direct purchases. It was expected that an excessive inflow of Japanese goods might arouse serious public repercussions.⁴⁵ Furthermore, Scott and English might succeed in selling its Japanese goods to the dollar area, 'thus acquiring dollars at Australia's expense'.⁴⁶ On the other

⁴¹ Department of State, 'Aide-Memoire', 25 August 1947, *ibid.*

⁴² Rix, 1986, p.64.

⁴³ Hong Kong was excluded from the Interim Agreement because, if included, Hong Kong, a centre of entrepot trade, would feel freer to spend its sterling to expand importation of Japanese goods which were likely to sell well in the sterling area and the other countries. This could culminate in a remarkable increase in SCAP's convertible sterling surplus, thus causing severe dollar drain which Britain in no way could bear. Cable from Crosec to Canberra, no. 246, 22 November 1947, AA, A609, 317/20/4.

⁴⁴ Cable from Canberra to Australian Government Trade Commissioner in Hong Kong, no.15, 10 February 1948, *ibid.*

⁴⁵ Cable from Australian Mission in Tokyo (AM) to Canberra, Department no.334, 14 October 1947, *ibid.*

⁴⁶ Cable from AM to Canberra, Department no.450, 28 November 1947, *ibid.*

hand, if SCAP preferred the Scott and English system to the normal financial settlement under the Interim Agreement, as seemed likely in view of Hong Kong's readiness to give SCAP much coveted credit for wool purchases in return for future delivery of Japanese manufactured goods, SCAP would not have to spend its sterling funds for Australian wool procurement and would leave a considerable amount of its sterling balance unused, which might eventually be converted into dollars.⁴⁷

In fact, SCAP did not indicate any interest in implementing wool procurement from Australia through the normal channels established by the conclusion of the Interim Agreement. Alarmed at the deadlock in trade, Patrick Shaw, Head of the Australian Mission in Tokyo, made an urgent plea to Canberra for consideration of some informal credit arrangement to facilitate Japan's wool import:

From a short term point of view, it is important that the stalemate be broken so as to overcome what is really an important criticism (*sic*) of Australia in GHQ, SCAP on the score of lack of cooperation in helping their industrial rehabilitation programme. There is also an erroneous belief that the Australian Government, perhaps at the instance (*sic*) of the United Kingdom Government, is disinterested in seeing the Japanese woollen textile industry restored. From a long term point of view, I would assume that Australia's main interest lies in restoring her former important market for raw wool in Japan ... I am aware that the present world demand for Australian wool is at a high peak, but it may still be wise to take some steps to encourage the maintenance of the former important market in Japan.⁴⁸

In particular, Shaw tried to draw Canberra's attention to the SCAP attempt to increase procurement of South American wool.

However, credit facilities for Japan had been categorically rejected for the political reason previously mentioned. Australia could not afford to give Japan purchasing power through forward purchases of Japanese goods, as the tightening of licensing restrictions against hard currency sources from December excluded Japanese goods altogether from the Australian market. Even if some licences were to be granted, Australian importers sought only cotton textiles which had to be purchased in dollars and did not show much interest in rayon and silk which were abundantly available from Japan.⁴⁹

⁴⁷ Cable from Canberra to Crosec, no.314, 24 November 1947, *ibid*.

⁴⁸ Patrick Shaw, Head, AM, 'Australian Wool Exports to Japan', Undated (December 1947?), *ibid*.

⁴⁹ W.R. Carney, Department of Commerce and Agriculture, 'Financing of Trade with Japan', 3 June 1948, AA, A606, R40/1/51.

In order to break the impasse, the Australian Commercial Counsellor in Tokyo, Hugh Wrigley, enquired in early December about the prospect of a sort of bilateral open account arrangement for SCAP's wool purchases, the payment of which should be made in sterling against its standing credit of raw silk exports to Australia.⁵⁰ SCAP was concerned about the possibility that the offset of two million dollars in credit with sterling purchases of wool might be taken as a precedent for dollar payments for future wool purchases. One of the ESS officials revealed that the deal would 'only be a very small beginning' and that he was most interested in the 'follow up'. Wrigley was asked to clarify Canberra's policy on the supply of wool to Japan,⁵¹ and in his report to Canberra he also mentioned SCAP's latest opinion that Japan's sterling trade would not amount to such a large sterling surplus for SCAP as had been previously estimated.

Conditioned to using dollars supplied from US appropriated funds only for overseas foodstuffs, SCAP could not expand its purchases of raw materials such as wool from the sterling area, as long as the sterling countries refused to provide SCAP with adequate sterling funds.⁵² SCAP's conservative estimate reflected its serious concern about dormant sterling trade due to the tight import controls imposed on Japanese goods by the sterling countries, and the Foreign Trade and Commerce Division started to consider waiving conversion of a certain amount of sterling surplus into dollars in order to dispell the British fear of a dollar drain.⁵³ Wrigley's report about the pessimistic atmosphere in Tokyo impressed Canberra, which proposed to the United Kingdom some relaxation of import restrictions against Japan.⁵⁴

Moreover, Canberra took up Wrigley's suggestion and instructed him to approach SCAP with a proposal for a bilateral trade arrangement on 23 January.⁵⁵ The Australian proposal was officially submitted to SCAP on 5 February. It revealed Australia's preparedness to relax import restrictions against Japanese silk and rayon and insulators up to the value of approximately £A2 million during the 1948 calendar year on the condition

⁵⁰ Wrigley to Tonkin, 7 December 1947, AA, A606, R40/1/42.

⁵¹ Wrigley to Tonkin, 12 December 1947, *ibid.*

⁵² Wrigley to Canberra, 8 December 1947, *ibid.*

⁵³ Pickelle to Marquat, 'Sterling Agreement with the British', 1 November 1947, SCAP, 6707(9), ESS(A)05093.

⁵⁴ Cable from Canberra to Crosec, no.343, 16 December 1947, AA, A606, R40/1/42.

⁵⁵ Cable from Canberra to AM, no.25, 23 January 1948, *ibid.*

that SCAP should spend the full amount of these proceeds on purchases of Australian products. Australia further offered to pay SCAP in sterling its outstanding liabilities for raw silk in order to provide 'immediate finance' for wool purchases as some delays might be expected before SCAP received payments for the proposed Japanese export goods from Australian importers.⁵⁶ The proposal was accepted by SCAP as 'an important step towards restoration of normal commercial relations between Japan and Australia'.⁵⁷

Thus, the initial financial predicament in postwar Australia-Japan trade was overcome, but the arrangement was only a provisional measure, and a wider, more multilateral sterling trade system had to be established before Japan could procure more freely Australian wool of desired quality and quantity. Under the bilateral trade arrangement, SCAP was provided with immediate credit through Australia's standing liabilities. But there was no guarantee that Australia would continue to provide SCAP with extra sterling funds, as Australia might be forced to tighten its import licensing at any time if the balance of payments deteriorated. With the Japanese woollen textile industry's potentially huge demand for Australian wool, such a small market as Australia did not have sufficient purchasing power for Japanese manufactures, to match prospective active Japanese purchases. There were, thus, severe limitations in the pursuit of balanced bilateral trade between the two economies because Japan tended to import far more from Australia. Hence a device had to be sought to give Japan adequate sterling funds to finance procurement of a larger volume of Australian wool by establishing a broader trading network involving balanced trade between Japan and a group of the sterling area countries including Australia as one party. This is discussed in the following chapters.

With the prospect of the proposed bilateral trade arrangement in sight, Australia withdrew its objections against the Scott and English deal to purchase Australian wool for Japan via Hong Kong. Canberra instructed Wrigley to take immediate steps to correct SCAP's impression based on Australia's opposition to the Scott and English deal that Australia was trying to intervene in SCAP's nomination of an agent for Japanese wool purchases.⁵⁸ It was in Australia's interest to impress SCAP with its eagerness to resume private trade with Japan and supply raw wool for the rehabilitation of the Japanese textile

⁵⁶ Wrigley to Pickelle, 'Private Trade with Japan', 5 February 1948, SCAP, 6783(1), ESS(A)05942.

⁵⁷ Pickelle to Wrigley, 'Private Trade with Japan', 14 February 1948, *ibid.*

⁵⁸ Cable from Canberra to AM, no.61, 13 February 1948, AA, A606, R40/1/42.

industry. In February 1948, SCAP concluded a contract with Scott and English for the procurement of £A1 million of Australian wool on the condition that the Hong Kong firm would purchase the equivalent value of Japanese woollen textiles.⁵⁹

This contract caused a further delay in SCAP's wool procurement from Australia. Australian wool interests were firmly opposed to any wool procurement system which would give an unknown firm such as Scott and English preferential treatment to act as SCAP's coordinator in Australia. The Australians suspected that the firm had no experience in Australian wool trade and that it might make the most of such an advantageous position for its own business purpose.⁶⁰ Their opposition was such that in April 1948, Max B. Laupheimer, Chief of Wool Procurement of the Foreign Trade and Commerce Division, visited Australia to settle the matter and arrange a procedure for wool procurement.

Australia's strong resistance drove concessions from SCAP. In late May, SCAP instructed Laupheimer in Sydney to negotiate agency contracts with three Australian wool brokers, namely, Dreyfus & Co., J. Gunton, and John Sanderson & Co. Together with Scott and English, these firms were commissioned to purchase wool at the Australian market in accordance with SCAP's instructions, and the initial purchase program of 250,000 bales was immediately authorised.⁶¹ This move was received with satisfaction by all interested parties in Australia. In response to SCAP's concession, the Commonwealth Bank of Australia approved Scott and English's original proposal of wool purchases in Australia being paid in Hong Kong sterling.⁶²

Thus, a stable system for Australian wool procurement in the early postwar period was established at last. There was no denying that Australia was potentially the largest supplier of wool to Japan, and it seemed to be in SCAP's interest to secure an adequate supply of Australian wool for the Japanese woollen mills. SCAP's decision to withdraw

⁵⁹ *Kanematsu Yomo Nempo*, 1949, p.79.

⁶⁰ D.A.S. Campbell, Chairman, New South Wales and Queensland Woolgrowers' Association to Laupheimer, 'Buying of Wool in Australia for S.C.A.P.', 22 April 1948, SCAP, 6747(19), ESS(A)05537.

⁶¹ Laupheimer, 'Summary: Australia and New Zealand Wool Mission, 2 April. to 25 June. 1948', 22 June 1948, *ibid*.

⁶² W.M. Forbes, Commonwealth Bank of Australia, to Stanley Smith, Scott and English, 'Banking (Foreign Exchange) Regulations: Control of Proceeds of Exports', 1 May 1948, SCAP, 6747, ESS(A)05538.

preferential treatment for Scott and English derived from this consideration. In support of withdrawal, the Textile Division of ESS wrote:

Since the Australians "opposed" the principle of the Scott and English contract when it was first announced, I think we would prejudice our position if we give this firm preferential treatment at this time ... It has taken us a long time to come to an agreement with the Australians on wool procurement and I would hate to see the procurement program bog down again, as it is a high time that the woollen and worsted industries were operating and contributing their share to the support of the Japanese economy. Giving Scott and English preferential treatment would, I think, jeopardise the good will that we have built up with the Australians and would probably hamper the functioning of our procurement program ...⁶³

Soon after the conclusion of the bilateral trade arrangement in February, SCAP had sterling funds in its account, paid by Canberra for its silk liabilities. Japan's wool purchases from this credit commenced in June.⁶⁴ But the delay in the arrangement of an Australian wool procurement program had already opened the door for other wool suppliers to initiate business with Japan.

ALTERNATIVE SOURCES OF RAW WOOL

After the arrival of the first shipment of Australian wool in the postwar period in June 1947, Japan did not procure Australian wool until mid 1948 due to this delay in reaching a financial arrangement. During this interval, SCAP extended the network of supply of raw wool into South America and South Africa. It was Draper and Company of Boston, USA, which promoted the diversification of the Japanese wool procurement. In August 1947, when Japanese wool stocks had almost run out, the company readily offered a direct sale of 500,000 lbs. of Argentine wool. Furthermore, Draper and Company showed its preparedness to sell an additional 500,000 lbs. of South American wool.⁶⁵ Both offers were duly accepted, and the company presented a third offer of 645,000 lbs. for SCAP's consideration. In view of the delay in the establishment of a procurement program for Australian wool, the prices of which had been pushed up due to keen competition among

⁶³ C.C. Campbell, Acting Chief, Textile Division, ESS to Pickelle, 'Procurement of Australian Wool', 18 March 1948, SCAP, 6116(6), ESS(D)00890.

⁶⁴ DCA, 'Trade with Japan', June 1948, p.29, AA, A609, 317/20/5.

⁶⁵ Foreign Trade Division, 'Memorandum for Record', 29 August 1947, SCAP, 6090(4), ESS(D)00808.

buyers at the auctions, the Foreign Trade and Commerce Division recommended acceptance of these offers, insisting, '[I]t appears advantageous at this time to develop alternative source of supply from which desirable qualities of wool can be obtained at favorable prices'.⁶⁶ The payment would be made in July from the million dollar SCAP Trust Fund which was allocated specially to immediate wool purchases to overcome the serious shortage.⁶⁷

This idea to develop South America as an alternative source of wool supply was prevalent within SCAP in early 1948. In February, an official of the Foreign Trade and Commerce Division presented a wool procurement plan for the first half of 1948. It proposed to purchase 15,000 bales of wool from New Zealand, 25,000 from Australia, 20,000 from South Africa and 20,000 from South America respectively. The financing of the first three purchases was yet to be settled with the exception of 10,000 bales of Australian wool to be paid from SCAP's standing credit with Australia, though the need to settle the Scott and English deal was to delay the implementation of the plan, as previously mentioned. It must be emphasised that SCAP had already authorised the spending of \$4,000,000 for direct purchases of 20,000 bales of South American wool. Since there were no other prospective suppliers, 'it was agreed that this was a reasonable and attractive investment opportunity for funds available in Japan'. In particular, it was planned to allocate not less than \$500,000 to Uruguayan wool, 'as this is an important method of initialing (*sic*) trade with Latin America'.⁶⁸ The fact that the Uruguayan wool was used for production of paper felt for domestic use rather than export goods illustrates the strategic character of this procurement to open a promising export market by providing the counterpart with the purchasing power for Japanese goods.⁶⁹

Draper and Company's vigorous activities did not stop with South America. In March, it succeeded in securing a shipment of more than 5,000 bales of South African wool which SCAP had had little hope of procuring. At the same time, the Company

⁶⁶ Foreign Trade Division, 'Memorandum for Record', 9 September 1947, *ibid*.

⁶⁷ Radio from SCAP to Washington, C-54018, 14 July 1947; Foreign Trade Division, 'Memorandum for Record', 29 August 1947, *ibid*.

⁶⁸ S.J. Janow, Chief, Plans and Programs Unit, Foreign Trade Division, to Pickelle, 'Wool Procurement', 5 February 1948, SCAP, 6445(27), ESS(B)03668.

⁶⁹ ESS (Textile Division?), 'Memorandum of Woolen Textiles Export Sales Program', March 1948, SCAP, 6709(38), ESS(C)05438.

recommended that it would be in Japan's interest to stop buying dearer Uruguayan wool and to look to the cheaper New Zealand market.⁷⁰ Thus during this period, SCAP's wool procurement had virtually been put under the guidance of one US company.

The merits of using Draper and Company were outstanding. Since it had an extensive information network throughout the world and good experience in South American and South African markets, it could find the required types of wool at cheaper prices from various sources which might be overlooked by the inexperienced SCAP officials and the Japanese wool interests which had a strong bias for Australian wool.⁷¹ The firm must have impressed the SCAP trade officials with its selflessness in pursuit of the cheapest possible wool as shown in its recommendation of the New Zealand market where Draper and Company had no previous business interest at all.

Draper and Company did not particularly prejudice SCAP against Australian wool. For the 1948-49 wool season, it advised that \$45,000,000 be spent on Australia, \$5,000,000 on New Zealand, \$20,000,000 on South Africa and \$15,000,000 on South America.⁷² This allocation gave a larger share to Australia than the previous SCAP plan of February. There is no denying, however, that since it specialised in South American and South African wool, Draper and Company had the ability to draw SCAP's attention to the wool from these sources. Hence, the Company was able to take full advantage of the deadlock in the negotiations for Australian wool procurement.

THE COORDINATION OF JAPANESE WOOL PROCUREMENT BY DRAPER AND COMPANY

The dominance of Draper and Company was further strengthened when the firm entered into a contract with the Japanese Board of Trade (*Boekicho*) to operate as coordinator of Japanese wool procurement on 25 October 1948.⁷³ The Company had shown its willingness to maintain business relations with SCAP, demonstrating its past achievement in procurement for Japan.⁷⁴ By that time, the SCAP officials had become aware of the

⁷⁰ The Draper to Laupheimer, 16 March 1948, *ibid.*

⁷¹ Joseph A. Malone, Draper and Company, to Pickelle, 30 April 1948, *ibid.*

⁷² Malone to Laupheimer, 6 July 1948, SCAP, 6445(27), ESS(B)03668.

⁷³ W.T.R. to Marquat, 25 October 1948, SCAP, 6116(9), ESS(D)00899.

⁷⁴ Malone to Pickelle, 30 April 1948; Malone to Laupheimer, 6 July 1948, SCAP, 6445(27), ESS(B)03668.

inefficiency of their procurement program during the 1947–48 season, particularly with regard to the disadvantages of awaiting firm offers from overseas buyers and then making purchasing decisions. Under such a system, Japan would often miss the chance to buy at the cheapest market prices. Thus, SCAP began to consider the possibility of appointing an experienced wool trader as coordinator to authorise brokers to buy up to a certain amount of specific types of wool within a stated price range. Little wonder that SCAP duly selected Draper and Company as coordinator especially in view of its past achievements and experience with Japanese requirements.⁷⁵

The introduction of the coordination system through Draper and Company meant that the company would become involved in wool purchases in not only South America and South Africa but also Australia and New Zealand. This provoked strong protests from Japanese wool manufacturers and importers. Since the start of the procurement of South American wool by Draper and Company, the Japanese interests had been critical of the procedure under which the Company was exclusively authorised to order local buyers to select certain types and qualities of wool.⁷⁶ The expansion of Draper and Company's activities into Australia where the Japanese buyers had been more experienced raised concern among the Japanese wool manufacturers who felt that they had completely lost their say in the selection of imported wool. In a desperate attempt to obtain raw wool of their own choice, the Japanese wool traders, to Draper and Company's dismay, tried to bypass the system by letting their agents in Australia ask Draper and Company's agent in Sydney to give SCAP firm offers for sales of certain designated types of wool.⁷⁷ Despite strong and frequent protests from the Japanese, it was impossible to change SCAP's policy. Although it is reported that some officials of the Textile Division had been sympathetic to the Japanese plea for more discretion in wool selection,⁷⁸ the Division itself revealed its

⁷⁵ Chandler M. Wright, Economic and Fiscal Adviser, to Chief, Fund Control Division, ESS, 'Wool Operations', 14 August 1948, SCAP, 6709(37), ESS(C)05438.

⁷⁶ *Kanematsu Yomo Nempo*, 1949, pp.81-82.

⁷⁷ It was reported that SCAP's wool brokers in Australia were incensed at the Japanese request, which they felt a 'reflection on them as well as Draper' which had been seriously serving SCAP in selection of suitable types of wool at cheaper prices on behalf of the Japanese. Cable from the Agent of Draper and Company in Sydney to Draper and Company in Tokyo, no.20, February(?) 1949, SCAP, 6782(7), ESS(A)05906.

⁷⁸ *Kanematsu Yomo Nempo*, 1949, p.80; Nihon Yomo Boseikikai [Japan Wool Spinners Association], *Nihon Yomo Kyogyo no Kaiko: Tokuni Gemmo Mondai wo Chushin nishite* [Wool industry in retrospect focusing on raw wool imports], 1980, p.40.

high regard for Draper and Company by sending an unusual memorandum to Marquat. Its purpose was simply to draw the attention of the Chief of ESS to the successful operation of the coordination system.⁷⁹

With only a few sympathisers inside SCAP, the Japanese wool interests virtually had no power to influence its policy. A Japanese businessman of Kanematsu and Company recalled that he was even refused admission to the ESS office because he had provoked Laupheimer's anger after visiting his office almost every day to campaign against the Draper system.⁸⁰ When the Draper coordination contract expired in July 1949, SCAP did not hesitate to extend it until 31 December 1949, despite the vehement opposition of the Japanese wool businessmen who had really been looking forward to the introduction of private wool imports.⁸¹ In view of their traditional strict selection of type and quality, it is quite understandable that the Japanese wool interests wanted to obtain wool from private channels. Under the fluctuating trading circumstances of the early postwar period, however, they could not be too particular about the quality of wool which had to be purchased due to the limited funds available. With hindsight, a prominent Japanese wool importer realised the merits of the Draper system, stating that 'since each buyer had to give serious consideration to various matters such as finance, profits and market conditions on every occasion under the private import system, it would have been more time consuming than the Draper system which simply aimed at reaching a target volume within a certain quality and price range, so 'it would have been difficult to purchase such a large volume of wool as was achieved under the Draper system between September and December 1948 when the amount of sterling available for wool imports was far less than expected'.⁸²

WOOL PURCHASES IN 1949

In mid 1949, SCAP considered increasing the amount of imported wool to be allocated to production for domestic use. In particular, the quality of wool for domestic use was to be raised in the light of the sizable sterling balance held in the SCAP account, as discussed in

⁷⁹ F.A. Williams, Chief, Textile Division, to Marquat, 'Draper Wool Purchase Coordination', 2 May 1949, SCAP, 6149(5), ESS(C)01493.

⁸⁰ Nihon Yomo Bosekikai, 1980, p.40.

⁸¹ Textile Division, 'Memorandum for Record', 12 August 1949, SCAP, 6149(6), ESS(C)01497.

⁸² Kikuo Tamai, 'Yomo Yunyu no Shomondai' [Problems in wool import], *Yomo*, May-June 1950, p.9.

the next chapter.⁸³ Since Australian wool was favoured by the Japanese mills, the increase in domestic allocation due to an excessive sterling balance certainly helped to bring Japan back into the Australian wool market.

Even so, the occupation authority did not make light of wool procurement from other sources. A good example is the recommendation of the ESS's Fund Control Division, which was responsible for management of trading funds, on wool procurement:

In view of the sizable imbalance of trade currently existing with the Sterling Area, it is desirable to go slowly in the procurement of wool from South American suppliers. However, if prices are lower than for comparable types of wool purchased for Sterling and exports of Japanese products are lined up, other factors being equal, it would be acceptable to the Fund Control Division to spend up to approximately \$700,000 [one fourth of annual trade program] for Uruguayan wool'.⁸⁴

The underlying idea in the wool procurement policy remained unchanged even when there were excessive sterling balances in that it emphasised the prospect of increased Japanese exports to wool supplying countries other than Australia. SCAP had expected South America to develop into a good market for Japanese goods especially wool manufactured goods. In 1949, SCAP made a commitment to South American wool by concluding further trade arrangements, after the SCAP Mission, led by Pickelle, visited Latin American countries during March and June. It is easy to imagine that one of the purposes of the Mission was to study wool procurement from the region because it included a Japanese wool trader to inspect the market conditions.⁸⁵

In SCAP's consideration of a wool procurement program for the 1949-50 season, the payment for raw wool was to be partly offset through export earnings from wool manufactured products. This meant that South America and South Africa had the edge on Australia which had never been a good market for such products.⁸⁶ Thus, tight financial conditions led SCAP to search for export opportunities in promoting the Japanese wool manufacturing industry.

⁸³ James G. Torrens, Chief, Procurement and Operations Branch, Textile Division, to Williams, 'Raw Wool Procurement', 17 May 1949, SCAP, 6782(7), ESS(A)05905.

⁸⁴ Paul Cleveland, Chief, Fund Control Division, to Textile Division, 'Uruguayan Wool', 26 July 1949, SCAP, 6149(6), ESS(C)01497.

⁸⁵ Nihon Yomo Bosekikai, 1980, p.56.

⁸⁶ Textile Division to Foreign Trade Division, 'Proposed Wool Program for the Period 1 July 1949 to 30 June 1950', 2 August 1949, SCAP, 6149(6), ESS(C)01497.

To be sure, SCAP initially looked to Australia to supply a larger volume of raw wool. But the difficulties in reaching an agreement over the procedure for procuring Australian wool caused a serious shortage of wool stocks for the Japanese woollen mills. Hence, SCAP was forced to seek alternative sources, and that situation gave Draper and Company the opportunity to emerge as Japan's chief wool trader. Under its coordination, Japan's wool procurement was diversified more into South African and South American markets. Despite the strong opposition to the Draper system from the Japanese wool industry which favoured private imports of Australian wool of its own choice, the system continued until the deregulation of Japanese import trade in January 1950.

SCAP's shortage of funds to finance wool purchases from Australia was the most significant factor in the diversification of postwar Japanese wool procurement. If it was to overcome the financial difficulties whereby most of its limited dollar funds had to be spent on raw cotton ahead of raw wool, SCAP desperately needed to obtain purchasing power in sterling cash to finance procurement of Australian wool by facilitating Japanese export trade to the sterling area countries. The following chapter discusses the question of SCAP's initial policy towards Japan's overall sterling trade and its implications for Australia.

4 Stagnant Sterling Trade and Dollar Shortage, 1948–49

Wool had long been established as Australia's main export to Japan. Yet, despite the strong demand for Australian wool by the Japanese woollen textile industry, resumption of wool purchases from Australia was slow because Australia was reluctant to allocate to the Japanese mills wool of finer quality which sold well at better prices to the other buyers under the postwar sellers' market conditions. This resulted in the diversification of Japanese wool imports under the coordination of the firm Draper and Company, to non-Australian sources. In the early postwar period, there was another factor which affected expansion of Australia-Japan trade. SCAP's shortage of funds to finance imports hampered active procurement of raw materials and foodstuffs from Australia. Even after the Overall Payments Agreement enabled Japan and the sterling area countries to trade on a sterling basis to overcome this financial predicament in May 1948, SCAP was quite slow to activate purchases from the sterling area countries among which Australia had the largest capacity to supply Japan.

This chapter traces the negotiations between SCAP and the sterling area countries after the conclusion of the Overall Payments Agreement. In order to facilitate smooth operation of the Overall Payments Agreement, SCAP and several sterling area countries entered negotiations for a Sterling Trade Arrangement to cover Japan's sterling trade in the financial year 1948/49. The sterling trade negotiations were held continually between SCAP and the sterling area countries to review trading activities and to make amendments to the Trade Arrangement annually, until SCAP handed over its negotiating power to the Japanese government in early 1951. The negotiations reflected SCAP's view of the significance of sterling trade for Japan's economic recovery and self-reliance. SCAP's policy had a severe impact on the expansion of Australia-Japan trade as well, for the level of its sterling funds was an important determinant of the level of procurement of Australian commodities such as raw wool.

During the period from mid 1948 to September 1949, SCAP did not show much interest in increasing purchases from sterling area countries. Since the occupation authority emphasised the promotion of exports of Japan's less competitive and less essential industrial goods to offset its purchases of commodities in trade with the non-dollar area, it showed increasing interest in cultivating commercial links with Latin American countries which seemed to be a good market for these items. On the other hand, the sterling area countries confined their purchases from Japan to essential items such as cotton textiles, which could have earned dollars if exported to the dollar area instead of the sterling area, so SCAP imposed strict control over the use of its sterling funds. As a result, SCAP accumulated a considerable sterling surplus. When SCAP showed signs of looking to the sterling area as a source of dollar income by converting its sterling funds into dollars in mid 1949, Japan's postwar trade relations with the sterling area seemed to break down, as the sterling area countries were prepared to curtail their imports from Japan substantially to forestall the loss of dollars.

When the devaluation of the pound sterling became imminent, SCAP revealed its intention to claim conversion to safeguard against depreciation of its sterling assets. The British government countered with a desperate threat to cease sterling payments in trade with Japan if SCAP converted. There emerged a real danger that Japan's sterling trade would return to the situation at the early stage of the occupation when both Japan and the sterling area could not expand their two-way trade due to the shortage of dollars. The contraction of Japan's sterling trade during this period resulted from SCAP's conservative approach to the financing of trade in order to save dollars and its aspiration to develop trade relations with non-dollar non-sterling area countries with which SCAP extended a network of bilateral trade and payments agreements. This chapter examines SCAP's conservative policy towards sterling trade, in order to show how it affected Australia's commercial interests as the main sterling supplier for Japan. SCAP's concern about dollar saving at this stage of the occupation hampered the expansion of Japanese trade on a more multilateral basis, despite the active demand for Japanese goods within the sterling area, since Australia could not earn purchasing power for other sterling area countries through its bilateral trade surplus with Japan.

THE OVERALL PAYMENTS AGREEMENT AND THE COTTON TEXTILES PROBLEM

On 29 May 1948, the Overall Payments Agreement was concluded between SCAP and the representatives of the British government to replace the Interim Payments Agreement of November 1947. The Agreement stipulated payment in sterling for all trade except Japanese cotton textiles between Japan and the sterling area countries except Hong Kong. SCAP retained the right to convert its sterling funds into dollars at six-month intervals or at any time that SCAP considered it necessary 'for the protection of foreign exchange assets of Japan or for the conduct of Japanese foreign trade'.¹

The so-called dollar convertibility clause was inserted to restrain the sterling area from overbuying Japanese manufactured goods, especially cotton textiles, for which the British colonies and the dominions had considerable demand due to the inability of United Kingdom manufacturers to produce them beyond the level of domestic needs. Since Japan procured raw cotton largely through dollar payment, SCAP desperately needed to maximise Japanese exports to the dollar area to reimburse loans provided by the US Commodity Credit Corporation (CCC) for Japan's purchases of American raw cotton. The dollar convertibility clause was established for the purpose of checking the diversion of Japanese export goods, otherwise capable of earning dollars, into the sterling area markets where the prices were attractive for Japanese exporters due to inflation and the application of the overvalued exchange rate of pound sterling. On the other hand, the sterling area countries could not afford to run the risk of a dollar drain due to the balance of payments crisis which caused the suspension of free convertibility of sterling into dollars in July 1947. Without SCAP's endorsement to offset exports of Japanese manufactures through active procurement from its counterparts, the sterling area countries would maintain their tight import controls for fear of incurring dollar liabilities under the Overall Payments Agreement. Such a situation would hamper expansion of Japan's sterling trade.

Hence, it was necessary to work out a trade plan to ensure balanced trade at the maximum level between Japan and the sterling area. With this objective in mind, SCAP officials and the British Commonwealth government representatives including the United

¹ SCAP to Head of the United Kingdom Liaison Mission in Tokyo (UKLM), 'Payments Arrangements for Trade between Japan and the Sterling Area', 29 May 1949, DAO, B'0.0.2.0.

Kingdom and its colonies, Australia, New Zealand and South Africa, entered negotiations for a Sterling Trade Arrangement in Tokyo on 8 July 1948. The basic objectives and general principles of the sterling trade negotiations can be summarised: (a) trade to be balanced at as high a level as possible; (b) trade to be on a sterling basis and payments and credits to be in accordance with the Overall Payments Agreement; (c) both sides to estimate maximum availabilities and requirements to guarantee the volume of transactions covered by private trade and to undertake to authorise and facilitate trade up to the agreed level of approximate balance.²

The sterling area countries participating in the Sterling Trade Arrangement with SCAP (participants), such as the United Kingdom and the Commonwealth dominions, gave the highest priority to securing purchases of Japanese cotton textiles in the negotiations.³ The participants estimated their annual requirements of cotton textiles and yarn as \$47.2 million in a total import estimate of \$75.7 million during the period from 1 July 1948 to 30 June 1949. A note attached to the figure for cotton textiles stated that this was an 'elastic item' and the sterling participants wished to buy 'as large a quantity as possible subject to keeping the account in balance'.⁴ Australia was no exception in its desire to import Japanese cotton textiles.⁵

Cotton textiles were treated in a different manner from other items in the Overall Payments Agreement. The Agreement exempted Japanese cotton textiles manufactured 'in whole or in part from raw cotton of U.S. origin' from the provision for all trade on a sterling basis. Japan's financing of raw cotton imports during 1946/47 totally depended on the loans by the CCC of the United States which required Japan to reimburse its debts in

² Cable from Crosec to Canberra, no.134, 8 May 1948, AA, A606, R40/1/51. Sterling Trade Arrangements Conference, 'Report of First Meeting on Trade Arrangements with Sterling Area', 8 July 1948, AA, A606, R40/1/67. In this chapter I frequently use the documents from the A606 series of the Australian Archives each file of which is numbered by three separate digits with a 'R' heading, as above. Hereafter I describe only the 'R' headed file numbers for quotation or citation of the documents from the files in the A606 series in this chapter.

³ While the Overall Payments Agreement covered all the sterling area countries except Hong Kong, only the United Kingdom and its colonies, Australia, New Zealand, and South Africa revealed their intention to participate in the Sterling Trade Arrangement at the start of the negotiations in July 1948. India later joined the 1948/49 Arrangement, and Ceylon became the party of the 1950/51 Arrangement. South Africa refused to join the 1949/50 and 1950/51 Arrangements.

⁴ E.R. Lingeman, Economic Adviser, UKLM, to Pickelle, Chief, Foreign Trade and Commerce Division, ESS, 3 July 1948, R40/1/66.

⁵ 'Report by Australian Delegation on Trade Conference in Tokyo-July/August 1948', R40/1/67.

dollars from the export earnings of its finished goods. Despite its pressing demand for Japanese cotton textiles, the UK government had no choice but to accept exclusion of cotton textiles from payment in sterling.⁶ Although the officials of the Foreign Trade and Commerce Division of the ESS recognised the importance of removing the dollar payment commitment in the CCC loans for promotion of sterling trade, at the time of the negotiations for the Overall Payments Agreement in late 1947 to early 1948, the CCC contract obliged them to offer cotton textiles only in return for dollar payment, which no sterling area countries could afford.⁷

However, SCAP began to show a more positive attitude to cotton textile sales on a sterling basis just before the start of the sterling trade negotiations. In April 1948, it announced its decision that only 50 per cent of the payments for Japanese cotton textiles produced from American raw cotton should be made in dollars and the other 50 per cent might be in other currencies.⁸ This immediately led to an increase in the export of Japanese cotton textile goods. The export of Japanese cotton textile goods had begun in January 1947 and its volume tripled within six months. In October of that year, however, the export figure slumped below the January level and did not recover the mid 1947 level until mid 1948. It was obvious that the dollar-denominated CCC commitment had hampered recovery of Japanese cotton textile exports to the traditional markets such as the Netherland East Indies and the sterling area.⁹ The improved situation drove SCAP to take another positive step; it offered sales of one hundred million yards of cotton textiles in sterling to the sterling area in June 1948. Appreciating the offer as the 'forerunner' to a more favourable arrangement, the sterling participants further pressed SCAP for cotton textile sales on the basis of 100 per cent sterling payment.¹⁰ In the end, the 'earnest hope' of the participants

⁶ Britain's concurrence in this provision was based on the consideration that trade between Japan and the sterling area would almost balance without inclusion of cotton textiles, thus minimising the risk of dollar drain. The Overall Payments Agreement was still considered preferable to open account arrangements which had proved restrictive to expansion of trade. Cable from the Australian High Commissioner's Office in London to Canberra, no.2753, 7 August 1947, R40/1/42.

⁷ Cable from UKLM to Foreign Office (FO), the British Government, no. REMAC 19, 26 February 1948, R40/1/51.

⁸ Cable from AM to Canberra, no.227, 24 April 1948, *ibid.*

⁹ Nihon Boseki Kyokai [Japan Spinners' Association], *Sengo Bosekishi* [The history of the postwar Japanese spinning industry], Tokyo, 1962, pp.41-44.

¹⁰ 'Extracts from letter dated 1 June 1948 from United Kingdom to General of the Army, Douglas MacArthur, Supreme Commander for the Allied Powers', R40/1/66.

was realised when SCAP officially deleted the exceptional clause for cotton textiles from the Overall Payments Agreement in August 1948.¹¹

SCAP's liberal approach to cotton exports to the sterling area reflected positive thinking towards expansion of Japanese trade held by the officials of the Foreign Trade and Commerce Division. In March 1948, its Chief, Frank E. Pickelle had made a proposal to General William F. Marquat, Chief of ESS, for cotton textile sales to the sterling area. Pickelle's plan had focused on the impeding effect of the 'dollar-straight jacket restrictions' of CCC cotton on export trade. Although he admitted that sales of cotton textiles to the sterling area would of necessity be restricted due to SCAP's shortage of dollars, the Trade Division Chief was concerned that the lack of sterling funds was also restricting the procurement of 'critical material' from the sterling area, such as wool from Australia, and SCAP might have to pay dollars for these commodities.¹² Since Japan's industrial production had just started to show signs of recovery by this time, such a positive approach to sterling trade suggests that the ESS officials aimed to increase the overall level of Japanese trade not only with the dollar area but also with any other countries which wished to trade with Japan, in order to sustain the improved domestic production levels.

The removal of the exceptional dollar payment provision for cotton textiles was in line with a series of measures for Japan, adopted by Washington as well as SCAP in 1948, for facilitating procurement of raw cotton and exports of cotton textiles. In anticipation of the complete reimbursement of the CCC cotton loans, Washington announced in May loans for raw cotton procurement to be provided by the US banks, using the Occupied Japan Export-Import Revolving Fund (OJEIRF) as collateral. In June the US Congress passed Public Law 820 which established the Natural Fibers Revolving Fund. From the Fund, \$90 million was allocated for Japan's import of American raw cotton. Until mid 1948, the US aid for Japan, named the Government Appropriation for Relief in Occupied Area (GARIOA), had not been allowed to be used for importation of raw materials but only for essential goods such as foodstuffs and medicines. In July, the Congress gave approval to the appropriation of \$165 million for the Economic Rehabilitation of Occupied Area (EROA) which could be used for Japan's import of raw materials such as cotton.¹³ These measures reflected the so-

¹¹ SCAP to UKLM, 17 August 1948, DAO, B'5.2.0.J/B2.

¹² Pickelle to Marquat, 'Inter-Agency Agreement', 30 March 1948, SCAP, 6707(9), ESS(A)05093.

¹³ Nihon Boseki Kyokai, 1962, pp.21-28; SCAP, *History of the Nonmilitary Activities of the Occupation of*

called 'reverse course' in the US occupation goals which shifted from deprivation of Japan's military capacity into Japan's economic recovery, as officially stated in the US National Security Council Document 13-2 in October 1948.

THE 1948/49 TRADE PLAN

The Sterling Trade Arrangement was an attempt to minimise the restrictive effects of purely bilateral payments and trade agreements in the postwar period, by treating the multiple sterling area countries as one party in trade with Japan. As indicated in the previous chapter, Japan could not expand its procurement from Australia under the suspension of sterling convertibility, as long as its financial settlement was made exclusively in bilateral terms, as Japan's imports from Australia had traditionally tended to surpass its exports. If Japan's sterling trade was settled on a more multilateral basis, Japan would be able to initiate active purchases from Australia without worrying about bilateral balancing of trade, because the other sterling area countries, especially India and the British colonies in Asia had active demand for Japanese industrial goods. On the other hand, Australia's sterling balance from its bilateral surplus with Japan could circulate within the area, to provide the other sterling area countries with purchasing power for Japanese goods, active exports of which would help to maintain Japan's industrial production at a higher level. In order to sustain such a multilateral transaction system without incurring a dollar drain for either parties to the Trade Arrangement, it was enough if only overall trade between Japan and the sterling participants was balanced. Thus the negotiations started by establishing a trade plan for the financial year 1948/49 between Japan and the sterling area. If SCAP really intended to promote expansion of Japan's overall trade, Australia could have expected dual benefits: an adequate supply of essential cotton textiles from Japan without dollar expenditure and increased exports of wool to Japan.

On the eve of the start of the sterling trade negotiations, however, the sterling participants found that SCAP was not prepared to buy from them as much as they had expected. On 1 July 1948, SCAP presented an estimate of 1948/49 trade between Japan and the sterling area. SCAP was prepared to purchase \$156 million worth of commodities and to sell \$140 million worth of goods including cotton textiles, thus leaving a favourable

Japan, 1945-1951, vol.9, Textile Industries, Chapter V, 'Cotton Production and Export'.

overall balance of \$16 million to the sterling area. These figures were almost twice as large as those estimated by the participants, and appear to have been more than acceptable to the sterling countries. But the participants were quite perplexed by the SCAP proposal, because SCAP allocated only \$73 million out of the estimated total Japanese purchases of \$156 million to the participants and the other \$83 million was reserved for raw cotton and foodstuffs procurement from the sterling area countries not participating in the Sterling Trade Arrangement (non-participants), such as Burma, India, Pakistan. Furthermore, the figure of \$73 million proved to be far more than the realistic supply capacity of the sterling participants which was calculated to be in the neighbourhood of \$58 million. Against this realistic sales level, the estimated purchases by the participants from Japan of \$96 million out of the total \$140 million would leave a trade deficit of \$38 million for the participants, while the non-participants were to enjoy a trade surplus of \$39 million with Japan.¹⁴ SCAP's underlying idea was to finance raw cotton imports from the non-participants by the sterling funds accrued from textile sales to the participants.

The representatives of the sterling participants in Tokyo had to find a way of dealing with this offer. The sterling delegates ruled out the participation of Burma and Pakistan on the grounds that Burma had left the British Commonwealth and Pakistan had 'categorically declined' to participate in the Sterling Trade Arrangement in preference for a bilateral deal with Japan. The sterling delegates thought it reasonable to include India which was being represented at the negotiations but was yet to make a final decision. On the assumption of Indian participation, the trade balance between Japan and the sterling participants was likely to favour the latter. The participants took the view that an adverse balance would be well offset through purchases by the non-participants because past experience had shown that the pattern of Japanese trade with the whole sterling area was traditionally in Japan's favour.¹⁵

Eventually in early August it was agreed to include the estimated SCAP adverse balance in overall sterling trade of \$12 million in the Trade Plan as a 'reserve purchasing pool' which could be used by the non-participants, particularly Burma and Iraq for their

¹⁴ Lingeman, 'Trade Arrangement between SCAP & Sterling Area: SCAP Estimate of 1.7.48', 7 July 1948, R40/1/66.

¹⁵ 'Statement Made by the Economic Adviser to UKLM on Behalf of Sterling Area Group at Second Full Meeting of Conference for a Trade Arrangement Between SCAP and the Sterling Area Participants', 12 July 1948, R40/1/67.

purchases from Japan.¹⁶ This adverse balance resulted from the inclusion of SCAP's past debts from the United Kingdom and India in government trade rather than expanded procurement from the sterling area. Excluding these debts, the estimated overall trade between Japan and the sterling participants including India was almost balanced slightly favouring purchases by the sterling area.

It was at the cost of Australian sales that this overall balance was worked out. At the meeting of the Wool Working Group on 9 July, SCAP officials submitted a counter-proposal for wool procurement against the sales offer by the sterling participants, shown in Table 4.1. SCAP's wool requirement from Australia was drastically reduced by \$16.7 million and from New Zealand by \$1.8 million. The only consolation was that SCAP did not rule out the possibility of increasing its total purchases by \$5–8 million (\$3–5 million from Australia). However, this additional purchase was to be explored in the form of a processing arrangement for woollen fabrics which the Australian representatives rejected as outside the scope of the negotiations.¹⁷

Table 4.1 Estimates of Wool Trade from the Sterling Participants to Japan, to Japan, 1 July 1948–30 June 1949

Suppliers	Participants offer	SCAP requirements
Australia	\$ 30,224,000	\$13,500,000
New Zealand	3,250,000	1,500,000
South Africa	4,673,800	5,000,000
United Kingdom (tops)	76,200	125,000
Total	\$ 38,224,000 (110,000 bales)	\$20,125,000

Source: From Hugh Wrigley, Australian Commercial Counsellor, Tokyo to Department of Commerce and Agriculture, Canberra, 'Trade Arrangements–Wool', 15 July 1948, AA, A606, R40/1/66.

¹⁶ Sterling Trade Arrangement Conference, 'Report of Eighth Meeting of Committee of the Whole', 11 August 1948, *ibid.*

¹⁷ Sterling Trade Arrangement Conference, 'Report of Scheduled Meeting: Australia Area Working Group', 10 July 1948, *ibid.*

Eric Lingeman, Economic Adviser to the United Kingdom Liaison Mission in Tokyo (UKLM) did not conceal his disappointment at the proposed reduction of wool sales figures, saying that it was 'most disconcerting' for the participants because their offer of \$38 million had been agreed to in the discussions in London in April between the British Board of Trade officials and Seymour Janow of the Foreign Trade and Commerce Division; and hence the participants had included wool as the main item, sales of which were expected to provide the sterling participants as a whole with purchasing power for Japanese cotton textiles.¹⁸ In fact, wool occupied half the amount of the total sales to Japan by the participants in their original estimates. SCAP responded to the participants' dissatisfaction in a cold manner by reiterating that the determinant factor in the revision of the wool figure was Japan's 'requirement' which had been fully examined by SCAP's commodity experts, and was not based on the participants' 'availability'. Moreover, SCAP maintained that it could not procure raw materials 'beyond the point of their useability (*sic*) and salability based on home needs plus export sales'.¹⁹

SCAP's wool procurement policy as explained to the Australian Commercial Counsellor in Tokyo, Hugh Wrigley, was that only 20 per cent of woollen manufactures produced from imported wool would be put into domestic use and 80 per cent would be exported to overseas markets. While the previous calculation of Japan's wool requirements had been based on the operation capacity of the woollen industry to handle imported wool rather than 'its ability to dispose of the finished products', it was found that SCAP's priority did not lie in mobilising the industry to provide clothing for the Japanese citizens beyond the minimum necessity for essential services.²⁰ Since woollen products, unlike cotton textiles, had never been Japan's major export earner in the prewar period and their largest export markets, namely China and Korea, were virtually closed, Japan had to find new outlets to put SCAP's policy into action. Although SCAP proposed that the participants should import \$7.75 million worth of woollen manufactures, delegates from the participating sterling countries considered it highly 'questionable' for them to absorb the proposed

¹⁸ 'Statement Made by the Economic Adviser to UKLM ...', 12 July 1948, *op.cit.*

¹⁹ Sterling Trade Arrangement Conference, 'Statement Made by the Chairman of the SCAP Trade Group [Pickelle] at Third Full Meeting Trade Arrangements Conference', 14 July 1948, R40/1/67.

²⁰ Wrigley, to DCA, Canberra, 'Trade Arrangements-Wool', 15 July 1948, R40/1/66.

amount.²¹ With limited demand for Japanese woollen products, the sterling participants had no leverage to push SCAP's estimate of wool procurement up and the figure of \$20 million for wool trade remained unchanged.²²

It is noteworthy that the Australian representatives in Tokyo were not as shocked at SCAP's reduced wool requirement as Lingeman. Wrigley observed, '[I]t does not seem that Australia has much cause for concern in regard to wool sales to SCAP other than the loss to the sterling group of the anticipated earnings from that source'.²³ L.A. McWatters of the Commonwealth Bank who had joined the Australian Trade Delegation for the sterling trade negotiations even saw the reduction partly as SCAP's 'bargaining factor' to expand Japan's woollen textile exports to the sterling area.²⁴ Neither Wrigley nor McWatters showed concern about the danger of losing Japanese wool market to other competitors, even in the light of South Africa's enthusiasm concerning a proposed SCAP trade mission including Japanese woollen interests.²⁵ In fact, SCAP had slightly increased its estimate of wool purchases from South Africa.

What worried the Australian representatives was that the reduced wool sales would result in curtailment of the purchasing power of the sterling participants as a whole to which Australia was expected to be a net contributor. In view of this predicament, Wrigley sent to Canberra a proposal to explore the possibility of extra sales of grains to Japan with the aim of making up for the loss in wool exports.²⁶ In early August, Wrigley, in correspondence with Canberra expressed his satisfaction with the approval of the sale of 25,000s ton of wheat to Japan:

You will have realised we were somewhat disappointed on receiving SCAP's proposed wool purchases, and we then felt that as practically our only assets had been slashed so much it was essential to build up our credits with other items. At that time it was felt by us all that the Trade Arrangements had been gravely

²¹ Sterling Trade Arrangement Conference, 'Report of the Scheduled Meeting: Wool Working Group', 9 July 1948, *ibid.*

²² Sterling Trade Arrangement Conference, 'Report of the Scheduled Meeting: Australia Area Working Group', 30 July 1948, R40/1/67.

²³ Wrigley to DCA, 15 July 1948, *op.cit.*

²⁴ 'Extract from memorandum dated 20th July, 1948, from Mr. L.A. McWatters', R40/1/66.

²⁵ Anonymous (Wrigley?), 'Trade Arrangement Between the Sterling Area & Japan', 13 July 1948, *ibid.*

²⁶ Wrigley to DCA, 'Trade Arrangements-Wheat', 16 July 1948, *ibid.*; E. McCarthy, Secretary, DCA to Wrigley, 'Off-Grade Wheat for Japan', 10 August 1948, R40/1/67.

prejudiced. However, the position has now been materially altered ... and special efforts to provide 'Sales' items are no longer necessary.²⁷

Wrigley's main concern at this stage lay more in providing credit for the participants in overall Japanese sterling trade than in expanding the traditional Japanese export market for Australian wool.

With the prospect of Australian wheat sales in sight, general agreements on the major points of the 1948/49 Sterling Trade Arrangement and the Trade Plan were reached at the eighth meeting of the negotiations on 11 August. Table 4.2 shows the outline of the 1948/49 Trade Plan as finally agreed after some minor modifications in late October.

Table 4.2 Sterling Area–Japan Trade Plan, 1 July 1948–30 June 1949

Area	Sales from Sterling Area to Japan	Purchases by Sterling Area from Japan
UK and Colonies	\$ 46,723,000	\$ 54,423,000
Australia	19,650,000	18,500,000
India	17,025,840	28,260,150
New Zealand	25,000,000	2,500,000
South Africa	8,191,000	6,768,000
For Internal Allocation among the Participants		850,000
Sub-Total	94,089,840	111,301,150
Reserve Purchasing Pool for the Non-Participants		1,488,690
Estimated Balance of Indian Open Account		14,700,000
Estimated Balance of UK Open Account		4,000,000
Total	\$ 112,789,840	\$ 112,789,840

Source: Sterling Area Trade Conference, 'Sterling Area-Occupied Japan Trade Plan: 1 July 1948–30 June 1949', 20 October 1948, AA, A606, R40/1/74.

²⁷ Wrigley to DCA, 10 August 1948, R40/1/67.

Financial matters had not been a central issue in the negotiations before August. Although the lack of adequate sterling funds was always a matter of concern for the SCAP officials, it had been expected that the inclusion of cotton textiles in the Overall Payments Agreement would provide Japan with adequate sterling cash to finance procurement from the sterling area.²⁸ In reality, however, cotton textile sales to the sterling area did not solve the problem of financing sterling trade, and while the sterling delegates in Tokyo were waiting for a reply from their respective governments to the draft trade arrangement, a new issue emerged in the negotiations.

THE STERLING CREDIT PROBLEM

On 10 July, the Fund Control Division was newly established in the Economic and Scientific Section of SCAP and Paul Cleveland, Controller of the OJEIRF, was appointed its Chief.²⁹ It was the Fund Control Division, responsible for financing export-import programs, that became the dominant force in controlling trade between Japan and the sterling area. In August, Cleveland began to realise the 'extremely bad' sterling position caused by various factors such as the open account liabilities with the United Kingdom and India incurred before the Interim and Overall Payments Agreements and the need to spend a larger sum of sterling on raw materials procurement than estimated export earnings.³⁰

The obligation to reimburse the open account debts and the seasonal concentration of Japan's purchases from the sterling area squeezed SCAP's sterling account. Even the active demand for Japanese textiles and other manufactured goods among the sterling area countries did not solve the short-term shortage of sterling because the volume of SCAP's heavy seasonal procurement far surpassed purchases during the corresponding season by the sterling area which tended to import Japanese goods at a relatively constant pace throughout the year. Therefore, the SCAP officials had to find the means of obtaining additional sterling.

²⁸ Radiogram from Seymour Janow, Foreign Trade and Commerce Division, in London, to Marquat and Pickelle, 30 April 1948, transmitted to Tokyo as radiogram from US Department of State to SCAP, no. WAR SVC 6289, 2 May 1948, SCAP 6707(9), ESS(A)05093.

²⁹ SCAP, *History of the Nonmilitary Activities of the Occupation of Japan*, vol.2, Administration of the Occupation, p.58.

³⁰ Memorandum by Paul Cleveland, Chief, Fund Control Division, ESS, Undated (August 1948?), SCAP, 6961(31), ESS(A)07366.

Initially, Cleveland tried to tackle this problem of a shortage of sterling through extra sales of cotton textiles to Egypt and the Sudan, but in early September, he was forced to take more decisive action. He approached the Financial Adviser to the UKLM, H.H. Thomas, and the managers of the British banks in Tokyo to request longer term sterling credit facilities. In the meantime, he did not validate import contracts with the sterling area pending a reply to this request, even at the cost of cessation of imports of essential raw materials such as rubber. However, the UK Treasury flatly refused any extension of credit facilities such as overdrafts and the OJEIRF based credits beyond the scope of the existing normal short-term commercial credits of 120 days.³¹ According to one of the US Embassy staff in London, the UK Treasury had been 'reluctant, on political grounds, to approve any scheme of granting a loan or long-term credits to any enemy country'.³² Cleveland reacted angrily to the UK Treasury reply, as had been feared by the sterling representatives in Tokyo. At the meeting to finalise the form of the trade plan on 20 October, Cleveland threatened to abandon the Trade Arrangement unless an overdraft or longer-term credit facilities were granted'.³³

It is possible to regard Cleveland's threat to abandon the Sterling Trade Arrangement as a 'lever' to obtain additional financial credit from the United Kingdom, as observed by G.P.H. Knight, Commercial Secretary to the Australian Mission in Tokyo. Pointing out the difference of views between the Fund Control Division and the Foreign Trade and Commerce Division, which preferred the financing of trade through the expansion of Japanese exports, within ESS over the shape of Japan's sterling trade, Knight referred to the fact that the Chief of the Foreign Trade and Commerce Division [Pickelle] 'requested the meeting not to regard the views of the Fund Control Division as necessarily being those of the Supreme Commander's Headquarters', after Cleveland stormed out of the negotiation room outraged by London's refusal on 20 October. In view of this, Knight

³¹ H.H. Thomas, Financial Adviser, UKLM, to Cleveland, 'Sterling Credit for Japan', 8 October 1948, R40/1/74. The OJEIRF was established to use the precious metals such as gold and silver which had been kept by the Japanese government (the so-called 'gold pot') as collateral in seeking a grant of credits from foreign banks. These credits were supposed to finance the import of raw materials to stimulate resumption of Japanese industrial operation.

³² Erle R. Dickover, Counsellor of the US Embassy, London, to Secretary of State, Washington, no. 1306, 8 June 1948, SCAP 6735(13), ESS(A)05441.

³³ Alvary Gascoign, Head, UKLM, to Secretary of State for Foreign Affairs, London, no. EA654/451/48, 9 November 1948, R40/1/74.

reported an optimistic view prevailing among the sterling representatives in Tokyo that Cleveland's opposition would be 'ruled out' and his threat 'should not be taken seriously'.³⁴

Cleveland's firm attitude had the desired effect. A day later, to the delegates' relief, London moved to break the deadlock by authorising the UKLM to hold further discussions with SCAP on the assumption that if a sufficient case could be made, the British government would not oppose proceeding with an appropriate loan.³⁵ While London considered it 'simplest and most satisfactory' for SCAP to use the so-called 'dollar swap', that is, to buy sterling through dollar deposits as security, it was prepared to offer £10–15 million of medium term credits for six to twelve months including the outstanding credits.³⁶

Thus, the 1948/49 Sterling Trade Arrangement including the attached Trade Plan was concluded between SCAP and the sterling participants including India on 9 November. The Arrangement covered trade during the period from 1 July 1948 to 30 June 1949 and stipulated that all trade should be conducted on a sterling basis in accordance with the Overall Payments Agreement. Each party undertook to expend on imports from the other party the full amount of the proceeds of its exports to the other party in order to balance trade at the highest practicable level. Since the Sterling Trade Arrangement provided a balancing of trade between Japan as one party and the five sterling area countries as the other party, it was expected that the Arrangement would have a far less restrictive effect than bilateral trade arrangements between Japan and each sterling country. The SCAP officials would not have to feel concerned about a prospective bilateral trade deficit with Australia in issuing import licences for purchases of Australian wool and other commodities, for such a deficit would be easily offset by active purchases of Japanese goods by the other sterling countries. The restrictive approach to sterling trade by the SCAP Fund Control Division, however, had serious effects on Japan's sterling trade in 1949.

CONTRACTION OF JAPANESE PURCHASE FROM THE STERLING AREA

SCAP's request for sterling credit, as revealed in the trade negotiations, had not been unfounded. In December 1948, the Fund Control Division estimated SCAP's sterling debt

³⁴ G.P.H. Knight, Commercial Secretary, AM, to DCA, 22 October 1948, *ibid.*

³⁵ *Ibid.*

³⁶ Cable from Crosec to Canberra, no.263, 23 October 1948, R40/1/74.

as of 1 February 1949 at £5.4 million which was within the range of the short-term credit of £6 million already granted by the British banks. In order to proceed with an additional £3 million worth of cotton procurement from India and Pakistan which had been under consideration, SCAP would need to be granted further sterling credit beyond this ceiling.³⁷ What had a serious impact on the flow of Japanese sterling trade was how SCAP had reacted to the estimated sterling shortage before credit facilities became available. If SCAP had taken the prospective export revenues into account in estimating its future sterling position, it could have adopted a more liberal approach to imports from the sterling area countries. As shown above, however, what concerned the Fund Control Division was solely the existing sterling balance. The result was a further contraction of procurement from the sterling area. Again the contraction involved sacrificing raw wool imports. In December 1948, five months after the beginning of the period covered by the 1948/49 Sterling Trade Arrangement, H.C. Menzies who succeeded Wrigley as the Australian Commercial Counsellor in Tokyo found that SCAP had given approval for the procurement of only \$2,000 of raw wool from the sterling area as opposed to the \$13,500,000 of the total estimated Japanese wool purchases from the sterling participants, as agreed in the Trade Plan.³⁸

It was obvious that the Fund Control Division gave considerably lower priority to wool than cotton in estimating its requirements. When in September 1948 the Textile Division of ESS proposed the purchase of Pakistani and Indian cotton, Cleveland gave an unconditional approval on the grounds that the procurement was 'a must'.³⁹ Then, as the prospective sterling position deteriorated in December 1948, Cleveland curtailed the amount of these cotton by more than half, but at the same time he totally rejected the wool purchases from Australia and South Africa, as also proposed by the Textile Division.⁴⁰

SCAP officials attributed slow wool procurement to the difficulty in increasing the export of woollen manufactures to the sterling area. The Australian Commercial Counsellor rejected this, insisting that the stagnant Japanese woollen exports were mainly caused by the

³⁷ Radiogram from SCAP to Department of the Army (DA), Washington, no. C-66308, 15 December 1948, SCAP6961(31), ESS(A)07365.

³⁸ H.C. Menzies, Australian Commercial Counsellor in Tokyo, to DCA, 17 December 1948, R40/1/80.

³⁹ Cleveland to Textile Division, 'Use of Pound Sterling for Procurement of Pakistan and Indian Raw Cotton', 13 September 1948, SCAP, 6961(31), ESS(A)07364.

⁴⁰ Cleveland to Textile Division, 6 December 1948, *ibid.*

virtual closure of the traditional Chinese and Korean markets and that the woollen producers in the sterling area were also faced with difficulty in selling their own products overseas.⁴¹ However, SCAP and the Japanese woollen industry were quite serious about their claim for increased exports to the sterling area. A matter of concern for the Japanese woollen industry was the looming trend towards introducing import restrictions on Japanese woollen textiles in the sterling markets such as India and South Africa, in order to safeguard their domestic industry. They were also dissatisfied with the hard currency treatment given to Japanese products by the sterling area even though the principle of balanced trade, as stipulated in the Sterling Trade Arrangement, should have dispelled any anxiety of dollar drain.⁴² The Textile Division of the ESS was more extreme in its pursuit of promotion of woollen exports, going so far as to make the extraordinary recommendation that the Australian and New Zealand governments should establish a 'special import quota' for which the two countries would guarantee to import Japanese woollen manufactures, in return for Japan's purchases of raw wool from these sources.⁴³ This was a similar idea to the bilateral processing arrangements in which the Australian government had expressed no interest.

SCAP's main concern lay in offsetting Japanese purchases of raw materials through export sales of finished goods to maintain a strict balance of trade rather than expanding the levels of industrial production and domestic consumption. While Menzies had already noticed by December 1948 SCAP's growing inclination towards a bilateral approach to sterling trade particularly at the administrative level as a 'disquieting factor' which was against the spirit of the Sterling Trade Arrangement, such a desperate approach as was adopted by the SCAP officials did reflect Japan's critical sterling cash position. In fact, Cleveland even withdrew his previous approval of the procurement of Indian and Pakistani raw cotton, to which he had given higher priority than raw wool.⁴⁴

⁴¹ Memorandum by Menzies, 17 December 1948, *op.cit.*

⁴² S. Aiba, Director, Textile Boeki Kodan, 'Sterling Payment Arrangement and Exchange Manipulation', 24 February 1949, SCAP, 6707(9), ESS(A)05092.

⁴³ From R.D. Cleaves, Chief, Textile Division, ESS, to Pickelle, 5 July 1949, *ibid.*

⁴⁴ Menzies to DCA, 17 December 1948, R40/1/80. This memorandum by Menzies is a different one from the previously cited memorandum by Menzies of the same date.

WAIVER OF CONVERTIBILITY

In order to overcome Japan's sterling shortage problem, Norman Young of the UK Treasury was sent to Tokyo to discuss the matter with Cleveland in late December 1948. At the meeting, Cleveland showed a more optimistic view concerning SCAP's sterling position, admitting that SCAP's sterling shortage was 'not likely to be a regular occurrence but was merely an isolated instance'. Cleveland also withdrew his earlier request for an overdraft and longer-term loans. With regard to the normal short-term credit by the banks, however, he rejected the option of a dollar swap which London preferred, as a 'wasteful use of his [SCAP's] dollars which he would use elsewhere'. From the discussions with Cleveland, Young drew the conclusion that the only means of preventing a further contraction of trade was an additional grant of £6 million of sterling credit to SCAP, which Young observed the British banks did not show much interest in offering.⁴⁵

Young's conclusion prompted the next move by the sterling participants. On 27 January 1949, Thomas, Financial Advisor to the UKLM, proposed that SCAP's 'accumulation of sterling as a result of increased buying by the sterling area' could provide an alternative solution to increased bank credit. In order to dispel any fear of dollar conversion of SCAP's sterling funds arising from additional purchases by the participants from Japan, Thomas suggested that SCAP should temporarily forego the right of converting its sterling surplus accrued as of 30 June 1949 and agree to reserve such balance for future procurement from the sterling area countries.⁴⁶ Underlying this proposal was the observation that SCAP might overcome the 'hump' of sterling shortage in March within the scope of the existing 120 days credits, in view of the sign of SCAP's postponement of reimbursement of the debts which it had incurred through government deals before the Overall Payments Agreement.⁴⁷

⁴⁵ Sterling Area Working Party, Tokyo, 'Minutes of the Seventh Meeting', 30 December 1948, R40/1/80; UKLM, 'Memorandum for the Supreme Commander on matters discussed by Mr. Norman Young in Tokyo', 11 January 1949, SCAP, 6707(9), ESS(A)05092. The delegates of the sterling area countries participating in the Sterling Trade Arrangement established the Sterling Area Working Party in Tokyo in November 1948 to exchange information on each member's management of Japanese trade under the Arrangement and to check any excessive trade imbalance.

⁴⁶ Thomas to Marquat, 'Sterling Financing', 27 January 1949, R40/1/80.

⁴⁷ Menzies to DCA, 3 February 1949, *ibid*.

On 5 February 1949, SCAP quickly responded favourably to the proposal of waiving the exercise of conversion before 31 December 1949 in anticipation of an expansion of trade.⁴⁸ Thomas had directly approached the Chief of ESS in presenting the waiver proposal, and on this occasion, Marquat had been 'extremely cooperative'.⁴⁹ There is no document to suggest whether this approach to appeal to SCAP's higher ranking officials was a tactical move to bypass the cautious view on expansion of sterling trade held by the Fund Control Division and the resultant bureaucratic conflicts with the Foreign Trade and Commerce Division or a mere coincidence due to the absence of Cleveland who had left for Washington from late January. When there emerged an impasse in the negotiations, the sterling delegates tried to approach directly SCAP's higher ranking officials such as Marquat or even MacArthur, who were more receptive to the plea by the sterling area for trade promotion than the administrative officials, particularly in charge of sterling fund control.

Cleveland's absence would certainly have strengthened the position of the Foreign Trade and Commerce Division which had already considered the waiver of convertibility as early as November 1947, in anticipation of SCAP's sterling surplus resulting from the inclusion of cotton textiles in the Overall Payments Agreement. According to Pickelle, the existence of the dollar convertibility clause would not entice the sterling area countries to relax their tight import licensing on Japanese goods and accordingly would 'dramatically limit' Japan's sterling trade. Hence, another step had to be taken to reach an agreement with the sterling area to minimise the risk of a dollar drain. Pickelle's proposal was to establish a 'ceiling' below which SCAP would forego the right to convert its sterling balance into dollars.⁵⁰ Without its Chief, the Fund Control Division also gave approval to the waiver of convertibility on the grounds that a large volume of procurement from the sterling area was envisaged in the purchase program for the second half of 1949, and SCAP's sterling surplus would duly be consumed before the end of the year.⁵¹

⁴⁸ Marquat to Thomas, 5 February 1949, *ibid.*

⁴⁹ Sterling Area Working Party, 'Minutes of the Tenth Meeting', 3 February 1949, *ibid.*

⁵⁰ Pickelle to Marquat, 'Sterling Agreement with the British', 1 November 1947, SCAP, 6707(9), ESS(A)05093.

⁵¹ Fund Control Division, 'Memorandum for Record', 4 February 1949, SCAP, 6768(5), ESS(C)06101.

SCAP DRIFTING AWAY FROM STERLING TRADE?

The waiver of conversion of SCAP's sterling surplus into dollars certainly brought about a solution to its sterling credit problem, as its cash position was improved so considerably that Menzies had the impression that the Fund Control Division might loosen the 'purse strings a little'.⁵² In the Sterling Area Trade Review Conference which was convened between the SCAP officials and the sterling participants in Tokyo from late March to early April to discuss the revised estimates of the Trade Plan, however, the sterling delegates expressed their dissatisfaction with SCAP's approach towards not only sterling trade but also Japan's general trade strategy. Already 'perturbed' by the 'unnecessarily restrictive' policy of the Fund Control Division for purchases from the sterling area,⁵³ the sterling representatives urged Cleveland to look more to prospective purchases in the future by the participants and to be less concerned about the outstanding credit in SCAP's account.⁵⁴ Cleveland responded that his serious concern about SCAP's sterling position in the previous autumn had been dispelled and revealed his preparedness to balance the accounts by issuing import approvals more freely.⁵⁵ In fact, SCAP had already released \$12 million for wool purchases in early March and according to the SCAP figures presented at the Conference, Menzies confidently predicted further sales of 80,000 bales of Australian wool to Japan at \$19 million, rejecting the Canberra estimate of \$11 million as 'unduly low'.⁵⁶ To be sure, taking into consideration SCAP's sterling position had sharply improved, Menzies might have been right in calculating these optimistic figures.

However, concerns had been growing among the sterling delegates over SCAP's sterling trade policy which was to undermine Menzies' calculation. They denounced SCAP's inclination to make specific purchases from the sterling area on the condition of counterveiling purchases from Japan, citing the flat disapproval of barter trade by

⁵² Menzies to DCA, 4 March 1949, R40/1/80.

⁵³ J.L. Hunt, Sterling Area Trade Co-ordinator to Cleveland, 'SCAP's Sterling Trade', 18 February 1949, R40/1/80.

⁵⁴ Sterling Area Trade review Conference, 'Plenary Meeting—March 21st 1949: Statement Made by Mr. Thomas in Regard to Barter', R40/1/83.

⁵⁵ Sterling Area Trade Review Conference, 'Minutes of Meeting Held at Forrestry Building at 2:00pm on Monday, April 11th 1949', *ibid.*

⁵⁶ Cable from AM to Canberra, no.146, 11 April 1949, R40/1/74.

MacAurthur.⁵⁷ They also accused certain SCAP officials of attempting to 'short-circuit' the Sterling Trade Arrangement, pointing out the announcement of the Japanese Board of Trade that it would only authorise the purchase of UK wool tops through the Hong Kong open account. The biggest concern of the participants was their impression that 'among the commodity men in General Headquarters there was a definite tendency to divert purchases away from the Sterling Area in order to make bilateral and open account arrangement purchases'. According to J.H. Ewing, Head of the Purchasing and Selling Section, UKLM, SCAP officials told him repeatedly 'we must buy from such and such a country because we do not have to pay any money'.⁵⁸ Criticising SCAP's complacency as the sterling position improved, the sterling delegates countered that the Japanese economy was more dependent on the sterling area for markets and supplies than the sterling area economies on Japan. Since the closure of supplies from the Chinese continent would increase Japanese demand for raw materials from the sterling area, SCAP officials were told not to be 'misled' by the existing huge demand for Japanese textiles which the participants insisted was not normal and had already started dwindling.⁵⁹

The concern of the sterling delegates was not without basis. In fact, during the period from mid 1948 to 1949 SCAP rushed to conclude a number of bilateral trade and payments agreements with other countries. In particular, many of these were established as a result of SCAP's mission to Latin American countries for the purpose of restoring Japan's trade with the area. The number of bilateral agreements concluded by SCAP during the period from the conclusion of the Sterling Trade Arrangement in November 1948 to the end of 1949 increased from 3 to 20.⁶⁰ Since bilateral agreements usually aimed at balancing trade, as was the case with the Sterling Trade Arrangement, such a rapid increase in the number of arrangements would mean a reduced share of trade for the sterling area unless the total Japanese trade volume recorded a remarkable growth.

In fact, in his policy paper of July which developed arguments against the cancellation of the dollar convertibility clause of the Overall Payments Agreement, Marquat asserted:

⁵⁷ Sterling Area Trade Review Conference, 'Plenary Meeting—March 21st 1949 ...', *op.cit.*

⁵⁸ Sterling Area Trade Review Conference, 'Minutes of Meeting ... April 11th 1949', *op.cit.*

⁵⁹ Sterling Area Trade Review Conference, 'Plenary Meeting—March 21st 1949 ...', *op.cit.*

⁶⁰ Between April and June 1949, SCAP sent the trade mission to Latin America and concluded a series of trade arrangements with Latin American countries; Argentina, Brazil, Chile, Columbia, Mexico, Peru, Uruguay and Venezuela.

The British claim that Japan cannot maximize its trade with the sterling area if she continues negotiating bilateral arrangements with other countries is an untenable position. The trade arrangements negotiated by SCAP in respect to Occupied Japan provide for trade to be balanced at maximum levels. If certain goods are available from 'trade arrangements countries' under terms and conditions more favorable than those applying in the sterling area then purchases should be made from these sources. This will reduce the level of trade with the sterling area but will not reduce the overall export trade of Japan. Again it is not desirable for Japan to direct her foreign trade into sterling channels. In the interest of sale (*sic*, 'safe?') guarding her future she should expand her trading areas in order not to be dependent upon any single country.⁶¹

Since this policy paper was drafted by the Foreign Trade and Commerce Division, it would be natural to deduce that Pickelle had participated in shaping the underlying idea. This paper is in contrast with his memorandum of August 1948 in which he recommended removal of the dollar convertibility clause after the Japanese government established a foreign exchange control authority capable of checking excessive accumulation of sterling. Pickelle thought that the removal would bring increased exports to the sterling area which he expected would change Japan's status from a 'hard currency' to a 'soft currency' source.⁶² At that stage, Pickelle was desperate to obtain export earnings from any source, provided that they could be used to finance raw material imports to sustain the developing operation of Japanese industries. Later on, however, the availability of raw cotton from the sterling area was found to be far below the level of Japanese requirement. Moreover, the sterling area countries had not shown any sign of classifying Japan as a 'soft currency' source the import licensing affecting which would have been considerably relaxed. As a result, Japanese exports of less essential goods to the sterling area remained depressed. For example, despite SCAP's high expectation, a large part of the sterling area was not prepared to increase imports of Japanese woollen products to a level where the sterling procurement of raw wool could be reasonably justified.

A further explanation of SCAP's dwindling interest in the development of sterling trade can be found within the Fund Control Division. In defence of the expansion of bilateral trade arrangements with various countries, Cleveland raised concerns about the 'growing and continual scarcity of dollars'. Listing various factors causing Japan's dollar

⁶¹ Marquat to Chief of Staff, 'Sterling Area-Occupied Japan Trade agreement', 19 July 1949, SCAP, 6734(25), ESS(A)05419.

⁶² Pickelle, 'Sterling Trade Arrangements', 16 August 1948, SCAP, 6735(13), ESS(A)05439.

shortage, he pointed out that the economic pressures would make 'sales to the Sterling Area more attractive from a business point of view and sales to dollar areas less attractive'.⁶³ Here 'economic pressures' meant inflation within the sterling area and the application of an overvalued official sterling-dollar exchange rate of \$4.03 which had allowed Japanese goods to be sold at better prices in sterling markets than in dollar markets. Furthermore, inflation had also made the prices of imported sterling commodities dearer. The development of a network of bilateral arrangements would give SCAP a handy leverage to withstand such pressure and to gain benefits for Japan by obtaining essential raw materials and foodstuffs at cheaper prices and opening new markets for manufactures in less demand in the sterling area. Thus there was bipartisan agreement between the Foreign Trade and Commerce Division and the Fund Control Division with respect to the fundamental need to develop the network of bilateral trade and payments agreements even at the cost of the expansion of sterling trade.

DISCORD OVER THE WAIVER OF CONVERTIBILITY

Reflecting SCAP's waning interest in procurement from the sterling area, the participants' sales to Japan had been so sluggish in the first half of 1949 that they had accumulated an enormous trade deficit with Japan by late May. At that stage, it was calculated that SCAP would have a \$32 million sterling surplus before 30 June 1949.⁶⁴ The sterling delegates in Tokyo were alarmed at the figure and reported the matter to London, warning that unless the sterling area pressed SCAP immediately it might become impossible, without drastic curtailment of the participants' purchases from Japan, to wipe off the trade deficit by 31 December when SCAP would convert its sterling funds in hand into dollars.⁶⁵

London made an interesting response to this report. Doubting that SCAP could buy an amount corresponding to the deficit of the participants within the next twelve months, London instructed its Tokyo representatives only to convey to SCAP the UK's grave concern about the existing situation and for the moment just to watch SCAP's next move.⁶⁶

⁶³ Memorandum by an ESS official named 'Terry' regarding his discussion with Cleveland on open accounts arrangements, 6 June 1949, SCAP, 6442(26), ESS(B)03588.

⁶⁴ Hunt to Marquat, 'SCAP's Sterling Purchases', 30 May 1949, R40/1/80.

⁶⁵ Cable from UKLM to FO, no.570, 24 May 1949, *ibid.*

⁶⁶ Cable from FO to UKLM, no.457, 3 June 1949, *ibid.*

The Tokyo delegates were frustrated at London's complacent response which 'apparently did not view the imbalance with such great concern' as they did.⁶⁷ According to Menzies, London seemed to 'contemplate with some pleasure the large state of imbalance as they thought it might give us additional bargaining power for the forthcoming negotiations'. It was 1 July when London thought that the time was 'ripe' for some remedial action and decided to apply stricter tests in giving approval to all imports for home consumption, particularly cotton textiles.⁶⁸ Accordingly, the UKLM reported to SCAP that the British government would temporarily suspend the issuing of import licences to Japanese goods.⁶⁹ It was on the occasion of handing this decision to a SCAP official that an extraordinary incident happened.

Having received the memorandum of 1 July, Peter McDermott, Director of Trade and Services, told Lingeman that SCAP would see this development 'as a tactical move designed to induce him to waive convertibility during the forthcoming negotiations'. McDermott expressed his conviction that Washington would never agree to a further waiver of convertibility and moreover would request 'a direct dollar contribution to the cost of dollar cotton' for purchasing Japanese cotton textiles.⁷⁰ In May, Cleveland had referred to Washington's pressure to seek dollars in Japan's sterling trade, and at that time he had stated that 'this was no way to treat the Sterling Area'.⁷¹ On this occasion in July, McDermott who had just returned from the United States showed no hesitation in stressing the 'sacrosanct character' of the dollar convertibility clause.

This time London's reaction was quick and unequivocal. The UK government instructed the UKLM to obtain from MacArthur himself a 'clarification' of his attitude to this question, in view of the huge gap that existed in the understanding of the fundamental principles of the Sterling Trade Arrangement between McDermott and the sterling participants. If SCAP's official policy was to earn dollars from trade with the sterling area as McDermott had suggested, London was even inclined to reconsider seriously the benefits

⁶⁷ Menzies to DCA, 4 June 1949, *ibid.*

⁶⁸ Menzies to DCA, 1 July 1949, *ibid.*

⁶⁹ Lingeman to Marquat, 1 July 1949, R40/1/88.

⁷⁰ Sterling Area Working Party, 'Minutes of the Thirtieth Meeting', 7 July 1949, R40/1/88. The Director of Trade and Services was directly responsible to the Chief of ESS for coordination of SCAP's overall trade policy for Japan.

⁷¹ Cable from UKLM to FO, no.571, 24 May 1949, R40/1/80.

of continuing not only the negotiations for a 1949/50 Sterling Trade Arrangement but also the Overall Payments Agreement. Thus London ruled that the departure of the UK negotiators to Tokyo be deferred pending MacArthur's reply.⁷²

The meeting between MacArthur and the Acting Head of UKLM was held on 11 July. At the same time, Lingeman approached Marquat with 'purely personal suggestions'. Lingeman pointed out that if SCAP was 'determined to make any leeway in his [SCAP's] purchases resulting in a deficit for the sterling area, it would be "always open to him [SCAP]" to eliminate the dollar convertibility clause'. In exchange for the waiver of convertibility, London was prepared to grant SCAP the facility of administrative transferability.⁷³ However, Marquat revealed quite an ambiguous attitude to the waiver of dollar convertibility. Although Marquat admitted SCAP's need to reserve a certain amount of sterling surplus as of 31 December as working capital, he also predicted Washington's disapproval of this measure.⁷⁴

Marquat's stance was understandable because SCAP had been under enormous pressure from Washington to spend all dollar appropriations in the United States even 'regardless of competitive factors' for the benefit of American taxpayers who had sustained the Japanese economy.⁷⁵ SCAP's increasing interest in expansion of trade with the bilateral arrangement countries such as those in Latin America and Washington's pressure for dollar payment for Japanese cotton textile exports inclined the SCAP officials towards diversion of Japanese trade away from the sterling area.

It was MacArthur who saved this critical situation. MacArthur unequivocally denounced his intention to convert SCAP's sterling surplus into dollars. According to the UKLM:

[MacArthur] said that he fully understood and sympathised with the dollar difficulties of the United Kingdom. Nothing was further from his thoughts than to 'squeeze' us for dollars which we did not have. He maintained that despite the inclusion of the convertibility clause in the Sterling Area Trade Arrangement, it

⁷² Cable from FO to UKLM, no.DRIVE 529, 8 July 1949, R40/1/88.

⁷³ Lingeman to Marquat, 11 July 1949, *ibid.* If a country was given administrative transferability, the country would be authorised to transfer its sterling balance to purchases from any other countries subject to approval of the British exchange control authority. At this stage, Japan was classified as a 'bilateral account country' which would be allowed to use its sterling balance only in the sterling area, due to the dollar convertibility clause.

⁷⁴ Cable from UKLM to FO, no.DRIVE 752, 11 July 1949, *ibid.*

⁷⁵ Cable from UKLM to FO, no.REMAC 111, 11 July 1949, *ibid.*

had never been his intention to invoke it. At the time when the Arrangement was being negotiated he told someone ... that though this clause had to be written into the Agreement to satisfy potential critics in Washington, he himself never intended to make use of it.⁷⁶

MacArthur further endorsed his intention of not looking to the sterling area as a source of dollars in SCAP's official memorandum of 22 July. MacArthur rejected the suggestion that the whole dollar convertibility clause be removed from the Overall Payments Agreement, and instead urged the sterling participants to increase availability of their commodities for Japan so as to offset their outstanding deficits with Japan.⁷⁷ After Marquat had agreed to the waiver of convertibility before 31 December 1949 in February, Washington accepted the SCAP decision on condition that this was not a waiver but an 'extension' and the right of conversion should be retained for emergencies.⁷⁸

MacArthur's sympathetic reply worked to relieve London's doubts and the UK delegates were instructed to leave for Tokyo on 21 July.⁷⁹ Again the deadlock in the sterling trade negotiations was solved by bringing the matter to a higher level in the SCAP bureaucracy, as had been the case with Thomas' direct approach to Marquat in February. This suggests that the high ranking SCAP officials were conscious of the long-term political significance of rehabilitating Japanese trade relations with the sterling area. Especially in view of Marquat's hesitation to endorse the waiver of convertibility under Washington's pressure, it seems to have been MacArthur himself who took the initiative in issuing the assurance on not seeking dollars from the sterling participants in July, from the highly political viewpoint of facilitating the occupation goal of Japan's economic recovery. If US aid had to be used in the most economical way, as requested by Washington and advocated by some SCAP lower ranking financial specialists, it would have been in SCAP's interest to save dollars as much as possible by concentrating Japanese exports of cotton textiles on dollar markets where export competition was extremely tough or even by exercising the right to convert sterling funds into dollars. Such an approach, however, would certainly have jeopardised promotion of Japan's sterling trade, for the sterling area countries would

⁷⁶ Cable from UKLM to FO. no.DRIVE 751, 12 July 1949, *ibid.*

⁷⁷ SCAP to Gascoigne, 'Japan's Trade with the Sterling Area', 22 July 1949, SCAP, 6768(5), ESSC(C)06099.

⁷⁸ Radiogram from Washington to SCAP, W-86896, 9 April 1949, SCAP, 6768(5), ESS(C)06101.

⁷⁹ Cable from Crosec to Canberra, no.13, 25 July 1949, R40/1/83.

have been forced to cease purchases of Japanese goods for fear of a dollar drain. This would have resulted in a drastic reduction of Japan's overall exports and accordingly disrupted industrial operations, hampering the achievement of the occupation objectives. Trade with the sterling area, especially export trade, was too large for the Japanese industries to risk. In this sense, MacArthur's decision assisted the Japanese economic recovery.

The anxiety about dollar conversion eased temporarily. There still remained the difficult task for the sterling delegates of persuading the SCAP officials to purchase more from the sterling area, once the question returned to specific issues of commodity procurements in the subsequent negotiations for a 1949/50 Sterling Trade Arrangement which was to replace the 1948/49 Arrangement that had lapsed in 30 June 1949.

STERLING TRADE ARRANGEMENT AT BAY

From the outset of the negotiations in early August, SCAP's purchasing prospects appeared bleak. Again it was wool that the sterling area expected to sell as the chief export commodity. The situation was more serious than the previous year for Australia as well as the other participants which depended on Australia to earn purchasing power from Japan, because this time Canberra could not find any surplus wheat to be shipped to Japan before the end of the year, as it had done to make up for the reduced wool figures in the 1948/49 Trade Plan.⁸⁰ SCAP's wool requirements at this time, were only 100,000 bales which was less than the volume of the previous year. Expressing disappointment at the low figure, the sterling delegates insisted that the sterling area 'needed to sell the maximum possible amount of wool to SCAP'.⁸¹ SCAP officials explained that the small figure of Japan's 'maximum' wool requirement of \$22.2 million, as against the 'minimum' offer of \$30 million by the participants, derived from 'disappointingly small' woollen exports and the rising interest in purchasing South American wool. As explained in Chapter 3, competitive prices of South American wool had attracted SCAP officials, and they envisaged developing South American markets as a promising outlet for Japanese woollen manufactures. In

⁸⁰ H.A.P., DCA, 'Trade with Japan', 15 July 1949, R40/1/83.

⁸¹ Sterling Trade Arrangement Conference, 'Notes of 1st Meeting', 2 August 1949, *ibid.*

addition, the bilateral trade arrangements with South American countries enabled Japan to import raw cotton which could be paid for in export goods without any dollar spending.⁸²

SCAP's low estimate did not mean that the Japanese industries had a limited demand for raw wool. The operation level of the Japanese wool textile mills was still only about 20 per cent at that time. Since the clothing of the Japanese people was still in a poor state, as Menzies observed, there really seemed to be considerable demand for woollen textiles in the Japanese domestic market. So once the Japanese could convince SCAP of their urgent need for not only food but also clothing, it would be much easier to balance trade between Japan and the sterling area at the highest possible level through active procurement of Australian wool. Menzies saw that there was a 'strong body of opinion' even among some SCAP officials in support of such an argument.⁸³

In reality, however, while SCAP had completed purchasing wool from Australia up to the volume prescribed in the 1948/49 Trade Plan by July 1949,⁸⁴ the Textile Division had a large amount of wool stocks in hand, and this kept SCAP's estimates of wool requirement at an extremely low level.⁸⁵ This suggests that SCAP still maintained its policy to utilise imported raw wool mainly for woollen exports which still remained at a low level. SCAP adopted the same principle as for cotton, that imports of raw materials should be offset as much as possible by exports of finished goods in order to make the most efficient use of Japan's scarce foreign currencies, which were mainly spent on procurement of foodstuffs from overseas. As long as SCAP took such an approach to sterling trade, especially wool imports, there was little prospect of expansion of sterling trade and recovery of Japanese industrial activities.

In an attempt to raise the volume of SCAP's purchase program, the sterling delegates asked SCAP to procure Japan's whole requirements of rubber exclusively from the sterling area. Pickelle was unimpressed with the proposal because he found it 'not to the advantage of Japan (or the United States) to place the British in a position where they are the sole supplier of crude rubber since such controls would permit them to dictate prices'.⁸⁶ He was

⁸² Pickelle to Marquat, 'Summary of Sterling Area-Occupied Japan Trade Discussions. 2-3 August', 3 August 1949, SCAP, 6768(6), ESS(C)06104.

⁸³ Menzies to DCA, 1 July 1949, R40/1/88.

⁸⁴ Menzies to DCA, 29 July 1949, *ibid.*

⁸⁵ Cable from AM to Canberra, no.310, 'Negotiations', 4 August 1949, R40/1/83.

⁸⁶ Pickelle to Marquat, 'Summary of Sterling Area-Occupied Japan Trade Discussions. 2-3 August', *op.cit.*

interested in maintaining trade with Indonesia centred on Japan's rubber imports, as Indonesia was expected to be a good export market allowing Japan to earn dollars.

The difficulty facing the sterling participants was further aggravated by their inability to supply an adequate amount of raw cotton. There was a wide gap in the figures between SCAP requirements and the participants' offer.⁸⁷ The low availability from the sterling area would further direct SCAP's purchases of raw cotton towards the United States. In fact, SCAP officials were aware of specific problems in raw cotton produced in the sterling area. From the commercial viewpoint, its price was still dearer than dollar cotton.⁸⁸ Moreover, the Indian supply was largely made up of short staple cotton for which the Textile Division found only a limited range of use for technical reasons, and India could not avail the Japanese mills of preferred medium staple cotton.⁸⁹ In view of the limited cotton availability, SCAP had to consider imposing some 'ceiling' on Japanese exports of cotton textiles to the sterling area to allocate more textiles for export to the dollar area to facilitate financing the procurement of dollar cotton.⁹⁰ The United Kingdom representatives were not particularly shocked at SCAP's reference to the possibility of limiting purchases of cotton textiles, which had been a strategic item in early postwar Japanese trade, and they even suggested a prospective fall in demand in the subsequent year.⁹¹

This development implies two important trends in the sterling trade negotiations. Firstly, the United Kingdom became less desperate to obtain manufactured goods in short supply such as cotton textiles from Japan. The British approach to Japanese trade was to lay more emphasis on protecting domestic industry from Japanese competition. As a result, a rift gradually developed between the UK and the other sterling participants over the level

⁸⁷ Sterling Trade Arrangement Conference, 'Notes of 1st Meeting', 2 August 1949, R40/1/83.

⁸⁸ Menzies to DCA, 1 July 1949, *op.cit.*

⁸⁹ Sterling Trade Arrangement Conference, 'Notes of 3rd Meeting', 4 August 1949, R40/1/83.

⁹⁰ Sterling Trade Arrangement Conference, 'Notes of 2nd Meeting', 3 August 1949, *ibid.* There was another reason for SCAP to restrain the sales of cotton textiles to the sterling area. The Textile Division was concerned about the fact that a large volume of Japanese cotton textiles had been sold in sterling to the entrepots in the area such as Aden, Singapore, and the United Kingdom from where they were re-exported to the non-sterling area. In particular, Manchester was processing cheaper Japanese grey cotton to export the finished goods to the European continent, thus creating tougher competition for Japanese textiles in these markets. In addition to elimination of entrepot trade from the Sterling Trade Arrangement, the Division recommended establishing quotas for cotton textile exports to the above destinations. C.C. Campbell, Acting Chief, Textile Division to Pickelle, 'Entrepot and Reprocessing Trade with Sterling Area', 17 August 1949, SCAP, 6734(25), ESS(A)05418.

⁹¹ Sterling Trade Arrangement Conference, 'Notes of 2nd Meeting', R40/1/83.

and allocation of purchasing power of Japanese industrial goods. Secondly, SCAP also became less desperate in seeking raw cotton from the sterling area as an alternative source of supply and placed more emphasis on procurement of foodstuffs from the sterling area.

The inability of the participants to supply Japan with attractive commodities did not augur well for the 1949/50 sterling trade negotiations. Particularly SCAP's conservative estimates of its requirements from the sterling area were such that the British negotiators even felt it 'pointless' to stay in Tokyo to tackle SCAP's 'minute' requirements. In the informal meeting with the UK delegates of 13 September, Pickelle revealed his estimate of purchases during the financial year 1949/50 at \$118 million.⁹² After deducting from this sum the outstanding deficits in trade with Japan during the financial year 1948/49 and the carryover of Japan's unfulfilled purchases from the previous year, this figure would leave virtually no new purchasing power for the sterling area.⁹³ Thus an absolutely unacceptable situation would have arisen where all the participants would have had to stop buying from Japan. Pickelle informed the sterling delegates that Marquat had authorised him to raise the SCAP purchase figure to \$160 million.⁹⁴ The fact that the Chief of ESS involved himself in issuing the new estimate suggests that this was just a tactical move to show SCAP's desire to prevent a breakdown in the negotiations rather than any sign of SCAP's rising interest in sterling purchases. In fact, the sterling delegates found that the figure of \$160 million was still disappointingly small, but they had no alternative but to console themselves that this was the best figure that they could obtain.⁹⁵

While the sterling delegates had no choice but desperately to push SCAP towards expansion of purchases, the SCAP officials responded with the argument that the existing predicament derived from 'overbuying' by certain participants.⁹⁶ The sterling delegates countered that the remedy to the situation should be sought in the Sterling Trade Arrangement provision for automatic balancing of purchases where each party undertook to 'expend on imports from the other party the full amount of the proceeds from exports to

⁹² Meeting of the Sterling Area Representatives, Tokyo, 14 September 1949, R40/1/90.

⁹³ Sterling Trade Arrangement Conference, 'Committee of the Whole: report of Scheduled Meeting', 14 September 1949, *ibid.*

⁹⁴ Meeting of the Sterling Area Representatives, 14 September 1949, *op.cit.*

⁹⁵ Meeting of the Sterling Area Representatives, 15 September 1949, *ibid.*

⁹⁶ Sterling Trade Arrangement Conference, 'Committee of the Whole', 14 September 1949, *op.cit.*

that party'.⁹⁷ The participants' view was that 'overbuying' could not occur because the provision ruled that the trade should be balanced. Some SCAP officials were even inclined to interpret it as obligating each party to purchase only up to the level of the estimates in the Trade Plan.⁹⁸ It is noteworthy that a year later the situation had completely reversed; parties changed sides entirely in repeating similar arguments concerning overbuying by SCAP this time.

With no chance of reversing SCAP's attitude to purchases from the sterling area, it seemed inevitable for SCAP to reserve a certain amount of sterling surplus beyond 31 December when the undertaking not to convert its sterling balance into dollars was to expire. So the key to the success of the negotiations rested much on SCAP's commitment to waive the convertibility clause. The sterling delegates had already seen that the atmosphere inside SCAP ruled out any further waiver of convertibility as 'unthinkable'.⁹⁹ The only assurance which they could get in early September was that SCAP had no desire to invoke the convertibility clause except at a time of emergency such as the devaluation of the pound sterling, which had been rumoured would happen soon.¹⁰⁰

Faced with the imminent danger of incurring dollar liability from Japanese trade, London made the most extreme response. The UK government conveyed to the Tokyo representatives its readiness to give serious consideration to terminating the Overall Payments Agreement and bringing Japanese trade back to an 'uncamouflaged dollar basis'.¹⁰¹ That would mean the introduction of tougher import licensing on Japanese goods, which might culminate in a virtual closure of Japan's trade with the sterling area. As long as London was determined not to allow any dollar liability in Japanese trade, the fate of the Sterling Trade Arrangement and expansion of Japan's sterling trade hinged on whether SCAP would give an unequivocal assurance of non-conversion of its sterling funds, even on the occasion of a drastic devaluation of the pound sterling. This would dispel London's serious concern. However, SCAP disclosed its intention to convert its sterling surplus into dollars in the case of devaluation of the pound sterling.

⁹⁷ Sterling Trade Arrangement Conference, 'Financial Working Group: Report of Scheduled Meeting', 8 September 1949, R40/1/83.

⁹⁸ Cable from AM to Canberra, no.340, 'Negotiations 4', 3 September 1949, *ibid.*

⁹⁹ Cable from UKLM to FO, no.DRIVE 789, 19 July 1949, R40/1/88.

¹⁰⁰ Sterling Trade Arrangement Conference, 'Financial Working Group', 8 September 1949, *op.cit.*

¹⁰¹ Cable from AM to Canberra, no.350, 'Negotiations 5', 15 September 1949, R40/1/83.

This was a prime example of its conservative approach to sterling trade during the period from 1948 to mid 1949. SCAP did not show as much interest in expansion of Japan's sterling trade as the sterling area countries which had active demand for imports of essential goods from Japan, particularly cotton textiles. In order to minimise the financial constraint in sterling trade, SCAP concluded the Overall Payments Agreement, stipulating the principle of all trade on a sterling basis in May 1948. When cotton textiles became available from Japan in sterling in June, further trade expansion seemed promising. The four sterling area countries including Australia duly participated in the negotiations with SCAP for a Sterling Trade Arrangement to minimise the restrictive effects of a bilateral trade arrangement and to balance Japan's sterling trade at the highest possible level. The Sterling Trade Arrangement was expected to lubricate Japan's sterling trade by introducing the system for more multilateral financial settlement of trade under which Australia's bilateral trade surplus through its sales of wool and foodstuffs would provide the other sterling participants with purchasing power for Japanese goods.

Initially, however, SCAP was quite slow to authorise imports from the sterling area due to the conservative approach adopted by the Fund Control Division and ESS's rising interest in the promotion of Japanese trade with Latin American countries. SCAP's sluggish procurement policy from the sterling area affected Australia's sales to Japan and SCAP accumulated sterling surpluses as the sterling participants maintained active purchases of Japanese goods centred on cotton textiles. In order to dissipate the fear of the sterling participants over SCAP's intention to invoke the dollar convertibility clause of the Overall Payments Agreement, SCAP agreed not to convert its sterling surplus. Despite the cooperative attitude revealed by Marquat in giving the guarantee of non-conversion in February 1949, SCAP was least interested in raising the level of Japan's purchases from the sterling area in the negotiations for the 1949/50 Trade Plan. In July 1949, even Marquat hesitated to give a clear assurance not to convert SCAP's sterling funds which had been left idle through inactive purchases. The SCAP officials were concerned about Washington's stricter approach to the handling of SCAP's sterling funds mainly earned from textiles produced from dollar cotton. As rumour of a sterling devaluation gathered strength around September, SCAP seemed to have abandoned the hope of promoting trade, being

determined to convert its sterling surplus into dollars to safeguard against the possible depreciation of its assets.

The lack of SCAP's interest in expansion of sterling trade derived from its concern about saving foreign currencies, especially dollars under pressure from Washington. Hence, it emphasised counterveiling imports of woollen fabrics by Australia in return for purchases of raw wool. SCAP also tried to cultivate commercial networks with South American countries, because there commodities were cheaper than in the sterling area and they had more demand for less essential Japanese goods which the sterling area was not prepared to import. SCAP did not worry about contraction of Japan's exports to the sterling area, a large part of which consisted of cotton textiles that could have earned more dollars if diverted into the dollar markets. This chapter has shown that so long as SCAP emphasised maintaining a sound foreign currency position, Japan and the sterling area could not hope for expansion of trade even under the multilateral settlement system in soft currency provided by the Overall Payments Agreement and the Sterling Trade Arrangement.

SCAP's conservative approach towards sterling trade, was to change dramatically in the event of the devaluation of pound sterling in September 1949, at which time SCAP did not, in fact, claim conversion of sterling funds into dollars. The next chapter discusses SCAP's rising interest in procurements from the sterling area from the devaluation to 1950 onwards.

5 SCAP Increases Food Procurement in Sterling, 1949–50

September 1949 saw a major turning point in postwar Japan's sterling trade. In 1948/49 SCAP's sluggish purchasing activity had hampered expansion of two-way trade between Japan and the participants in the Sterling Trade Arrangement. As the rumour of the pound's devaluation prevailed, SCAP faced the important decision of whether or not it should run the risk of jeopardising promotion of Japan's sterling trade by claiming conversion of its sterling surplus into dollars in accordance with the provision of the Overall Payments Agreement. In the end, SCAP did not convert its sterling funds with the pound's devaluation in September 1949, to the relief of the sterling participants who had been alarmed at the possibility of a dollar liability. In fact, SCAP displayed a desire to expand sterling trade in the negotiations for a 1949/50 Sterling Trade Arrangement.

This chapter highlights the increasing interest in food procurement from non-dollar sources, as the main reason for SCAP's decision to retain sterling funds even in the event of the pound's devaluation and its attempt to propose an extensive procurement program from the sterling area in the subsequent negotiations for a 1949/50 Trade Plan. The drastic curtailment of US aid to Japan was also a factor turning SCAP's attention to developing Japan's commercial links with non-dollar areas. Although SCAP tried to promote rice imports from Southeast Asia and to procure wheat through the International Wheat Agreement, these attempts were blocked by the British. As a result, the promotion of networks of bilateral trade arrangements became the sole instrument to secure increased food procurement from non-dollar sources. Under SCAP's new policy for diversion of trade from dollar to sterling and other non-dollar sources, Australia came to play a significant role as one of the main suppliers of foodstuffs, particularly wheat, for Japan. Australia also functioned as a dynamo to Japan's sterling trade, by providing the other sterling area countries with purchasing power for Japanese industrial goods through its huge bilateral trade surplus with Japan.

Once the Japanese occupation authority committed itself to a strategy for Japan's economic self reliance through trade promotion on a more multilateral basis without depending on extra dollar supply, Japan's sterling trade should have soon flourished. However, in an attempt to restrain SCAP's increasing food procurement in sterling — for such increased procurement would decrease the share for the sterling consumers which might have been compelled to seek these foodstuffs by paying in dollars — the United Kingdom tried to keep trade with Japan under tight control. The negative British approach to relaxation of import licensing against Japanese goods resulted in the deterioration of SCAP's sterling shortage caused by heavy seasonal purchases. Subsequently, SCAP's fund controllers had no alternative but to introduce a suspension of purchases from the sterling area, which badly affected Australia's export sales to Japan. The recovery of Japanese trading activities on a more multilateral basis created a divergence between the commercial interests of Britain and Australia.

SCAP'S POSITIVE RESPONSE TO THE DEVALUATION OF THE POUND STERLING

On 18 September 1949, the United Kingdom announced the devaluation of the pound sterling by 30 per cent. The other sterling area countries soon followed suit by devaluing their own currencies. Facing a grave situation, SCAP responded positively towards expansion of sterling trade. In his discussions with Sir Alvary Gascoigne, Head of the UKLM on the eve of the devaluation, MacArthur made it clear that he had no intention of asking the sterling area for dollars.¹

The sterling devaluation meant depreciation of SCAP's sterling funds earned from sales of Japanese goods. A large part of the Japanese exports consisted of cotton textiles which were mostly made from American raw cotton purchased in dollars. If SCAP was to defend the value of its assets strictly, it should have claimed conversion of its sterling surplus before the 30 per cent devaluation, as it was entitled to according to the Overall Sterling Payments Agreement. In fact, SCAP had not concealed its intention to convert in early September. SCAP reported to Washington:

¹ Meeting of the Sterling Area Delegates, 23 September 1949, R40/1/90.

There is a definite understanding with the UK representatives that neither party to the Trade Arrangement will be a source of dollars to the other. However, devaluation of the currency of trade does create an emergency by reason of a threatened loss of purchasing power which we consider would warrant use of the emergency clause in the payments arrangement.²

The SCAP officials seem to have been really concerned about loss of assets which might be caused by the decision to retain SCAP's sterling surplus in the event of devaluation. In October after the devaluation, even Pickelle, Chief of the Foreign Trade and Commerce Division, who had shown the most positive attitude towards expansion of sterling trade, submitted to Cleveland, Head of the Fund Control Division and Controller of SCAP's foreign exchange funds, a proposal that the Overall Payments Agreement should be amended to include a guarantee from the UK Treasury that SCAP's sterling funds be duly compensated for loss resulting from a further devaluation of sterling. Cleveland's reply was mystifying, '[I]t may be possible to so change the OPA that the recommended guarantee becomes unnecessary'.³ In view of his past conservative approach to sterling trade, Cleveland might have had in mind withdrawal of the waiver of convertibility or even the introduction of dollar-based trade with the sterling area to forestall conversion in the event of any future devaluation. Pickelle's proposal and Cleveland's response illustrate the strong underlying force among the ESS officials advocating conversion as an emergency measure against the pound's devaluation.

In the light of this situation and Marquat's hesitation to give a clear assurance to Lingeman in July, as mentioned in the previous chapter, SCAP's non-conversion of its sterling funds seems to have been the outcome of MacArthur's own highly political decision. Why did MacArthur make such a decision? With regard to this question, there are so few SCAP documents that it is extremely difficult to ascertain the answer. The few SCAP documents referring to the pound's devaluation were all drafted after 17 September to justify the non-conversion of sterling and to negate the alleged ill-effects of the devaluation on Japanese export trade. The fact that there was little discussion of non-conversion before the devaluation further strengthens the assumption of an independent decision by MacArthur.

² Radiogram from SCAP to Washington, no.C-52238, 1 September 1949, SCAP, 6768(6), ESS(C)06103.

³ Cleveland to Pickelle, 'Sterling Valuation Guarantee', 24 October 1949, 6768(6), ESS(C)06101.

There are two factors which explain the decision not to convert. Firstly, SCAP had started to show interest in the procurement of an increasing volume of commodities, especially foodstuffs, from the sterling area. In the informal meeting with the sterling delegates in late August, Pickelle pressed his counterparts for drastic increases in the supply of foodstuffs. In reply to the British argument that foodstuffs would not be oversold as they could earn dollars elsewhere, Pickelle hit back, arguing that sterling trade had already been limited by non-availability of Indian cotton and unless foodstuffs were made available for Japan, the desire of the participants for trade expansion would be seriously questioned.⁴

The sterling delegates responded favourably to Pickelle's argument. They showed their readiness to supply \$30 million of foodstuffs in addition to the previous firm estimate of SCAP purchases to the order of \$155 million. The additional foodstuffs included supplies from the non-participants in the Sterling Trade Arrangement, namely \$18 million of Burmese rice and \$11.5 million of Iraqi barley, as well as \$1.5 million of Australian cereals. Since this meant the transfer of export opportunities of the participants to the non-participants, the offer revealed the participants' willingness to match SCAP's requirements. The participants further proposed exploration of the availability of an additional \$30 million of Australian barley and Indian sugar to double SCAP's total purchases from the sterling area during the financial year 1948/49.⁵

Based on this offer, SCAP estimated total 1949/50 imports at \$220.5 million and exports at \$180.9 million, as against the 1948/49 achievements in sterling trade imports valued at \$97.2 million and exports valued at \$162.5 million.⁶ While SCAP's estimated deficit in 1949/50 was to be offset by the outstanding deficit of the participants carried over from the previous year, obviously it would be necessary for SCAP to retain some sterling cash, in order to proceed with this increased procurement program. Furthermore, Japan's purchases from the sterling area tended to concentrate in the October–December and the January–March quarters. Past experience had shown that SCAP would run short of sterling funds in these quarters, even though the annual sterling trade balance culminated in SCAP's favour.

⁴ Pickelle to Marquat, 'Sterling Area Trade Discussions', 28 August 1949, SCAP 6768(6), ESS(C)06103.

⁵ Commonwealth Delegations to SCAP, 31 August 1949, *ibid.*

⁶ Radiogram from SCAP to Washington, no.C-52288, *op.cit.*

In fact, SCAP's sterling surplus of \$40 million as of 30 June and of still about \$35 million as of 31 August had rapidly decreased to approximately \$23 million by 17 September, due to accelerated purchases from the sterling area in anticipation of the devaluation. The net balance of \$23 million worth of sterling was not regarded as a situation where 'there appeared to be no reasonable possibilities of utilizing net balances for purchases', so that conversion into dollars was not justified.⁷

Secondly, with regard to the pound's devaluation, Japanese domestic circles were more concerned about the ill-effects on export sales than depreciation of the value of SCAP's sterling funds. Japanese industries, which already felt anxious about the official 360 yen to one dollar rate established in April, which they considered overvalued, were shocked at the pound's devaluation.⁸ MITI made a plea for the application of the old exchange rate to Japan's exports of uncompetitive heavy machinery to the sterling area countries which might cancel the contracts in preference for British products.⁹ Against the Japanese request for devaluation of the yen rate, however, SCAP ruled out any change.

A memorandum presented by the Program and Statistics Division of the ESS a couple of days after the devaluation of the pound recommended against devaluation of the Japanese yen.¹⁰ The memorandum stressed the merit of the pound's devaluation in the prospective decreases in import prices of sterling commodities such as wool and foodstuffs. The strengthened price competitiveness of the sterling area would contribute to greater availability of these commodities for Japan. On the other hand, the ill-effects on Japanese export sales could be minimised by elimination of the premium prices for Japanese cotton textiles in the sterling markets and possible abolition of Japan's export floor prices. These approaches were in line with the Dodge Plan for Japan's economic self-reliance. In fact, as discussed in Chapter 2, the abolition of the floor price system for exports in October, as recommended by the Freile Mission, was one of the policies introduced to overcome the effects of the pound's devaluation.¹¹

⁷ Draft memorandum for SCAP, 'Devaluation of the British Pound', 19 September 1949, SCAP, 6321(10), ESS(B)02364.

⁸ Shiraishi, 1983, pp.77-78.

⁹ A. Hirota, MITI, 'Application of Old Exchange Rate to Certain Heavy Machinery Export Contract', 21 January 1950, SCAP, 6516(24), ESS(A)03248.

¹⁰ Program and Statistics Division, ESS, 'Probable Effects of Sterling Devaluation and Japanese Trade and Some Tentative Recommendation', 22 September 1949, SCAP, 7691(16), ESS(E)83078.

¹¹ Nishikawa, 1990, pp.206-207.

The Program and Statistics Division recommended the introduction of rationalisation programs for Japan's uncompetitive heavy and chemical industries which were likely to be seriously affected. The Division asserted that the pound's devaluation would even improve Japan's balance of payments position as a drop in import prices would have larger effects than the decrease in export earnings, and Japan's import trade would be diverted from the dollar to the sterling areas. Thus, devaluation of the Japanese yen was rejected, in view of the ill-effects on Japan's dollar position, the imminent need for industrial rationalisation, and the inflationary pressure which would be caused by a yen devaluation. These recommendations were duly endorsed as SCAP's official policy.¹²

If SCAP was to pursue export promotion to the sterling area with the 360 yen rate fixed, conversion of sterling funds into dollars before the devaluation was out of the question. Once sterling funds were converted into dollars by SCAP, it would be definitely remembered as a precedent. Thereafter, the sterling area countries would not relax their tight import licensing against Japanese goods, in order to forestall any risk of a further dollar drain from Japanese trade, no matter how SCAP reiterated its commitment to waive dollar convertibility. The result would be a drastic curtailment of Japanese exports to the sterling area which occupied a considerable share in the total export sales.¹³ As observed by the Australian Mission in Tokyo, it was unlikely that the sterling area would maintain the existing rate of purchases from Japan without obtaining extra purchasing power through export promotion by the devaluation. If the sterling participants reduced their imports from Japan, it would culminate in curtailment of Japan's purchasing power for sterling foodstuffs and raw materials 'without which Japan cannot subsist'.¹⁴ Such a situation would have meant a return to the situation in 1947 when Japan had enormous difficulty in financing imports of Australian wool, as shown in Chapter 3. The resultant shortage of raw materials would have caused serious disruption of Japanese industrial activities. It would have been too costly for Japan to risk the overall level of its sterling trade in an attempt to save the 30 per cent depreciation of sterling funds held by SCAP in the event of the pound's devaluation.

¹² S.T.F., 'Devaluation of Yen', 23 September 1949, SCAP, 7691(16), ESS(E)83078.

¹³ For example, cotton textile sales to the sterling area jumped up to 75.5 per cent of the total cotton textile exports in the first half of 1949 from 41.4 per cent in 1948. Nihon Boseki Kyokai, 1962, p.45.

¹⁴ Cable from AM to Canberra, no.353, 'Devaluation of Sterling', 20 September 1949, AA, CP553/1, 194/B/10/60.

The Japanese government seems to have been aware of the need to trade with the sterling area. In a memorandum of July to the ESS, MITI, which had been established in May, supported the idea of promoting sterling trade:

In order to increase Japanese imports from the Sterling Area with object of stimulating her sales to this Area in turn, it is considered necessary to purchase from the Sterling Area, commodities which may be dearer than those of non-Sterling Area. This apparent disadvantage must sometimes be borne by Japan *for the sake of the long-range policy of maximising her trade with the Sterling Area (my emphasis)*.¹⁵

This was a position similar to that of the Foreign Trade and Commerce Division. In order to advocate promotion of sterling trade even at the cost of short-term financial benefits, it would be in Japan's interest to withhold conversion of sterling, for the pound's devaluation would bring to Japan dual benefits of maintaining export sales and lowering import prices.

Thus, the devaluation of the pound in September 1949 provided SCAP and the Japanese with the opportunity to reconfirm their commitment to the Dodge Line under which they had to seek Japan's economic self-reliance without dependence on government subsidies nor US appropriated funds. For this purpose, it was considered necessary to develop commercial networks on a more multilateral basis, so that Japan could trade any partners who were prepared to buy Japanese industrial goods some items of which were yet to strengthen their price competitiveness and prepared to supply Japan with raw materials and foodstuffs to substitute US commodities. SCAP duly revealed a positive attitude in the subsequent sterling trade negotiations.

SCAP'S INFLATED 1949/50 STERLING PROCUREMENT PROGRAM

SCAP's non-conversion of its sterling funds was a significant breakthrough in the 1949/50 sterling trade negotiations which had been suspended pending SCAP's response to the

¹⁵ MITI, 'Concerning Trade with Sterling Area', 26 July 1949, SCAP, 6768(5), ESS(C)06099. Amakawa argues that the naming of the Ministry reflected the idea of the Prime Minister Shigeru Yoshida who advocated promotion of foreign trade. The original naming of the Ministry of Industry and Trade which had been proposed by the then Ministry of Commerce and Industry was amended through the initiative of Yoshida who also held the portfolio of the Minister for Foreign Affairs. Many officials from the Ministry of Foreign Affairs joined the MITI to take up the positions responsible for promotion of overseas trade. Akira Amakawa, 'Tsusho Sangyosho no Secchi' [The establishment of the MITI], Tsusho Sangyo Seisakushi Hensan Iinkai, 1990a, chapter 6, section 3.

pound's devaluation. Soon after the devaluation, SCAP revealed its preparedness to retain £10 million of sterling funds as inconvertible working capital which it would reserve against a short-term sterling shortage.¹⁶ Even when London later requested SCAP to amend the assurances of non-conversion of working capital into a more unequivocal wording than that initially offered by Cleveland — which the sterling delegates in Tokyo thought was as far as SCAP could go¹⁷ — the Controller accepted London's position.¹⁸ It seemed certain that SCAP firmly recognised the need to hold inconvertible sterling funds to ensure the smooth operation of trade between the two parties.

Furthermore, SCAP shifted to a more positive approach concerning Japan's purchases from the sterling area. On the same day as the devaluation of the pound sterling from \$4.03 to \$2.8, SCAP estimated the total purchases under the 1949/50 Sterling Trade Arrangement in the order of \$140 million at a new rate, that is, £50 million. This figure was equivalent to about \$200 million at the old rate which was higher than the previous offer by \$40 million. This would give the sterling participants a reasonable amount of new purchasing power even after deducting the outstanding trade deficits. In fact, this time the Tokyo delegates felt confident about the prospect of the negotiations. Informing London of the new figure, they wrote, '[O]ur general impression was that SCAP may at last have accepted the need to reorientate the Japanese economy towards the Sterling Area though effects of this may be slow in appearing'.¹⁹ SCAP further surprised the sterling delegates when Pickelle made a proposal to express the figures in the proposed 1949/50 Trade Plan in sterling instead of dollars. The participants had already been considering the idea but were hesitant to raise the issue with SCAP lest they should be misunderstood as being prompted by their fear of an increased burden due to the outstanding deficit to be caused by the devaluation.²⁰ In addition to the obvious benefit of technical convenience, this move reflected SCAP's increasing commitment to purchases from the sterling area. In fact, SCAP later agreed to expand the size of the overall balanced trade from £50 to £55 million.²¹ Thus by mid

¹⁶ Meeting of the Sterling Area Delegates, 23 September 1949, AA, A606, R40/1/90.

¹⁷ Meeting of the Sterling Area Delegates, 10 October 1949, *ibid.*

¹⁸ Meeting of the Sterling Area Delegates, 17 October 1949, *ibid.*

¹⁹ Cable from UKLM to FO, no.DRIVE 1089, 23 September 1949, *ibid.*

²⁰ Meeting of the Sterling Area Delegates, 22 September 1949, *ibid.*

²¹ Sterling Trade Arrangement Conference, 'Committee of the Whole: Report of Scheduled Meeting', 7 October 1949, *ibid.*

October, agreements had been reached between the two parties on the main points of the 1949/50 Trade Arrangements and the Trade Plan.

SCAP's inflated purchasing program boosted Australia's trade prospects. By mid October, it had become clear that SCAP was prepared to purchase during 1949/50 a total of 150,000 bales of wool, an amount in excess of the previous estimates by 50,000 bales. According to confidential information Menzies received, the figure could reach 200,000 bales, while rumours in Tokyo predicted purchases as high as 250,000 bales.²² Although these were merely the estimates, the increased wool purchasing program reflects SCAP's now positive approach in calculating Japan's requirements from the sterling area.²³ This is particularly noteworthy in view of the fact that SCAP had once taken the position that wool requirements should be estimated on the basis of reciprocal export prospects for Japanese woollen textiles which had been least demanded in the sterling markets.

Some SCAP officials even suspected that the total estimate of £55 million was beyond Japan's realistic industrial requirements. In his memorandum to Pickelle, W.J. Krossner, Chief of the Trade Arrangement Branch of the Foreign Trade and Commerce Division, pointed out that:

The present estimate ... which has been allocated to specific commodities has been arrived at by stretching *every imaginable point in favor of the Sterling Area Countries*. In at least 19 items the entire procurement has been thrown into the £ Area. This was done deliberately to build up £ trade (*emphasis in the original document*).²⁴

Taking into account such factors as the less competitive prices of the sterling area commodities, the delay in implementing the purchasing programs and the emerging tendency of Japanese consumers to cut back the planned imports both on the overall level

²² Cable from AM to Canberra, no.390, 'Negotiations 16', 12 October 1949, *ibid.* It was expected that Australia would occupy 70 per cent of these total Japanese wool import programs.

²³ Although these commodity figures were continually presented at the talks between SCAP officials and the sterling delegate, the 1949/50 Trade Plan did not include estimated purchases of any specific commodities, as undertaken in the 1948/49 Trade Plan. In order to avoid detailed and protracted discussions on the figures of each traded item, the 1949/50 Trade Plan simply set out the total SCAP purchases from the participants and the non-participants, the allocation of purchasing power among the participants and the non-participants, and the estimated invisible balances.

²⁴ W.J. Krossner, Chief, Trade Arrangement Branch, Foreign Trade and Commerce Division to Pickelle, 'Fifty-five million £ estimate of Japanese purchases from the Sterling Trade Arrangement Participant Countries during FY 50', 28 September 1949, SCAP, 6734(18), ESS(A)05401.

and from the sterling area, Krossner warned that it would be difficult to attain the envisaged figure unless positive steps were taken to increase purchases from the sterling area. Pointing to an amount of inconvertible working capital as large as £10 million, a Japanese official of the Ministry of Foreign Affairs described it as 'virtually dead stocks lest export industries should be damaged'.²⁵ These observations suggest that SCAP's sudden rise in interest in promoting Japan's sterling was the outcome of a deliberate attempt to divert Japan's trade into sterling channels.

DECREASING US AID AND THE SEARCH FOR A RICE SUPPLY FROM SOUTHEAST ASIA

SCAP's increasing interest in the expansion of Japan's sterling trade from September 1949 onwards was based on the necessity to secure a supply of foodstuffs through normal commercial channels rather than US aid. A large part of US aid for Japan under the occupation consisted of funds appropriated for the Government Appropriation for Relief in Occupied Area (GARIOA), which were used to purchase foodstuffs, fertiliser, fuel and medical goods in order to prevent 'disease and unrest' in the occupied areas. In mid 1948, due to the active campaign by the Department of the Army, US Congress had accepted an increase in the GARIOA funds for Japan in the financial year 1948/49. Table 5.1 shows that throughout the occupation period Japan received the largest amount of US aid during 1948/49.

At the same time, SCAP was informed by Tracy Voorhees, Assistant Secretary of the Army, of the possibility of a drastic reduction in funds for 1949/50. Voorhees saw that the Congress had become more receptive to the appropriation of funds for the purpose of industrial recovery than relief aid.²⁶ The GARIOA aid for Japan in 1948/49 duly included funds for the Economic Rehabilitation in Occupied Area (EROA) to be used for the procurement of industrial raw materials such as raw cotton, machinery and other capital goods. The prospect of reduced aid and the increased allocation of the EROA funds meant that fewer funds would be available for food procurement in 1949/50. In order to cope

²⁵ Bunroku Yoshino, 'Shin-Nichi-Ei Tsusho Kyotei heno Kitai' [Prospects of the new Anglo-Japanese Trade Arrangement], *Jitsugyo no Nippon*, vol.52, no.24, 15 December 1949, p.16.

²⁶ Radiogram from Tracy S. Voorhees, Assistant Secretary of the Army, to MacArthur, no. WAR-85578, 12 July 1948; Voorhees to MacArthur, 19 July 1948, SCAP, 6709(20), ESS(C)05429.

with the decreasing appropriation for foodstuffs, it was recommended that \$57 million worth of foodstuffs should be purchased through SCAP's own funds based on Japanese export earnings, while SCAP had a 'year's respite' as it could count on an abundant supply of dollar aid during 1948/49.²⁷ This is another reason for SCAP's inactive attitude to the 1948/49 sterling trade negotiations, as discussed in the previous chapter.

Table 5.1 US Budget of the Appropriated Funds for Japan

Financial Year	GARIOA	EROA	Administration Expenses	(unit: \$ million)
				Total
1945/46	93	—	—	93
1946/47	287	—	13	300
1947/48	351	—	20	371
1948/49	426	97	26	549
1949/50	237	188	19	444
1950/51	183	— ^a	15	198
Total	1,577	285	93	1,955

a In 1950/51, the EROA funds was not specifically classified, but integrated with the GARIOA funds.

Source: Tsushosangyosho Tsushokyoku Tsusho Chosaka, 1956, p.98.

Although SCAP was prepared for the GARIOA cut, it found that Washington was determined to make a far more drastic reduction. SCAP revised its original GARIOA request for 1949/50 of the total \$754 million including \$155 million for EROA as of July 1948 into a total of \$558 million including \$165 million for EROA in May 1949. Washington pressed for a further \$63 million cut and later an additional \$75 million to reduce the total amount to \$420 million. These reports stunned SCAP officials so much that MacArthur himself made a protest to Voorhees in Washington. MacArthur stressed that the proposed reduction of US appropriated funds would hamper the achievement of economic stabilisation programs under the Dodge Plan, would result in delaying Japan's economic self-reliance and would put the 'Japanese nation on a dole for an indefinite

²⁷ H.F. Smith, Food Branch, Price Control and Rationing Division, ESS, to Marquat, 'Temporary Duty in Washington re FY 1950 GARIOA Budget and Related Matters', 4 August 1948, *ibid.*

period'. MacArthur revealed his pessimism about securing the required amount of foodstuffs through import trade, since he could expect only \$50 million in export earnings against the \$75 million requirements. Dearer prices in the sterling area would result in lesser quantities through purchases there than if the equivalent sum of funds were to be spent in the American food markets.²⁸

Facing Washington's determination, it became imperative for SCAP to search seriously for alternative sources of food supply on a commercial basis through Japan's export earnings. As MacArthur admitted in his protest to Voorhees, the level of Japanese export earnings was dependent on the availability of the EROA funds for purchases of American raw cotton, which no other non-dollar suppliers could offer. Since the share of the EROA funds was raised in the total US aid, as shown in Table 5.1, SCAP was relieved from the necessity of concentrating cotton textile exports on the dollar area. This enabled Japan to direct its textile exports more into non-dollar markets than to the tough US market. Textile export earnings would give SCAP purchasing power for foodstuffs from non-dollar sources to make up for the decreasing relief aid. This explains SCAP's request for an increased supply of foodstuffs from the sterling participants in an attempt to consume SCAP's sterling surplus just before the pound's devaluation, mentioned before. In early August 1949, Pickelle observed:

The only hope of an extension of trade with the Sterling Area is through increased purchases of foodstuffs and to some extent crude oil. GARIOA-cordination ... will permit SCAP to buy such items for trade goods and divert the dollars saved to other 'appropriated funds' projects for materials which are available from the USA only, such as raw cotton.²⁹

If SCAP was to procure foodstuffs from non-dollar areas, it might as well look to East and Southeast Asian countries for rice, the staple food for the Japanese people. In fact, the Foreign Trade and Commerce Division saw the possibility of a cutback in wheat imports, if substantial quantities of rice were available from Thailand and Burma.³⁰ As discussed in Chapter 2, Voorhees was a strong advocate of the idea of linking Southeast

²⁸ Radiogram from MacArthur to Voorhees, no.Z-11385, 25 May 1949, *ibid*.

²⁹ Pickelle to Marquat, 'Summary of Sterling Area-Occupied Japan Trade Discussions 2-3 August', 3 August 1949, SCAP, 6768(6), ESS(C)06104.

³⁰ Pickelle to Deputy Chief, ESS, 'International Wheat Agreement', 15 November 1949, SCAP, 6705(1), ESS(A)05018.

Asian foodstuffs and raw materials with the Japanese industrial capacity to supply capital goods for regional economic development, in order to make up for Japan's loss of its traditional trade partner, China, and decreasing US appropriated funds. Accordingly, in January 1950, Voorhees sent the Andrews and West Mission to Southeast Asian countries to explore food availabilities for Japan. The significance of Southeast Asian rice supply capacity had already been perceived by SCAP and Washington earlier. In 1948, Thailand asked the International Emergency Food Committee (IEFC), which had controlled world food allocation until 1949, to give approval to its rice supply to Japan in exchange for Japanese railway equipment.³¹ In support of the SCAP proposal of May 1949 to conclude trade arrangements centred on rice import with Thailand and Burma, the Department of the Army asserted:

Since rice is the only major food available for exchange in this vital trading area and this is first opportunity to exploit such trade, Dept of Army considers it imperative these trade agreements be fully implemented. View here is that trade with SE Asia should be expanded to maximum even though short range approach might indicate acceptance of rice in exchange for Jap exports not desirable.³²

The British Commonwealth countries made several attempts to block SCAP's active procurement of rice in Southeast Asia. The United Kingdom and India raised a strong objection in the IEFC conference to reject the proposed barter supply of Thai rice in exchange for Japanese railway equipment in 1948.³³ When SCAP began to enter into a series of rice import contracts with Thailand and Burma from late 1949 to early 1950, the sterling participants were so alarmed that London sent a special mission to dissuade SCAP from any further rice procurement in Southeast Asia:

One pernicious feature of SCAP's dip into the S.E. Asian rice bowl, Mr. Lingeman [Economic Adviser to the UKLM] pointed out, was his [SCAP's] over-readiness to pay the monstrous price which Burma in particular had been standing out for, thus recently forcing the Governments of India and Ceylon to pay this price much against their will.³⁴

³¹ Smith, 4 August 1948, *op.cit.*

³² Radiogram from DA to SCAP, no. W-89200, 27 May 1949, SCAP, 6442(26), ESS(B)03588.

³³ Smith, 4 August 1948, *op.cit.*

³⁴ Sterling Area Working Party, 'Minutes of the Fifty Fourth Meeting', 14 April 1950, AA, A606, R40/1/88.

SCAP dismissed the British allegation that its overpurchases in Southeast Asia were raising rice prices on the grounds that the occupation objectives made it imperative for SCAP to maximise food procurement through normal commercial channels. SCAP criticised the British estimates of rice availability in Asia as unduly low and argued that increased rice production through supply of Japanese machinery and equipment in exchange would work to stabilise rice prices.³⁵

Although SCAP was undaunted by the British protest, the sterling participants successfully resisted SCAP's ambition to increase rice purchases from Southeast Asia in the 1950/51 Sterling Trade Arrangement which imposed restraints on transferability of SCAP's sterling funds, as will be explained in the next chapter. It restrained SCAP from diverting sterling funds earned from the participants into purchases of a large volume of foodstuffs such as Burmese rice from non-participants. Furthermore, despite the efforts to secure procurement through trade arrangements, rice producing countries in Southeast Asia had not increased their production levels yet. It was inevitable for the Japanese to look to wheat imports to cover their shortage of foodstuffs.³⁶

THE PROBLEM OVER JAPAN'S ACCESSION TO THE INTERNATIONAL WHEAT AGREEMENT

Another move to secure food procurement was Japan's accession to the International Wheat Agreement (IWA) which was established in July 1949. In August ESS's Price Control and Rationing Division inquired about the intention of the Japanese government to join the Agreement. Washington ruled that the accession was a matter which should be decided by the Japanese government. Since IWA consumer members could enjoy a supply of wheat from producer members at cheaper prices than normal market prices, membership was considered advantageous from the viewpoint of dollar saving. The Japanese government duly asked SCAP to initiate arrangements for Japan's accession in September.³⁷

³⁵ Radiogram from SCAP to DA, no.C-55800, 10 April 1950, SCAP, 6678(35), ESS(C)05064.

³⁶ Gaimusho Seimukyoku Keizaika [Economic Affairs Division, Political Affairs Bureau, MFA], 'Kokusai Komugi Kyotei Kanyu narabini Hosho Suryo ni kansuru ken [Accession to the International Wheat Agreement and the import guarantee quantities], 21 November 1949, DAO, B'6.4.0.7.

³⁷ For the negotiations over Japan's accession to the IWA, see Hagiwara, 1972, pp.303-312.

The Japanese Ministry of Foreign Affairs observed that the US Department of the Army, especially Voorhees, was behind the proposal for IWA membership, with the aim of overcoming the decreasing GARIOA funds.³⁸ In fact, Voorhees estimated that the IWA would bring benefits by securing \$16 million by facilitating Japan's food procurement from non-American sources.³⁹ Here Australia's presence had a significant meaning. Since a recipient of US aid had been obligated to pay full market prices for American foodstuffs purchased from the appropriated funds, Japan would not be able to enjoy IWA discounted prices as long as the GARIOA funds were used for purchases of American wheat. If Australia could make a sufficient volume of wheat available to Japan for payment in sterling at IWA prices, it would be of great benefit in terms of increased food supply with considerable dollar saving.⁴⁰

In October, both Japan and West Germany officially applied to enter the IWA. An official of the MFA represented the Japanese government, accompanied by the Chief of the Prices and Rationing Division of the ESS, because SCAP ruled that this was an issue over Japan's official membership in the international organisation, and that the Japanese government should be duly involved in the negotiations.⁴¹ Japan guaranteed to import 1.2 million tons of wheat annually; West Germany requested 1.8 million tons. When the negotiations were resumed in January 1950, the United Kingdom objected to the applications by Japan and West Germany on the grounds that membership by these two big consumer nations in the IWA would reduce the UK's voice as one of the principal consumers within the organisation, and the British government was concerned that Australia might use Japan's accession as a 'lever' to raise the prices of sterling wheat for Britain.

Instead, the UK proposed a condition for Japanese accession: the quantities of Japanese purchases of Australian wheat under the IWA terms should not exceed the margin of increase in Australia's total supplies for all IWA consumer countries as a result of Japan's membership. In other words, Britain tried to preclude Japan from deliberately

³⁸ Gaimusho Seimukyoku Keizaika, 'Nihon no Kokusai Komugi Kyotei Sanka ni kansuru ken', [Japan's participation in the International Wheat Agreement], 24 August 1949, DAO, B'6.4.0.7.

³⁹ Radiogram from Voorhees to MacArthur, no.W-96103, 3 November 1949, SCAP, 5979(2), ESS(C)00107.

⁴⁰ Pickelle to Deputy Chief, ESS, 'International Wheat Agreement', 15 November 1949, *op.cit.*

⁴¹ Hagiwara, 1972, p.303. There had already been the precedents of membership in international organisations by the Japanese government under the occupation such as participation in the Universal Postal Union in September 1948.

increasing the volume of purchases of Australian wheat at IWA discounted prices beyond an internationally prescribed amount. While Australia was determined to vote against 'anything but unconditional accession' and the United States also supported Australia, the UK successfully vetoed Japan's unconditional accession to the IWA.⁴²

The Japanese government was not prepared to participate in the IWA on these conditions. Such entry would not bring as many benefits to Japan as unconditional accession. According to estimates by the Price and Distribution Division, Japan could save only \$1.1 million under conditional membership, which would allow Japan to purchase only 100,000 tons of Australian wheat. On the other hand, unconditional membership would give Japan 400,000 tons of Australian wheat at discounted prices to save a total of \$3.2 million.⁴³ SCAP officials understood well that IWA entry without the benefits of Australian wheat would not give much advantage to Japan. In discussions with Japanese officials to calculate the level of Japan's guaranteed purchases under the IWA, Pickelle commented that the Japanese proposal for 1.2 million tons was too large because Britain was likely to reduce allocation of Australian wheat to Japan and then Japan would be obligated to increase the share of dollar purchases of American and Canadian wheat to consume all the amount of 1.2 million ton import guarantee.⁴⁴

In the event, Japan rejected conditional IWA membership. Since the large volume of guaranteed purchases proposed by Japan was such a threat to other IWA consumers, it was not until June 1951 that Japan was finally admitted to the IWA with drastically reduced quantities of guaranteed imports.⁴⁵ The breakdown of the IWA option turned SCAP's attention more closely to procurement of Australian wheat on a normal commercial basis through the Sterling Trade Arrangement. Pickelle was optimistic about this prospect:

Further supplies of Australian wheat could be purchased by Japan outside of the IWA agreement. The prices would probably be somewhat higher [than IWA discounted prices], but still, from an overall consideration economic to Japan

⁴² Floyd L. Whittington, Chief, Price and Distribution Division, ESS, to Marquat, 'Present Status of Japan's Application to the International Wheat Agreement', 28 January 1950, SCAP, 5979(2), ESS(C)00108. In late 1949, the Price Control and Rationing Division was renamed the Price and Distribution Division.

⁴³ Whittington to Marquat, 'Current Status of Japan's Application to the International Wheat Agreement', 27 May 1950, SCAP, 6705(1), ESS(A)05018.

⁴⁴ Gaimusho Seimukyoku Keizaika, 'Kokusai Komugi Kyotei ni Tomonau Hosho Suryo ni kansuru ken' [The guaranteed quantities in the International Wheat Agreement], 10 November 1949, DAO, B'6.4.0.7.

⁴⁵ Hagiwara, 1972, p.311.

since it would save dollars and reflect additional purchasing power by the sterling area.⁴⁶

Washington echoed SCAP's opposition to Japan's conditional accession to the IWA, '[S]ince Australia is natural market [of wheat] for Japan it would seem that Japan has less to gain than Ger[many] by accession subject to above condition ... [I]t should be noted that this condition would not prevent Japanese procurement of Australian wheat outside IWA'.⁴⁷

The negotiations for Japan's accession to the IWA reflected two important trends emerging from the latter half of 1949 to early 1950. Firstly, SCAP/Washington became firmly committed to increased food procurement for Japan from non-dollar sources among which Australia had the largest supply capacity. Secondly, there emerged a rift between Australia and the UK over the reestablishment of trade relations with Japan. While Australia, as the main supplier in the sterling area, welcomed the increasing commercial opportunities afforded by Japan's return to the international trading activities, Britain was alarmed at its decreasing share of the intake of foodstuffs which was caused by Japan's increasing procurement from the sterling area.

TOWARDS ACTIVE FOOD PROCUREMENT THROUGH TRADE ARRANGEMENTS

Without access to cheaper wheat from the IWA, it was only through normal commercial channels that SCAP could hope to secure increased food procurement from non-dollar sources. With a worldwide dollar shortage, expansion of trade could not be expected without dispelling each party's fear of dollar liabilities by concluding bilateral trade arrangements to achieve balanced trade at the highest level. Table 5.2 shows the list of payments and trade arrangements concluded by SCAP. The list clearly indicates SCAP's rising interest in trade arrangements from mid 1949 to early 1950 in line with the recommendations under the Logan plan, discussed in Chapter 2.

⁴⁶ Pickelle to Russel Hale, Deputy Chief, Foreign Trade and Commerce Division, 'Attached IWA Radio Dated 17 January 1950', 18 January 1950, SCAP, 6705(1), ESS(A)05018.

⁴⁷ Radiogram from the US Department of State to SCAP, no.161314-Z, 17 January 1950, SCAP, 5979(2), ESS(C)00108.

Table 5.2 Japan's Trade and Payments Arrangements Concluded by SCAP, 1948-50

	Date of Effectuation	Country	Payments Methods
1948	May 11	French Union	\$ O/A (TA from 9 Jun 49)
	May 31	Sterling Area	£ cash
	Nov 2	Sweden	\$ cash (\$ O/A from 1 Apr 50)
	Dec 4	Thailand	\$ O/A
	Dec 30	Netherlands and Indonesia	\$ O/A
1949	Apr 21	Mexico	\$ cash
	Apr 23	Korea	\$ cash (\$ O/A from 2 Jun 50)
	May 6	Chile	\$ cash
	May 19	Uruguay	\$ cash
	Jun 2	Brazil	\$ O/A
	Jun 8	Argentina	\$ O/A
	Jun 15	Peru	\$ cash
	Jun 21	Colombia	\$ cash
	Jun 21	Finland	\$ cash
	Jun 27	Venezuela	\$ cash
	Jul 9	Belgium	\$ cash
		Monetary Area	
		Oct 4	West Germany
	Dec 18	Ryukyu	\$ cash
	Dec 31	Pakistan	£ cash
1950	Mar 16	Burma	£ cash (TA from 30 Jun 51)
	May 18	Phillipines	\$ O/A
	Jun 30	Indonesia	\$ O/A
	Sep 6	Taiwan	\$ O/A
	Oct 9	Spain	\$ O/A

O/A: Open Accounts TA: Trade Arrangement

Source: Inuta, 1976, pp.410-423.

If SCAP was too cautious about its foreign exchange position when approving import contracts from the countries in trade arrangements, as had been the case in sterling trade during 1948/49, its counterparts would run short of funds to maintain their purchases of essential goods from Japan. This would have in turn culminated in a shortage of SCAP funds to finance the extensive purchasing programs, as the counterparts would tighten their import restrictions against Japanese goods. Hence, as early as May 1949, the Foreign

Trade and Commerce Division proposed allowing imports of less essential commodities, in order to promote trade with the countries in trade arrangements in preparation for the decreasing GARIOA funds:

In planning for [financial year] 1951, it must be recognised for the most part private trade will be used in both importing and exporting, therefore a [dollar] fund now should be set aside for category II [such as raw cotton] imports so that *trade may be left open for the barter of commodities ... even though they may not be urgently required.* This is especially necessary for such areas...as the Sterling Area, Korea, Burma and other Far Eastern Areas. The import program should be elastic enough to allow for the maximization of trade with all areas, especially those other than hard currency areas(*my emphasis*).⁴⁸

The position of the Foreign Trade and Commerce Division was in line with the idea of an 'import first method' recommended by the Logan plan which was to be adopted by SCAP from October.

If SCAP was to permit imports of less essential commodities to expand the overall level of Japan's trade, it would also be logical to allocate more raw materials to production for Japanese domestic consumption. In September, SCAP planned to increase imports of crude rubber from the sterling area and Indonesia during 1950/51 up to 45,000 tons with 40,000 tons for domestic use. This contrasts with SCAP's claim for increased woollen textile exports in return for Japan's imports of Australian wool, as revealed in the 1948/49 sterling trade negotiations. Domestic consumption was justified on the grounds that increased procurement would raise the level of trade with non-dollar areas and the increased utilisation of the Japanese industrial capacity would result in lower production costs and strengthened export competitiveness through economies of scale.⁴⁹

From this perspective, conversion of SCAP's sterling surplus into dollars in the event of the pound's devaluation in September 1949 was unacceptable to SCAP, since it would jeopardise Japanese export promotion to the sterling area countries. Furthermore, the devaluation reduced the prices of raw materials and foodstuffs from the sterling area from which Japan could purchase without dollar expenditure, making up for decreasing GARIOA funds. In fact, SCAP's purchasing activity in the second half of 1949 was such that the

⁴⁸ Foreign Trade and Commerce Division to Price Control and Rationing Division, 'Transmittal Draft of Certain Projects of GARIOA and EROA Budget, FY1951', 9 May 1949, SCAP, 6709(29), ESS(C)05436.

⁴⁹ Radiogram from SCAP to DA, no.C-52659, 22 September 1949, *ibid.*

availability of commodities from the sterling and other non-dollar sources rose remarkably in 1949, as shown in Table 5.3. Since in 1949/50 more than \$400 million EROA funds could be utilised intensively for purchases of strategic industrial raw materials, SCAP could afford to procure more foodstuffs and raw materials for manufactured goods for domestic consumption from non-dollar sources. This provided the opportunity to raise Japanese living standards through improved daily nutrition and increased supply of clothing during 1950.⁵⁰

Table 5.3 Japan's Exports and Imports by Trading Area, 1946–49

(Unit: \$ '000)				
Exports from Japan				
Year	SEP'45–DEC'46	1947	1948	1949
\$ Area	82,203	48,816	86,983	168,029
£ Area	2,325	56,223	61,653	227,745
O/A Area ^a	18,764	68,529	109,635	113,926
Total	103,292	173,568	285,271	509,700
Imports to Japan				
Year	SEP'45–DEC'46	1947	1948	1949
\$ Area	302,747	490,618	562,782	680,336
£ Area	345	24,747	73,493	139,610
O/A Area	2,519	10,765	47,945	84,899
Total	305,611	526,130	684,220	904,845

a O/A Area includes the transactions with the countries covered by the open account payments arrangements.

Source: Nihon Ginko Tokeikyoku [Statistics Department, Bank of Japan], Hompo Keizai Tokei [Economic Statistics of Japan], 1952, p.270.

Washington found it 'absolutely essential' to continue to cut the appropriated funds for Japan, so that it was imperative for SCAP to further divert Japanese trade away from the dollar area into non-dollar areas.⁵¹ Indeed in October 1949, Washington informed

⁵⁰ ESS, 'Narrative Statement to Accompany the FY 1951 Budget Request', Undated (October–November 1948?), *ibid.*

⁵¹ Matthew J. Rose, Deputy Chief, Programs and Statistics Division, 'Conference Report: 1950–51 Budget

SCAP of its policy to reduce the \$420 million 1949/50 US aid to about \$350 million in 1950/51, in the light of the expansion of procurement from non-dollar sources.⁵² At the end of 1949, Washington made its intention clear to further cut the \$350 million to as little as \$140 million, which Voorhees thought 'disastrous'.⁵³

In order to cope with drastically reduced GARIOA funds, the Department of the Army and SCAP agreed that it might be necessary, first to enable 50 per cent of the shipment of the GARIOA relief goods to Japan to be made by non-American vessels, second to disregard the necessity to consume US surplus grains, and third:

to utilize appropriated funds to a much larger extent for cotton which, for the most part, cannot be obtained elsewhere while leaving the Japanese free to buy in Australia, Canada or wherever they can find a market for the purchases of grains at a much lower price.⁵⁴

The proposed cut in the US appropriated funds was so drastic that SCAP was forced to give preference to non-dollar trade even at the cost of American commercial interests.

The rapid diversion of Japanese trade to non-dollar commercial channels was so successful that in early 1950 the Foreign Trade and Commerce Division could present an estimate of \$130 million or more for food procurement from non-dollar suppliers before the end of 1949/50 against the 1948/49 achievement of \$7.4 million.⁵⁵ Washington also showed a 'favorable response' to SCAP's 'energetic' food procurement, since it would help to lessen the burden of American taxpayers who had sponsored Japanese economic recovery.⁵⁶ Apart from the need for Japan's economic self-reliance, there seems to have been another aim behind this inflated estimate for non-dollar food procurement by the Division. Its Chief, Pickelle, who was in Singapore accompanying the Andrews/West Mission for Southeast Asian Food Trade in February 1950, instructed his colleagues in

Conferences—19–26 October and 2 November 1949, Washington D.C.', undated, *ibid.*

⁵² K.D. Morrow, Chief, Programs and Statistics Division, to Marquat, 'Review of US FY 50–51 import Program (Civilian Supply Projects)', 19 October 1949, *ibid.*

⁵³ Teleconference between SCAP and DA, 'FY 51 Budget Estimates', no.TT2895, 13 December 1949, *ibid.*

⁵⁴ Teleconference between SCAP and DA, 'Fiscal Year 1950–51 Budget', no.TT-2899, 15 December 1949, *ibid.*

⁵⁵ Pickelle to Marquat, 'Food Procurement', 11 January 1950, SCAP, 6678(35), ESS(C)05065.

⁵⁶ Pickelle to Marquat, 'Staff Service Message from (SCAP's) Fine and Garvin (in Washington) Dated 10 March 1950', 11 March 1950, SCAP, 6678(35), ESS(C)05064.

Tokyo to prepare a report on SCAP's achievement of increased food procurement during 1949/50, in order to convince Andrews and West that SCAP had 'exhausted every possibility to obtain food'.⁵⁷ This was aimed at demonstrating SCAP's past effort for food procurement, in order to convey the message to Washington that there was little room for additional non-dollar food procurement on a commercial basis and therefore SCAP could not bear any further cuts in the GARIOA funds.

Thus, the prospect of decreasing GARIOA funds brought accord between SCAP and Washington about the necessity to cultivate Japan's normal commercial networks with non-dollar area countries, centred on active food procurement. Because of the Sterling Trade Arrangement, the sterling participants had a larger capacity to absorb Japanese industrial goods providing Japan more purchasing power for foodstuffs and raw materials than other non-dollar countries which had concluded bilateral trade arrangements with SCAP. There was every reason for SCAP to look to Australia for increased supplies of grain in implementing its new trade strategy for Japan.

THE PROBLEM OF SCAP'S STERLING SHORTAGE

SCAP's new and active purchasing policy from the sterling area encouraged SCAP officials and the sterling delegates to reach an agreement on the basic points during the sterling trade negotiations of October 1949. The 1949/50 Sterling Trade Arrangement was finally concluded on 9 November. The delay in conclusion was caused by the discord between Australia and Britain over increased allocation of purchasing power for Australia which had been given only a limited share of purchases of essential Japanese goods among the participants due to the overbuying by India and the British colonies. It had an urgent need to procure steel from Japan.⁵⁸ Despite the divergence in approach to Japanese trade, the United Kingdom appreciated Australia's strategic role in the Sterling Trade Arrangement:

The underlying conception of the trade agreement with S.C.A.P. is that some sterling countries should sell more to Japan than they buy and allow the excess purchasing power to be used by other territories ... During the first trade agreement with S.C.A.P., Australia played a notable role in augmenting the total purchasing power available. We would hope that we could count on continuing

⁵⁷ Pickelle to Marquat, 3 February 1950, SCAP, 6678(35), ESS(C)05065.

⁵⁸ For the widening rift between Australia and the United Kingdom over the allocation of purchasing power for Japanese goods, see Rix, 1986, pp.101-102.