

Australian help in this regard; In this way Australia contributes to saving of dollars by the Sterling Area...⁵⁹

In fact, SCAP's purchases from the sterling area, centred on Australia, had increased so remarkably that the participants recognised that their previous trade deficit with Japan might be ameliorated.⁶⁰

Once SCAP tried to maximise procurement from the sterling area, it soon fell short of sterling funds to finance its purchasing program in late 1949. Japan's procurement from the sterling area tended to be heavily concentrated on the December quarter of each year, when the major import commodities such as wool, grains and cotton became available.⁶¹ Although SCAP held approximately £12 million sterling cash in mid November, this amount was far from adequate to finance heavy seasonal purchases. Furthermore, SCAP's sterling funds were dwindling so rapidly that by January 1950 it had become extremely difficult for SCAP to purchase the planned volumes from the sterling area. The situation which had existed the year before was totally reversed. It was now SCAP, which had been repeatedly criticised for its sluggish buying activities, urging the sterling participants to become more active in purchasing from Japan.⁶²

Hence, SCAP's seasonal shortage of sterling funds became the main focus of the Sterling Area Trade Review Conference held in Tokyo from 24 January to 15 February 1950. The sterling participants did not show any sympathy for the SCAP request to increase imports from Japan to parallel its heavy seasonal purchases. The sterling delegates argued that it would take a fairly long time to adjust each participant's requirement to revise the whole purchasing programs. The participants pointed out that they had to remain

⁵⁹ Cable from Crosec to Canberra, no.195, 29 November 1949, AA, A606, R40/1/90.

⁶⁰ It was reported that SCAP entered £12 million worth of contracts of purchases from the participants between October and early November 1949, making full use of its £16 million sterling surplus as in early September. Since SCAP was likely to further increase procurement during November and December, the participants were virtually out of the danger of incurring dollar liability in Japanese trade. Sterling Area Working Party, 'Thirty Fourth Meeting', 3 November 1949, AA, A606, R40/1/88.

⁶¹ SCAP's purchases from the sterling participants in the latter half of 1949 was calculated as follows.

Month	JUL	AUG	SEP	OCT	NOV	DEC	TOTAL (unit)
Purchases	3	2	1	10	1.5	21	38.5 (£ million)

Source: J.L. Hunt, Sterling Area Trade Co-ordinator representing the Sterling Participants, 'SCAP's Shortage of Sterling 28 March 1950', *ibid.*

⁶² Pickelle to Gascoigne, 'Current Status of Trade Between the Sterling Area and Japan', 3 January 1950, *ibid.*

cautious in relaxing their tight import licensing for Japanese goods in the light of past experience. Rejecting SCAP's request, the delegates suggested that SCAP should use the existing facility of ordinary short-term commercial credits of 90 to 120 days to finance its heavy seasonal purchasing. While admitting the imminent need to extend sterling credits by the British banks as requested by the SCAP officials, the participants ruled that this was not a matter to be discussed at the Trade Review Conference but to be negotiated between SCAP and each British bank.⁶³

SCAP officials, however, had faced serious difficulties in utilising this financial facility. No British banks were prepared to extend sterling credits on a normal 50 per cent deposit basis to the newly established Foreign Exchange Control Board of the Japanese government.⁶⁴ Furthermore, R.H. Marlow, Acting Controller and Deputy Chief of the Banking and Foreign Exchange Division, ruled out short-term credits because he found it 'unsound' to enter into credit commitments counting on unknown levels of future sterling balance. The SCAP officials in charge of foreign funds still adopted the policy of authorising expenditure of foreign exchanges based on the amount of cash in hand rather than prospective export earnings.⁶⁵

Without extension of sterling credit, the controllers of SCAP's foreign exchanges did not hesitate to curtail purchases from the sterling area. With no solution from the Review Conference, H.H. Thomas, Financial Adviser to the UKLM proposed, as a 'last resort', a new alternative measure — the so-called dollar-sterling 'swap' — under which the Bank of England would give SCAP sterling credit against dollar deposits.⁶⁶ Since Japan's dollar position was found to be quite healthy at that stage, Thomas could convince SCAP's

⁶³ Sterling Area Trade Review Conference, 'First Scheduled Meeting of the Financial Working Group', 31 January 1950, AA, A606, R40/1/95.

⁶⁴ Telegram from UKLM to London, 31 January 1950, AA, A606, R40/1/88. Although the Foreign Exchange Control Board which took over SCAP's power to control Japan's foreign exchanges with the complete introduction of private import trade on 1 January 1950, SCAP virtually retained its control over its standing foreign exchange account until October 1951. Since the Overall Payments Agreement stipulated that payments should be made into SCAP's accounts, the financing of sterling trade remained under the influence of SCAP's policy, until the Overall Agreement was replaced by the new Sterling Payments Agreement concluded by the Japanese government on 31 August 1951. SCAP gave the Japanese government full discretion over the negotiations for a new Payments Agreement, as mentioned in Chapter 7. Inuta, 1976, pp.79-81.

⁶⁵ Telegram from UKLM to London, 31 January 1950, *op.cit.* The Fund Control Division was reorganised and renamed the Banking and Foreign Exchange Division in mid 1949.

⁶⁶ Thomas to Cleveland, Chief, Banking and Foreign Exchange Division, 22 February 1950, AA, A606, R40/1/88.

officials in charge of its funds, especially Paul Cleveland, Chief of the Banking and Foreign Exchange Division and Controller of SCAP's foreign exchanges, to accept a dollar swap of £5 million after 'considerable persuasion' at the end of February.⁶⁷ Despite this, the proposal for a dollar 'swap' was turned down by W.F. Marquat, Chief of the ESS. According to the information passed to Thomas, Marquat refused to consider the option because he was 'irrevocably opposed' to any 'sale' of dollars 'on political grounds'.⁶⁸ There was no way for Cleveland to move Marquat. To be sure, Japan's dollar reserve had shown a tendency to increase even before the outbreak of the Korean War.⁶⁹ However, the financing of Japan's essential dollar imports such as raw cotton was still dependent on US aid to a considerable extent, and Washington had pressed SCAP for a drastic cut in the GARIOA funds in 1950/51. In view of this, SCAP could not show any sign which might be interpreted by Washington as Japan using its dollars, financed from American taxpayers' money, in an extravagant way.

With no extra supply of sterling credit to maintain its purchasing program, SCAP reached the conclusion that there was no alternative but to stop buying from the sterling area. In early March 1950, the Foreign Exchange Control Board instructed MITI to suspend the licensing of imports from the sterling area.⁷⁰ As a result, Japan's sterling position improved rapidly to record a surplus by May.⁷¹ Table 5.4 shows the effects of SCAP's tight import controls on sterling trade from March onwards. Furthermore, SCAP made a move which led the sterling delegates to doubt whether it had completely committed itself to the expansion of Japan's sterling trade. In early May, it was reported that SCAP proposed to purchase iron ore from French Indo-China and hides and skins from the United States, although these commodities were available from the sterling area.⁷²

⁶⁷ Cable from AM to Canberra, no.67, 2 March 1950 (received date), AA, CP553/1, 194/B/10/91.

⁶⁸ Telegram from Thomas to H.M. Treasury, no.67, 3 March 1950, AA, A606, R40/1/88.

⁶⁹ The Japanese dollar reserve as of December 1949 was \$156 million. The amount was \$250 million in June 1950. It jumped up to \$465 million at the end of the year due to the effect of the Korean War Boom. In contrast with active Japanese exports to the dollar area from late 1949 to early 1950, the sales to the sterling area dwindled due to the pound's devaluation and, more significantly, the tight import licensing against Japanese goods (Tsushosangyosho Tsushokyoku Tsusho Chosaka, 1956, pp.115-119).

⁷⁰ Cable from AM to Canberra, no.67, 2 March 1950, *op.cit.*

⁷¹ Hunt to Marquat, 11 May 1950, DAO, B'0.0.2.0.

⁷² Sterling Area Working Party, 'The Minutes of the Fifty Eight Meeting', 8 May 1950, AA, A606, R40/1/88.

Table 5.4 Japan's Monthly Exports and Imports with the Sterling Area in 1950
(Unit:\$ '000)

Month	January	February	March	April	May	June
Exports	11,136	9,498	12,467	13,386	13,967	21,294
Imports	9,006	20,930	17,922	13,555	14,719	15,028
July	August	September	October	November	December	Total
21,578	27,226	19,502	19,766	22,348	33,842	226,016
8,831	18,807	15,339	19,090	20,986	26,280	200,499

Source: Nihon Ginko Tokeikyoku, *Hompo Keizai Tokei*, 1951, p.351.

Australia, as the main supplier to Japan among the sterling participants, was hard hit by SCAP's tight sterling control. The rising prices in the sterling wool markets had reduced the quantities of scheduled wool imports during the January–March quarter. Since March, however, shipments of Australian wool and wheat to Japan had been suspended. The SCAP officials in charge of the supervision of the Japanese textile industries saw the danger of a shutdown of the woollen mills in autumn due to a lack of raw materials.⁷³ Against the urgent plea for procurement from both the Foreign Trade and Commerce Division and the Industry Division of the ESS, the Controller of SCAP's funds flatly rejected spending sterling on additional wool procurement:

In view of the few days remaining in the January–March quarter it is highly improbable that a re-examination of Japan's sterling position could be effected ... prior to the beginning of the next quarter. That such a re-examination would indicate availability of any additional sterling at this time is even less probable as day-by-day sterling receipts have as yet shown no significant signs of improving.⁷⁴

This illustrates Cleveland's determination to defend SCAP's cash position even running the risk of a disruption of industrial activities.

⁷³ W.N. Robins, Chief, Trade Coordination Branch, to Carl C. Campbell, Special Assistant, Foreign Trade and Commerce Division, 'Raw Wool Procurement Program', SCAP, 6188(11), ESS(A)01306.

⁷⁴ Cleveland to Foreign Trade and Commerce Division, 22 March 1950, SCAP, *ibid.*

SCAP's tight control made H.C. Menzies, Australian Commercial Counsellor in Tokyo, pessimistic about the possibility of Australia exporting to Japan before May the whole amount of wool that had been estimated in the 1949/50 sterling trade negotiations. He reported to Canberra that SCAP's intention at that moment was to increase the procurement of South American wool even though the Japanese wool manufacturing industry was 'very perturbed' at the cessation of the raw wool supply from Australia.⁷⁵ The preference of the Japanese wool mills for Australian types and qualities was set aside by the occupation authority in the face of the shortage of sterling funds.

The contraction of Japanese sterling trade in early 1950 cannot be attributed solely to SCAP. As previously mentioned, while SCAP did not regard the sterling area countries as attractive trade partners in 1948/49, it had begun to reveal its intention to expand sterling procurement from mid 1949. Its seasonal shortage of sterling funds, however, prevented SCAP from expanding sterling trade. The sterling shortage was caused not only by the remarkable increase in imports from sterling suppliers but also by the inactive purchasing from Japan by the sterling participants. Since the participants suspended licensing of imports from Japan in July 1949 when they accumulated a large amount of adverse balance in Japanese trade, the United Kingdom had been quite slow in resuming licensing. Even after import licensing was resumed at the end of 1949, it was administered with great caution. London did not issue import licences for Japanese goods even when SCAP's sterling funds were rapidly running out and SCAP's introduction of tight import controls on sterling commodities looked imminent. The United Kingdom's response to SCAP's plea for urgent extension of sterling credits was cool. London's rejection of a credit extension forced SCAP to impose a tight control on its sterling account, and this seriously affected export sales to Japan by the other sterling area countries such as Australia. Why did London, in fact, restrict trade with Japan at this stage even at the risk of disrupting the commercial interests of the other sterling participants?

Against SCAP's plea for increased purchases by the participants, the British government justified its cautious issuance of import licensing for Japanese goods as deriving from the experience of the previous year when its active purchasing from Japan led to a large adverse balance and the resultant danger of SCAP's conversion of sterling surplus into

⁷⁵ Menzies to Canberra, 31 March 1950, AA, A606, R40/1/95.

dollars.⁷⁶ This argument was not plausible because London had confidentially admitted to the other participants that the danger of dollar liability had been dispelled as SCAP was unlikely to invoke the dollar convertibility clause of the Overall Payments Agreement.⁷⁷ This suggests that the British government had other reasons for imposing tight controls on trade with Japan.

London's negative approach to the expansion of Japan's sterling trade is best illustrated by a cable sent on 26 May 1950 to all the governments participating in the Sterling Trade Arrangement. In this cable, despatched on the eve of the 1950/51 sterling trade negotiations in Tokyo, the British government made it clear to the members that the sterling area should adopt a new approach to Japanese trade in response to the emergence of new situations. London's cable began thus:

Most serious problem results from Japanese revival. Internal recovery of Japan and diminished financial assistance from the United States must drive Japan to seek to increase trade with the Sterling area.⁷⁸

It considered that two serious problems for the sterling area would arise from expansion of trade with Japan. Firstly, if Japan was allowed to obtain an increased volume of foodstuffs, especially rice, and essential raw materials by payment in sterling, the other sterling area countries might be forced to purchase these commodities from other sources for dollars. Secondly, expansion of balanced trade between Japan and the sterling participants would put the latter under pressure to import non-essential goods from Japan. The United Kingdom could not incur the risk of losing a portion of its limited dollar reserves and exposing its manufacturing industries to tough competition from the resurgent Japanese export drive, while giving Japan the benefit of procuring essential supplies. Hence, London instructed that the sterling delegates should avoid authorising SCAP to inflate its purchasing power in the coming negotiations in Tokyo.⁷⁹

If London's instruction was to be observed strictly, it would have the effect of hampering expansion of the overall level of trade between Japan and the sterling

⁷⁶ Cable from Australian High Commissioner's Office in London to Canberra, no.1370, 28 March 1950, *ibid.*

⁷⁷ Cable from Crosec to Canberra, no.50, 3 March 1950, AA, CP553/1, 194/B/10/91.

⁷⁸ Cable from Crosec to Canberra, 26 May 1950, no.100, AA, A606, R40/1/95.

⁷⁹ *Ibid.*

participants. The total export commodities available to Japan from the sterling area in 1950/51 were likely to be lower than their total import requirements from Japan by approximately £22 million.⁸⁰ If SCAP were not to be allowed, as London insisted, to fill this gap by procurement of some commodities from the sterling area countries not participating in the Trade Arrangements, the participants would have to reduce their purchases from Japan to balance the overall trade. This would provoke enormous dissatisfaction among the other participants such as India and Ceylon which still had high levels of demand for Japanese manufactured goods. Furthermore, curtailment of purchases from Japan might cause a recurrence of SCAP's seasonal sterling shortage, which would culminate in cessation of sales to Japan. This would have jeopardised Australia's commercial interests in Japanese trade. Canberra's reply to the cable from London revealed its concern about this danger. Although recognising the problems of the increased Japanese competition over foodstuff procurement within the sterling area and the pressure for imports of less essential Japanese goods, the Australian government insisted on the importance of Australia's 'continued access to available supplies' and 'maintenance and development' of its sales to Japan. It concluded that Australia's fundamental interests lay in 'promoting high level of two-way trade' between Australia and Japan.⁸¹ Thus, SCAP's attempt to divert Japan's trade relations from the dollar into the sterling area faced the British resistance and resulted in the divergence of commercial interests between Britain and the other sterling area countries including Australia.

The strong pressure from Washington for drastic cuts in the GARIOA funds made it imperative for SCAP to divert Japan's commodity procurement from dollar to non-dollar suppliers. Due to the lower availability of strategic raw materials such as raw cotton from non-dollar sources, SCAP instead came to look to the sterling area for increased procurement of foodstuffs, as demonstrated in its active purchases in late 1949. Because of the need to purchase a large volume of foodstuffs in sterling, it was in SCAP's interest to dispel the fear of the sterling participants about dollar liabilities by not converting its sterling surplus when the pound was devalued and to seek expansion of two-way trade with the sterling participants. Under SCAP's new trade strategy, Australia was considered an

⁸⁰ *Ibid.*

⁸¹ Cable from Canberra to Crosec, no.126, 1 June 1950, AA, A606, R40/1/95.

alternative grain supplier for Japan, as illustrated in SCAP's push for Japan's accession to the IWA and in the review of the 1949/50 Trade Plan which allocated more sterling funds for purchases of wheat than raw wool from Australia.

Decreasing US appropriated funds prompted Japan's return to normal commercial networks on a more multilateral basis in an attempt to maximise food procurement from non-dollar sources. The United Kingdom did not welcome this move since it wished to reserve sterling foodstuffs for internal allocation within the sterling area. Accordingly, Britain blocked SCAP's active rice procurement from Southeast Asia and Japan's accession to the IWA. London also adopted a negative approach to opening sterling markets for non-essential Japanese goods for domestic industrial protection. This caused a delay in the relaxation of import restrictions on Japanese goods. As a result, SCAP's heavy seasonal procurement from the sterling area culminated in a serious shortage of sterling funds in early 1950. Due to the policy of issuing import approvals based on a cash position, the SCAP controllers of sterling funds tightened the import licensing for sterling commodities. Although SCAP appreciated Australia's importance as supplier in developing Japan's economic self-reliance, Britain's conservative import licensing policy forced SCAP to restrain its sterling purchasing programs which affected Australia's commercial interests in Japanese trade.

Thus, in 1949-50, SCAP and Britain completely changed sides with regard to Japan's sterling trade. It was London that tried to restrain its expansion. On the other hand, SCAP came to take a remarkably positive approach. In the subsequent 1950/51 sterling trade negotiations, SCAP further revealed its policy to put Japan's sterling trade on a more multilateral basis. The United Kingdom also resisted this strongly.

6 SCAP's Quest for More Multilateral Trade with the Sterling Area: The 1950/51 Sterling Trade Negotiations

While SCAP wanted to divert Japanese trade from dollar to sterling and other non-dollar sources to make up for decreasing US appropriated funds in 1949/50, the United Kingdom tried to restrain Japan's entry into the international trade scene. The issue came to a head in the 1950/51 sterling trade negotiations, held in Tokyo in June 1950. The conclusion of the 1950/51 Sterling Trade Arrangement was delayed until 22 November 1950, with conflict arising between SCAP officials and the sterling delegates over SCAP's ambitious proposal. Firstly, SCAP wanted to enhance substantially the volume of trade outlined in the Trade Plan. In order to balance its enhanced procurement program, SCAP requested increased exports of non-essential Japanese goods to the sterling participants. Secondly, SCAP proposed to conclude a new, formal trade agreement stipulating the lowering of trade barriers between the two parties and the exchange of most-favoured-nation treatment on a non-discriminatory basis. Such an agreement would give Japan the benefits similar to those which could be gained from accession to the GATT. Thirdly, SCAP requested the British to authorise use of sterling funds accruing from exports to sterling participants for purchases from sterling area countries not participating in the Trade Arrangement. The objective was to conduct Japan's sterling trade on a more multilateral basis by introducing flexibility of transfer within the whole sterling area.

This chapter traces the negotiation process of the 1950/51 Sterling Trade Arrangement in order to clarify SCAP's intention to put Japan's sterling trade on a freer, more multilateral basis, through more flexible operation of the Sterling Trade Arrangement. Such an approach was in line with the strategy to achieve Japan's economic self-reliance under the Dodge Line through trade promotion in more multilateral directions. Although resistance by the sterling participants prevented full achievement of SCAP's objectives, the 1950/51 sterling trade negotiations showed SCAP's full commitment to expansion of

Japan's sterling trade, especially in the procurement of foodstuffs and raw materials, in order to divert sources of supply from the dollar to the non-dollar area, in preparation for the decrease in US appropriated funds.

THE TRADE EXPANSION PLAN AND PROMOTION OF NON-ESSENTIAL JAPANESE EXPORTS

From the outset of the 1950/51 sterling trade negotiations, SCAP did not conceal its ambition to increase substantially procurement from the sterling participants. According to SCAP's draft Trade Plan for 1950/51, which was submitted to the first meeting of 7 June, total annual Japanese purchases from the sterling participants were calculated at about £96 million.¹ This figure far exceeded the £55 million allocated in the 1949/50 Trade Plan. The estimates indicated that SCAP was looking to Australia as the chief supplier of raw materials and foodstuffs. Total imports from Australia were estimated at about £41 million. Its share in the total purchases of the participants was to be more than 40 per cent. There was a notable shift in emphasis in that more money was to be spent on the procurement of foodstuffs than wool, which had been Australia's main export commodity in previous years. Of total estimated imports from Australia of £41 million, £25 million was allocated to purchases of grain, including wheat at £21 million and barley at £4 million.² SCAP's total wool requirement from the sterling participants amounted to only £23 million, of which £16 million was allocated to Australian wool.³ This proposal reflected SCAP's policy of looking to non-dollar sources for the supply of foodstuffs, in preparation for the considerable curtailment in US appropriated funds, as discussed in Chapter 5.

Initially, the sterling participants raised doubts about the practicability of SCAP's purchasing program. Based on the 'reasonable' availability of commodities, they calculated the appropriate level of sales to Japan for 1950/51 at around £65–£70 million at most. Against this sales figure, essential requirements from Japan were estimated at £77 million.⁴

¹ Sterling Area Trade Conference, 'The Report of the First Meeting of the Committee of the Whole', 7 June 1950, AA, A606, R40/1/105.

² Sterling Area Trade Conference, 'The Third Meeting of the Commodity Working Group', 9 June 1950, *ibid.*

³ Sterling Area Trade Conference, 'The First Meeting of the Commodity Working Group', 7 June 1950, *ibid.*

⁴ Cable from AM to Canberra, no.218, 15 June 1950, AA, A606, R40/1/95.

If overall trade was to be balanced at the level of the SCAP figure of £96 million, the participants would have to expand their purchases of non-essential Japanese goods to match SCAP's vast purchases. In the light of London's conservative approach to imports of this nature, the sterling delegates felt that it was most appropriate to keep the level of trade around £77 million.

By mid June, however, delegates had reached an agreement that it might not be excessive to balance overall trade between the participants and Japan at around £85–90 million.⁵ This figure was considered appropriate because it would open the way for the participants to promote their export trade to Japan.⁶ The amendment derived from pressure exerted by the chief exporter to Japan, Australia. The Australian delegate expressed concern about the restrictive effects on Australian sales if total essential requirements were kept below £77 million, thus limiting SCAP's purchasing power.⁷ The fact that the United Kingdom accepted the Australian claim indicates that there was less objection among the other participants to expansion of export trade with Japan. By mid July, there appeared to be every chance of settling the size of the Trade Plan at a considerably expanded level around £91 million.⁸

SCAP then raised a new problem. In its attempt to boost the size of the Trade Plan, SCAP did not hide its intention to increase exports of non-essential Japanese goods. In mid July, SCAP officials approached the sterling delegates to purchase £5.8 million of non-essential goods from Japan. SCAP's argument was based on the principle of reciprocity. On the grounds that the Japanese purchase program included £5.8 million of non-essential imports to raise the level of balanced trade, SCAP insisted that participants should also purchase the same amount of non-essential goods from Japan.⁹

The sterling participants were unwilling to accept SCAP's request. There was a firm consensus among delegates that imports from Japan should be centred on essential goods in short supply in the sterling area. There was no need to make a commitment to purchase

⁵ *Ibid.*

⁶ Sterling Area Working Party, 'Minutes of the Sixty Fourth Meeting', 12 July 1950, AA, CP553/1, 194/B/10/50/5.

⁷ Cable from AM to Canberra, no.218, *op.cit.*

⁸ Sterling Area Working Party, 'Minutes of the Sixty Sixth Meeting', 14 July 1950, AA, CP553/1, 194/B/10/50/5.

⁹ Sterling Area Working Party, 'Minutes of the Sixty Fifth Meeting', 13 July 1950, *ibid.*

non-essential goods from Japan in order to match SCAP's active purchasing program because countries such as Australia, India and Ceylon still had considerable demand for purchases of Japanese essential goods.¹⁰

Receiving a flat refusal from the sterling participants, SCAP withdrew the request and did not raise the issue again. This suggests that the export of non-essential Japanese goods to the sterling area did not have a high priority in SCAP's negotiation strategy. When, for example, SCAP asked Australia to consider increasing its purchases of Japanese machinery, exports of which had been hit by the pound's devaluation in the previous year, the Australian delegate, H.C. Menzies, suspected that the proposal was less a SCAP initiative than the result of strong pressure exerted by the Japanese government and industry.¹¹

In 1950 a certain section of SCAP proposed to integrate Japanese industrial capacity with the economic development of Southeast Asia, as mentioned in Chapter 2. Unlike Japanese business and government circles, which held excessive expectations of a stable source of extra dollar income through the US strategic aid program, SCAP at this stage focused on the promotion of Japanese trade with the region on an unsubsidised commercial basis. The Sterling Trade Arrangement was an ideal instrument for implementing this strategy. The more Japan could export non-essential items to the region, the more purchasing power for raw materials and foodstuffs Japan could expect to obtain in sterling. Extensive Japanese procurement would in turn give the sterling area countries in Asia purchasing power for Japanese industrial goods, especially in the less competitive heavy and chemical industry sectors. Thus SCAP's emphasis on non-essential Japanese exports should be interpreted as a clear sign of its intention to link the expansion of sterling trade with the restoration of Japanese industrial activity.

PROPOSAL FOR THE APPLICATION OF GATT PRINCIPLES

Another ambitious proposal which SCAP raised in the negotiations was application of GATT trade principles between Japan and the sterling participants. When the two sides reached agreement on the overall level of the 1950/51 Trade Plan in mid July, the focus of the negotiations turned to drafting the 1950/51 Sterling Trade Arrangement. The sterling

¹⁰ Menzies to Canberra, 13 July 1950, AA, A606, R40/1/95.

¹¹ *Ibid.*

participants did not wish to make drastic amendments to the provisions in the previous Arrangement. On the other hand, SCAP proposed the negotiation of a formal trade agreement which included provision not only for balanced trade on a sterling basis but also the removal of trade barriers between Japan and the sterling participants. SCAP's draft Sterling Trade Agreement, dated 23 July 1950, outlined this proposal in several controversial clauses:

1. Both parties to recognise that 'quota and exchange restrictions and other restrictive practices which have the effect of acting as barriers to international trade must be reduced to a minimum' (Preamble).
2. Both parties to 'do everything feasible to relax existing trade, currency, and other controls which may have the effect of restricting trade' (Article V-C).
3. 'The Governments of the Sterling Area Participants will accord to the merchandise trade of Japan and Japanese flag ships treatment similar to that accorded by the United States of America to such trade and shipping' (Article VII).
4. Parties to the Agreement 'will consult ... with respect to the possibility of developing trade and settling trade balances on a multilateral basis' (Article X).¹²

These clauses were totally unacceptable to the sterling participants. They were alarmed at SCAP's move because it seemed to be an attempt to introduce GATT provisions by back-door methods.¹³ The proposed preamble went beyond the GATT in that it did not contain GATT-style safeguard clauses exempting nations from reducing trade restrictions. With regard to the relaxation of trade, currency and other controls, the sterling participants were not prepared to 'relax for Japan what they could not relax for the rest of the world' at that stage.¹⁴ They had refused to commit themselves to importing non-essential Japanese goods and now were not prepared to accept drastic liberalisation of trade with Japan. A formal trade agreement with Japan would raise grave concern about the influx of cheap Japanese manufactures and might cause serious domestic political problems.

Faced with an unequivocal refusal by the sterling delegates, SCAP voluntarily withdrew its draft Trade Agreement. The SCAP officials said that it was not 'their intention

¹² SCAP, 'Trade Agreement Between Certain Countries in the Sterling Area and Occupied Japan', counter draft, 23 July 1950, AA, A606, R40/1/98.

¹³ Meeting of the Sterling Area Delegates, 28 July 1950, *ibid.*

¹⁴ Sterling Area Trade Conference, 'Third Meeting of the Committee of the Whole', 31 July 1950, AA, A606, R40/1/105.

to introduce controversial matters' into the negotiations. They also accepted the British argument that there were some doubts as to the legal right of SCAP to sign such a formal trade agreement. Although SCAP was an entity created by the Allied Powers, it was now proposing to sign a formal agreement on behalf of Japan with the sterling participants, some of whom were members of the Allied Powers, SCAP's founders.¹⁵ Subsequently SCAP agreed to negotiate a draft which took the form of the existing trade arrangement.

SCAP inserted a proposal on Japanese shipping treatment in sterling area ports into the draft formal trade agreement, in response to the British attempt to obtain similar treatment for its vessels in Japanese ports. At the beginning of the negotiations, the sterling delegates expressed their concern about Japan's discriminatory tendency in shipping, alleging that the Japanese used only Japanese vessels in transportation to Japanese ports when they purchased Burmese and Thai rice. They duly tried to insert into the Arrangement a clause stipulating 'no discriminatory action and no unnecessary restrictions' in Japan against any shipping.¹⁶ This clause would impose a unilateral commitment on Japan to grant non-discriminatory treatment to the vessels of the sterling participants in Japanese ports. It would expose the war-devastated Japanese shipping industry to competition with British vessels in Japan without giving it reciprocal access to British ports.

The proposal was unacceptable to SCAP because Japanese shipping was under reconstruction as part of SCAP's policy at the expense of American taxpayers, and so had to become operational on a commercial basis as soon as possible. SCAP therefore proposed reciprocal benefits for the Japanese shipping industry in Article VII of its draft formal Trade Agreement. Under this Article, the participants would have to permit entry of Japanese vessels to their ports as long as the United States gave such treatment to Japan. This was totally unacceptable to some sterling area countries, such as Australia, for political and security reasons. The sterling participants made it plain that they were not prepared to include any provision for free access of Japanese ships to their ports in the Trade Arrangement.¹⁷ Again realising the difficulty of reaching such an agreement, SCAP dropped the clause from the draft Trade Arrangement.

¹⁵ *Ibid.*

¹⁶ Sterling Area Trade Conference, 'The First Meeting of the Shipping Working Group', 9 June 1950, AA, A606, R40/1/105.

¹⁷ 'Third Meeting of the Committee of the Whole', 31 July 1950, *op.cit.*

This did not mean that SCAP gained nothing from raising the shipping issue. SCAP's shipping clause demonstrated its determination to insist on reciprocal access for Japanese ships to ports of the sterling countries whenever a provision on non-discrimination in shipping was to be included in the Sterling Trade Arrangement. SCAP's shipping clause was too politically sensitive for the sterling participants to accept, in view of the strong wartime antipathy to the Japanese among some sterling area countries, and the participants did not pursue Japan's unilateral commitment to non-discriminatory treatment for sterling vessels at Japanese ports. After SCAP dropped the shipping clause, the sterling participants agreed to eliminate the shipping problem from the negotiation agenda, but with 'a considerable measure of disappointment'.¹⁸

In August 1950, it became clear that the SCAP attempt to promote the export of non-essential Japanese goods and to establish a formal institutional framework for Japan's sterling trade had not been successful. The fact that SCAP readily withdrew its proposals when faced with determined objection from its counterparts suggests that it did not regard them as issues of utmost importance in the negotiations for the 1950/51 Sterling Trade Arrangement. Why did SCAP present these proposals? In particular, what led SCAP to seek to apply GATT principles to sterling trade?

SCAP AND MOST-FAVOURED-NATION TREATMENT FOR JAPAN

The question of the desirability of applying GATT principles, especially most-favoured-nation treatment, for Japan's overseas trade had been contemplated by SCAP since the early occupation period. Examining the draft Charter for an International Trade Organization just before the United Nations Conference on Trade and Employment in Havana in November 1947, SCAP/ESS's Foreign Trade Division argued that the granting of most-favoured-nation treatment to Japanese exports including tariffs was 'of major importance in view of the necessity of maximizing Japanese exports'.¹⁹ Although US delegates tried to raise the issue of most-favoured-nation treatment for Japan at sessions of the GATT contracting parties and other meetings during 1948, there was strong opposition to Japan's

¹⁸ Sterling Area Trade Conference, 'Statement by the Sterling Area Delegation at the Plenary Meeting Held on 17th August, 1950', DAO, B'0.0.2.0.

¹⁹ Foreign Trade Division, 'Memorandum for Record', 14 November 1947, SCAP, 6704(42), ESS(A)05015.

readmission into the international trade organisation. The memory of prewar unfair trading practices, the export drives exercised by the Japanese and wartime anti-Japanese animosity drove the United Kingdom and the British Commonwealth dominions into a flat refusal of the US proposal, on the grounds that Japan's establishment of a single exchange rate was 'mandatory' before any negotiation took place.²⁰

In 1949, the atmosphere within SCAP was conducive to Japan's obtaining most-favoured-nation treatment. In view of the decreasing GARIOA funds, as the US Department of the Army observed, most-favoured-nation treatment for Japan seemed necessary 'in order to lighten the burden of appropriations to support the deficit caused in the Japanese economy by those countries which continued to discriminate in their trade with Occupied Japan'.²¹ The Chief of the Foreign Trade and Commerce Division, Pickelle, also advocated the introduction of most-favoured-nation treatment for Japan to forestall discriminatory action against Japanese exports induced by overseas pressure groups which were alarmed at the recovery of Japanese trading activities.²² As discussed in the previous chapter, decreasing US aid made it imperative for SCAP to develop a network of normal commercial links with non-dollar areas that had, in the past, tended to refuse to open their markets for Japanese goods. The application of GATT principles would give Japan a strong lever to cultivate these markets.

SCAP was not in a position to press sterling area countries strongly for most-favoured-nation treatment in the first half of 1949 because it had recorded a huge trade surplus with the participants due to its inactive purchasing policy, as discussed in Chapter 4.²³ In the second half of 1949, however, SCAP began to feel the ill-effects of the discriminatory treatment of Japanese goods when it initiated active sterling food procurement programs. These rapidly squeezed its sterling balance due to the tight and selective import controls of the participants as well as the heavy seasonal concentration of

²⁰ L.F. Schockner to Robert R. West, Deputy to Assistant Secretary, DA, 'Report on Third Session of the Contracting Parties to the General Agreement on Tariffs and Trade, Held in Annecy, France, 20 July 1949', SCAP, 6442(26), ESS(B)03587-03588.

²¹ David M. Maynard, SCAP Headquarters, San Francisco, 'Status of MFN General Agreement for Japan', 23 June 1949, SCAP, 6442(17), ESS(B)03582.

²² Pickelle, 'Status Report on Japan's Foreign Trade', Undated (August 1949?), SCAP, 7651(6), ESS(A)10538.

²³ Sterling Area Working Party, 'Minutes of the Eighteenth Meeting', 15 March 1949, AA, A606, R40/1/80.

Japanese purchases. Furthermore, news from London in September that the GATT Working Party had decided to send only West Germany and Korea an invitation to attend the Torquay Round of trade negotiations among the GATT contracting parties (scheduled for September 1950) shocked Japan. Exclusion from the list was due to the opposition of British Commonwealth and other West European countries, to the disappointment of Japanese as well as SCAP officials.²⁴

This rejection of Japan impressed SCAP officials with the necessity to use different channels to press sterling area countries to help Japan accede to the GATT. The sterling delegates in Tokyo observed that a certain section of SCAP was endeavouring to insert a clause in the 1949/50 Sterling Trade Arrangement which would give Japan most-favoured-nation treatment. Although Pickelle did not support this idea, perhaps concerned about causing a further delay in concluding the Arrangement, it was reported that SCAP was going to make a separate presentation to each government which it felt was imposing discriminatory measures on Japanese goods.²⁵ Pickelle did in fact draft a memorandum to the Australian representative in Tokyo protesting against Australia's discriminatory treatment of Japan. Pickelle insisted that as long as Japan granted unconditional most-favoured-nation treatment to all trade with Australia, Canberra should reciprocally extend equivalent benefits to Japan.²⁶ There is no document to suggest that Pickelle's memorandum was actually sent to the Australian Mission in Tokyo. However, the draft memorandum does show that serious concern had emerged among SCAP officials about trade discrimination against Japan.

A direct appeal to the discriminating parties for most-favoured-nation treatment for Japan appeared in the SCAP draft Trade Agreement of the 1950/51 sterling trade negotiations. The idea was worked out in the SCAP/ESS document of mid May 1950. The ESS memorandum justified application of the GATT principles to Japanese trade, citing the 1949/50 Sterling Trade Arrangement clause that 'the parties will continue to take all steps consistent with established policies to facilitate the reestablishment of prewar commercial activities or the establishment of new ones'. SCAP interpreted this to mean that agreement

²⁴ Memorandum of Conversation between Japanese and SCAP Officials, 'Steps Which Japan Should Take for Eventual Participation in GATT', 11 October 1949, SCAP, 6704(22), ESS(A)05004.

²⁵ Cable from AM to Canberra, 'Negotiations 9', no.370, 4 October 1949, AA, A606, R40/1/90.

²⁶ Pickelle to AM, 'Discrimination against Trade of Japan', Draft memorandum, 9 November 1949, SCAP, 6783(20), ESS(A)05958.

in principle had already been reached with the sterling participants for non-discriminatory treatment of Japan's sterling trade and for freedom of entry for Japanese merchants in the sterling area. SCAP also pointed out some positive factors which would qualify Japan to conduct trade under the GATT rules, such as the establishment of the 360 yen exchange rate in April 1949, improved labour conditions under the occupation and the introduction of a legal mechanism to preclude unfair competition.²⁷ However, the memorandum did not develop an argument to counter opposition by the sterling participants, despite the warning by a SCAP official who had attended the previous GATT session that opposition to most-favoured-nation treatment for Japan from Australia, the United Kingdom and other Commonwealth countries 'seemed assured'.²⁸

As indicated by SCAP's immediate withdrawal of the draft formal Trade Agreement, SCAP does not seem to have been seriously determined to pursue most-favoured-nation treatment for Japan in the negotiations. But the proposal for application of GATT principles to Japan's sterling trade implied SCAP's complete departure from its previous trade policy, which was to tie Japanese trade closely with the dollar area, depending on US appropriated funds. In presenting the proposal, SCAP stated:

Japan is making every effort to *develop and foster its trade along sound economic lines* within the context of a non-discriminatory multilateral trading system and within the principles of the General Agreement on Tariffs and Trade (*my emphasis*).²⁹

SCAP had instructed the Japanese to 'develop and foster its trade along sound economic lines' in accordance with the Dodge Line. It would then be in Japan's interest to pursue the liberalisation of trade relations through various channels apart from the normal GATT forum, especially in view of the strong concern about Japan's resurgence as a trading nation, revealed in discussions over its entry into the GATT. In fact, the Japanese government was later forced to use economic diplomacy in order to pursue bilateral settlement of the trade

²⁷ ESS, 'Position Paper for the Sterling Area Trade Agreement Negotiations: Application of General Agreement on Tariffs and Trade (GATT) Principles to Trade between Sterling Area and Japan', 16 May 1950, SCAP, 6687(1), ESS(A)04829.

²⁸ Sherwood M. Fine, ESS, 'Report on Fourth Session Proceedings of General Agreement on Tariffs and Trade (GATT), Geneva, Switzerland', 2 May 1950, SCAP, 6959(29), ESS(A)07278.

²⁹ 'Position Paper for the Sterling Area Trade Agreement Negotiations', 16 May 1950, *op.cit.*

discrimination under the GATT. The 1957 Commerce Agreement with Australia was the first successful case of such a diplomatic approach.

SCAP was undaunted by setbacks in its attempts for expansion of non-essential Japanese exports and the application of the GATT principles. As the 1950/51 sterling trade negotiations continued, SCAP proved itself determined to seek facilities to 'foster [Japan's] trade along sound economic lines' on a more multilateral basis, not only with the sterling participants but also within the whole sterling area.

SCAP'S RIGHT TO DISPOSE FREELY OF STERLING FUNDS

In 1950 there was still considerable demand for essential Japanese goods within the sterling area. On the other hand, it became evident that the sterling participants had only a limited capacity to supply Japan with required commodities. In view of the principle of balanced trade, the gap between high import demand and the low export capability of the sterling participants had to be filled by SCAP's purchases of non-essential commodities, or by increased procurement from the non-participants in the Sterling Trade Arrangement. It was over this issue of the range within which SCAP was allowed to use its sterling surplus that tough negotiations were thrashed out between the two sides from August until November 1950. SCAP insisted that it should be allowed to transfer the sterling balance accruing from export sales to the participants freely into procurement from non-participants. Although the participants strongly resisted this move, SCAP was firmer than it had been in the cases of increased exports of non-essential Japanese goods and the application of GATT principles.

At the final stage of drafting the Trade Plan in early August, the sterling delegates presented their latest estimate to balance overall trade at £93.6 million. While high import demand meant that the participants could absorb this amount, their supply capacity reached only £76.8 million. It was proposed that the difference be made up by enlisting £5 million for extra inconvertible working capital and £11.8 million for an unallocated purchasing reserve. The extra £5 million was to be added to the existing £10 million working capital agreed upon in the previous year, and used to tackle SCAP's sterling shortage in financing its heavy seasonal purchases. The unallocated purchasing reserve was established to provide an 'ample cushion' for any prospective Japanese deficit in transactions in invisible accounts with the sterling participants. The sterling delegates stipulated that all the

unallocated purchasing reserve had to be spent on purchases from the participants to ensure the overall balance of trade.³⁰

In reply, SCAP rejected a clause in the first draft of the Trade Arrangement presented by the sterling participants. The clause precluded SCAP from diverting its sterling funds accruing from export sales to the participants into purchases from the non-participants without mutual agreement after due consultation. W.J. Krossner, Chief of the Trade Arrangements Branch, Foreign Trade and Commerce Division, ruled out the provision as a 'complete departure' from the previous Trade Arrangement. Krossner argued that SCAP could not accept a clause proposing balanced trade only between Japan and the participants because Japan's trade with the sterling area should balance at an overall level which included the non-participants.³¹ The participants could not supply Japan with the required commodities; therefore, SCAP considered it essential to secure the right to divert freely its unused sterling surplus resulting from imbalanced trade with the participants into procurement from the sterling non-participants, thus striking an overall balance of sterling trade.

Opposition to the clause came from a number of SCAP officials. Peter McDermott, ESS Director of Foreign Trade and Services, also intervened in the informal meeting of 4 August. McDermott strongly opposed Article IV of the third draft of the Trade Agreement, which had been worked out jointly between SCAP officials and sterling delegates. McDermott flatly rejected the article's provision that diversion of purchasing power to trade with the non-participants should only be undertaken 'by mutual consent, after due consultation'. Firstly, the constraint imposed on free sterling transfers would limit the scope of Japanese sterling trade. Such restriction was 'in direct conflict' with the policy of the US administration and SCAP to conduct Japanese trade on a multilateral basis whenever possible. Secondly, the clause might constitute a violation of the Overall Payments Agreement, which gave SCAP a guarantee that sterling funds were 'freely utilisable' in any part of the sterling area. Thirdly, Article IV might cause serious administrative problems. Russel Hale, who had succeeded Frank Pickelle as Chief of the Foreign Trade and

³⁰ Sterling Area Trade Conference, 'Statement by the Sterling Area Delegate at the Plenary Meeting', 4 August 1950, AA, A606, R40/1/98.

³¹ Thomas to Hunt, Sterling Area Trade Co-ordinator for the Sterling Participants, 'Discussion with Mr. Hale about the Draft Trade Arrangement', 20 July 1950, SCAP, 6726(19), ESS(C)05748.

Commerce Division after his death in April 1950, put the case that the clause would require SCAP to divide its sterling funds into one amount for purchases from the participants and another for purchases from the non-participants. Such a separation, although not impossible, was extremely difficult because of the lack of administrative arrangements to handle this classification.³²

The sterling delegates strongly rejected SCAP's arguments. While conceding that Article IV would 'impose for the time being a limitation on SCAP's use of sterling', they said that such a limitation was inherent in bilateral arrangements for trade on a balanced basis and that the Sterling Trade Arrangement concluded by six British Commonwealth countries as one signatory was far less restrictive than any other bilateral trade arrangements entered into by SCAP. Article IV was, rather, a concession by the participants leaving some room for diversion of purchasing power. The sterling delegates also pointed out that the 1949/50 Sterling Trade Arrangement had already included a clause precluding SCAP's diversion of purchasing power to 'other Japanese sterling trade' without mutual agreement after due consultation with the participants.³³ Furthermore, they argued, this provision for mutual agreement had been SCAP's initiative.³⁴

This suggests that SCAP had not given serious consideration to the issue of free transferability of sterling funds in 1949. In the Sterling Trade Review Conference of February 1950, however, SCAP had begun to show an interest in non-participant trade. SCAP had interpreted the provision to mean that mutual agreement was required only in the event of diversion of purchasing power to or from a third country outside the sterling area. It was considered that in the case of diversion to a country participating in the Overall Payments Agreement, but not in the Sterling Trade Arrangement, this obligation would be exempted and SCAP would be entitled to transfer its sterling funds freely to purchases from the non-participants.³⁵

³² 'Sterling Trade Conference (Informal Meeting)', 4 August 1950, AA, CP553/1, 194/B/10/101.

³³ Telegram from UKLM to FO, no.852, 4 August 1950, AA, A606, R40/1/98.

³⁴ It was observed that this clause was inserted at the suggestion of the US State Department to relieve the rigidity of SCAP's bilateral trade arrangements and foster the spirit of multilateral trade. Cable from AM to Canberra, no.370, 'Negotiations 9', 4 October 1949, AA, A606, R40/1/90.

³⁵ Sterling Area Trade Review Conference, 'Fourth Meeting of the Committee of the Whole', 15 February 1950, AA, A606, R40/1/95.

SCAP's emphasis on sterling transferability derived from the fact that during the second half of 1949 it made heavy purchases of foodstuffs from the sterling non-participants: rice from Burma and wheat from Iraq. The procurement was made with little consideration for balancing bilateral transactions with each of the two countries. Against the imports of £3.3 million from each country, SCAP exported only £356,000 to Iraq and £48,000 to Burma.³⁶ As discussed in Chapter 5, SCAP needed to expand food procurement from non-dollar sources to cope with drastic cuts in US appropriated funds for Japan. It was more efficient for it to spend sterling funds earned from the participants on financing the procurement of foodstuffs from the non-participants than to waste funds on non-essential commodities from the participants.

SCAP's heavy procurement of foodstuffs from the non-participants, however, had a disruptive effect on the participants. In so far as Japan could obtain for sterling a large volume of foodstuffs in short supply, such as rice, other consumer countries in the sterling area might be forced to purchase such commodities from non-sterling suppliers for dollars. This could cause a serious dollar drain. Accordingly, London was determined to prevent SCAP by any means from being entitled to 'use any surplus earned from participants to inflate his [SCAP's] purchases of scarce commodities from non-participants', as pointed out in the previous chapter.³⁷ It was essential for the sterling delegates to secure SCAP's concurrence in a provision for non-diversion.

The sterling participants were not on strong ground in pressing SCAP to accept a limit on sterling transfers. Firstly, the participants had once supported the increased transferability of sterling in Japanese trade. In February 1949, J.L. Hunt, Sterling Area Trade Co-ordinator representing the participants, had conceded that a 'rigidly bilateral approach to Japanese trade should be avoided even for non-participants, since this would be contrary to the spirit of the Overall Sterling Payments Arrangement'.³⁸ Secondly, SCAP had already established a *fait accompli* by using sterling funds earned from the participants

³⁶ Sterling Area Trade Review Conference, 'Japan's Trade with the Sterling Area Non-Participants', 14 February 1950, DAO, B'0.0.2.0. While the huge deficits with Burma and Iraq were partly offset by the large surplus with Pakistan, total Japanese trade with the sterling non-participants in this period culminated in a deficit of £1.3 million, with imports at £8.2 million and exports at £6.9 million.

³⁷ Cable from Crosec to Canberra, no.100, 26 May 1950, AA, A606, R40/1/95.

³⁸ Hunt to Deputy Chief, Fund Control Division, 'Sterling Area Trade between Occupied Japan and Pakistan', 11 February 1949, AA, A606, R40/1/80.

to purchase Burmese rice and Iraqi wheat in the previous year, based on the interpretation that SCAP was obligated to consult only in cases of transfer to countries outside the sterling area.

These difficulties forced the sterling participants to offer some concessions. In their revised draft Trade Arrangement dated 7 August, the sterling delegates proposed permitting the 'temporary use' by SCAP of sterling funds earned from the participants on purchases from the non-participants, provided that the ultimate trade balance between Japan and the participants at the end of the period as set out in the Trade Plan was not disturbed.³⁹ This would minimise SCAP's administrative difficulties in keeping sterling funds from participants and non-participants separate. It would also enable SCAP to procure food from the non-participants as in the previous year, as long as it observed sales and purchasing programs as set out in the Trade Plan with the participants. SCAP thus agreed in principle to the 'temporary use' of sterling funds in its revised draft Trade Arrangement dated 21 August.⁴⁰

At the meeting of 18 August, however, Krossner surprised sterling delegates by insisting that SCAP's net sterling cash balance in the order of £12 million as of 30 June 1950, which had been reserved as inconvertible working capital, would be considered sterling funds that SCAP could use freely to finance any sterling trade as circumstances required.⁴¹ At a subsequent informal meeting on 23 August, Krossner further argued that the 1949/50 Arrangement had lapsed on 30 June 1950, and that the commitment to use working capital exclusively for purchases from the participants had therefore also expired. Hence, as Krossner asserted, SCAP had the free discretion to dispose of £12 million sterling as of 30 June in any transaction.⁴²

The sterling delegates strongly contested Krossner's argument. They insisted that the 1949/50 Arrangement had not lapsed because neither party had given notice of termination as required by its provisions. The SCAP proposal was a breach of the past understanding that working capital should not be used as purchasing power for non-participant trade. The

³⁹ Sterling Area Trade Delegate, 'Trade Arrangement between Certain Countries in the Sterling Area and Occupied Japan', Fourth draft, 7 August 1950, DAO, B'0.0.2.0.

⁴⁰ SCAP, 'Trade Arrangement Between Certain Countries in the Sterling Area and Occupied Japan', sixth draft, 21 August 1950, *ibid.*

⁴¹ Menzies to Canberra, 24 August 1950, AA, A606, R40/1/95.

⁴² Hunt to Hale, 25 August 1950, AA, A606, R40/1/103.

delegates began to doubt whether SCAP would honour its previous commitments.⁴³ They were so alarmed that they directly informed the ESS Chief, W.F. Marquat of the impasse in the negotiations caused by the approach adopted by his officials.⁴⁴ This petition to a higher ranking official of the SCAP bureaucracy was the last resort of the participants in an attempt to break the deadlock; the sterling delegates had approached not only Marquat, but also MacArthur when McDermott refused to give them a definite assurance of non-conversion of the sterling balance into dollars in July 1949, as mentioned in Chapter 4.

Meanwhile the sterling delegates also prepared a new proposal to settle the matter. Their chairman, H.H. Thomas, thought that the only pragmatic way to break the deadlock was to include a provision allowing SCAP to 'switch' its purchasing power to purchases from the non-participants freely up to a maximum of £3 million.⁴⁵ Thomas firmly rejected SCAP's demand for free disposal of working capital. Thomas's determination was such that he even proposed that the participants consider proceeding without a 1950/51 Sterling Trade Arrangement if SCAP maintained its present position. If SCAP was allowed to use its working capital freely as Krossner claimed, SCAP might use all its inconvertible sterling balance for food procurement from the non-participants. This would virtually mean the withdrawal of SCAP's assurance to reserve a certain amount of inconvertible working capital. The participants were concerned that this setback might culminate in SCAP's withdrawal of its commitment not to convert working capital into dollars. In the light of the increasing interest in food procurement from non-dollar sources since mid 1949, it is inconceivable that SCAP officials had the intention to seek dollars from sterling trade, as the participants had suspected in the first half of 1949. But the approach by McDermott and Krossner must have made the sterling delegates doubt SCAP officials' credibility concerning their previous commitments.

The SCAP officials accepted Thomas's proposal. In his memorandum dated 7 September to Hunt, Hale indirectly denied the allegation that Krossner had insisted that the

⁴³ *Ibid.*

⁴⁴ Thomas to Marquat, 29 August 1950, AA, A606, R40/1/103.

⁴⁵ If more than £3 million of purchasing power was to be diverted, this would become a matter subject to mutual agreement after due consultation. The idea of switching purchasing power up to £3 million had been presented by Thomas to London as the 'last resort' to solve the deadlock when McDermott adamantly insisted on SCAP's right of free diversion in the informal meeting on 4 August. Telegram from UKLM to FO, no.853, 4 August 1950, AA, A606, R40/1/98.

1949/50 Arrangement had lapsed, attributing this to a misunderstanding by the sterling delegates. Hale further proposed a new principle for working capital to be called the 'open operating policy'. Its main point was to affirm SCAP's commitment to retaining the same sterling balance at the end of each trade year as held at the end of the previous year.⁴⁶ Hale's reply was perceived as a positive sign of SCAP's willingness to settle its differences with the sterling delegates.⁴⁷

In his memorandum of 13 September, Hale gave further details of the 'open operating policy'. SCAP proposed that 'actual operations under the proposed trade plan should result in increased net accrued balances in SCAP's sterling accounts over and above the amount as of 30 June 1950'. Such an understanding would have the effect of dispelling the fear of the participants about the depletion of working capital. On the other hand, it was considered necessary to use a 'portion of existing balance' for Japanese procurement of raw materials from the non-participants, up to a maximum of £8 million. SCAP admitted that such a use of sterling funds would have a disruptive effect on the participants, and therefore should be avoided as much as possible.⁴⁸ In comparison with the £3 million suggested by the sterling delegates, the proposed figure of £8 million seems to be a promising starting point for bargaining over the amount of purchasing power divertible to non-participant trade.

Intervention by McDermott, however, again brought the negotiations to a standstill. At a meeting with Thomas on 16 September, McDermott explained that the £8 million offer was not a counter-proposal to the offer of £3 million, but just an 'outside estimate' of the balance to be disposed of by the end of the trade year. McDermott insisted that nothing in the Sterling Trade Arrangement impinge on SCAP's legitimate right under the Overall Payments Agreement to transfer its sterling balance freely within the sterling area, saying that any mention of a specific figure for diversion to the non-participants would imply a restriction.⁴⁹ Moreover, SCAP's revised draft Trade Arrangement presented soon after the meeting made no reference to mutual agreement in the event of diversion of purchasing

⁴⁶ Hale to Head, UKLM, 'Sterling Area Trade Arrangement', 7 September 1950, *ibid.*

⁴⁷ Hunt to Marquat, 'Sterling Area Trade Arrangement', Draft memorandum, Undated, *ibid.*

⁴⁸ Hale to Thomas and Hunt, 'Sterling Area Trade Arrangement', 13 September 1950, *ibid.*

⁴⁹ Telegram from UKLM to FO, 16 September 1950, quoted in Menzies to Canberra, 20 September 1950, *ibid.*

power, although it included an ambiguous provision that the parties consult each other as circumstances required for the development of trade on a multilateral basis.⁵⁰

This was a retreat from Hale's proposal of an 'open operating policy'. If SCAP was allowed, as McDermott insisted, to deplete its working capital by £8 million, it would surely do so by increasing purchases from the non-participants. And if working capital was reduced, SCAP would fall short of sterling funds during the season of heavy procurement from the participants. That might again cause SCAP to suspend the import licences of the sterling participants. Hence, there was no alternative for the sterling delegates but to stand firm against any provision which might imply depletion of working capital. In his personal memorandum to Hale, Thomas warned that if SCAP continued to insist on the right to deplete working capital, London would have to consider the possibility of proceeding 'without a trade arrangement at all for 1950-51, with the almost inevitable consequence of a drastic reduction in the volume of purchases by the participants'.⁵¹

This tough stance had the effect of moderating SCAP's stance. In the draft memorandum from Marquat to Thomas dated 30 September, SCAP for the first time agreed 'in the exercise of good faith' not to divert its purchasing power to the non-participants except by the agreed Trade Plan or mutual readjustment of the Plan. With regard to working capital, the document confirmed that SCAP's sterling funds had to 'always be available for free utilization subject to the limitations of the Overall Payments Arrangements'. But it indirectly denied the possibility of depletion of working capital: 'unless unforeseen contingencies arise from the international situation or actions by sovereign countries, it is improbable that balances as of 30th June 1951 will be less than £12 million'.⁵² Although the provision contained some ambiguous expressions, this was the most promising response to date in that it specifically quoted a figure for the sterling balance at the end of the trade year.

The draft memorandum of 30 September broke the deadlock and brightened the prospects for settlement. At the meeting of 3 October, the two parties reached a basic agreement to delete altogether the most controversial clause on diversion of purchasing

⁵⁰ SCAP, 'Trade Arrangement Between Certain Countries in the Sterling Area and Occupied Japan', Seventh draft, 20 September 1950, DAO, B'0.0.2.0.

⁵¹ Thomas to Hale, 23 September 1950, AA, A606, R40/1/103.

⁵² Marquat to Thomas, 'Trade Negotiations with Sterling Area Participants', Draft memorandum by Hale, 30 September 1950, *ibid.*

power from the draft Trade Arrangement. Instead, it was agreed to attach to the Trade Plan a new footnote regarding the use of unallocated purchasing power, which was settled at £17 million. Up to £3 million of this amount could be utilised for Japanese purchases from the non-participants. It meant that SCAP had accepted the original proposal of the sterling delegates for a £3 million switch. The unallocated reserve could also be used by SCAP as extra working capital to 'accrue additional sterling finance' of up to £5 million if there was a sterling shortage.⁵³ The sterling participants responded to SCAP's concessions with their counter-concession that they were prepared to accept the Japanese application for sterling transfer between Japan and non-sterling area countries.⁵⁴

Despite this development, it took another month to finalise the wording for the agreed memorandum on the use of inconvertible working capital. In his draft memorandum to be sent from Marquat to the Sterling Area Trade Delegation, Thomas inserted sentences that the figure of £17 million was SCAP's 'minimum requirement of sterling to meet estimated near-term commitments in the sterling area'. This amount of £17 million was reached by adding the agreed amount of £5 million for extra working capital to SCAP's existing sterling balance of £12 million as of 30 June 1950. Thomas proposed that conversion into dollars would be made if SCAP's sterling balance exceeded £17 million and 'only if such amount appears to be continuing to increase'.⁵⁵ From the viewpoint of the SCAP officials, however, considerable concessions had already been made, and such a proposal seemed to impinge further on the SCAP principle of free utilisation of sterling funds.⁵⁶

Thus, SCAP countered the Thomas proposal with its revised draft memorandum dated 19 October. It replaced the amount of £17 million with £20 million and dropped the phrase 'only if such amount appears to be continuing to increase'. Furthermore SCAP avoided using the term 'working capital'.⁵⁷ The SCAP officials again brought the principle

⁵³ 'Report of the Meeting Held on Tuesday the 3rd October, 1950', *ibid.*

⁵⁴ Thomas to Marquat, 'Trade in Sterling by Japan with Non-Sterling Area Countries', Draft memorandum, Undated, Attached to the Report of the meeting of the Sterling Area Delegates, 9 October 1950, *ibid.*

⁵⁵ SCAP to Sterling Area Trade Delegation, 'Use of Sterling Balances as Working Capital', Draft memorandum by Thomas, Undated, Attached to the Report of the meeting of the Sterling Area Delegates, 9 October 1950, *ibid.*

⁵⁶ Trade Arrangements Branch, Foreign Trade and Commerce Division, 'Sterling Area Participants Trade Negotiations', 18 October 1950, SCAP, 6734(29), ESS(A)05421.

⁵⁷ SCAP to Head, UKLM, 'Sterling Balances', 19 October 1950, Draft memorandum, AA, A606, R40/1/103.

of free use of sterling funds back into issue. J.R. Allison, ESS Director of Finance, had previously objected strongly to the figure of £17 million, but he was now prepared to insert the figure of £20 million into SCAP's draft memorandum. Allison asserted that SCAP had to retain a 'completely free hand' as to disposal of its sterling balance. He further insisted on the need to treat Japan's sterling trade as a whole without separating participants from non-participants.⁵⁸ SCAP had no objection to including the estimated figures of sterling balance likely to remain at the end of the trade year, but it would reject any wording or figure which might give the impression that SCAP had abandoned its right to dispose of sterling funds freely.

Allison's attitude again raised doubts among the sterling delegates about SCAP's intention to respect its commitment to non-depletion of working capital, as presented in Hale's memorandum on SCAP's 'open operating policy'.⁵⁹ They lost no time in expressing their disappointment at the introduction of an arbitrary figure of £20 million by issuing an 'Aide Memoire'.⁶⁰ It was not until 16 November that this problem was eventually settled. The outcome was the product of mutual compromise. SCAP undertook not to convert sterling into dollars unless its balance exceeded 'outstanding commitments' or £17 million, whichever was greater.⁶¹ While the sterling participants could specify a figure of £17 million for inconvertible sterling balance, the wording was more ambiguous, as SCAP wished, in that the £17 million was separated from 'outstanding commitments', giving the impression that the figure was an arbitrary one. Furthermore, the phrase 'only if such amount appears to be continuing to increase' was deleted from the document. The sterling delegates agreed to omit the phrase on the grounds that they feared that 'its interpretation would almost certainly lead to controversy'.⁶² The amended document would impose fewer constraints on SCAP's right to dispose of its sterling funds at will. SCAP's concession was to present a memorandum that it would respect all of its specific commitments

⁵⁸ Meeting of the Sterling Area Delegates, 26 October 1950, *ibid.*

⁵⁹ Hale to N.S. Roberts, Chairman and Spokesman, Sterling Area Participants Delegation, 'Trade Negotiations with Sterling Area Participants', Draft memorandum, 14 October 1950, *ibid.* This memorandum was based on the draft memorandum dated 30 September to be sent from Marquat to Thomas.

⁶⁰ UKLM, 'Aide Memoire', 25 October 1950, *ibid.*

⁶¹ SCAP to Head, UKLM, 'Non-Conversion of Sterling', Draft memorandum, 4 November 1950, *ibid.*

⁶² Telegram from UKLM to FO, no.1547, 16 November 1950, *ibid.*

undertaken in the Trade Arrangement, the Trade Plan, the Hale memorandum on the 'open operating policy', and the above memorandum on non-conversion of sterling.⁶³

DIFFERENT APPROACHES TO STERLING TRADE WITHIN THE SCAP BUREAUCRACY

The negotiations for the 1950/51 Sterling Trade Arrangement were finalised on 22 November. The fact that it took considerable time to reach an agreement over SCAP's right for free disposal of sterling funds indicates that the trade interests of both sides were at stake over this issue. Why did SCAP persist in retaining the right of free disposal?

There were conflicting opinions within the SCAP bureaucracy over SCAP's right to freely utilise sterling funds. From the organisational viewpoint, officials in charge of trade promotion could have reached an agreement with the sterling delegates. However, other SCAP officials raised objections. According to Menzies, the delay in the negotiations, particularly in the final stages, was caused by differences in approaches towards sterling trade among the officials of SCAP's Economic and Scientific Section.⁶⁴

Negotiators such as Russel Hale, Chief of the Foreign Trade and Commerce Division, and A.J. Greco, Sterling Area Trade Co-ordinator representing SCAP, adopted conciliatory approaches to the negotiations. Hale and Greco assumed responsibility for preparing the draft Sterling Trade Arrangement and the detailed figures of the Trade Plan in cooperation with the sterling delegates. Their main concern lay in securing the smooth operation of daily commercial transactions between Japan and the sterling participants. When other SCAP officials intervened and blatantly insisted on SCAP's right to deplete working capital, Hale expressed his anxiety about such an approach, since it would only result in a further delay in negotiation and unfavourably affect the Japanese economy.⁶⁵ In fact, it was estimated that the delay in finalising the 1950/51 Trade Arrangement resulted in loss of Japanese exports to the sterling area of approximately £10 million.⁶⁶

⁶³ Hale to Roberts, 'Sterling Area Trade Arrangement', 16 November 1950, *ibid.*

⁶⁴ Menzies to Canberra, 1 December 1950, *ibid.*

⁶⁵ Meeting of the Sterling Area Delegates, 29 August 1950, *ibid.*

⁶⁶ R.H. Marlow, Acting Controller, ESS, 'Sterling Position', 13 December 1950, SCAP, 6735(13), ESS(A)05438.

On the other hand, Peter McDermott, Director of Foreign Trade and Services, J.R. Allison, Director of Finance, and William Krossner, Chief of the Trade Arrangements Branch, Foreign Trade and Commerce Division, wanted to ensure SCAP's legitimate rights as assured by the Overall Payments. They insisted that the Overall Payments Agreement entitled SCAP to dispose of sterling funds in hand at any time for any purpose, for example, in trade with the non-participants in the Sterling Trade Arrangement except Hong Kong. They were opposed to any clause or expression which might be interpreted as indicating that SCAP had relinquished the right to spend its sterling funds in this way, or that SCAP had undertaken to use a certain portion of balance exclusively for purchases from the participants. They were only prepared to concede the insertion of estimates of the amounts which SCAP was likely to reserve for trade with the participants 'in good faith'.

These officials persisted in their strict interpretation of SCAP's rights over sterling funds, despite the anticipated adverse effects on the Japanese economy. Since the Directors were authorised to give advice directly to the ESS Chief, both McDermott and Allison had the power to intervene in the negotiations. This was not the first time that McDermott had made full use of his power to uphold SCAP's rights as endorsed by the Overall Payments Agreement. In July 1949, McDermott refused to confirm SCAP's commitment to waive its right to convert sterling surplus into dollars. This action provoked serious concern about a dollar drain among the participants and caused them to suspend import licensing of Japanese goods. Since McDermott's intervention often worked against the interests of the participants and the smooth operation of Japan's sterling trade, the sterling delegates labelled him as an extremely obstructive person.⁶⁷ In the 1950 negotiations, McDermott adopted such an uncompromising stance that even other SCAP officials revealed their concern about its effect on the negotiations. At the end of August, Hale and other trade officials informed Hunt of their disagreement with McDermott's approach on the grounds that his attitude would make it impossible to bring the sterling participants into an agreement over the issue of working capital.⁶⁸

Although he was an official of the Foreign Trade and Commerce Division, Krossner, as the chief of its Trade Arrangements Branch, had the responsibility to examine the

⁶⁷ Menzies to Canberra, 6 September 1950, AA, A606, R40/1/95.

⁶⁸ Meeting of the Sterling Area Delegates, 29 August 1950, AA, A606, R40/1/103.

provisions of Japan's trade arrangements. He adopted a strict legalistic approach to every line of the clauses lest arbitrary interpretation should prevail. In the 1950 negotiations, Krossner worked closely with McDermott. When McDermott and Krossner insisted on a free transfer of sterling funds into non-participant trade at the informal meeting in August, it was reported that their views were derived without full communication with other SCAP officials.⁶⁹

As Director for Finance, Allison was concerned about the financing of Japan's sterling trade. In 1950 Japan recorded huge deficits in trade with sterling non-participants such as Burma and Iraq because of its heavy imports of foodstuffs. From the sterling delegates' perspective, there was little hope of SCAP being able to balance trade with the non-participants. This moved Allison to firmly oppose separate treatment for non-participant trade.⁷⁰ From the legal viewpoint, the Overall Payments Agreement provided for free use of sterling within the area. The SCAP financial people found that these provisions justified their claim for free diversion of sterling funds earned from the participants into non-participant trade.

The Chief of the Economic and Scientific Section, W.F. Marquat, played a role in settling the differences of opinion among his trade and financial officials. He was approached by the sterling delegates when a deadlock resulted from the tough approaches of McDermott, Krossner and Allison over the free use of sterling funds. On such occasions, the sterling delegates considered it best to approach Marquat directly because they had the impression that he had not been informed of the tough policies adopted by his officials and the resultant impasse in the negotiations.⁷¹ When McDermott and Krossner insisted on SCAP's right to dispose freely of its working capital, a direct approach to Marquat resulted in Hale's proposal for an 'open operating policy' under which SCAP undertook to make every effort not to deplete working capital. The fact that this was a far more conciliatory policy than McDermott's suggests that Marquat rejected McDermott's claim and supported the case of the trade officials for early settlement of the Trade Arrangement to avoid any interruption of Japan's trade with the participants. Marquat had made a similar decision

⁶⁹ *Ibid.*

⁷⁰ Meeting of the Sterling Area Delegates, 26 October 1950, AA, A606, R40/1/103.

⁷¹ Meeting of the Sterling Area Delegates, 29 August 1950, *op.cit.*; Cable from AM to Canberra, 'Trade Negotiations', no.517, 29 August 1950, AA, A606, R40/1/95.

when McDermott insisted on SCAP's right to claim conversion into dollars. Alarmed at this, the sterling delegates had petitioned Marquat to waive convertibility in February 1949.

Marquat did not always side with the trade officials. On 10 October, the sterling participants proposed inserting into SCAP's memorandum on non-depletion of working capital a sentence stating that the intention of the sterling participants in agreeing to increased working capital had been to provide SCAP with adequate sterling finance to make purchases from the participants. Hale was receptive to the proposal on the condition that appropriate language could be found to clarify that the sentence was simply a restatement of the position of the sterling participants but not of SCAP. Asked his opinion, however, Marquat made a final decision to reject insertion, supporting Allison's recommendation that the sentence could create future differences over its interpretation.⁷² Marquat also did not try to intervene when Allison proposed at the final stage of the negotiations that the figure of non-convertible sterling balance should be of an arbitrary nature. Although Allison's manner was uncompromising enough to upset the sterling delegates, he did not have to withdraw his proposal as McDermott had done in the earlier stages. On the contrary, the sterling negotiators were told that it would be difficult to get approval inside the SCAP bureaucracy for any other form of provision on the non-convertible sterling balance.⁷³

The above intra-organisational differences of view over free disposal of sterling funds mask the important shift in SCAP's approach to sterling trade, from dollar conservation to expansion of overall trade. The negotiation process suggests that SCAP's ultimate objective was to exclude any clause which might work to restrict the right of free disposal of sterling funds. The fact that the intervention by McDermott and Krossner protracted the settlement of this issue considerably may give us the impression that these officials tried to obstruct the establishment of a freer institutional framework for Japan's sterling trade, as they did in 1949. However, in common with trade officials such as Hale and Greco, it was their intention to promote sterling trade on a more multilateral basis. McDermott, Krossner and Allison perhaps tried too hard to facilitate the financing of procurement of foodstuffs from the sterling non-participants through diversion of purchasing power earned from export sales to the participants. These supplies from the sterling area would help to lessen

⁷² Krossner, 'Sterling Area Trade Participants' Trade Negotiations', 10-11 October 1950, SCAP, 6738(29), ESS(A)05421.

⁷³ Krossner, 'Sterling Area Participants Trade Negotiations', 18 October 1950, *ibid.*

Japan's dependence on US commodities. In this sense, there was consensus between SCAP trade and financial officials over the need to link Japan's economic self-reliance under decreasing US appropriated funds with promotion of sterling trade. SCAP's positive approach to sterling trade is further endorsed by the more liberal operation of the Sterling Trade Arrangement, it displayed in this period.

SCAP'S NEW LIBERAL IMPORT FINANCING POLICY

There is no denying that SCAP's interest in trade with the sterling area had increased remarkably compared with previous years. Firstly, it was a SCAP initiative which led to increased trade with the sterling area. SCAP pressed for active purchasing from the sterling participants, showing that it appreciated the significance of the sterling area as a supplier of important commodities to Japan. On the other hand, anxious not to run short of their own commodities through excessive purchases by Japan, the sterling participants responded cautiously. This SCAP initiative was in sharp contrast with the 1949/50 sterling trade negotiations, in the initial stages of which SCAP had revealed extremely limited interest in procurement from the sterling area.

Secondly, SCAP made several moves to promote exports to the sterling area. In previous years SCAP had blamed the participants for overbuying from Japan, as it was necessary for Japan to concentrate on exports to the dollar area in order to offset its huge dollar deficit. In an attempt to expand the 1950/51 Trade Plan, SCAP called for increased purchases of less essential Japanese goods by the participants. The proposal for application of the GATT principles to sterling trade was aimed at facilitating Japanese exports to the participants. These requests were clear messages from the occupation authority signalling the increasing significance of sterling export markets for the Japanese economy.

In fact, SCAP made a quick response when the sterling delegates complained that Japanese exporters tended to discriminate against sterling buyers in favour of dollar earnings, taking advantage of special procurement during the Korean War. In October 1950, they were informed of the SCAP attitude to the problem:

SCAP officials had recently warned M.I.T.I. of the danger of diverting Japanese trade away from long established customers in the Sterling Area in favour of supplying goods to U.S.A. for Korea. SCAP officials had emphasized to M.I.T.I. that if prices were raised against the Sterling Area buyers, and if

delivery was unduly delayed, there was a danger that Sterling Area buyers would find it more profitable to switch their purchases elsewhere, and having once done so their trade might be permanently lost to Japan.⁷⁴

SCAP had never before issued such an explicit statement as to the importance of the sterling area markets in the Japanese trade network.

Thirdly, SCAP officials in charge of financing of trade relaxed their tight control on sterling funds. At first, they introduced control on import licensing in order to tackle sterling shortages caused by heavy seasonal purchases and the slow relaxation of import restrictions against Japanese goods; this caused purchases from the participants to be considerably curtailed by May 1950. Paul Cleveland, the Controller of SCAP's foreign exchange funds up to his death in April 1950, had taken an extremely cautious approach to the use of sterling funds for trade. He had never permitted the issuance of import licences unless there was an adequate amount of sterling cash in sight in the SCAP account. Later, however, the change in SCAP personnel steered the administration of sterling trade finance in a less restrictive direction.

One development after Cleveland's death was that SCAP's sterling fund controllers began to seek a new means of financing sterling trade instead of tight import controls in order to cope with short-term sterling shortages. A couple of weeks after the conclusion of the 1950/51 Trade Arrangement, R.H. Marlow, who took over from Cleveland as Acting Controller, informed the sterling delegates of SCAP's intention to 'swap' a part of its abundant dollar reserves between £10 and £15 million into sterling. Marlow revealed his view on 'swapping':

He [Marlow] had made it clear that he was thinking in terms of increasing the level of sterling procurement beyond Japan's expected sterling income from exports under the Trade Plan, and that he wished to be free to finance these increased procurements by increased 'swaps', in the hope that the Sterling Area would match Japan's increased purchases.⁷⁵

S.T. Baron, who had been working under Marlow, had an even more positive view of sterling trade. Although he conceded that he had had considerable difficulties in getting the

⁷⁴ Meeting of the Sterling Area Delegates, 19 October 1950, AA, A606, R40/1/103.

⁷⁵ Sterling Area Working Party, 'Minutes of the Sixty Seventh Meeting', 15 December 1950, AA, A606, R40/1/98.

approval of his colleagues, Baron felt that 'Japan's trade could only expand satisfactorily if it were accepted by SCAP that Japan's purchases from the Sterling Area must always be considerably ahead of Japan's sales'.⁷⁶ Purchasing ahead of sales would certainly involve the risk of inviting a sterling shortage. The admission by one of the officials in charge of sterling trade finance of the need to import before obtaining an adequate amount of sterling cash through export sales marked a clear departure from Cleveland's conservative policy.

In fact, SCAP had developed a more liberal import financing policy for Japan by late 1950. In November 1950, the ESS Foreign Exchange Budget Committee presented new recommendations on the financing of foreign trade. The memorandum advocated the revision of the import policy 'to permit a more liberal use of available funds'. This meant that raw materials and foodstuffs should be imported from sources which could 'offer Japan the best buy on the basis of price and usual commercial considerations regardless of funding, even though this might require modification of certain Trade Plan commitments'. With regard to the sterling area, the Foreign Exchange Budget Committee ruled that 'the purchase of sterling with dollars to meet financing requirements would be justified if competitive prices or other commercial considerations made it preferable to buy from the Sterling Area rather than a dollar source in the first place'. The underlying idea was that '[s]uch a policy would provide a better opportunity for Japanese industry to secure the raw materials required for both export and domestic production and the Japanese economy would benefit accordingly'. The recommendations were based on the observation that procurement from the sterling area and some other non-dollar, non-sterling trade arrangement countries had been restricted due to a shortage of foreign exchange but that great benefits were now envisaged from expansion of trade with these areas.⁷⁷ The memorandum marked a shift in SCAP's emphasis from dollar saving and cautious trade financing to the economical procurement of industrial raw materials.

SCAP's liberal import financing policy reflected the new international trade circumstances caused by the outbreak of the Korean War in June 1950. Hale, the Chief of the Foreign Trade and Commerce Division, set out a new foreign trade policy in his memorandum dated 18 November 1950. The memorandum noted two recent changes in

⁷⁶ *Ibid.*

⁷⁷ Foreign Exchange Budget Committee, ESS, 'Foreign Trade Financing Policy', 6 November 1950, SCAP, 6709(21), ESS(C)05430.

Japan's economic situation: the improved dollar position due to the special procurement for the US Army, and the increasing difficulties in procurement of foodstuffs and raw materials under sellers' market conditions. Based on grave concerns about the reduction in both exports and domestic consumption caused by shortages of industrial raw materials, Hale asserted that Japan's existing trade and financial policies 'must be liberalized to maximize the import of foodstuffs, essential raw materials and other commodities at prices and under conditions most favourable to Japan'.⁷⁸ The memorandum recommended the extensive utilisation of abundant dollar funds, should the situation require, for procurement from the sterling and other non-dollar areas.

This document clearly indicates that SCAP gave the highest priority to preventing any disruption in the supply of foodstuffs and raw materials to maintain Japan's industrial operations. This explains SCAP's strong persistence in securing sterling transferability and the right of free disposal of sterling funds in the 1950/51 sterling trade negotiations. SCAP showed a readiness to accept a 'switch' of sterling earnings from participant into non-participant trade, up to the value of £3 million. This would enable the mobilisation of sterling funds to finance urgent import contracts with suppliers from the non-participant countries without British approval, even though SCAP was obligated to put certain restraints on purchases from the non-participants in order to maintain the agreed £17 million sterling balance at the end of the trading year. This would virtually give SCAP free disposal of sterling funds, at least in short term import financing. What SCAP did not want was a situation where it was obliged to obtain British approval on every occasion it wished to finance imports from the non-participants using sterling.

Although SCAP observed that the new trade circumstances would offer good opportunities to cultivate Japan's export markets, this objective was not perceived as being of utmost importance. Apart from essential goods such as raw cotton, most countries had not shown any willingness to purchase Japanese goods. According to the Foreign Trade and Commerce Division, in a situation in which the world's major trading countries were allocating an increasing proportion of their industrial capacity to armaments production, Japan could expect to establish its position in export markets 'when resistance to Japanese goods will be lower because of the inability of normal sources' to meet their import

⁷⁸ Hale, 'Foreign Trade Policy', 18 November 1950, SCAP, 6698(25), ESS(B)06753.

demand. Therefore, 'continuing efforts' had to be made to introduce freer multilateral trading conditions. This consideration was in line with the SCAP proposal for application of the GATT principles in the sterling trade negotiations. But Hale admitted the limits of this approach:

It must be recognized, however, that this requires agreement on the part of the other governments concerned. Although agreeing in principle on the desirability of multilateral trade, in practice, various countries of the world find it necessary to impose exchange controls and other trade restrictions. Japan's dependence upon foreign trade makes it impossible for her to divorce her trade and financial policies from those of other trading nations.⁷⁹

This pragmatic observation on international trade circumstances made SCAP further stress the significance of bilateral trade and payments agreements for Japan's economic self-reliance. Hale's memorandum of 18 November set out the principle that 'preference in the expenditure of dollars should be given to trade agreement countries over countries which have made no arrangements'. Trade arrangements were favoured, firstly, to enhance export opportunities, as experience had shown that Japan's dollar liability to a certain country tended to give the creditor country an incentive to increase purchases from Japan. And secondly:

Should Japan's dollar position become less favorable in the future or should her requirements for essential "dollar" commodities decrease, no change in existing agreements or arrangements would be required to readjust Japan's trade and financial policies to take care of such eventuality.⁸⁰

This consideration suggests that SCAP envisaged a return to the pre-Korean War situation where Japan could not count on an abundant dollar supply. In other words, it was in line with the strategy for Japan's economic self-reliance through trade promotion on an unsubsidised commercial basis into more multilateral channels, as prescribed under the Dodge Line. Therefore, the expansion of Japan's commercial networks through bilateral trade and payments agreements was found to be an important instrument to cope with the lingering worldwide dollar shortage and the suspension of dollar convertibility of currencies. In view of the large volume of trade covered by the Sterling Trade Arrangement and the

⁷⁹ *Ibid.*

⁸⁰ *Ibid.*

financial facilities provided by the Overall Payments Agreement, it is no wonder that SCAP recognised the significance of sterling trade.

Australia's position under SCAP's new import financing policy remained strong. SCAP had revealed its intention to expand procurement in sterling from the non-participants — particularly rice from Southeast Asia — making use of sterling earnings from the participants. Resistance by the participants to SCAP's claim to entitlement of free disposal of sterling funds drew from it a commitment to establishing a £3 million ceiling on the free 'switch' of purchasing power to non-participant trade. Combined with the inflated size of the 1950/51 Trade Plan, this limit on the 'switch' meant that SCAP would have to continue to expand purchases from participants, including Australia, to achieve balanced trade.

To take the example of wool procurement, SCAP's liberal import financing policy created strong demand by the Japanese textiles industry for Australian wool in 1950. With the return of Japan's import trade to private channels from January 1950, SCAP abolished the coordination of Japan's wool procurement undertaken by Draper and Company, which had given non-Australian wool producers marketing opportunities in postwar Japan, as mentioned in Chapter 3. The abolition of the coordination system enabled the Japanese woollen industry to concentrate on purchases of their favourite Australian merino wool. The increased allocation of the foreign exchange budget to purchases of raw materials during 1950 further promoted sales of Australian wool. Table 6.1 shows that Australia regained its prewar dominant position in Japanese wool imports during 1950. The Japanese rush into Australian wool markets reflected the potential for Australia and Japan to develop flourishing trade relations once trade was conducted on a less restrictive, more multilateral basis.

The 1950/51 sterling trade negotiations revealed SCAP's quest for the development of Japan's sterling trade on a freer, more multilateral basis, to be achieved through increased exports of non-essential Japanese goods and the application of GATT principles to sterling trade. The sterling participants desperately resisted these moves, reflecting strong domestic concern about the revival of Japanese trading activities. SCAP persisted in asserting its right to dispose freely of sterling funds to make procurements in sterling not only from the participants but also from non-participants. Although SCAP's insistence on this right prolonged the negotiations, this did not mean that its officials intended to restrain the

expansion of sterling trade in favour of dollar savings, as they had tried to do in previous negotiations. On the contrary, SCAP adopted a more liberal import financing policy, as its approval of dollar swaps to obtain sterling credits indicates.

Table 6.1 Japan's Wool Imports, January 1950–March 1951

Suppliers	(Unit: bales)			
	Jan–Aug 1950	Sep–Dec 1950	Jan–Mar 1951	Total
Australia	49,680	65,412	144,992	260,084
(%)	(92.9)	(87.8)	(83.1)	(86.0)
New Zealand	1,474	1,340	6,566	9,380
South Africa	215	1,283	1,460	2,958
South America	1,686	1,810	3,594	7,090
United Kingdom	427	1,898	3,842	6,167
Other	5	2,797	14,055	16,857
Total	53,487	74,540	174,509	302,536

Source: Kanematsu Yomo Nempo, vol.20, 1950–51, pp.110–12; vol.21, 1951–52, p.123.

Thus, the 1950/51 Sterling Trade Arrangement negotiations clearly revealed that SCAP had consolidated its commitment to the strategy of Japan's economic self-reliance through trade promotion on a more multilateral basis. The delay in reaching an agreement mainly resulted from the ambition of SCAP officials to place Japan's sterling trade on a freer, multilateral basis, as illustrated in their insistence on SCAP's right of free disposal of sterling funds. It is noteworthy that SCAP's emphasis on increased procurement from the sterling non-participants coincided with the emergence of a proposal to integrate the Japanese industrial capacity with the economic development of the non-Communist Southeast Asian countries on a normal commercial basis, as pointed out in Chapter 2. Extensive use of bilateral trade and payments agreements was considered the best solution to link postwar Japanese commercial networks with the region under a worldwide dollar shortage. Since the Overall Payments Agreement covered the largest portion of Japan's trade with Asia, it was important for SCAP to establish a freer institutional framework for trade with the sterling area, in order to proceed with this strategy.

SCAP's positive approach to promotion of Japan's sterling trade was, however, soon to be reviewed. The administration of foreign trade was to be handed over to the Japanese government from the end of 1950 to early 1951. This meant that the Japanese government, rather than SCAP, would become the new determiner of trade policy. While SCAP had shown its readiness to expand purchases from the sterling area, even at the cost of spending its dollar reserves to procure from sterling sources, the Japanese government had a different view on strategy to reestablish Japan's trade networks in the post-Peace Settlement period. The difference was to emerge in the subsequent negotiations for revision of the Overall Payments Agreement.

7 Japan at the Crossroads in Postwar Trade Development: The New Sterling Payments Agreement of 1951

The Japanese government took over from SCAP the power to negotiate a new Sterling Payments Agreement when the United Kingdom expressed its intention to terminate the existing Overall Payments Agreement in early 1951. Britain was determined to delete the dollar convertibility clause in the new Payments Agreement. The clause aimed to impose exchange control to guide a certain portion of Japanese exports into dollar markets. The dollars earned were used to finance imports of strategic raw materials and foodstuffs from the United States. Deletion of the clause would mean further integration of Japanese trade with the sterling area, as Japan's purchasing power of sterling commodities would have to be expanded through increased export sales to the sterling area. At the same time, however, if the supply capacity of the sterling area countries did not match their demand for Japanese imports, deletion of the clause would incur the risk for Japan of an excessive accumulation of unusable sterling funds. Since a large part of essential Japanese export goods to the sterling area was produced from raw materials financed in dollars, an excessive accumulation of sterling funds would mean a dollar drain for Japan. If the Japanese were seriously concerned about dollar earnings, as was SCAP in the 1948/49 sterling trade negotiations, it was in Japan's interest to retain the dollar convertibility clause by any means. The outcome of the sterling payments negotiations, therefore, would have a significant effect on the direction of Japan's post-independence trade networks.

This chapter examines the different approaches to dollar convertibility and the sterling payments negotiations of SCAP and the Japanese government. SCAP emphasised the promotion of Japan's sterling trade on a multilateral basis, through such measures as increasing the transferability of Japan's sterling balance. On the other hand, concerned about excessive sterling accumulation, the Japanese government wanted to retain the dollar convertibility clause to restrain exports to the sterling area. Japan was prepared to propose

that it be included in the dollar area, even at the cost of the trade network with the sterling area established by SCAP under past Sterling Trade Arrangements. Behind this proposal, which might severely reduce the existing level of sterling trade, lay optimism among the Japanese about the prospects of dollar earnings, derived from excessive expectations for the US-Japan Economic Cooperation Program. British determination and the political necessity to settle the negotiations before the opening of the San Francisco Peace Treaty, however, forced the Japanese government to accept the deletion of the dollar convertibility clause. Reluctantly, Japan chose to direct its post-independence trade networks more towards the sterling area, abandoning its quest for dollar-based trade. This decision was crucial in the evolution of Japan's postwar strategy for trade promotion on a more multilateral basis.

THE BRITISH PROPOSAL FOR DELETION OF THE DOLLAR CONVERTIBILITY CLAUSE

By early 1951, it had become necessary to revise the Trade Plan as agreed in the 1950/51 Sterling Trade Arrangement. In January and February, the Sterling Area Trade Review Conference was held between SCAP and the participants to review the 1950/51 Sterling Trade Arrangements. SCAP demanded a revision of the Trade Plan which had been based on commodity prices as of July 1950 on the grounds that there had been considerable changes in 'basic factors', including sharp price rises and non-availability of commodities due to the Korean War Boom.¹ In only five months, from 1 July to 30 November 1950, Japanese purchases from the sterling area reached 80 per cent of the £93.6 million scheduled in the 1950/51 Trade Plan.² In order to cope with the tight supply and the financial stringencies, SCAP insisted on inflating Japan's purchasing power during 1950/51 to £136 million while requesting the participants to relax import licensing on Japanese goods.³

¹ Sterling Area Trade Review Conference, 'First Meeting of the Committee of the Whole', 16 January 1951, AA, A606, R40/1/105.

² Japan imported the total sum of £72.5 million in the five months, while exporting £48.6 million. Controller, ESS, 'Sterling Area Trade: Under 50-51 Trade Plan', 10 December 1950, AA, A606, R40/1/103.

³ Sterling Area Trade Review Conference, 'Second Meeting of the Committee of the Whole', 17 February 1951, AA, A606, R40/1/105.

SCAP's request for a relaxation of import licensing renewed Britain's determination to enter into negotiations for a new Sterling Payments Agreement with Japan with no dollar convertibility clause. In its cable of 28 February 1951 to the governments of the sterling participants, London pointed out the defects in the existing sterling trade and payments agreements with Japan.⁴ Firstly, the dollar convertibility clause had caused unduly restrictive effects on Japan's sterling trade. Secondly, the existence of bilateral trade arrangements between Japan and certain sterling area countries such as Pakistan would eventually impair the unity and negotiating power of the whole sterling area.⁵ In view of these predicaments and with the conclusion of a Japanese Peace Treaty in sight, London revealed its decision to announce on 31 March the required three-month notice of its intention to terminate the Overall Payments Agreement. Britain expected that a new Sterling Payments Agreement without a dollar convertibility clause would facilitate trade between Japan and the sterling area, as it would introduce 'a more liberal criterion for imports from Japan than essentiality' and help to encourage 'the widest possible use of sterling as currency of international trade and payments in the Far East as elsewhere'.

Despite its stated position, London's real intention at this stage still lay in the minimisation of the risk of dollar liability in Japanese trade. The British government insisted on the need to continue to exercise a degree of restraint on purchases from Japan even under the proposed new Payments Agreement. Although Japan's dollar position was favourable due to Korean War special procurements, Japan's dependence on the United States for essential industrial raw materials such as raw cotton might entice Japan to extract dollars from the sterling area. It could do this either by dollar-invoicing in exporting essential goods in short supply or by claiming conversion of its sterling balance, particularly if it became large.⁶ According to Australian officials in London, while the Board of Trade considered it inevitable for Japan to have a reasonable accumulation of sterling funds, the

⁴ Cable from Crosec to Canberra, no.43, 28 February 1951, *ibid*.

⁵ Pakistan had refused to join the Sterling Trade Arrangements and individually concluded a bilateral trade arrangement with SCAP in September 1950. In response to London's cable, the Pakistani government informed London of its intention to continue the existing bilateral trade arrangement with Japan. Cable from the government of Pakistan to Canberra, 13 March 1951, *ibid*.

⁶ Cable from Crosec to Canberra, no.43, 28 February 1951, *ibid*.

Treasury would not admit that the risk of dollar liability in Japanese trade was negligible and stressed the importance of retaining tight import controls.⁷

London's cautious approach conditioned subsequent negotiations with SCAP. Having decided to announce its intention to terminate the Overall Payments Agreement, the UK government was concerned about the risk of conversion of the sterling balance to be left in SCAP's hands at the termination date.⁸ In response to a SCAP request that purchases by the participants should match SCAP's proposed expanded purchases of £136 million, the UKLM agreed to issue import licences up to £136 million on condition that before conclusion of any future payments agreement, Japan's sterling balance should be regarded as inconvertible.⁹

At first, SCAP avoided giving any such definite assurance of inconvertibility. However, as SCAP's sterling position deteriorated in mid March, the Controller of SCAP's foreign funds made a strong plea for a dollar swap to finance sterling trade. The UKLM Financial Adviser, H.H. Thomas, declined to take up the issue until 'there was a proper ruling about the question of convertibility'. SCAP showed its readiness to give the requested guarantee on condition that 'it did not prejudice future negotiations with regard to payments agreements, it did not alter the existing O.P.A. in any other respect, and that the Sterling Area would give SCAP swap facilities on demand as required'.¹⁰ In early April, it was eventually agreed that SCAP would 'regard any sterling balance as of 30 June 1951 or thereafter pending conclusion of a new payment agreement or until 31 December 1951, whichever earlier, as not convertible'.¹¹ This agreement made it unnecessary for Britain to take the formal step of repudiating the Overall Payments Agreement, allowing the Agreement to lapse as soon as a new payments agreement was signed.¹²

⁷ Cable from Australian High Commissioner's Office in London to Canberra, 9 March 1951, *ibid.* The Australian government did not share London's pessimistic view. Canberra observed that the risk of dollar drain was negligible because Japan would continue to need sterling funds for 'payment for arrears, resumption of sterling debt service and as part of her foreign exchange reserve'. Cable from Canberra to Australian High Commissioner's Office in London, no.1340, 6 March 1951, *ibid.*

⁸ Cable from Crosec to Canberra, no.44, 1 March 1951, *ibid.*

⁹ N.S. Roberts, Commercial Minister, UKLM, to Hale, Chief, Foreign Trade and Commerce Division, ESS, 2 March 1951, *ibid.*

¹⁰ Sterling Area Working Party, 'Minutes of the Seventy Third Meeting', 17 March 1951, AA, A606, R40/1/98.

¹¹ SCAP to Head, UKLM, 'Sterling Area Trade', 6 April 1951, AA, A606, R40/1/105.

¹² DCA, 'Trade Relations with Japan: United Kingdom-Japan Sterling Area Payments Agreement', 20 February 1952, AA, A606, R40/1/111.

Two objectives lay behind SCAP's concession on the non-convertibility of sterling funds at the termination date. Firstly, as already mentioned, SCAP needed to obtain an extension of £15 million additional sterling credits through a dollar swap in order to improve its deteriorated sterling position. Secondly, SCAP did not wish to let the United Kingdom pre-empt negotiations on the convertibility of Japan's sterling funds into dollars by formally terminating the Overall Payments Agreement. In this way, SCAP also hoped to avoid prejudicing the forthcoming negotiations, which would be conducted by the Japanese government. By early January 1951, with the conclusion of the Peace Treaty imminent, the Foreign Trade and Commerce Division was prepared to hand over its negotiating power to Japan.¹³ The stage was set for negotiations for a new Sterling Payments Agreement between the United Kingdom and the Japanese government.

SCAP'S APPROACH TO THE DOLLAR CONVERTIBILITY CLAUSE

The British request for non-convertibility of the sterling balance at the termination of the Overall Payments Agreement did not attract opposition from the ESS fund controllers, who had insisted on the right of free disposal of sterling funds of the sterling trade negotiations in the previous year. This liberal approach on the dollar convertibility clause in April 1951 was in direct contrast with SCAP's restrictive approach in July 1949, when the sterling delegates even suspected that SCAP might look to sterling trade as a source of dollar income.

At this stage, it is worth tracing the evolution of SCAP's ideas about the dollar convertibility clause and Japan's sterling trade. In mid 1949, SCAP had no intention of allowing the dollar convertibility clause to be deleted. In his memorandum of July, Marquat asserted that the clause should be retained in order to check excessive accumulation of unusable sterling funds. Marquat's recommendation was based on the lower priority given to sterling trade. Pointing to the poor supply capacity and dearer commodity prices of the sterling area, he argued that 'it would be unwise for SCAP to be stampeded into a buying spree, during a period of declining prices for materials not essential for the domestic economy or for the export program of Japan merely for the sake of expending his [SCAP's]

¹³ Hale to Marquat, 'New Trade Arrangements Operating Policy', 25 January 1951, SCAP, 6715(37), ESS(B)07008.

surplus balances'. Marquat even asserted that it was 'not desirable for Japan to direct her foreign trade into sterling channels' because it would 'place Japanese trade in the hands of the sterling area trade authorities in that trade could be minimized or maximized according to their dictates' and that Japan should 'expand its trading areas in order not to be dependent upon any single customer' even at the price of decreased purchases from the sterling area.¹⁴ All SCAP would concede at this stage was to waive convertibility of sterling funds up to \$15 million. This was the minimum needed to prevent a complete closure of sterling trade.

A couple of weeks before Marquat's memorandum, the ESS Textile Division presented an interesting proposal on the use of sterling funds: to gain British approval to export for sterling some goods produced from Japan's indigenous or sterling raw materials (such as woollen and worsted yarn and piece goods, raw silk, silk piece goods) to other, non-dollar, non-sterling countries.¹⁵ Although these goods did not sell well in sterling markets, the report of the SCAP trade mission to South America had indicated good marketing potential there. Furthermore, some Latin American countries, such as Argentina, Uruguay and Peru, had accumulated a large sum of unusable sterling. This sterling could stimulate Japan's trade with South America; Japan might in return be able to purchase important raw materials and foodstuffs without dollar spending. Of course, it was unlikely that the British financial authority would endorse such a facility, because it would allow Japan to further accumulate a sterling balance which could be converted into dollars under the Overall Payments Agreement. But the proposal of the Textile Division did show that SCAP might be more interested in sterling trade, if it could use the sterling funds earned from the participants over a wider range.

In fact, SCAP came to place more emphasis on sterling transferability than retention of the right of dollar convertibility. In its memorandum of March 1950, which was drafted in response to Washington's inquiry about possible inclusion of Japan in the transferable sterling account system, the ESS Foreign Trade and Commerce Division advised Marquat that 'a reappraisal of the convertibility provision of the Sterling Overall Payments

¹⁴ Marquat to Chief of Staff, 'Sterling Area-Occupied Japan Trade Agreement', 19 July 1949, SCAP, 6734(25), ESS(A)05419.

¹⁵ R.D. Cleaves, Chief, Textile Division, to Chief, Foreign Trade and Commerce Division, 'Sterling Area Trade Arrangement', 5 July 1949, SCAP, 6680(12), ESS(C)05161.

Arrangement is considered appropriate'. The Chief of the Division, Pickelle, asserted that SCAP's right to convert sterling was 'solely theoretical', for the past operation of the Sterling Trade Arrangement proved that 'under no conditions would Japan be permitted to acquire sterling balances in excess of the requirements for near term commitments and of the agreed upon £10,000,000 for working capital'.¹⁶ This observation was based on SCAP's tight sterling position since late 1949 due to its heavy seasonal purchases and the slow relaxation of import licensing by the sterling participants. The Foreign Trade and Commerce Division went so far as to recommend including an amendment to the Overall Payments Agreement to eliminate the dollar convertibility clause. The Division ruled out the danger of excessive accumulation of unusable sterling, on the grounds that Japan's Foreign Exchange and Trade Control Law, enacted in December 1949, would establish the machinery to check the flow of foreign currency reserves.¹⁷

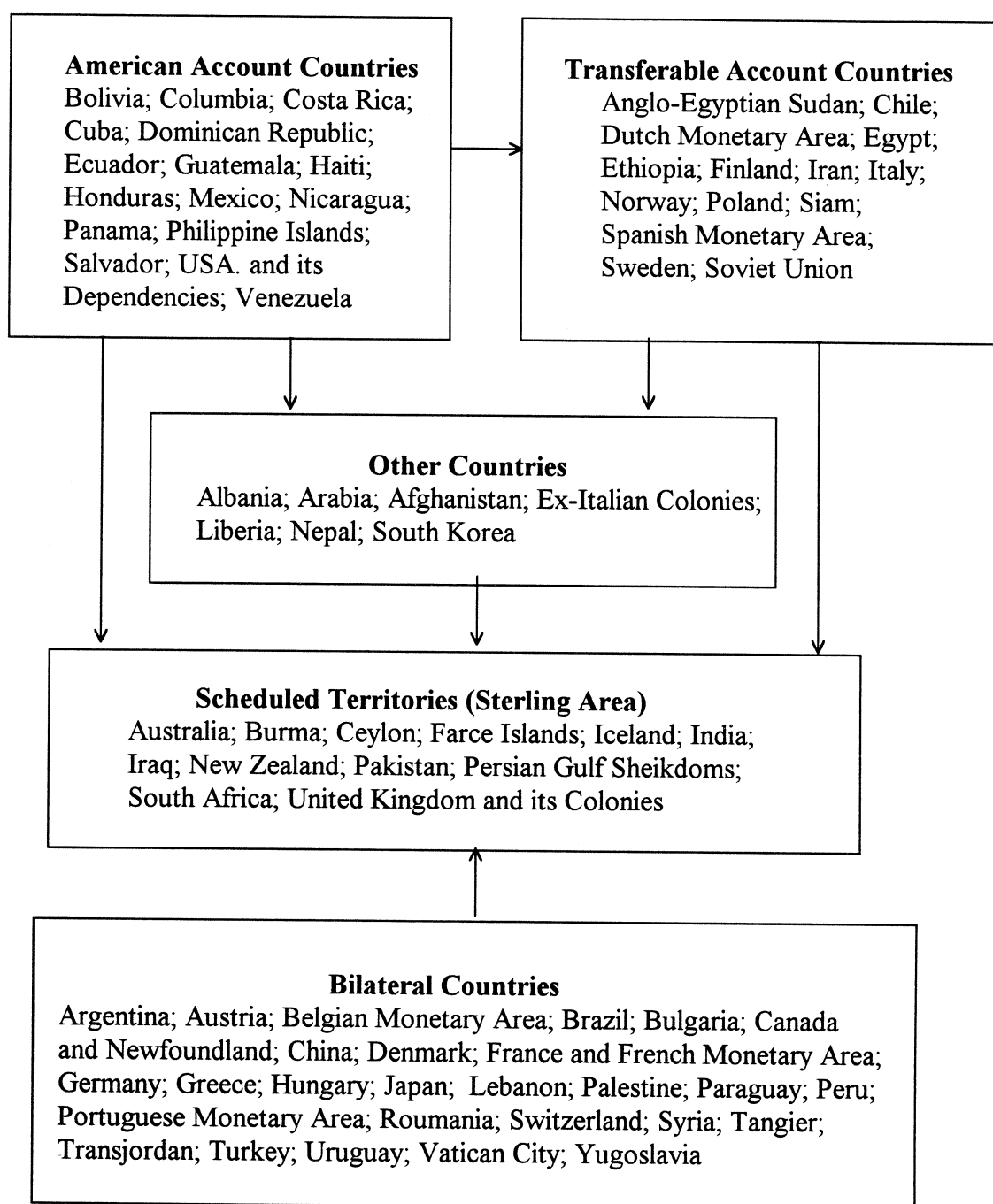
The Foreign Trade and Commerce Division further proposed that Japan be included in the Transferable Sterling Account Countries under the British exchange control criteria.¹⁸ Figure 7.1 gives a classification of countries by the UK financial authority. Since Japan had been listed among the Bilateral Countries, without approval of the Bank of England its sterling balance was transferable only to the Scheduled Territories, that is, the sterling area. Transfer within the sterling area was further restricted by the provisions of the Sterling Trade Arrangement, which stipulated the ceiling to be placed on diversion of Japan's purchasing power earned from the participants into trade with the non-participants. If the United Kingdom agreed to categorise Japan as a Transferable Account Country, the range of countries to which Japan could freely make payments in sterling for its commodity procurement would be widened to cover all the Scheduled Territories, Other Countries and Transferable Account Countries.

¹⁶ Pickelle to Marquat, 'The Change in the Status of Japan from a Bilateral Sterling Account Country to a Transferable Sterling Account Country', 6 March 1950, SCAP 6735(19), ESS(A)05450.

¹⁷ The Foreign Trade and Commerce Division envisaged that control of sterling accumulation would be exercised by invoking new legislation prohibiting exports of specific items to the sterling area for a specific period in accordance with Article 51 of the Foreign Exchange and Trade Control Law. A.J. Greco, Sterling Area Trade Coordinator representing SCAP, to W.J. Krossner, Chief, Trade Arrangements Branch, Foreign Trade and Commerce Division, 'Transferable Sterling', 18 April 1950, SCAP, 6680(21), ESS(C)05187.

¹⁸ Pickelle to Marquat, 6 March 1950, *op.cit.*

Figure 7.1: United Kingdom's Exchange Control Regulations: Outline of Permissible Transfers, January 1949



Note: Arrow indicates direction of transfer without the need for individual approval by the UK exchange control authorities, between different categories of sterling accounts. In principle, internal transfer within groups was permitted without British approval, except for Bilateral Countries. All other transfers required separate approval.

Source: Pickelle to Marquat, 'The Change in the Status of Japan from a Bilateral Sterling Account Country to a Transferable Sterling Account Country', 6 March 1950, SCAP, 6735(19), ESS (A) 05450.

While it would not result in dollar earnings, an increase in sterling transferability would develop trade on a more multilateral basis and expand not only supply sources but also export markets. Payment in sterling would entice Transferable Account Countries to purchase Japanese goods which 'they would otherwise have to forego because of dollar shortage'.¹⁹ Elimination of the dollar convertibility clause would promote relaxation of British import licensing of Japanese goods because the United Kingdom would no longer have to worry about the danger of dollar liability in Japanese trade. The extensive use of transferable sterling would also raise the value of sterling as an international reserve currency. Pickelle observed:

In the event it is decided that the Japanese yen will be backed in part by sterling it would be desirable to secure the necessary amount of sterling through the export sale of Japanese goods and to accumulate such sterling in an orderly fashion and over a relatively long period of time.²⁰

Despite the obvious merits of this proposal, SCAP did not raise the issue of termination of dollar convertibility or of Japan's inclusion in Transferable Account Countries at the subsequent 1950/51 sterling trade negotiations. In examining the effects of these proposals on Japanese trade, A.J. Greco, Sterling Area Trade Coordinator representing SCAP, pointed out the possibility of excessive sterling accumulation resulting from deletion of the dollar convertibility clause on the grounds that the United Kingdom was likely to prefer to sell to hard currency countries some goods which otherwise would have been sold to Japan.²¹ Freed from the risk of dollar liability, the British authority would no longer feel pressed to export commodities in short supply to Japan to match SCAP's increased purchases. It was unclear whether sterling transferability would lead to increases in the overall volume of Japanese trade, because Japan had already succeeded in promoting trade with some Transferable Account Countries through bilateral trade arrangements.²²

SCAP had another objective in its attempt to increase trade through transferable sterling. Greco ruled that the existing Sterling Trade Arrangement enabled Japan to obtain

¹⁹ Greco to Krossner, 18 April 1950, *op.cit.*

²⁰ Pickelle to Marquat, 6 March 1950, *op.cit.*

²¹ Greco to Krossner, 18 April 1950, *op.cit.*

²² By April 1950, Japan had concluded trade arrangements based on dollar open account or cash payments with five Transferable Account Countries, namely Chile, the Dutch Monetary Area, Finland, Siam and Sweden. Krossner to Greco, 'Transferable Sterling', 17 April 1950, SCAP, 6680(21), ESS(C)05187.

its required commodities from the sterling non-participants.²³ As discussed in Chapter 6, at the 1950/51 sterling trade negotiations SCAP officials adamantly persisted in the position that the Overall Payments Agreement entitled SCAP to use freely any sterling earned from the participants to make payments within the whole sterling area, regardless of the provisions of the Sterling Trade Arrangement, which obligated each party to reach mutual agreement in the case of such diversion of trade.²⁴ Such an interpretation would enable SCAP to expand Japan's sterling trade — without asking Britain to give Japan Transferable Account status — simply by using the sterling surplus earned from the participants for purchases of important commodities from the non-participants. W.J. Krosser, Chief of the Trade Arrangements Branch of the Foreign Trade and Commerce Division, who received this advice directly from Greco, was the most outspoken of the SCAP officials insisting on sterling transferability in the 1950/51 negotiations.

SCAP's insistence on sterling transferability did not detract from its overall goal of expanding Japan's overall sterling trade. In fact, SCAP showed its determination to increase the size of the 1950/51 Trade Plan. For example, the Textile Division ignored the opposition from MITI to the allocation of cotton textiles to exports to the sterling participants at the expense of domestic consumption.²⁵

Just before the opening of the sterling payments negotiations in 1951, Krossner visited Washington, where he had discussions with US State Department officials. They described the main objective of a new sterling payments agreement as the expansion of Japanese trade with the sterling area. On the import side, the problem was recognised as 'one of maximizing procurement of critically needed raw materials', while on the export side, as 'one of maximizing Japan's exports to the Sterling Area by consolidating her present position in these markets and developing these markets for Japanese sundry goods'.

²³ Greco to Krossner, 18 April 1950, *op.cit.*

²⁴ Japanese officials regarded SCAP's interpretation as 'arbitrary', because SCAP overlooked the principle that transactions should be subject to the regulations of the Trade Plan encompassing the whole sterling area and each country's exchange control, even if free transfer within the sterling area was stipulated by the Overall Payments Agreement. What SCAP requested was not 'transfer of accounts' but 'diversion of purchasing power'. Since 'diversion of purchasing power' meant revision of the Trade Plan, it should be subject to mutual agreement. Gaimusho Seimukyoku Keizaika [Economic Affairs Division], 'Nihon no Sutaringu Kanjo no Furikae Kanosei oyobi Boeki Torikime Dai-1-ko(g) no Kaishaku ni tsuite' [Transferability of Japan's sterling account and the interpretation of paragraph 1-g of the Sterling Trade Arrangement], 30 May 1950, DAO, B'0.0.2.0.

²⁵ Seimukyoku Keizaika, 'Sutaring Chiiki Tsusho Kaidan: Yushutsu Keikaku' [Sterling area trade negotiations: export programs], 12 June 1950, DAO, *ibid.*

The discussions further focused on the need for the 'avoidance of present and possible future restrictions' by the British foreign exchange control authorities which 'might have the effect of reducing the potential volume of trade between Japan and the Sterling Area countries'.²⁶

Although reference was not made to deletion of the dollar convertibility clause, Krossner's discussions with State Department officials emphasised the significance of the sterling area as a potential export market for Japan and the need to moderate Britain's restrictive import licensing. No concern was expressed about the possibility of an excessive accumulation of sterling balance. These factors suggest that SCAP and US Administration officials would not object to termination of dollar convertibility if this would encourage the UK exchange control authorities to change Japan's status to a soft currency source. As a hard currency source, Japan had been subject to tight import licensing on the grounds of possible dollar liability.

Thus, as SCAP came to lay more emphasis on the significance of the sterling area with respect to raw materials supply and the marketing of manufactured goods, its resistance to moderating the dollar convertibility clause subsided. On the eve of the 1951 sterling payments negotiations, SCAP and Washington worked out the main negotiation strategy for the Japanese government. While it could accept an increase in the amount of inconvertible working capital, this should be in return for such concessions from the United Kingdom as removal of restrictions on transferability, extensive use of Japan's sterling funds in non-participant trade and further extension of sterling credit facilities, which would permit expansion of Japan's sterling trade.²⁷ The dollar convertibility clause was thus no longer a measure to control Japan's scarce foreign exchange but a bargaining tool to expand its sterling trade. The occupation authority was also determined to hand over to the Japanese government the right to make its own independent decisions over the future of Japan's sterling trade in the forthcoming payments negotiations. Now it is necessary to trace the Japanese approach to dollar convertibility and sterling trade in order to clarify Japan's post-independence trade strategy.

²⁶ Krossner to Pickelle, 'Sterling Financial Negotiations', 22 May 1951, SCAP, 6729(22), ESS(A)05204.

²⁷ Radiogram from DA to SCAP, no.DA92078, 24 May 1951, SCAP, 6718(15), ESS(B)07095.

THE JAPANESE GOVERNMENT'S APPROACH TO THE DOLLAR CONVERTIBILITY CLAUSE

SCAP first admitted the Japanese to negotiations at the Sterling Area Trade Review Conference in January 1950, in preparation for the day when it would take over from SCAP the power to make decisions on sterling trade. A memorandum by an official of the MFA, drafted in late April 1950, gave careful consideration to the problem of the dollar convertibility clause, recognising its restrictive effects. In order to minimise control on trade 'as much as possible', it recommended the relaxation of the convertibility clause. It is noteworthy that, while presenting several options, the memorandum considered the possibility of abolishing the whole clause. This would be preferable if it proved that Japan's dependence on the sterling area was such that it did not have a large surplus with the area, or if any surplus which did exist could be used to trade with other Transferable Account countries.²⁸ This indicates that the Japanese government wanted to establish closer trade links with the sterling area in the post-occupation period.

The subsequent inter-ministerial meeting in early May found it 'possible' to remove the convertibility clause in the light of the need to moderate the restrictive British import licensing policy directed at Japanese goods. However, the meeting concluded that there was little possibility of removing the clause, taking into account 'various restrictions under the occupation, US aid to Japan and the backward countries development plan', and opted instead for a 'relaxation' of convertibility through an increase in the sum of working capital from £10 million to £15 or 20 million.²⁹

With regard to the 'various restrictions under the occupation', Japanese government officials were concerned about the 'unfavourable conditions of a non-economic nature under the existing occupation controls' which had resulted in restrictions on Japan's sterling trade. Its occupied status did not allow Japan to enter into a formal trade agreement to giving it non-discriminatory and most-favoured-nation treatment in trade with foreign countries. Many of these countries were in any case alarmed at the resurgence of the

²⁸ Arata Sugihara, Keizaika, Seimukyoku, 'Nichi-Ei Shiharai Torikime no Kokan Kanosei Joko Kanwa no Mondai' [Relaxation of the convertibility clause of the Overall Payments Agreement], undated (27 April 1950?), DAO, B'0.0.2.0.

²⁹ 'Dai-2-kai Nichi-Ei Tsusho Kaidan Jumbi Renrakukai Hokoku' [Report of the second inter-ministerial meeting for the Anglo-Japanese trade conference], 2 May 1950, *ibid.*

Japanese export drive of the 1930s. In fact, the sterling participants flatly refused to discuss SCAP's draft formal Sterling Trade Agreement in the following 1950/51 sterling trade negotiations. The other restriction mentioned at the inter-ministerial meeting concerned 'US aid to Japan'. This referred to Japan's need to earn dollars to finance imports of raw materials and foodstuffs which were available only from dollar sources, in preparation for the decreasing US appropriated funds.³⁰ The Japanese government was aware of the need to maintain control over Japan's exports to the sterling area in order to maximise dollar earnings from export sales to the dollar area.

These factors did not discourage Japanese officials from eagerly seeking sterling trade. In the same inter-ministerial meeting, MITI proposed an 'enormous' Trade Plan with the sterling participants in which annual purchases for 1950/51 amounted to as much as £140 million. This figure was still larger by £4 million than that of the revised Trade Plan of April 1951; which was inflated from the original figure of £92 million because of the increase in commodity prices triggered by the Korean War Boom. In presenting the proposed Trade Plan, it was stated that 'the Plan was drafted by MITI and the Economic Stabilisation Board based on *a policy of diverting imports into the sterling area to the fullest possible extent* and thereby strengthening Japan's dependence on the area' (*my emphasis*).³¹ Japanese officials even considered a proposal to extend sterling credits by depositing Japanese yen in the Bank of England as collateral. Although they predicted strong opposition from both the United States and Britain, officials saw that this was an 'ideal' solution in that it would overcome the difficulties in obtaining sterling credit facilities while helping to strengthen the status of the Japanese yen as an international currency.³² This proposal shows that the Japanese government had little hesitation in strengthening the link between the Japanese yen and the pound sterling.

Thus, before the outbreak of the Korean War, there was little doubt among Japanese officials about the potential of the sterling area as a trade partner. The Japanese

³⁰ Sugihara, 'Nichi-Ei Shiharai Torikime no Kokan Kanosei Joku Kanwa no Mondai', *op.cit.* A handwritten comment on this document reads, 'what must be purchased from the dollar area will amount to \$200–300 million, oil, cotton, foodstuffs'.

³¹ 'Dai-2-kai Nichi-Ei Tsusho Kaidan Jumbi Renrakukai Hokoku', 2 May 1950, *op.cit.* Japanese officials were well aware of the problem of the feasibility of the proposal, taking into account the possible shortage of purchasing power due to the delay in relaxation of import licensing and the still ambiguous British policy on Japan's sterling trade.

³² *Ibid.*

government was concerned more about the import restrictions adopted by the sterling area than the strict controls placed on sterling balance through the dollar convertibility clause. A handwritten comment by a MFA official on the prospect of Japan's sterling reads, 'we cannot hope for a big surplus'.³³ The Japanese concern about import licensing suggests that officials expected that the United Kingdom and other sterling area countries would continue to restrict imports from Japan for political reasons to protect domestic industries so that an excessive sterling surplus might not accumulate even if the dollar convertibility clause was deleted, as long as Japan continued to utilise its sterling surplus for increased commodity procurement from the sterling area.

The positive approach of Japanese officials towards expansion of sterling trade prevailed throughout 1950. In his article commenting on the 1950/51 Sterling Trade Arrangement concluded in November 1950, an official of the Foreign Exchange Control Board (FECB) proposed the termination of dollar convertibility to preclude difficulties in expansion of sterling trade. The official argued that the termination would lead the British exchange control authority to regard Japan as a Transferable Account country, promoting Japan's trade in sterling with countries such as the Sudan, Egypt, Chile and Siam. Since there was little prospect of large trade surpluses accruing with these countries, Japan was unlikely to build up an excess of sterling.³⁴ By the start of the sterling payments negotiations in May 1951, however, this lack of concern about sterling accumulation had disappeared, and the Japanese government attempted to shift its trade strategy away from the sterling area.

THE US-JAPAN ECONOMIC COOPERATION PROGRAM

On the eve of the negotiations for a new Sterling Payments Agreement in May 1951, the Japanese Prime Minister, Shigeru Yoshida, expressed his government's intentions in a memorandum to Marquat. The Japanese government wanted a dollar convertibility clause similar to the existing one, while being prepared to increase the amount of inconvertible working capital from 17 million pounds, as at present, to some higher reasonable figure.³⁵

³³ Sugihara, 'Nichi-Ei Shiharai Torikime no Kokan Kanosei Joko Kanwa no Mondai', *op.cit.*

³⁴ Mamoru Niihara (Trade Division, Secretariat, FECB), 'Nichi-Ei Shin Boeki Kyotei ni tsuite' [On the new Sterling Trade Agreement], *Gaikoku Kawase*, no.17, 1 January 1951, pp.16-17.

This proposal was closely in line with the views expressed by government officials twelve months before.

Yoshida's memorandum explored in detail several alternative approaches to the sterling payments negotiations. The option to accept the likely British proposal to maintain Japan's status as a Bilateral Account country with deletion of the dollar convertibility clause was dismissed on the grounds that Japan would probably accumulate an excessive and unusable sterling balance. To avoid such an accumulation, the Japanese government would be compelled to strengthen controls on exports to the sterling area. The option to include Japan among the Transferable Account Countries with the dollar clause deleted was also undesirable 'unless ample safeguard could be visualized against possible dangers of unduely (*sic*) large sterling accumulation'. It was concluded that Japan should not abolish the dollar convertibility provision but increase the amount of inconvertible working capital so that the sterling area countries could relax import licensing. This shows that, although aware of the restrictive effects of the existing Overall Payments Agreement particularly on 'exports of such desirable items as machinery and sundries' for which the sterling area had been a good customer in the prewar period, the Japanese government was hesitant to open the floodgates to purchases of Japanese goods by the sterling area.³⁶

Anticipating that the United Kingdom might reject the Japanese request for retention of the dollar convertibility clause, Yoshida included a more drastic option in his memorandum: to 'seek to negotiate an agreement which would place Japan on an "American Account" status'.³⁷ For Japan to have American Account status and be classified as a dollar area country in the British import licensing system would have serious implications for sterling trade. Once Japan was admitted as an American Account country, the Bank of England would have to guarantee to exchange Japan's sterling funds for dollars at any time. Japan's sterling balance would also become freely transferable for payments to the countries of the American Account group, Transferable Account group, Other Countries group and the sterling area. Taking an extreme example, Japan could pay in sterling for purchases from the United States.

³⁵ Shigeru Yoshida, Japanese Prime Minister to Marquat, 4 May 1951, DAO, B.0.0.2.0.

³⁶ *Ibid.*

³⁷ *Ibid.*

On the downside, it was obvious that the sterling area would in response impose extremely tight import licensing on Japanese exports for fear of a dollar liability. It was doubtful that Japanese goods were as yet competitive enough to have penetrated successfully tough American markets. On the import side, Japan would be asked for dollar payments for the procurement from the sterling area. Another concern was that the sterling area countries would not increase their imports of Japanese goods sufficiently to cover Japanese purchases of commodities which were not available from the dollar area such as wool, rubber, zinc, bauxite and manganese. As a consequence, Japan could end up with a large dollar deficit both with the dollar and the sterling areas.³⁸

Since it should have been easy to predict these contractionary effects on Japanese trade, why did the Japanese government raise the proposal for American Account status? Yoshida's memorandum pointed out several merits of the proposal. Firstly, American Account status was 'sound' in view of the 'basic concept of liberalizing the flow of world trade'. Secondly, the Japanese industry needed to advance its rationalisation programs to obtain a competitive edge in dollar markets. The memorandum admitted that 'Japan's trade structure, if it remains in its present form, will make a large dollar shortage inevitable'. In view of 'the fact that we should not depend indefinitely upon U.S. aid ... the reason for adoption of this plan becomes all the more cogent'. American Account status would force Japanese industries to concentrate their exports on tough dollar markets.

The Japanese government did not overlook the short-term disadvantages of American Account status culminating in an adverse balance of \$100 million in payments for the following year. It also admitted that some industrial sectors might suffer if exports to the sterling area declined.³⁹ This would seem to be too large a risk for a recovering economy to run. In making this proposal, the Japanese government was daring to reverse SCAP's trade policy of developing networks of trade arrangements with non-dollar areas to sustain Japanese trade without dependence on US aid. Although there is no direct evidence, it is likely that this proposal originated with the idea of the Foreign Exchange Control Board, especially its Chairman, Nobutane Kiuchi. As will be explained later, Kiuchi was an

³⁸ 'Doruken ka Pondoken ka?: Sono Ronkyo to Hoko: Nichi-Ei Shiharai Kyotei Kosho no Yukue' [Dollar trade or sterling trade?: Prospects of the Anglo-Japanese payments negotiations], *Ekonomisuto*, 11 June 1951, p.33.

³⁹ Yoshida to Marquat, 4 May 1951, *op.cit.*

outspoken advocate of exchange controls to keep the national currency 'as hard as possible'. Perhaps Prime Minister Yoshida was swayed by the need to pursue a hard currency strategy, consistent with the Dodge Line. Even so, the risk involved in this proposal was too great to take. In view of the fact that obtaining American Account status had not been considered in the previous inter-ministerial discussions, some special factor to support this option must have emerged in mid 1950.

At this stage the Japanese were optimistic about the prospects for dollar earnings. Yoshida's memorandum pointed out several promising factors to offset estimated dollar deficits, such as dollar receipts from the Korean War special procurement, increasing US overseas spendings and '[L]oans or investments, both government and private, from the United States for the development of Japan's production capacity'. The memorandum stated further that Japan's participation in the Southeast Asia development plans advocated by the US Economic Cooperation Administration would invite a considerable increase in Japan's dollar receipts. In 1951 Japanese government and business circles held high hopes for the US-Japan Economic Cooperation Program, under which US dollar aid to Southeast Asia was to be used to purchase Japanese industrial goods. Japan would have to reserve its supply capacity of industrial goods to be mobilised for the US aid program, even if this meant curtailing export shares to the sterling area. The significance of this was such that the Japanese government asserted that '[T]o increase exports to the Sterling Area on a large scale before Japan's production shows a marked increase would be detrimental in the interest of economic co-operation with the U.S.A'.⁴⁰ The prospect of securing an abundant dollar supply through US aid to Southeast Asia was the key factor pushing Japan towards closer links with the dollar area, even at the risk of reduced sterling trade.

As discussed in Chapter 2, SCAP's Programs and Statistics Division led by Kenneth Morrow, campaigned for the US-Japan Economic Cooperation Program from late 1950. Washington had also worked out a plan to link Japanese industrial capacity with the economic development of Southeast Asia. Its dual objectives were to forestall Communist infiltration into the region and to obtain alternative export markets for Japan, whose traditional trade with China had been closed down. As pointed out in Chapter 6, SCAP duly emphasised in the 1950-51 sterling trade negotiations its right to use sterling earnings

⁴⁰ *Ibid.*

from the participants for procurement from the non-participants, particularly in Southeast and South Asia. But Morrow's plan went further in proposing to mobilise a large portion of Japan's industrial capacity for the US rearmament program in East Asia in preparation for a Third World War.⁴¹

Morrow's initiative stimulated high expectations in Japanese business circles of an abundant supply of dollars to be obtained either directly, through US investment and military procurement in Japan, or indirectly, through a Marshall Plan type of US aid to Southeast Asian countries, which would use these dollars to procure capital goods from Japan. Although neither the US Administration nor SCAP had announced anything definite, the Federation of Economic Organizations (Keidanren) prematurely established a body in preparation for the implementation of the Economic Cooperation Program with the United States.

Yoshida's memorandum to Marquat on the Japanese stance toward the forthcoming sterling payments negotiations was based on these premature expectations and an optimistic view of Japan's future dollar position. The proposal for Japan to be categorised as an American Account country could not stand without an artificial injection of extra dollars through the US rearmament program. The plan thus totally contradicted the strategy put forward under the Dodge Line for achieving Japan's economic self-reliance, based on trade promotion on a more multilateral basis through normal commercial channels with non-dollar areas, by introducing flexibility in the implementation of bilateral trade and payments agreements. Their readiness to incur even the risk of losing large portions of Japan's sterling and other non-dollar trade indicated that the Japanese expected a recurrence of the windfall dollar profits they had received during the Korean War Boom.

Japan's enthusiasm met with a cool response from Washington. On his return from Washington, Marquat announced the broad outline of the US-Japan Economic Cooperation Program on 16 May. No specific US investment and/or procurement plan was revealed. Instead, Marquat stressed that Japan needed to make its own efforts to secure raw materials and foodstuffs and to develop export opportunities on a commercial basis.⁴² In a radiogram

⁴¹ Ikuhiko Hata, *Amerika no Tai-Nichi Senryo Seisaku* [US occupation policy for Japan], Okurasho Zaiseishishitsu, ed., *Showa Zaiseishi: Shusen kara Kowa made*, vol.3, Toyo Keizai Shimposha, 1976, pp.500-504.

⁴² Arisawa and Inaba, 1966, p.145.

to SCAP dated 24 May, Washington also ruled out Japan's proposed stance towards sterling trade as explained in Yoshida's memorandum. While looking to Japan as a source of supply to meet military and other requirements, Washington had yet to make a firm commitment on the Economic Cooperation Program. SCAP was told that the Japanese government should discount estimates of the US aid program to Southeast Asia or US investments in Japan, in working out its strategy for the sterling payments negotiations.⁴³ Thus, the Japanese government had to enter the negotiations for a new Sterling Payments Agreement with Britain without a definite assurance of financial support from the United States. This virtually ended any hope it had of concentrating on dollar-based trade, leaving it no option but to maintain its sterling trade networks.

NEGOTIATIONS OVER PREVENTION OF A STERLING ACCUMULATION

Negotiations for a new Sterling Payments Agreement began in Tokyo on 24 May between Ryuji Takeuchi, International Trade Administrator, MITI, and H.H. Thomas, Financial Adviser, UKLM. In contrast with the previous trade negotiations, only British delegates represented the sterling area. The two chief negotiators, Thomas and J.B. Loynes, Assistant Cashier of the Bank of England, regarded the negotiations as purely a financial matter. The Australian Commercial Counsellor, H.C. Menzies, shared serious concern with the Commercial Minister of the UKLM, N.S. Roberts, about this 'narrow outlook', which might affect the commercial interests of the sterling area countries. But Thomas and Loynes had ruled that 'such mundane matters as trade should not intrude' into the payments negotiations.⁴⁴ On the other hand, as Menzies predicted, the Japanese delegates, headed by a MITI official, were determined to have likely developments in Japan's sterling trade as a result of any new financial settlement taken into account. They requested 'specific and firm assurances' to forestall unduly large accumulation of sterling balance resulted from deletion of the dollar convertibility clause.⁴⁵

⁴³ Radiogram from DA to SCAP, no.DA92078, 24 May 1951, SCAP, 6718(15), ESS(B)07095. Yoshida's memorandum was transmitted to Washington on 16 May. Radiogram from SCAP to DA, 16 May 1951, *ibid.*

⁴⁴ Menzies to Canberra, 24 May 1951, AA, A606, R40/1/105.

⁴⁵ Sterling Financial Conference, 'Statement of Mr. R. Takeuchi, International Trade Administrator, Ministry of International Trade and Industry', 24 May 1951, DAO, B'0.0.2.0.

From the outset, however, the British delegates asserted that financial facilities were 'not merely the oil which lubricates the course of trade' but also 'a force which can make or mar a full development of the international exchange of goods and services'. Thomas lost no time in pointing out the restrictive effects on trade of the dollar convertibility clause, the meticulous task of negotiating a trade arrangement each year and Japan's sterling shortage due to its heavy seasonal purchases. He eagerly proposed deletion of the dollar convertibility clause.⁴⁶

Early on in the negotiations, the British delegates were evasive in giving any assurance about excessive sterling accumulation with Thomas simply stating that such a situation was 'not our desire'. Instead, Thomas pointed out to Japan Britain's readiness to permit the use of Japan's sterling funds in transactions with third countries on an administrative basis, that is, subject to permission by the British exchange control authorities on each occasion. This would extend the range of uses for Japan's sterling funds to include, for example, open account settlements, thus dispelling the possibility of excessive accumulation.⁴⁷ The Japanese expressed strong doubts about whether a third country would readily accept settlement in sterling when Japan had previously paid dollars.⁴⁸

Removal of the dollar convertibility clause might also divert sterling commodities into more attractive dollar markets, since sterling suppliers would be freed from the necessity to make up for trade deficits with Japan through their export sales. In response to Japanese concerns about the resultant limited supply from the sterling area, Thomas refused to guarantee to monitor the export policies of other sterling area countries on the grounds that they were not under British control.⁴⁹

Asked what would be done if unfavourable circumstances arose, Thomas simply answered that consultations could take place if excessive sterling accumulation seemed likely.⁵⁰ Takeuchi was not satisfied with this, anticipating that accumulation would continue while the United Kingdom held prolonged talks with other sterling area countries

⁴⁶ 'Statement of Mr. H.H. Thomas, Financial Adviser to the United Kingdom Liaison Mission', 24 May 1951, *ibid.*

⁴⁷ *Ibid.*

⁴⁸ 'Statement of Mr. R. Takeuchi', 28 May 1951, *ibid.*

⁴⁹ 'Minutes of the Fourth Meeting of the Anglo-Japanese Payments Negotiations', 1 June 1951, *ibid.*

⁵⁰ 'Minutes of the Third Meeting', 29 May 1951, *ibid.*

over the measures to be adopted to counter it.⁵¹ When the Japanese requested an estimation of the likely accumulation, the British delegates declined to respond. The new financial agreement was, they said, just an 'experiment' and 'it was not possible to forecast results, or to guarantee that it would take a certain direction'.⁵²

Faced with Britain's uncooperative stance, Takeuchi clarified the Japanese position in his statement on 14 June:

... it is essential for Japan to protect and promote dollar exports; especially is that so when we consider that we should not continue to depend upon U.S. aid. On a commodity wise basis also, it is necessary to buy in dollars those commodities such as raw cotton, food, iron ore, coking coal, phosphate rock, pulp, crude oil, etc., which we cannot depend upon to obtain from the sterling area ... The problem for Japan is how to apportion her limited export capacity in the various directions to cover her imports. Apart from a case where Japan's production capacity and hence her capacity to export, increase greatly at some future date, it would not be very desirable for Japan, for the time being at least, to permit her exports to be directed to the sterling area to a degree which would be out of promotion to necessary imports. Such a situation will mean that it would invite on the one hand a dollar shortage, while it would give rise to sterling accumulation or an unavoidable import of non-essentials on the other.⁵³

This position to give a lower priority to sterling than to dollar trade was similar to that expressed by Marquat in July 1949, as previously mentioned. Since that time, decreasing US aid had led SCAP to divert Japanese trade from dollar to sterling and other non-dollar channels. In mid 1951, however, Japanese officials were stressing the need to maintain exports to the dollar area in preparation for the termination of US appropriated funds. Takeuchi's statement revealed that there prevailed among Japanese government circles both a strong sense of dependence for postwar Japan's trade on the United States and pessimism about developing Japan's commercial networks on a more multilateral basis. As pointed out in Chapter 2, the closure of traditional Chinese trade due to the Cold War in Asia created such pessimism about the future of Japan's postwar trade that some leftist intellectuals even advocated concentrating on the development of domestic resources as an alternative to promoting foreign trade. This pessimism created excessive expectation within Japanese government and business circles for the US-Japan Economic Cooperation

⁵¹ 'Statement of Mr. R. Takeuchi', 1 June 1951, *ibid.*

⁵² 'Minutes of the Fifth Meeting', 5 June 1951, *ibid.*

⁵³ 'Statement of Mr. R. Takeuchi', 14 June 1951, *ibid.*

Program. In mid 1951, strong aspirations for extra dollar supplies from US 'coordinated aid' to Southeast Asia still lingered, despite the fact that Washington had so far made no definite move in this direction.

Thomas quickly denounced the Japanese position as 'unjustifiably pessimistic' in his letter to Takeuchi two days later. He further revealed that he was 'under categorical instructions from His Majesty's Government not to offer a "dollar clause"'.⁵⁴ In response to Thomas's unequivocal stance, Takeuchi raised his suspicion that the British delegates were refusing to calculate the likely figures of Japan's sterling surplus, because they actually envisaged an accumulation of an excessively large amount. He then suggested that £40–50 million was, for the time being, the maximum sterling balance which Japan could hold.⁵⁵

Takeuchi's reply broke the deadlock, and the negotiators began to work out a definition of 'excessive accumulation'. In the meeting of 21 June, Thomas admitted Japan's right to define the amount it considered excessive. The United Kingdom was prepared to take steps in six months to reduce Japan's surplus 'if Japan's reasonable limits showed signs of being surpassed chronically'. Thomas further suggested that Japan would be able to dispense with the dollar convertibility clause if Britain gave Japan a 'reasonable assurance' that it would attempt to keep Japan's sterling balance within the amount which the Japanese considered appropriate'.⁵⁶

Considerable progress was made in the subsequent ninth meeting of 5 July, in which the Japanese showed preparedness to 'shelve' the question of the dollar convertibility clause, on condition that the United Kingdom provide satisfactory assurances with respect to sterling accumulation.⁵⁷ The British delegates duly conceded in their draft Sterling Payments Agreement that Britain would not 'restrict the availability' of Japan's sterling funds for transfer to payments to the non-sterling area, as agreed between the Bank of England and the Japanese Foreign Exchange Control Board.⁵⁸

Pending instructions from London, hope emerged of reaching an agreement over the 'reasonable assurance' against excessive accumulation in late July. Although the British had

⁵⁴ Thomas to Takeuchi, 16 June 1951, *ibid.*

⁵⁵ Takeuchi to Thomas, 21 June 1951, *ibid.*

⁵⁶ Sterling Financial Conference, 'Minutes of the Eighth Meeting', 21 June 1951, *ibid.*

⁵⁷ 'Minutes of the Ninth Meeting', 5 July 1951, *ibid.*

⁵⁸ 'Anglo Japanese Sterling Payments Agreement', Draft by the British delegates, 10 July 1951, *ibid.*

refused to make a commitment to prevent accumulation of sterling in excess of a certain specified amount as requested by the Japanese government, it submitted on 20 July a draft exchange of letters which confirmed both parties' willingness to keep Japan's sterling balance 'within reasonable limits' and to take all reasonable measures to prevent 'any chronic imbalance'.⁵⁹ Takeuchi thought that this draft 'would, in general, be acceptable'.⁶⁰ The British further agreed that Japanese delegates should state in the final minutes 'their assessment of the standard limit of their sterling holdings at £50 million' and 'their expectation that the U.K. would take necessary steps to keep the balance within such limits'.⁶¹ With regard to administrative transferability, the United Kingdom made another concession by showing its preparedness to approve any transfer of sterling to Transferable Account Countries and Other Countries.⁶²

These concessions seem to have been made as recompense for Britain's ambiguous assurance concerning Japan's right to dispose freely of its sterling balance upon the termination of the new Payments Agreement. Britain guaranteed free disposal only 'in normal circumstances' as long as Japan's sterling trade continued on a sterling basis. If the British interpreted Japan's excessive accumulation of sterling balance as not taking place 'in normal circumstances', Japan would be bound against conversion of its sterling funds into dollars, even after it terminated the new payments agreement to restore Japan's right to convert. Takeuchi did not conceal his disappointment, saying that such a reply 'knocked away one of the "pillars" for deleting the dollar clause'.⁶³ One of the Japanese negotiators, Jiro Shirasu, Adviser to the ESB, informed the British of the considerable difficulties he would have in persuading cabinet ministers without definite assurance on this point. Since Shirasu had close personal relations with Prime Minister Yoshida, the British could be sure that this question of free disposal of sterling balance at the termination date would have serious political repercussions.

Placing confidence in the British assurances and recognising Britain's difficulty in making commitments binding on the whole sterling area, the Japanese delegates eventually

⁵⁹ Thomas to Hale, Director of Trade and Services, ESS, Draft memorandum, 20 July 1951, *ibid.*

⁶⁰ Sterling Financial Conference, 'Minutes of the Eleventh Meeting', 20 July 1951, *ibid.*

⁶¹ 'Minutes of the Twelfth Meeting', 26 July 1951, *ibid.*

⁶² Thomas to Hale, 'Transfer of Sterling between Japan and Countries outside the Scheduled Territories', Draft memorandum, 26 July 1951, *ibid.*

⁶³ 'Minutes of the Eleventh Meeting', 20 July 1951, *op.cit.*

announced their intention 'not to pursue' the dollar convertibility clause any further at the twelfth meeting of 26 July. Although the terms of Britain's assurances were vague, it seemed that this was as far as London would go. Japanese government officials accepted the British terms rather grudgingly. They even considered the possibility of abandoning the negotiations and joining the dollar area, but ruled out this option in view of the danger that the United Kingdom might 'block' free disposal of Japan's existing sterling balance in such a case. Since the issue of excessive sterling accumulation was the most important consideration in Japan agreeing to shelve the dollar convertibility clause, it is remarkable that Japan failed to gain other important concessions such as free disposal of sterling balance at the termination date, extension of credit facilities, and relaxation of import and export controls.⁶⁴ However, Britain had agreed to confine the terms of the Agreement to one year as well as to Japan's right to terminate the Agreement on three months notice in advance, and the Japanese government judged that excessive accumulation was unlikely to emerge within the next twelve months. If it did occur, Japan would be able to overcome the predicament by announcing its intention to abrogate the new Sterling Payments Agreement and to claim dollar payment for Japanese exports.⁶⁵ Thus, both sides had reached agreement in principle on this most important issue by the end of July. However, the negotiations stalled for another month over a new problem.

THE HONG KONG QUESTION AND POLITICAL SETTLEMENT OF THE NEGOTIATIONS

On 20 July the British proposed inclusion of Hong Kong in the new Sterling Payments Agreement, though it was 'prepared to hear what the Japanese had to say'. In response, the Japanese proposed to discuss this issue in the Drafting Committee, which would begin its work on 30 July.⁶⁶ The Japanese government raised strong opposition to Hong Kong's inclusion. Firstly, there was the serious danger of an even greater accumulation of unusable sterling surplus, because the postwar trade pattern indicated consistent overpurchases by Hong Kong from Japan. It was for this reason that Hong Kong had been excluded from the

⁶⁴ Gaimusho Kokusai Keizaikyoku [International Economic Affairs Bureau], 'Nichi-Ei Shiharai Kyotei no Mondaiten' [Problems in the Sterling Payments Agreement], 23 July 1951, DAO, B'0.0.2.0.

⁶⁵ Radiogram from SCAP to DA, no.C-67972, 30 July 1951, SCAP, 6417(22), ESS(E)00968.

⁶⁶ 'Minutes of the Twelfth Meeting', 26 July 1951, *op.cit.*

sterling cash settlement under the Overall Payments Agreement. SCAP had been alarmed at the entrepot trade within the sterling area centred on Singapore and Aden, which purchased essential Japanese goods in sterling and earned dollars elsewhere by reexporting them. So the sterling entrepot meant the loss of opportunity for dollar earnings for Japan.⁶⁷ Secondly, Hong Kong itself had expressed its desire to maintain trade with Japan under the existing dollar open account arrangement.⁶⁸ Thirdly, Hong Kong's inclusion would put its entrepot trade under British control, and the United Kingdom might try to restrain expansion of trade between Hong Kong and Japan.⁶⁹

By mid August, the Drafting Committee had reached agreement on all issues except that of Hong Kong's status. In the meeting of 21 August, the parties clashed over this issue. In response to the Japanese request for separate treatment for Hong Kong, Thomas asserted that 'any suggestion to exclude one of the Scheduled Territories would be in direct conflict with a fundamental principle of sterling area policy' and it would create 'an undesirable and indeed impossible precedent'.⁷⁰ Faced with Britain's flat refusal, the Japanese government proposed to defer formal discussions on this matter until after the end of the year to allow an interim period for a full investigation of trade developments under the new agreement. But Thomas asserted that 'there would be no purpose in further discussion' and requested adjournment to allow the Japanese cabinet to consider the proposal prior to a final decision.⁷¹

Thomas's determined rejection drove Japanese officials to petition SCAP for 'guidance'. However, SCAP told them flatly that 'this decision must be made by Japanese Government'.⁷² SCAP and Washington were determined not to intervene in Japan's sterling negotiations, as the Japanese 'should assume responsibility for final decision on sterling payments agreement and consequently feel that there is no basis for US

⁶⁷ Since the 1949/50 Sterling Trade Arrangement, the sterling area had undertaken not to resell Japanese goods purchased in sterling for payment in dollars. Pickelle, 'Entrepot Trade', 9 November 1948, AA, A606, R40/1/74.

⁶⁸ Hale to Chief of Staff, 'Anglo-Japanese Financial Agreement', 17 August 1951, SCAP, 6726(14), ESS(C)05742.

⁶⁹ Radiogram from SCAP to DA, no.C-67972, 30 July 1951, SCAP, 6417(22), ESS(E)00968.

⁷⁰ Sterling Financial Conference, 'Minutes of the Thirteenth Meeting', 21 August 1951, DAO, B'0.0.2.0.

⁷¹ Radiogram from SCAP to DA, no.C-69402, 22 August 1951, SCAP, 6417(22), ESS(E)00968.

⁷² *Ibid.*

Government's questioning arrangement Japs develop with Britain'.⁷³ On the other hand, Japanese officials seem to have counted on SCAP's intervention to break the deadlock caused by the intractable position of the British. When Thomas conveyed the British determination to stand firm on the issue of Hong Kong's inclusion on 16 August, one of the Japanese chief negotiators, Nobutane Kiuchi, FECB Chairman, strongly challenged his counterparts:

Mr. Kiuchi stated that ... they [Japanese negotiators] desire to stand firm, insisting upon the exclusion of Hong Kong for reasons which they have stipulated in the record of previous meetings. He further stated that the Japanese negotiators would now have to refer this question to the Japanese Cabinet and that any change of position of the JG would be reported to SCAP before it was taken up in conference with the UK representatives.⁷⁴

Kiuchi's attitude suggests that he was sure that SCAP would try to persuade the UK delegates, once informed of the serious danger of added sterling accumulation. In an article written after the negotiations, Kiuchi revealed his belief that SCAP officials had opposed the deletion of the dollar convertibility clause in order to maintain sound management of Japanese foreign exchange.⁷⁵ As already discussed, SCAP had become receptive to the removal of the dollar convertibility clause by this stage, and there is no SCAP document to endorse Kiuchi's observation. It is possible, however, that some SCAP officials, especially those in charge of foreign exchange, could have held such negative views about the clause's removal. As the custodian of Japan's foreign exchange, Kiuchi would have had many opportunities to contact these SCAP officials.

SCAP's refusal to give 'guidance' meant that the Japanese government had no alternative but to accept Hong Kong's inclusion. The Ministry of Foreign Affairs seemed to feel that the Japanese case for excluding Hong Kong was not strong enough to persuade the British.⁷⁶ On 27 August, Kiuchi announced that the Japanese government would accept the Sterling Payments Agreement with Hong Kong included, and it was signed on 31 August.⁷⁷

⁷³ Radiogram from DA to SCAP, no.DA98128, 5 August 1951, SCAP, 6417(22), ESS(E)00968.

⁷⁴ R.W. H[ale], 'Memorandum for Record', Undated (17 August 1951?), *ibid.*

⁷⁵ Nobutane Kiuchi, 'Boeki Seisaku no Kaiko to Hansei: Sono 2' [Retrospect and Review of Trade Policy: Part 2], Gaikoku Kawase, no.101, 15 August 1954, p.4.

⁷⁶ Kokusai Keizaiyoku, 'Nichi-Ei Shiharai Kyotei no Mondaiten', 23 July 1951, *op.cit.*

⁷⁷ Radiogram from SCAP to DA, no.C-50008, 1 September 1951, SCAP, 6417(22), ESS(E)00968.

This was the first major agreement that the Japanese government concluded with a foreign country in the postwar period.

There was an important political factor behind the Japanese decision: the Japanese government needed to settle the sterling payments negotiations prior to the departure of high ranking Japanese government ministers and officials to the San Francisco Peace Conference, due to commence on 4 September.⁷⁸ The new Sterling Payments Agreement was subject to the approval of the Japanese cabinet, which hoped to impress the Allied Powers with its ability to accommodate into the postwar international society by concluding successfully its inaugural negotiations with one of the world's major nations. Thus, Japan's acceptance of Britain's guarantee can also be interpreted as an outcome of its need for early settlement of the negotiations.

Japanese government officials were also aware of the need to conclude a Peace Treaty before they could initiate negotiations on Japan's treatment in the postwar international trade system under the GATT. Pointing to Britain's flat refusal to endorse SCAP's draft formal trade agreement, including provisions on non-discrimination and most-favoured-nation treatment, submitted to the 1950/51 sterling trade negotiations before Japan's independence, a MFA official noted that 'this case illustrates that it is impossible to improve Japan's terms of trade with the sterling area unless a Peace Treaty is concluded'.⁷⁹

JAPAN'S APPROACH TO THE STERLING PAYMENTS NEGOTIATIONS

The political schedule for signing the Peace Treaty drove the reluctant Japanese government into concluding the new Sterling Payments Agreement. Whether the Japanese welcomed it or not, the Agreement was significant for the direction of Japan's postwar trade strategy. Before examining its implications for Japanese trade policy, it is worth reviewing the Japanese government's stance on the sterling payments negotiations.

Firstly, it was obvious that the most important objective of the Japanese government was prevention of excessive accumulation of sterling balance. Washington's cool response to Japan's expectation of securing an abundant dollar supply through the US-Japan

⁷⁸ Hale, 'Sterling Financial Conference', 27 August 1951, SCAP, 6213(12), ESS(B)01874.

⁷⁹ Seimukyoku Keizaika, 'Sutaringu Chiiki Tsusho Kaidan: Boeki Torikime Ambun Kento ni kansuru Zentai Kaigi' [Sterling Trade Conference: the Committee of the Whole], 31 July 1950, DAO, B'0.0.2.0.

Economic Cooperation Program, made the option of seeking American Account status unworkable. It could then have been logical for the Japanese government to claim retention of the dollar convertibility clause. From the outset of the negotiations, however, the United Kingdom demonstrated its firm determination to have the dollar convertibility clause deleted. The British position that the negotiations were solely a financial matter also influenced the Japanese stance. The Japanese government had initially appointed a MITI official, Takeuchi, as chief negotiator, reflecting its intention to discuss broad trade issues as well as sterling financial settlement. From the Seventh Meeting on 14 June, however, when the negotiations focused on a British assurance that there could be no excessive accumulation, the FECB Chairman, Kiuchi, joined the Japanese delegation. These factors forced Japanese officials to seek other ways of preventing overpurchasing of Japanese export goods and to ensuring commodity availability from sterling suppliers.

Secondly, the emphasis on financial matters and the need to prevent sterling accumulation prevented the Japanese negotiators from pursuing such trade issues as non-discrimination and most-favoured-nation treatment. In his opening statement, Takeuchi stressed Japan's intention 'to work for the promotion of trade upon the principles embodied in the General Agreement on Tariffs and Trade'.⁸⁰ Takeuchi also pointed out the discriminatory effects of the British preferential tariffs.⁸¹ Furthermore, in return for Japan's preparedness to 'shelve' the dollar convertibility clause, the Japanese demanded non-discriminatory treatment for Japanese imports in the sterling area.⁸² These Japanese requests received a flat refusal from the British as 'entirely outside the scope of a payments agreement'.⁸³ After that, Japan did not again raise trade issues.

Since SCAP had regarded promotion of sterling trade as one of the most important objectives of Japan's post-independence trade strategy, it was critical of the passive approach of the Japanese negotiators towards trade issues. In his draft radiogram to Washington in mid August, Krossner reviewed the Japanese negotiation strategy:

Japanese Government has not exerted maximum efforts in its own behalf in regard to accession to GATT. Although a relevant subject during early stages of Sterling Payments negotiations and possibility of using concession to the shelving

⁸⁰ Sterling Financial Conference, 'Statement of Mr. R. Takeuchi', 24 May 1951, *ibid.*

⁸¹ 'Statement of Mr. R. Takeuchi', 28 May 1951, *ibid.*

⁸² 'Statement of Mr. R. Takeuchi', 5 July 1951, *ibid.*

⁸³ 'Statement of Mr. H.H. Thomas', 10 July 1951, *ibid.*

of sterling dollar convertibility clause as bargaining lever to obtain commitment in principle by U.K. of early Japanese accession to GATT, the Japanese Government representative did not bring up subject at any stage of the negotiations. Deemed too late now to raise issue in the current negotiations.⁸⁴

Krossner's observation seems rather harsh, given Britain's adamant refusal to discuss trade issues, but it illustrates that Japanese officials showed less determination in seeking elimination of trade barriers in sterling markets than in seeking to prevent excessive sterling accumulation. As mentioned earlier, the Japanese government recognised the difficulty in discussing with Britain such trade issues as most-favoured-nation treatment for Japan before the conclusion of the Peace Treaty. Raising this issue in the sterling payments negotiations might make it difficult to settle the Agreement before the San Francisco Peace Conference or might even affect conclusion or ratification of the Peace Treaty.

Furthermore, Japan was presenting contradictory cases when it expressed on the one hand its strong concern about excessive accumulation due to increase in exports to the sterling area, while on the other requesting measures to facilitate Japan's export trade in sterling markets. During the negotiations, the Japanese demanded export facilities such as an extension of sterling credit facilities and a relaxation of Britain's import licensing, especially for non-essential Japanese goods.⁸⁵ Evading these requests, the British negotiators made an effective counter-argument that the best means for Japan of obtaining these export facilities from the sterling area would be to 'strive to accumulate a working balance' by agreeing to deletion of the dollar convertibility clause.⁸⁶

The higher priority given to prevention of sterling accumulation and Kiuchi's appearance within the Japanese delegation reflected the Japanese stance towards a post-Peace Treaty trade policy. In retrospect, Kiuchi pointed out that the FECB had the 'ideology' to 'keep the Japanese currency as hard as possible' in order to 'return to the normal situation' where there was no need for exchange control. Accordingly, in working out a negotiation strategy for the Sterling Payments Agreement, the FECB insisted that

⁸⁴ Radiogram from Marquat to DA, Draft by Krossner, 17 August 1951, SCAP, 6727(3), ESS(A)05116. It is interesting to note that in the same document Krossner observed that Japan's amendment to moderate the strict Anti-Monopoly Law might 'cast doubt on sincerity of announced adherence of Japanese Government to GATT and ITO principles'.

⁸⁵ Sterling Financial Conference, 'Statement of Mr. R. Takeuchi', 28 May 1951; 'Minutes of the Fourth Meeting', 1 June 1951, DAO, B'0.0.2.0.

⁸⁶ 'Minutes of the Third Meeting', 29 May 1951, *ibid*.