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Wartime and Post-war Economies (Japan)

By Michael Schiltz

Although the military and geopolitical relevance of World War I to Japan must be considered limited, its economic impact was considerable. In sharp contrast to the prewar deficit years, Japan saw its external trade expand rapidly. This article describes how the country's establishment reacted to this shift. In addition to lending to several allies, it also engaged in the politically risky strategy of extending loans to China. These "Nishihara loans" not only reverberated in U.S.-Japan relations for decades to come, but also impacted the Terauchi cabinet's decision to take part in a multilateral Siberian intervention. The domestic consequences of this intervention (the rice riots of 1918) would lead to the downfall of the cabinet and the shelving of pan-Asianist policies until the early 1930s. Economically, the 1920s were a decade of crises and reorientation in the postwar, mostly American-led order.

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Introduction

Although the military and geopolitical relevance of World War I to Japan was arguably limited (apart, perhaps, from the seizure of the German-leased territories and later, its island colonies in East Asia), its economic impact was considerable and, perhaps surprisingly, positive. This assessment must be placed against the backdrop of the complicated decade(s) preceding the first truly global conflict. Quite a few researchers have reiterated Matsukata Masayoshi's claim that Japan used the indemnity of the Sino-Japanese War (1894-1895) to adopt the gold standard, but difficulties in the wake of this policy shift have received far less attention. The "postbellum administration" and yet another military spending spree in the wake of the Russo-Japanese War (1904-1905) were a heavy burden on state finances.[1] To this one should add the structural, state-promoted shift towards military-oriented heavy industry. Large imports of raw materials and machinery meant that Japan ran constant trade deficits between 1894 and 1914, with the exceptions of 1906 and 1909.

This was in sharp contrast to the years leading up to the Sino-Japanese War. In effect, the foreign borrowing necessary to maintain the course towards a nascent empire would be massive; on the eve of World War I, it stood at 36 percent of the GNP.[2] It led to a situation in which "[Japan] floated overseas bonds in order to maintain the gold standard", as one Bank of Japan official put it.[3] What made this unsustainable debt burden nevertheless possible was not the health of Japan's economy, but the Anglo-Japanese alliance.[4]

Seen in hindsight, adopting the gold standard was an audacious attempt to attain superpower status. The outcome of this strategy was not only unforeseeable to its authors (the Meiji oligarchs), but also crucially dependent on the long-term commitment to an agenda that required very considerable sacrifices from the country's population and its institutions. Two major wars (the Sino-Japanese and the Russo-Japanese) paved the way for a restructuring of the country's economy. From the early 20th century onwards, exports from the cotton and silk industries were the drivers behind the massive imports of heavy material which could be re-engineered and produced domestically (*kokusan*).[5] The impact of this restructuring on everyday life must have been remarkable. Especially after 1907, the country's electrification proceeded rapidly;[6] slowly but steadily, the traditional Japanese scenery made room for the modern cityscape, with its electric poles, iron bridges, tram lines, etc. In the works of print artists as Inoue Yasuji (1864-1889) and, later, Kobayashi Kiyochika (1847-1915), one can still find traces of this transformation.

Outbreak of the War as "Divine Providence" (*ten'yū*)

The world war changed the image of a nation that seemed on a path of unsustainable borrowing. As could be expected, the very outbreak of the war was disruptive. The prices of products Japan was importing from European belligerents rose sharply. Much worse, however, were changes in the British, and, to a lesser degree, American, willingness to lend to Japan. Whereas Japan's creditors had already grown wary of the country's apparent insatiable hunger for new loans (between 1904 and 1913, Japan had borrowed approximately one billion yen in British and American funds), the British decision to suspend gold shipments suddenly upset the fragile balance on which the finances of the late Meiji state rested. Most importantly, it cut off its lifeline to the London capital market, the financial foundation of Japan's import and export trade.

Soon, however, the tide turned in Japan's favour. Diminished competition from European producers led to a subsequent (and unprecedented) demand for Japanese products. European-produced beet sugar, to take one example, more or less disappeared from world markets during the war, thereby greatly increasing the price of cane sugar and the profits of Taiwan's sugar producers—especially the Suzuki concern's sugar interests and its bank, the semi-governmental Bank of Taiwan (BOT).[7]

The wartime boost of the Japanese economy began in 1916. When the United States experienced its wartime boom, it was ready to absorb more Japanese exports than ever before. Within Japan itself, domestic producers were able to supply the market for many high-technology goods formerly imported from European countries. From whatever perspective, this development was spectacular: "Between 1914 and 1918, domestic manufacturing increased by 54 percent in inflation adjusted terms [. . .]; exports increased by three times in money terms and by 47 percent in value."[8]

Moreover, Japan was building up a very large gold reserve, in the form of foreign-held currencies. Through the smooth operations of its state-sponsored exchange bank, the Yokohama Specie Bank (YSB), ¥94.4 million in gold poured into the country in 1916; in 1917, the number rose to ¥247.2 million. According to leading financier Inoue Junnosuke (1869-1932), the war economy supplied Japan with enough financial resources to potentially liquidate all its outstanding debts, both foreign and domestic.[9]

Japan as a Creditor Nation

Given the country's dependence on foreign trade for development, however, this was not what happened. It may not be well known, but in the period between 1915 and 1918, Japan lent a total of ¥640,627,000 to Great Britain, France, and Russia; a syndicate of Japanese banks functioned as underwriter. Itō Masanao has made clear that these loans were primarily economic in nature, and stemmed from problems associated with limited specie exchange.[10] This was especially the case after 1917 (when the United States, too, placed an embargo on the export of gold). Facing the prospect of not being able to remit its growing trade surpluses, Tokyo decided to engage in lending in an effort to "fund its own trade". Imports of raw cotton from India were a key commodity. Gold shipments were immediately transferred to Indian wholesalers, in order to enable further imports into Japan and thus sustain furious economic growth.

Japan's first experiment with foreign lending was not entirely successful. Although Great Britain and France were able to pay back their debts by the end of 1924, the Bolshevik revolution of 1917 led Russia to default. Approximately one-third of the loan issues, or ¥220 million, was never recovered.

China’s disintegration: American and Japanese reactions

There were also other loan schemes, and these carried all the hallmarks of a pronounced political interest. These loan schemes were, again, connected with events in the European theatre of war. Most prominently, wartime expediency forced Great Britain to abandon its aggressive economic and political activities in China. Both Japan and the United States, relatively unaffected by happenings on the European battlefield, both attempted to fill the resulting power vacuum. At stake was the policy of “exclusive rights” that the European powers had imposed upon China, and which they regarded as immutable and inalienable.

The American reaction to the opportunity represented, rhetorically at least, a break with the concession imperialism that had been characteristic of European meddling in Chinese affairs. As the United States had sailed a largely isolationist course until roughly 1890, its nascent influence in Asia was already undercut by a series of contracts (for mining rights, building railways, a telecommunications infrastructure, and so on) held by European powers, and through which China’s sovereignty had been further eroded.

The United States’ adoption of the gold standard, in particular, put an end to isolationism, and saw the birth of a strand in American politics that stressed greater American involvement in international affairs. The U.S. government sponsored the establishment of a Commission on International Exchange, whose aim was to investigate the possibility of establishing gold-exchange standards in, among other countries, Panama, Cuba, the Dominican Republic, and Mexico. Their respective currencies would not be based on the pound sterling (the system pioneered by the British in India), but on the U.S. gold dollar. China remained, however, the *nec plus ultra* in the Great Power scramble for concessions and favourable trade agreements, although U.S. interests there had been substantially weakened.

Washington’s reaction consisted of the Open Door Policy. Formulated in the terminology of freedom, equality of privilege, and progress, the Open Door policy managed to mobilize not only public opinion, but also key policy-makers and administrations. Its novelty was not so much the values it claimed to incorporate, but its rhetorical force as an expression of enlightened self-interest. Most importantly, this American cause proved hard to resist. Appealing to a sort of multinational cooperation, the (failed) Jenks mission to China in 1904 was a typical attempt to bring China onto the gold-exchange standard by establishing an overseas specie reserve held by all international partners. There were also other efforts. In 1910, after several series of protracted negotiations, the United States signed an agreement establishing a banking consortium with Great Britain, France, and Germany (Russia and Japan were left out of the agreement until 18 June 1912, because of their lack of financial resources), with the aim of providing financial aid to China. Around 1913, however, soon after the signing of the final consortium agreement, this “reinvented” Open Door policy seemed on the verge of collapse. Two years after the Revolution of 1911, the Manchu empire disintegrated. The country fell prey to a period of warlordism.

Japan saw its opportunity. Financially, Japan’s presence in China had grown significantly after 1900. Through the Yokohama Specie Bank, Tokyo had invested aggressively and almost exclusively in China’s mining sector. In efforts to sustain lending in the face of German competition, in particular for the strategic objective of developing the Hanyeping Coal and Iron Company, YSB went to great lengths. In several cases, the Japanese government guaranteed the loans; in other instances, it even provided direct funding. In total, twenty-six loans materialized (ten of them for the Hanyeping Coal and Iron Company). Yet it was not until 1915 that the country’s policy stance grew bolder. In that year, the Ōkuma Cabinet formulated the infamous Twenty-One Demands, in effect a Japanese attempt to wring concessions from the battered Chinese government of General Yuan Shikai (1859-1916). The policy led to a sharp rebuke from Great Britain and the United States.

Although the final version of the treaty, concluded in 1915, marked an about-face in the Japanese attitude (factually, it gave Japan little that it did not already have in China), the country’s economic presence in China was bolstered like nothing before. Indeed, the evolution of the financial conglomerates or *zaibatsu* cannot be understood without reference to the heavy-handed imperialist tactics of this period.[11] Specializing in heavy industry, mining, foreign trade, and military production, they effectively controlled large swaths of the Japanese economy. After the Russo-Japanese War, a group of “second-tier” *zaibatsu* had developed, primarily in reaction to the lucrative contracts associated with military production. These thus developed an innate, natural connection to Japan’s imperial project.

The Nishihara Loans

A domestic policy shift, namely, the inauguration of the Cabinet of Terauchi Masatake (1852-1919), marked a sharp rhetorical departure from the the Okuma Cabinet's unilateral and miscalculated initiative. In many ways, this foreshadowed the Pan-Asian ideology that characterized much of the 1930s. Its architect was Nishihara Kamezō (1873-1954)[12], at the time an unknown Japanese businessman and adventurer, who had sought to make his fortune in the newly acquired territory of Korea. He appears to have been particularly close to then Governor General Terauchi Masatake, for whom he acted as a policy adviser; he also met Shōda Kazue (1869-1948), governor of the Bank of Korea. Together, this tightly knit trio would form the "Korea connection," which, however small, would manage to leave an important imprint on Japan's foreign policy. It could do so only by upsetting the existing order of institutions engaged in making Japan's foreign policy.

The Yokohama Specie Bank turned out to be the first victim. Highly critical of the Korea connection, its cadre insisted on the importance of the established framework of the multinational China Consortium. For obvious reasons, they regarded Nishihara's proposal for an independent Japanese consortium as reckless. In a remarkable break with tradition, YSB was sidelined. During a series of several (partially secret) missions to China in early 1916, Nishihara would negotiate several loans on behalf of the Japanese government. After 1916, Nishihara's activities accelerated. When both Ōkura and Co. and YSB proved unwilling to lend to the Bank of Communications, Nishihara chose to side with Transportation Minister Cao Rulin (1877-1966) in the new regime led by Duan Qirui (1865-1936). He signed a preliminary loan for ¥5 million. This first Bank of Communications loan (*daiichiji kōtsū ginkō shakkan*) was the only one of the ensuing series of loans for which the banks bore the full risk. In design, it was one of the most obviously colonial loans. Gold currency notes of the same type as Japanese currency were to be issued, backed by Japanese gold notes. This not only would favour Japanese commerce at the expense of the Western powers, but would also be a first step toward incorporating China into a yen-based exchange-standard zone.

When the United States entered the war (6 April 1917), Nishihara's activities intensified. On 20 September 1917, the Japanese government endorsed its support for Duan Qirui. The familiar three-bank group signed a ¥20 million loan contract on 29 September; the total amount would be taken out of the Deposit Fund (*Yokinbu*) of the Ministry of Finance. Yet another loan aimed to bring China into Japan's immediate monetary orbit. Domestic opposition to this blatant hijacking of the foreign policy community only succeeded in postponing the conclusion of negotiations. The progress of the negotiations was slow at first, but they were concluded rapidly—indeed, frantically. The loans were, in chronological order: 1. The Kirin–Hueining Railway Primary Loan (18 June 1918): ¥10 million 2. The Mine and Forestry Loan (2 August 1918): ¥30 million 3. The Manmō Four-Railway Loan (28 September 1918): ¥20 million 4. The Shandong Two-Railway Preliminary Loan (28 September 1918): ¥20 million; and 5. The War Participation Loan (28 September 1918): ¥20 million. These, together with the earlier loans, amounted to no less than ¥145 million. Interestingly, three of the loans had been hastily concluded on the Terauchi cabinet's final day in office.

When news of the agreement was reported in the international press, a rebuke was swift and decisive. The Japanese government was pressured into writing the loans off completely, with the exception of a token repayment of ¥5 million (the first Bank of Communications loan, see above). Statesman Inoue Junnosuke remembered the episode as follows:

> These investments with the central and provincial governments of China— investments running to several hundred million yen—resulted in a dead loss, and today Japan can recover neither the capital which she thus locked up nor one penny of interest on it. To put the matter in a nutshell, I would say that foreign investment was not practiced by this country, and that such trifling investments as were effected might just as well have been thrown into the sea.[13]

The Siberian Intervention and Aftermath: Social Turmoil and Financial Crises

Possibly haunted by the prospect of a condemnation à la Inoue, the Terauchi administration engaged in yet another adventure, this time in the wake of the Bolshevik revolution of 1917. Although the official government stance was that Japan had mobilized out of fear that the Bolshevik revolutionary spirit would contaminate other regions of the world (in particular, China), the army's short-lived plan to occupy large swaths of Siberia hinted at another ambition. Might it not have been intended as a way to recoup losses incurred by lending to Russia? In that scheme, Siberian railways would function as collateral for the loans to the tsar's regime on which the Bolsheviks had defaulted.

It was not to be. The "rice riots" (*kome sodō*), caused by postwar inflation in food prices and exacerbated by rice shortages caused by the Siberian expedition itself, proved too contentious for the administration's survival. On 29 September 1918, Terauchi stepped down. Pan-Asianist ambitions would be shelved until much later in the 1930s.

Seen in the wider domestic context, too, the period was tumultuous. Labour disputes were common in industrializing and industrial nations, and Japan was no exception.[14] During the war and the corollary economic expansion, however, they had to a certain degree subsided. But as the wartime boom came to a grinding halt, the postwar bust set in. Many scholars consider the years between 1918 and 1921 to mark the peak of organized labour power.[15]

The latter cannot be separated from the profound volatility that followed World War I. Although the ending of hostilities had caused a shock to prices and economic activity, the wartime boom seemed to continue from mid-1919. Fuelled mostly by American demand, it had everything of a speculative mania. For approximately ten months, inflation was rampant. Wholesale prices rose 200-250 percent until early 1920. Then, they crashed. Largely as a result of austerity policies adopted by consecutive governments, price deflation continued for twelve years, i.e., until 1932.[16]

For the financial sector in particular, the 1920s proved brutal. Having over-lent during the wartime boom and afterwards, in the postwar inflationary bubble, many banks carried large amounts of bad debts in their books. The provision of financial relief by means of “earthquake bills” after the devastating earthquake in 1923 allowed these bad debts to be borne under a new guise. Banking panics occurred in 1920, 1922, and 1923, but at each time, the Bank of Japan intervened and bailed out the affected institutions. It was a classic example of a “moral hazard” in the making. With every intervention, bankers became more convinced that they could take on more risk. Clearly, a major crisis was inevitable.

The Shōwa financial crisis of 1927 gave Japan a foretaste of the Great Depression that would occur two years later. Doubtlessly aided by rumours spread by the old *zaibatsu*, the crisis took down thirty-seven banks. Most important among them was the Bank of Taiwan, an organ bank (*kikan ginkō*) with extensive ties to the Suzuki Trading Company (*Suzuki shōten*), a newer, second tier *zaibatsu*. The latter was considered a *narikin* institution—a company that had grown rich by fuelling the unsustainable economic bubble of the early postwar period, and that was therefore looked upon with scorn by the older conglomerates. Several scholars have argued that the latter was allowed to fail in order to correct the moral hazard problems that had arisen out of earlier bailouts.[17]

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Notes

1. ↑ Schiltz, Michael: Money on the Road to Empire. Japan’s Adoption of Gold Monometallism, 1873–971, in: The Economic History Review 65/3 (2012), pp. 1147-1168; Nochi, Kiyoshi: Nisshin, Nichiro sengo keiei to taigai zaisei 1896–1913. Zaigai seifu shikin o chūshin ni [Political and economic policies after the Sino and Russo-Japanese Wars and foreign public finance, 1896–1913. An inquiry into the overseas government funds], in: Tochi seido shigaku 23/4 (1981), pp. 19-40.
2. ↑ For an overview of loan issues, see Suzuki, Toshio: Japanese Government Loan Issues on the London Capital Market, 1870–1913, London and Atlantic Highlands 1994, pp. 198-199.
3. ↑ Fukai, Eigo: Kaiko nanajū nen [Looking back at seventy years of my life], Tokyo 1941, p. 80.
4. ↑ Pittaluga, Giovanni B. / Seghezza, Elena: How Japan Remained on the Gold Standard despite Unsustainable External Debt, in: Explorations in Economic History 59 (2016), pp. 40–54.
5. ↑ Samuels, Richard: Rich Nation, Strong Army. National Security and the Technological Transformation of Japan, Ithaca 1996; Umemura, Mataji / Nakamura, Takafusa: Matsukata zaisei to shokusan kōgyō [Matsukata Finance and the Policy of “Promoting Industry”], Tokyo 1993.
6. ↑ Kikkawa, Takeo: The History of Japan’s Electric Power Industry before World War II, in: Hitotsubashi Journal of Commerce and Management 46/1 (2012), pp. 1-16.
7. ↑ Metzler, Mark: Lever of Empire. The International Gold Standard and the Crisis of Liberalism in Prewar Japan, Berkeley 2006, p. 91.
8. ↑ Ibid., p. 95.
9. ↑ Inoue, Junnosuke: Problems of the Japanese Exchange, 1914-1926, London 1931, p. 229.
10. ↑ Itō, Masanao: Nihon no taigai kin’yū to kin’yū seisaku, 1914-1936 [Japan’s international finance and financial policies, 1914–1936], Nagoya 1989, pp. 59-62.
11. ↑ Sakamoto, Masako: Zaibatsu to teikoku-shugi. Mitsui Bussan to Chūgoku [The zaibatsu and Imperialism: Mitsui Heavy Industries and China], Kyoto 2003.

12. ↑ For a more exhaustive description, see Schiltz, Michael: The Money Doctors from Japan. Finance, Imperialism, and the Building of the Yen Bloc, 1895-1937, Cambridge 2012, pp. 121-154.
13. ↑ Inoue, Problems of the Japanese Exchange 1931, p. 37.
14. ↑ The Ashio riot of 1907 is a typical example. For an exploration, see Nimura, Kazuo: The Ashio Riot of 1907. A Social History of Mining in Japan, Durham 1997.
15. ↑ For a history of Japan's labor movement, see Garon, Sheldon: The State and Labor in Modern Japan, Berkeley and Los Angeles 1990.
16. ↑ Metzler, Lever of Empire 2006.
17. ↑ Yabushita, Shiro / Inoue, Atsushi: The Stability of the Japanese Banking System. A Historical Perspective, in: Journal of the Japanese and International Economies 7/4 (1993), pp. 387-407; Okazaki, Tetsuji: Micro-Aspects of Monetary Policy. Lender of Last Resort and Selection of Banks in Pre-War Japan, in: Explorations in Economic History 44/4 (2007), pp. 657-679.

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