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Early Postwar Economic Policies

— The Priority Production Program and the Dodge Line —

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The late 1940s were a period of economic crisis for Japan. The country faced food and energy shortages, mass unemployment, and high inflation. In addition, Japanese and American officials disagreed about what kind of economic course to adopt. The Japanese preferred to increase production and tolerate significant inflation. The Americans wanted Japan to suppress inflation quickly in order to strengthen export industries. These competing priorities were reflected in two of the most important early postwar economic policy programs, the Priority Production program and the Dodge Line. These policies were not completely successful, but they helped to pave the way for the development of Japan's strong export industries.

Table 1 Timeline: Economic Policies, 1945-52

1945	Sept 1	The war ends
1946	June	The cabinet ends military-related payments, but the economy worsens
	Aug	The Economic Stabilization Board (ESB) is established
	Dec	The Priority Production program is adopted by the cabinet
1947	Jan	The Reconstruction Finance Bank (RFB) begins operation
	March	The ESB is given strong economic powers
	Aug	The EBS issues the first Economic White Paper
1949	Jan	Conservatives win election and Shigeru Yoshida becomes prime minister
	Feb	Dodge arrives in Japan
	April 23	The exchange rate is set at 360 yen to one US dollar
	Sep 18	The pound is devalued from \$4.03 to \$2.80
1950	June 25	The Korean War begins
1952	Jan	The RFB is absorbed by the Japan Development Bank
	Aug	The ESB is abolished

Coal shortages and high inflation made it very difficult to revive the economy, especially manufacturing industry. Coal was Japan's main source of energy, but by the end of the war, the coal mining industry had almost collapsed. Output fell from more than 4 million tons per month during the war to only 554,000 tons per month in November 1945. One reason was that a labor shortage resulted when SCAP repatriated thousands of Korean and Chinese mineworkers to their home countries. Afterwards, the Japanese workers had disputes with managers. In addition, the mining companies lacked capital for investment.

Inflation, which had risen rapidly during the war, increased even faster in the year after the surrender. From August 1945 to March 1946, prices increased about 12 times. One reason for high inflation was that the government continued to pay companies for military contracts in an unsuccessful effort to stimulate investment. In mid-1946, SCAP finally forced the government to

stop paying for military contracts. But the government's budget deficit continued to grow, partly because of low taxes and heavy costs for government-owned schools, hospitals, and companies. From 1946 to 1948, the budget deficit accounted for 10 to 15 percent of the national income, and was thus a major source of inflation. Table 2 shows inflation rates during the Occupation. 1 represents the wholesale price index in 1934-36. The index is calculated to include both official and black market rates, so that it reflects real prices as accurately as possible. It can be seen that from 1934 to 1952 prices increased 350 times.

Table 2 Inflation during the Occupation, 1945-52

Year	Multiple*	Annual rate of Increase, %
1945	3.5	
1946	16.3	365.7
1947	48.2	195.7
1948	127.9	165.3
1949	208.8	63.2
1950	246.8	18.2
1951	342.5	38.8
1952	349.2	1.9

Source: Tsuru, *Creative Capitalism*, p. 45

*The wholesale price index for 1934-36 = 1.

The government established the Economic Stabilization Board (ESB) and the Reconstruction Finance Bank (RFB) to deal with the crisis. The ESB was established in August 1946 to coordinate economic planning. In early 1947, it was given special powers to administer the Priority Production program (*keisha seisan hoshiki*; literally weighted production). The Reconstruction Finance Bank (*Fukko Kin'yu Kinko*) was created to loan money to industry.

The Priority Production Program

Several economists and bureaucrats in the ESB devised the Priority Production program in late 1946 as a way to revive the economy. The main architect of the plan was Hiromi Arisawa. The program's strategy was to concentrate resources on the most important economic sectors, especially coal and steel. The program gave the steel industry first priority in receiving coal and imported oil supplies so that steel companies could increase output; the steel was then used to repair coal mines in order to increase coal output; and finally, steel and coal were allocated to other industries to bring about an overall recovery. The policy was controversial because ordinary people and other industries, especially railways, also needed coal. The secondary priorities included other basic industries, especially fertilizer and railways.

The ESB was established in August 1946 to be a planning agency, but in March 1947 it took charge of executing Japan's economic policies. From March 1947 until early 1949 it administered the Priority Production program. The ESB bought commodities from companies at high prices and sold them to consumers at low prices, and gave subsidies to industry.

The Reconstruction Finance Bank (*Fukko Kin'yu Kinko*) began operating in January 1947. Between January 1947 and early 1949, loans from the Reconstruction Finance Bank (RFB) accounted

for about three-fourths of investment in all industries. The loans were administered by the ESB, and coal received top priority. 84 percent of the money went to the coal, iron and steel, fertilizer, electric power, shipbuilding, and textile industries. 60 percent of the loans were received by only 97 firms. The ESB was disbanded in 1952 and replaced by the Economic Planning Agency (Keizai Kikakucho) and the RFB was absorbed by the Japan Development Bank in January 1952.

In general, the Priority Production program was effective in increasing coal production and helping to revive industry. However, it also spent large amounts of money and worsened inflation. Many of the loans to business were probably never repaid. By mid-1948, the government and SCAP realized that the system had to be changed. Table 3 shows the payment of government subsidies during the 1940s. It shows that between 1946 and 1949 the government spent from around 20 percent to 30 percent of its general account budget on industry. SCAP thought that the ESB director, Tanzan Ishibashi, did not care enough about stopping inflation, so it purged him. (However, Ishibashi became prime minister in 1956.)

Table 3 Government payments of price subsidies and indemnities, 1940-1952 (million of yen)

Year	Total general account		Price subsidies		Indemnities for losses	
	Budget	expenditures	(kakaku	chousei hi)	(sonshitsu	hoshu hi)
1940	5,856	100 %	17	0.3%	60	1.0%
1941	7,929	100	95	1.2	55	0.7
1942	8,271	100	305	3.7	240	2.9
1943	12,491	100	510	4.1	265	2.1
1944	19,872	100	1,266	6.4	567	2.8
1946	115,207	100	3,731	3.2	22,661	20.0
1947	205,841	100	28,178	13.7	8,566	4.2
1948	461,974	100	93,118	20.2	16,632	3.6
1949	699,448	100	179,284	25.6	31,838	4.6
1950	633,259	100	60,162	9.5	7,830	1.2
1951	749,836	100	26,975	3.6	9,560	1.3
1952	873,942	100	40,308	4.6	8,183	0.9

Source: Johnson, *MITI*, p. 184

The Dodge Line

The Japanese and American governments had different economic priorities. The Japanese wanted most of all to revive industry, and were not worried about moderate inflation. The American government wanted Japan to suppress domestic consumption in order to increase exports. American officials were anxious to reduce the heavy expense of aid to Japan. They also wanted Japan to be able to participate in a global free trade economic system, which would support the anti-communist containment policy.

The US government wanted a strong anti-inflation program for Japan. General MacArthur opposed such a policy, so the government appointed Joseph Dodge, a conservative banker, to take charge of SCAP's economic policy. Dodge spent three months in Japan in spring 1949. During this time, he established a harsh anti-inflation policy, forced the government to balance its budget, and decided the exchange rate. Dodge's policies are called the Dodge Line.

Dodge ended government subsidies and RFB loans to industry because he believed that they were the main causes of inflation. To replace the RFB, he introduced the US Aid Counterpart Fund. The Fund resembled the Marshall Plan for Europe. It was designed to dispense aid without stimulating inflation. Dodge also forced the government to balance its budget. Taxes and train fares were raised and government spending was reduced. At least 320,000 government employees were fired, and welfare and public works spending was cut sharply. The government began to run a surplus because it received more money from taxes and American economic assistance than it spent. In addition, Dodge set the exchange rate at 360 yen to the dollar. This surprised the Japanese, because most American and Japanese officials believed that 330 yen (or less) was the appropriate rate. (In fact, Washington officials, not Dodge, made the decision, because they knew that Britain was planning to devalue the pound.)

Many of Japan's leading businessmen, government officials, and conservative politicians wanted the US to impose a strong anti-inflation program, although they did not say so publicly. Prime Minister Shigeru Yoshida and Finance Minister Hayato Ikeda supported Dodge. Conservative leaders supported policies that would help to rationalize industry and weaken labor. However, even conservatives probably thought the policies were too harsh. Dodge did not even allow the government to pay for building new schools because he thought money should be used for productive investment. However, the economy continued to weaken during 1949 and early 1950. Unemployment grew much worse and many small businesses failed.

The Ministry of Finance and the Bank of Japan wanted to soften the effects of the Dodge Line and find new ways to channel money to business after the RFB closed. They were quietly helped by American officials who disagreed with Dodge. The Ministry of Finance and the Bank of Japan instituted the Tight Money Neutralizing Measure (Kane Zumari Kanwa Hosaku). The Bank of Japan began to loan money to city banks, and the city banks then made loans to industry, mainly to large companies (therefore, bank deposits and loans increased rapidly; see Table 4). This practice

Table 4 Change in Financial Conditions from April 1949 to June 1950

(1) Supply of Funds					
(100 million yen)					
Funds withdrawn by the government from the private sector					1,289
Increase in deposits at financial institutions					3,825
Total of the above (amount of funds withdrawn from private holders)					5,114
Increase in lending by financial institutions					4,753
Increases in industrial funds supply from other sources					5,574
(2) Major accounts of commercial banks					
	Total deposits	Total borrowings	Total Lending	Holdings of national bonds	Holdings of corporate bonds
End of March 1949	5,060	534	3,571	799	312
End of June 1950	7,896	1,017	6,815	429	528
Net increase	2,836	483	3,244	-373	216

Source: Nakamura, p. 40

became the start of “overloaning.” (Overloaning means that the Bank of Japan increased loans to city banks, so that the city banks were able to make very large loans to business.)

The economy began to recover in mid-1950 because of demand caused by the Korean War and new US economic assistance. Prime Minister Yoshida called the Korean War, which began in June 1950, “a gift of the gods.” The war stimulated global demand, and led the US to change its economic policy toward Japan. The US began to purchase many of its military supplies from Japan in order to strengthen the Japanese economy. The military purchases were called special procurements (tokuju), and they continued after the war ended. Between 1950 and July 1953, when the Korean War ended, the US spent 970 million dollars for special procurements. By 1955, the total was 3.65 billion dollars. Since Japan lacked foreign exchange, the special procurements made it possible for Japan to greatly increase its imports of raw materials and other products necessary for industry.

The Dodge Plan is still controversial. It failed to stimulate economic growth and export growth in the short term, partly because the international economy was depressed (in contrast, the global economy grew rapidly during Japan’s high growth era, creating strong demand for Japanese steel, ships, and other products). In addition, some analysts believe that Dodge’s policies were less harsh than they appeared. Nevertheless, the Dodge Line had three important consequences.

1. The Dodge Line caused a recession that badly weakened small business and labor unions. As a result, the national bureaucracy and big business increased their control over the national economy.
2. The Dodge Line established a tradition of strictly balanced budgets. Balanced budgets remained Japan’s basic fiscal policy until the late 1960s. (However, monetary policy after 1950 was generally expansionist.)
3. The Dodge Line (indirectly) paved the way for the “high-growth” industrial policies of the 1950s and 1960s, especially by strengthening the ties between big companies and banks and by encouraging overloaning.

In addition, the government continued to provide special assistance to priority industries during the early 1950s. Other priority industries included fertilizer, railways, shipbuilding, and electric power. By increasing investment and efficiency in basic industries, the government was attempting to make the national economy more internationally competitive. The government subsidized the purchase of coal mining technology from Germany, but the coal policy eventually failed because the quality of Japan’s coal is poor.

The Production Priority Plan and the Dodge Line encouraged the government to make economic growth its main priority, and strengthened the influence of the government ministries, including the Ministry of Finance, and big business. These factors encouraged the development of Japan’s export industries during the high growth era.

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