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DATE October 27, 1953

COPY NO. 1

OPERATIONS COORDINATING BOARD

Washington, D.C.

PROGRESS REPORT ON NSC 125/2 AND
NSC 125/6 (JAPAN)

REFERENCE: NSC Executive Secretary Memo to OCB 12/15/53

OCB FILE NO. 11

100124

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This document contains information affecting the national defense of the United States, within the meaning of the espionage laws, Title 18, Sections 793 and 794, U.S.C., the transmission or revelations of which in any manner to an unauthorized person is prohibited by law.

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OPERATIONS COORDINATING BOARD
Washington 25, D. C.

December 16, 1954

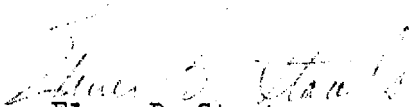
MEMORANDUM FOR THE OPERATIONS COORDINATING BOARD

SUBJECT: Progress Report on NSC 125/2 and NSC 125/6 (Japan)

The attached Operations Coordinating Board progress report on NSC 125/2 and NSC 125/6 "United States Objectives and Courses of Action With Respect to Japan," dated October 27, 1954, was noted and discussed by the National Security Council on December 9, 1954, Action No. 1285a.

The NSC further noted (Action No. 1285b) that the NSC Planning Board would prepare a revised policy statement on the subject for Council consideration in January 1955.

The previous draft of this report dated October 22, 1954 is obsolete and may be destroyed in accordance with the security regulations of your agency.


Elmer B. Staats
Executive Officer

Attachment:

OCB Executive Officer Memo to Mr. Lay, NSC, dated 10/28/54, subject as above, with attachment as listed.

OCB File No. 11

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OPERATIONS COORDINATING BOARD
Washington 25, D. C.

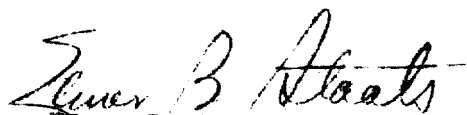
October 28, 1954

MEMORANDUM FOR: Mr. James S. Lay, Jr.
Executive Secretary
National Security Council

SUBJECT: Progress Report on NSC 125/2 and NSC 125/6 (Japan)
(Policy approved by the President, August 7, 1952
and June 26, 1953)

There is attached the first Progress Report by the Operations Coordinating Board on NSC 125/2 and NSC 125/6, "United States Objectives and Courses of Action with Respect to Japan." These NSC papers were assigned to the Board on December 12, 1953; and this report covers the period through September 15, 1954 with the addition of the latest information available on the Japanese economic situation. The report was approved by the Operations Coordinating Board on October 27, 1954.

The Board noted that since September 15, 1954 an agreement on reparations between Japan and Burma, mentioned on page 10 of the report, was initialed in Tokyo on September 25. It provides for payment by Japan of \$20 million annually in goods and services over a period of ten years and economic cooperation in the form of joint enterprises with Japanese investment in the amount of \$5 million annually for ten years. This agreement will be concluded formally in Rangoon on November 3.


Elmer B. Staats
Executive Officer

Attachment:

Progress Report on NSC 125/2 and
NSC 125/6 (Japan), dated 10/27/54.

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October 27, 1954

PROGRESS REPORT ON NSC 125/2 and 125/6

"UNITED STATES OBJECTIVES AND COURSES OF ACTION
WITH RESPECT TO JAPAN"

(Policy approved by the President, August 7, 1952 and June 26, 1953)

A. SUMMARY OF MAJOR ACTIONS

1. The United States has in the past two years concluded a number of important agreements with Japan, including a Mutual Defense Assistance Agreement, Treaty of Friendship, Commerce and Navigation, and revision of the criminal jurisdiction provisions of the Administrative Agreement. Joint agreement was also reached for return of the Amami Oshima group to Japanese control.

2. During 1953 Japan incurred a serious balance of payments deficit notwithstanding a continued high level of United States special expenditures of about \$785 million. This imbalance continued during the early part of 1954. Corrective measures initiated by Japan in October 1953 alleviated this condition. For the past six months ending September 1954 a balance of payments surplus appeared even though U.S. special expenditures declined to an annual rate of about \$550 to \$600 million. Japan was admitted provisionally to the General Agreement on Tariffs and Trade and the United States is taking the lead in multilateral negotiations to bring Japan fully into GATT. United States preparations are underway for comprehensive United States-Japanese tariff negotiations, which are scheduled for early 1955. Private technical assistance arrangements and loans totalling \$40 million by the International Bank for Reconstruction and Development have been made, but Japanese productivity is still deficient in important fields. United States economic assistance to Japan consisted of a grant of \$10 million in local currencies to Japan under the agricultural surplus program, and three short-term cotton loans totalling \$160 million by the Export-Import Bank. Japan's contribution to U. S. forces was reduced by \$7 million. Negotiations for settlement of the claims of the United States arising out of economic assistance rendered during the occupation (GARIOA) were begun.

3. Japan has increased the size and strengthened the functions of the Japanese defense forces, although the total is still well short of that considered desirable by the Joint Chiefs of Staff. The Japanese Diet has authorized an expansion of Japanese defense forces to a total of 164,538 men, including the new air force, and

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has empowered them to resist direct attack. The United States provided increased military assistance to Japan, and will continue to do so under the Mutual Defense Assistance Agreement through substantial military grant-aid and training programs. Some progress has been made toward the establishment of a Japanese defense production base, largely through the activation by offshore procurement of a broad range of ammunition and explosive manufacturing facilities for small arms and artillery. Plans are being formulated for the establishment of limited capacity for production of certain tactical military aircraft over the next two years. Arrangements have been completed for a joint United States-Japanese industrial mobilization planning group to study the development of a broader production base in Japan.

4. Vigorous information programs have been carried on to give the Japanese a better understanding of the United States and of world problems and to combat leftist and neutralist influences.

5. Japan has continued to cooperate with the United States on security export controls. Pursuant to understandings with the United States it has gradually reduced the number of items embargoed to Communist China to those multilaterally agreed.

B. OPERATIONAL CONSIDERATIONS BEARING ON POLICY

6. The NSC 125/2 and NSC 125/6 were designed to cover the immediate post-Treaty period, during which the Japanese were regaining their sovereignty. Certain important objectives have not been achieved and it can be anticipated that troublesome problems in relation to Japan will arise and continue. Economic difficulties, ineffectual governmental leadership, pressure from Communist areas, and reluctance in moving positively toward self-defense have not been solved. In addition, there have arisen a serious increase in neutralist sentiment, periodic flare-ups of anti-Americanism and an intensification of communist overtures to Japan. New factors have arisen in U.S. relations to Asia such as the SEATO and the proposed SEA economic grouping. As a consequence, a complete review of NSC 125/2 and NSC 125/6 and of U.S. objectives and courses of action is recommended.

7. NSC 125/2, paragraph 7b(2) and NSC 125/6, paragraph 3b(1) give emphasis to the development of Japanese ground forces while Defense has stressed the necessity for a force structure composed of appropriate strength in naval and air forces as well as ground. The Japanese on their part appear to question this force concept, laying greater emphasis on air and naval forces. There is also feeling in Japanese military circles that nuclear weapons require revision of present defense plans. Several problems such as joint planning, Japan's role in the Far East security picture, and ultimate initiation of withdrawal of U.S. forces have become more important now that Japan has taken the initial steps to expand its defense structure. A new NSC paper should take cognizance of these problems in the light of the current situation.

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C. EMERGING PROBLEMS AND FUTURE ACTIONS

8. Economic Difficulties

Japan's economic difficulties present an obstacle to the attainment by the U.S. of certain major objectives in Japan, particularly in respect to the strengthening of international economic relationships, cooperation with other friendly nations of the Far East, and the indigenous support of an adequate defense program. There exists an uncertainty as to the ability of the Japanese Government to continue and expand measures which recently improved the balance-of-payments position in the face of diminishing U.S. military expenditures. Japan's financial future is further obscured by the unsettled reparations arrangements with Southeast Asian countries, which are also adversely affecting the development of a healthy trade pattern. Decision has been made to establish an FOA mission in Tokyo. The prospective decrease in U.S. special expenditures will increase the difficulties of Japan attaining self-support by Japan, and the U.S. should, therefore, give particular attention and emphasis to (1) reduction of trade barriers, by negotiating with Japan at the GATT negotiations scheduled for February 1955, and by encouraging friendly third countries to negotiate similarly; (2) exercise of greater control over the programming of U.S. Government expenditures in Japan, so as to anticipate and ameliorate the effect of diminishing dollar receipts from this source; (3) improvement of productivity, through a jointly financed technical assistance program, and the investment of dollars and local currencies; (4) provision of continuing support for the Japanese defense structure through military assistance, defense facilities assistance, and offshore procurement; (5) assistance and encouragement in the development of raw material availabilities, particularly in Southeast Asia countries; (6) encouraging the Japanese to improve their receptivity toward foreign private investment and to continue and strengthen sound internal financial and economic measures to improve their international position; (7) provision of economic aid when necessary and appropriate predicated on Japanese participation and self-help.

9. Ineffective Political Leadership

Conservative groups are politically dominant but continue to be split by personal rivalries rather than differences of principle. If these groups could cooperate effectively they would control about two-thirds of each House of the Diet, and would be able to carry out policies on which they generally agree for economic stabilization, control of leftist activity and stronger defense. Particularly needed are government programs to awaken the nation to a sense of international responsibility, to take legal measures against Communists, and to combat the neutralist, anti-American tendencies of many of the individuals in Japan's educated groups. The U.S. should do what it can to encourage effective conservative action in Japan, although the immediate prospects of conservative merger and effective government leadership are not good.

10. Inadequacy of Defense Measures

Measures undertaken by the Japanese Government to expand its self-defense forces including tentative five-year plans, fall far short of the goals set by the JCS. In contrast to the JCS force goals of 348,000 for ground forces, the Japanese Government has shown a comparatively greater interest in expanding its air and naval forces. Serious disappointment has been shown by the Japanese Government in the alleged failure of the U.S. to make available the 17 naval vessels requested. However, a general support has been obtained for the government's defense program and there appears to be a growing popular acceptance of military institutions. In addition to the economic situation, there are political and psychological factors which impede the development of an adequate defense program. A growing tendency is becoming evident on the part of the Japanese Government to make any defense build-up dependent on increased U.S. military and economic assistance and reduction in Japan's contribution to the maintenance of U.S. security forces in Japan. In view of the present international picture in the Far East the pressures in this direction can be expected to increase rather than to diminish. The U.S. should continue programs of military assistance as well as efforts to reach agreement with Japan on the size and strategic role of its forces. Further progress toward the establishment of a Japanese defense base adequate to meet U.S. objectives will be dependent largely on the furnishing by the U.S. of technical production services, facilities assistance, educational orders, and a continuing offshore procurement program; and the development of all these programs will call for a substantial cooperation by the Japanese themselves. In view of Japan's reluctance to act positively and the economic situation, with the likelihood of diminishing U.S. military assistance funds, - particularly those authorized for offshore procurement - the U.S. must be prepared to take measures to provide specifically for this purpose, or accept a slow rate of development in this field.

11. Attraction of Communist Trade

The consolidation of Communist power in Mainland China and North Korea and its expansion into Southeast Asia are exerting pressure on Japan to increase economic relations and to consider more seriously establishment of political relations with Communist Asia. Japanese ties, both political and economic, to the United States and the free world will remain proportionately much greater, but under foreseeable circumstances trade with the Asian mainland will exercise a powerful attraction. If the Communists see fit to encourage it, such trade could develop substantial magnitudes even under present international multilateral limitations. While United States influence on Japan and bargaining power would remain considerably greater, the development of Communist trade will probably tend to give the Japanese Government a greater sense of freedom in dealing with the United States. A major purpose of measures discussed under paragraph 8 above is to assist Japan in resisting Communist attractions and align Japan more firmly with the United

States. It should be noted that Indochina itself is not of great trade significance for Japan but the problem of Communist attraction and pressure would be greatly increased by Communist expansion into other areas of Southeast Asia.

12. Formation of Western Pacific Defense Arrangement

NSC 5429/2, Section II, 2d provides that the U.S. should "encourage the conditions which will make possible the formation of, and be prepared to participate in, a Western Pacific collective defense arrangement, including the Philippines, Japan, the Republic of China, and the Republic of Korea, eventually linked with the Southeast Asia security structure and 'ANZUS'". This policy statement clearly accords with the course of action set forth both in NSC 125/2, para 7a(4), which provides that the U.S. should encourage Japan and the free countries of the Pacific area to develop relationships which will contribute to their security, and in NSC 125/6, para 3a(2), which provides that the U.S. should continue to explore the possibilities of collective security arrangements in the Pacific area which would include Japan. The problem of developing a sense of interdependence in the area, which is clearly the necessary prerequisite to the establishment of a security organization of the nature contemplated, and U.S. actions taken to overcome this difficulty, are discussed on pp. 9 - 11 of Annex "A". In particular a resolution of outstanding issues between Japan and Korea and the settlement of the reparations and other questions between Japan and the Philippines, Indonesia, Burma and the Associated States are prerequisites to the effective development of constructive political relationships, economic cooperation and collective security arrangements in the Far East.

13. Need for Intensified Information Programs

The complex emotional reactions of the Japanese, particularly as sensationally represented in their press, to United States actions and policies, the threat of nuclear warfare, and the growth of Communist power in Asia have tended more and more to prejudice United States-Japanese relationships. To strengthen counter-measures an intensive reevaluation both of the existing Psychological Strategy Program for Japan (PSB D-27) and of its implementation by the various agencies concerned is necessary. (pp 14-16, of Annex A). The Inter-Agency Committee in Tokyo, which was established to implement the psychological strategy plan has not thus far been effective except for the handling of the Troop Acceptance problem. The committee, which has met only infrequently, has not been able to bring to bear the full strength of U.S. capabilities in furtherance of our psychological objectives. Ambassador Allison has been asked to make recommendations as to how the committee may be made more effective.

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14. Psychosis Regarding Nuclear Weapons

The violence of Japanese reactions to any matter relating to nuclear weapons is an element in all of our relations with Japan and raises particular problems in connection with any further U.S. tests in the Pacific as well as in relation to U.S. actions in the development of peaceful use of nuclear energy.

15. A number of lesser problems require continuing United States consideration:

(a) War Criminals

The continued incarceration of Japanese war criminals sentenced by United States courts remains an important source of friction between the United States and Japan and creates a psychological climate which is not conducive to full Japanese cooperation with the United States. The expeditious handling of cases by the Board of Clemency and Parole, to the end that only a hard core of prisoners who committed the most heinous crimes remain in prison by the end of 1955, is important to implementation of United States objectives toward Japan.

(b) Japanese Desire for Return of Ryukyus and Bonins

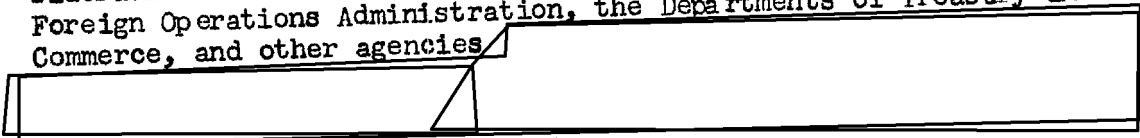
The Japanese Government and people continue to desire the return of the Ryukyu and Bonin Islands to Japan, although public pressure for their return has declined somewhat, and return of Amami Oshima to Japan was an important source of good-will to the United States. Because of the critical strategic importance of these islands the United States must continue to impress upon the Japanese its intention to retain control over them pending the establishment of enduring conditions of peace and stability in the Far East. (pp 17-19 of Annex A)

(c) UN Membership

The Japanese Government continues to seek fuller association with the United Nations and to press for United States action in support of this. (pp 8-9 of Annex A)

D. EXTENT OF AGENCY INTERESTS

16. The Departments of State and Defense have been primarily involved in implementation of NSC 125/2 and NSC 125/6 with considerable assistance by the United States Information Agency, the Foreign Operations Administration, the Departments of Treasury and Commerce, and other agencies



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ANNEX "A"

DETAILED DEVELOPMENT OF MAJOR ACTIONS

NSC 125/2 Para 7a Political

Para 7a(1): "The United States should strive to maintain a political relation of trust and confidence between Japan and the United States."

While the Japanese Government has demonstrated a sense of trust and confidence in the willingness and determination of the United States to assist in the realization of Japan's legitimate national aspirations, the failure of the Japanese Government to exert strong leadership, to resolve intra-conservative factionalism and to combat intellectual and neutralist tendencies affords a latent threat to Japan's political stability and consequently to its ability to cooperate effectively with the United States and the free world.

In agreeing to revision of Article XVII of the Administrative Agreement regarding criminal jurisdiction, in relinquishing control over the Amami Oshima group, and in negotiating the Mutual Defense Assistance Agreement and other important agreements on a basis of full equality, the United States has recognized Japan's independent status and legal requirements, and has sought to foster the relation of trust and confidence embodied in the Peace Treaty. The United States has also attempted to keep the Japanese Government apprised of United States and Allied views on major international developments such as the Berlin and Geneva Conferences, and the Manila Pact.

In part the results of such efforts are reflected in the fact that the foreign policy of Japan continues to be based on the assumption that continued cooperation with the United States and other free nations is the best and possibly only guarantee of Japan's independence and national self-interest. In addition, Japan's reliance on United States military power in the Far East to meet any threat of Soviet aggression and its dependence on the raw materials and markets of the United States and other nations of the free world reinforce Japan's continued alignment with the free world. Similarly, the conservative nature of Japan's society, the traditional suspicion of Russian designs on Japan, and the gradual movement to reject neutralism and pacifism in favor of the acceptance of responsibility for self-defense through United States military assistance provide some of the psychological factors strengthening Japan's association with the free world.

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Despite this broad pattern of cooperation, incidents prejudicial to United States-Japanese relations, such as anti-base sentiments and the furor created as a result of injuries to Japanese fisherman stemming from United States nuclear tests in the Pacific, have occurred and can be expected to occur in the future. More effective leadership on the part of the Japanese Government combined with increased orientation of the Japanese in the realities of the international situation could do a great deal to minimize such problems.

NSC 125/6 Para 3a(1): "The United States should try to resolve the question of criminal jurisdiction over United States and United Nations forces in Japan, and

NSC 125/2, Para 7a(3): "The United States should negotiate with Japan on behalf of the Unified Command on agreement on the status of United Nations forces."

Article XVII of the United States-Japan Administrative Agreement for the implementation of the Security Treaty was formally amended on September 29, 1953, to provide for the exercise of concurrent jurisdiction by Japan and the United States over criminal offenses committed by United States service personnel in Japan. These arrangements are similar to those applicable to United States forces in the NATO countries. In the first six months after the coming into force of the agreement Japan has waived its right to exercise jurisdiction in all but about two per cent of the cases. United States representatives assigned to attend Japanese trials of United States servicemen have reported that the accused servicemen were accorded a fair trial and safeguards similar to those accorded in United States courts.

The United States acting as the Unified Command also concluded with Japan, on February 19, 1954, the United Nations Status of Forces Agreement. This agreement was signed by the Commonwealth governments and is open for signature by any government contributing forces to the UNC. It was designed to formalize the status of United Nations forces other than United States forces while in Japan and is essentially identical with the United States-Japan Administrative Agreement as amended.

NSC 125/2, para 7a(2): "The United States should take feasible steps to achieve membership for Japan in the United Nations and other international organizations."

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Despite the fact that the United States resolution submitted to the Security Council on August 28, 1952, recommending Japan's admission to the United Nations was vetoed by the Soviet Union, the United States has consistently sought means to obtain Japan's admission to the United Nations. Japan is represented at the United Nations by an observer delegation and is a member of all the specialized agencies of the United Nations and of a number of other international organizations. It acceded to the Statute of the International Court of Justice in December 1953. A formula for temporary association with the contracting parties to the General Agreement on Tariffs and Trade (GATT) was worked out last October, pending an opportunity to negotiate for full concurrence to the Agreement. Japan is also a member of the Consultative Group, Coordinating Committee, China Committee (COCOM). The United States has taken the lead in sponsoring Japan's membership in these groups.

NSC 125/2, para 7a(4): "The United States should encourage Japan and other free countries of the Pacific to develop relations contributing to their security and to development of economic ties" and

NSC 125/6, para 3a(2): "The United States should continue to explore the possibilities of collective security arrangements in the Pacific including Japan," and

NSC 125/6, para 3a(3): "The United States should continue to offer appropriate assistance on reparations and fishery problems between Japan and the Philippines, Indonesia, the Associated States and Burma, and to take other measures to reduce friction," and

NSC 125/6, para 3a(4): "The United States should impress upon Japan and the Republic of Korea the desirability of resuming negotiations."

(a) Relations between Japan and Southeast Asia.

The United States has through its missions in the countries of Southeast Asia extended its good offices or made diplomatic representations wherever appropriate to assuage fears of a revived Japan aggressive militarily and economically in the area, and to encourage willingness to cooperate with Japan with a view to resolving outstanding issues such as reparations and fisheries and developing mutually beneficial relationships.

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While Japan enjoys full diplomatic relations only with Thailand and Cambodia among the nations of Southeast Asia, de facto relations exist between all these countries and Japan. Full relations with Vietnam and Laos are expected to be established shortly. Diplomatic ties with India and Ceylon have been established. Japan and the Philippines have exchanged diplomatic missions. Japan maintains consulates general in Indonesia and Burma.

The failure of the Philippines, Burma, and Indonesia to establish full treaty and diplomatic relations with Japan is due in part to lack of agreement on reparations and in part to the residue of anti-Japanese sentiment. The Philippines and Indonesia both signed the San Francisco Peace Treaty but have not ratified it. It is expected that the Philippines will ratify the Treaty once a reparations settlement has been reached. Burma, which did not attend the San Francisco Peace Treaty Conference and Indonesia, despite the latter's signature of the San Francisco Treaty, have expressed willingness to sign bilateral treaties with Japan provided a satisfactory agreement is reached on reparations. An initial agreement with Burma has just been reached.

(b) Relations between Japan and Korea

Normal relations between Japan and Korea have not been established since the end of the war. Underlying this failure and the chronic tension between the two countries is the deeply ingrained Korean fear and suspicion of Japan, and the equally fundamental Japanese sense of superiority over the Koreans. Fisheries problems, claims and property questions and nationality and territorial disputes continue despite four major conferences between the two governments since 1951 and innumerable private official conversations. Sustained efforts by the United States to bring about a rapprochement between the two countries have not proved successful. The United States, however, has offered its good offices and has played an active but necessarily inconspicuous role in arranging negotiations between the two governments. Although the U.S. offered to supply a mediator, there are no present prospects of an improvement in the situation.

The seizure of Japanese fishing vessels within the Rhee Line by the ROK remains a potentially explosive issue between the two governments. The inability of the two countries to reach agreement on the resumption of discussions is tending to drive the Japanese to the conclusion that only the passage of time and the further development of its national strength can resolve their problems with the ROK. Relations have been further exacerbated by sporadic but heated Korean press campaigns against Japan, and by the public statements of President Rhee himself.

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TOP SECRET(c) Relations between Japan and Australia and New Zealand

Continued suspicion of Japan and fear of its ever expanding population tend to color Australian and New Zealand attitudes toward Japan. Reluctance to accept Japanese exports, unilateral regulation by Australia of pearl fishing in the Arafura Sea and the strong objection to the use of Japanese in a New Guinea mapping project all manifest the importance of Japan in the domestic politics of the two countries. The United States has kept these governments, along with the United Kingdom, France and the Netherlands, informed in considerable detail as to its plans with respect to the development of Japan's defense forces. In view of United States power in the Pacific, the Security Treaty with Australia and New Zealand, and the United States assurance of the purely defensive nature of United States-Japanese plans to expand Japan's security forces, these governments have gone along with the policies of the United States, although they continue to have considerable concern over the possibility of the resurgence of aggressive power in Japan. Australia, in particular, is evincing increased understanding of the necessity of keeping Japan on the side of the free world.

(d) Collective Security Arrangements in the Pacific Area

Little progress has been made toward the establishment of collective security arrangements in the Pacific area which would include Japan. While Japan on its part would favorably consider participation in a regional organization designed for economic purposes, it has to date not favored participation in a regional security pact in view of its internal problems in respect to rearmament and its unwillingness to enter into a commitment that might involve the sending of Japanese forces abroad. Furthermore, Korea and the Philippines show no disposition to be associated with Japan in any regional arrangement. The Japanese Government has indicated its "moral support" of the Manila Pact and its desire to be associated with the economic aspects of this organization. The United States is continuing to stress development of the centers of interdependence of the nations of Southeast Asia as the basis for eventual creation of a security organization in the area.

NSC 125/2, para 7a(5): The United States should encourage representative government.

The United States has to the extent feasible encouraged representative government in Japan by assisting the moderate political groups constituting post-treaty Japanese governments. Moderate conservative leadership under the majority Liberal Party has been confirmed in two general elections since the coming into force of the Peace Treaty on April 28, 1952.

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Representative government has, however, been subject to considerable strain during this period. Continuing partisan instability among conservative political groups, which have consistently gained about 2/3 of the seats in the National Diet, has been aggravated by inexperience with laws and practices instituted by the Allied occupation. In addition, the new system has functioned under the handicaps of conflict with traditional values and practices, lack of national direction, and a continuing tendency to shift responsibility to the United States for unpalatable political decisions.

Nevertheless the system of representative government has operated with fair success in the past two years. It has provided the political support necessary for such major decisions as Japan's adherence to the Peace Treaty and the Security Treaty, establishment and expansion of a self-defense force, somewhat strengthened measures against internal subversion, and the institution of a program of economic austerity. The instability now being displayed in Japan is in essence the result of the nation's attempt to adjust traditional values and practices to the new laws and ideas stemming from defeat in war and occupation. Japan's dominant conservative forces are trying to facilitate this adjustment by grouping together in opposition to Socialists and leftist forces and by legalizing certain prewar practices, such as central police, stronger control over education, and economic concentration. Continued measures along these lines are probable. Readjustments by Japan to date have not violated the principle of representative government and have for the most part been essential to permit the effective administration necessary for representative government.

NSC 125/2, para 7a(6): "The United States should encourage and appropriately assist Japan to deal with the internal Communist menace and encourage Japan to reach a realistic appraisal of 'Business as usual' relations with Communist areas."

United States officials and agencies in Japan carry on continuing consultations with Japanese officials regarding means of dealing with the internal Communist menace and the danger of broader relations with Communist areas. Public statements regarding United States experience in these matters have been made by United States officials in Japan on a number of occasions.

Estimates vary as to the strength of the Japan Communist Party. The best guess would put its strength at about 80,000 including 25,000 secret members. Another 25,000 closely support the Japan Communist Party and active sympathizers number well over 100,000.

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Popular support of the Japan Communist Party has, however, steadily decreased. From its prewar high of 3 million votes and thirty-five Diet seats in the 1949 election for the Lower House support fell to 652,700 votes and one seat in the April 1953 Lower House election. The Left Socialist Party contains a number of extreme Leftists who follow lines barely distinguishable from the Communists.

The Communist Party has recently been split by differences of doctrine and personality. Seven of its nine central committee members as of 1950 are underground and their activities are largely unknown. The party has shifted emphasis from mob violence as evidenced by the May Day riot of 1952 to a policy of conciliation with other leftists and law enforcement authorities. Available information indicates, however, that it is making efforts to develop small trained para-military units throughout Japan.

The Japan Communist party relies heavily on the North Korean minority of approximately 700,000 in Japan, on student leftists and on communists in the trade union movement. Although only a small fraction of those in these three groups are communists, these small minorities nevertheless give willing and powerful support to Communist causes including violent ones. Communist influences have also been pervasive in the fields of public information and education in Japan. The press is generally opposed to the policies of the present government and takes an attitude of reserve toward close cooperation between Japan and the West. Press sensationalism over the recent Bikini incident in which 23 members of a Japanese fishing boat were injured by a fall-out of radioactive ash reflects considerable susceptibility to leftist influences and to neutralist and anti-American ideas.

The Japanese Government has taken measures to reduce and weaken leftist activity. Internal security controls are fairly rudimentary. A law for control of subversives was passed in 1952. A bill for strengthening the police has been approved by the Diet. Laws penalizing political activity by teachers have been approved. Some efforts have been made to establish a government information agency designed to present the Japanese people with an official and presumably realistic view of Japanese problems. The government has also passed a law to protect classified information given the Japanese Government by the United States under the recently concluded MDA agreement. Legislation to protect official Japanese Government information, however, has not been enacted. All efforts by the government to control leftist activities or even to present a clear picture of communism at home and abroad run into strong opposition by both leftists and sincere liberals on the ground that Japan is reverting to "thought control."

Japan has not established treaty relations with the Soviet Union or Red China. The Soviet Union remains in a technical state of war with Japan although it maintains an unofficial mission

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in Tokyo. Japanese officials have indicated willingness to resume diplomatic relations with the Soviet Union on the conditions that a bilateral treaty between them conform with the San Francisco treaty; that sovereignty over the Kurile Islands and South Sakhalin be satisfactorily determined; and that the Soviet Union not interfere in internal Japanese affairs through support of the Japan Communist Party. Soviet seizures of Japanese fishing vessels, overflights of Japanese territory, espionage activities, and failure to account for unnumbered Japanese prisoners of war are causes of friction which have not lessened Japanese resentment despite recent Soviet repatriation of about 800 Japanese prisoners of war and civilian detainees. Despite arrangements for the repair of Soviet fishing vessels in Japan's shipyards, the importation of coal from Sakhalin and the export of textiles and miscellaneous items, Japan's trade with the Soviet Union remains negligible.

Japan maintains controls over trade with Communist China which are being relaxed to the multilateral level. Japanese of all political persuasion are eager to increase trade relations with China and to get a look at developments inside Asia. The recent repatriation of some 2800 Japanese from the Communist mainland served to increase Japan's favorable sentiments toward China although there are still no formal relations. Japan's estimate of its relations with Communist China is strongly affected by its desire for expanded foreign trade and its awareness of the power of China in Eastern Asia.

NSC 125/2, para 7a(7): "The United States should conduct programs designed to develop in Japan recognition and understanding of basic mutual interests of the United States and Japan and to combat misconceptions created by Soviet propaganda;" and

NSC 125/6, para 3a(5): "The United States should combat neutralist, communist and anti-United States sentiment particularly by implementation of the 'Psychological Strategy Plan for Japan.'" "

United States agencies in Japan, particularly USIS, conduct the following major programs:

1. Under the Fulbright and Smith-Mundt exchange programs a total of 357 Japanese including teachers, lecturers, research scholars and leaders in various fields were brought to the United States in 1953 while 35 American students were given financial assistance in attending schools in Japan. Fifty-six American teachers, lecturers

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and scholars were sent to Japan.

2. Fourteen information centers are operated in major cities and are widely used by Japanese, especially students and teachers. In addition there are eight bi-national centers jointly supported by Japanese local entities. USIA has arrangements at 170 other places where United States books and magazines are deposited for public use under the care of local Japanese organizations.

3. Special emphasis on explaining the American labor movement has been made particularly through use of pamphlets and motion pictures.

4. A wireless bulletin in Japanese is distributed to major newspapers throughout Japan giving complete official texts of United States policy statements and documents and authoritative information on important happenings in the United States. The same material is also available in English for distribution. Japanese newspapers reprint an average of 8,000 column inches a month from the USIA wireless bulletin.

5. Arrangements have been made with commercial radio stations resulting in use of five percent of their total time for USIA locally produced or adapted programs. USIA programs broadcast by Japanese government and commercial radio stations average 400 station hours weekly, and represent a donation by the Japanese of radio time which could be commercially valued at \$4,700,000 per year. VOA relays over Japanese national broadcasting networks have frequently blanketed the nation.

6. Indirect support is given to translation and publication of anti-Communist books, two of which (A Reluctant Traveler in Russia by Wittlin and City Boy by Herman Wouk) were best sellers. With the cooperation of Japanese publishers many documents exposing germ warfare charges and Communist atrocities in Korea have been circulated. USIA is producing full length book translations in Japan at the rate of 70 per year not counting condensations and shorter works. Also, USIA initiative has been instrumental in unassisted commercial publication of about 50 other American books in Japanese translation.

7. Important items of Americana have been adapted for use in Japanese high schools as text books and discussion material.

8. Prominent Japanese have been reached and influenced through personal contacts to assist in explaining American points of view and in enabling Japanese organizations to obtain and use USIA material mostly unattributed.

9. USIA has begun subsidizing commercially produced Japanese motion pictures on anti-Communist themes, One unattributed film,

Stormy Youth showing communist brutality in the Japanese student movement, became a major box office success.

10. USIA subsidizes two unattributed anti-Communist periodicals in Japanese. One is designed for intellectuals, the other for use in the student movement.

Principally through the above means American agencies have sought to implement the "Psychological Strategy Plan for Japan." The effect of these programs in conjunction with other United States policies has been to weaken materially certain Communist and leftist propaganda lines. Attacks on "United States military bases" have for example largely subsided. The Inter-Agency Committee in Tokyo, which was established to implement the psychological strategy plan has not thus far been effective except for the handling of the Troop Acceptance problem. The committee, which has met only infrequently, has not been able to bring to bear the full strength of U.S. capabilities in furtherance of our psychological objectives. Ambassador Allison has been asked to make recommendations as to how the committee may be made more effective.

NSC 125/6, para 3a(6): "Encourage and support anti-Communist elements of the labor movement in Japan."

United States officials in Japan have counselled the Japanese Government and labor leaders to isolate and weaken Communist elements in the labor movement. They have given discreet encouragement to a split from Sohyo by moderate elements. The United States has conducted one program by which 11 Japanese labor leaders were brought to this country for a 90 day orientation trip. This program was considered highly successful and a similar project is now being planned.

Sohyo is Japan's largest labor federation with a membership of about 2.75 million. Its secretary general, Minoru TAKANO, closely follows extreme leftist lines as do many of the leaders of Sohyo. Because of strong opposition to Sohyo's leftist policies several important unions have seceded and along with other labor groups have formed a new moderate federation called Zenro with an active membership of about 750,000.

The growing splits between pro-Communist and anti-Communist elements in Sohyo are expected to result in further efforts toward moderation by important groups in the Japanese labor movement. Sohyo's draft policy declaration for 1954 is definitely conciliatory toward moderate political groups and toward the International Confederation of Free Trade Unions (ICFTU) in contrast to declarations for the past several years. The powerful Japan Teachers Union at its June convention also took a reasonable position in regard to political activities by teachers and cooperation with the United States. There is evidence that Takano's supremacy is being challenged by moderates in Sohyo and that Takano is being forced to soften his obdurate, pro-Communist line.

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Although several of Sohyo's larger unions are affiliated with ICFTU, the federation itself has not done so. Moderate elements within Sohyo and ICFTU's international leadership are now vigorously attempting to force this important issue.

NSC 125/2, para 7a(8): "The United States should strengthen friendly relations between United States personnel in Japan and the Japanese people by procedures for minimizing friction and settling disputes between United States and Japanese agencies and by orientation and information programs."

A United States-Japan joint committee has been established to carry out the Administrative Agreement governing the relations between United States forces in Japan and the Japanese Government. This committee meets regularly to discuss and resolve problems. It has had marked success in working out friendly cooperative relations. The Committee has encouraged the establishment of bi-national community relations advisory councils in many places throughout Japan; these councils have been increasingly effective in reducing "base problems."

The United States forces carry out continuing orientation and information programs for all United States military personnel, including lectures, books, movies and radio programs.

The United States forces in Japan employ several hundred thousands of Japanese laborers. A "master labor contract" regulating the conditions and terms of employment has been under negotiation for over two years but despite important concessions by the United States forces the Japanese Government appears reluctant to conclude this agreement. Unrest on the part of Japanese labor hired by the forces has been a continuing problem but has not reached serious proportions. Efforts continue to conclude the master labor agreement.

NSC 125/2, Para 7b Military

Para 7b(1): "Long term military requirements of the US in and about the Ryukyus, Bonin and other islands covered by Article III of the Peace Treaty with Japan will be sought in accordance with recommendations to the President by the Departments of State and Defense."

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NSC 125/6, para 4: "The US should relinquish civil administration of the Amami group subject to agreement on US military rights but should maintain present control and authority over other islands mentioned in Article III of the Peace Treaty during present international tensions in the Far East."

An agreement to relinquish in favor of Japan rights granted the United States under Article III of the Peace Treaty over the Amami group of the Ryukyu Islands was concluded in Tokyo on December 24, 1953, effective December 25. Secretary Dulles announced concurrently the intention of the United States to retain indefinitely its rights in the remaining islands mentioned in Article III. The President on August 2, 1954 approved a revised civil affairs directive for the Ryukyus.

NSC 125/2, para 7b(2): "The U.S. should assist Japan to develop military forces which will eventually be capable of assuming responsibility for defense of Japan against external aggression. As a first stage, assist Japan to develop a balanced 10 division ground force and appropriate air and naval arms."

NSC 125/6, para 3b(1): The U.S. should discuss with the Japanese Government on a broad basis levels considered appropriate for Japan by the JCS and the timing of a program for reaching the levels which are mutually agreed as a result of these discussions.

JCS Force Goals

Based on recommendations by the Joint Chief of Staff and approval by the Secretary of Defense, the following ultimate balanced force goals for the Japanese National Self-Defense Agency were established in December 1953: ground force -- 15 small divisions of approximately 12,000 strength organized into 5 corps and supporting units (regional strength 348,000 men); air force -- 36 squadrons of fighter-interceptor, interceptor, fighter bomber, light-bomber, tactical reconnaissance and transport aircraft (approximately 921 planes); navy -- 4 light carriers, 3 AA cruiser types, 30 DD's, 75 DE's, 50 large minesweepers and a large number of anti-submarine craft, small minesweepers, minelayers, and patrol craft and a small number of coastal submarines for training in anti-submarine warfare.

TOP SECRETSteps Taken by the Japanese Government in Developing its Defense Forces

During the period of this report, Japanese ground forces continued at a level of approximately 110,000 consisting of the approximate equivalent of 4 Japanese infantry divisions. The US has loaned the Japanese ground forces equipment procured out of 1950-53 army appropriations and has trained these forces in the use of this equipment. Japanese officers were also brought to the US for training. In the past year and a half the personnel of the Coastal Safety Force was increased from about 6,000 to 10,000. In terms of tonnage the Coastal Safety Force was increased by almost 20,000 tons largely as the result of the turnover by the US of 18 patrol frigates and 50 landing craft pursuant to the authority contained in Public Law 467, 82nd Congress.

In January 1954 an agreement was reached in Tokyo (and formalized by exchange of confidential letters by the Ambassador and the Foreign Minister) whereby the Japanese agreed, during their fiscal year beginning April 1, 1954, to increase the overall strength of its defense forces (headquarters, ground, naval and air forces) by about 41,000 of which about 31,000 would be uniformed personnel. The ground force would be increased from 110,000 to 130,000; the naval forces from 10,000 to 16,000; and an air force established at 6,000. The Japanese Government also agreed to construct about 12,000 tons of naval vessels and to initiate a naval air program. It also indicated it was prepared to establish an air force including the necessary flying and technical schools and to purchase with its own funds approximately 96 trainer aircraft, and that it would create a reserve system initially comprising approximately 15,000 persons. Legislation authorizing these increases in personnel was passed at the last session of the Japanese Diet. This legislation also provided for the conversion of the National Safety Agency into the National Defense Agency with the specific mission of defending Japan against external aggression. The National Safety Force (Army) and Coastal Safety Force (Navy) became respectively the Ground and Maritime Self-Defense Forces. A third staff, the Air Self-Defense Force was established. This legislation also called for the establishment of a Joint Chiefs of Staff on the US pattern to coordinate the activities of the land, sea and air defense services. In addition the law authorized the establishment of a National Defense Council to advise the Cabinet on fundamental policies of national defense, programs, and defense production.

The budget for Japan's defense establishment was increased by 29% in the year beginning April 1, 1954. In dollar amounts the increase was from the yen equivalent of about \$170 million to \$220 million. While Japan's contribution to the maintenance of U. S. forces stationed in Japan provided by Article XXV of the US-Japanese

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Administrative Agreement was through agreement reduced by \$7 million, the Japanese contribution for the current fiscal year will total about \$161 million (including rental of privately owned facilities), bringing Japan's total defense appropriation to \$381 million or about 14% of the total national budget and about 2% of estimated GNP. In addition certain government-owned properties are provided our forces on a rent free basis. As to combat effectiveness Japan's ground forces are considered to be fairly well trained up to and through the regimental level. Naval action is generally considered satisfactory in individual ship performance but unsatisfactory in ship tactical units.

Recently the Japanese Government reduced the expenditures for defense for the current year by 10% because of the general decline in the price levels and delayed implementation of their naval recruitment program in view of the fact that the United States was not making available to Japan the number of vessels originally anticipated by the Japanese and on which the naval budget had been premised. These measures are being discussed with the Japanese in Tokyo in the light of their budget commitment. The U.S. is unable to make additional vessels, beyond those presently programmed, available to Japan because there are none available in excess of US's own mobilization needs.

Mutual Defense Assistance Agreement and Implementing Arrangements

The Governments of the US and Japan signed on March 8, 1954 a Mutual Defense Assistance Agreement which entered into effect on May 1, 1954. This agreement provides the legal basis for the grant of military assistance under the mutual security program. A US Military Assistance Advisory Group (MAAG) was activated as of May 1. The US and Japan also signed an agreement on May 14, 1954 for the loan of naval vessels. The annex provides for the loan of two destroyers and two destroyer escorts to Japan. The loan of a submarine for the purpose of training Japanese naval forces in anti-submarine warfare is presently under discussion in Tokyo.

U.S. Military Assistance

Japan was included in the mutual security program for US fiscal year 1954. This program provides for the grant of assistance in the amount of \$80.7 million: \$40 million for the army, \$10.6 million for the navy; \$26.2 million for the air force and \$3.9 million for training. The U.S. fiscal year 1955 MDAP was set forth in a tentative program at approximately \$102 million; a tentative breakdown provided 0 for the army, \$46 million for the navy, \$54 million for the air force, and \$1.8 million for training. The effect of the cut in the mutual security program has not yet been determined. The lack of any

program for the ground force is based on the assumption that Japanese ground forces can be adequately supplied with equipment procured from earlier Defense Department appropriations. Some of this equipment is presently on loan to Japan's ground and maritime forces. A provision in the Mutual Security Act permits the transfer of title to this equipment to the Japanese Government.

The U.S. fiscal year 1954 navy program would provide for the loan of 2 DD's, 2 DE's, 3 AM's and the grant of miscellaneous World War II type aircraft. The U.S. fiscal year 1954 air force program would provide for the grant of 48 T-33's, 20 RT-33's, 18 C-46's and 65 T-6's. The illustrative fiscal year 1955 navy program includes one training submarine. The illustrative fiscal year 1955 air force program calls for the grant of 90 jet fighters.

Para 7 b(3): "Assist Japan upon completion of the foregoing and in the light of circumstances then prevailing, to develop military capabilities for participating in the defense of the free nations of the Pacific area."

In view of Japan's reluctance to move rapidly in developing a balanced defense establishment it is difficult to consider constructively at the present time the participation of Japan in regional security organizations in the area. However, Japan's eventual participation in such organizations as may be established in the area remains an ultimate goal. On their part, however, the Japanese are opposed to the sending of forces abroad and find in the Constitutional prohibition on rearmament a rationalization for such position. It is expected that no action will be taken to revise this article of the Constitution until after the next election of the House of Counsellors in 1956 in view of the unprobability that two-thirds of the present House of Counsellors would support such an amendment.

Para 7 b(4): "Until Japanese forces are adequate for the defense of Japan, maintain in and around Japan U.S. forces in sufficient strength so that, in collaboration with Japanese forces, they can secure Japan against external aggression and enter into agreement with Japan as soon as possible to establish working arrangements which will commit, in event of hostilities or the imminent threat thereof the creation of effective combined forces."

During the period of this report the U.S. maintained in Japan, Okinawa and Korea 9-2/3 divisions of ground forces of which for much of the time 2-1/3 divisions were stationed in Japan. Current redeployment plans called for withdrawal of 4 divisions and 1 RCT from Korea, one of which would be brought to Japan for the division moving from Japan to Okinawa, a second to Hawaii and two plus the RCT to the zone of the interior. Present plans call for the continued maintenance of 2-1/3 divisions in Japan. However, General Hull is presently developing a long-term program for the gradual withdrawal of US forces from Japan as Japanese forces become strong enough to assume increased responsibility for the defense of Japan.

In connection with the US-Japan agreement on a program for the expansion of Japan's defense forces, the Japanese Government agreed to make arrangements as soon as possible for effective joint planning by its defense forces with the US armed forces in Japan. While the Japanese remain hesitant to date to engage constructively in joint planning, satisfactory arrangements were worked out by General Hull with the Japanese Government for the withdrawal of the First Cavalry Division from Hokkaido and its replacement by Japanese ground forces. This has now been largely accomplished.

Prime Minister Yoshida has on at least two occasions orally indicated that in the event of an emergency, Japanese forces would operate under the command of CINCPAC. For political reasons he has been reluctant to reduce this understanding to writing.

Para 7b(5): "Continue to maintain forces in Japan for the support of UN operations in Korea so long as they are required."

During the period of this report by agreement with the Government of Japan forces were maintained for the support of the UN operations in Korea prior to the armistice and forces were maintained in Japan subsequent to the armistice in support of UN tasks in Korea.

NSC 125/2, para 7b(6): "Encourage Japan to develop the industrial capacity to produce such military equipment and supplies as are determined to be in the United States interest for Japan to produce."

para 7c(5): "Utilize Japan to the extent practicable in the interests of the United States as a source of supply on a commercial basis for equipment and supplies procured for U.S. armed forces or under U.S. aid programs for other countries."

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NSC 125/6, para c(6): "Develop with the Japanese, a program for Japanese industrial mobilization for defense, and support such a program by United States offshore purchases with Defense and Mutual Security funds."

Progress was made toward the establishment of a Japanese defense production base, through an expanded military offshore procurement program; initiation of industrial mobilization planning in participation with the Japanese; an intergovernmental production assistance program; research and development studies conducted by the MAAG in conjunction with the Japanese Defense Forces; and completion of an initial survey of Japanese capability for military aircraft production.

In the absence of defense support, facilities assistance and direct economic aid programs for Japan, the offshore procurement of military end-items, in connection with MDA programs for Title III countries, constituted the major contribution to the development of a Japanese defense production base. Offshore procurement contracts placed in Japan by the three military services under the FY 1954 MDA program totalled approximately \$70 million, contributing for the most part to the activation and maintenance of ammunition production facilities ranging from small arms to artillery ammunition and explosives. Inability to reach a preliminary OSP target of \$100 million in FY 1954 was due to over-all cutbacks in military assistance funds, adjustments in Title III OSP programs necessitated by the emergency in Southeast Asia, the lower cost of certain end-items procured in Japan compared with the original program estimates, and the fact that procurement programmed under the Japanese MDA program was not placed since that program was not activated during FY 1954.

Present planning contemplates a sharp reduction of funds available for OSP in USFY 1955, the preliminary estimate for OSP in Japan being in the neighborhood of \$25 million. Such a drastic reduction of military end-item procurement in Japan will markedly impede efforts to develop adequate defense industries in Japan and also adversely affect Japan's balance-of-payments situation.

Industrial mobilization planning studies undertaken by the Department of Defense resulted in the delegation to CINCFE in October 1953 of responsibility for coordinating the military aspects of industrial mobilization planning activities in Japan. In February and March 1954, a representative of the Secretary of Defense visited Japan to review and make recommendations regarding the problems and organization requirements for the establishment of a coordinated defense production program. In June a further delegation was made to CINCFE of broader responsibilities in the establishment

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of a defense production base and industrial mobilization planning in Japan, to include the administration and coordination of military assistance programs, coordination of offshore procurement with IMP, evaluation of Japanese defense production capacity and potential, and participation in joint US-Japanese defense production planning.

A small program of facilities assistance was initiated in connection with the purchase of agricultural surplus commodities during FY 1954 pursuant to Section 550 of the Mutual Security Act. Of the total yen proceeds (approximately \$50 million), it was agreed that forty million dollars would be used to finance FY 1954 MDA offshore procurement, and ten million dollars would be used for assistance to Japanese industry, primarily defense. Negotiations are in progress with respect to the projects for which these yen funds will be used. Substantial Japanese cooperation in additional facilities assistance programs must be assured if industrial mobilization planning is to be implemented effectively.

By exchange of notes between the US and Japanese Governments, a program of technical production assistance was established and in April the first group of Japanese production technicians visited the U.S. under the auspices of the Department of Defense, for a two month tour of U.S. military and commercial plants engaged in the production of small arms ammunition and explosives.

The Department of Defense has concluded that Japan had a potential capability for producing a substantial portion of its requirement for tactical aircraft, and that this should be developed, with U.S. financial and technical assistance. The U.S. Air Force has contracted with Japanese manufacturers for the repair and overhaul of certain U.S. type aircraft. Plans are in process for the initial assembly and later fabrication in Japan of the U.S. type aircraft considered most compatible with Japanese defensive requirements (the F-86-F aircraft) and it is anticipated that production may begin within the next two years.

With technical assistance from U.S. aircraft manufacturers through private US-Japanese licensing agreements, the Japanese have begun the production of a few small aircraft.

Preparations have been completed for initiation of negotiations with the Japanese Government of a Technical Property Agreement similar to those which have been concluded elsewhere in connection with foreign production of US military equipment.

Through a continuation of efforts begun by the U.S. Safety Advisory Group, the MAAG has provided considerable advice and assistance to the Japanese Defense Agency in the establishment of its recently authorized Technical Research Institute. Through this Institute, the Japanese are reconstituting a program of

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research and development as a vital part of the Japanese defense capability. The current program which is being supported in the JFY 54-5 budget involves projects for all three services, designed to develop and produce material and supplies from Japanese sources. Specific examples are the development of Japanese manufactured target aircraft, radar and radio equipment, ammunition items and vehicle type equipment; design of several types of naval vessels; and the standardization of items of clothing.

NSC 125/2, Para 7c • Economic

NSC 125/2, Para 7c(1): "The United States should facilitate the achievement by Japan of an economy which is self-supporting, expanding and capable of maintaining adequate living standards, supporting the defense of Japan, and contributing to the defense of the Pacific area."

Far from advancing toward a position of self-support, the Japanese economy underwent a consumption boom in 1953 which caused a serious deterioration in Japan's balance-of-payments position. The index of production reached the all time high in December 1953 of 173 (1934-36 = 100), but notwithstanding a continuing high level of special United States expenditures Japan's foreign exchange holdings declined by about \$300 million in all currencies during the Japanese fiscal year beginning April 1, 1953. Earnings from commercial exports and normal invisibles remained at approximately the level of the previous two years but imports increased by \$450 million over JFY 1952/53. Some improvement in the balance-of-payments position is anticipated in the current fiscal year in spite of the recent decline of United States special expenditures. In the first six months of the fiscal year (April - Sept) there was a net payments surplus of \$80,000,000.

United States special expenditures have declined in recent months from the 1953 level of \$785 million to an annual rate of \$550-600 million. The current rate of these expenditures constitutes 25-30% of Japan's total foreign exchange earnings and nearly 4% of Japan's gross national product. Their impact on the Japanese economy as a whole is enormous. It is important that the decline which will occur when major units of United States forces are withdrawn from Japan and Korea take place gradually and be accompanied or preceded by a correlative expansion of Japan's commercial earnings. Information on the effect of present redeployment is awaited.

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The Government introduced measures to limit the domestic inflation late in the year, and steps to modernize Japan's industrial plants were continued, but in general little was accomplished to lower the costs of Japan's exports.

NSC 125/2, para 7c(2): "The United States should keep Japan's internal and external financial position under constant review in connection with United States security objectives, including in the review the possibility of rendering appropriate economic assistance if necessary" and

NSC 125/6, para 3c(5): "The United States and Japan should periodically review their respective contributions to security and make adjustments in arrangements so as to provide a maximum Japanese contribution and to render assistance required by Japan's financial position."

No economic assistance as such is being given Japan in USFY 1955 and none was provided in USFY 1954. The following steps in the nature of financial assistance have been taken: (a) It was agreed to reduce the monetary support by Japan to United States forces in Japan pursuant to Article 25 of the Administrative Agreement from the yen equivalent of \$155 million to the yen equivalent of \$148 million. (b) The United States has undertaken to furnish military equipment for Japanese forces on a grant or loan basis, the precise equipment to be determined on the basis of further consultations. \$78 million of USFY 1954 military assistance funds have been programmed for Japan and \$102 million are tentatively programmed for USFY 1955. In addition legislative authority was obtained in the Mutual Security Act of 1954 to transfer equipment for the Japanese ground forces procured out of previous Defense Department appropriations and the authority given in PL 188 is being and will be used for the transfer of vessels. (c) Procurement of military and naval equipment in Japan for Title III countries other than Japan totalled about \$70 million in USFY 1954 of which approximately \$40 million will be financed by the yen proceeds of the sale of agricultural commodities to Japan under the provisions of Section 550 of the Mutual Security Act. (d) An agreement has been concluded under Section 550 of the Mutual Security Act whereby Japan will purchase approximately \$50 million worth of agricultural commodities and one-fifth of the local currency proceeds will be used for assistance to Japanese industry (principally defense industries).

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The Japanese have proposed additional local currency purchases of United States surplus agricultural commodities in United States FY 1955, yen proceeds to be used for economic development. This proposal is being carefully considered within the United States Government.

A decision to establish an FOA mission in Tokyo has been made by reason principally of FOA's responsibilities under the Agricultural Trade Development and Assistance Act and the recognized importance of an economically strong Japan. Announcement will be made soon.

NSC 125/2, para 7c(3): "The United States should encourage the expansion of international trade between Japan and other free nations," and

NSC 125/6, para 3c(1): "The United States should seek Japanese accession to the General Agreement on Tariffs and Trade and should negotiate with Japan for tariff reductions."

Congress has passed the one-year extension of the Trade Agreements Act. The Department of State has already circularized its missions in the GATT countries to seek the agreement of those countries to multilateral negotiations for the dual purpose of bringing Japan into GATT and of reducing duties on Japanese exports.

Arrangements concluded in January 1954 between Japan and the Sterling area give promise of increasing this trade and eliminating the discrimination against Japan by countries of the Sterling area which was prominent in 1953. Countries which do not now accord non-discriminatory treatment to the trade of Japan include Australia, New Zealand, South Africa and France.

NSC 125/2, para 7c(4): "The United States should encourage the reestablishment of mutually beneficial business relationships between United States and Japanese nationals," and

NSC 125/6, para 3c(2): "The United States should conclude with Japan a treaty of friendship, commerce and navigation, and treaties for the avoidance of double taxation."

A Treaty of Friendship, Commerce and Navigation has been concluded and has entered into force. Treaties to avoid double taxation were signed on April 16, 1954. In March 1954 an agreement was

concluded for the guarantee of American investments in Japan under the terms of the Mutual Security Act. The Contact Clearing House Service of the Foreign Operations Administration for exchange of information on investment opportunities has been extended to Japan.

Various elements of the United States Government, in particular the Embassy in Japan, have promoted United States business relationships and investment through the exchange of information and the exercise of good offices. The Japanese Government has continued to publicize fields in which investment is desired. A substantial number of new arrangements have been negotiated or concluded in the last year.

A serious resistance has developed within the Japanese Government, however, to the approval of investment arrangements involving substantial equity ownership by United States interests in Japanese corporations. This issue has been taken to high levels of the Japanese Government and our Embassy has been authorized to make formal representations under the Treaty of Friendship, Commerce and Navigation. A substantial flow of American capital, as distinguished from the furnishing of patents and know-how, does not appear likely.

NSC 125/2, para 7c(6): "The United States should seek to prevent Japan from becoming dependent on China and other Communist-dominated areas for essential food and raw material supplies," and

NSC 125/6, para 3c(3): "The United States should exercise its good offices to further Japanese participation in trade and investment arrangements and to assist Japanese access to resources."

Availabilities of foodstuffs and basic materials outside the Communist orbit presented no problem in 1953; iron ore and rice in particular were in easier supply in Southeast Asia, although abundance of rice for export in the area is probably a short-term phenomenon. Communist China and the Soviet Union retain the capability of offering coking coal, iron ore, salt, soy beans, cereals and miscellaneous agricultural raw materials at attractive prices compared with alternative sources.

The principal attraction for Japan of trade with Communist Asia is the possibility of compensating for imports by Japanese exports. Although trade figures do not yet reflect it, some progress was made in the last year in laying the basis for expanded markets for exports in the free world. It would require a vast expansion of free world markets, however, to remove the basic attraction of trade with mainland China.

NSC 125/2, para 7c(7): "The United States should encourage Japanese contribution to the economic development of South and Southeast Asia," and

NSC 125/6, para 3c(3): "The United States should exercise its good offices to further Japanese participation in trade and investment arrangements."

The Japanese have actively pursued trade and investment opportunities in South and Southeast Asia. A few investment projects, principally in iron ore sources, have been concluded. The Japanese Export-Import Bank has made loans aggregating \$25 million in 1953, almost all short-term export credits. Substantial credits have been extended in connection with trade arrangements, principally to Korea, Pakistan and Indonesia. The Japanese have participated actively as an associate member of ECAFE, and Japan was admitted to full membership on April 22, 1954. In part as a result of United States good offices, invitation will probably be extended to Japan shortly to participate in the Colombo Plan.

A number of proposals for closer economic integration of the free countries of Asia have been advanced within the United States Government with particular reference to the position of Japan. They include (1) the establishment of an Asian payments union, (2) the creation of an organization of countries receiving United States aid along the lines of the OEEC in Europe, (3) the calling by an Asian country of a conference to consider trade and payments problems, (4) the creation of a new lending institution to make developmental loans and (5) the use of repayments by Japan of the GARIOA debt as a fund for loans or grants for development. These projects are under study but no decisions have been taken with respect to their feasibility or desirability.

NSC 125/2, para 7c(8): "The United States should encourage the expansion, rehabilitation and modernization of Japan's industries on a sound economic basis," and

NSC 125/6, para 3c(3) and (4): "The United States should encourage private American investment in and technical assistance arrangements with Japan, foster Japanese productivity and facilitate sound loans of the International Bank for Reconstruction and Development and the United States Export-Import Bank."

Although the number of technical assistance arrangements between Japanese and foreign companies increased during 1953 from 214 to 314, no significant effect upon the productivity and competitive position of Japanese industry as a whole has become evident during the past year. This remains a major internal measure which must be pressed if the Japanese are to improve their foreign trade prospects. The International Bank for Reconstruction and Development concluded a loan of \$40 million for modern high-pressure thermal power units and has reached conclusions with respect to the fields in which the Japanese should be encouraged to seek further loans up to a tentative ceiling of \$100 million. An agricultural mission was recently sent to Japan by the IBRD to examine the need for IBRD loans in the field of agriculture. The austerity budget and stringent credit policy adopted by the Japanese Government limit the amount of funds available for agriculture, power development and improvement of Japan's industrial plant and much will depend upon the wisdom with which available funds are used. Requests for assistance through United States or IBRD loans may be expected to increase. After an initial coolness Japanese industry is showing interest in sponsoring a United States-Japanese productivity program under the Mutual Security Act. Such a program is being actively considered by the Foreign Operations Administration.

Fear of competition and nationalism are restricting the number of investments by American firms which could improve Japanese production techniques. American observers consider that with significant exceptions such as textiles, shipbuilding and optical goods Japanese productive processes are twenty years behind the times and that a revolution in managerial thinking is required. In general, of Japan's major manufactures only textiles, processed foods and certain specialties are internationally competitive today, but the yen is overvalued and it is difficult to determine the true cost position on the basis of the international value of the yen.

NSC 125/2, para 7c(9): "The United States should encourage Japan to maintain a free, competitive economy and to carry on its foreign trade and commerce in conformity with internationally accepted fair trade practices," and

NSC 125/6, para 3c(7c): "The United States should encourage Japan to avoid forms of business organization and practices which would tend to restrict productivity and impair Japan's trading position."

Since the end of the occupation Japan has moved away from rather than in the direction of a free competitive economy. The

anti-monopoly law enacted under the occupation has been amended to permit the organization of cartels with the approval of the Fair Trade Commission and there are strong pressures for a further liberalization of the law. Japanese are convinced that Japan's trading position requires the formation of fewer and larger industrial and trading units. The former Zaibatsu groups are actively reforming around the respective banks. This process of business concentration is being accelerated by the present stringent credit policies.

There has been no general revival of abusive trade practices and the Japanese Government has taken measures to restrain such practices. The basic position of the economy, however, with the yen overvalued and Japanese companies financially shaky, creates strong incentives for sales below the domestic price and in some cases below cost of production. Under present circumstances, such mal-practices could increase to a point where competing countries might be forced to adopt counter-measures.

NSC 125/2, para 7c(10): "The United States should seek an adequate financial and material contribution by Japan to mutual security objectives."

The budget for the Japanese fiscal year commencing April 1, 1954 provides the equivalent of \$220 million for the Japanese defense forces, an increase of 29% over the previous year. Total appropriations for defense, including contributions for the support of United States forces, equal \$381 million, an increase of 17% over the previous year and about 14% of the total budget. Expenditures are expected to equal about \$500 million by reason of carryovers from previous years. These increases in defense expenditures are being made in the face of an overall reduction in the Japanese budget as compared with the previous year. Defense expenditures and veterans' pensions are the only major items being increased. While the Japanese defense expenditures are not high in relation to the national income of Japan, compared with other countries of similar per capita national income, the decisions reflected in the budget for the new year represent a significant advance on the part of the Japanese Government and public opinion.

Further increases in Japan's defense expenditures will depend in large measure on success in dealing with Japan's basic economic problems, as well as the development of a sense on their part that their security can be provided for in no other way.

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NSC 125/2, para 7c(11): Continue the special bilateral understanding with the Japanese with respect to export controls.

and (12): "Export controls to be maintained in the post-aggression period should be determined through agreement reached by negotiation among the free nations principally interested in trade with the Far East areas of the Soviet bloc."

Japan has continued to cooperate with the United States on security export controls and has removed items from its list of items embargoed to Communist China only pursuant to understandings with the United States. The NSC decided (NSC 152/4) that Japan should be released gradually from the undertaking to maintain more stringent export controls than those multilaterally agreed. Pursuant to this policy decision the United States cancelled the bilateral agreement. The Japanese agreed to release items on the Japanese control list and not on the IL CHINCOM list over a period of approximately 12 weeks in order to avoid the appearance of any sudden change in policy. The Japanese show every indication of willingness to cooperate on whatever controls are agreed by the free nations principally interested in trade with the Far East area of the Soviet bloc.

NSC 125/6, para 3c(7) a and b: The United States should use United States influence and bargaining power to obtain Japanese adoption of non-inflationary fiscal and monetary policies and policies designed to maximize domestic investment in essential areas of the economy.

In part as a result of United States prodding the Japanese Government has adopted a policy of an austerity budget, of stringent credit controls and of import controls with a view to reducing Japanese prices, reducing imports and promoting exports. Implicit in this policy is the necessity through government decision to determine the most important areas of the economy for domestic investment. Credit controls are now being applied in moderation but it is too soon to determine the success of these measures. There is danger that unemployment and business failures will result in an easing of credit and thus negate the basic objective of improving Japan's export position.

Negotiations for settlement of the claims of the United States arising out of economic assistance rendered to Japan during the occupation (GARIOA) began in Tokyo May 10, 1954. The United States has requested payment of about \$700 million and under the decision

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of the National Advisory Council that the Japanese settlement should be not less favorable to the United States than the German settlement would be prepared to accept about \$650 million. The Japanese have not yet made a definite proposal but have raised questions with respect to the accounting, Japan's capacity to pay and the possibility of acceptance of local currency which could be used for economic development in the area.

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