Currency Blocs: The Yen

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Michael Schiltz

破綻しますよ、いつかは破綻しますよ、それは (hatan shimasuyo; itsuka hatan shimasuyo, sore wa)
"Of course [such scheme] is bound to implode; of course it will implode at some time."
Ohara Masahiroshi 小原正弘, former Yokohama Specie Bank banker and once appointee to the Federal Reserve Bank of China (中國聯合準備銀行)
in: S.a. En no sensō "The War of the [Continental] Yen"『圓の戦争』
"Japan and the yen ha[d] an overpowering dominance, and arrangements [were] made with an eye to the needs of Japan and the yen, rather than in consideration of the other areas and their currencies."
Hunsberger, "The Yen Bloc in Japan's Expansion Program," p. 251.

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Abstract
Historically, unilateral political attempts at boosting the liquidity and prestige of a currency have rarely been successful. In the context of catastrophic events as, for instance, a World War, several countries have nevertheless experimented with schemes to develop currency blocs. This chapter describes the Japanese experiment with establishing an economic zone in which the yen was either the main or the sole currency of reference. We proceed chronologically. Taiwan and Korea are explained as consolidating currency policy in the nascent Japanese empire. World War I temporarily reversed Japan's balance of payments problem. It heralded bold attempts at incorporating China within the Japanese *yen-bloc*, by means of aggressive lending schemes. Although the latter failed, the *yen-bloc* became an important political objective throughout the 1930s. The chapter explores the financial technology that governed the monetary set-up of the wartime empire, and it attempts to explain why it contained the seeds of its destruction.

Keywords
Imperialism · Gold-exchange standard · Blocism · Japan

Introduction

Is it possible to hack liquidity? Are there ways to boost the credibility of a currency? Put in the vocabulary of international rivalry, what are the chances of success in attempting to readjust the monetary pecking order to one's advantage and to challenge the position of a key currency?

If anything, the historical record would lead us to be rather skeptical. Monetary regime changes are conspicuously few and can hardly be said to have succeeded because of political initiative or imperialist intent. The United States' National Monetary Commission (1908–1912), among others set up to study the ways in which the international use of the dollar could be promoted, might appear as a successful exception but is probably best understood as a belated and corrective reaction to the steady rise of the dollar as reserve currency from the late nineteenth century onwards. The catastrophe of World War I merely consolidated a long-term shift in the monetary force field; on the surface of the broker's "course of the exchange," such evolutions remain only marginally visible, if at all. Only after World War I did it become obvious that this map had to be redrawn as well.

Other attempts at core currency status, not accidentally developed in reaction to a succinctly political aspiration, were less successful, if not to say outrightly disastrous. The Nazi's attempt at developing a *Großraumwirtschaft*, in which a group of inconvertible currencies was tied (pegged) to the German *Reichsmark*, is one such example. Japanese attempts at developing a yen-bloc are another. The Japanese project is, in a way, *sui generis* for it dated back to the early days of Japanese imperialism. Tracing its evolution is the mainstay of this chapter. We will witness that the contradiction between Japan's aspiring ambitions, on the one hand, and the

chronic lack of capital and credibility, on the other, led to a schism within the policy making community: pragmatists were in a constant struggle with hard-nosed ideologists. This is not to say that cleavages in the policy-making constituency developed along the lines of imperialist vs. anti-imperialist. As policy goals, expansion, and imperialism were not contested. Instead, the discussion concentrated on the means of securing real political and economic influence in East Asia, and on the political styles and tactics that would best secure a degree of autonomy and independence in a geopolitical environment that was, in fact, fundamentally adverse to both prospects.

An Early House-Call: Taiwan

> From now on, international conflict will not consist of invading countries and their peoples by means of military might [*wanryoku*], but of occupying [them] by means of financial power [*kinryoku*]. In other words, it is a fact that we will have to wage conflict not [according to the principles of] military tactics [*senryaku*], but [of] business strategy [*shōryaku*].
> —Gotō Shinpei

Perhaps surprisingly, yen diplomacy started long before the tumultuous 1930s and was closely bound up with nascent Japanese imperialism in the wake of the country's adoption of the gold standard (1897). Although several, if not most, observers have been led to stress the long-term beneficial effects of the monetary reform effort, short- and mid-term difficulties in the wake of this policy shift have received far less attention. Seen in hindsight, gold standard adoption was an audacious and profoundly risky bet at attaining superpower status. The outcome of this strategy was not only unforeseeable to its authors (the Meiji oligarchs) but also crucially dependent on the long-term commitment to an agenda that required very considerable sacrifices from the country's population and its institutions (Ōkurashō 1900). It also put into question Japan's commitment to the new imperial subjects of the freshly acquired overseas territories.

Nowhere was confusion so obvious as in the case of Taiwan. As Japan's first Asia colony, but especially in view of the state of its underdevelopment, it only seemed a natural starting point for the hands-on policies and the "steady sense of imperial purpose" for which Japanese expansionism became famous. There was not a single institutional remnant of earlier attempts at colonization (as there were in Korea); no rich pre-modern legacy that reformers felt to be at the core of their own identity (as in the case of the Chinese "cultural sphere"); and, especially, nothing of the types of infrastructure we commonly associate with colonial modernity (telegraphy, trams, and railway networks, and so on). Indeed, Taiwan was so far off the imperialist compass that General Charles LeGendre had suggested a Japanese expedition to the island, implying that it was simply for the taking (Thomson 1971).

Even so, a narrow yet important fissure developed in Japan's decision-making constituency from the very outset. The strategy of assimilationism for which the Taiwanese case has become known was not rigorously adhered to in the "hard" field of finance and fiscal matters. As Japan's reformers were soon to discover, the

society-wide imperialization of the colonial subjects was a long-term and, particularly, expensive undertaking. Famously, some Meiji leaders seemed to have pondered the sale of the island to France. Although this never happened, the Japanese faced several formidable tasks. Already in the immediate aftermath of Taiwan's annexation, there was a lot of soul-searching to be done about the validity of fully incorporating Taiwan's economy within the one of the mainland. In this sense, Taiwan was Japan's first encounter with the limits of expansionism and empire.

In the field of economic policy making, this manifested itself first in the context of the establishment of a Taiwanese central bank (factually one of the earliest central banks created, as Bytheway and Metzler have reminded us) (Bytheway and Metzler 2016, p. 19). First, it was difficult to find people willing to sit on a founding committee (*sōritsu iinkai*). When solicited, many of the newly formed Meiji elite politely demurred. Such reluctance was to a certain degree understandable: although in the immediate aftermath of the Sino-Japanese War investment in Taiwan increased, returns on these investments were far from certain and they were therefore considered risky by Japan's vested business interests. It is probably for this reason as well that, in the autumn of 1898, the industrialist Yasuda Zenjirō proposed to drop the concept of a bank of issue at all and, instead, to transform the Bank of Taiwan into a Sino-Japanese Bank (*nisshin ginkō*), with a mission of furthering trade. As a "financial institution [. . .] specializing in the trade with China and Korea [. . .], it should establish branch offices both in China and Korea" in order to "further Sino-Japanese trade relations."

Eventually, the central bank plan was saved by Gotō Shinpei, the visionary bureaucrat behind several of Japan's imperial schemes and the country's first money doctor (accidentally or not, he also was a medical doctor by training). The Bank of Taiwan (BOT) was central to Gotō's interest in the long-term development of the island and especially its integration with Japan's modernity while avoiding enforcement through military force. Cleverly playing to the expansionist forces in Tokyo, Gotō stressed the missionary importance of the BOT as a modern institution and a powerful means to gain influence for Japan farther south. His plea fell upon receptive ears. In June 1897, the BOT opened its doors in Taipei; its capital was five million yen, of which one-fourth was paid up. The foundations of Japan's southward economic advance had been laid.

Or had they? In the immediate aftermath of BOT establishment, and linked with the adoption of the gold standard in Japan proper, the question for Taiwan's monetary destiny once more uncovered schisms within Tokyo's policy-making constituency. Matsukata Masayoshi's stance had, from the very outset, been very sympathetic to Taiwan's assimilation, as we understand from his design of the island's institutions. Not only was Taiwan's financial and monetary administration subordinate to the Minister of State for Finance (Matsukata himself). The BOT was not granted the privilege of note-issue, as would have been the case for an independent central bank, but had only the right to issue bearer notes (Bank of Taiwan Law, Article 8).

Still, Ministry of Finance officials, understanding that the specie- and capital-poor Japanese government would have grave difficulties upholding the gold standard

in Japan proper, were forced to propose a hybrid solution to Taiwan's currency question. It was decided to leave core elements of the silver standard system intact, at least "for the time being" (Matsukata 1899, p. 383). This measure was certainly inspired by adoption of the gold standard in Japan proper. After all, an important element of the policy would be the liquidation of the country's accumulated silver reserves. At the time, fear of large amounts of exported silver yen coming back for redemption was one of the objections to the plan for bringing Japan onto gold (Soyeda 1899, p. 472). By offsetting the effects of the inflow of re-imported coins through putting silver to use in newly acquired territories, the Ministry of Finance probably thought it had found a key solution to alleviating at least a part of the pressure inherent in the monetary reform. For Taiwan, however, this meant that transaction costs *vis-à-vis* the Japanese mainland were bolstered, especially because the valuation of the Taiwanese "stamped" silver coin was based on the market rate of exchange in Hong Kong. Attempts at explaining the delayed integration of Taiwan into the Japanese economy soon made way for a plea to "cover Taiwan's expenditures by means of its receipts" (Namikata 1985, p. 70) – in effect, a recognition of the fact that Taiwan would have to be economically independent, more or less as a colony.

Eventually, the unexpected (and short-lived) upshot in the international silver price around 1902 would force yet another change of course (for a general discussion, see Kemmerer 1912). With the silver price becoming unpredictable, speculative exchange operations, mostly from Hong Kong and Amoy (Xiamen), but also from within Japan, were behind sharp shifts in Taiwan's money supply and cumulative losses at the BOT. In 1906, after years of administrative tug-of-war, the Japanese Government acknowledged that Taiwan was in practice incorporated within Japan's gold standard system. As for the BOT, it would become an institution in the forefront of Japanese imperialism in Southeast-Asia.

Korea: The First Monetary Laboratory

> Unlike other imperial states Japan has never been accused of having neglected her colonies; on the contrary, if any charge may be made, it is that Korea [. . .] suffered from excessive attention.
> —Hyman Kublin

Around the same time, i.e., more or less coinciding with the end of the Russo-Japanese War, another reformer was preparing the complete overhaul of Korean monetary affairs. This is not to say that this meddling on the peninsula was Japan's first. As a matter of fact, Tokyo had tried to gain influence for decades, more or less since the early 1870s. This had to do with the strategic position of Korea, which was quite in contrast with, say, Taiwan. Often dubbed the "dagger aimed at the heart of Japan," the Meiji reformers had decided that Korea was to function as a last line of defense of the homeland, both a geographic and political buffer against foreign interventionism. Monetarily, this position translated in (a) fierce attempts at, among

others, controlling the exchange rate of indigenous currencies, (b) (abortive) proposals for loans issued in order to gain financial leverage, and (c) an aggressive commercial presence of Japan's First Bank (*daiichi ginkō*).

Still, it would be Russo-Japanese rivalry that would have the greatest impact on the peninsula's economy. Throughout the 1890s, both parties implemented a series of monetary reforms that were cloaked in the discourse of assistance, yet clearly aimed at destroying each other's influence and legacy. Russia, from its side, used anti-Japanese opinion to quickly expand its grip on the political class and hasten the acquisition of concessions. Sergei Witte, the Russian finance minister who had become dissatisfied with similar efforts to obtain railroad concessions in China and other interests through the Russo-Chinese Bank (a heavily subsidized bank operating with French and Belgian money), found Korea a less contested target for his expansionist plans. The new Korean government was eager to help. Most forcefully, it resorted to a scheme of issuing large amounts of nickel currency (*paekt'ong*) of low denomination, partly in an attempt to drive Japanese currency out of the market.

But the Koreans, just as the Chinese, also attempted to play the imperialist powers against themselves. In 1898, they solicited Japanese authorities for a loan, with the express aim of bringing some order to Korea's perennially chaotic currency system. Shibusawa Eiichi's First Bank, too, would gladly undertake efforts at Korean monetary reform if they seemed profitable. This turned out to be the case. In 1900, Shibusawa therefore relentlessly pushed for negotiations with McLeavy Brown, an Englishman who had been in charge of the national finances since 1893 (his job being to see to it that Korea's foreign creditors were properly repaid). In 1901, it was agreed that that the First Bank issues banknotes, and that it lends them to the Korean government when it was in need of capital. Although the Ministry of Finance first objected on the grounds that note issuing was reserved to officially established banks, it later approved, with the stipulations that First Bank notes would circulate only under approval of the Korean government and only in Korea, hence not contradicting the legal provision that prohibited privately issued money on Japanese soil. First Bank notes went into circulation in 1902.

Unsurprisingly, none of the reforms were to much avail. If anything, they only added to the country's monetary complexity. Overcoinage, mostly of nickel coins (so called *paekt'ong*), and corollary inflationary pressures furthermore led to the massive destruction of homegrown wealth. What Megata Tanetarō, Japan special envoy to Korea, inherited in 1905 was thus an economy that was not only profoundly debased, yet also characterized by strong regional differentiation [illustration?]. The cure Korea was to be prescribed came right out of the money doctor's medical textbook (Drake 1993; Rosenberg 2003). Put in the dispassionate terminology of monetary advise, its core objectives were the thorough uniformization of Korea's money, financial practices, and, by extension, institutions. If we look more critically at its effects and its implementation, though, we are struck by the severity of its societal impact: the disenfranchising of certain Korean classes, especially the bourgeoisie or *yangban*; the confusion arising from neglect of existing financial practices

and relief measures; and especially the profoundly deflationary pressure on the Korean economy, with foreseeable consequences.

The most detrimental consequences of reform arose from the readjustment of Korea's monetary system, especially in the nickel coin regions. As a matter of fact, the rate Megata imposed for the latter to be redeemed was primarily set with the objective of boosting the relative share of already circulating Japanese currency in Korea. The societal impact of this decision must have been immediate. It was certainly advantageous to the *yen*-holding commercial classes. Vice versa, it was a direct blow to Korean commoners. This was not all. If reports of the time are to be a guide, it is clear that the process of redemption contained extraordinary bias in favor of members of, again, the (mostly Japanese and Chinese) merchant classes. They not only were the main holders of Grade A coins (lower grade coins were excluded from redemption), but they also benefited from the system set up to manage the process of redemption. During the first 3 months, the only applications accepted for currency transactions were for individual exchanges of between 1000 and 10,000 *wŏn* – amounts that were, for obvious reasons, out of the league of Korean commoners. This resulted in remarkable imbalances in exchange by nationality, with a large number of abstentions by Japanese nationals (131 individuals out of 178 total abstentions). Presumably, they filed their applications with the aim of making a quick profit, but then did not manage to buy the required number of coins by the exchange date.

Copper coins (*yŏpchŏn*), too, were to be redeemed. Here, the problem was not so much an artificially set exchange rate but rises in the international copper price. Large-scale exportation of what was the medium of exchange in the peninsula's (mostly remote) provinces resulted in a nagging deflation. For a lot of Koreans, reform thus came at a tremendous cost. Continuing shortages of cash depressed prices of farm products, increasing farmers' tax burdens, and once more forcing many into bankruptcy. Japanese measures at relief read as a cynical way of furthering imperial tactics. Seoul merchants, for instance, could pledge their real estate and receive loans on their merchandise, but the latter was strictly overseen, and loans were only granted in the new currency.

Although often overlooked in economic analyses, the profits accrued to Japanese institutions (more specifically, the First Bank, now turned into Korea's national bank, the *Bank of Chosen* (BOC)) were inversely proportional. Clearly, seigniorage occupied a large share of the latter. Remarkably, however, the BOT was much more than a "banker of banks." The *Economic History of Chosen*, published in commemoration of the bank's tenth anniversary, could rightfully claim that "so diverse and manifold are the services rendered by the bank that, since its establishment, there has been scarcely any reform undertaken in this country [...] which can absolutely disclaim the Bank's assistance given it in one form or another. It has done a great deal more than a central bank, as such is understood in most countries, ought to do" (Chosŏn Ŭnhaeng 1920). Conveniently left out of the discussion, however, was the process of *creative wealth destruction* that had made this activity possible in the first place. The same dictum applies to all other institutions of Megata's making. There were quite a few of them. Almost overnight, the Megata reform departed from the

decentralized, even fragmented structure of Korea's economy and attempted to install a modern financial system characterized by sound dealings, and in which several types of institutions were to address different sectors of the credit business. All institutions, including agricultural and industrial banks, established in accordance with Imperial Ordinance 13 (March 1906), built on the credit pyramid imposed by Tokyo and its imperialist agenda.

In this context, it is therefore instructive to reiterate Metzler's and Schiltz' indication of the profoundly *political* and *hegemonic* dynamics behind the reform effort, in fact creating and cementing a core-periphery distinction within Japan's nascent empire in Asia (Metzler 2006; Schiltz 2012a). As pointed out in the epitaph to this chapter, "Japan and the yen ha[d] an overpowering dominance, and arrangements [were] made with an eye to the needs of Japan and the yen, rather than in consideration of the other areas and their currencies." This had very tangible implications. Although the currency reports of the day indicate that Korea did adopt the gold standard, Korea's standard was, by its very design, a *gold-exchange standard* levered upon the Japanese yen. As in Japan proper (the standard of which was arguably levered on the British pound), gold coins were never in circulation. Neither did the First Bank hold much gold as a convertible reserve. First Bank notes were convertible into BOJ notes, which were convertible into gold only in Tokyo: "thus there was almost no connection between the issue of Daiichi Ginkō notes and the gold reserve." This disconnect was further reinforced by certain amendments with regard to the issue of notes. Although the bank was in principle backed by a gold money reserve or BOJ convertible notes held at the First Bank's Seoul branch, it was also allowed to issue notes backed by government bonds and other credit securities, and it could issue notes beyond the limits of convertibility on the condition of approval by the Finance Minister.

This model of the inverted credit pyramid, de facto a technocratically managed structure of debt claims built upon a very limited amount of physical gold, would nevertheless become the blueprint for all of Japan's financial domination in Asia. In the following paragraphs, we will explore what this entailed for the region's economies.

World War I: Japan's Balance-of-Payment Surplus, and Foreign Loans

> As we cannot expect the newly established Chinese government to unify the currency in Manchuria overnight, it is up to us [Japanese] to unify Manchuria's currency, further trade among Japan, Korea, and Manchuria, and gradually expand our economic zone to the south.
> —Nishihara Kamezō

World War I was, in many ways, a watershed in the history of modern Japan and its fragile gold standard. As said before, and typically erased from the Meiji leaders' attempts at remembering this period, gold standard adoption had been a mixed blessing. In the long run, expansionary military build-up programs in the wake of

both the Sino-Japanese and Russo-Japanese War, together with the country's turn to industrialization depressed the state's finances. Steep imports of raw materials and machinery meant that Japan would run constant trade deficits for the whole period between 1894 and 1914, with the exceptions of 1906 and 1909. This was in sharp contrast to the years leading up to the Sino-Japanese War. In effect, the foreign borrowing necessary to maintain the course towards a nascent empire would be massive; at the eve of World War I, it stood at 36% of GNP. De facto, it led to a situation in which "[Japan] floated overseas bonds in order to maintain the gold standard," as one Bank of Japan official put it (Fukai 1941, p. 80). What made this unsustainable debt burden nevertheless possible was not the health of Japan's economy but the Anglo-Japanese alliance.

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

Soon, however, the tide turned to Japan's favor. Diminished competition from European producers led to the consequent (and unprecedented) demand for Japanese products. European-produced beet sugar, to take one example, more or less disappeared from world markets during the war, thereby greatly increasing the price of cane sugar and the profits of Taiwan's sugar producers – especially the Suzuki concern's sugar interests and its bank, the semi-governmental Bank of Taiwan (BOT). What was more, Japan also was to build up a very large gold reserve, in the form of foreign-held currencies. Through the smooth working of its state sponsored exchange bank, the Yokohama Specie Bank (YSB; 横濱正金銀行), ¥94.4 million of gold poured into the country in 1916; in 1917, the number rose to ¥247.2 million. According to leading financier Inoue Junnosuke (井上準之助), the war economy had supplied Japan with enough financial resources potentially to liquidate all its outstanding debts, both foreign and domestic (Inoue and de Bunsen 1931, p. 38).

Given the country's dependence on foreign trade for development, however, this was not what happened. It may not be well known but, in the period between 1915 and 1918, Japan lent a total of ¥640,627,000 to Great Britain, France, and Russia; a syndicate of Japanese banks functioned as underwriter. Itō Masanao has made clear that these loans were primarily economic in nature, and stemmed from problems associated with limited specie exchange (Itō 1989). This was especially the case after 1917 (the year in which the United States too placed an embargo on the export of gold). Facing the prospect of not being able to remit its growing trade surpluses, Tokyo decided to engage in lending in an effort to "fund its own trade." Imports of

raw cotton from India were a key commodity. Gold shipments were immediately transferred to Indian wholesalers, in order to enable further imports into Japan and thus sustain furious economic growth. Japan's first experiment with foreign lending was not entirely successful. Although Great-Britain and France would pay back their debts by the end of 1924, the Bolshevik revolution of 1917 would be the cause behind Russia's default. Approximately one third of the loan issues, or ¥220 million, would never be recovered.

There were also other loan schemes, and these carried all the hallmarks of a pronounced political interest. The initiation of the latter was, again, connected with events on the European theater of war. Most prominently, wartime expediency forced Great Britain to abandon its aggressive economic and political activities in China. Both Japan and the United States, temporary winners of hostilities in Europe, would declare their candidacies at filling the power vacuum. At stake were the politics of "exclusive rights" that the European powers had wrought upon China, which they regarded as immutable and inalienable.

The American reaction to the opportunity represented, rhetorically at least, a break with the concession imperialism that had been the hallmark of European meddling in Chinese affairs. As the United States had largely sailed an isolationist course roughly until 1890, its influence in Asia had effectively been undercut by a series of contracts (for mining rights, building railways, a telecommunications infrastructure, and so on) through which China's sovereignty had been further eroded. The United States' own adoption of the gold standard, in particular, put an end to isolationism and saw the birth of a strand in American politics that stressed greater American involvement in international affairs. The US government sponsored the establishment of a Commission on International Exchange whose aim was to investigate the possibility of establishing gold-exchange standards in, among other countries, Panama, Cuba, the Dominican Republic, and Mexico (United States 1903). Its ambition was the establishment of a *dollar bloc*, no more, no less. The currencies of these countries would not be based on the pound sterling (the system pioneered by the British in India) but on the US gold dollar. China remained, however, the *nec plus ultra* in the Great Power scramble for concessions and favorable trade agreements, although US interests there had been substantially weakened.

Preempting a confrontation with the USA, the Terauchi government retorted to the Pan-Asian ideology and tactics that would otherwise characterize much of the 1930s. Concretely, the administration sought out to sideline the multilateral China consortium, a syndicate of British, French, German, and American bankers committed to sharing equally all future business in China. The architect of Japan's strategy was Nishihara Kamezō 西原亀三, at the time an unknown Japanese businessman and adventurer, who had sought to make his fortune in Korea (interestingly, Nishihara had been a harsh critic of the Megata reform; Megata allegedly tried to have him expelled from Korea).

During a series of several (partially secret) missions to China in early 1916, Nishihara would negotiate several loans on behalf of the Japanese government. After 1916, Nishihara's activities accelerated. When both Ōkura and Co. and YSB proved

unwilling to lend to the Bank of Communications, Nishihara chose to side with Transportation Minister Cao Rulin (曹汝霖) in the new regime led by Duan Qirui (段祺瑞). He signed a preliminary loan for ¥5 million. In the course of 1917 and 1918, negotiations concerned even larger loan issues. Clearly, the stakes had gotten higher, yet Nishihara wanted to reinforce and cement his role as a political fixer.

Ultimately, another five loans were concluded, in the following chronological order:

1. The Kirin–Hueining Railway Primary Loan (June 18, 1918): ¥10 million for linking Manchuria and northern Korea
2. The Mine and Forestry Loan (August 2, 1918): ¥30 million for developing gold mines and forests in the Russian zone of northern Manchuria
3. The Manmō Four-Railway Loan (September 28, 1918): ¥20 million for linking Manchuria and Mongolia
4. The Shandong Two-Railway Preliminary Loan (September 28, 1918): ¥20 million for linking Shandong with central and southern China; the railway was to be a jointly-owned Chinese and Japanese line
5. The War Participation Loan (September 28, 1918): ¥20 million

These, together with the earlier loans, amounted to no less than ¥145 million. Interestingly, three of the loans had been hastily concluded on the Terauchi cabinet's final day in office.

A full discussion of the Nishihara loans falls beyond the scope of the chapter. Here we suffice with pointing out the rationale behind them. Nishihara was particularly concerned with schemes for economic cooperation and the need to develop a unified currency zone – the "yen bloc" (*en burokku* 円ブロック). Especially after the US entry into World War I (1917), this policy stance hardened. Probably blind to the irony, Tokyo proposed a "Monroe Doctrine for East Asia, or Pan-Asianism" (*Tōyō no Monrō sunawachi zen-Tōyō shugi* 東洋のモンロー即ち全東洋主義). The notion of an "East Asian self-sufficient zone" (*Tōyō jikyūken* 東洋自給圏), in particular, was a radical departure from former foreign policy ideology.

The idea certainly went beyond the earlier set-up of gold-exchange standards in Taiwan and Korea. Nishihara and his co-conspirators envisaged a more radical connection between the Chinese and Japanese monetary systems than yen-based gold exchange standards (*engawase ken* 円為替圏 or yen *exchange* bloc). What they had in mind was a full-fledged bloc, encompassing all the countries in Japan's sphere of influence, in which the Japanese yen would be the sole standard against which other currencies would fluctuate (*enkei tsūkaken* 円系通貨圏). Gold currency notes of the same type as Japanese currency were to be issued, backed by Japanese gold notes. In Nishihara's original proposals, the convertibility of local currency with Japanese paper yen was set at the rate of 1:1; Bank of Chosen notes too were to be allowed for circulation in China, at the same rate. This would wipe out transaction costs and clearly favor Japanese commerce at the expense of the Western powers. Further imperial overtones were obvious: as the host nation, China would "invite" high-profile Japanese to oversee the reforms. In an attempt to sugarcoat the

arrangement, Nishihara promised Japanese assistance in increasing Chinese custom duties with the aim of stimulating the country's domestic development and trade, in exchange for "the abolition of export tariffs on cotton, wool, iron, and copper, and possibly two or three other commodities." It was difficult not to see the geopolitical implications of such an arrangement.

Although the Nishihara loans were eventually written off (cf. infra), Nishihara must be considered as a visionary, albeit an imperialist one. If anything, his arguments foreshadow the grim realities of the 1930s and prefigure the German and Japanese militarist belief that war was inevitable. After this war, he predicted, the world would fall apart into several blocs, "be it in the form of economic wars between the powers, or [in the form of] the unification of one British empire, or realized through extreme protectionist measures [*kyokutan naru hogo seisaku* 極端なる保護政策]." His predictions would turn into a self-fulfilling prophecy, propelled by Japan's increasingly unbridled military apparatus.

And yet, as said above, hardliners had to shelf their plans for the time being. Once the foreign powers had been alerted to the magnitude of the Nishihara loans, they conspired for the loans' immediate termination. To its international embarrassment, the Japanese government was pressured into writing them off completely, with the exception of a token repayment of ¥5 million. Thus, ¥140 million was unaccounted for, which probably went to line the pockets of corrupt Chinese officials. In hindsight, the main effect of the Nishihara loans may thus very well have been merely to prolong China's civil war. Consecutive Japanese administrations implored the loss of foreign exchange and prestige this episode implied. The financier and statesman Inoue Junnosuke put it as follows in 1926: "these investments with the central and provincial governments of China—investments running to several hundred million yen—resulted in a dead loss, and today Japan can recover neither the capital which she thus locked up nor one penny of interest on it. To put the matter in a nutshell, I would say that foreign investment was not practiced by this country, and that such trifling investments as were effected might just as well have been thrown into the sea" (Inoue and de Bunsen 1931, p. 37).

The 1930s: Manchuria

> We pioneered a new realm [*atarashii tenchi*], and had the genuine intention of partaking in the building of a new country. Owen Lattimore called Manchuria the "cradle of conflict" in East Asia. Until the construction of Manchukuo, it was just that. But turning [that situation] around, and making it into the cradle of East Asia's peace was the honest intention of those who took part in the building of Manchukuo.
> —Hoshino Naoki, Mihatenu yume (1963)

Much later, i.e., after the crisis-ridden 1920s, blocist ideology would make a comeback. And once more, the object of Japan's currency imperialism was China, in particular the country's Northeastern regions. Actually, Japanese financial interests in Manchuria were long-standing; they dated from the 1890s, when

nascent Japanese imperialism started to flex its muscles on the Asian mainland. The Bank of Chosen developed its function as an overseas bank or *kaigai ginkō* because Korea's trade deficit with the Japanese mainland and its consequent balance-of-payments problem made it necessary for the bank to venture into those countries with which it had a trade surplus. Bank of Chosen bills thus almost necessarily came to circulate in the adjacent territory of South Manchuria. According to the *Economic History of Manchuria*, not accidentally published by the bank, "the demand was always present, and the Bank in most cases had simply to follow it" (Chosŏn Ŭnhaeng 1920, p. 285). As could be expected, it greatly expanded its network of branches in Manchuria. Since the outset of its establishment, it had maintained a branch in Andong (immediately over the Yalu River); to this were added branches in Mukden, Dairen, and Changchun (all founded 1913), and, later, Sipingjieh (1914), Kaiyuan (1915), Harbin (1916), Fujiadian (1916), Yingkou (1916), and Longjing (1917). Remarkably, from 1918 onward, the bank's business in Manchuria and mainland Japan equaled and even overtook its business in Korea proper, in terms of both deposits and loans. Important for the discussion, BOC was the most vocal proponent of incorporating Manchuria within a gold-yen bloc, an orientation that is related to its cadre's closeness to the Terauchi government and Nishihara (Shōda Kazue, finance minister at the time, was a former BOC governor).

BOC did, however, have to reckon with a formidable competitor: the Yokohama Specie Bank, which had been charged with money issuance in the aftermath of the Russo-Japanese war. Much has been said of the fact that it was strongly opposed to large scale monetary reform, and that it sought to keep silver as an integral part of Manchuria's byzantine monetary fabric. Several authors have explained it as pragmatic, yet this misses the point. As I argue in forthcoming research (Schiltz forthcoming), it points directly to a concern with its management strategy of hedging all foreign exchange risk, which had been mandated in the early 1890s, and which stemmed from the volatility of the world silver price. For the same reason, YSB also resisted the demands to give preferential treatment to Japanese customers; its silver using clientele was key to its business success. In any case, YSB remained a firm and stabilizing factor in Japanese policy versus Manchuria during the whole prewar period. Unlike BOC, which in the 1920s even came on the verge of bankruptcy, YSB and its currency enjoyed a sterling reputation among Chinese, Manchurian, and Japanese business circles.

The early 1930s, however, reignited the gold versus silver debate in a novel fashion. Unsurprisingly, military hostilities were the catalyst of the feud. As is well known, the Japanese military used an alleged Chinese provocation as pretext for an occupation of cities and towns along the line of the South Manchurian railway, which soon extended to all of Manchuria. Shortly thereafter, they created the semisovereign state of Manchukuo, with the aim of turning it into an industrial powerhouse for the militarists. Politically, Tokyo confirmed its international isolation by withdrawing from the League of Nations. Takahashi Korekiyo's decision to take Japan off the gold standard signaled the end of Japanese internationalism in financial matters.

The impact of Japanese control over Manchuria was immediate and total. Together with establishing Japanese military and political dominance, the occupying forces set out to control the region by economic and monetary means. They immediately confiscated all banks, put them under the supervision of employees of SMRC, YSB, or BOC, and seized both their assets and ledgers. BOC was eager to declare its candidacy at leading the new country's monetary organization, but, given Japan's own retreat from the gold standard, found it difficult to convince the political class. YSB silver advocates were more successful. Stressing the importance of stabilizing Manchuria rather than implementing yet another large-scale reform effort, and pointing out Japan's own need for bullion, they explained that a unification of Manchurian money on a silver bullion standard would be the only viable option. Their proposals were accepted in 1932, although ultimately all references to the convertibility of the Manchurian paper yuan were omitted from the charter of the Central Bank of Manchukuo! Thus, from a rather optimistic assessment of Manchuria's monetary and financial future, even the gold proponents made a complete U-turn. Still, the process of currency unification was considered a success. In the words of a contemporary observer: "Thus far the chief benefit of Japanese rule, the new banking system, has abolished fiat currency which the peasants formerly were forced to accept by avaricious warlords. As remarked earlier, they issued crisp but soon worthless paper [. . .] in exchange for the great soya-bean crop [. . .] and for other cereals, which they then sold for hard money. [. . .] The Central Bank of Manchukuo [. . .] converted most of the more reputable old notes. It succeeded in stabilizing the Manchukuo yuan [. . .] at a par with the China dollar" (Snow 1933, pp. 271–272).

In the end, however, it was sharp swing in the international silver price that would necessitate the reorientation of Japan's monetary position in Manchuria. Initially, Manchuria's silver standard had been a boon. Not in the least, it had functioned as a buffer against the Great Depression which, by the early 1930s, was in full swing and had rapidly enveloped the whole world. Yet Roosevelt's controversial silver buying policy (1934) turned the tide. As explained in *The Money Doctors from Japan* (Schiltz 2012a), and contrary to the official explanation, the program's rationale was not so much economic as geopolitical. Roosevelt was determined to spite Tokyo for its own unilateral policies. The silver purchase program was a subtle, yet powerful, way to do so. The latter explains, among others, why the policy was also so detrimental to Chinese interests, a consequence of which Roosevelt had been warned. If anything, the effect of the silver purchase program was a *maelstrom* of deflation. Put simply, as silver was not a mere commodity, but China's money, the outflow of silver sent commodity prices plummeting, translating into a fall in income and employment (Friedman 1992). Within Manchuria, it became increasingly difficult to maintain stable exchange rates between the still circulating silver and gold notes.

Eventually, and clearly frustrated by American policy, Manchurian authorities opted for a radical solution. In September 1935, they agreed to couple the Manchurian yuan to the yen, in other words, to have the economy of Japan proper subsume the Manchurian economy (*naichika*). In a fateful twist of irony, Roosevelt's controversial silver purchase program had only further buttressed Japan's choice for autarky.

From the Outbreak of the Second Sino-Japanese War (1937)

In the aftermath of this Manchurian episode, the technocratic grip on the monetary affairs of the *gaichi* was strengthened even further. In a typical example of over-confidence that characterized the bureaucratic elite, the Kyoto economist Matsuoka Kōji hailed the gold-exchange standard as the future of monetary arrangements (1936; 1938); establishing an economic zone on the basis of the latter was Japan's destiny, an "important and pressing" need.

His view is actually doubly meaningful, because he is correctly credited for being the first to describe Japan's standard as a gold-exchange standard levered upon the British pound. And indeed, if the set-up of monetary standards in China, Mongolia, the Dutch Indies, etc. seems similar to, in particular, the country's early experiences with gold monometallism, this is *because it is*. The mechanism behind Japan's gold-standard was described long ago by Kojima Hitoshi (1981). As in the context of the Indian gold-exchange standard, the key was a currency board (Jpn. *azukeai kanjō* 預け合い勘定, literally "joint custody account"). The function of the latter was to aid with pegging or fixing the value of the soft currency vis-à-vis the value of the core currency, primarily by selling/buying foreign exchange between legally stipulated band (Keynes 1913; Kemmerer 1905; United States 1903). One way in which Japan's gold standard set itself apart from the Indian set-up is that the accounts of the Japanese government and the Bank of Japan in London were administered by a semi-official Japanese institution (the Yokohama Specie Bank) rather than an foreign entity. Another is that these accounts included a "specie reserve account" on the basis of which paper money in Japan was issued.

The latter had led to heated debates in Japanese monetary policy circles. Some had compared the unorthodox practice to the "Ninben" katsuo-don (bonito and rice bowl) shop, which had famously issued its own bills on the security of its reserves of fish still swimming in the sea (Metzler 2006, p. 98). And yet, difficulties of maintaining the yen par notwithstanding, there is no denying that this system worked. In the case of colonial monetary systems, however, the mechanism and its metaphor were stretched to its very limits. Importantly for our discussion, "anchors" were levered upon each other. Concretely, the monetary systems of Japan's periphery (colonial yen, expressed as 圓, rather than the yen 円 used within the Japanese islands) were anchored to the yen in the way the yen was anchored to gold. As put by Metzler: "What we could call first-order money in this system—gold—was leveraged into a larger supply of gold-based national monies, such as the British pound—'second-order' money. This second-order money in turn constituted the monetary base for banks who leveraged it into a much greater volume of money by making loans and creating bank deposits—'third-order' money. In a like way, gold-exchange standards in peripheral countries pyramided gold-based foreign exchange money such as the British pound into third-order or fourth-order money" (Metzler 2006, p. 37).

Clearly, there were and are limits to leverage. As the epitaph to this chapter reminds us, the pitcher goes so often to the well that it is broken at last. In August 1941, when the Roosevelt administration implemented a financial siege and made

the already inconvertible yen illiquid (Miller 2007), something had to give. That "something" turned out to be any meaningful limitation, economic or not, on the arbitrary expansion of the money supply and thereby, debt claims. As the chain connecting the proverbial gold anchor to Japan's gold-exchange boats was then factually severed, the boats drifted and swayed according to the mercurial demands of Japan's war machine.

As could be expected, military dominance led to a dangerous experiment with "inflation capital": freshly created (and inconvertible) yen that were used to buy what the Japanese military wanted, and that denied the captive regions and countries the foreign exchange that might have been used for their own growth and industrialization. What this meant for countries and territories occupied by Japan we know from their rates of inflation: "From the beginning of the Pacific War to the end of the War, the amount of currency issued in the several regions [of the Greater East-Asian Financial Sphere] increased, and the price index [of these regions] shows an identical pattern. Yet, one should not lose sight of the fact that this increase took the form of a rising wave, originating in the center and growing toward the periphery [.. .]. Comparing the outset of the war with its end, prices in Tokyo rose by a factor of one-and-a-half, whereas they rose extraordinarily [elsewhere], i.e., by a factor of 350 in Singapore, and by a factor of 1,850 in Rangoon" (Yamamoto 1997, p. 19).

As explored in a recent documentary by Japan's public national broadcasting company, the folly that was the "Greater East-Asian Financial Sphere" (Shimazaki 1987; 1988a, b, c, d) leaves its traces even today. In the accounts of the Ministry of Finance, one entry entitled "extraordinary war expenditures" still shows a debt running into more than 41 billion yen. Unlikely to ever be repaid, this loan, created out of thin air by the penstrokes of Japan's military planners, nevertheless presents very real goods and services that were extracted from the occupied territories and put to the service of the imperialist center. In Japan's imperialist project, for which, according to Ishiwara Kanji, "the war was to be used to feed the war" (*sensō wo motte sensō wo yashinau* 戦争をもって戦争を養う), some players thus turned out to be more equal than the others. Simply put, not even one domestic Japanese yen had been used for the conquering of Asia (Tatai 2014). Vice versa, if viewed through the eyes of the occupied regions and territories, they had been paying for their own occupation. Clearly, as has been argued in the context of the Nazi economy: "[u] nlike communism, fascism was not for export, and the collaboration and the sensibilities of the conquered peoples were of relatively little concern to the conquerors" (Wolfe 1955, p. 400).

Cross-References

► International Monetary Regimes: the Gold Standard
► International Monetary Regimes: the Interwar Gold Exchange Standard
► Money in Wars

▶ The Historical Evolution of Monetary Policy (Goals and Instruments) in Japan: From the Central Bank of an Emerging Economy to the Central Bank of a Mature Economy

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