Asia Journal, Volume 3, Number 2 (1996)

HOW THE JAPANESE STATE DEALS WITH INTERNATIONAL OIL MAJORS?: INTERNATIONALIZATION, CARTELS, AND LICENSING

Yul Sohn
Seoul National University

From a historical perspective, the central concern for late industrializers was how to establish and promote the national economy. This meant the protection of strategic but infant industries from foreign competition and nurture them to be competitive. Regulation was required and protective tariffs have been most instrumental. As with all advanced Western countries, Japan, as it entered the modern world, had to protect and nurture its own industry by erecting tariffs. However, the new leadership, so-called Meiji oligarches, failed to recover the right of tariff autonomy that was lost by the unequal treaties concluded before their seizure of power.[1] But the loss did not lead to free trade. Mercantilism prevailed as they experimented various sorts of industrial policy that would meet both the necessity of protection and the pressures from the enforced free trade.

This paper explores how Japanese policymakers protected and nurtured the nascent indigenous oil industry from foreign competition without recourse to protective tariffs. From the late nineteenth century, especially from the early 1920s, two multinational oil firms, Standard-Vacuum (an East Asian joint subsidiary of the Standard Oil of New Jersey and the Standard Oil of New York) and Rising Sun (a Japanese subsidiary of Royal Dutch-Shell), had consistently held more than half the market share of refined oil in prewar Japan and maintained their dominant status even after 1934 when the Japanese state finally formulated a comprehensive set of protectionist measures — the Petroleum Industry Law (*Sekiyugyo-ho*), which gave the state the right to license the business of crude oil imports and refinery construction and also to set production quotas and subsidies as well as enforce a six-month oil stockpiling requirement. (Tsusho sangyosho 1980: 159-162). Since penetration by the two giant

[1] Japan signed the unequal treaties with the Western powers between 1857-1868. Until 1899, these treaties forced Japan to maintain a single non-tariff barrier of up to five percent on all imported items.

multinational corporations was swift and large in scale under a liberal trade and monetary regime in East Asia, the Japanese policymakers tried to devise institutional arrangements that enabled Japan to stabilize the now increasingly transnationalizing, fluctuating market.

This paper narrates the history and nature of the Japanese efforts to establish a stable industrial order by which an indigenous oil industry was developed. A central attention focuses on the state's decision-making process which eventually led to the enactment of the Petroleum Industry Law (PIL) and its operation over the running of the cartel. We will see that the Japanese state could eventually find an industrial order (i.e., control of market players, price, production, and sales) at the cost of the consumer's sacrifice, but that neither could it regulate foreign firms satisfactorily, nor achieve the much desired autonomy in the oil refining sector.

Two contrasting explanations account for such policy results.[2] First, Irvine Anderson in *The Standard-Vacuum Oil Company and United States East Asian Policy* argues that the international oil regime's power frustrated Japan's quest for oil autonomy. This is seen in the effective coordination between Standard-Vacuum and Royal Dutch-Shell in bargaining with the Japanese state (Anderson 1975). Since his work relies entirely on the US State Department records, it inevitably highlights the powerful role of foreign capital and the US Government, but completely failed to examine the Japanese politics within which the intrastate actors and domestic firms interacted to influence the bargaining process toward particular institutional arrangements called licensing.

On the other hand, in *The Business of the Japanese State*, Richard Samuels stresses domestic factors to account for the inconsistency of state intervention, and he argues that while the state repeatedly aimed for a

[2] Most Japanese-language literature on the Japanese oil industry regarded the PIL as a symbolic monument of a successful protectionist policy, but they tend to accept the PIL at face value while ignoring its incoherent, ineffective implementation. For example, Takeda Haruhito, "Shiryo kenkyu: nenryokyoku sekiyu gyosei senshi," in Sangyo seisakushi kenkyujo, ed., *Sangyo seisakushi kenkyu shiryo* (1979), pp. 171-240; Abe Sei, "Dainisha taisenzen ni okeru nihon sekiyusangyo to beiei sekiyujihon," *Shogaku ronsan* 23-4 (1981), pp. 169-209; Udagawa Masaru, "Senzen Nihon no kigyo keiei to gaijitei kigyo (1)," *Keiei shirin* 24-1 (1987a) and "Senzen nihon no kigyo keiei to gaijikei kigyo (2)," *Keiei shirin* 24-2 (1987b); Kikkawa Takeo, "1934-nen no Nihon no sekiyugyo-ho to Standard Vacuum Company, (1)" *Aoyama keiei ronshu* 23-4 (1989a), pp. 21-43; "1934-nen no nihon no sekiyugyo-ho to Standard Vacuum Company (2)," *Aoyama keiei ronshu* 24-2 (1989b), pp. 63-100; "1934-nen no Nihon no sekiyugyo-ho to Standard Vacuum Company (3)," *Aoyama keiei ronshu* 24-3 (1990c), pp. 39-68; "1934-nen no Nihon no sekiyugyo-ho to Standard Vacuum Company (4)," *Aoyama keiei ronshu* 24-4 (1990), pp. 55-67; and "1934-nen no seikiyugyo-ho to gaikoku sekiyu kaisha to no kosho," in Oishi Kaichiro, ed., *Senkanki Nihon no taigai keizai kankei* (1992), pp. 173-205.

vertically integrated, horizontally unified oil industry, what emerged instead was a vertically truncated, horizontally fragmented industry, since the interests of the domestic firms were too diverse; that is, the fragmented nature of the domestic industry constrained state intervention (Samuels 1987). What is less recognized in this account is the extent to which the internationalized market helped to shape specific policy ideas of various actors and the way in which public and private actors sharing their own ideas were organized to respond to that evolving market.

This paper instead focuses on the conflict both within the Japanese state and within the vertically disintegrated industry which include oil producing, refining, and trading firms. We will explore how different ideas were formulated around the issue of oil industry protection, and how they affected the formation of political coalitions including state actors and firms (domestic/foreign) within the context of the international oil industry's structure. We will then find an institutional framework that political, business, and bureaucratic actors made political exchange to produce "licensing system" that, as we will see, was borrowed from the French experience, but its introduction and operation were complicated by the political conflict between the two coalition camps.

Historical Background

As in the case of Standard Oil's domination of the US oil industry before its dissolution in 1911, and of the Seven Sisters' control of world oil since the late 1940s, the oil industry was regarded as one of the most concentrated industrial sectors among modern industries. Shaffer argues that in the oil industry's early phase, its monopolistic character was shaped by (1) the presence of scale economies in refining, (2) the geographical distance between major markets and the producing centers, and (3) the limited supplies of crude oil available (Shaffer 1988: 20). Indeed, Standard's initial control over both transportation (the reduction in unit costs through lower transportation charges) and major refineries controlled over 90 percent of domestic production and between 90 to 95 percent of the total refining capacity in 1880 (Bromley 1991: 90).

From the beginning, Standard Oil's exports of refined products exceeded domestic sales. In 1866, for example, it exported more than two-thirds of its refinery output (Shaffer 1983: 30). It also established 67 foreign affiliates engaged in the oil trade. Nonetheless, it failed to achieve hegemonic position in the international oil market; it never reached one-third of the market share before World War I whereas European firms like Shell, Royal Dutch, Nobel, and Rothschild occupied the remainder of the non-US markets (ibid.: 35).

Meanwhile, Standard dominated the East Asian market by establishing a distribution network that in 1893 was assigned to the Standard Oil Company of New York (Socony). Market success here replaced the losses suffered in Europe following the rise of Russian oil. It was, in fact, the fastest growing market for US oil (ibid. 32). Standard's dominant position, however, had been challenged at the turn of the century, first by the Shell Transport and Trading Company, which began selling refined Russian products to East Asia via Rothschild, and later by Royal Dutch, which was organized to produce, refine, and distribute Dutch Indies oil. Predicting that the Dutch Indies would become a major force in the East Asian market because of its rich oil fields, geographic proximity to China and Japan, and cheap local labor force, Standard made two aborted attempts to buy out Royal Dutch in 1895 and 1897, respectively. Due to the Dutch Government's intervention, Standard failed to obtain concessions in southern Sumatra. Soon, it initiated a fierce price war in East Asia (Fursenko 1990: 82).

In 1903, Shell, Royal Dutch, and Rothschild responded by creating a joint trading firm, "the Asiatic Petroleum Company," which controlled all their oil transactions "east of Suez." Four years later, Royal Dutch-Shell was set up to emerge as the Standard's biggest rival in the world oil market. For the next twenty years, the East Asian market became the world's hottest battlefield for market share between Standard (after the breakup in 1911, Standard-New Jersey and Standard-New York) and Royal Dutch-Shell.

This international condition shaped the modern history of the Japanese oil industry beginning with the establishment of Nippon Oil, the largest domestic producer and refiner up until now. Nippon Oil was followed by numerous small-scale producers which in 1891 totaled 430 firms, but two foreign trading firms soon dominated the field. In 1893 both Socony and Rising Sun opened offices in Yokohama. Both firms aggressively penetrated the Japanese market by selling refined products (mostly kerosene), and later they directly participated in production and refining, i.e., Socony's International Oil Company. In 1907, due to high production costs and a limited reservoir in Japan, it abandoned upstream business and sold its facilities to Nippon Oil. In 1909, Rising Sun constructed a refinery in Fukuoka, but abandoned it during World War I. Throughout the rest of the century, the two majors continued to dominate the Japanese oil market by marketing foreign refined products while domestic firms struggled to survive.

Private Control for Protection

As we can see in Table 1, domestic oil had been consistently dominated by the imports of foreign oil products most of which was controlled by the two oil majors. In this circumstance, the development of the domestic oil industry meant the protection of it from foreign oil.

Bereft of the right to impose tariffs, mergers and cartels became the primary methods to protect Japanese oil firms. As early as 1901, Okuma Shigenobu, together with Shibusawa Eiichi, addressed to domestic oilmen the necessity of a "grand merger (*taigodo*)" by which to "multiply [Japanese] power and compete with [Standard]." He stated that "[the grand merger] is the way to secure eternal profits from oil mining" (Inoguchi 1963: 110). Initially, the plea for a merger centered on the Nippon Oil was stimulated by Socony's establishment of the International

Table 1. Refined Oil Supply in Japan, 1919-1940

(k*l*)

Years	Production from Domestic Crude	Production from Foreign Crude	Subtotal	Import of Refined Oil	Total
1919	–	–	253,792	177,768	431,560
1923	222,229	97,410	319,639	272,387	592,026
1926	227,304	281,772	509,076	411,178	920,251
1927	246,204	289,224	535,428	436,479	971,907
1928	249,876	307,764	620,640	888,137	1,508,777
1929	293,760	416,484	710,244	1,164,506	1,874,750
1930	279,007	459,092	738,099	1,515,271	2,253,370
1931	301,731	489,653	791,384	1,601,972	2,393,356
1932	–	–	913,354	1,847,444	2,760,798
1933	–	–	1,074,440	1,854,777	2,928,217
1934	–	–	1,297,135	2,298,764	3,495,899
1935	–	–	1,516,344	2,911,056	4,427,400
1936	–	–	1,730,837	2,677,049	4,407,886
1937	–	–	2,091,071	3,281,129	5,372,200
1938	–	–	2,005,162	3,401,337	5,406,499
1939	–	–	1,939,795	1,706,763	3,645,558
1940	–	–	1,652,384	1,921,636	3,574,020

Source: Calculated from Inoguchi Tosuke, 1963: 212, 259.

Oil Company on Japanese soil, and it continued throughout the entire prewar oil history.[3]

On the other hand, the first private joint action appeared in 1904. Two leading domestic firms, Nippon and Hoden, realized that the competition between them caused prices to fall, which weakened their competitiveness vis-a-vis foreign firms. They organized the "National Oil Sales Union (*kokuyu kyodo hambaisho*)" to improve the quality of products and strengthen the marketing network. It collapsed in two years. Subsequent attempts to protection invariably failed. In fact, it was ineffective for domestic firms to organize themselves for collective action while excluding two dominant foreign players. They had to be dealt with.

The first domestic-foreign (*naigai*) cartel in the Japanese oil history was formed in 1910. Standard, Rising Sun, Nippon, and Hoden reached a four-way agreement. It set quotas between domestic producers (35%) and foreign importers/producers (65%). It also attempted to limit production, stabilize the level of price and divide profits. This private agreement which lasted less than a year was followed by a series of cartels subsequently formed during that decade. All were abortive because players, particularly domestic, could not efficiently control their distribution network (i.e., retailers), and more importantly world market conditions were extremely unstable (i.e., competition between majors, fluctuation in production) (Inoguchi 1963: 146-7; Nippon Sekiyu 1970: 176). Also, as Samuels points out, a successful collusion in the early Japanese oil industry was elusive because demand itself was transformed — the age of illumination (kerosene) gave way to age of energy (gasoline/heavy oil) (Samuels 1987: 170).

State Intervention

Oil became a strategic commodity in the early 1900s after the British Admiralty converted its fleet from coal to fuel oil, but it was during World War I that its strategic potential was fully recognized (Shaffer 1983: 43). Not only was oil used to power the fleet, but it was also used for tanks, trucks, and airplanes in a motorized war, as French President Clemenceau stated oil was as necessary as blood. Now, all major powers recognized that oil was not only important economically, but also militarily, and each

[3] For example, a *genro*, Matsugata Masayoshi urged Nippon Oil and Hoden Oil to merge in 1902. Goto Shimpei did it too in 1911 (Samuels 1987: 171).

subsequently sought oil sources all over the world. The French consolidated their domestic industry and searched for concessions in Romania and Iraq. At the San Remo Conference, the British were awarded mandates for Iraq and gained concessions in Iran. The Dutch consolidated control over the Dutch East Indies oil fields; and in the United States, the world's largest oil producer, where the wartime oil shortages gave rise to fears that domestic oil reserves would soon run out, firms also searched for new oil fields worldwide (Bromley 1991: 94).

As in the case of Britain, it was the Japanese Imperial Navy that first appreciated the strategic implications of oil and it subsequently played an important role in developing Japan's domestic oil industry (Kikkawa 1989a: 29). Already in 1905, the Navy had built its first heavy oil tankers at Yokohama Yard, and in 1919 built its first liquid fuel boiler for a battleship. Afterwards, had their steam boilers replaced with oil powered boilers. In 1917, due to insufficient supplies of domestic oil, the Navy began to purchase foreign oil from the Anglo-Saxon Petroleum Company, and two years later it signed a five-year contract with Rising Sun for one million barrels per year. In 1921, it decided to directly enter into the refining business by building the Tokuyama Fuel Depot, which became the largest Japanese refinery in the prewar period.

Henceforth, the original impetus for direct state intervention in the oil industry came from the Navy. In 1918, the Navy made a proposal called "Attention to Fundamental Measures Regarding Petroleum Supply for Military Use (*Gunyo sekiyu jyukyu no konponsaku ni kansuru kaku*)" which included the nationalization of the oil industry, the grand merger of all domestic firms, and the construction of a Navy refinery. This initiative was followed three years later by the "Investigative Council for Oil Policy (*Sekiyu seisaku ni kansuru chosakai*)" with representatives from ministries of Agriculture and Commerce (MAC, later, the Ministry of Commerce and Industry), Finance, Foreign Affairs, Army, Navy, and National Census Board (*Kokusein*), which reviewed the national oil monopoly plan proposed by the Navy.[4] After a detailed study of the feasibility of that plan, members accepted it as a "relatively appropriate (*hikakuteki tekito*)" policy but the Navy ironically opposed it by asserting that the Navy-use fuel should not be subject to this policy (Kogane bunsho I).[5] This

[4] The Kokusein was established in 1920 to conduct a unified, Cabinet level statistical survey, and conduct research to prepare for the national mobilization plan relating to the implementation of the Munitions Industry Mobilization Law. It lasted for only two years and its function was delegated by the Ministry of Agriculture and Commerce and the Cabinet's Statistics Bureau.

committee came to an end without yielding concrete results. According to Takeda Haruhito, Navy's opposition resulted when they realized that the plan would give jurisdiction to the MAC and MOF and would lessen their influence on the national oil policy (Takeda 1979: 172).

While the state's first attempt at controlling the domestic industry failed perhaps because of the division of interests among ministries, there is little evidence showing the private attempt to influence, whether directly or indirectly, the above decision making process. In fact, the state was considering market intervention during the period of time when two leading firms, Nippon Oil and Hoden Oil, were doing highly profitable business — during 1919-1922 Nippon Oil paid a highest dividend of 25% up to 45% on the stocks while Hoden did 20% to 40% in their respective prewar business history.[6] This might mean that each intrastate actors hardly found its own private constituency in decision making. Equally important was the limited business opportunity for domestic traders since the domestic refiners used domestic crude. Nevertheless, the 1922 state attempt to intervene was important because the discussion of direct state control in the form of a national oil champion set the tone for later national oil policy.

Although the Navy had been consistently the largest consumer in prewar Japan, private demand also grew with the proliferation of automobiles (gasoline) and commercial fleets (heavy oil), reflecting the steady growth of the overall Japanese economy. It was particularly during and after World War I that domestic oil firms enjoyed unprecedented profits as demand of oil drastically increased due to the wartime economic boom. New firms (i.e., Mitsui Mining, Mitsubishi Mining, Kuhara Mining, Murai Mining) subsequently entered into the business and competed with the two existing powers, Nippon Oil and Hoden Oil, as well as with other foreign giants.

Just as the crude production of domestic field began to decline in the early 1920s, domestic firms shifted their business from "mining" to "processing." Domestic refiners began in 1921 when Asahi Oil was established to buy out the Nishibezaki refinery, which Rising Sun had abandoned and started instead to refine the Dutch crude obtained from it. In the same year, Ogura Oil constructed the Tokyo refinery to refine Mexican crude imported through Asano Bussan. The Petroleum Sales

5 "Nenryo chosa iinkai setchi ni kansuru shorui," *Kogane Bunsho I: Nenryo chosa iinkai kankei shorui.*

6 For Nisseki's data, see Inoguchi, 1963, p. 159 and p. 211. Also Nippon Sekiyu, 1971, pp. 221-222. For Hoden's data, see *ibid.*, p. 220.

Union (*Sekiyu kyodo hambaisho*) was established to import Western Indies oil via Rising Sun. Imperial Oil (*Teikoku sekiyu*) established a modern refinery in Tokuyama. In 1924, Nippon Oil also constructed the Tsurumi refinery to refine California crude. By this time, oil imports (particularly foreign crude) began to be prolific. Major trading firms (*shosha*) became active players in the market. From the early 1920s, they obtained master licenses for domestic distribution, mostly, from California oil firms, i.e., Asano Bussan from Sinclair and Socal, Mitsui from General, Mitsubishi from Associated, Nisho from Union, Nidatsu from Sunset (Kitazawa and Ui 1941: 315-6). Together with the change in the vertical structure of the oil industry, sales competition from the two majors intensified. Fierce price competition resulted, especially between the two.

Oil became an important business sector. Large-scale firms appreciated its business value not just because its market was rapidly expanding, but also because it played an increasingly important role in the economy as an important industrial and transportation fuel. It was precisely at this time that state intervention was considered again.

In 1926, the Navy made another effort to urge the MCI to organize an interministry committee, called the "Fuel Investigation Committee (*Nenryo chosa iinkai*)," which included the MCI, the MOF, the MFA, the Army, and the Navy, and was chaired by the MCI vice-minister. This time, it launched comprehensive research on national oil policy and formulated concrete agendas as to how to develop the domestic oil industry: (1) the exploration of both domestic and foreign oil fields, (2) domestic industrial restructuring, (3) tariff controls, (4) development of an alternative energy sector (i.e., synthetic oil).

The central attention focused on the measures dealing with the problem of how to protect domestic oil from foreign competitors. Again, two issue areas were set for debate: tariff control and industrial restructuring. Under the unequal treaties that set customs duty up to 5 percent, tariff rates on imported crude and refined oil had been altered with a minimal increase in 1899, 1901, 1904, 1905, 1906, and 1908 (Kogane bunsho II), respectively.[7] Even after Japan's regain of tariff control, protective tariffs were not actively used in the oil sector. For oil demand was rapidly increasing while domestic oil production was stagnant. Rather, policies tended toward oil consuming industries. For example, import duties on industry-use oil were exempt, subject to the MCI's permission. In fact, 70-80 percent of the private applications were accepted and granted permits (Takeda

[7] "Sekiyu kanzei no enkaku," *Kogane Bunsho II.*

1979: 185).

Essentially, the Fuel Investigation Committee (FIC) intended to change policy from consuming industry protection to producing industry protection. The point at issue was which part of the domestic oil industry should be protected. Positions were split between the Navy and the MCI. The Navy suggested imposing heavy import duties on foreign refined products, but only small duties on foreign crude (Kogane bunsho III).[8] Since the Navy's strategic focus was placed on reducing the de facto dependence on US oil, what it wanted was to import crude from diverse supply sources and to achieve self-sufficiency in refining. To do so, the promotion of the domestic refining industry was of utmost significance. Then, discriminatory protective tariffs should be a means to attract non-US crude and help the domestic refining business.

The MCI opposed the Navy's policy position and argued that higher tariffs imposed on oil products would adversely affect oil consumers. Instead, the MCI wanted to subsidize the domestic upstream industry with the revenue earned from both imported foreign crude and refined products. In the end, no decision was reached because of the unresolved confrontation between the Navy and the MCI. While the former stressed refining, the latter emphasized mining. The existing low-level tariff system remained continued.

However, more heated debates centered on the measures regarding how to rationalize the domestic industrial structure. Since all major domestic firms were increasingly dependent on imported oil and foreign firms were expanding their sales networks, the point at issue was how to deal with foreign investment (i.e., foreign activities in the Japanese market). The FIC attempted to find appropriate measures to make a grand merger of firms (*taigodo*) in exploration, crude production, refining, and marketing while at the same time protecting consumer interests; formulate incentives to induce firms to merge; and study the advantages and disadvantages of the merger. As a result, three alternatives were prepared.

Nippon Oil, which then achieved a hegemonic position among domestic firms after merging with Hoden, the second largest domestic oil firm of that time, entered into the decision-making process.[9] Just as it began to import foreign crude to refine in 1923, its dependency on the foreign oil market grew. In 1929, 52 percent of its products were refined from foreign crude. Profits steadily declined as oil prices dropped from 1926. This

8 "Wagakuni nenryo no shorai ni taisuru konpon hosaku," *Kogane Bunsho III*.

9 After the merger in 1922, Nippon Oil immediately held 87 percent of the domestic crude production share and 96 percent of the domestic product share. Nippon Sekiyu, 1971, p. 233.

coincided with the intensifying worldwide rivalry and competition between Standard and Shell which peaked in the middle of the 1920s. Their competitive edge vis-a-vis the domestic producers became clear. Between 1919-1931, when the refined oil market was expanding fivefold, the volume of domestic production (both from domestic and foreign crude) increased approximately three times. This meant that the rate of the amount of foreign supply outweighed that of domestic supply. To put it another way, domestic firms could not profit as much from the expanding oil market in which oil demand steadily increased.

It was in this changing context that Nippon Oil considered market intervention. The company was actively involved in decision making, which contrasted with the earlier case. It submitted its own plan (called Plan I) which proposed a merger between existing domestic refineries including Tokuyama refinery largest in the Navy. A joint public/private firm (*kanmin godo kaisha*) would refine crude and exclusively market all domestic products. Plan I unequivocally represented Nippon Oil's interests. It would leave the domestic upstream intact where Nippon Oil enjoyed a virtual monopoly (it accounted for 68 percent of domestic production at that time), but it would grant the would-be firm a monopoly on the distribution sector, which was the weakest side of Nippon Oil's business.

The Navy proposed two plans.[10] Plan II proposed that the state would monopolize foreign oil imports (both crude and refined products) and would delegate its monopoly rights to a joint public/private refining firm which could freely import foreign crude. But the firm must obtain a license from the state if it imports refined products. All tariffs would be lifted, and the state would allocate a certain amount of the firm's profits in order to subsidize the exploration of domestic oil fields. Under this system, the would-be firm would be granted exclusive rights to import crude and refined products, a major difference from Plan I. In return for monopolistic import license, the private sector would allow the state to set prices and allocate profits. Here, private firms would be limited to produce and refine domestic crude oil.

Plan III was the most radical alternative. It proposed a national oil champion, a vertically integrated and fully consolidated a grand joint venture firm which would refine, import, and distribute oil. The new firm would also engage in upstream exploration and production which Plan I and II leaves entirely to the private sector. However, the plan does not

[10] For the full text of three plans, *Kogane Bunsho III*; and see also Takeda, 1979, pp. 187-188.

specify concrete methods of how to deal with the existing business operations of firms. This vaguely stated plan proposed that there be no tariffs on crude imports. Refined products, however, would be subject to high tariffs.

The subcommittee was organized to draft a concrete policy plan. After extensive negotiations among members (July 1927 through May 1928), it rejected Plan III and the Nippon Oil plan, and drafted a plan called the "Concrete Summary Plan for the Merger of Domestic Oil Firms (*Naikoku sekiyu kigyo no godo ni kansuru gutaian yoko*)" based on Plan II (Takeda 1979: 190). This plan gave the state the licensing right for foreign oil imports, and would delegate to a grand joint firm (*Ittai godo kaisha*) the rights to import, refine, and market oil. The firm would buy out all existing domestic facilities relating to importation, refining, and distribution of products from both domestic and foreign firms, but would leave intact domestic crude and refining production (Kogane bunsho III).[11]

At the same time, the Committee proposed a plan for consolidating the domestic upstream industry forming a private cartel which would receive government subsidies for exploration research and purchase of overseas oil fields.

Government licensing was first introduced. Terms such as "kyoka," "ninka," "tokkyo," which refer to license in English, appeared in the text of the proposal and also in the context of industrial nurturing. Hereafter, the licensing idea was one continuing theme until after the PIL was enacted in 1934. However, this idea was not exclusively Japanese. The Committee took the French law of 1925 and of 1928 as a model. In France, import licensing was used chiefly for stockpiling — importers stockpiled a certain amount of imported oil, i.e., one fourth of the quantity imported in the previous year. This law was unambiguously for military purposes. Interestingly, it was Ohashi, Army general, who submitted to the committee a lengthy report on the French oil policy of the 1920s, with particular emphasis on the necessity of merger and stockpiling. It is, therefore, not difficult to imagine that the French experience influenced the deliberation of the Fuel Investigation Committee. The key difference between Japan and France at this time was that Japan planned to use licensing as a means to industrial restructuring whereas France used it for stockpiling. This refers to a less military character of the 1928's concrete summary plan. The stockpiling requirement was not adopted anywhere in the committee. Of central importance, at any rate, was the idea of using

11 "Waga kuni nenryo no shorai ni taisuru hosaku," *Kogane Bunsho III*.

licensing as a chief regulatory tool.

Since 1918 the Navy had sought this type of plan: the establishment of a public-private joint foreign crude refining firm, which would control the leading domestic oil firms (Nippon Oil and Ogura Oil). The central feature of it was to promote state intervention driven by the desire to protect domestic industry or gain autonomy from overwhelming foreign competitors, and mergers (and to a lesser extent cartels) as a protective measure while imports are controlled mainly by the state's use of licensing and not exclusively discriminatory tariffs.

However, this proposal arranged by the subcommittee lost its concrete contents when it was reviewed by the main committee, and the three-year comprehensive report (called *Toshinan*) was submitted to the MCI Minister. It revealed a disappointingly general statement:

> from the perspective of the national fuel policy, it is an urgent task to renovate the organization of the domestic oil industry and to manage its control by the state··· it is necessary to organize a grand oil firm merging the importing, refining, and marketing facilities owned by domestic oilmen and to reduce the costs for refining and marketing, and improve the refining facilities thereby rationally reducing the production costs and consolidating the base of the domestic oil industry (Kogane bunsho III).

Why could not the Japanese state translate its efforts into concrete form (i.e., legislation)? Or why was the originally proposed concrete plan (*gutai-an*) substituted by a fundamental outline plan (*kompon hosaku*)? Certainly, there had been an interministry struggle. Up until the late 1920s, they consistently disagreed on what best serves Japan's national interest in oil. From the very beginning, the Navy had been the sole actor seriously interested in the oil issue, and took the initiative in formulating a national oil policy by proposing several plans on how to achieve relative autonomy from oil. In contrast, the MCI, as the ministry with the jurisdiction over fuel policy, was ambiguous on this issue. As an ex-Navy bureaucrat wrote, the MCI bureaucrats were not enthusiastic in protecting and consolidating the oil industry; they thought that, although formal jurisdiction was under theirs, the Navy should play a major role in formulating oil policy simply because it was the largest consumer of oil (Yanagihara 1952: 9-10).

Here, the interfuel rivalry should be mentioned. Oil was not an important industrial fuel at that time. On the eve of the Pacific War it made up less than 10 percent of Japan's total industrial energy supply while coal remained the most important source (Samuels 1987: 170). Together, the oil industry was fragmented along upstream and downstream whereas coal had a highly concentrated industrial structure — in 1933 five highly profitable zaibatsu firms including Mitsui, Mitsubishi, and Sumitomo accounted for 40.5 percent of the total domestic production. In this sense, the MCI probably would have considered the concentrated interest of coal prior to the diffuse interest in oil.[12] Thus, for the MCI, the oil policy was considered only as a long-term project — *kokka hyaku-nen no taikei* (Kogane bunsho I) — that hardly evoked an immediate policy concern at the moment when domestic oil firms could manage to survive from foreign competition.

Although Nippon Oil showed a decreasing rate of profits at the end of the 1920s, there seemed to be no reason why it should accept "gutai-an" based on Plan II, which, if implemented, would detach the foreign crude refining business from Nippon Oil and incorporate it into the new firm controlled by the state and other interests. This means that its newly invested Tsurumi refinery would be surrendered (a give-up of 30 percent of its current refining output) and its business would be limited to declining domestic crude production and refining (Takeda 1979: 191-2).

Similarly, the MOF was always passive at the Navy's proposal to establish the public policy company because its financial conservatism opposed any plan requiring huge amounts of revenue (Kitazawa and Ui 1941: 494). Further, since it did not understand the economic significance of oil, as in the case of the MCI, it later opposed the exemption of mining tax to oil firms, maintaining that it was unfair to give preferential treatment to these firms but not to others, like those in the coal industry.

In contrast to the Navy, the Army was silent. Although it began to pay attention to aviation oil as its airforce expanded from 1925, the only visible activity was research and experiment with synthetic oil by the "Army Automobile School (Inoguchi 1963: 198)." It was not until the Manchurian Incident that the Army's interest in oil grew substantially as it appreciated the strategic significance of oil-powered trucks, tanks, and airplanes (Yoshino 1971: 151).

These trends, however, significantly changed when rapidly expanding domestic oil industry was threatened by the international oil majors whose price-cutting behavior reflected a worldwide overproduction of oil

12 Compared to the fragmented nature of the oil industry, coal had a highly concentrated industrial structure where in 1933 five highly profitable zaibatsu firms including Mitsui, Mitsubishi, and Sumitomo accounted for 40.5 percent of the total domestic production. See Samuels, 1987, p. 30. In 1933 Mitsui accounted for 14.9 percent and Mitsubishi for 11.0 percent of the total national coal output. See Yasuoka Shigeaki, ed., *Mitsui Zaibatsu* (1982), p. 308; and Mishima Yasuo, ed., *Mitsubishi Zaibatsu* (1981), p. 282.

in the early 1930s. This was a time when Japan experienced two of the most important events in the early Showa history: the Great Depression and the Manchurian Incident.

Before moving on to the 1930s, let us briefly discuss the "Commerce and Industry Deliberation Council (*Shoko shingikai*)." This committee was the primary organ to discuss the methods for the implementation of the industrial rationalization movement which the MCI (in fact, Yoshino Shinji) initiated in order to overcome the Showa's persistent economic distress or financial depression (*kinyu kyoko*). It dealt with oil issues, continuing from the FIC. This means that the oil industry became an object of rationalization. In other words, oil drew attention because it was regarded as one of the commodities causing Japan's balance-of-payment problems.

In 1928, having received the Fuel Investigation Committee's report, MCI Minister Nakahashi Tokugoro sought advice from the Commerce and Industry Deliberation Council. The following year it established the "Fuel Problem Special Committee (*Nenryo mondai tokubetsu iinkai*)" to discuss oil issues raised from the 1928 report. It made a comprehensive study on the oil industry for two years. Although this committee did not produce any added progress other than reiterating the general statement of the report (Takeda 1979: 210-3), two interesting points were discussed. While Nippon Oil basically recapitulated its original plan that was proposed before the FIC, it now explicitly claimed the oil industry's strategic position by writing that the primary enemy for the Japanese oil industry was foreign importers. The committee thought that from the viewpoint of "balance of power vis-a-vis foreign firms," it was necessary to establish a joint public/private firm, which would monopolize the domestic refining and marketing business to achieve economies of scale and compete against foreigners (Shokosho 1929: 125-6).

But, what interests us most was that committee members began to link the oil issue with industrial rationalization issues: mass production, standardization, and simplification in oil production (ibid.: 123). This meant that they narrowed their focus on "oil refining," among other sections of the industry, as a manufacturing sector to be protected and developed: as Nakajima Kumakichi, Chair of the Committee, aptly pointed out, oil was in the end a question of industrial rationalization (ibid.: 125). The targeting of the refining industry was meaningful because civilian bureaucrats (MCI and MOF) began actively to take part in the whole discussion of oil which was now shaped under the framework of industrial rationalization: that is, the oil policy not only secured oil autonomy but also promoted the manufacturing industry in general (ibid.: 125).

Toward the Petroleum Industry Law

The immediate impetus for full-fledged state intervention in the oil industry this time came from the disruption of the domestic market, particularly when Japan was hit hard by the Great Depression. For economic recovery, the lifting of the gold standard and the depreciation of the yen might have given domestic firms a favorable condition. But in the early 1930s, worldwide overproduction of crude oil due to the dramatic discovery of major oil fields in east Texas, the Soviet Union, Venezuela, and Sumatra drove down oil prices. The global price war that followed directly affected domestic oil prices. Between 1929 and 1931, the price dropped 11 percent for kerosene, 6 percent for gasoline, 16 percent for light oil, and 17 percent for machine oil (Nippon Sekiyu 1971: 295). During the summer of 1932, the gasoline price dropped from 40 sen per gallon to 33 sen even though, in June of 1932, the tariff revision for oil imports was made to increase the tariff rate to 35 percent. Tariffs could not affect the downward trend of oil prices.

After having revised the tariff rate, the MCI began to intervene directly in the market and urged firms to form a cartel. In August 1932 a cartel was formed — the six-firm agreement (Stanvac, Rising Sun, Nippon, Ogura, Mitsubishi, and Mitsui) — which increased gasoline prices by 10 sen per gallon. It also aimed to regulate the sales volume of its members. For example, 55.5 percent for the foreign share (31.7 percent for Rising Sun, 23.8 for Stanvac) and 45.5 percent for domestic share (26.3 percent for Nippon, 11.4 percent for Ogura, 6.8 percent for Mitsubishi).[13] Policy responses appeared successful, for the moment. In two months, gasoline prices returned to 1929 levels. High prices, however, caused strong protest from the oil consumers (mostly taxi cap unions), leading to protest campaigns.

The MCI needed to both stabilize the market by supporting domestic business while at the same time meeting the needs of oil consumers. The application of the Important Industry Control Law to the gasoline market in November 1932 was a logical consequence. Market stability was not achieved, because the rumors of the impending imports of cheap "red oil"

[13] Mitsui's share was allotted from the Stanvac's share.

delayed the making of the law-supported cartel agreement. The news was shocking not just because it was "enemy oil" but also because it was put together by Matsugata Kojiro, son of Meiji *genro* Matsugata Masayoshi, who secretly went to Moscow and agreed to import 35,000 tons of Soviet refined products per year, and was about to establish Nisso Sekiyu (Japan-Soviet Oil) (Inoguchi 1963: 246-50; Kitazawa and Ui 1941: 381-2). The new agreement finally reached under the Important Industry Control Law (IICL) in June 1933 was immediately breached when Soviet oil arrived in September. Nisso entered the market and strategically set the price 2 sen cheaper than the cartel price. Since Nisso's sales were on consignment basis with the Soviet Petroleum Export Union (thereby the latter, on paper, set the sales price for the former), Matsugata did not have to abide by the cartel price set under the IICL (Nippon Sekiyu 1971: 301). Moreover, new entry into the industry was outside the jurisdiction of the law. A price war began between Nisso and the cartel members causing the price to drop from 40 sen down to 26 sen. Domestic firms were pushed on the brink of bankruptcy (Takeda 1979: 214).

This motivated MCI bureaucrats to devise a more fundamental industrial policy that could deal with the vagaries of the world market. Unlike the earlier situation in which they thought domestic collective action (i.e., a merger or cartel among domestic firms) would stabilize the fragile market, they now felt a strong necessity to regulate foreign intervention. In order to facilitate an effective operation of the IICL, market entry had to be regulated. An obvious method was strengthening entry barriers that would discriminate among players appropriate to stable industrial order. Further, the point was not just to stabilize the market but also encourage indigenous industrial development while at the same time meeting oil consumer needs.

Protective tariffs alone did not and would not work simply because of the diverse types and sources of oil, which would kill domestic as well as foreign players. Ever since the 1918 committee, tariff control had been a secondary protective solution next to industrial restructuring. In fact, as industrialization grew rapidly in the early 1930s, the value of oil as an industrial fuel became acknowledged, and cheap oil was desirable as much for related industrial sectors as for transportation. In this connection, as we have noticed earlier, the MCI initiated a tariff exemption system on heavy oil which was used to produce a variety of industrial fuels for metal fabrication, ceramics, or metal heating.

A selective use of protective tariffs had to be combined with industrial policy which would target the sector, discriminate players and encourage independent growth. For the MCI bureaucrats who viewed the oil industry through the lens of industrial growth than national autonomy and integrity, it was the refining sector, among others in this vertically-long industry, that interested them most. For it was a manufacturing sector producing a variety of industrial fuels from crude oil and thus, as we have seen earlier, it was the target of industrial rationalization.

Having primary responsibility for controlling government subsidies, tax rebates, and the national balance of payment, the MOF approached the oil problem from the perspective of the balance of payments which had worsened since the mid-1920s, particularly during the Manchurian Incident (Hashimoto 1984: 206). Plans for encouraging the domestic refining industry initially appealed to the MOF because it might reduce imports of refined products, the prices of which were higher than those of foreign crude. Since oil was one of the four biggest import items for Japan during 1930-1935 (Mizuda 1938), reducing imports by protecting and developing the domestic refining industry seemed to be a good target for correcting the balance of payment deficits. Foreign exchange could then be used for the betterment of the economy instead of purchases.

The Manchurian Incident made a significant impact on the military view of the oil industry. The Navy's consumption of heavy oil dramatically increased when the Incident broke out. Its consumption doubled in two years from 233 thousand tons in 1931 to 475 thousand tons in 1933. Moreover, the rising demand for aviation oil was linked to the strategic importance of the airforce. The Navy constructed facilities which could produce 2,000 tons of aviation oil each year.

Despite the lessons from World War I, the Army resisted a rapid technological change in arms and transportation. Only after the Manchurian Incident did the Army begin to seriously consider the strategic importance of oil as a transportation fuel for automobiles (Yoshino 1971: 151). Motor trucks, used for the first time in north China, enormously enhanced the mobility of the troops. The high mobility of the Ford motor trucks allowed the Japanese to swiftly defeat the Chinese troops in the Rehe battlefield (Nihon jidosha kogyokai 1969: 24-5). However, the Army's primary interest in oil came from its recognition of the airforce power and concerns about aviation oil reserves. It purchased aviation oil from Nippon, Ogura, and Rising Sun, and for the first time, constructed an aviation oil reservation system in Manchuria in 1934.

The extremely unstable conditions of the domestic oil market was particularly discouraging to both military agencies. From a strategic perspective, it was imperative that they find appropriate means to restore market stability from which to develop an autonomous source of oil supply. The quest for autonomy in oil was of particular importance since Japan relied on the imports from a potential adversary.

In early 1933, "the Interministerial Committee on Liquid Fuel Problem (*Ekutai nenryo mondai ni kansuru kankei kakusho gyogikai*)" was organized. This committee started under grave political circumstances. Japan's foreign relations were aggravated by the Manchurian Incident and its subsequent defection from the League of Nations. There emerged in the military the assertion of the 1936 crisis (Crowley 1966). At the same time, Japan was struggling to escape from the Great Depression. It was this coincidence of political and economic problems of the early 1930s that fueled the state to intervene in the oil industry as a strategically and economically vital sector.

Now, each ministry entered the decision-making stage with clearer interests and agendas. The assumption behind the repeated private and public market stabilization attempts was that the stabilization and development of the oil industry critically depended on the regulation of foreign players' activities. The key reason why repeated cartelization attempts failed even under the guidance of the Important Industry Control Law was the lack of controls over foreign (or foreign-related) insiders and outsiders. Therefore, industrial policy should erect market barriers which would make the private collective action effective. Now, the question was how to devise concrete measures to implement these agendas.

In order to establish market barriers, the state must first target primary areas of interest. Here, there reached a convergence of interests among economic ministries (i.e., the MCI and the MOF) and the Navy. For the latter, the refining sector was the only one that Japan could feasibly reduce foreign reliance. For it was impossible for Japan to achieve national autonomy in crude oil or supply unless it controlled foreign oil fields, by force. Civilian bureaucrats considered oil refining an import-substituting industry that manufactures fuel used for industrial development while at the same time, helped correct the chronic balance of payment problem. Viewing oil as a manufacturing rather than a mining industry enabled the MCI to figure out problems and concrete measures to fix it under the framework of industrial rationalization that it had pursued since the late-1920s. Both targeted the oil refining sector. The business of refining would be encouraged most. If private firms wanted to be protected, they had to engage in oil refining rather than importing or marketing foreign products.

Second, a common agenda was set to value the "mass production" of refined oil as the top criterion of business activity. Insofar as private firms were equipped with the necessary refinery facilities to achieve scale economies and conduct mass production (regardless of levels of domestic demand and profits), the state would provide market protection, which would guarantee monopoly rents in the name of an adequate level of profit.

Third, it was the state that controlled access to the refining sector. Government licensing was the primary means of selecting who would be favored. The state would discriminate for "controlled competition." It would prop up producers who could achieve scale economies. Large-scale zaibatsu firms would be favored because of their superior financial and organizational capacity to compete with foreign firms.

Based on these common agendas, the Mining Bureau of the MCI, collaborating with the Navy, drafted two plans for review before the Committee: one based on the 1928 Fuel Investigation Committee's Plan III and the other based on the 1928 Concrete Summary Plan. They were also modeled after the Spanish oil law of 1928 and the French oil law of 1928, respectively (Tsusho sangyosho 1961: 477-80). The former was a plan for nationalization (*Sekiyu kokka kanri-an*) which would give the state a monopoly over all crude production, refining, trade, and sales. The state would then delegate it to a half-public half-private national oil champion. All profits after dividends and operating expenses would be deposited in the state treasury and used to explore domestic sources and to experiment with synthetic fuels. All foreign facilities would be expropriated to state equity in the joint firm (Samuels 1987: 177).

The latter was the Licensing Control Plan (*Kyokashugi tosei-an*) which gave the state the right to license refiners and crude oil importers, to enforce a six-month stockpiling requirement to all the licensees. The state would also provide subsidies to encourage domestic firms to explore overseas oil fields (ibid.: 177).[14] Here, unlike the earlier cases promoting import licensing (*yunyu kyoka*), this plan would use business licensing (*eigyo kyoka*), thereby enhancing the scope of licensing.

Throughout the summer of 1933, in debating both plans, members formed two distinct coalitions (outward mercantilist versus inward mercantilist) each having distinct agendas about the best route for developing the domestic oil industry and Japanese industrialization in

[14] For the discussion of the French Oil Law (1928), see Leslie Grayson, *National Oil Companies* (1981); Nippon sekiyu kabushiki kaisha hishoka, *France no sekiyugyo-ho to sono kyoka* (1934); and *Shoko seisaku-shi 4: Juyo chosakai*, pp. 477-480.

general. The two coalitions weighed the significance of the following issues differently.

The first issue centered around how important the oil industry was to national development. For the autarky-oriented inward mercantilists, oil was regarded as a strategic commodity crucial to wage a modern mechanized war: gasoline for trucks and tanks, heavy oil for the fleet, and aviation oil for air fighters. In addition, although the oil industry involved little "backward and/or forward linkage," oil was an important source for civilian transportation and industrial energy. Since the oil supply was vital to the national economy, control of oil should be understood not merely in terms of preparing for total war but in achieving national economic autonomy. They continued that the world oil regime was, however, controlled by "a few international oil firms like Standard and Royal-Dutch Shell behind which both the American and British Governments support and control," and that "it is naive, in the future, to anticipate their goodwill [toward Japan]." It is therefore an urgent task to protect and encourage the autonomous development of the Japanese oil industry, which literally means "national autonomy and independence (*jishu tokuritsu*) (Kogane bunsho III)."

Since outward mercantilists like the MCI (and also the MOF) approached the oil problem from the viewpoint of industrial growth, their primary concern was related to the balance of interest between producers (here, refiners) and consumers. While the refining sector became important as an area of the industrial rationalization movement, their appreciation of its industrial value changed in accordance with world market conditions. For example, until late 1920s, they doubted whether domestic refining could be economical, whether the costs for refining

Table 2. The Price of US Oil in Japan, 1929-1933.

(US $ per barrel)

	crude volume	price	gasoline volume	price
1929	37,800	1.43	266,904	4.44
1930	32,153	1.40	250,647	3.96
1931	20,828	–	109,301	3.96
1932	27,639	1.00	79,081	–
1933	35,374	0.96	57,520	2.21
net reduction, 1929-1933		32%		50%

Source: American Petroleum Institute, *Petroleum Facts and Figures*, 4th ed., pp. 23-25; 5th ed., pp. 154-155; and 6th ed., p. 108.

foreign crude by domestic refiners would be cheaper than importing refined products from the major producers who had the most efficient refineries in the world (Kikkawa 1989a: 40). This skepticism continued even after domestic refineries became equipped with efficient refining facilities during the second half of the 1920s, because the price of foreign refined products dropped below foreign crude. As Table 2 illustrates, while export prices of US crude dropped by 32 percent between 1929 and 1933, during the same period, US refined gasoline prices dropped by 50 percent.[15] These phenomena were reflected in the Japanese market where the price of gasoline (40 sen when the gold standard was lifted) dropped to 32 sen in July (Inoguchi 1963: 245).

For the outward mercantilists, the feasibility of infant-industry protection in the refining sector depended on price levels because they included the interest of both industrial oil and gasoline consumers as an important factor. Due to the availability of cheaper foreign refined oil, the MCI and other outward mercantilists were not as interested in erecting an indigenous refining industry (which would inevitably require the sacrifice of industrial and commercial consumers) as developing a way to find an industrial order to stabilize the rapidly fluctuating market.

The second issue was whether foreign ownership should be taken for granted in the domestic industry. Like Plan III which was presented by the Fuel Investigation Committee (1928) and the national monopoly plan (1933), the inward mercantilists had asserted that the national oil policy should exclude foreign ownership by radical means (i.e., expropriation and nationalization) because foreign ownership in such a key strategic sector as oil would threaten Japan's political and economic autonomy.

By contrast, outward mercantilist's alternative was "Japanization," the strategy which would require firms to be either majority Japanese owned or equal with foreign capital. Mitsubishi Oil, a joint venture with the Associated in 1931, was a showcase example. Also in this category were later efforts by two key Japanese negotiators with the oil majors, Yoshino Shinji (MCI vice-minister) and Kurusu Saburo (Commercial Bureau Chief, MFA). They urged Stanvac to organize a joint venture with Mitsui Bussan (Anderson 1975: 100). Here, the strategy of Japanization was a means to include foreign players into the cartelized market, thereby reducing high transaction cost by halfway indigenizing them. Moreover, this scheme

15 Some argued that the drastic fall of the price of refined products during the early 1930s was due to an excessive competition and the lack of cooperation within the US industry. V.R. Garfias and R.V. Whetsel, "World Oil Consumption Next Year to Rival 1929," quoted in RG59, 894.6363/174A.

should be pursued gradually and incrementally so as not to cause any serious trade disputes with the majors and their respective governments (the US and Britain). They did not want to adversely affect the ongoing success of the export promotion strategy of the early 1930s.[16]

The following issue was how to restructure the domestic oil industry. The inward mercantilists believed that since the private sector was underdeveloped incompetent, strong state involvement was seen as inevitable. Here, state intervention meant regulatory control over individual firms. State ownership was not their only option. In case they found unreliable private actors, they would directly intervene as a market-displacing actor. What they preferred instead was a joint public/private enterprise with which they could maintain secure access to decision making while having the advantages of private entrepreneurship. This had been their first choice throughout the fifteen years of interministerial discussions on how to restructure the domestic oil industry. They actually established such an enterprise in north Sakhalin and experimented on a full-scale basis in Manchukuo since 1931.

On the other hand, private mergers and cartels were the key subjects for the outward mercantilists. Their primary concern was to make the Japanese industry stable and competitive in the world market, and since oligopoly was characteristic of the oil sector, it was necessary to achieve economies of scale by limiting the number of firms through mergers in the first place. A national oil champion did not fit because it would eliminate competition and sacrifice efficiency for control (Yanagihara 1952: 24). Ever since the Meiji Ishin, Japan has oriented toward private-sector entrepreneurship, preferring private initiative with the state's assistance. Collective arrangements between a small number of players within a highly compartmentalized market (through merger and state license) would be effective, and thereby a stable industrial order would be achieved. Cheating might occur, but its negative effects could be checked as long as a number of insiders were fixed and protected.

While the two plans were discussed in the interministry committee, the two oil majors had never been involved in the decision making. Only after the Petroleum Industry Law was issued in 1934 were they asked to bargain with the Japanese state over the terms of the decree.

Organized labor was not included in the decision making, either. In

16 For this idea, see Memorandum of Conversation between Mr. Dickover and Mr. Kurusu, October 18, 1934, RG59. 894.6363/107; and ex-MCI bureaucrat Yanagihara's *Sekiyu Zuiso* (1952), pp. 59-60. For the phenomenal growth of the export industry, see Nakamura Takafusa, *Economic Growth in Prewar Japan* (1983), pp. 244-249.

general, the Japanese political system's primary objective was to maintain a stable, docile labor force conducive to rapid industrialization. To achieve this goal, labor was systematically excluded through sanctions and co-optation.[17] In particular, the oil producing/refining sector is characterized as "process-oriented" with "capital-intensive technology," one that is made up almost entirely of machine-paced technical processes. This sector involves chemical and mechanical processes which take place in a series of machine-controlled operations, and the limited number of those key processes limit the range of choices open to labor and management, and thus it is evident that the bargaining power of organized labor in this sector would be minimal (Hirschman 1958: chapter 8; Alam 1984: 367-72).

Private firms had been included. Nippon Oil would have had the easiest access to the state not only because it was the largest domestic oil firm but also because its president, Hashimoto Kisaburo, was originally a prominent economic bureaucrat who served as MOF vice-minister and MAC vice-minister before entering the private sector. Throughout the history of institutional adjustments during the 1920s and early 1930s, Nippon Oil had been frequently called upon by committees like the Fuel Investigation Committee (1926-1928), the Fuel Problem Special Committee (1929-1930) for consultation. At one time, it prepared a plan on its own terms, only to be rejected. They were consulted only after state managers had developed basic agendas. In the 1933 committee, the state initially determined who could participate in the decision making (i.e., like Nippon Oil which was Japanese-owned and had a strong financial and organizational capacities, and at the same time, how they would operate within a restrictive choice situation (i.e., methods for the mass production of refined oil).

For inward mercantilists, the new oil law could be used as a means to discriminate foreign firms from the Japanese market and to develop a pure Japanese industry that had national autonomy and integrity. Believing that private firms were so fragmented and weak, they supported, as a first choice, the state monopoly plan that proposed a joint public/private national oil champion. But if this plan was deemed unfeasible, they could accept the license plan insofar as the stockpiling requirement (essential for security) and preferential quota setting would be strictly observed by the

17 Note Silberman argues that the state bureaucracy excluded the interests of labor because they thought the "labor's claims to equity" was based on "notions of justice as fairness rather than as social utility." Thus, the state either suppressed the labor movement by force or tried to "declass" labor by "forcing it to be absorbed into the organizational structure of large-scale enterprise." Silberman, 1982, pp. 244-246.

use of licensing. If complete autonomy was not possible, insofar as Japan could maintain a secure supply of oil from non-US sources, the form of ownership (joint public/private versus private) could be compromised.

Since outward mercantilists understood the upcoming law as a means to stabilize the domestic market and, in time of war, ensure adequate supplies of foreign crude and refined products at reasonable prices, the radical market-displacing measure (the state monopoly plan) was not desirable. Nor did they support the institutional mechanism by which the state intervened at the individual-firm level (i.e., regulating private business activity). Kurusu Saburo, Chief of the International Trade Bureau (MFA) stated "[the license plan] was a bad one all around and was bound to create trouble, either internally or internationally;" it would allow too much state interference in the market, and also cause serious diplomatic disputes with the United States and Great Britain because the law would severely harm the oil majors' business in Japan. In particular, he asserted, the mandatory stockpiling requirement would not only cause diplomatic trouble but also be economically unfeasible (RG59, 894.6363/107).[18]

Nonetheless, the license plan could be accepted not just because it was imperative to formulating a national policy to regulate the precarious domestic oil industry as soon as possible, but more importantly because this plan was less objectionable than the state monopoly plan, which would entail huge costs for implementation (Kitazawa and Ui 1941: 494). This plan would be compatible with their agendas insofar as quotas are flexible flexibly for foreign firms and the stockpiling requirement be flexibly implemented. Government licensing towards cartel outsiders and foreign players could be cautiously utilized to regulate the flow of foreign investment in an attempt to stabilize the market without hurting the flow of international trade.

The adoption of the license plan that outward mercantilists advocated was however contingent upon the private sector's support. Here, their political asset in relation to the inward mercantilist coalition was that they could enlist support from the private sector. Private firms undoubtedly opposed the national monopoly plan. Neither did they show monolithic support for the license plan. While some welcomed protectionist measures like tariff control, quota setting, and measures limiting the number of firms, most industry members were dissatisfied with the measures that gave the state too much control over their business activities. For example,

[18] Memorandum of Conversation between Dickover and Kurusu, October 18, 1934, RG59, 894.6363/107.

forcing compulsory purchases, monitoring business activities, regulating regular submission of business plans, fixing prices, and most importantly, making a six-month mandatory oil stockpiling (RG59, 894.6363/143; RG59, 894.6363/153). Nonetheless, for private firms, as in the case of trade-oriented outward mercantilists, the licensing plan was more acceptable than the state monopoly plan because the former was less objectionable.

In August 1933 the state opted for the licensing control plan and in April 1934, the Diet passed the Petroleum Industry Law (PIL) based on this plan. It was apparent that this law would protect domestic large-scale refiners while restricting the business of foreign oil majors. However, the law only provided a basic framework and key issues still remained: (1) the inclusion and exclusion of firms, (2) a six-month stockpiling requirement, and (3) setting quotas. Negotiations and bargaining followed.

The Structure of International Oil Industry

It became apparent in the process of the Diet discussion early in 1934 that the PIL would adversely affect foreign oil firms and those who would lose most were Standard-Vacuum (Stanvac) and Rising Sun. Stanvac was organized in 1933 as an East Asian subsidiary of Standard-New Jersey and Standard-New York.[19] It was the merger between the former's production facilities in the Dutch Indies and the latter's marketing networks "east of Suez." After a long struggle with Shell in the Dutch Indies that Standard-New Jersey organized in the 1920s Koloniale Petroleum, which later discovered prospective oil fields in south Sumatra and Talan Akar. Jersey then constructed refineries and pipelines and refined crude, which accounted for approximately 30 percent of the total Dutch Indies oil production. Now, its strategy in the East Asia changed. The oil giant fully appreciated the strategic importance of Japan as a major marketing outlet (Kikkawa 1989b: 91).

On the other hand, as the Japanese kerosene market was declining, Socony needed to change its commodity from kerosene to gasoline but was unable to supply gasoline at a competitive price in Japan. Note that, in comparison with other oil majors, Socony had been short of crude, and furthermore, since its refineries were located in the east coast of the US, its

[19] For the emergence of Stanvac, see Irvine Anderson, 1975, p. 32, and pp. 35-38; and Kikkawa, 1989b, pp. 89-91.

price competitiveness was decreasing vis-a-vis California and Dutch Indies oil, primarily due to increases in transportation costs. While Socony needed gasoline, Standard-New Jersey needed a marketing network. The formation of a joint venture between the two complemented each other's interests. The emergence of Stanvac meant that the Japanese market was becoming more important to Jersey which needed to sell the products refined in the Dutch Indies. Its business became identical with Rising Sun's, which had been the major seller of gasoline supplied from the Dutch Indies. As with Rising Sun's case, there was little reason for Stanvac to build a refinery in Japanese territory. PIL's attempt to restrict market share for imported refined products and its Japanization strategy (i.e., building refineries in Japan by the majors) were in sharp conflict with the interests of Stanvac and Rising Sun.

Now, let us explore how Stanvac and Rising Sun responded to the PIL. In examining their bargaining with the Japanese state, we need to analyze their bargaining power, which reflected the strength of the international oil regime at that time. Implementation of the PIL would be ineffective if a strong international cartel led by the majors existed.

The international oil industry, controlled by the seven sisters, has been known to be one of the tightest regimes in the world market. They include: Standard-New Jersey (later Exxon), Royal-Dutch Shell, Socony (later Mobil), Socal, Texaco, Gulf, and British Petroleum (BP). According to the Federal Trade Commission data, in 1949, the Seven Sisters held 65 percent of total world oil reserves and 82.1 percent of non-US reserves. Their crude production accounted for 54.6 percent of total world production and 70 percent of non-US production.[20]

The majors were able to control world oil because they controlled the Middle East. From the 1940s, just as crude production in that region

Table 3. Average Cost at Wells in US, 1931-1934 **(US $ per barrel)**

California	0.661
Texas/Oklahoma/Kansas	0.729
East/Midwest	1.426
Average	0.74

Sources: Yokohama shokin ginko chosaka, *Kashu sekiyu o chushin to seru beikoku sekiyu gaikan*, 1938, p. 28.

[20] Figures recalculated from charts 7, 10 and tables 8, 9, 10 in Federal Trade Commission, *The International Petroleum Cartel* (1952), pp. 1-25.

surpassed the production from the rest of the world, the oil majors correspondingly dominated the world market. John Blair points out that the primary instrument by the seven sisters used to form the international oil cartel was their joint ventures (Blair 1975: 29-47). The joint ownership of subsidiary and affiliated firms constituted partnerships in various areas of the world, particularly in the Middle East. Decision making was thus concentrated in the hands of a few powerful men, and joint action were enforced. The control by joint ownership was further tightened by the interlocking directorates among them — a considerable number of directors held multiple directorships in subsidiary firms (Federal Trade Commission 1952: 29-32).

Joint ventures made their first appearance in 1928 with the establishment of the Iraq Petroleum Company initially by BP and Shell. Standard-New Jersey and Standard-New York later joined this group. Another joint venture between Socal and Texaco led to the formation of Aramco, while the Kuwait Oil Company added Gulf. This made up the seven sisters who by the end of the 1930s had well sewed up the production and supply of the Middle East oil.

Supplementing and reinforcing the joint ventures were supplier contracts which covered very large volumes of oil, extending over many years. These contracts contained highly restrictive provisions relating to the terms and conditions of sales. Beginning in 1928, a series of international agreements had been reached for control over marketing oil: (1) the Achnacarry Agreement (1928) accepted and maintained the status quo of each member's market share; (2) the Memorandum for European Markets (1930) established quotas, which could be increased only at the expense of outsiders; (3) the Heads of Agreement for Distribution (1932) provided for the exchange of statistics and information among local representatives of the oil majors; and (4) the Draft Memorandum of Principles (1934) set forth detailed rules governing quotas revision, proscribing unilateral price determination, and restricting claims of product superiority.

Although, from 1928 to the end of the 1930s, the seven sisters had carved up oil supplies from the Middle East, Venezuela, and the Dutch East Indies, if we narrow our focus to the interwar years (particularly the early 1930s when Japan designed the PIL), the international oil regime was much looser than in the period that immediately followed.

As mentioned earlier, the key sources where the majors gained monopoly power were the rich oil fields in the Middle East and Venezuela. But oil production in those regions during the 1930s was not as dominant as in later period. From 1931-1939, crude production in those areas constituted a mere 14 percent to 18.7 percent of the world production.

Further, global competition among previous oil majors (i.e., Jersey, BP, Shell) and new oil majors (i.e., Socal, Texaco) during the 1930s and 1940s was another factor that caused the oil regime to be less tight. In an effort to achieve an "equitable" distribution among the majors to control world oil, power struggle between Socal and Jersey continued. As a late comer in the world market, Socal started to participate in the Middle East oil fields in 1932, by obtaining concessions from Bahrain and Saudi Arabia both of which were outside the "red line," the area where the individual activities of the members of the Achnacarry Agreement (Jersey, Shell, BP, and Socony) were restricted (Blair 1975: 35). During those years, the existing majors regarded Socal as a distinct threat to their *de facto* interests. Their initial reaction was to prevent Socal from obtaining those concessions, and after they failed, they attempted to devise other means of prevention and again failed. A fundamental reason for this failure was the provisions of the Achnacarry agreement, which did not restrict individual activities of members outside the red line. When one member's interest conflicted with the others as in the case of Socal, members were shackled by the provisions. It was not until 1946, when Socal brought Jersey and Socony into its Aramco partnership, that Socal and Texaco were fully incorporated into the international cartel led by Jersey and Shell.

Behind the aforementioned competition between Jersey and Socal, there existed contrasting characteristics in their business activities. While Jersey historically had been crude short, Socal has been crude long (Greene 1985: 274). The interests of the latter, as the world leading crude exporter, inevitably clashed with the former, the world leading refiner. With the enormous output of oil from Saudi and Bahrain as well as from California, Socal now needed to develop worldwide distribution networks. In 1936 it reached an agreement with Texaco to establish a jointly owned trading subsidiary, Caltex, under which it received a one-half interest in Texaco's marketing position "east of Suez," while Texaco gained a one-half interest in the Bahrain concession and facilities (Blair 1975: 36). Now, Socal had established a position as a serious competitor to Stanvac and Asiatic (Rising Sun) in the East Asian markets.

What made Socal distinct from the other oil majors (Jersey/Socony/Shell) in the Japanese market was that it had been the largest crude supplier. It accounted for 26 to 36 percent of Japan's total crude imports between 1935-39, plus crude from Bahrain ranged 5 to 7 percent of the total crude imports during the same time period (Kikkawa 1989b: 70-71). Ever since the dissolution of Standard, with its plentiful Californian crude (in 1919 California provided 26 percent of the total US production), Socal was forced to go abroad to find markets while Standard-New Jersey and Standard-New York, in contrast, had to find oil fields (Blair, 1975: 36-7). Socal found its outlet in Japan and supplied crude through Asano Bussan and later through the powerful Mitsui Bussan. It became a leading crude exporter throughout the prewar period.

In fact, Socal was the chief beneficiary of the PIL not only because it had been the largest crude supplier to Japan, but also because, since the enactment of the PIL, it became one of the leading sellers of gasoline whose market share (ranging 13 to 23 percent during 1935-37) approached Stanvac's (Kikkawa 1989b: 70-71). The rise of Socal in Japan meant reduced market shares for Stanvac and Rising Sun, particularly after the PIL which increased the market share for domestic refiners and Socal.

In short, the effective international coordination among the majors had not been attained during the 1930s because Socal, the world largest crude exporter, was not incorporated into the scheme other majors tried to forge. Besides, there were still substantial oil sources not controlled by the oil majors such as Soviet Russia and Romania, which ranked second and fourth in world crude production in 1933. For example, as mentioned earlier, Stanvac and Rising Sun's predominant position in the Japanese market was disrupted by the imports of Soviet oil — Nisso Oil accounted for 9 percent of Japanese gasoline imports in 1934 (Inoguchi 1963: 247-50).

However, the most important constraint preventing the formation of a strong international oil cartel was the existence of American independents which controlled more than half the US crude production at that time. Decentralization was inherent in the crude production sector. Production was scattered among a large number of small and medium-sized fields each of which had its own independent producers. Although the subsequent stages of refining and transportation offered the potential for centralized control,[21] crude exports by independents could hardly be controlled by the oil majors. In response to this problem, the majors lobbied the US government to control crude exports. The result was the passing of the 1928 Webb-Pomerene Export Trade Act which formed two export trade organizations: the Standard Oil Export Corporation and the Export Petroleum Association. The former was designed to centralize

21 As capital entrance requirement is high and rising in the refining industry, the number of refiners became low. Blair, 1975, pp. 131-132.

control over the export activities of oil firms under the influence of Standard-New Jersey, whereas the latter was designed to control members with regard to export prices and quotas. Such arrangements were ineffective, however. For example, in 1929, only 45 percent of US exports were made by members of the two organizations. Moreover, its unanimous-consent rule for decision making led to its collapse (Blair 1975: 218-25). As Raymond Vernon notes, "the strength of the independents, then as now, rested in part on the fact that they were well distributed over the face of the US and could rally formidable Congressional support for any position they took (Ikenberry 1988: 65)."

For Japan, California firms were the major crude supplier. Until 1928, California had been the largest crude producing state in the United States. Although the state's market share declined to 25.4 percent in 1930 due to massive production in east Texas, California's crude production during the 1930s was greater than that of the world's second largest producer, the Soviet Union (American Petroleum Institute 1931: 34).

A distinguishing feature of California oil was the predominance of non-major oil firms. For example, in 1940, the oil majors' (except Socal) crude production in California was less than 10 percent. During the 1930s, approximately 10 to 15 percent of California crude was exported, and its major outlets were Japanese refineries. Socal, Union, General, Tidewater, and Richfield all supplied crude to Japan via Japanese trading firms. For instance, the majors could not control independents like Tidewater, which had ties with Mitsubishi Oil. Kikkawa Takeo's recent study of Rising Sun demonstrates that the two majors (Stanvac and Rising Sun) failed to prevent Mitsubishi Oil from expanding its market share in the *naigai* cartel (Kikkawa 1992). As Irvine Anderson says, these independents had nothing to lose from the PIL, because the expansion of Japan's domestic refining industry would inevitably need more foreign crude (Anderson 1975: 82).

In summary, during the 1920s and 1930s rivalry for new markets led to international competition among the oil majors and between majors and independents. This international structure led to the sharp division of interests among foreign firms in relation to the Japanese oil market: there were regional competition between Stanvac and Socal; between Stanvac/Rising Sun and Californian independents; and between the majors and Soviet oil. Now, as these international conditions generated opportunities to the Japanese state, its potential bargaining power vis-a-vis the majors would grow, as long as either side, the majors (i.e., Socal) or US independents (i.e., Californian oilmen), were competing to supply crude oil.

In fact, Japanese state managers recognized this point. In 1934, in the hearings before the special Diet committee on the PIL, MCI Minister Nakajima Kumakichi stated:

> In the United States of America, there are some sources of supply not connected with Standard Oil; also it appears that there are good sources of supply in the South Sea Islands not under the control of those two companies [Stanvac/Rising Sun] (RG59, 894.6363/78).

Similar statements were made by another MCI official, Sakai:

> At present, crude oil is coming mainly from American sources not connected with Standard Oil···there is a reasonable chance of our being able to obtain future supplies from such sources···Dutch Borneo, Venezuela, Romania, etc. (RG59, 894.6363.78).

However, even though Japan could import crude from sources other than the oil majors, this by itself does not mean that it has achieved autonomy in oil. Japan would be self-sufficient only if the domestic refining capacity is able to replace the amount of refined products imported from the majors.

Kobayashi Hisahira estimated Japan's 1934 refining output level at 65,042 kilolitters, which was only 52 percent of its domestic refining capacity, compared to the US where refineries were producing 84 percent capacity. He argued that the low output level was due to insufficient crude supplies, and that the output level reflected the size of refineries. This means that the smaller the refinery, the more difficult to acquire crude oil (Kobayashi 1936: 91-93).

Following Kobayashi's estimation, Sakai argued that Japanese refineries were obliged to leave about half their capacity idle due to price wars in the refined oil market (RG59, 894.6363/78). In this sense, in so far as enough crude could be supplied and the prices of refined products high enough, domestic refiners could have doubled their output of refined products in that year, and therefore could have taken the oil majors' market share, which accounted for about half the domestic consumption (Kobayashi 1936: 91-93).

However, the problem of how to cover the projected yearly increases in consumption by the existing refineries remained. MCI minister Nakajima stated that "because consumption is significantly increasing, it will not be easy for refiners in Japan to meet the increased demand. Therefore, foreign refined oil must be imported."[22] In retrospect, the productive capacity of domestic refiners were limited. From 1934-6, while the oil majors complained that discriminatory quotas always filled 100 percent, domestic refiners could not meet the allotted quota amount. For example, in case of gasoline, domestic production went 5-7 percent below the target set by the MCI. Other categories figured worse. Domestic refiners produced 87 percent of the government-targeted goal in kerosene, 68 percent of the targeted goal in light oil, and 80 percent of machine oil.

Domestic refiners were given an increasing market share set by the MCI, which remained to be met. Preferential quotas could reduce Japan's dependence on the two oil majors, but it did not automatically guarantee an independent development. In order to have some sense of what accounts for this phenomenon, let us briefly examine the configuration of the domestic oil industry at the time of PIL's enactment and move on to the implementation process.

Diffused Domestic Industry

An industry comprised of Nippon Oil, Ogura Oil, and Mitsubishi Oil would make an ideal combination for the PIL — three large-scale firms, all majority-owned Japanese firms. The three welcomed PIL's objective of limiting the number of firms, which could be realized by the state's licensing right, because fewer firms meant larger market shares for survivors. Here, all firms under a minimum size were targets for consolidation. When PIL was promulgated, there existed 53 refiners, 17 importers, and 20 producers, all domestic. Those firms opposed PIL enactment.

The three were convinced that they would be given a license, but, as discussed earlier, their reaction to the PIL was complex. While they were pleased with the licensing idea, they did not like some of PIL's clauses which permitted strong state control over their business activities, i.e., fixing prices, forcing compulsory purchases, monitoring business activities, and forcing mandatory submissions of business plan on a regular basis. Moreover, the six-month stockpiling requirement was particularly onerous because it would require an enormous amount of

22 See RG59 894.6363/78 (September 6, 1934) The annual average increase in oil consumption between 1932 and 1936 was 15 percent. It increased rapidly from 3,876 kilolitter in 1932 to 6,300 kilolitter in 1936. Calculated from Table in Abe, 1981, p. 193.

revenue to construct and maintain additional tankers. Once it was announced that the state would not give any financial benefits (e.g., subsidies, price increases, tax breaks) for observing the requirement, they protested that the stockpiling clause was not feasible (RG59, 894.6363/143; RG59, 894.6363/153; RG59, 894.6363/189). Nonetheless, the three firms supported PIL because it would protect their interests from foreign capital.

Trading firms were an essential part of the Japanese oil industry because they imported most of the foreign crude and some refined products. In general, trading firms such as Asano Bussan imported crude from Union and Socal, Mitsubishi Shoji imported crude from Associated and Tidewater, Nisho got crude from Union, Nidatsu obtained crude from Sunset, and Seru was supplied from Texaco. These firms were better off because more demand for foreign crude would be expected after PIL.

In contrast, those who were importing refined products or crude/heavy oil from the two oil majors would be hurt by the PIL. Asahi Oil which had been closely tied to Rising Sun was an example. Asahi Oil was a pioneer because it was the first domestic firm to refine imported crude on the Nishibezaki refinery, which was abandoned by Rising Sun.

The most salient case was the powerful Mitsui Bussan which handled almost one-fifth of Japan's total imports and exports in the 1920s. It entered the oil industry by importing crude/heavy oil from General. When General was absorbed by Socony, Mitsui then made a contract with Socony and later Stanvac to import refined products and heavy oil into Japan. It imported as much as 10 to 12 percent of the heavy oil market during 1930-33. It also imported gasoline (2 percent), and other products like grease, wax, and asphalt (7 percent) (Kikkawa 1989b: 70-71).

Mitsui, in this regard, represented Stanvac's interests. Moreover, as the leading trader controlling one-third of Japanese silk exports, 18 percent of the cotton-textile exports to the US, one-third of raw cotton imports, and half the wheat imports from the US. Any economic and diplomatic dispute with the US incurred by the PIL would threaten its major businesses (Schumpeter 1939: 633). Its strong interests in maintaining good relations with the US were apparently incompatible with a radical protectionist policy like the PIL.

Finally, Nisso Oil positioned itself ambiguously. From the perspective of diversifying oil sources, it would be welcomed by Japanese leaders, but at the same time it was the enemy's oil (i.e., the Army regarded Soviet Russia as its biggest enemy, and was already preparing for total war).[23] Also,

[23] For Army's view of Soviet Russia, see James Crowley, *Japan's Quest for Autonomy* (1966);

gasoline imports were not consistent with the interests of domestic refiners. In sum, its business was likely to be threatened rather than supported.

Just as the interests of foreign firms were divided with regard to the PIL, those of domestic firms were also diffuse. While major domestic refiners and traders, if not enthusiastically, welcomed the PIL, Mitsui Bussan, the largest trader in Japan and Asahi Oil opposed it. Implementing the protectionist policy was not easy because the Japanese state faced a divided constituency in the oil industry.

Implementation

After the PIL, negotiations were carried on as two foreign oil majors sought changes in state policy on two issues: the six-month stockpiling requirement and preferential quotas.

An Imperial Ordinance on 26 June 1934 ordered all firms operating in Japan to fulfill a requirement of building and maintaining at their expense a stockpile worth six months of sales. Stanvac estimated U$375,000 for additional tankage construction plus U$1,900,000 for stocks unnecessarily tied up for maintenance. This adds up to a total of U$2,275,000. which would account for 18 percent of Stanvac's total investment until 1934. The cost for Rising Sun would surpass Stanvac's because it had less tankage in place (RG59, 894.6363/84).

To make matters worse, when Japan announced quotas for July through December 1934, the combined market share for Stanvac and Rising Sun was reduced from 53.6 percent to 50.1 percent. While they were allowed approximately the same actual volume as before, they were not allocated any of the predicted increase in demand for the new period — note that between 1929 and 1934 the Japanese oil market expanded 14 percent annually.[24]

Strong protests by Stanvac and Rising Sun initially led to the idea of an oil embargo against Japan. (Anderson 1975: 80-91). Walter Teagle of Standard-New Jersey and Henri Deterding of Royal Dutch-Shell proposed to the US government that she "frighten" the Japanese into moderation by hinting at an embargo on crude shipments to Japan. They sought to mobilize the US government because its explicit backing of the idea would

and Michael Barnhart, *Japan Prepares for Total War* (1987).

24 For the market share for the majors in 1934, see Anderson, 1975, p. 77. For the statistics of Japanese oil consumption, see Table 12 in Abe, 1981, p. 193.

affect not only the Japanese oil industry but also US-Japan commercial relations. Given Japan's dependency on US oil, an embargo backed by the US government would be a deadly blow to Japan.

Initially, the British Foreign Office supported the idea and was willing to take action on the condition that overt action would have to come from the US government. The US government's reaction, however, was negative. Stanley Hornbeck, the Far Eastern Division Chief of the State Department, maintained that since Shell, the British company, had a larger stake in Japan, any initiative toward an embargo should come from London.

After lengthy discussions with Shell, the British Foreign Office obtained approval from the Cabinet for this course of action, provided American support could be ensured. But, Washington still refused even though they initially suggested that they would. Hornbeck said:

> We do not believe that··· [without] definite restrictive action on the part of the American Government, effective restriction of petroleum exports from the United States to Japan and Manchuria could be achieved. This Government does not for the present feel moved to proceed in the direction of such action and it does not look as though the oil companies adversely affected are in a position to take or cause the oil industry to take such cooperative action as might be effective (Anderson 1975: 90).

The foregoing statement reveals differences of opinion between the oil majors and the US government on how to deal with the Japanese oil problem. The two majors failed to enlist the US government's support which would have been undoubtedly their biggest asset in bargaining with Japan. There could be several reasons why the US Government refused to interfere.

Basically, the US rejected decisive action toward Japanese protectionism because of the way they perceived the world trends at that time (i.e., economic nationalism, regional economic blocs, and the New Deal). In a conversation with Parker, president of Standard, Hornbeck warned that:

> More and more, governments are going to be confronted with the question of employment for their own people; that in countries circumstances as are Japan and China···there will presumably be more and more a tendency to try to substitute domestic labor and employment for foreign labor and imported services; that, to limit the thought to Japan, the Japanese would import raw materials but as far as possible do they own processing and their own merchandising; hence, foreign countries doing business in Japan would need to think seriously (FRUS 1934, III: 757-58).

This view implies that the US government would recognize the PIL as a trend that is inevitable for aggressive nations such as Japan.

Behind this statement was a dilemma the United States faced. The US was not in a position to strongly protest Japanese protectionism of its oil market because it was itself one of the leading protectionist countries of the time. Most notable was the signing of the Smoot-Hawley tariff in 1930, which raised the effective tariff rates in the United States by almost 50 percent between 1929 and 1932. This triggered retaliatory tariffs from US trade partners. In 1935, it also negotiated the first voluntary export quota on Japanese textile exports, despite the fact that the US textile industry was already protected by tariffs of 40 to 60 percent.[25]

Moreover, it would have been extremely difficult for the US government to control the oil industry's independents. This was also a time when US crude exports were increasing in the early 1930s, accounting for 5 percent in 1932 and 9.7 percent in 1938 (Williamson 1961: 720). Japan had been the second largest importer of US oil (both crude and gasoline) during the 1930s, and California oil was the nation's leading exporter most of which headed for Japan. In this sense, restricting oil exports of the independents would not only have been difficult for the US government, it would have been going against US interests.

After the episode of the abortive embargo idea, both parties entered into negotiations. The Japanese state directed the oil majors to submit plans for constructing a three month reserve stockpile in addition to the existing stocks by 1 April 1935. By 1 October 1935, they were to increase the reserves to a six-month level. But the majors refused to submit the 1935 business plans by the September 30 deadline, protesting that their future

Table 4. US Oil Exports to Japan, 1932-1936.

	exports in value (thousand Yen)	growth	exports in quantity (thousand k*l*)	growth
1932	37,055		1,364	
1933	59,309	60%	1,508	10%
1934	71,689	21%	2,106	40%
1935	86,842	21%	2,459	17%
1936	118,581	37%	3,087	26%

Source: Calculated from Table 13 in Abe, 1981, p. 194.

25 For the US protectionism in 1930s, see the World Bank, "Threat of Protectionism," *World Bank Report* (1987).

in Japan remained uncertain (Anderson 1975: 79-80).

After repeated demands for compliance with the PIL by the state and repeated refusals by the oil majors, the state finally yielded, and agreed to a "five-point memorandum" on 13 April 1935. The document stated that the three-month stockpiling requirement, which had been effective on 1 April 1935, would include the existing stocks, and the six-month requirement would be postponed until October 1. As Anderson points out, since the oil majors already carried roughly a two-month reserve in working stocks, this arrangement effectively permitted them to continue operation in Japan with minimal additional expenses and inconvenience (Anderson 1975: 95). This was a major setback for the Japanese state.

The problem with enforcing the stockpiling requirement also occurred on the domestic side. Although domestic refiners were ready to comply with the PIL, they kept complaining about the burden of the extra cost of the requirement. They found that they would need 40 million yen to build tankers and the oil to fill them, and that under the present situation they could not hope to make the additional investment profitable (Jiji shimpo, December 13, 1934). Hashimoto of Nippon Oil agreed with other firms (Mitsubishi and foreign firms) on taking joint steps in an attempt to either end or lessen the burden of stockpiling. He wanted either a subsidy or to raise gasoline prices in order to cover the cost incurred by stockpiling (RG59, 894.6363/189; RG59, 894.6363/153).[26] They petitioned the MCI for a subsidy but the MOF refused (RG59, 894.6363/205).

In response, in May 1935, the state decided to increase oil prices to help them to construct additional tanks, an increase of 2.5 sen per gallon of gasoline. The state was forced to withdraw this plan because of strong protests from oil consumers. The state also had to postpone implementing the requirement until it could provide subsidies to cover the extra cost (Takeda 1979: 230). Finally, by the Imperial Ordinance of 13 July 1936, subsidies were provided to domestic firms for stockpiling expenses. Subsidies were given in the form of a six-percent return on capital invested in extra tankage and stocks. Meanwhile, those firms having fulfilled the requirement were compensated with most of the quota for the projected 1936 increases in the market (Anderson 1975: 97).

While domestic firms soon complied with the deadline and received

[26] However, at the time, it was unimaginable that government subsidies would be granted to foreign firms and that price increase would fully cover the huge amounts of capital to build tanks. Further, foreign importers were in no way certain of their future business opportunities. In this sense, although both domestic and foreign firms opposed stockpiling, they stood on entirely different ground.

subsidies, the oil majors who were ineligible for the government subsidy, again disregarded the deadline set by the "five-point memorandum." This time, the state urged Stanvac to arrange with Mitsui Bussan a joint venture as a means of complying with the PIL. Mitsui would construct tankage and store oil for Stanvac and it would receive compensation partly from government subsidies and partly from commissions on an additional allocation of Stanvac products (ibid.: 100). Negotiation, particularly over the issue of which side would take the management, came to an end with no settlement. Eventually the majors entered 1937 in technical violation of the PIL but with no penalties from the state. They kept refusing to stockpile at their own expense. The state did not take action until 1940.

Another key issue leading to the confrontation was the preferential quota. As mentioned earlier, the quotas set for the second half of 1934 clearly favored domestic refiners whose share increased from 46.4 percent to 49.9 percent. In response, the oil majors defected from the gasoline cartel that was formed in June 1934, and they also refused to participate in other cartels that were subsequently formed. They would only comply if they were guaranteed a market share of over 45 percent for the next ten years (RG59, 894.6363/173). The Japanese state yielded again, offering the oil majors a share of the projected increase in domestic consumption for 1935 instead of restricting their actual volume. Now, although their market share would drop to 43.7 percent, they were allocated 30 percent of the projected increase. The increase of actual volume would be 943,500 barrels (Takeda 1979: 228), which was close to what the majors demanded.

In April 1935, Stanvac and Rising Sun's marketing network controlled approximately 46 percent of gasoline sold in Japan (Anderson 1975: 94). Finally, the Japanese state yielded to guarantee them the previous year's actual volume of sale as a minimum, plus at least one-third of future increases, and a price structure that would not force foreign firms to sell at a loss (ibid.: 95).

Ultimately, the Japanese state's attempt to restrict the oil major's

Table 5. Exports of Gasoline to Japan, 1935-1940. **(thousand barrels)**

Export	1935	1936	1937	1938	1939	1940
U.S.A.	699	1,081	1,042	1,422	1,379	3,188
British Malaya	1,236	388	754	882	929	n.a.
Dutch Indies	4,692	6,694	6,192	8,015	7,475	6,798

Source: "Gasoline Exports to Japan," Stanley Hornbeck Papers, 183 Grew file, p. 2, Hoover Institution.

business by discriminative quotas turned out to be ineffective. Since domestic firms could not single-handedly cope with the expanding market, the de jure status of the oil majors were inviolated after all. As Anderson puts it, "the limited statistical data available do not reveal any drastic curtailment of Stanvac sales in Japan despite all the rhetorical thunder of the mid-1930s (Anderson 1975: 102)." Table 4 confirms this statement by illustrating that gasoline exports to Japan, which constituted virtually the entire business of Stanvac and Rising Sun in Japan were increasing until Pearl Harbor.

In sum, foreign firms were not controlled in view of the original purpose of the PIL. Quotas were consistently allotted to the minimum requests of the majors and the six-month oil reserve was never implemented. Some domestic firms could obtained state subsidies for the fulfillment of the latter requirement while profiting from the highly protected market. After setting the basic agendas, what the state had done was to relegate licensed firms to implement them. As an ex-MCI bureaucrat recollects, the state's business was not to inspect and permit the licensee's business plans, as formally stated in the PIL, but to allocate quotas and subsidies in response to the latter's requests (Sangyo seisakushi kenkyu shiryo 1978: 58). In the end, what Japan achieved through the implementation of the PIL was a stabilized oil market that protected the interests of all major market players (both domestic and foreign). It was able to regulate foreign players to the extent that monopolistic rents coincided with consumer's sacrifice.

Conclusion

For the first time in the modern history of Japan's political economy, a full-fledged state intervention, or a comprehensive set of industrial policies was applied to the oil industry. The state was fully equipped with the power to grant subsidies, tax breaks, protective tariffs, quotas, and most importantly, licensing. However, it is too simplistic to say that the state intervened this much because this strategically important sector attracted the attention of the military whose political power bypassed civilian control during the 1930s. For example, the six-month stockpiling requirement, an important precaution established by the military, needed almost three years to be implemented after it was substantially modified to accommodate domestic oil interests. The requirement was never observed by the oil majors. This happened between 1935 and 1941 when the Japanese military dominated civilian affairs. Without the support of the civilian economic bureaucrats and the domestic oil industry, this law would never have been realized.

Throughout the history of the Japanese oil industry, together with mergers, cartelization was a strategy that the state used to protect and maintain the country's industrial order by controlling foreign players. Cartels were initially formed among fledgling domestic oil firms to protect their interests vis-a-vis foreign firms. Later they realized that it was impossible for them to perform effective collective action by excluding the two giant foreign firms. A series of abortive *naigai* cartels proliferated. It was then that the state intervened to strengthen these cartels. Controlling both insiders and outsiders was difficult, in part because of the changing conditions in the world system. Even the application of the formidable Important Industry Control Law to the gasoline market was unsuccessful because it could not control foreign entrants. The PIL which followed was basically an attempt to limit the activities of foreign players through the state's licensing powers. It purported to fix players (a small number of domestic and foreign firms) by setting up high entry barriers and thereby reducing transaction costs between stabilized actors.

In short, the Japanese state targeted the sector where the world-systemic factors prevailed. Industrial policy was used for foreign investment control (i.e., an institutional attempt to protect the domestic industry from the global competition). Through protection, it basically sought to achieve a stable industrial order and gain oil autonomy. Although inward mercantilists wanted to use the licensing system for preventing foreign encroachment into the Japanese market and outward mercantilists wanted to use it as a device for market stability by accommodating foreign capital, both agreed that introducing a radical state intervention was needed.

Foreign players were not immediately kicked out as the military maintained. What the military contributed in this story was giving the state a situational urgency and thereby the means to a tremendous intervening power (i.e., licensing rights vis-a-vis the private sector). The archetypal protectionist law like the PIL was therefore an outcome of a historical conjuncture of the security and general economic interests.

References

English Works

Alam, M. Shahid. 1984. "Hirschmann's Taxonomy of Industries: Some Hypotheses and Evidence." *Economic Development and Cultural Change* 32.
Anderson, Irvine. 1975. *The Standard-Vacuum Oil Company and United States East Asian Policy, 1933-1941.* Princeton: Princeton University Press.
Blair, John. 1975. *The Control of Oil.* New York: Pantheon.
Bromley, Simon. 1991. *American Hegemony and World Oil.* University Park: Pennsylvania State University Press.
Crowley, James. 1966. *Japan's Quest for Autonomy.* Princeton: Princeton University Press.
Federal Trade Commission. 1952. *The International Petroleum Cartel.* Washington: U.S. Government Print.
Fursenko, A. A. 1990. *The Battle for Oil: the Economics and Politics of International Corporate Conflict Over Petroleum, 1860-1930.* Greenwich: JAI Press.
Grayson, Leslie. 1981. *National Oil Companies.* New York: Wiley.
Greene, William N. 1985. *Strategies of the Major Oil Companies.* Ann Arbor: UMI Research Press.
Hirschman, Albert. 1958. *Theory of Economic Development.* Boulder: Westview.
Ikenberry, G. John. 1988. *Reasons of State.* Ithaca: Cornell University Press.
Samuels, Richard. 1987. *The Business of the Japanese State.* Ithaca: Cornell University Press.
Schumpeter, Elizabeth ed. 1939. *The industrialization of Japan and Manchuquo.* New York: MacMillan.
Shaffer, Ed. 1983. *The United States and the Control of World Oil.* New York: St. Martin's.
Silberman, Bernard. 1982. "Bureaucratic State in Japan: The Problem of Authority and Legitimacy." In Tetsuo Najita and Victor Koschmann, eds., *Conflict in Modern Japanese History.* Princeton: Princeton University Press.
The U.S. Department of State. *Foreign Relations of the United States.*
The U.S. Department of State. Record Group 59.
Williamson, Harold. 1961. *The American Petroleum Industry: The Age of Energy, 1899-1959.* Evanston: Northwestern University Press.
World Bank. 1987. "Threat of Protectionism." *World Bank Report.*

Japanese Works

Abe, Takashi. 1981. "Dainisha taisenzen ni okeru Nihon sekiyusangyo to beiei sekiyu shihon." *Shogaku ronsan* 23-4.

Hashimoto, Juro. 1984. *Taikyokoki no Nihon shihonshugi.* Tokyo: Tokyo daigaku shuppansha.

Inoguchi, Tosuke. 1963. *Gendai Nihon sangyo hattatsushi II: Sekiyu.* Tokyo: Gendai Nihon sangyo hattatsushi kenkyukai.

Kikkawa, Takeo. 1989a. "1934-nen no Nihon no sekiyugyo-ho to Standard Vacuum Company(1)." *Aoyama keiei ronshu* 23-4.

Kikkawa, Takeo. 1989b. "1934-nen no Nihon no sekiyugyo-ho to Standard Vacuum Company(2)." *Aoyama keiei ronshu* 24-2.

Kikkawa, Takeo. 1990. "1934-nen no Nihon no sekiyugyo-ho to Standard Vacuum Company (3). "*Aoyama keiei ronshu* 24-3.

Kikkawa, Takeo. 1990. "1934-nen no Nihon no sekiyugyo-ho to Standard Vacuum Company (4). "*Aoyama keiei ronshu* 24-4.

Kikkawa, Takeo. 1992. "1934-nen no seikiyugyo-ho to gaikoku sekiyu kaisha to no kosho." In Oishi Kaichiro ed., *Senkanki Nihon no taigai keizai kankei.* Tokyo: Nihon keizai shimbunsha.

Kitazawa, Shinjiro and Ui Ushinosuke. 1941. *Sekiyu keizai-ron.* Tokyo: Senso shobo.

Kobayashi, Hisahira. 1936. *Sekiyu kogyo.* Tokyo: Nihon hyoronsha.

Kogane Bunsho, vols 1-12.

Mishima, Yasuo. 1981. *Mitsubishi zaibatsu.* Tokyo: Nihon keizai shimbunsha.

Mizuda, Seikichi. 1938. *Sekiyu.* Tokyo: Daiamondo shobo.

Nippon sekiyu kabushiki kaisha hishoka. 1934. *France no sekiyugyo-ho to kono kyoka.*

Takeda, Haruhito. 1979. "Shiryo kenkyu: nenryokyoku sekiyu gyosei senshi." In Sangyo seisakushi kenkyujo, ed., *Sangyo seisaku-shi kenkyu shiryo.* Tokyo: Sangyo seisakushi kankyujo.

Takeda, Haruhito. 1992. *Teikokushugi to minponshugi.* Tokyo: Shueisha.

Tsusho sangyosho. 1961. *Shoko seisakushi 4: Chuyo chosakai.* Tokyo: Shoko seisakushi kankokai.

Tsusho sangyo-sho. 1964. *Shoko seisakushi 11: Sangyo tosei.* Shoko seisakushi kankokai.

Tsusho sangyo-sho. 1980. *Shoko seisakushi 23: Kyogyo.* Shoko seisakushi kankokai.

Yanagihara, Hiromitsu. 1952. *Sekiyu zuiso.* Tokyo: Hara shobo.

Yasuoka, Shigeaki. 1982. *Mitsui zaibatsu.* Tokyo: Nihon keizai shimbunsha.

Yokohama seikin ginko chosaka. 1938. "Kaishu chushin to seru beikoku sekiyu gaikan."

Yoshino, Shinji. 1971. *Shoko sgyosei no omoide.* Tokyo: Yuhikaku.