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## Keeping Friends Close and Enemies Closer: Classical Realist Statecraft and Economic Exchange in U.S. Interwar Strategy

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## **Keeping Friends Close and Enemies Closer: Classical Realist Statecraft and Economic Exchange in U.S. Interwar Strategy**

TIMOTHY C. LEHMANN

*This article addresses the relationship between economic exchange and grand strategy and explains why rival states exchange with each other. The theoretical debate among realists is defined, while a novel, yet classical, realist exchange theory is proffered and evaluated against the record of U.S.-Japanese exchange, 1918–41. In this particular case, the origins of Japan's oil dependency on the United States are detailed for the first time as is the U.S. policy toward Britain and the Netherlands that created this dependency. The article finds U.S. strategic coordination of Japan's economic vulnerabilities and their use advanced U.S. grand strategy leading into WWII. The article concludes that the July 1941 U.S. oil embargo against Japan was purposeful and the product of a larger policy arc from the early post-WWI period.*

Why do rival great powers often have extensive economic exchange relations, and can realism explain these recurring patterns?<sup>1</sup> Since Kenneth Waltz's 1979 treatise, realism has generally been cast as a theory framework in which the necessities of state survival lead states to minimize economic exchange among themselves and with great power rivals in particular.<sup>2</sup> This

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<sup>1</sup> This dynamic is evident in several cases: Germany and Britain, pre-WWI; Germany and Russia, pre-WWI; the United States and Japan, 1918–41; Germany and the Soviet Union, 1939–41; Russia and China and the United States and China, 1991-present.

<sup>2</sup> See Kenneth Waltz, *Theory of International Politics* (Reading, MA: Addison-Wesley, 1979), 105–07; Joseph Grieco, "Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism," in *Neorealism and Neoliberalism: The Contemporary Debate*, ed. David Baldwin (New York: Columbia University Press, 1993), 134; Joseph Grieco, *Cooperation Among Nations: Europe, America and Non-Tariff Barriers to Trade* (Ithaca: Cornell University Press, 1990), 47.

proscription is often linked to variations in system polarity, yielding the rather dubious proposition that exchange under multipolarity is aimless, or worse, pursued out of a narrow concern for one's own gains amidst strategic uncertainty as to friend and foe.<sup>3</sup> This article holds that these propositions are inconsistent with classical realism's core contention that states pursue the maximum of relative power possible, which arguably can be as readily achieved through economic exchange as through military means. In order to maximize power, exchange with friend and foe alike is necessary for a great power to attempt to control its external strategic environment and others' capabilities and choices therein.

Because at least one great power—even a status quo great power such as interwar America—seeks to control others through the exchange, increasing exchange often ends in war as states contest each other's autonomy. Until now, scholars have generally concluded that the United States was a status quo great power that countenanced disproportionate economic gains to accrue to Japan.<sup>4</sup> This article demonstrates that the United States in fact achieved the opposite effect upon Japanese relative capabilities through economic exchange and, more importantly, bound Britain and the Netherlands to U.S. grand strategy through bilateral U.S.-Japanese exchange. Most scholarship has accepted it as natural that Japan received 80 percent of its oil supplies from the distant shores of the United States in the 1930s without inquiring as to the origins and political sentiments attached to this critical dependency. For this reason alone, the U.S.-Japan interwar case is intrinsically important and worthy of a deeper look. Other reasons why this case is ripe for reexamination include the extreme values and variation in Japanese oil dependency upon the United States across the period, the divergent predictions from competing theories (particularly structural realism), and the contemporary policy relevance of this case.<sup>5</sup>

This article finds that the United States became Japan's largest and most stable oil supplier by the late 1920s to reduce the possibility of Anglo-Japanese realignment and continued to supply Japan with oil and other vital

<sup>3</sup> Peter Liberman's analysis of multipolarity's effects summarizes several of these arguments. See Peter Liberman, "Trading With the Enemy: Security and Relative Economic Gains," *International Security* 21, no. 1 (Summer 1996): 152–55. Although not from realists, a typical and succinct account that many neo-realists embed within their works holds that "the source of gains from trade is the increased efficiency with which domestic resources can be employed. This increased efficiency itself frees economic resources for military uses. As a consequence, trade enhances the military power of any country that engages in it." Joanne Gowa and Edward Mansfield, "Power Politics and International Trade," *American Political Science Review* 87, no. 2 (June 1993): 408.

<sup>4</sup> Liberman is most erroneous here in asserting that "the deepening conflict had little effect on U.S.-Japanese trade until 1941." Liberman, "Trading with the Enemy," 168. The United States ended loans to Japan in January 1932; managed trade with Japan from 1933 forward, maintaining Japan's trade deficits with the United States; and carefully titrated its exports of strategic items up to the embargo in July 1941.

<sup>5</sup> See Stephen Van Evera, *Guide to Methods for Students of Political Science* (Ithaca: Cornell University Press, 1997), 77–78. For the contemporary use of the interwar case to justify a position on the U.S.-China case, see Amy Jaffe, "Wasted Energy," *New York Times*, 27 July 2005.

materials until July 1941 in order to execute its wartime strategy vis-à-vis Japan, Britain, and other leading and lesser states. By better conceptualizing and understanding the strategic setting of bilateral economic exchange, this article advances a realist theory of exchange that is grounded in classical realist philosophy, explains the interwar period in important new ways, and is more capable of hypothesizing about the observable realities that confound modern realists (for example, contemporary U.S.-China economic exchange).<sup>6</sup> This article is divided into three sections. The first section reviews the realist debate and the effects of multipolarity on the pursuit of power. The second introduces classical realist exchange theory. The third section examines the crucial case of U.S.-Japanese interwar exchange and compares classical realist theory with structural realism and other non-statist alternative explanations.

## CLASSICAL AND STRUCTURAL REALISM ON MULTIPOLARITY AND THE PURSUIT OF POWER

Ever since Waltz posited a system composed of security-seeking states with bounded power aspirations, there has been rigorous debate regarding the validity and utility of his defensive structural realism.<sup>7</sup> Little empirical validation has accompanied Waltz's structure-induced conception that states can knowingly seek only that power necessary to their security and thereby prevent other states from acting upon the system-induced imperative that states balance the excess power of others.<sup>8</sup> In recent years, John Mearsheimer has advanced an opposite structural argument, declaring that security-seeking states must seek the maximum of relative power possible in order to survive. In advancing his argument, Mearsheimer dismisses Hans Morgenthau, and classical realism more broadly, because Morgenthau allegedly develops the state-level proposition for the pursuit of maximum relative power almost

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<sup>6</sup> For example, Kenneth Waltz marries his rationalist nuclear peace theory with his relative gains propositions and states that "because states with second-strike forces cannot convert economic gain into strategic advantage, an important part of the relative-absolute gains problem is negated." This means, of course, that states without a secure second strike should be doubly circumscribed from receiving exchange gains. Therefore, while China does not yet possess a secure second strike, vis-à-vis the United States, Chinese economic gains through exchange with the U.S. are inexplicable in Waltz's theory. See Kenneth Waltz, "The Emerging Structure of International Politics," in *The Perils of Anarchy: Contemporary Realism and International Security*, ed. Michael E. Brown et al. (Cambridge: MIT Press, 1995), 72.

<sup>7</sup> The core of Waltz's structural defensive realism is the proscription not to seek too much power. In his formulation Waltz also embeds the assumptions that a state can know its relative power position and that balancing is the behavioral norm among states. See Waltz, *Theory of International Politics*, 126; Joseph Grieco, "Realist International Theory and the Study of International Politics," in *New Thinking in International Relations Theory*, ed. Michael Doyle and G. John Ikenberry (Boulder: Westview Press, 1997), 167.

<sup>8</sup> Waltz recently reaffirmed this argument. See Kenneth Waltz, "Evaluating Theories," in *Realism and the Balancing of Power: A New Debate*, ed. John Vasquez and Colin Elman (New Jersey: Prentice Hall, 2003), 54.

exclusively from the individual-level motivation to dominate others (human nature realism).<sup>9</sup>

Far from the stereotype, classical realism is better conceived as a theory that fuses the levels of analysis (individual, state, and system) by making the statesman the most important unit of analysis.<sup>10</sup> The statesman's pursuit of maximum relative power for the state is driven both by the much maligned human nature assumption and the inherent inability to know what the relative power balance is.<sup>11</sup> For classical realists, the purpose of the pursuit of maximum relative power is to control one's external environment as much as possible by influencing other states into actions that increase the relative power of the state. For structural realists, aggregation of a bounded amount of power (defensive) or the maximum of material power available in the system (offensive) forms the purpose of the state's interest in and definition of power.

The argument classical realists understand—at least since Albert Hirschman made it clear, and Morgenthau adopted it—is that states seeking the maximum of relative power possible are willing to trade some of their capabilities for influence positions around and within other states.<sup>12</sup> The purpose of applying and potentially trading one's capabilities in this fashion is to fulfill the policy ends of relative power maximization in terms of controlling “the minds and actions of other men” and their government policies. Drawing on Hirschman, Morgenthau notes, “It is necessary to distinguish between say, economic policies that are undertaken for their own sake and economic policies that are the instruments of a political policy—a policy, that is, whose economic purpose is but the means to the end of controlling the policies of another nation.”<sup>13</sup>

Structural realists and other non-classical realists do not have much room in their theories for this constant exchange rationale. Yet, they offer only tepid

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<sup>9</sup> Mearsheimer, *Tragedy*, 19–21. For other works that dismiss classical realism due to this, see Kenneth Waltz, *Man, the State, and War* (New York: Columbia University Press, 1959); Bradley Thayer, “Bringing in Darwin,” *International Security* 25, no. 2 (Fall 2000): 124–51. Grieco dismisses Morgenthau more bluntly when he contends that Morgenthau “is not representative of realist thinking about the particular matter of state preferences for security versus power.” Grieco, “Realist International Theory,” 188.

<sup>10</sup> Hans J. Morgenthau, *Politics Among Nations: The Struggle for Power and Peace*, 3rd ed. (New York: Alfred A. Knopf, 1966), 206. See also Hans Morgenthau, *Scientific Man vs. Power Politics* (Chicago: University of Chicago Press, 1946), 10; Daniel Byman and Kenneth Pollack, “Let Us Now Praise Great Men: Bringing the Statesman Back In,” *International Security* 25, no. 4 (Spring 2001): 107–46.

<sup>11</sup> While Waltz assumes one can know it and thus statesmen need have mere “competence” in its pursuit and Mearsheimer allows that it may occur from time to time, according to Morgenthau, relative power miscalculation is an enduring systemic feature (a constant). See Waltz, *Theory of International Politics*, 131; Mearsheimer, *Tragedy*, 343–44. Morgenthau, *Politics Among Nations*, 210.

<sup>12</sup> See Albert Hirschman, *National Power and the Structure of Foreign Trade* (Berkeley: University of California Press, 1945), 26; Morgenthau, *Politics Among Nations*, 31. Michael Mastanduno reiterated this classical point. See Michael Mastanduno, *Economic Containment: CoCom and the Politics of East-West Trade* (Ithaca: Cornell University Press, 1992), 54.

<sup>13</sup> Morgenthau, *Politics Among Nations*, 31.

alternatives. In his epic work on foreign investment in resources, Stephen Krasner found himself opposed to Morgenthau on largely defensive structural realist grounds. He notes, "Power for what is always the puzzling question. The clearest answer is: power to protect the core objectives of the state, its territorial and political integrity."<sup>14</sup> Because of his narrow assumption of state purpose, Krasner asserts that the United States prefers security of its own supply in critical raw materials first and then competition among private actors for lower prices in these goods. He fails to account for states that seek dominion over others' resources despite having more than enough for themselves. The United States was such a state vis-à-vis all other oil-producing states in the interwar period when America still represented between 63 percent and 75 percent of world oil production. As a result, Krasner largely misses the explanation and significance of the 1927–28 Dutch East Indies oil arrangements.<sup>15</sup> Statesmen seek dominion over resources abroad for the political influence these positions generate over other parties, not just for their own consumption.

Existing realist assertions of state and statesmen objectives under system characteristics such as multipolarity are underspecified. For example, Peter Liberman holds that "the security implications of relative economic gains should be lower in multipolar systems, even among adversaries, and particularly among nuclear-armed states. Policy makers will tend to focus on prosperity or political objectives in formulating trade policy."<sup>16</sup> How does multipolarity cause "political objectives" to become so barren of power impulses such as influencing the strategic choices and alignments of both rivals and allies, which are even more crucial in a fluid multipolar system? Instead of addressing the weak reasoning within structural approaches to exchange under multipolarity, defensive structural realists merely contend that rival states should not exchange in ways that disproportionately benefit the rival's material capabilities (for example, trade imbalances favoring the rival). Exchange relations are and should be of minimal importance to both states and easily severable.<sup>17</sup> For offensive structural realists, the conclusion regarding appropriate exchange relations mirrors that of defensive realists. Mearsheimer sees economic exchange "as likely to lead to conflict as cooperation, because states will struggle to escape *the vulnerability that interdependence creates*, in order to bolster their national security." Christopher Layne is also leery of economic interdependence because it "has adverse strategic consequences: it contributes to, and accelerates, a redistribution of relative power among

<sup>14</sup> Stephen Krasner, *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy* (Princeton: Princeton University Press, 1978), 41.

<sup>15</sup> Compare Krasner, *Defending the National Interest*, 109–18, with the case assessment herein.

<sup>16</sup> Liberman, "Trading with the Enemy," 155.

<sup>17</sup> See Joseph Grieco, "Anarchy and the Limits of Cooperation," 134. Grieco, *Cooperation Among Nations*, 47.

states in the international system (allowing rising competitors to catch up to the United States more quickly than they otherwise would).<sup>18</sup>

The basic and liberal-derived premise of both structural realist variants is that exchange creates economic gains that can be used to enhance the overall power of exchange participants; state policy therefore accounts, or should account, for these power externalities.<sup>19</sup> Joanna Gowa states the position most clearly. "Trade with an adversary produces a security diseconomy."<sup>20</sup> Implicit to these scholars' logic is the premise that trade leads to efficiency gains through the specialization of domestic production. These propositions also assume that exchange actually creates freed resources and not their diversion into unproductive, duplicative, and inefficient operations. They further assume that the administrative state, not private actors, captures the gains from freed resources and then seamlessly diverts the gains to state military purposes. This final assumption runs counter to the liberal proposition it is drawn from, namely that trade and increased efficient production constrain the capacity of the state to interfere with the private actors involved in the production and trade.<sup>21</sup>

Because of potential security externalities, exchange interests are, or should be, considered concomitantly with security interests within a state's grand strategy. Structural realists and liberals alike, however, assume exchange has a unidirectional, positive effect on capabilities and therefore must be circumscribed with rivals in order to either maintain state position (defensive) or maximize one's own relative military capabilities (offensive). While logically consistent, these positions fail to account for contemporary U.S.-China economic relations and do not capture U.S.-Japan economic relations in the interwar period. If we know the purposes of economic exchange can be as varied as creating or cementing alliances to rendering another state

<sup>18</sup> John Mearsheimer, "Back to the Future," 118 (emphasis added); Christopher Layne, "From Preponderance to Offshore Balancing," *International Security* 22, no. 1 (Summer 1997): 109. For classical realists, increasing economic interdependence is likely intended to increase influence, if not dependence, and therefore is more conflict laden.

<sup>19</sup> See Gowa and Mansfield quote in note 3 above. Perhaps in drawing his allusions to systemic politics from oligopolistic economic theory, Waltz embeds these liberal assumptions throughout his work unwittingly. For example, Waltz discusses relative gains wherein exchange generates varying gains, though they are all positive, see Waltz, *Theory of International Politics*, 105. I, however, take him at his word regarding the superiority of liberal economic thought and assumptions. For example, he recently stated, "The best example of a social science research program is the elaboration of classical and neoclassical economic theories over a period of more than 150 years, stretching from Adam Smith to John Maynard Keynes." Kenneth Waltz, "Thoughts about Assaying Theories," in *Progress in International Relations: Appraising the Field*, ed. Colin Elman and Miriam Elman (Cambridge: MIT Press, 2003), x-xi.

<sup>20</sup> Joanne Gowa, *Allies, Adversaries and International Trade* (Princeton: Princeton University Press, 1994), 6. David Baldwin defined "strategic" trade similarly as trade in any items that are "relatively inefficient to produce at home," because "what really matters is the amount of resources in the target country freed for other uses." David Baldwin, *Economic Statecraft* (Princeton: Princeton University Press, 1985), 215-6.

<sup>21</sup> For this argument's best exposition, see Albert Hirschman, *The Passions and the Interests: Political Arguments for Capitalism before its Triumph* (Princeton: Princeton University Press, 1977), 80-90.

bereft of trade through embargo or principled sanctions, why do we not question whether the effects of exchange might vary as well?

### CLASSICAL REALIST EXCHANGE THEORY

All forms of exchange are risky. When a state educates another's citizens, promotes scientific cooperation, or engages in military-to-military dialogues, there is an ever-present risk that capabilities may be transferred to the detriment of the state. There is also, of course, the possibility of increasing one's relative power position by increasing one's ability to influence others and gain insight into and possibly control over others' capabilities and intentions. According to classical realism, this possibility compels states to exchange with others, regardless of variations in their friend or foe status. The core premise of classical realist exchange theory holds exchange as necessary to the creation of influence, the garnering of intelligence, and the possible control of a rival's capabilities. Economic exchange can generate these positions and provide an avenue for pursuing control over others and one's grand strategic environment. For this reason, it properly forms a central aspect of the analysis of state objectives.

I advance two critical distinctions with Albert Hirschman's seminal work on states that purchase influence positions with other states. First, exchange-related increases in the capabilities of a rival do not necessarily mean that the rival is subject to equivalent decreases in its capabilities with a cessation in exchange. Some exchange is not only cumulative in its effects on capabilities but, more importantly, autonomy enhancing (for example, synthetic fuels or rubber technologies which might eliminate any trade vulnerability).<sup>22</sup> This exchange and its opposite (dependency-enhancing exchange) properly frame the conceptual analysis of exchange. In essence, exchange carries with it potential opportunity costs to one's relative autonomy, and while a state may increase its capabilities, these might be dependent gains. Second, bilateral gains and losses for influence positions take place within multilateral strategic environments. Thus, influence position assessment has to consider this larger environment, not just positioning regarding one country, even a rival.

The basic purpose of exchange in classical realism is to maximize the state's relative power and autonomy by constraining all others into policy choices the state prefers. Ultimately, the state seeks to limit others' autonomous use of their relative economic and military capabilities in wartime. From these classical objectives I have derived three classical realist exchange hypotheses.

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<sup>22</sup> See John C. Matthews, "Current Gains and Future Outcomes: When Cumulative Relative Gains Matter," *International Security* 21, no. 1 (Summer 1996): 112–14.



## Hypothesis 1

States are willing to pay for and desire to be large trading partners to their allies and rivals because of the intelligence and signaling benefits from exchange. Exchange ties provide a lens onto others' capabilities and intentions (monitoring imports, stockpiling efforts, foreign expansion through investment) and possibly a lever against their ability to act independently of the state's preferences. To these ends, states are willing to "purchase" exchange relations with a rival that lead to these capacities.<sup>23</sup> If necessary, states will trade some of their own relative capabilities (extend disproportionate gains) for an influence position vis-à-vis other states in order to make them reliant on economic exchange (export earnings for government, inward foreign direct investment (FDI) for economic development, or necessary imports for production processes). These commercial ties then allow states to signal, interpret, and influence each other. Nigel Ashton and Duco Hellema capture this function well for Anglo-Dutch relations in the twentieth century, noting, "This Anglo-Dutch commercial elite could also be used as a way of bypassing the official channels of relations between the two states, and as an additional means for one government to put pressure on the other."<sup>24</sup> Exposed corporate actors, whether operating as "commercial fifth columns" in Hirschman's term or merely canaries in the coal mine of another state, can at a minimum yield insight into the future directions of states and are therefore highly prized.

## Hypothesis 2

States will attempt to control others' material capabilities and introduce large negative adjustment costs for when exchange ceases, particularly as war approaches. Exchange can introduce a range of negative effects onto a target's capabilities, from increasing marginal inefficiencies in operations to destruction through acts of economic warfare. States may also divert another's resources and capabilities instead of simply negating them, for example,

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<sup>23</sup> For these and other statist reasons and examples, see Baldwin, *Economic Statecraft*, 41–42; Hirschman, *National Power and the Structure of Foreign Trade*, 29; Hedieh Nasheri, *Economic Espionage and Industrial Spying* (New York: Cambridge University Press, 2005); Brian Champion, "Spies Look Like Us: the Early Use of Business and Civilian Covers in Covert Operations," *International Journal of Intelligence and Counterintelligence* 21, no. 3 (September 2008): 530–564; P. Tomaselli, "C's Moscow Station-The Anglo-Russian Trade Mission as Cover for SIS in the Early 1920s," *Intelligence and National Security* 17, no. 3 (Autumn 2002): 173–80; Walter Pincus, "Agencies Debate Value of Being Out in the Cold: Spies under 'Nonofficial Cover' are among most Sensitive Operations," *Washington Post*, 12 January 1996; Krasner, *Defending the National Interest*, 310–11.

<sup>24</sup> Nigel Ashton and Duco Hellema, *Unspoken Allies: Anglo-Dutch Relations Since 1780* (Amsterdam: Amsterdam University Press, 2002), 13. German Chancellor Otto von Bismarck used the banker Gerson von Bleichröder for similar purposes vis-à-vis other European capitals. Eugene Staley describes this account in what remains the best work done on this subject. See Eugene Staley, *War and the Private Investor* (New York: Doubleday, 1935), 218.

“resource-absorbing” diversion into wholly unproductive investments, technologies, and materials usage.<sup>25</sup> Similarly, a state can imbed inefficiencies into another’s economy based on trade with oneself. For example, refineries built to operate most efficiently based on one type of source country crude oil will be less efficient with any others’ crude. The introduction of marginal inefficiencies into an opponent’s economy, if it trades with any other is a principal reason to trade, and this economic effect can be at least as important as the purported efficiency gains from trade (for example, trade in components/parts and technology support for capital intensive goods like military equipment and airplanes). Additionally, by foreclosing or reducing a target’s alternatives and substitution possibilities, states seek positions from which they can alter a target’s capabilities in time of war and reduce the target’s opportunities to seek autonomy. Collectively, the effect of these measures on a target’s economic and military capabilities is best judged after exchange has ceased, and the full import of lost technologies, traded inputs, and squandered investment becomes apparent.

### Hypothesis 3

Because states pursue grand strategies in which bilateral exchange relations with likely enemies serve grand strategy and not some narrow bilateral prescription, such as minimizing disproportionate gains, states will run deficits with or extend disproportionate gains to a rival to isolate it from other states, including prospective allies or neutrals. This proposition flows directly from the classic divide and rule maxim—divide and rule by orienting others toward oneself and away from each other. Precisely because today’s ally may be tomorrow’s foe, states desire the leverage over all others that economic exchange can generate. For example, in order to gain leverage over a region, a state may need to run trade deficits with the most threatening state in the region, thereby shielding third countries from the threatening target and orienting them toward itself instead. Taking this necessarily multilateral view, it is easier to understand why states exchange with friend and foe alike and why exchange vis-à-vis one target has to be coordinated across multiple states (alternate suppliers). At a basic level, a state wants to prevent alignments against its interests and build up its potential allies’ capabilities.

<sup>25</sup> See Michael Mastanduno, *Economic Containment*, 55–57; Barrett Riordan, “State-Sponsored Economic Deception and its Determinants,” *Intelligence and National Security* 17, no. 4 (Winter 2002): 22–23. David Wise describes the U.S. government’s success at enticing the Soviet Union to steal inferior nerve gas technologies in the 1960s and 1970s, precisely for the purpose of diverting and wasting its resources. See David Wise, *Cassidy’s Run: the Secret Spy War over Nerve Gas* (New York: Random House, 2000), 49. Most recently, James Risen found a U.S. plot to set the Iranian nuclear program back by implanting defective Russian nuclear designs through a CIA-controlled Russian defector exchanging covertly with Iran. See James Risen, *State of War: The Secret History of the CIA and the Bush Administration* (New York: Free Press, 2005), 193–212.

Orienting other states primarily toward oneself can help forestall alignments against one's interests, as exemplified by Bismarck's hub-and-spoke strategy.<sup>26</sup> Concern for prospective allies' or neutrals' positions within a state's grand strategy is a major factor influencing bilateral exchange with a rival. In fact, bilateral trade with a rival may increase precisely because the rival becomes more threatening, and the desire to coordinate with other states against the rival requires the state to assuage allied and neutral concerns by assuming greater exchange with the rival away from them.

### U.S. INTERWAR GRAND STRATEGY AND JAPANESE EXCHANGE: THEORY EXPECTATIONS AND OVERVIEW

In applying the foregoing three classical hypotheses to the crucial interwar case, one expects to find state behaviors and exchange occurrences different from those under structural realism with its simple mono-directional prescription for less exchange—threat goes up or down, less exchange expected. These hypotheses are evaluated in this case across several types of exchange: trade in luxury (silk) and strategic (oil) goods; autonomy-enhancing technology (synthetic oil); and capital markets (loans).<sup>27</sup> In contrast to the structural expectation of less exchange between the United States and Japan, classical realism expects to see expanded exchange as the U.S. government attempts to gain both greater insight into Japan's intentions and leverage over Japan's autonomous capabilities, such as use of corporations as intelligence collection and signaling agents and creating dependent capital infrastructure. Similarly, classical realism expects that the U.S. government will act to isolate Japan from other exchange partners and, where possible, shift its critical dependencies (oil, finance) to U.S. control and away from others' alignments with Japan, as Hypothesis 3 expects. Where corporations play an intermediary role in this exchange, the U.S. government is expected to condition corporate actions to achieve these functions as well as increase Japanese dependency on the United States and increase the adjustment costs borne by Japan with any cessation in the exchange. This does not mean, however, the U.S. government has to condition companies to exchange with Japan when the companies may be so inclined to yield these ends. As David Baldwin notes, "It is not the decisions of the private traders themselves that constitute economic statecraft, but rather the statesman's decisions to *permit or encourage*

<sup>26</sup> For a recent summary and analogy to U.S. hegemonic strategy, see Josef Joffe, "Defying History and Theory: The United States as the 'Last Remaining Superpower,'" in *America Unrivaled: The Future of the Balance of Power*, ed. G. John Ikenberry (Ithaca: Cornell University Press, 2002), 155–80.

<sup>27</sup> See Harold Eckstein, "Case Study and Theory in Political Science," in *Handbook of Political Science*, vol. 7, ed. Fred Greenstein and Nelson W. Polsby (Reading, MA: Addison-Wesley, 1975), 94–120; Stephen Van Evera, *Guide to Methods for Students of Political Science* (Ithaca: Cornell University Press, 1997), 50–67.

such trade.”<sup>28</sup> Therefore, the proper evaluative lens and observational focus is whether governmental permission or encouragement of exchange or its corollary dissuasion or blocking occurs.

In contrast, if classical realism is not operative, states would not use exchange for strategic purposes and corporations would exchange without any governmental guidance or assistance. Under these conditions, we would expect to observe expanded U.S. exchange with Japan that serves corporate interests and agreements, (for example, 1928 world oil cartel principles), and controlling political support of the exchange’s continuance vis-à-vis any divergent U.S. government preference. Among other expectations addressed in the case, this would have meant expanded U.S. exchange with Japan, even after the Manchurian crisis, due to U.S. bankers’ preference for continued transactions with the most important Asian market, Japan. More importantly, it would also have meant actually less U.S. oil to Japan as the Dutch East Indies (DEI) was nearly 1,500 miles closer, and the 1928 world oil cartel agreement stipulated supply from the nearest source country.<sup>29</sup>

United States strategic calculation in the interwar period revolved around several interrelated concerns. Foremost among these were the naval balance with Britain and Japan, alliances and ententes inimical to U.S. interests in Asia and Europe, and ownership and control of oil-producing assets crucial to any future mechanized warfare among great powers. While most interwar scholarship in political science has treated the Asian and European theaters separately, recent historical works begin with the fundamental insight that Europe and Asia were linked in the grand strategies of many major states, principally Britain, the United States, and the Soviet Union.<sup>30</sup> In accord with Hypothesis 3, one of the main ways the United States advanced its fairly consistent grand strategic interests across Asia and Europe was by inserting U.S. influence into previously closed great power economic and military alignments and preventing others from emerging. This was particularly true of the Anglo-Japanese alliance (1902–1923) but also for Anglo-Dutch relations in the DEI and Chinese affairs. These concerns led the United States to pursue three primary objectives within its interwar grand strategy.

<sup>28</sup> Baldwin, *Economic Statecraft*, 116, note 3 (emphasis added).

<sup>29</sup> For the cartel’s operating principles, see B.S. McBeth, *British Oil Policy 1919–1939* (London: Frank Cass, 1985), 106–07; Daniel Yergin, *The Prize: The Epic Quest for Oil, Money and Power* (New York: Simon & Schuster, 1991), 264.

<sup>30</sup> For an excellent recent work emphasizing Asia as the core of Anglo-American relations, see Greg Kennedy, *Anglo-American Strategic Relations and the Far East 1933–1939* (London: Frank Cass, 2002). For other recent works stressing the two-theater nature of all the major states’ grand strategies, see Niall Ferguson, *War of Worlds: the War of the World* (New York: Penguin, 2007), 306–19; Ian Cowman, *Dominion or Decline: Anglo-American Naval Relations on the Pacific, 1937–1941* (Oxford: Berg, 1996); Jonathan Haslam, *The Soviet Union and the Threat from the East, 1933–1941: Moscow, Tokyo, and the Prelude of the Pacific War* (Pittsburgh: University of Pittsburgh Press, 1992); Albert Weeks, *Stalin’s Other War: Soviet Grand Strategy, 1939–1941* (New York: Rowman & Littlefield, 2002).

First, the United States sought to isolate Japan from Britain and terminate the Anglo-Japanese alliance which united the first and third largest navies in the world. The Anglo-Japanese alliance had put pressure on Russia from the start and also provided Japan with great power cover to pursue regional expansion, which often challenged U.S. interests.<sup>31</sup> Thomas Mahnken recently reaffirmed the central part Japan played in U.S. war plans. "A war with Japan was the U.S. Navy's top planning contingency throughout the interwar period. . . . In 1923, the Joint Army-Navy Board, composed of the Army Chief of Staff, the Chief of Naval Operations, their deputies, and their chief planners, identified a war with Japan as the most pressing contingency facing the United States, a judgment reaffirmed five years later."<sup>32</sup> The United States was determined to use economic leverage against both Japan and Britain to force a lasting sundering of their alliance and to keep them at odds during this period. Second, throughout the interwar period, the United States was also committed to building a sovereign and capable China as a beachhead for expanded U.S. interests in Asia and a bulwark against Japanese, British, and Russian privations. Finally, the United States was determined to gain an expanded ownership position in the world's oil-producing regions over which Britain had established dominance.<sup>33</sup> Even a pro-business, small government conservative like president Calvin Coolidge understood oil's import. He held, "The supremacy of nations may be determined by the possession of available petroleum and its products."<sup>34</sup> In Asia, this meant expanding American influence in and over the DEI oil fields, the fourth largest production site in the world and the single largest in Asia. These fields were the economic core of the Anglo-Japanese alliance as Britain ensured its ally's oil supplies primarily from these fields.

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<sup>31</sup> This was most evident at the Versailles Treaty negotiations with Britain backing Japanese claims to the former German island possessions in the Pacific. These islands surrounded U.S. possessions such as Guam and threatened the Philippines, causing great concern within the U.S. Navy and Joint Army-Navy Board that worked on U.S. military strategy. Thomas H. Buckley, *The United States and the Washington Conference, 1921–1922* (Knoxville: University of Tennessee Press, 1970), 90–93; Russell H. Fifield, *Woodrow Wilson and the Far East: The Diplomacy of the Shantung Question* (New York: Thomas Y. Crowell, 1952), 137–39.

<sup>32</sup> See Thomas Mahnken, *Uncovering Ways of War: U.S. Intelligence and Foreign Military Innovation, 1918–1941* (Ithaca: Cornell University Press, 2002), 43; Harold and Margaret Sprout, *Toward a New World of Sea Power: American Naval Policy and the World Scene, 1918–1922* (Princeton: Princeton University Press, 1940), 82–83.

<sup>33</sup> See John DeNovo, "The Movement for an Aggressive American Oil Policy Abroad, 1918–1920," *The American Historical Review* 61 (July 1956): 854–76; Confidential Memoranda for the American Delegates to the Conference on Limitation of Armament, "The Petroleum Situation with Special Reference to the Far East" (Washington, DC: GPO, 1921).

<sup>34</sup> President Calvin Coolidge, quoted in Yergin, *The Prize*, 222.

## Position Signaling and Expansion through Exchange

Beyond the presidents and secretaries of state, the most important interwar U.S. statesman was Stanley Hornbeck at the State Department. He was the key policymaker and analyst on Asia, oil matters globally, and eventually grand strategy for President Roosevelt.<sup>35</sup> Hornbeck was a technical expert with President Wilson at Versailles, chief of the State Department's Division of Far Eastern Affairs from 1928 forward, drafter of the non-recognition policy after Japan's invasion of Manchuria, and the lead governmental official directing oil companies' activities in Asia.<sup>36</sup> His legacy and influence were present even before the end of WWI when the United States established its penchant for using economic leverage with Japan to check Japanese expansion. By early September 1918, Japan had sent over seventy-two thousand troops into Siberia, well beyond its agreed upon Allied force contribution of twelve thousand to stabilize the Russian Far East during Russia's civil war.<sup>37</sup> At this time, the United States had unilateral economic leverage over Japan in the silk and cotton trades only. As a result of British unwillingness to act jointly against Japan using steel exports or other more ostensibly strategic goods, president Woodrow Wilson chose to act unilaterally against Japanese silk exports to and cotton imports from the United States. In the only published account of this incident, the December 1918 Japanese withdrawal of fourteen thousand troops and near-term commitment to withdraw another thirty-four thousand came as a result of President Wilson's 18 November 1918 order that the U.S. War Trade Board suspend U.S. cotton export licenses to Japan and silk import licenses from Japan.<sup>38</sup>

<sup>35</sup> Stanley K. Hornbeck was a career State Department official and ambassador to the Netherlands at the end of WWII. He coordinated State and Navy Department relations and often vetted admirals for promotion prior to his own to political advisor in 1937. See Louis Morton, *The War in the Pacific: Strategy and Command: The First Two Years* (Washington, DC: GPO, 1962), 37; Robert K. Wolthius, "United States Foreign Policy Towards the Netherlands Indies, 1937–1945" (PhD diss., Johns Hopkins University, 1968), 28–30; Shizang Hu, *Stanley K. Hornbeck and the Open Door Policy, 1919–1937* (Westport, CT: Greenwood Press, 1995).

<sup>36</sup> For more detailed discussions of Hornbeck's centrality to U.S. policy, see Kenneth McCarty, "Stanley Hornbeck and the Manchurian Crisis," *The Southern Quarterly* 10, no. 4 (July 1972): 305–24; Richard Dean Burns, "Stanley Hornbeck: The Diplomacy of the Open Door," in *Diplomats in Crisis*, ed. Richard Dean Burns and Edward Bennett (Santa Barbara: ABC-CLIO, 1974), 91–117; Russell Buhite, "Stanley Hornbeck and American Far Eastern Policy," in *Makers of American Diplomacy*, ed. Frank Merli and Theodore Wilson (New York: Scribner, 1974), 431–58; Justin Libby, "Rendezvous with Disaster," *World Affairs* 158, no. 3 (Winter 1996): 137–47; Shinjiro Nagaoka, "Economic Demands on the Dutch East Indies," in *The Fateful Choice: Japan's Advance into Southeast Asia, 1939–1941*, ed. James W. Morley (New York: Columbia University Press, 1980), 142–43; Herbert Feis, *The Road to Pearl Harbor: The Coming of the War Between the United States and Japan* (Princeton: Princeton University Press, 1950), 130.

<sup>37</sup> See Fifield, *Woodrow Wilson and the Far East*, 107; Burton F. Beers, *Vain Endeavor: Robert Lansing's Attempts to End the American-Japanese Rivalry* (Durham: Duke University Press, 1962), 131–34; James William Morley, *The Japanese Thrust into Siberia, 1918* (New York: Columbia University Press, 1957), 308–11.

<sup>38</sup> Henry H. Douglas, "A Bit of American History—Successful Embargo Against Japan in 1918," *Amerasia* 4 (March 1940–February 1941): 258–60. See United States Tariff Commission, *The Foreign Trade of*

This U.S. governmental action was taken without consideration or regard for domestic U.S. cotton interests or silk importers, many of whom were Japanese. Were their preferences controlling, the silk and cotton trade would never have been restrained in the first place. This short-term embargo on silk alone threatened 2.7 percent of Japan's economy in 1918 and, more importantly, it threatened the dollar earnings needed to meet foreign loan obligations of the Japanese state.<sup>39</sup> Despite silk's status as a luxury good, it had strategic import for the Japanese state because of this earnings need and the inability to substitute for the U.S. market which absorbed approximately 95 percent of Japan's most important export of silk.

The Japanese government complied with the U.S. government signal and economic coercion and began troop withdrawals, noting its choice was due to "consideration of the turn in world affairs, the Siberian situation, *and the intention* of the United States government."<sup>40</sup> The precedent of the U.S. government signaling its intentions to the Japanese government and Japanese receipt of this signal in an attempt to influence decisions through economic pressure was established at this juncture, not after the Manchurian invasion in 1931. Because the United States used this trade to influence Japan's foreign policy, in the future, trade spiked in silk and cotton as well as in scrap iron and steel before and during major developments in Japanese foreign expansion. For example, during the first six months of 1937, Japanese imports of U.S. scrap iron and steel surged and the State Department monitored this development in the context of deteriorating Sino-Japanese relations and the eventual full-scale war started by Japan in July 1937.<sup>41</sup> As Hypothesis 1 expects, the United States observed all of these purchases for precisely this reason.

More important than trade's strategic signaling function is its utility in affecting others' capabilities and intentions as well as others' perceptions of one's own. Stanley Hornbeck understood this well regarding the silk trade with Japan when it was first put under government licensure during WWI. He

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*Japan: A Study of the Trade of Japan with Special Reference to that with the United States* (Washington, DC: GPO, 1922), 198–203.

<sup>39</sup> Japanese silk exports to the U.S. comprised 3.9 percent of Japanese GDP in 1919 as well. For the data, see *Hundred-Year Statistics of the Japanese Economy* (Tokyo: Bank of Japan, July 1966), 278–79; B.R. Mitchell, *International Historical Statistics Africa and Asia* (New York: New York University Press, 1982), 390; U.S. Tariff Commission, *The Foreign Trade of Japan*, 36–37, 201–02; Teijiro Uyeda, *The Recent Development of Japanese Foreign Trade* (Tokyo: Hosokawa Printing, 1936), 57, 70.

<sup>40</sup> Ambassador Ishii delivered these words on 28 December 1918. See Hikomatsu Kamikawa, ed., *Japan-American Diplomatic Relations in the Meiji-Taisho Era* (Tokyo: Pan-Pacific Press, 1958), 368 (emphasis added).

<sup>41</sup> During the first half of 1937, the United States sent Japan 1.3 million metric tons of scrap iron and steel out of a year-end total of 1.9 metric tons. This represented a huge increase over all previous years, and as with prior large increases in Japanese goods demand, it was being monitored at the State Department for indications of Japanese intent. See Feis, *The Road to Pearl Harbor*, 11; Lockwood, *Trade and Trade Rivalry Between the United States and Japan*, 165; ed. Elizabeth Schumpeter, *The Industrialization of Japan and Manchukuo, 1930–1940* (New York: MacMillan, 1940), 446; U.S. Department of Commerce, *Trade of the United States with Japan in 1938* (Washington, DC: GPO, April 1939), 3.

clearly stated the U.S. intent to use the mere continuation or possible cessation of this trade as a political weapon: "The issuing of the imports licensing order by President Wilson injects a new feature and gives the United States a new weapon . . . making it appear that this is a special concession (continuing Silk imports) evidencing our friendship and good will. . . . Japan has Silk. The United States is her market for Silk. The United States could do without Silk."<sup>42</sup>

## Oil Positioning After World War I

Despite the large negative adjustment costs to Japan in the event of a cessation in its silk trade, the United States, after WWI, sought to expand its relative power over Japan, Britain, and the Netherlands through increased global oil trade and ownership rights, particularly those pertaining to the DEI in Asia. In order to expand U.S. oil influence beyond its own large domestic base, the United States passed and began to invoke the 1920 Mineral Leasing Act which allowed for retaliation against non-reciprocating countries in terms of lease rights to government oil lands. The United States experienced frustration in obtaining expanded ownership rights for its oil nationals in the DEI because the Dutch were unwilling to grant U.S. companies oil rights without some security or alliance provisions accompanying expanded cooperation in oil ownership. Additionally, the Dutch were not willing to allow U.S. concerns into expanded ownership positions in the DEI without some assurance that Japan's equally ardent desire for ownership rights there would be managed by Britain and America in some way that shielded the DEI from any increased Japanese military pressures.<sup>43</sup>

In late 1920, Dutch and British intransigence led the U.S. government to countenance the sale of Standard Oil of New Jersey's small oil producing assets in the DEI to Japanese interests, directly challenging the Dutch desire to limit Japanese economic penetration of the Dutch colony. Consistent with classical realism, this sale offer was only made after the U.S. government was informed and had an opportunity to disapprove the offer.<sup>44</sup> The offer led to

<sup>42</sup> See Hornbeck, memorandum, 1917–18, "Concerning Negotiations for Cooperation between the United States and Japan," box 240, folder "Japan: How to Coerce," Stanley K. Hornbeck Papers, Hoover Institution on War, Revolution and Peace, Stanford University (hereafter cited as Hornbeck Papers).

<sup>43</sup> See Peter Mellish Reed, "Standard Oil in Indonesia," *Business History Review* 32 (Autumn 1958): 319–22; Gerald D. Nash, *United States Oil Policy, 1890–1964* (Pittsburgh: University of Pittsburgh Press, 1968), 61–63; Frank C. Hanighen, *The Secret War* (New York: John Day, 1934), 108–12. For the Dutch threat perception of Japan, see Amry Vandenbosch, *The Dutch East Indies: Its Government, Problems and Politics* (Grand Rapids: Eerdmans Publishing, 1933), 328–29. See also Ludwell Denny, *We Fight for Oil* (New York: Alfred A. Knopf, 1928).

<sup>44</sup> See John A. Fowler, American Trade Commissioner at Batavia, Java to U.S. Department of Commerce, Foreign Service Division, Bureau of Foreign and Domestic Commerce, 30 October 1920, file 856d.6363/33, RG 59, General Records of the Department of State, National Archives, Washington, D.C. (hereafter cited as RG 59). In 1920, Standard Oil of New Jersey's DEI subsidiary, Kolonial, produced less



perturbations in the oil trade toward Japan from both the United States and the DEI; it also coincided with rising anti-Japanese sentiment in California, as evident in the 1920 California Exclusion Act and the naval arms race. As a result of U.S. Navy pressures and public opinion, U.S. oil shipments to Japan fell off at the end of 1920 and throughout most of 1921, increasing Japan's sense of economic and military vulnerability (see Figure 1). Standard Oil representatives corresponded with U.S. naval intelligence and reported on Japanese purchase offers with the clear implication that guidance on accepting or rejecting such offers would be forthcoming from the U.S. Navy. Other naval intelligence reports highlighted the pressure and unwelcome "notoriety" that Royal Dutch Shell received by supplying the Japanese Navy with California oil. In early 1921, as a result of these pressures from the U.S. Navy, U.S. government officials, and the California press, Royal Dutch Shell arranged for Japanese naval tankers to stop receiving oil from California and instead get oil from Mexico and the DEI.<sup>45</sup> A typical account from a California newspaper article at this time noted: "Senator Phelan will fight all the remainder of this session to get through his bill empowering the President to place an embargo on the export of fuel oil, and also hopes to get either the Senate Committee on Naval Affairs or some bureau of the government to make a world survey of all the available fuel oil to show that the bulk of the supply is rapidly getting into the hands of Great Britain and Japan to the permanent injury and disadvantage of the United States."<sup>46</sup>

This event revealed and exacerbated the concomitant rivalries among Britain, the United States, and Japan in naval armaments and oil and the U.S. perception that the Anglo-Japanese alliance was positively harming American interests and position in Asia, if not the world. Consistent only with classical realism, the supply shocks at this time did not result merely from corporate preferences but rather from U.S. government actions in support of oil interests abroad (DEI sale threat) and public pressure against U.S. oil sales to Japan by leading government officials (Senator James Phelan of California, Secretary of Navy Joseph Daniels). If corporate preferences were controlling, U.S. oil would have flowed in greater amounts to Japan during this period. Instead, the U.S. government was ratcheting up the pressure on Britain's exclusive oil deals with the Dutch and its military alliance with Japan, leading to less U.S. oil to Japan.

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than 1 percent of the crude oil in the DEI; Royal Dutch-Shell produced 99 percent. Royal Dutch Shell was and still is a merger of British and Dutch corporate interests with British influence paramount.

<sup>45</sup> See Office of Naval Intelligence (ONI) three-part report, "Oil Situation of Japan, January 1921, file o-1-g, register 14039, Record Group 38, Records of the Office of Naval Intelligence, Naval Attache Reports, National Archives, Washington, DC (hereafter cited as RG 38); Wallace Bertholf, Commandant Twelfth Naval District, to Director of Naval Intelligence, memorandum, 21 April 1921, in report, "Navy Oil Contract 1917-1920 with Shell Oil Co.," 6 May 1921, file e-10-d, register 13177, RG 38.

<sup>46</sup> "To Embargo Fuel Oil," *Los Angeles Times*, 2 February 1921.

The Washington Conference, November 1921–February 1922, was an attempt to simultaneously alleviate several of these tensions and nearly failed due to continued Anglo-American rivalry over oil and naval parity.<sup>47</sup> Fortunately for the U.S. bargaining position at the conference, all diplomatic communications were intercepted by U.S. intelligence with the full cooperation of subordinate U.S. cable companies, such as Western Union and Postal Telegraph. Consistent with Hypothesis 1, these intercepts proved invaluable in understanding and exploiting Japan's position and in concluding a successful conference.<sup>48</sup> The question, however, of Anglo-American cooperation in worldwide oil development cast some suspicion over the possibility of a successful conference. Yet, "the matter was laid to rest when Lord Cadman established the oil peace at the end of 1921. The Nederlandsche-Indische Aardolie Maatschappij, owned jointly by the Royal Dutch and the Netherlands Government, could begin the exploitation of the Djambi deposits with the blessings of the State Department in return for a compromise in the Middle East and the promise of subsequent concessions in the East Indies."<sup>49</sup>

As a result of Britain's pledge to open its exclusive oil spheres to expanded American oil nationals, the American, British, and Dutch governments began to settle some smaller outstanding differences regarding oil development for their national corporations in Mexico, Costa Rica, and Venezuela, replacing exclusive development arrangements with joint ones. In these dealings the United States disavowed its commitment to the "Open Door" and accepted exclusionary ownership arrangements after U.S. companies, usually Standard of New Jersey, received a position (for example, the 1924 Iraq Petroleum Company agreement).<sup>50</sup> Despite the termination of the Anglo-Japanese alliance and the joint recognition of Chinese sovereignty embodied in the Nine Power Treaty, these dealings did not, however, resolve the

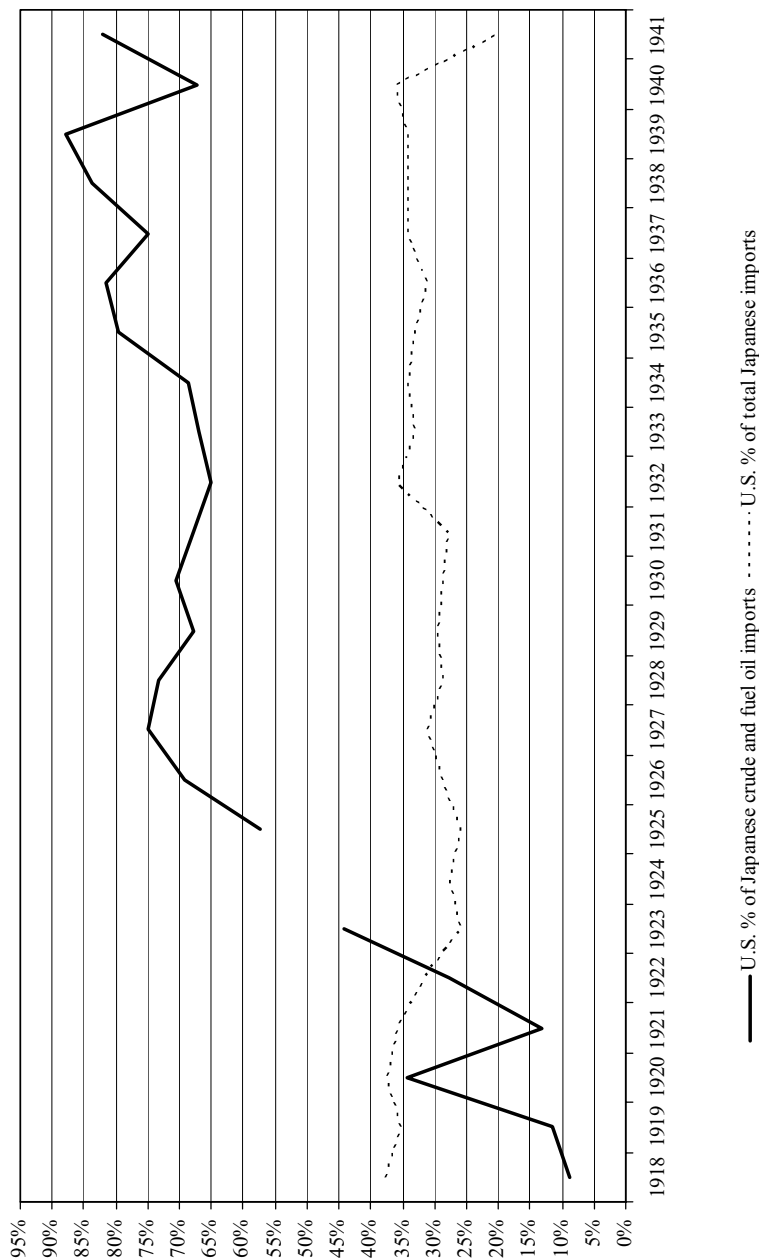
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<sup>47</sup> See Thomas Buckley, *The United States and the Washington Conference, 1921–1922* (Knoxville: University of Tennessee Press, 1970); Erik Goldstein and John Maurer, eds., *The Washington Conference, 1921–1922: Naval Rivalry, East Asian Stability and the Road to Pearl Harbor* (Portland: Frank Cass, 1994).

<sup>48</sup> See James Bamford, *The Puzzle Palace* (New York: Penguin, 1983), 25–30; Herbert Yardley, *The American Black Chamber* (Indianapolis: Bobbs-Merrill, 1931), 280–317.

<sup>49</sup> Michael Brooks, *Oil and Foreign Policy* (London: Lawrence & Wishart, 1949), 117. The Djambi oil reserves in the DEI were much coveted by the United States, Japan, and the British-Dutch actors who gained the concession. Sir John Cadman was technical adviser on petroleum to the British government and the chief oil negotiator for Britain with America. See Stephen Randall, *U.S. Foreign Oil Policy Since WWI*, (Montreal: McGill-Queen's University Press, 2007), 337, note 32; Benjamin Shwadran, *The Middle East, Oil and the Great Powers*, 3rd ed. (New York: John Wiley & Sons, 1973), 35, note 63.

<sup>50</sup> These ownership arrangements are in no way consistent with the "free trade" interpretation of the 1920s. Once U.S. corporations were in, the "open door" closed behind them. See Peter Sluglett, *Britain in Iraq: 1914–1932* (London: Ithaca Press, 1976), 103–16; Michael J. Hogan, *Informal Entente: The Private Structure of Cooperation in Anglo-American Economic Diplomacy, 1918–1928* (Columbia, MO: University of Missouri Press, 1977), 166–77, 180–82; Randall, *U.S. Foreign Oil Policy Since WWI*, 33–40; Yergin, *The Prize*, 200–02.



**FIGURE 1** Comparison of U.S. Share in Japan's Overall Imports and Crude and Fuel Oil Imports, 1918–41. Note: Imports from the United States as a percentage of total Japanese imports are compared with Japan's crude and fuel oil imports from the United States as a percentage of total Japanese crude and fuel oil imports. Oil data for 1922–25 do not include countries other than the United States and the Dutch East Indies and therefore overstate to a small extent the U.S. percentage in Japan's total oil imports. Sources: U.S. Department of Commerce (DOC), *Foreign Commerce Yearbook* (Washington, DC: GPO, 1922–41); U.S. DOC, *International Trade in Petroleum and its Products* (Washington, DC: GPO, 1929), 138; *Hundred-Year Statistics of the Japanese Economy* (Tokyo: Bank of Japan, July 1966), 278–79; B.R. Mitchell, *International Historical Statistics Africa and Asia*

**FIGURE 1 (Continued)** (New York: New York University Press, 1982), 390; U.S. Tariff Commission, *Foreign Trade of Japan: A Study of the Trade of Japan with Special Reference to that with the United States* (Washington, DC: GPO, 1922), 36–37, 201–02; Uyeda, *Recent Development of Japanese Foreign Trade*, 57, 67, 70; Ohara, *Japanese Trade*, 447–54; Harold Moulton, *Japan: An Economic and Financial Appraisal* (Washington, DC: Brookings Institution, 1931), 487–93; U.S. Department of Interior (DOI), *Petroleum, Mineral Resources* (Washington, DC: GPO, 1924–29); DOI, *Crude Petroleum and Petroleum Products in 1931* (Washington, DC: GPO, 1933); DOI, *Minerals Yearbooks* (Washington DC: GPO, 1934–42); Netherlands Government, *Statistiek van Den Handel en de in-en Uitvoerrechten in Nederlandsch-Indie over het Jaar, 1921–1923* (The Hague: NV Boekhandel Visser, 1925); Central Statistical Office, Netherlands East-Indies, *Statistical Abstract for the Netherlands East-Indies, 1929–1930* (Batavia: Government Printing Office, 1929–30); British Department of Overseas Trade, *Report on the Economic Situation of the Netherlands East Indies* (London: His Majesty's Stationery Office, 1929–1933); ONI reports, file e-10-d, registers 13177, 13177E, 13177F, 13177G, 13177I; file c-10-l, register 14017, RG 38; Albert Coumbe, *Petroleum Products and Trade of the Dutch East Indies*, (Washington, DC, GPO, 25 June 1923); DOC, *Trade of the United States with the World, 1920–1921* (Washington, DC: GPO, 1922), 402; “The Petroleum Situation with Special Reference to the Far East,” Anderson, *The Standard Vacuum Oil Company*, 223–27; J. Thomas Lindblad, “The Petroleum Industry in Indonesia Before the Second World War,” *Bulletin of Indonesian Economic Studies* 25, no. 2 (August 1989): 64; “Total Imports-Japan and Manchuria,” British memorandum attached to Hornbeck memorandum, 21 March 1941, box 338, folder “Petroleum,” Hornbeck Papers.

fundamental crux of political-military relations in Asia—the DEI oil resources. All interested parties understood that in any event of war, DEI resources would be seized by Japan and potentially denied seizure by force of arms of the Netherlands, Britain, and the United States.<sup>51</sup> The DEI's central position and its understanding by all relevant statesmen did not change through 1941.

Because of continued intransigence by Dutch and British authorities and a desire to demonstrate American power to all interested parties, in March 1923, the United States sent a naval squadron to the DEI with the express purpose of establishing the centrality of American naval power in everyone's deliberations.<sup>52</sup> Charles Hoover, the American Consul in Batavia, noted, “I hope that the visit of the fleet here in March will assure them [the Dutch] eventually that there is a strong power on the line of communication between Japan and these islands which, in spite of our policy of non-interference in European affairs, would undoubtedly have something to say to any attempt

<sup>51</sup> See Dr. Feuilletau de Bruyn, “Our Petroleum Industry and the International Position of Netherlands India,” in letter from Charles Hoover, American Consul, Batavia to Secretary of State, 23 September 1924, file 856d.6363/445, RG 59. Hoover noted that de Bruyn's review article was “officially inspired” and corresponded to the Netherlands' Fleet Law legislation introduced for the Volksraad session of 14 October 1924.

<sup>52</sup> See Reed, “Standard Oil in Indonesia,” 330; ONI report, from D. McD. LeBreton, Naval Attache, The Hague Netherlands to Director of Naval Intelligence, 28 March 1923, file o-1-l, register 12865A, RG38.

to seize the islands, which is what they fear.”<sup>53</sup> American efforts at political-military coercion were paralleled by an opposite desire to demonstrate commercial reliability to Japan in oil exports from the United States in order to assuage Dutch and British concerns about precipitous American trade reactions against Japan and their effect on Japanese designs on the DEI. (For the expanded U.S. percentage of Japanese oil imports post-1922, see Figure 1.) In short, consistent with Hypothesis 3, the United States increased its trade with its likely enemy Japan to build stronger investment relations with its potential allies, Britain and the Netherlands. Nonetheless, the Dutch and British remained opposed to expanded American ownership in the DEI throughout the middle 1920s. Only after the Geneva Naval Conference failed in June 1927, due to Britain’s rejection of American demands for naval parity, did progress occur on DEI oil ownership.

The prior unsuccessful effort of the United States and Standard Oil to get more DEI oil concessions by using the threat of sale to Japanese interests significantly affected the U.S.-Japan relationship in two important, related ways. First, when oil exports from the United States to Japan fell in late 1920 and 1921, the Dutch became increasingly worried about their position and helped the U.S. government to fully understand the need to appear a reliable commercial partner to Japan. U.S. commercial reliability would make Japan on the one hand and the British and Dutch on the other not worry about the consequences of decreased U.S. oil supplies to Japan (that is, greater Japanese military demand on DEI oil). The British and Dutch simply would not grant the United States significant oil ownership in the DEI without the United States assuming the role of reliable supplier to Japan from U.S. sources. This would require, of course, no undue U.S. governmental supply shocks to Japan. As supplies of U.S. oil to Japan stabilized, the Dutch were willing to expand American oil ownership in the DEI, content to cede increasing influence to American actors instead of solely British ones.

Second, to prevent Anglo-American naval competition that would also cause Japan to increase its navy, Standard Oil was given increased oil concessions in the DEI in 1928. During the passage of the Dutch law enabling this action, Japan’s ability to obtain oil from California was called into question by the U.S. Navy and in the press as it had been in 1920–21. The State Department oversaw the silencing of the U.S. Navy because it jeopardized Standard Oil’s expanded direct investment stake in the DEI and the consequent political benefits to U.S. relative power. Arthur Young, economic adviser at the State Department, noted that U.S. reliability in oil supplies to Japan was critical to gaining greater ownership in the DEI and was therefore not to be

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<sup>53</sup> Charles Hoover, American Consul at Batavia, to Secretary of State, 26 April 1923, file 856d.51/48, RG 59. This military signaling is also consistent with Hypothesis 3. The United States was beginning to exploit the insecurity of the Netherlands to divide it from Britain, thereby increasing American influence over both.

compromised by any temporary concern regarding Japan's oil trade with the United States. He stated, "The Japanese Navy can buy in the United States all the oil it wishes. We have no export restrictions. . . . Reports that the Navy Department would cancel leases were used in the Dutch Parliament against the Government which was trying to put through the Standard Oil concession."<sup>54</sup>

This statement neatly summarizes overall U.S. policy at this time and through 1941, in which the United States sought to develop as much trade with Japan as possible, particularly in items where Japan was also dependent on British-influenced sources. This was the unstated U.S. policy born of competition with Britain and motivated by a classical realist American preference to hold Japan's oil supply dependency instead of continuing to yield Britain that leverage and influence position. By increasing both its bilateral trade with Japan and direct stake in DEI resources, the United States was building its controlling influence position over all Asian oil matters and establishing the precedent of coordinated action under American primacy with the British and Dutch on oil.<sup>55</sup> In so doing, the United States secured for itself control over Japan's vital oil supply line and thus control over the trigger for war with Japan—its necessary expansion southward for DEI oil, the known effect of a U.S. oil embargo.<sup>56</sup>

This interpretation is fully consistent with classical realism Hypothesis 3 and directly contradicts Stephen Krasner's account of the same event wherein he ascribed American policy to a narrow concern for security of its own supply.<sup>57</sup> In direct contravention of structural realism, the United States was increasing the sale to Japan of its own ample supplies in order to gain a relative influence and control position over allies and adversaries. This increase

<sup>54</sup> Arthur N. Young, Economic Adviser, to Secretary of State, 2 March 1928, file 856d.6363/513, RG 59.

<sup>55</sup> U.S. oil companies' production in the DEI increased from 1 percent of total DEI production in 1921 to almost 30 percent by 1940. Consistent with Hypothesis 3, the increased oil position in the DEI expanded U.S. control over Britain and the Netherlands vis-à-vis Japan in at least two important ways. First, the United States could countenance another, and now more consequential, sale of DEI assets to Japan if Britain and Japan grew too close, causing a split between the British and the Dutch to America's benefit (prevent Anglo-Japanese realignment based on DEI oil and reluctant Dutch compliance). Second, with American companies playing a larger role in DEI output and exports, the U.S. government could use them as intermediaries with Japanese demanders, thereby forging coordination with the Dutch and British along American preferences. For the later manifestations of the resulting Anglo-American-Dutch collusion against Japan and American primacy in this policy (1940–41 trade negotiations with Japan and oil tanker removals from the Pacific in 1941), see Irvine Anderson, *The Standard-Vacuum Oil Company and United States East Asian Policy, 1933–1941* (Princeton: Princeton University Press, 1975); Shinjiro Nagaoka, "Economic Demands on the Dutch East Indies," 142–43; Feis, *The Road to Pearl Harbor*, 130.

<sup>56</sup> It is thus unsurprising that DEI oil exports to Japan and their share in overall DEI oil exports were larger in the pre-1928 deal era, with the largest peak in 1922 when DEI oil exports to Japan represented 46.7 percent of total DEI oil exports. The DEI exported similar amounts of crude and fuel oil to Japan in 1935 and 1937, but by then these represented substantially less in total DEI exports (usually no more than 10 percent of DEI oil exports) and Japanese consumption due to increased production in the DEI and consumption in Japan from largely American sources.

<sup>57</sup> Krasner, *Defending the National Interest*, 118.

in U.S. influence can not be accounted for without reference to the several controlling governmental actions: invocation of non-reciprocity provision of Mineral Leasing Act against the Dutch in 1922, naval rivalry with Britain forcing compromise in oil ownership, and diplomatic support for oil corporations regarding the DEI and elsewhere.<sup>58</sup> Even if there were no government role and the world oil cartel had still come into being in 1928, the United States would not have been the dominant oil supplier to Japan. The cartel's chief operating principle called for supply fulfillment from the geographically nearest source. In this case, that would have mandated the DEI as during the Anglo-Japanese alliance era and not the United States over one thousand five hundred miles further from Japan.<sup>59</sup>

### MAXIMIZING POSITION VIA MONETARY AND TECHNOLOGY EXCHANGES

As later events would prove valid, the United States was not inclined to yield Britain the latitude to conduct an independent policy of appeasement toward Japan, whose root material basis would likely have been DEI oil. A further arena of common interest and potential policy alignment between Britain and Japan was China. President Franklin Roosevelt sought early on in his administration to bolster China against possible Anglo-Japanese privations and the effects of the actual Japanese invasion of Manchuria and northern China in 1931–32. Three months into his first term in office in June 1933, President Roosevelt pushed through a \$50 million loan to beleaguered Nationalist China. The loan's ostensible and domestic justification was for the Chinese to purchase American cotton and wheat with the loan proceeds, bolstering U.S. farm incomes and commodity prices amidst the Depression's price collapses. However, this function could easily have been ensured through any other country's similar purchases as well as domestic governmental purchases. The available record leads to a more strategic rationale.

In his diary, Henry Morgenthau quotes President Roosevelt as having said, "Do not make the Chinese pay too quickly for this transaction and do not make the interest rates too high."<sup>60</sup> In fact, the Chinese did not pay back much of the loan proceeds at all and resold the cotton and wheat imports in order to facilitate payment for more "productive purposes," including American war planes and training programs begun in 1932 by Stanley

<sup>58</sup> Ibid.; Staley, *War and Private Investor*, 156–57; Nash, *United States Oil Policy*, 61–67.

<sup>59</sup> See sources in note 29; Gregory Nowell, *Mercantile States and the World Oil Cartel, 1900–1939* (Ithaca: Cornell University Press, 1994).

<sup>60</sup> President Franklin D. Roosevelt, Farm Credit Administration Diary, 17 May 1933, 26, Henry Morgenthau Papers, Franklin D. Roosevelt Library, Hyde Park, New York.

Hornbeck.<sup>61</sup> President Roosevelt overrode Stanley Hornbeck's and secretary of state Cordell Hull's objections to this first China loan and substantiated Henry Morgenthau's later summary of the loan's purpose in not asking the transaction to be financially viable. Consistent with Hypothesis 3, Morgenthau observed the loan's simple intent, "It would also strengthen China against Japan."<sup>62</sup> This governmental loan, meant to affect Japan's relative position in Asia, was not dissimilar from the U.S. State Department's guidance on all American bank loans to Japan from March 1922 forward and certainly would not have occurred from private U.S. banks' preferences, which were pro-Japanese. The U.S. State Department blocked several loans from U.S. banks to Japanese entities throughout the 1920s, particularly the South Manchuria Railway Company, and sought to condition Japanese expansion in so doing.<sup>63</sup>

As great power relations grew more violent and complicated across the 1930s, with each power facing at least a two front or theater strategic dilemma, President Roosevelt maneuvered the United States into a position of primacy vis-à-vis Japan and its potential suitors or appeasers—Britain, Germany, and the Soviet Union. The United States observed challenges to its position by Britain in the middle 1930s, as senior members of Britain's government sought a non-aggression pact with Japan. For example, then Chancellor of the Exchequer Neville Chamberlain offered a non-aggression pact to Japan in early 1934, reprising the Anglo-Japanese alliance.<sup>64</sup> Partly in response to this and other perceptions of rising German-Japanese joint hostility and potential British appeasement of it, the United States continued increased purchases of Japanese gold and silver under the Gold Reserve Act of January 1934 and the Silver Act of June 1934.<sup>65</sup> Despite the domestic merits and justifications for these programs, these two acts stimulated Japanese

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<sup>61</sup> See Dorothy Borg, *The United States and the Far Eastern Crisis of 1933–1938* (Cambridge, MA: Harvard University Press, 1964), 63; Arthur Young, *China's Nation-Building Effort, 1927–1937* (Stanford: Hoover Institution Press, 1971), 382–86; Guangqiu Xu, "The Eagle and the Dragon's War Wings: The United States and Chinese Military Aviation, 1929–1940" (PhD diss., University of Maryland, 1993), 116–18.

<sup>62</sup> See Henry Morgenthau, "The Morgenthau Diaries," *Collier's Weekly*, 11 October 1947, 72.

<sup>63</sup> In no way consistent with "free trade," all U.S. loans by private banks were reviewed for approval/disapproval by the State Department beginning formally in March 1922. Justifying U.S. government direction, President Coolidge himself stressed the difference between loans to Japan and the South Manchuria company, where assistance to the latter "might carry with it the implication that we endorsed what might be called the Japanese special position [in Manchuria]." President Calvin Coolidge, quoted in, Akira Iriye, *After Imperialism: The Search for a New Order in the Far East, 1921–1931* (Cambridge, MA: Harvard University Press, 1968), 185. For the direction of U.S. loans, see *Diplomatic Protection of American Investments Abroad* (New York: Foreign Policy Association, September 1928), pamphlet no. 52, 10; Herbert Feis, *The Diplomacy of the Dollar: First Era, 1919–1932* (Baltimore: Johns Hopkins Press, 1950), 7–8.

<sup>64</sup> Yoichi Kibata, "From the Manchurian Incident to Pearl Harbor," in *The History of Anglo-Japanese Relations, 1600–2000, Volume II: The Political-Diplomatic Dimension, 1931–2000*, ed. Ian Nish and Yoichi Kibata (New York: St. Martin's Press, 2000), 7–9.

<sup>65</sup> See Robert Dallek, *Franklin D. Roosevelt and American Foreign Policy, 1932–1945* (New York: Oxford University Press, 1979), 117.



military expansion against North China in an effort to extract silver and later gold for export to the United States to pay for much-needed U.S. imports.

Japan was in this position because the U.S. government ended loans to it in January 1932 and restricted Japanese dollar earnings from the United States and the Philippines with the import quotas from the June 1934 "Gentleman's Agreement" on Japanese cotton goods exports. The loan ban was upheld by the U.S. government against vociferous opposition from U.S. bankers who wanted to recognize Japan's puppet state Manchukuo and held Japan as a force for stability in Asia.<sup>66</sup> These governmental decisions reinforced Japan's trade deficits with the United States that turned the prior trade surpluses Japan enjoyed from 1922 to 1931 into the annual deficits with the United States that persisted from 1932 forward, causing Japan to search for monetary assets to pay for U.S. imports.<sup>67</sup>

If the U.S. government had not intervened in these ways to affect these trade and monetary relations, Japan might have been able to accumulate more U.S. capital from U.S. banks or use its gold and silver reserves for other more autonomy-enhancing purposes. Consistent with both Hypotheses 2 and 3, American policy undermined Japanese autonomy and kept Japan enmeshed in bilateral exchange with the United States which prevented it from more potentially beneficial exchange with others (for example, gold to Germany). In so stimulating this particular avenue of Japan's expansion, the United States was contributing to deteriorating British-Japanese relations over how to protect British-Japanese interests in China while also achieving Chinese stability. This was made evident in the failure of Lord Frederick Leith-Ross's mission to stave off Chinese financial collapse by keeping cooperative relations with Japan over China. Instead, Japan resented the British entreaties into its now-expanded sphere of influence in North China.<sup>68</sup> The result of this deterioration due to its effort to lead in Asia was that in November 1936,

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<sup>66</sup> See Joan Hoff Wilson, *American Business and Foreign Policy, 1920–1933* (Lexington: University of Kentucky Press, 1971), 232–35; Iriye, *After Imperialism*, 189; Mira Wilkins, "The Role of U.S. Business," in *Pearl Harbor as History: Japanese-American Relations, 1931–1941*, ed. Dorothy Borg and Shumpei Okamoto (New York: Columbia University Press, 1973), 353, 359.

<sup>67</sup> Because the United States managed Japan's exports to it (cotton piece goods) and Japan had devalued the Yen, Japan was running trade deficits with the United States and constantly in search of monetary assets to exchange for U.S. goods. For a recent account of this, see Edward Miller, *Bankrupting the Enemy: The U.S. Financial Siege of Japan Before Pearl Harbor* (Annapolis: Naval Institute Press, 2007). See also William Lockwood, *Trade and Trade Rivalry Between the United States and Japan* (New York: American Council Institute of Pacific Relations, 1936), 16–18, 52; Keishi Ohara, *Japanese Trade and Industry in the Meiji-Taisho Era* (Tokyo: Obunsha, 1957), 364–66. For the predominant domestic interpretation, see Dallek, *Franklin D. Roosevelt*, 93–94. For the effects of these acts on Japanese predations upon China, see Henry Douglas, "America Finances Japan's 'New Order,'" *Amerasia* 4 (March 1941): 221–24; William B. Ashbaugh, "The Yardstick of Trade: The Far Eastern Division and American-East Asian Relations" (PhD diss., Temple University, 2000), 292–300; Michael A. Barnhart, *Japan Prepares for Total War: The Search for Economic Security, 1919–1941* (Ithaca: Cornell University Press, 1987), 39–42; M.A. Aziz, *Japan's Colonialism and Indonesia* (The Hague: Martinus Nijhoff, 1955), 41.

<sup>68</sup> See Kibata, "From the Manchurian Incident to Pearl Harbor," 11.

Japan listed Britain for the first time as a potential enemy in its "Plan for Imperial Defence."<sup>69</sup>

After the Japanese were betrayed by their German partner in the Nazi-Soviet Non-Aggression Pact, allowing the Russians to defeat the Japanese at Nomonhan and temporarily solve Germany's and Russia's two-front war predicaments, Japan's trade with Germany in technology and specialty materials dried up, and Japan sought increased trade with the United States in these areas (specialty steel tubing for synthetic oil refineries, molybdenum for hardening aircraft frames and machine tools). Previously and dating back to the early post-Washington Conference period, the United States became a significant supplier within Japan's oil and specialty steel industries.<sup>70</sup> The United States was the most important foreign player in Japan's oil refinery and related specialty steel sector, but it had to contend with the competitive entry by Germany beginning in late 1935. Germany began supplying Japan with synthetic oil technologies despite a conclusion by its war ministry's military-economic section director that Japan lacked the ability to secure its military-industrial base from debilitating sanctions.<sup>71</sup> Consistent with Hypothesis 3, the United States competed with Germany in supplying Japan refinery parts for synthetic oil facilities as well as conventional ones until an Office of Naval Intelligence (ONI) assessment following the outbreak of the European war was completed in December 1939. This ONI report concluded that Germany had severed its trade in these crucial areas since the war began, and Japan was now solely vulnerable to U.S. actions.<sup>72</sup>

Upon receipt of this information, President Roosevelt ordered several cessations in U.S.-Japanese exchange, which crippled Japan's search for oil autonomy, despite maintaining the actual export of declining amounts of

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<sup>69</sup> Ibid., 12; Borg, *United States and the Far Eastern Crisis*, 136–37. Japanese resentment at efforts to affect Chinese stability was finally beginning to be directed at Britain instead of the United States only. Ian Nish summarizes the paradoxical results of British policy: "It was, of course, a strange irony that the Leith-Ross mission—in some ways the brainchild of the Chamberlain-Fisher circle, which might be described as 'pro-Japanese'—was widely regarded in Tokyo as an example of confrontation." Ian Nish, "Anglo-Japanese Alienation Revisited," in *From Pearl Harbor to Hiroshima: The Second World War in Asia and the Pacific, 1941–45*, ed. Saki Dockrill (New York: St. Martin's Press, 1992), 18.

<sup>70</sup> The U.S. position within Japan's oil sector typifies this as most of Japan's refineries and synthetic oil plants were based on U.S. imports and engineering talent. See USSBS, *Oil in Japan's War, Final Report No. 51* (Washington, DC: GPO, February 1946), 23; Albert Coumbe, U.S. Department of Commerce, "Petroleum in Japan," *Trade Information Bulletin No. 245* (Washington, DC: GPO, 1924); Homer Fox, U.S. Department of Commerce, "World Trade in Gasoline," *Trade Promotion Series No. 20* (Washington, DC: GPO, 1925), 59.

<sup>71</sup> See John Chapman, "The Have-Nots Go To War: The Economic and Technological Basis of the German Alliance with Japan," in *The Tripartite Pact of 1940: Japan, Germany and Italy*, ed. Ian Nish (London: London School of Economics, International Studies Center, 1984), 28–29.

<sup>72</sup> See report from the Naval Attache at Tokyo, 7 December 1939, file o-1-g, register 12417A, RG 38. Germany's decision not to supply Japan any further was based primarily on Germany's own need for the machine tools and equipment, but Premier General Abe's desire not to affiliate too closely with Berlin after the betrayal of the Nazi-Soviet pact played a role in this. See Williamson Murray, *The Change in the European Balance of Power*, (Princeton: Princeton University Press, 1984), 256–59.

crude and some finished products (for example, aviation gasoline).<sup>73</sup> The following examples are all decisive government actions that are consistent with classical realism and yielded significant relative power advantages to the United States. First, and most visibly, the United States recalled all American oil engineers and other related technical personnel from Japan.<sup>74</sup> Second, on 20 December 1939, the State Department firmed up its prior July 1938 “moral” embargo on aviation products to a full and final embargo on “plans, plants, manufacturing rights or technical information required for the production of high quality aviation gasoline.”<sup>75</sup> As a result, Japan lost the much-needed assistance to its potential long-term autonomy in military and power projection capabilities from both Germany and the United States.<sup>76</sup> Japan’s inability to secure oil autonomy at home based on synthetic oil or through reliable crude and refined products from the United States caused Japan to focus increasingly on securing the DEI oil resources necessary to the future of any protracted war with either the Soviet Union or the United States or worse, both. More pointedly, Japan’s long-standing effort at synthetic oil from coal failed in extremis due to the cessation of this exchange with the United States at this point. In contrast to Germany’s synthetic fuels program and consistent with Hypothesis 2, Japan’s was a dramatic failure that consumed much needed capital and other resources.<sup>77</sup> The postwar Strategic Bombing Survey summarized the effects of Japan’s synthetic program best: “Strategically, the contribution of Japan’s synthetic oil industry to the war may be regarded as negative. The manpower and materials expended on it certainly impeded the national war effort more than the synthetic oil production aided it.”<sup>78</sup>

<sup>73</sup> U.S. crude and fuel oil exports peaked in 1938 at 21.2 million forty-two gallon barrels and declined precipitously thereafter, with 16.1 million barrels in 1939, 11.5 million barrels in 1940 and only 5.2 million in 1941. For critical assessments of the temerity in U.S. export limits, see Jonathan Utley, *Going to War with Japan, 1937–1941* (Knoxville: University of Tennessee Press, 1985), 100; Feis, *The Road to Pearl Harbor*, 88, note 1.

<sup>74</sup> John Masland, “Commercial Influence upon American Far Eastern Policy, 1937–1941,” *Pacific Historical Review* 11 (September 1942): 290; Barnhart, *Japan Prepares for Total War*, 181.

<sup>75</sup> For the official text, see U.S. State Department, *Foreign Relations, Japan: 1931–1941*, vol. 2 (Washington, DC: GPO, 1943), 203–04.

<sup>76</sup> Consistent with Hypothesis 2, significant Japanese investment in several conventional refining projects based on U.S. technology and parts went fallow at this point because, among other deficiencies, “furnace tubes and hot oil pumps could not be obtained.” See USSBS, *Oil in Japan’s War*, 25.

<sup>77</sup> Germany’s program led the world with synthetic fuel production, accounting for 60 percent of Germany’s consumption of liquid fuels and supplying 95 percent of Germany’s base aviation fuel needs during the war. See Raymond Stokes, “The Oil Industry in Nazi Germany, 1936–1945,” *Business History Review* 59, no. 2 (Summer 1985): 254–77; Raymond Stokes, *Opting for Oil* (Cambridge: Cambridge University Press, 1994), 14–39; Kudo Akira, *Japanese-German Business Relations: Cooperation and Rivalry in the Inter-War Period*, (London: Routledge, 1998), 130–47.

<sup>78</sup> USSBS, *Oil in Japan’s War*, 42.

## Endgame

Despite these crucial stoppages in U.S. exchange with Japan, Stanley Hornbeck was interested in restarting the aviation and refinery assistance to Japan in order to inflict even greater negative adjustment costs upon Japan when the exchange would eventually cease. In December 1940, Hornbeck lobbied for repeal of the aviation gasoline refinery construction embargo. Instead, the United States should allow the building of the expensive plants but withhold "the catalytic agents which go into the production of aviation gasoline and thus render the plants practically valueless to the Japanese." Hornbeck recommended this approach because it feigned cooperation, forestalling Japanese aggression southward, and would earn back large amounts of Japan's dwindling dollar holdings without actually letting the Japanese acquire aviation gas that they were then purchasing and stockpiling.<sup>79</sup> By early 1941, President Roosevelt was not interested in restarting closed exchange areas with Japan and was intent rather on coordinating joint war-planning strategy with Britain, albeit under American dominance. This desire and Prime Minister Churchill's reluctant acceptance of American leadership in joint planning and force deployments led to the ABC-1 Agreement of March 1941.<sup>80</sup>

After Japan signed a neutrality agreement with the Soviet Union in April 1941, which restored some small oil supplies from North Sakhalin island to Japan, the United States waited patiently for the remaining great powers to play their hands. The apparent conundrum of American intent in the oil embargo of Japan begun in late July 1941 is more understandable when one considers the benefit of the American position holding Japan's oil dependency and the objective of delaying U.S. entry into the war.<sup>81</sup> After the German attack upon the Soviet Union on 22 June 1941, President Roosevelt waited and observed the internal Japanese debate as to "which way they are going to jump." Would Japan move north against the Soviet Union in league with Germany or south against the DEI and Anglo-Dutch and American forces?<sup>82</sup>

<sup>79</sup> See Hornbeck, memorandum, 28 December 1940, box 338, folder "Petroleum," Hornbeck Papers.

<sup>80</sup> See James Leutze, *Bargaining for Supremacy: Anglo-American Naval Collaboration, 1937-1941* (Chapel Hill: University of North Carolina Press, 1977).

<sup>81</sup> The various arguments regarding the embargo are as follows: that it was the machinations of administration hawks, not the president (Utley, Anderson); that it shielded the Soviet Union from a joint German-Japanese attack by orienting Japan south (Heinrichs); and that once begun for whatever reason, Roosevelt would not walk away from it due to "fear" of domestic opinion (Sagan). See Dallek, *Franklin D. Roosevelt*, 275; Utley, *Going to War with Japan*, 155-56; Jonathan Utley, "Upstairs, Downstairs at Foggy Bottom: Oil Exports and Japan, 1940-41," *Prologue* 8, no. 1 (Spring 1976): 17-28; Anderson, *The Standard-Vacuum Oil Company*, 177-78; Waldo Heinrichs, *Threshold of War: Franklin D. Roosevelt and American Entry into World War II* (New York: Oxford University Press, 1988), 176-77; Waldo Heinrichs, "The Russian Factor in Japanese-American Relations, 1941," in *Pearl Harbor Reexamined: Prologue to the Pacific War*, ed. Hilary Conroy and Harry Wray (Honolulu: University of Hawaii Press, 1990), 163-77; Scott Sagan, "The Origins of the Pacific War," in *The Origins and Prevention of Major Wars*, ed. Robert Rotberg and Theodore Rabb (New York: Cambridge University Press, 1989), 336.

<sup>82</sup> President Roosevelt to Harold Ickes, 1 July 1941, quoted in Dallek, *Franklin D. Roosevelt*, 273.

Only after it became clear Japan would honor its neutrality deal with the Soviets and move south, did Roosevelt institute the new and purposefully obtuse bureaucratic procedures for future Japanese imports from the United States.<sup>83</sup>

Three days after Japan occupied southern Indochina, on 24 July 1941, the president publicly declared the U.S. policy of freezing Japanese funds and placing all future trade under a complicated joint Treasury-State Department program under Treasury Secretary Henry Morgenthau's primary control, not the liberal Cordell Hull at State. Roosevelt ordered his close friend and confidant undersecretary of state Sumner Welles to revoke all existing licenses for oil exports to Japan. This forced any oil trade aspirant to reapply under the new framework, which was opaque, staffed by economic warfare advocates and first directed by Welles not to act on any Japanese applications for "a week or so."<sup>84</sup> This delay in early August was a permanent bureaucratic briar patch. No oil exports or any other traded items left the United States or the DEI for Japan after 5 August 1941, because Britain and the Netherlands followed suit in freezing Japanese finances and in ending the oil trade from the DEI. These friends acted in concert with the United States at this time because the United States successfully maneuvered them into a cooperative yet submissive role beginning in the 1920s based on the United States holding Japan's vital oil supply line and consequent trigger for war. The fact that the United States concealed its embargo of Japan through bureaucratic obfuscation does not imply lack of purpose.<sup>85</sup>

The Roosevelt administration's use of an opaque embargo sought to delay the well-known effects of Japan's reaction to a fully understood and publicly declared oil and trade embargo. Delay was imperative and strategically necessary in order to draw down Japanese oil reserves as much as possible and build up the American military position before the outbreak of actual hostilities.<sup>86</sup> Consistent with Hypothesis 2, every month of delayed exchange would mean less war-fighting capability for Japan in the coming conflict, which both sides viewed as likely to be long and determined by

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<sup>83</sup> This obvious chronology challenges the general thrust of Heinrichs' argument that the embargo helped impel the Japanese south and was so intended. If this were the intent, why wait for Japan to choose first? If Japan had instead attacked north in league with Germany against the Soviets, the United States could then also have cut off its oil and further divided its forces to America's strategic advantage. This remains as conjectural as Heinrichs' argument.

<sup>84</sup> Wolthus, "United States Foreign Policy towards the Netherlands Indies," 219; Utley, *Going to War with Japan*, 217–18, note 42.

<sup>85</sup> Recently, Marc Trachtenberg has agreed with this assessment. See Marc Trachtenberg, "Preventive War and U.S. Foreign Policy," *Security Studies* 16, no. 1 (January–March 2007): 23–25.

<sup>86</sup> After finally reading various MAGIC decrypts detailing Japan's southern advance plans despite diplomatic overtures, even Secretary of State Hull stated, "I just don't want us to take for granted a single word they [Japan] say, but to appear to do so to what ever extent it may *satisfy our purpose to delay further action by them.*" Cordell Hull to Sumner Welles, 4 August 1941, quoted in Blum, *From the Morgenthau Diaries: Years of Urgency*, 380 (emphasis added).

material resources.<sup>87</sup> U.S. officials were driven by the logic of delaying Japan's requests for as long as possible while appearing willing to negotiate. After Roosevelt and Churchill met in early August 1941, Churchill summarized the "President's idea . . . to [continue to] negotiate . . . and thus procure a moratorium of, say, thirty days in which we may improve our position. . . . He will also maintain in full force the economic measures directed against Japan. These negotiations show little chance of succeeding, but President considers that a month gained will be valuable."<sup>88</sup>

For its part, Japan was neither "irrational," nor "hasty" in responding to American economic coercion by force of arms at Pearl Harbor.<sup>89</sup> In fact, Japan waited more than four months after the embargo before terminating negotiations and attacking the United States. Just before this, the Japanese sent yet another proposal for a "required quantity of oil" and cooperation over the DEI's resources, which the United States met with its infamous "ultimatum" of 26 November 1941.<sup>90</sup> Even prior to this last diplomatic exchange, Stanley Hornbeck summarized the exasperation on the U.S. side.<sup>91</sup> On 18 November 1941, he wrote, "We have had on occasion to note mention by the Japanese of their 'last proposal,' 'final proposal,' and 'last final proposal'; now, we note mention of an 'absolutely final proposal.'"<sup>92</sup> The Japanese attacked the United States to preserve some hope of future economic and military autonomy in the face of their economic dependence on the United States, which was

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<sup>87</sup> This was clear to all the great powers at the end of WWI as well. In contrast to Peter Liberman's contention that Japan drew the wrong conclusions from WWI, Japan drew the correct conclusions regarding the necessities of economic and military autonomy. Japan simply failed in its bid for them diplomatically in the 1920s and then militarily in the 1930s and WWII. See Peter Liberman, "The Offense-Defense Balance, Interdependence and War," in *Power and the Purse: Economic Statecraft, Interdependence and National Security*, ed. Edward Mansfield et al. (Portland: Frank Cass, 2000), 82–86.

<sup>88</sup> Churchill to Foreign Secretary Anthony Eden, 11 August 1941, quoted in Anderson, *The Standard-Vacuum Oil Company*, 190.

<sup>89</sup> The irrationality assertion is ubiquitous among American political scientists and disregards the fact that Japan did not wage an irrational campaign against all enemies; it kept the peace with the Soviets and fought an expanded war against Anglo-American forces only, with whom it had rough parity in existing forces in 1941. This is not to say that Japan entertained delusions of victory, merely that when the matter is one of economic coercion and affronts to national honor, prestige, and autonomy, war often results. On Japan's haste in attacking the United States, see Stephen Van Evera, *The Causes of War: Power and the Roots of Conflict* (Ithaca: Cornell University Press, 1999), 91–92.

<sup>90</sup> The Japanese made no specific mention of any other traded items such as scrap iron, steel, or cotton in their proposal, highlighting the core of the relationship yet again. For the Japanese offer, see Japanese government Plan B text, reproduced in Akira Iriye, *Pearl Harbor and the Coming of the Pacific War* (Boston: St. Martin's, 1999), 40. Section 2, article 3 of the U.S. State Department counter-note of 26 November 1940 stated, "The Government of Japan will withdraw all military, naval, air and police forces from China and from Indochina." See text of note in Iriye, *Pearl Harbor and the Coming of the Pacific War*, 69–77. Arguably, this meant withdrawing from all positions Japan had achieved since the Manchurian invasion, a settlement against which Japan was determined to fight.

<sup>91</sup> Arguably, Roosevelt had been maneuvering to get the United States into the war as evidenced by the Greer incident in September 1941. See Heinrichs, *Threshold of War*, 166–79.

<sup>92</sup> See Hornbeck note, 18 November 1941, box 533, folder "Intercepted Japanese Telegrams and Notes," Hornbeck Papers.

purposefully created by the United States and based primarily on oil from the middle 1920s forward. The United States had the luxury of holding the “noose” of an economic embargo around its enemy’s neck because it built a controlling position over both its friends Britain and the Netherlands and its dependent enemy Japan in the 1920s.

The United States used this position when and only when it suited the U.S. strategic self-interest in maximizing its relative power. The result of Japan’s prewar failure to achieve economic and military autonomy, particularly in oil—either through synthetic partnership with Germany or secure ownership and trade with the DEI or the United States—was catastrophic. Japan’s wartime oil-based economy failed due to over-invested plant and equipment based on American supplies and technology and the military inability to secure the DEI-Japan line of communication. Japan’s forces were crippled as a result, and many had operational radii reduced by the fuel shortages to a defeat-inducing level as early as 1943.<sup>93</sup>

## CONCLUSION

Much of the extant literature on economic and dependency analysis fails to assess the deeper strategic purposes of bilateral trade within multipolar environments and the potential opportunity costs to state autonomy that inhere in any exchange. Evaluating the degree of these costs requires assessment of decisions that surround and reinforce a given vulnerability, including a state’s actions or its corporations’ with respect to alternative partner countries and exchange in items that affect the vulnerability induced by other items. Assessing these interaction effects is critical to understanding changes in a rival’s dependence and, in the final analysis, on the political relations among a state, its rivals, and potential allies. For example, from 1936 to 1941, the United States exported to Japan crude oil and related refining equipment but not viable synthetic technology for coal liquefaction into oil. This reinforced the dependence of Japan’s domestic production base on imported crude oil through the import across two exchanged items and one non-exchanged item. Japan’s oil import reliance on the United States in 1936 was roughly the same as in 1941 (81.6 percent in 1936 and 82.1 percent in 1941), and therefore it alone would not capture this increase in Japanese dependence and lost opportunities for autonomy.

Even if quantitative approaches assessed critical trade items like oil, they would still miss the political importance of related trade and non-traded items to changes in a country’s dependence. This is, of course, starker when the necessary analyses of third-country exchange effects and relations are taken into consideration. When Germany fell out as a potential partner to

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<sup>93</sup> See Yergin, *The Prize*, 351–67; conclusions in USSBS, *Oil in Japan’s War*.

Japan's synthetic program and search for oil autonomy, the United States acted decisively to reinforce Japan's vulnerability, much like it had in the early 1920s vis-à-vis Britain's alliance with Japan and oil flows thereunder from the DEI. Over the course of the interwar period, U.S. leaders consistently sought paramount influence over all of these other actors. Due to the United States' dominant position in oil, technology, and finance, U.S. statesmen were able to keep friends close and enemies closer still until that time when they chose to exercise America's economic power to its wartime advantage.

Structural approaches have had a difficult time accounting for U.S.-Japan interwar exchange, Japan's alleged relative gains vis-à-vis the United States, as well as current U.S.-China exchange. This article makes clear that Japan did not gain in exchange with the United States, rather it lost its position, empire, and bid for regional hegemony. From the beginning of the interwar period to the end, U.S. statesmen used economic exchange to condition Japanese behavior, isolate Japan from Britain, isolate Britain from the Netherlands, bolster China, and render necessary Japanese energy investment of negative value in wartime. This article illuminates the utility of and need for realists to have their own operating assumptions and propositions regarding the purpose and effects of exchange. Simply put, realists should not embed liberal exchange assumptions within their works, particularly when these fail to explain much observable interaction among rivalrous states. All U.S. government efforts in the interwar period redounded to Japan's decline relative to the United States. As the earlier formulation of classical realist exchange theory explains, states trade with their enemies and allies alike for the consistent purpose of maximizing their relative power position. Multipolarity does not alter this; it merely increases the incentive to trade with enemies and allies. American ascendancy to global dominance in WWII was not merely the product of superior material capabilities; it took exceptional statesmanship to use these properly to advance America's position during peace and war.

A standard critique of the foregoing explanation argues that America was somewhat irrational and self-defeating, or at least ineffective, in its exchange with Japan, particularly in maintaining the exchange after it became clear that the U.S. would likely go to war with Japan.<sup>94</sup> According to this argument, the United States should have denied the benefits of American trade to Japan earlier than July 1941. This position fails, however, to consider the known consequences of an American trade embargo on Japan—Japanese attack on U.S.-British-Dutch forces to gain secure DEI line of communication—and the global strategic environment in which U.S. policy was made. Because a trade embargo would cause Japan to seize the DEI, President Roosevelt was not interested in inciting U.S. entry into the war prematurely. Prior to March 1941,

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<sup>94</sup> Anonymous reviewer no. 3 and Peter Liberman make the point that structural realism's relative gains logic does not account very well for continued U.S. supply to Japan. See Liberman, "Trading with the Enemy," 173.



the Germans had not played their hand vis-à-vis the Soviet Union, Britain was not strategically aligned under the United States, and the U.S. naval program for a dominant two-ocean navy was only nine months old. To have begun the war prior to these processes developing more fully would not have served American grand strategy of winning the global war as envisioned in the “Rainbow” war plans.

The further applicability of classical realist exchange theory from this supporting interwar case appears promising. For example, from a classical realist perspective, contemporary U.S.-China economic “interdependence” is as much a product of each state’s desire for leverage over the other as it is for economic growth. At present, China is not dependent on the United States for energy.<sup>95</sup> China is, however, reliant on the U.S. consumer market to absorb 30–40 percent of its annual exports, which represent approximately 11 percent of its GDP and significant domestic Chinese employment. U.S. exports to China are trivial to U.S. GDP, but the increase in U.S. Treasury debt held by China from \$17.2 billion and a negligible percentage of the total in 1994 to \$467 billion and 13.5 percent of total marketable U.S. Treasuries as of June 2007 represents some potential leverage for China.<sup>96</sup>

As with any assessment of relative power, the ability to substitute for a given exchange activity and the costs of cessation require careful evaluation (who will lose more?). American leverage vis-à-vis China resides in the U.S. consumer market and the capacity to issue so much debt that China’s increasing purchases do not yield the ability to influence America with any unilateral action, such as dumping U.S. Treasuries. Some scholars conclude that America’s leverage through debt and consumption is as important as that formerly had through production and capital exports, yielding America “sticky” power over China and a disincentive for China to prompt a cessation of exchange, causing, in effect, a mutually assured depression.<sup>97</sup> For classical realists, consumer market power is a “wasting asset” and debt has limited utility in generating relative power.<sup>98</sup> The large and asymmetrical trade relationship between the United States and China appears to yield the United

<sup>95</sup> In fact, despite American protestations against China’s direct ownership strategy, Chinese energy diversification in terms of country suppliers is impressive. Long-term deals with Iran, Saudi Arabia, Kazakhstan, Venezuela and now Iraq among others presage continued autonomous Chinese energy-related development. For arguments that Chinese energy security efforts are irrational or mercantilist, see Rawi Abdelal and Adam Segal, “Has Globalization Passed its Peak?” *Foreign Affairs* 86, no. 1 (January/February 2007); David Sanger, “China’s Rising Need for Oil is High on US Agenda,” *New York Times*, 19 April 2006.

<sup>96</sup> Data are from 2006 U.S. Census Bureau’s Foreign Trade Division, World Bank GDP data and the U.S. Treasury’s *Report on Foreign Portfolio Holdings of U.S. Securities as of 30 June 2007* (April 2008), 8, 10, <http://www.treas.gov/tic/shl2007r.pdf>. China’s holdings of U.S. government agency debt have also grown dramatically (from .02 percent of total in 1994 to 6.2 percent June 2007); this raises questions of U.S. housing market vulnerability to potential Chinese actions.

<sup>97</sup> See Walter Mead, “America’s Sticky Power,” *Foreign Policy* 141 (March/April 2004): 52.

<sup>98</sup> E.H. Carr noted the withering utility of consumer market demand. Edward Hallett Carr, *The Twenty Years’ Crisis, 1919–1939* (New York: Harper & Row, 1964), 128. Alexander Hamilton held, “the debt too may be swelled to such a size, as that the greatest part of it may cease to be useful as a Capital, serving only

States some Hirschmanesque influence at present. But, the ability of China to substitute for it, both in its internal and export markets, is potentially greater than the U.S. ability to find alternate purchasers of the ever-increasing, low-yield U.S. debt.<sup>99</sup>

Consistent with Hypothesis 3, the United States may be trading deeply with China today to forestall China's more rapid absorption of its Asian neighbors into economic and strategic condominium. For example, Japan and China became each other's largest trading partner in 2004 and remain so. James Hoge notes the classical hub and spoke logic of this. "Even worse, from the American perspective, would be if China and Japan were to seek a strategic alliance between themselves rather than parallel relations with the United States."<sup>100</sup> The more important assessment of U.S. intent in the China exchange and whether it comports more with realism, liberalism, or even Marxism, awaits further research. As with the U.S.-Japan interwar case, proper evaluation of the intent and effects of exchange requires extensive primary research of both government and corporate actors. The three hypotheses offered earlier are each viable research guides for evaluating the strategic utility of exchange among states, whether rivals or allies. As ever before, classical realism offers the broadest template for understanding the important class of great power rival cases and will likely prove as beneficial in explaining cases of great power allies and others where dependency is easier to foster.

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to pamper the dissipation of idle and dissolute individuals: as that the sums required to pay the Interest upon it may become oppressive, and beyond the means, which a government can employ, consistently with its tranquility, to raise them; as that the resources of taxation, to face the debt, may have been strained too far to admit of extensions adequate to exigencies which regard the public safety. Where this critical point is, cannot be pronounced, but it is impossible to believe, that there is not such a point." Alexander Hamilton, "Report on Manufactures," in *The Papers of Alexander Hamilton*, vol. 10 (New York: Columbia University Press, 1966), 282. Total U.S. debt "outstanding" (that held by households, corporations, government at all levels, etc.) as a percentage of GDP has increased from 142 percent of U.S. GDP in 1980 to 230 percent at year-end 2007. Data available at <http://www.federalreserve.gov/releases/z1/current/z1r-2.pdf>.

<sup>99</sup> For China's growing export diversification, see Keith Bradsher, "China Leans Less on U.S. Trade," *New York Times*, 18 April 2007.

<sup>100</sup> James Hoge, "A Global Power Shift in the Making—Is the United States Ready," *Foreign Affairs* 83, no. 4 (July/August 2004): 5. Hypothesis 1 may also have explanatory validity as, among other events, the unresolved story regarding former Chinese president Zemin's Boeing plane containing satellite-operated listening devices suggests. See James Kynge, "China Claims Spy Bugs Found on President's Jet," *Financial Times*, 19 January 2002; Stephen Fidler and James Kynge, "US and China Try to Limit Spy Device Damage," *Financial Times*, 21 January 2002; BBC coverage available at <http://news.bbc.co.uk/1/hi/world/asia-pacific/1769642.stm>.