

# TAXATION AND CAPITAL ACCUMULATION

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One of Japan's most difficult problems is to stabilize her national economy without foreign assistance as was given during the occupation period, and without procurement demands as were offered during the War in Korea. Strenuous efforts will be needed before we can provide a desirable level of economic prosperity to Japan's eighty-six million inhabitants who dwell in a restricted mountainous territory of only 142,000 square miles.

Among other things, it is urgently necessary to make a substantial improvement in productive powers so that we may be able to lower costs of production and thereby compete favourably with foreign countries on the world market. We have not enough efficient capital equipment to remove obstacles standing in the way of any attempt in this direction. Many economists and politicians alike are now discussing means of fostering the accumulation of necessary capital, urging that this accumulation is an essential prerequisite to a successful stabilization of Japan's economy.

Under these circumstances, it is only natural that tax reform should become a serious issue. The present system of taxation contrived in accordance with the Shoup Recommendations has been alleged to be injurious to both willingness and ability to save. As a result the tax reform bills are now under debate in the present session of the Diet, which was given a complete restoration of its legislative power after the ratification of the Peace Treaty concluded in 1951 in San Francisco.

As will be shown later in this article, the Government has, to a considerable extent, complied with wishes and demands vigorously put forward by business circles for tax cuts; and both houses of the Diet are expected to pass the tax reform bills without fail by the middle of August, 1953.

This article intends to examine the recent development of the tax reform movement in favour of an easier accumulation of capital. Before entering into details, I think it is necessary to make a brief preliminary survey of opinions on the nature and significance of capital in its bearing on taxes and public spending.

## I. *General Considerations*

It goes without saying that taxpayers always pay their taxes with some abhorrence, regarding them as injurious to capital accumulation.

Taxes are no doubt a portion of social products placed under the disposal of a government, and are always paid either from the capital or from the revenues of a country. Thus, the lower they are, the better the taxes are. This adverse feeling against taxes is, to some extent, unchangeable. Taxpayers may well be said to demand "cheap government" in every case.

It was not until the middle of the eighteenth century, however, that the idea of "cheap government" began to be considered by the ruling class. Before Adam Smith, the maxim "not to impose heavy taxes" had been much more of a moral or political nature than an economic, objective necessity.

For example, political economists, if any, before Adam Smith or the Physiocrats, were apt to insist upon the doctrine that public expenditure usually provides a great stimulus to industry and commerce. They maintained that public spending would not only make "omnipotent" government activities possible, but would increase the velocity of money circulation, and thereby would bring about general briskness on commodity markets. The possible adverse effects of taxation would be alleviated to that extent.

Among the writers of the period of Mercantilism, there were even those who compared taxes to seasonable rains, saying that taxes are collected from a great majority of the people just as calmly as watery vapour is volatilized by sunshine from all parts of the soil, and are used for public purposes just as effectually as rains are used for cultivation.

In addition, many prominent economists before Adam Smith made it a rule to lay stress upon the bright side of taxation, asserting that a tax upon individuals or consumable goods would necessarily stimulate the "diligence and assiduity" of the working class.

Vigorously opposing these arguments, the Physiocrats and, subsequently, the English classical school of economics emphasized the harmfulness of government intervention to economic prosperity and opulence of a country. According to Adam Smith, public spending maintains unproductive, though useful, labourers such as soldiers, officials etc., and public investment, if any, would lead to a disastrous misconduct or waste of national resources. In his view, taxes, too, impede the natural functioning of a "system of natural liberty", i.e., free competitive price-mechanisms, giving rise numerous clashes between tax authorities and taxpayers, and hindering capital from flowing into the most profitable branches of industry. In short, taxes not only deprive individuals of so much revenue or capital, but also impose burdens not to be measured in terms of money—toil and trouble.<sup>1</sup>

Also, David Ricardo was of the same opinion. He said that there were no taxes which have not a tendency to lessen the power to accumulate; and that all taxes had to either fall on capital or revenue.<sup>2</sup>

<sup>1</sup> Adam Smith, *Wealth of Nations*, BK. V. chap. 1.

<sup>2</sup> David Ricardo, *Principles of Political Economy and Taxation*, chap. VIII.

Along the same line, J. B. Say asserted: *Le meilleur de tous les plans de finance est dépenser peu, et le meilleur de tous les impôts est le plus petit.*<sup>3</sup>

Smith's doctrine seems to contain an undeniable truth even now. Generally speaking, public expenditure is, in itself, of an unproductive nature. But we should take account of the fact that Smith lived in an age of restrictions in which the most urging task was to remove the many obstacles to effectual industrial activity of the growing number of "self-made" wealthy people. The whole body of Smith's theory is based upon the assumptions that there is no idle money which is laid aside of investment for any appreciable length of time, and that there is no government that knows what the most profitable industry into which to invest public funds is. If these assumptions are no longer valid, we are required to make some fundamental revisions in the theory of the classical school.

In recent economic analysis, there has been growing recognition that savings (exactly speaking, expected savings) do not always run parallel to investment (exactly speaking, expected investment), and if the volume of private investment falls short of the amount of income not spent on consumption, there will be a deflationary tendency in the national economy as a whole, and money capital, however large it may be, will be useless. In this case, savings may be said to be a matter of anxiety instead of congratulation.

Under the influence of J. M. Keynes, the theory of fiscal policy has recently been greatly developed. What is noteworthy here is that the recent theory bears much resemblance to the mercantilistic doctrine in that more attention is paid to consumption and spending, whether private or public. The income-creating effects of expenditure have now been recognized again as a more decisive factor in overcoming economic depressions. To that extent, state intervention or government control over economic activities has also been approved. The active antagonism expressed by the classical school of economics against public borrowing, too, has thus largely been neutralized by the recognition that increased expenditure will give significant stimulus to new investment.

Some prominent writers are now trying to show that a balanced budget with a greater scale alone may fill the investment-saving gap.<sup>4</sup> Thus, if the argument be proved to conform to reality, taxes may possibly be exalted again to the higher place that was given them by the Mercantilists.

Now that I have shown three different opinions on the nature and significance of capital accumulation in its bearing on taxation and public spending, let us consider the validity of each opinion.

I believe that each opinion has its own extent of force according to

<sup>3</sup> J. B. Say, *Economie Politique*, Vol. II, p. 298.

<sup>4</sup> Trygve Haavelmo, "Multiplier Effects of a Balanced Budget", *Econometrica*, Vol. 13, October, 1945.

the varying circumstances. Each of the three doctrines on a whole corresponds to a particular stage of economic development.

Recollecting that there were an overwhelmingly large number of uneducated people always adhering to old customs and constantly resisting any changes in a mode of traditional life, it had to be unavoidable that enlightened politicians should awake people to secular riches and powers by dint of political regulations. Economic history proves the truth of this view to an important degree. In spite of Smith's refutations, the mercantilistic activities had produced a very favourable, progressive influence upon the economic development of the European countries before modern capitalism was set up on a solid foundation. Government regulation of trade and industry made a substantial contribution to paving the way to a modern efficient economic system, putting aside the medieval residuum such as the guild and manor systems which existed in a stagnant, traditional atmosphere.

Taxes, as distinguished from those feudalistic burdens which were levied upon serfdom, had an incentive effect on free labourers. Self-satisfied household economy was dissolved by taxation to a not insignificant degree.

When market production had once been thoroughly established, the interest of manufacturing industry surpassed that of merchants. The more the system of natural liberty matured, the less state regulation was needed. Stress was naturally to be laid on the dismal side of Mercantilism; narrow nationalistic, militaristic measures originally inherent in mercantilistic policy were condemned. It was undoubtedly true that despotic financial policy many times produced economic disorders and national disasters. It was largely due to the remarkable development of capitalism in the nineteenth century in Europe and in the new world that the theory of the classical school of economics became predominant.

In spite of the fact that, whenever markets became depressed and unemployment grew serious, we did hear bitter complaints against a shortage of demand, the general plea was not raised for government action against depression and unemployment, whether by means of increasing public spending or by direct regulation until the world economic crisis of the year 1929. On account of the subsequent world-wide economic depression, the ending of which no one could guess, accompanied by unemployment to a degree unprecedented in history, firm belief in the system of natural liberty was greatly threatened, and this led to a fundamental revision of the classical theory. The virtual cause of depressions has come to be found not in capital shortage, but in over-accumulation of capital.

If this reasoning is correct, the validity of the three opinions should be carefully judged according to the real circumstances of a particular economy.

There must still be a country where a lack of self-made wealthy, efficient people makes it difficult to attain economic development without authoritative regulations contrived by a small number of selected political economists.

There must be still more countries where the cause of unsatisfactory development of economy should be found not in over-accumulation, but in general shortage of capital.

In a less advanced and less matured economy, reckless money expansion caused by an enlarged budget would produce the adverse effect of raising prices without increasing real products. Of course, no country exists unconnected with the rest of the world. In this sense we cannot imagine a country where no theory but the classical economic one can be adopted to its full extent. But we should remember that the assumption that government expenditure is, on the whole, of an unproductive nature, is applicable with special force to the less advanced economy of Japan. Public spending is, in such a case, likely to produce a resource-exhausting effect rather than an income-creating effect upon the national economy.

The theory of fiscal policy which developed under the sway of the Keynesian doctrine is to be more relevantly applied to a rich and matured economy in which further progress seems to be restrained owing to the lack of market potential enough to digest a huge amount of products.

It seems to me that the theory of fiscal policy chiefly attends to the quantitative aspect of the issue, making little difference between government spending and private. It appears not to pay sufficient attention to the question of whether the increase in national income is caused by public spending or private. This shortcoming, negligible in a wealthy country, may cause a grave problem in a less wealthy, less matured economy. If we are to do justice to the qualitative aspect of the issue, we must recognize the different effects produced by the "exogenous" demand from outside the private economy and the "endogenous" demand arising from inside the private economy. The "exogenous" demand arising from public expenditure tends to deform the whole structure of industry and commerce, especially when public spending is controlled by a nationalistic, or militaristic tendency.

Why do we mention a nationalistic or militaristic tendency? Because experience affirmatively shows that excessive public spending is the gift of war and defence, and it was largely due to military expenditure that the "exogenous" demand led to the unsymmetrical development of the national economy.

I have tried to demarcate the validity of the three different opinions in their bearings upon the real economic circumstances, but it is of course not an easy task to acknowledge an economic reality as relevant to any one of the three opinions. This is true even of an advanced economy that seems to have passed each stage of development—Mercantilism, Economic Liberalism and Modified Capitalism<sup>5</sup>—one after another slowly but steadily. But there are many non-typical countries where each stage appears somewhat irregularly;

<sup>5</sup> According to W. Sombart, it may be more adequately expressed as: *Frühkapitalismus*, *Hochkapitalismus* and *Spätkapitalismus*.

while the first period is still continuing, the middle period often begins. In less advanced countries, on account of a dire necessity to compete with advanced countries, the length of each period has to be shortened as much as possible. In compressing the growth of centuries into generations, an incongruous story appears.

## II. *Historical Survey*

If we are allowed to follow the model of W. Sombart, Japan's modern economic history, too, may be divided into three stages as follows:

- (a) Mercantilistic Stage, or *Frühkapitalismus* (1868-1912)
- (b) The Stage of Economic Liberalism, or *Hochkapitalismus* (1913-1928)
- (c) The Stage of Modified Capitalism, or *Spätkapitalismus* (1929- )

This division is made entirely for the sake of convenience. According to W. Sombart, capitalism was blooming in the years 1830 to 1913. In this sense my division may seem absurd. But an outstanding characteristic of Japan's economic development is, as was suggested above, that it can not be easily analyzed with the method generally applied to economic development in advanced countries. Viewed from the point of politics, Japan replaced political regulations peculiar to Mercantilism soon after the Meiji Restoration in 1868, and it was 1889 that she introduced the representative system fairly successfully. But in view of a large scale of government activities, Japan was far behind the west in the growth of economic liberalism. In a sense, it is not too much to say that Japan has never enjoyed the full bloom of liberalism in its strict sense of the word.

The economic development of this country, remarkable as it was, was, to an important extent, due to the active policy carried out by Government. We may safely say that from the very beginning of the new regime, the ruling class betook themselves to an excessive strain on the financial resources of the country.

The correct official statistics are not available for the purpose of affording bird's-eye view of the whole development. Relying upon the figures for national income, elaborated by Dr. Yuzo Yamada<sup>6</sup> I computed the ratio of national expenditure to national income (see Table I on p. 21.).

If we acknowledge that, when Japan began to introduce modern institutions, she was an overwhelmingly agricultural country, and the level of her national income was extremely low, then, we must admit that, in order to create new institutions and foster a new mode of production unknown to her people up to that time, it was a positive necessity for Japan to adopt a mercantilistic type of policy until the end of the Meiji Era (1868-1912).

<sup>6</sup> Yuzo Yamada, *Materials for Estimating National Income of Japan* (in Japanese), 1952.

Table I National Income and Government Expenditures  
 compared on an average of every five years  
 (In millions of yen)

Year	National Income <sup>1</sup>	Government Ex- penditure <sup>2</sup>	Ratio per cent
1883—1887	(395) <sup>3</sup>	79.0	8.4
1888—1892	968	100.1	10.3
1893—1897	1,095	188.7	17.2
1898—1902	1,851	268.3	14.5
1903—1907	2,787	877.6	29.7
1908—1912	3,503	698.0	19.9
1913—1917	4,507	812.7	18.1
1918—1922	12,031	1,888.3	15.7
1923—1927	12,754	2,073.0	16.3
1928—1932	11,911	1,801.0	15.1
1933—1937	14,376	2,424.9	16.9
1938—1939 <sup>4</sup>	22,225	8,551.0	38.5
1940—1941 <sup>4</sup>	27,916	12,495.5	48.4
1942—1943 <sup>4</sup>	37,877	31,203.5	82.4
1944	50,901	93,366.0	183.0
1945	—	30,755.0	—

<sup>1</sup> National Income distributed

<sup>2</sup> General Account and War Expenditure Account

<sup>3</sup> National Income produced

<sup>4</sup> Average of two years

During the mercantilistic period of Japan, what is conspicuous to present students is that the Government collected many taxes from peasants and consumers. On the contrary, manufacturers and carrying traders were encouraged with subsidies and other financial aids. Many public funds were outlayed for the purpose of a "Wealthy and Strong State", a slogan typical of mercantilistic ideas.

The tax charged peasants was the land tax. It was very heavy and aroused many revolts among the farmers in the early period of the Meiji Era. This tax drew nearly fifty million yen, more than eighty per cent of all tax revenue until 1877, and never fell below fifty per cent until 1895.

Another major item that constituted a large part of tax revenue was the excise tax.

Taxes upon consumer goods ranging from liquor to cakes were gradually increased to hold first place in tax revenue after 1896. For example, in 1911, thirty-four per cent of all tax revenue was derived from the tax on

*Sake* (Japanese liquor), soy, sugar, textiles, and oil. Profits of the Tobacco Monopoly amounting to more than sixty-six million yen, if included, would add greatly to the percentage of excise revenue.

As will be shown later,<sup>7</sup> another important feature of the period under discussion is that foreign loans amounting to more than 11 billion yen had been contracted by 1907. We should attach more importance than is usually placed, to the role that foreign loans played in encouraging Japanese economic growth during the Meiji Era.

Now, let us turn our eyes to the second period.

As I have said, the period of economic liberalism was strikingly short. It was the first World War that provided Japan with the necessary prerequisite to the sudden rise of free competitive capitalism. During the War, Japan could take advantage of her entirely favourable position on the world market. The period of fifteen years from 1913 to 1929 seems to have been the only blessed period for Japan. She could enjoy the blessings of peace. The Government tried, for the first time, to keep itself from meddling much in economic activities of the private sector.

A remarkable rise in the standard of living, a vigorous growth of wealth, an unprecedented accumulation of foreign exchange funds caused by a boom in exports, and so on; all these advantageous circumstances could not but reflect upon public finance. One of the great achievements in this period was an enormous increase in the revenue provided by the income tax, which may well be said to satisfy the modern principle of taxation—the principle of ability-to-pay.

When the War came to an end in 1919, tax revenues of this country were as follows:

Table II Tax Revenues in 1919  
(In millions of yen)

Taxes	Amount	Per cent
Land Tax	73	7.9
Income Tax	193	20.7
War-time Profit Tax	162	17.4
Excises	227	24.4
Custom Duties	82	8.8
Others	196	20.8
Total	933	100.0

Table II shows that the land tax fell decisively in importance, and instead of this, direct taxes such as the income tax and the war-time profit

<sup>7</sup> See below p. 31.



tax rose in significance. During this period the outstanding national debt was increased owing to the great earthquake in 1923, but the financial condition was, on the whole, quite satisfactory.

But this favourable condition was not sustainable. Because, under the surface of prosperity, there was a structural contradiction in the Japanese economy. What was the structural contradiction? It was what was left behind after the war boom. What remained after the war boom?

After the war boom there remained an inflexible economy imbued with the spirit of Mercantilism. A lack of "endogenous" demand could not be cured with a short-term prosperity caused heteronomously by the outbreak of World War I. There was an appalling discrepancy between the unproportionally well-equipped huge industries on the one hand, and the miserably ill-equipped small-size industries, on the other hand. There was also a keen discrepancy between cities and villages, and there was a sharp contrast between plutocrats who had a close relation to state power, and the millions of ill-paid labouring masses.

The third stage was ready to begin.

Facing the world depression starting in 1929, it was only natural that business circles should have again sought after Government assistance. The effort to overcome the depression soon tended towards political arrangement to secure a particular market for Japanese exports. And this political programme to establish a Japanese sphere of influence, of necessity, made international relations important. The more serious the necessity to overcome economic difficulty became, the more acute the defense problem was. And the more the defense programme enlarged, the more acute became the necessity to secure war stores and raw materials abroad.

These circumstances were quickly reflected in the budget, which, in the fiscal year, 1932-33, is to be remembered as having given plain indication that a militaristic policy had begun to establish its supremacy in budget making as well.

After 1933, the ministers of finance had to give way to fresh borrowing. While at the end of March, 1930, the Government was in debt to the amount of nearly six billion yen, or fifty five per cent of the national income, the increase in national debt in the succeeding years was quite appalling in amount. To make the matter intelligible, I will show the growth of national debt as well as the changes in price index in the period covering eighty years.

Table III The Total Amount of the National Debt  
as shown at the end of selected fiscal years  
(In millions of yen)

Year	Total	Domestic Loans		Foreign Loans		Price Index 1873=100
		Amount	Per cent	Amount	Per cent	
1877	226	213	94	13	6	111
1897	399	399	100	—	—	170
1907	2,254	1,088	48	1,165	52	249
1914	2,506	991	40	1,514	60	243
1924	4,863	3,356	69	1,506	31	526
1930	5,955	4,476	75	1,479	25	349
1936	10,574	9,257	88	1,316	12	408
1945	140,810	139,922	99	887	1	1,380
1949	391,509	290,853	74	100,656 <sup>1</sup>	26	82,253
1952	404,983	302,657	75	102,326 <sup>1</sup>	25	137,650

<sup>1</sup> The increase in Foreign Loans in these years is due to a change in the rate of exchange.

From the fiscal year, 1932-33, because the attempts to improve tax revenue did not bring about the desired effect, enormously increased government expenditure had no way to be defrayed except from the proceeds of domestic loans issued.

But under the pressure of financial strain, the taxation system underwent substantial changes in 1940 in the anticipation that the use of the armed forces in the Asiatic Continent should cause a greater financial difficulty. Among others, the most important changes were a great extension of the income tax to the lower-income groups previously exempted from it, and the co-ordination of miscellaneous taxes introduced during the "China Incident".

When Japan declared war against the United States of America and the British Commonwealth of Nations, the tax burden was no less tolerable. Soon after a temporary success in the aggressive attack of 1941, Japan found it difficult to compete with the enemy's huge productivity. War production was desperately encouraged at the cost of daily necessities.

Under these circumstances a noteworthy change was produced in tax revenues. As the production of consumer goods decreased, taxes upon profits and wages began to surpass those upon goods, in yield. The direct-tax-principle was unexpectedly realized under the pressure of war-time control.

In spite of great expansion of public credit, the financial problem seemed to offer no insuperable difficulties, because the inflation gap was seemingly filled up by such measures as a semi-compulsory saving plan to urge individuals to purchase public bonds with their salaries and wages.

As long as the war continued, inflation was checked, to a successful extent, by a strict rationing programme and by price regulations.

At last, however, the catastrophe came. Owing to a sweeping crack in the worn-out mechanism of war economy, a free outlet was given to pent-up evils. There were tremendous ravages of war on the one hand, and huge amounts of money assets on the other hand. The lack of adequate fiscal and monetary policy gave rise to a vehement inflation.

This stormy inflation made the taxation system completely unworkable. Tax collecting agencies could no longer keep track of enormous profits which arose from black market trading, while wage-earners were forced to pay income taxes withheld and collected at the source of payment. Although nominal wages were belatedly raised on account of an increase in prices, the burden upon labourers was both intensively and extensively augmented.

But, as long as inflation continued, taxpayers did not pay much attention to tax reform, because manufacturers and dealers were being satisfied with larger profits compared with taxes which they could belatedly pay with depreciated currency, and wage-earners were too busy seeking higher wages to reflect upon tax reforming.

It was in 1949, when an organized effort was successfully made to overcome inflation under the leadership of SCAP, that tax reform became an urgent problem for taxpayers. And it was in that year that the Shoup Mission was sent to Japan to recommend a reasonable tax system.

### III. *The Shoup Recommendations and Capital Accumulation*

The Shoup Plan was put into effect in April, 1950. Objectives, that the Shoup Mission aimed at, were by no means incomprehensive; for example, it laid stress on the necessity to designate productive taxes to municipalities (except prefectures), to check the overgrowth of plutocratic power, to avoid taxes not helpful in fostering citizenship, morale, and democracy, and last but not least, to satisfy the modern principle of taxation as much as possible—the principle of ability-to-pay as the standard of equity.

But it must be borne in mind that the "Report on Japanese Taxation", nevertheless, paid much attention also to the problem of how to encourage the accumulation of capital.

In view of recent assertion made by many writers and businessmen, that the Shoup-Plan is not favourable to the rapid accumulation of capital, we should review the extent to which the Mission took account of capital accumulation, and the basis on which the Mission advocated its tax system plan as not harmful to capital accumulation.

Needless to say, it is on no occasion an easy task to reconcile capital accumulation with the other objectives of taxation. And the "Report on Japanese Taxation" may be said to be an elaborate display of painstaking

scientific work. Those who read the report will easily understand what I mean. It has a remarkable coherence.

Where does this coherence come from?

Though with necessary reservations, I dare say that this coherence seems to be maintained by a rationalistic philosophy common to those who grow in the countries where economic liberalism has deeply taken root.

According to this philosophy a society is considered as composed of concrete person; society is but the aggregate of individuals. Corporations are also reducible to partners or share-holders. Business corporations are, as it were, agents taking charge of the production and distribution of social products. Accordingly it is only for convenience' sake that legislation orders business corporations to pay taxes; in reality it is not the corporations or partnerships, but the persons who compose them, that should pay taxes. By this view, it is supposed, all income is to be distributed among the members of a society; if a part of incomes should be saved, it is not the corporations or partnerships, but individuals who take charge of saving money.

By the same reasoning, it is asserted that equity in taxation should primarily be a matter among individual income recipients. Therefore, so far as business is concerned, a matter of substantial importance is to prevent a business from losing unduely in its relative ability to compete with other businesses on account of "unfair" taxation.

Let us consider, with reference to capital formation, the way in which such a clear-cut philosophy is embodied into the tax system recommended by the Shoup Mission.

#### A. Tax Cuts in favour of Higher Income Groups

The Shoup-Plan recommended that the top rate of the income tax should be reduced to fifty-five per cent for incomes over ¥ 300,000 (\$ 833), considering the necessity of fostering the willingness and ability of the high income bracket to save, and to weed out the maladministration of tax collecting agencies.

According to the tax reform enforced, the top rate of fifty-five per cent was to be applied to incomes over ¥ 500,000 (\$ 1,388) instead of the ¥ 300,000 proposed. In order to explain the extent of reform, I will show the following table.

Table IV Income Tax Rate Schedules Compared

Net Yearly Income after Exemptions etc.	1949	Shoup-Plan	1950
	%	%	%
0 to 20,000 yen	20	20	20
20,000 to 40,000	25	20	20
40,000 to 50,000	30	20	20

50,000	to	70,000	30	25	25
70,000	to	80,000	35	25	25
80,000	to	100,000	35	30	30
100,000	to	120,000	40	35	35
120,000	to	150,000	40	40	40
150,000	to	200,000	45	45	45
200,000	to	250,000	50	50	50
250,000	to	300,000	55	50	50
300,000	to	500,000	60	55	50
500,000	to	700,000	65	55	55
700,000	to	1,000,000	70	55	55
1,000,000	to	2,000,000	75	55	55
2,000,000	to	5,000,000	80	55	55
	over	5,000,000	85	55	55

As was indicated above, a sudden change from inflation to deflation was indescribably active in causing friction between tax agencies and taxpayers. It was an urgent necessity to increase the level of compliance, assessment and collection so that a reasonable degree of enforcement could be obtained. The Shoup Plan expected that a sharp reduction in the top rate of the income tax would increase the level of compliance, etc.

This reduction was to be favourable also to incentives, production and investment, the Report stressed.

But at the same time what is noteworthy is that the following three counteracting steps were contrived against the reduction of the income tax.

Firstly, the Shoup Report urged with all the emphasis at command the necessity to include all incomes in the taxable incomes; incomes, whether from royalties, or capital gains, or fluctuating revenues, were proposed to be subject to the progressive rate of the income tax.<sup>8</sup>

Secondly, a net worth tax was proposed to fill the gap left by the reduction in the top rates of the income tax. The rate schedule of the net worth tax recommended was as follows:

Table V The Net Worth Tax

Networth Bracket (Yen)			Rate of Tax
less	than	5 million	Exempt
5 million	to	10 million	0.5 per cent
10 million	to	20 million	1.0 per cent
20 million	to	50 million	2.0 per cent
	above	50 million	3.0 per cent

<sup>8</sup> The "Report on Japanese Taxation" says: "Indeed, it cannot be so strongly emphasized that inclusion of the full amount of capital gains, other than those attributed to inflation, is a basic cornerstone of our program of tax reform and that no departure from this principle can be admitted without seriously impairing the coherence of the program." (Appendix B, p. 11.)

The introduction of a net worth tax (as well as the proposed increase in the estate and gift tax) was expected to check the growth of undue concentration of economic power. With regard to an adverse effect the new tax might have upon the "due" accumulation of capital, the recommendation asserted that this form of taxation would produce less impairment of good management and industrial efficiency than income tax at comparable rates. In addition the Shoup Mission tried beforehand to refute objections presumably taken against such an ordinary property tax as the net worth tax, saying that its very existence would induce "intelligent" taxpayers to make more efficient use of their assets.

Thirdly, the Shoup scheme granted a credit for each individual stockholder against his individual income tax of an amount equal to twenty-five per cent of the dividends he receives from corporations subject to a tax of thirty-five per cent on their net income.

This arrangement, as was suggested above, clearly corresponds to the idea that a corporation is but an aggregate of individuals, formed for the purpose of carrying on a given business and distributing its net income. According to this idea, there will be an impermissible double taxation, if no credit is allowed for shareholders. This credit for shareholders was to foster willingness and ability to save and invest.

#### B. Efforts to Improve Business Relationships

If inclusion of all incomes of whatever kind, and, if possible, application of direct, and progressive tax to them was one of the cornerstones of the Shoup Programme, the other one was, speaking broadly, repeal or reduction of taxes that were likely to prevent the competitive relationship of business from coming into existence to its full degree.

When the Mission was sent to Japan, business relationships were badly malfunctioning. And it caused great bitterness for business to have been forced to submit to taxes utterly spoiled by inflation. The Shoup Mission gave much attention to this issue.

First of all, the excess profits tax was pounced upon. This tax was in the exemplar pattern of taxes that cause unfair relationships, because it was a "mockery" to impose a tax upon "excess profits" that were computed on the basis of a book value having nothing to do with the current value of the assets.

The same unreasonableness was to be found in the taxation of "ordinary profits". After paying tax upon fictitious profits, business could not maintain industrial capital at its existing level.

The Recommendation urged the necessity of writing up the *yen* value of assets in the hands of business concerns, provided that this write-up in value be subject to the revaluation tax of six per cent.

What deserves our attention in this case is that, according to the

programme, all corporations were required to write up the value of their depreciable assets and land, as of July 1, 1949, and to file a complete re-valuation return by September 1, 1950, if they were to receive the benefit of increased depreciation for the corporation income tax.

Along the same line, many other improvements in the method of computing profits were recommended. But we should remember that the programme did not intend to discriminate between businesses according to political decisions upon the degree of their importance.

With regard to a tax on a value-added base, it is noteworthy that the Shoup Mission expected favourable effects upon modernization of capital equipment.

A scheme to make corporations pay an interest surcharge of one per cent each year on accumulated earnings reserves was, according to the Mission, necessary to counterbalance the pressure for "undue" accumulation of earnings which arises from the progressive income tax on shareholders. This scheme, too, was obviously in exact accordance with the specified conception of corporate form.

It was mainly due to the idea of fair business relationships and the principle of ability-to-pay that the Mission recommended the abolition of, or reduction in, many indirect taxes except the excise upon liquor and tobacco. Thus, the transactions tax, the textile tax, the sugar tax, the soft drinks tax, the tax upon transfer of securities, and the registration tax were to be repealed; and the commodity excises, the tax upon travelling etc., were to be reduced.

Only the liquor tax, the revenue of the Tobacco Monopoly, the commodities tax, and the gasoline tax were justified for various reasons.

Taken altogether, we may be able to conclude that the Shoup-Plan, on the whole, rested upon orthodox economic liberalism with regard to the fostering of capital accumulation. The plan did not favour fostering government investment, nor increasing corporation surplus reserves etc. It counted solely upon voluntary saving and direct investment on the part of "intelligent" wealthy people.

#### IV. *Modifications of the Programme commenced soon after its enforcement*

In spite of the valuable effort exerted by the Mission to rationalize the Japanese taxation system in accordance with the emphasized principle of ability-to-pay, the tax burden upon the lower income brackets was not reduced to a satisfactory extent, because the decrease in the top rate of the income tax did not much affect incomes below 120,000 yen, as was shown on Table IV on p. 26-27.

And tax administration was not improved as was expected with regard to the self-assessed income tax. But, on the other hand, those subject to

the income tax withheld and collected at sources were forced to pay their taxes to the letter of the law.

An inflationary tendency took place again, owing to the outbreak of the War in Korea. Wages were, though belatedly, raised in the wake of an increase in prices and profits. This made it necessary to revise the rate schedule of the income tax, and to increase the exemptions, the dependency allowance, the earned income credit, etc. There appeared, nevertheless, a conspicuous contrast between the rising revenue of the tax withheld and the declining revenue of the income tax self-assessed.<sup>9</sup>

Reduction in the income tax upon the lower income groups, in itself, by no means indicates a departure from the principles advocated in the Shoup Recommendations. The Government actually tried to reduce taxes in this direction.

The principle of including all incomes in taxable income, though stressed emphatically in the Report, underwent much resistance from the very start.

Firstly, the loophole, for concealing interest income was not completely closed. Wealthy people could spread their deposits anonymously in large numbers of tax-free accounts. Secondly, the optional flat rate (sixty per cent) on interest income was abolished in 1950 only to be re-introduced in the following year with lower rate of fifty per cent. Thirdly, the inclusion of capital gains in taxable income was substantially invalidated owing to the fact that fierce opposition against the registration of all the transfers of shares induced the government to neglect the Recommendations.

There were also other items which represented a departure from the Recommendations. For example, the business tax on a value-added basis was postponed indefinitely; administration of the net worth tax was scarcely improved.

While the Shoup-Plan recommended that business should write up the value of its fixed assets once and for all, the Government allowed repeated revaluations.

In disregard of the Shoup Programme, the Industrial Rationalization Promotion Act of 1951 allowed specified branches of industry to write down fifty per cent of the price of machinery for two years including the year of acquisition.

Furthermore, it was also suggestive of the future of the direct tax principle, apparently proclaimed in the Report, that the sugar tax was not abolished.

We can thus indicate many modifications. Of course it is doubtless that the taxation system of Japan as a whole was reorganized in accordance with the Recommendations. Modifications were, it should be remembered, apparently slight. But at the same time we must be attentive to the grave significance involved in the modifications. They were suggestive of a fun-

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<sup>9</sup> See below p. 35.



damental change in the two cornerstones: the principles of inclusion of all incomes as taxable income on the one hand, and of ability-to-pay or direct taxation on the other hand. Let us consider the subsequent development of the Japanese taxation and taxes with reference to capital accumulation.

#### V. *Demands of Business Circles and the Recent Tax Reform*

To begin with, we should give a glance to the changed economic conditions since 1951. As was mentioned above, the War in Korea began in June, 1950. The expansion of the war caused a world-wide boom on the war products market. On account of its geographic nearness to the front, a large number of war procurement contracts were given to the industry of Japan. The Korean War boom had a deep effect upon the Japanese economy which has only poor productive powers. There was again a steep rise in prices and wages.

Under these circumstances, the pressure for dollars and pounds was alleviated, and the brisk market made business circles temporarily forget the seriousness of improving industrial efficiency.

But as the Korean War waned and was soon expected to end, the increased costs of production of necessity caused Japanese industry greater difficulty. So tax cuts for the sake of capital accumulation have once more become urgent.

In the fourth assembly of the Japan Tax Study Association, the financial circles urged the necessity of (a) reducing both the rate of the withheld tax and of the optional flat rate of tax upon interest incomes arising from deposits and others, (b) allowing depositors a credit against their individual income tax, (c) exempting long-term deposits from taxation. The stock-dealer circles insisted on, (a) the exemption of capital gains from income tax, (b) the reduction of tax upon dividends on the additional capital paid in cash. The industrial circles formulated the draft of the "Capital Accumulation Promotion Act".

The draft of the "Capital Accumulation Promotion Act" was published in November of 1952 by the "Business Companions Club". The act was to promote the accumulation of capital stock primarily through a substantial reduction of taxation upon business. It contained the following items:

- (a) Extension of the special depreciation system and reduction of the service life of assets
- (b) Extension of the system of reserve against changed prices
- (c) Extension of the limit of bad credit reserve
- (d) Enforcement of the third revaluation of capital assets with the six per cent revaluation tax (extension of the spread of taxpayment from three years to five)

- (e) Reduction of taxation upon a surplus reserve within a limit of, say, fifty per cent of profits
- (f) Exemption from the corporation tax for dividends within a limit of, say, ten per cent
- (g) Abolition of tax upon capital gains.

The Ministry of Industry and Foreign Trade also published a plan to reform taxation along the same lines, laying special stress on the necessity of improving the export industry. In addition to items similar to those mentioned just above, there were also such items as apparently represent the prevailing opinion of the business circles on the property tax and the value-added tax: the plan urged abolition of these taxes altogether.

It is needless to give more examples.

Largely influenced by these demands, the Cabinet under Premier Yoshida, President of the Liberal Party, contrived tax reform bills to be introduced before the Diet early this spring. Owing to the political unrest and the subsequent general election, the bills have not yet been carried, but there is now nothing to suggest their failure.

Let us survey the important points of the recent tax reform bills.

As was pointed out above, business was allowed to write up the value of fixed assets in 1950. The second valuation was admitted in 1951. The recent reform of the Revaluation of Assets Act prescribes that business will be allowed to resort to a third revaluation with the benefit of spreading the revaluation tax payments over five years.

The recent reform plan admitted an extension on the limit of several reserves and establishment of new reserves for the export contracts cancelled, etc.

The value-added tax was to be again postponed indefinitely.

Grave impairments of the Shoup Principles are that, according to the reform bill, capital gains will be excluded from the taxable income tax, and instead of this, subjected to the tax upon transfers of securities, and that the ten per cent tax will be introduced to do away with any other taxation upon interest incomes.

Wealthier people will be altogether freed from the net worth tax by the repeal of the Net Worth Tax Act. On the other hand, they will be subject to an increased rate of income tax of sixty per cent on their incomes over three million yen, and sixty-five per cent on those over five million yen.

The National Savings Bond Act will also afford much benefit to wealthier persons, because the Act prescribes that purchasers of bonds will be allowed to pay their income tax or corporation tax at a discount of a specified ratio in proportion to the amount of bonds purchased.

Another noteworthy feature of the recent tax reform plan is that the rate of the sugar tax will be raised by twenty per cent, and the tax upon transfers of securities will be restored.

VI. *Priority of Tax Reductions*

The Government has been keen about tax reductions, and proud of the recent reform bills, insisting that they will give relief to taxpayers to the amount of 100 billion yen.

It is indeed true that the paper reduction in the letter of the tax laws amounts to more than 100 billion yen. And it is also true that, on the surface, there will be no taxpayers whose tax may be increased more than in proportion to increases in their incomes. But in so far as we take it for granted that the retrenchment of Government expenditure is impossible, fair reduction in taxes is difficult. Tax reductions in favour of capital accumulation may perhaps mean an increased taxation upon those who are deemed to make no valuable contribution to the accumulation of capital stock.

As I endeavoured to show in my article published in 1952, the ratio of direct tax revenue to indirect tax revenue does not necessarily indicate the propriety of a tax system,<sup>10</sup> but in the light of recent developments, a decline in the ratio of direct to indirect tax revenue denotes a receding tendency on our tax system as a whole, because direct taxes have been improved upon, since 1950, at least in comparison with indirect taxes. The following table shows the changes in the ratio of direct to indirect tax revenues in the National Budget.

Table V Ratio of Direct to Indirect Tax Revenues in the National Budget  
(In millions of yen)

Year	Total		Direct Taxes		Indirect Taxes		Others	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
1920	1,179	100	385	32.7	691	58.6	102	8.7
1935	1,202	100	420	35.0	687	57.2	93	7.8
1940	4,218	100	2,695	63.9	1,288	30.5	234	5.6
1945	11,541	100	7,334	63.5	3,500	30.3	707	6.2
1949	636,406	100	344,374	54.1	243,783	38.3	48,249	7.6
1950	570,547	100	313,625	55.0	245,779	43.1	11,123	1.9
1951	723,141	100	424,997	58.8	285,921	39.5	12,224	1.7
1952	844,041	100	475,615	56.4	352,093	41.7	16,330	1.9
1953	859,843	100	455,016	52.9	383,587	44.6	21,240	2.5

(1) Figures are shown according to settled accounts, except for 1952, in which anticipated accounts were used, and for 1953, in which estimated accounts were used.

(2) Including profits of the Tobacco and Alcohol Monopolies.

<sup>10</sup> M. Kimura, Conditions for Direct Taxation, *The Journal of the Hitotsubashi Academy*, April, 1952.

In the budget for the fiscal year, 1953-54, the estimated increase in indirect taxes is 31.5 billion yen, whereas, direct taxes are to be decreased by 21 billion yen, as compared with those in the previous year. This decidedly denotes the unhappy future of our taxation system.

Indeed, if the decline in the ratio should be compensated for by a great improvement in direct taxation, that would alter the case. But unhappy reality is that the decline in the ratio of direct to indirect tax revenue is being accompanied by an unsatisfactory tendency in direct taxation.

I have repeated that the income tax administration was far from satisfactory, especially with regard to the self-assessed parts of it. This tendency still persists and the Ministry of Finance each year is forced to concede its failure.

Indeed the income tax law has repeatedly been revised in favour of taxpayers. For example, the basic personal exemption was raised from 15,000 yen in 1949 to 25,000 yen in 1950 (according to the Shoup Plan: 24,000 yen); to 30,000 yen in April of 1951; to 38,000 yen in September of 1951; to 50,000 yen in 1952; and by the Special Tax Treatment Act of 1953, it has now been raised to 60,000 yen. The credit for dependents was also raised accordingly from 12,000 yen for each dependent in 1950 to 35,000 yen for the first dependent and 20,000 yen for each of the rest of the dependents in 1953. As a consequence of these raises the number of those who are subject to the income tax is now expected to be 8,307,000 persons, showing an enormous decrease compared with the strikingly large number of 21,397,000 persons in 1949. Those who file returns will also be reduced in number to 3,170,000 persons as compared with an amazingly large number of 11,723,000 persons in 1949.

This is, indeed, a remarkable improvement in the income tax. But if we take account of the pre-war income tax, which I mentioned above as a great achievement in our public finance, we should admit that the recent improvement is but trifling.

In the pre-war period from 1934 to 1936, the personal exemption limit was 1,200 yen (yearly). The real value of this 1,200 yen is equal to at least that of 319,200 yen (yearly) in 1953, if adjusted by the Consumers' Price Index. In spite of the fact that the ratio of direct to indirect tax revenues was 34.8 : 57.1 in the pre-war period, and taxes upon liquor, soft drinks, textiles, sugar, tobacco, etc., were substantially heavier than now, the income tax must, nevertheless, have been far less oppressive for the lower income brackets, since the single income-earner of 319,200 yen previously exempted from the income tax is now required to pay more than 54,000 yen, that is to say 18 per cent of his revenue.

As was shown before, business circles have eagerly requested a reduction of taxes upon business. In an excess of eagerness, some of the influential industrialists and their spokesmen have advocated even an increase in indirect

taxes to recompense for a decrease in taxes upon business. Such an opinion is not frequently expressed, but we may safely say that the underlying tendency in business circles is generally in favour of an increase in indirect taxes. But it is doubtful whether such an opinion has any justification.

For the sake of brief illustration, let us put aside the effect of all taxes other than the corporation and the income taxes. In 1934-36, the revenue of the corporation tax (then the income tax of the first kind) was 97,111 thousand yen per year on an average of three years, whereas the personal income tax (then the income tax of the third kind) drew 11,089 thousand yen. Computing the ratio, we get 46.6 : 53.3. Since the personal exemption limit was, as mentioned above, 1,200 yen (yearly) in 1934-36, it may be concluded that the personal income tax was, to a great extent, paid by those who lived upon revenues arising from property or dividends. In other words, the income tax at that time did not affect the low income group of wage-earners. Recent developments in extraction of revenue from the income tax and the corporation tax are as follows:

Table VII Revenues of Corporation Tax  
and Income Tax Compared<sup>1</sup>  
(In billions of yen)

Year	Corporation Tax		Income Tax					
			Total		Withheld <sup>2</sup>		Self-Assessed <sup>3</sup>	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
1947	7.1	9	79.2	91	27.9	32	51.3	59
1948	27.9	13	190.8	87	76.4	35	114.4	52
1949	61.2	16	278.7	82	141.5	42	137.2	40
1950	83.7	28	220.1	72	127.5	42	92.6	30
1951	149.4	39	234.5	61	132.2	34	102.2	27
1952	186.0	40	269.8	60	186.8	41	83.0	19
1953	170.1	39	267.1	61	191.8	44	75.3	17

<sup>1</sup> Corporations pay a Revaluation Tax of 13 billion yen per year on an average in addition to the corporation tax, but we omitted this tax.

<sup>2</sup> A large part of the income tax withheld and collected at sources falls on the shoulders of the wage-earner: for example, it is estimated in 1953, 164.4 billion yen out of 191.8 billion yen will be paid by recipients of earned incomes.

<sup>3</sup> Those who are requested to file returns are, in most cases, wealthy people.

Table VII reveals notable facts, for example,

- (a) that the revenue of the self-assessed income tax has been decreased since 1950,
- (b) that the earnings of corporations have been steadily increased,
- (c) and that, despite frequent reductions of the rate of the income tax,

the burden upon earned incomes has not been virtually alleviated.

In this connection, it is noteworthy that a large number of personal business enterprises has been reorganized into the corporate form. There were about ninety thousand corporations in Japan in 1934-1936. Since then their number had been usually augmented by ten thousand every year. But in 1947 the number jumped from 106,000 to 144,000, in 1948 to 207,000, in 1949 to 207,000, and in 1950 to 230,000. This remarkable tendency, though slowed down, has not disappeared. An increase in the number of corporations may be attributed to several causes, but such a striking increase as is seen in Japan cannot be adequately explained without taking account of the fact that the income tax is more intolerable than the corporation tax.

The great fall of the self-assessed income tax in its importance may, too, to a considerable extent, be explained by the same reason.

There is unsatisfactory administration of the self-assessed tax. Even the official publication admits that only eighty per cent of the self-assessed income tax will be collected within the present fiscal year, as compared with ninety-six per cent of the withheld income tax. This low rate of collection no doubt reveals on the one hand, the advantageous position of the self-assessing taxpayers, but, on the other hand, it seems to signify an unsatisfactory relation between the tax officials and taxpayers. This dissatisfaction appears to be one of the important reasons why merchants and manufacturers wish to reorganize their concerns into the corporate form. In the case of corporations, the flat rate of forty-two per cent (the rate was raised in 1952 from thirty-five to forty-two per cent) is by no means an insignificant tax burden upon business, but corporations can save much trouble involved in "negotiating" with tax agencies in computing net profits.

If there is no reason, in principle, either to encourage individuals to make use of the corporate form or to deter them from using it, and if there is an actual tendency for taxes to induce individuals to utilize the corporate form, then the taxes well deserve revision.

And if it is true that the income tax withheld and collected at sources, (in practice, just like indirect taxes collected without evoking much disgust from taxpayers) has, on its own accord, an adverse effect upon true citizenship, morale, and democracy, and upon the principle of ability to pay as our standard of equity, it is, surely, not the corporation tax, but the withheld income tax that has prior claims for reduction.

However, viewed from the standpoint of capital accumulation, it may be desirable that business acquire a priority in tax reduction.

The more priority we give to business, the less easy it is to reduce the withheld tax or indirect taxes.

Now, the banking circles have successfully urged the Government to reduce the tax upon interest revenues to such an amazing extent as to allow bank depositors to pay no tax other than the withheld ten per cent

tax upon their interest revenues.

There can be no doubt that such a great reduction of taxation will encourage bank savings. But at the same time, we should recognize that bank deposits have been increased without tax reductions. Indeed it is true that the low rate of interest is essential for a sound handling as well as a low working cost of business, and tax reduction upon interest incomes will help to lower the rate of interest, thereby contributing the augmentation of Japan's stock of capital equipment. But the reason why the rate of interest is high in Japan is not simple. A high rate of interest cannot be attributed to heavy tax alone. In the prewar period, interest payment amounted to nearly sixty per cent of all the costs of loanable funds of banks. To-day the ratio of interest payment to the costs of loanable funds is only twenty-five per cent. Such a great difference is largely due to a startling increase in the working expenses as well as the profits of banks. If the rate of interest is to be lowered, the first step must be to reduce the amount of these two items.

The banking circles make it a rule to plead that the legal duty charged banks to make interest payment returns gives occasion to increased operating expenses, but this pleading does not seem to carry much conviction.

From any point of view, among the recent tax cut plans, nothing is more absurd and unjustifiable than the reduction of the income tax upon interest incomes; a wealthy person who possesses deposits in banks or other financial facilities is required only to pay a flat rate tax of ten per cent upon his interest income, however large they may be. But, on the other hand, a labourer who works overtime is forced to pay income tax at the progressive rate of more than twenty per cent at least, upon his overtime pay, however small it may be, if he earns wages exceeding the total sum of his exemptions, credits for dependency, etc.

Although business circles have not expressed their satisfaction, a relief of about twenty billion yen in favour of business corporations would be a big windfall to them.

### *Conclusion*

A too hasty conclusion would lead us in the wrong direction with respect to the problem: which is the shortest and healthiest road to capital expansion?

- (a) Voluntary saving of individuals resulting in direct investment (purchase of stocks and other equities by savers), or
- (b) Voluntary deposits in banks or other financial facilities other than Government savings agencies resulting in indirect investment (bank loans, purchase of equities and bonds by banks), or

- (c) Accumulation of surplus reserves, etc. in the hands of business concerns (undistributed profits) resulting in re-investment in the same place where capital is accumulated, or
- (d) Acquisition of public funds through taxation, public borrowing, and / or receipts on deposits resulting in Government investment in public enterprise and / or public lending to particular branches of industry, distinguished from sheer spending.

It is true that these four routes to capital formation (saving and investment) are not always in conflict with each other. Route (b) may well be supported by Route (c). Route (c) can be in harmony with Route (d), and so on. But in many cases, Route (d), that is to say, public investment of public funds has an adverse effect upon other routes of capital formation. And we may well maintain that each route, of its own accord, affects somewhat differently the economic development as well as the industrial structure of a country.

Viewed from another angle, this also means that a given state or stage of economic development, and a given structure of industry is apt to give a preference to a particular route.

As was explained elsewhere in this article,<sup>11</sup> Japan is a country where government had (and perhaps has) played an important role in investment for many generations, while, on the contrary, individuals have held less bonds, less stocks and less equities. If we dare to arrange the routes of capital expansion according to the degree of importance that each of them has possessed in the economic development of this country, ranking will be first, Route (d), second, Route (c) and (b), and third, Route (a).

As I have indicated repeatedly, the Shoup-Plan attached much importance to Route (a), that is to say, it asserted that capital accumulation was to be attained most normally by way of individuals' saving and individuals' intelligent investment. In reality, the practice of holding stocks has not yet matured among people of this country. In general, those who save their money, prefer to go to the savings account windows of banks or post offices to deposit it. Only restricted circles of wealthy people have used the facilities of stockdealers.

It was due to a large amount of deposits that big banks were able to wield great influence upon business concerns in the pre-war period. Bankers are now doing their best to recover from the great loss of their authority caused by Japan's defeat in the last war.

Route (c), that is to say, accumulation of earnings reserves, etc. seems to be the most favourable means of expanding capital stocks of equipment in that the owners or directors of business concerns can make use of the accumulated reserves at any time and in any way precisely in accordance

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<sup>11</sup> See above, pp. 20-25.



with their decisions. To-day, when the ratio of investors' capital to creditor' capital is extremely unfavourable to the former, the necessity to increase reserves, in principle, can not be denied. But at the same time, what is noteworthy is that, if a large enterprise of a monopolistic type can enjoy greater concessions in taxation with regard to its accumulated reserves, there will be a greater danger of their being invested in the wrong way.

Much of the recovery of this country has been due to American aid, and to the subsequent fortuitous economic windfall of the war in Korea. Thanks to the greatly increased war procurement demands of more than 790 million dollars in 1952, Japan has compensated for the adverse balance of trade amounting to 430 million dollars, and moreover, has increased her economic activities in every respect.

But this is but a superficial thriving on a flimsy foundation of temporary economic windfall. With the end of the war in Korea virtual realities are now being disclosed. The business circles, while demanding tax cuts in favour of business, and retrenchment of government administrative expenditure, are, at the same time, covetous of another market, whether foreign or domestic, in substitution for procurement demands, and are expecting that the Government will embark on a re-armament programme sooner or later, which will provide a large market for munitions and other war products, and will give munition industries the benefit of public lending.

What is necessary for us is not the expansion of capital equipment that is used only to produce goods no one but the Government purchases, but the formation of capital necessary to produce goods that can either be bought by individual consumers or be exported abroad. If the "endogenous" demand, whether foreign or domestic, is not enough to maintain the production of goods, the industrial structure will be warped. And an undue concession to capital formation would impair the expansion of the endogenous demand.

The recent tax reform tends to adhere to the patterns of capital accumulation which were prevailing before the unconditional surrender of 1945. The Shoup Programme, which was proposed in the hope that Japan, if she so desires, may within a few years have what would be the best tax system in the world, is now undergoing grave modifications, in the name of capital accumulation.

It is extremely difficult for Japan, overpopulated and scant of resources, to accumulate capital without resorting to taxes upon the labouring masses, and to government investment or lending. But one thing is obvious, that we must be cautious enough not to allow "capital accumulation" to become a hypnotic spell potent enough to deprive persons of their due consideration of the other objectives of taxation.

—Written in July 31, 1953—