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FISCAL POLICY AND INDUSTRIALIZATION IN JAPAN 1868-1895

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Professor Nurkse has made a substantial contribution to the theoretical explanation of capital formation in under-developed countries. After examining all possible methods of economic growth in poverty-ridden areas, he emphasized the importance of creating a home market in those countries where there is concealed unemployment. According to his analysis, what is needed most is that the surplus labor in the primitive farm be withdrawn and set into work on industrial projects. He discussed the ways and means by which the surplus laborers can be fed by the remaining farmers and equipped with capital of a kind or other.

In this concealed unemployment, Professor Nurkse argued, one can find concealed saving. Even before industrialization, the unproductive surplus laborers are being fed by the productive laborers; so that the productive laborers are performing virtual savings; in other words they are producing more than they are consuming. But saving is being swallowed up by the unproductive consumption of those people who contribute nothing to output. The accumulation of capital can be materialized and financed, only if a re-allocation of labour is performed in favor of capital projects, provided that surplus labor which can be withdrawn without decreasing the total farm product, does exist.

Without the corresponding domestic savings, any increment in current income derived from foreign trade cannot secure any net increase in investment. Nor can the saving of wealthier people be of much help for the formation of capital. The inflow of capital from abroad or foreign aid of any kind is neither likely to be adequate in realizing a sufficient capital accumulation.

It is interesting to see that the whole reasoning of Professor Nurkse's theory of disguised saving bears a great similarity to the "Free hands" doctrine of James Steuart,¹ although Professor Nurkse maintained that his theory stood midway between the classical and the Keynesian approach. In my article² written on taxation and capital accumulation, I mentioned,

¹ *Inquiry into the Principles of Political Economy*, 1767.

² The Annals of the Hitotsubashi Academy, October, 1953.

although with some reservations, the validity of the mercantilistic doctrine in the transitional period from feudalism to capitalism.

This paper will treat the process of transforming the unproductive surplus labor into productive labor by means of fiscal policy in the early part of the Meiji Period, from about 1860 to 1895 when the Sino-Japanese War was ended. Although Professor Nurkse refers to the dissolutive effect of public finance on the over-populated peasant economy by pointing out the steep land tax in Japan, he makes little mention of the public debt which reached a very large amount in comparison with the small national income of the time. In addition, we cannot ignore the important role which the reparation payments from the Chinese government played in the fiscal history of Japan. It is quite natural that Professor Nurkse should not worry about such a fortuitous event as that, for his main concern was to make a theoretical and general approach to the subject. But, I may wonder whether reparation payments in such a large amount can be treated in the same category as any other foreign investment.

I. *The Agrarian State in 1868*

When Japan was enforced in 1854 to abandon her 250-year-old seclusion policy, fifteen years before the Meiji Restoration, she was an overwhelmingly agrarian state. Immediately after the opening of the country, foreign trade showed a rapid progress, causing thereby a tremendous rise in the prices of both export and domestic goods. Apparently foreign trade had a favorable balance, nevertheless there was a large outflow of gold because of the import of munitions (which were not included in the import items) and of smuggling which was a thriving business before the Restoration.

The revision of the parity of gold and silver contributed also to the sharp rise in prices.

The impact of foreign trade was seen also in the marketing system, the manufacturing methods and in some of the farming activities like the conversion of cotton crops into the cultivation of mulberry trees.

But, what the Meiji government inherited from the Tokugawa Shogunate was still a peasant economy with an insignificant manufacture and a comparatively precocious merchant capital. There were 17,319,000 gainfully occupied people in 1872, distributed as follows: agriculture and forestry 14,100,000; mining, 6,000; manufacturing, 826,000; fishery, 395,000; communication, 118,000; commerce, 948,000; public service, 502,000; miscellaneous, 179,000.

Moreover, the new regime not only succeeded the old debt left by the Tokugawa government and many other local governments, but also was

confronted with almost unmanageable tasks such as the suppression of unsatisfied elements, the abolition of feudalism, the foundation of a unified communication system, the unification of the monetary system, the introduction of modern manufacture, and last but not least, the completion of the national defense. All those tasks could not be accomplished without money. How to raise the public revenue was one of the most urgent problems that the new government had to solve without delay. However, the systematic reform of a fiscal system, needless to say, had to take longer time than the government had expected. Thus, the debt came first, in either the form of borrowing or issuing money, as the case might be.

Contrary to the ordinary text book descriptions, modern states emerge apparently as insolvent debtors.

II. *The Meiji Government as a Great Debtor*

In principle the feudalistic wars can be maintained without money. But, as soon as the fire arms were invented, ever increasing money expenditures were needed. The Meiji regime was supported from the beginning by the feudal lords, and, as far as the Emperor was concerned, he need not provide his army with munition. Nevertheless the war against the Tokugawa Shogunate costed more than five million ryo (yen). Viewed from the standpoint of those days, this sum was fabulous. The leaders of the new government tried every means to raise money, such as:

(1) Borrowing from merchants in Kyoto, Osaka, Sakai, Yedo (the former Tokyo) and many other places. It took a whole year to receive in cash the total amount of two and a half million ryo.

(2) Issuing paper money. At the beginning, the paper money called "kinsatsu" (gold backed money) was contrived to provide the companies with money capital, and in fact, it was being lent out to local governmental companies. But the lack of funds to carry on the war compelled the Revenue Office to issue it for the purpose of supplying the military with necessary funds. The circulation was extraordinarily difficult, because the people did not have confidence in the new government. The successive prohibitions on the undervaluation of the note were ignored.³

(3) The debasement of the coinage. In order to extract a net profit of about 400,000 ryo, the mintmasters were ordered to pass coins to the amount of four million ryo.

The Revenue Office scraped together the sum needed from whatever sources they could lay their hands on. Under the pressure of circumstance,

³ After the Shogunate regime was overthrown, the value of the Kinsatsu was restored considerably, and the new Government depended largely upon it.

the government could not compile the budget at that time, and the exact course of the inflow and outflow of revenues was not available until ten years later.

In the meantime, the new government had to engage in a drastic reformation of the economic, social and political inheritances left over from the Tokugawa regime. What was most urgent was, above all, to strengthen the political power of the newly established government by converting the antagonistic lords and warriors into propitious co-operators. For that purpose, the new leaders planned to recognize the old feudal feuds by giving hereditary pension bonds to lords and warriors. In other words, they were compelled to return the land and people to the Emperor, and had no longer the right to govern their feuds as such, but they were given capitalized pensions in the form of government bonds which, at least in theory, enabled them to secure a livelihood.

As I mentioned before, another important factor, namely, the acceptance of the old debts under which many of the lords had been straitened, contributed to the accumulation of public debts. This tolerant measure was taken because of the necessity to obtain the goodwill of giant merchants, who had lent money to the feudal lords.

The policy of the Meiji government to liquidate the old debt was so tolerant as to take over the paper money issued by the Tokugawa Shogunate and the subordinate feudal lords for the amount of 38.5 million ryo. The treasury distributed a new paper money for the sum of 22.6 million yen against the old issuance and the 3.45 million yen gold and silver reserves held by the feudal governments.

It is worth noticing that, besides this, the new regime floated the first foreign loan for 4.88 million yen (£1,000,000) and a second one for 11.71 million yen (£2,300,000), both raised in London, in 1869 and 1872 respectively. The former was for the construction of a railway from Tokyo to Yokohama and from Osaka to Kobe, and the latter was to provide with business capital to all those who returned their feuds.

All together, the amount of debts and paper money reached a sum of more than 332.6 million yen. The following table shows how large was this amount.

Table 1. Expenditure, Public Debt and Paper Money, 1868-1877 (in thousand yen)

	Expenditure	Public Debt		Government issued
		Domestic	Foreign	Paper Money
1868	30,505	—	—	24,037
1869	20,785	—	—	50,090
1870	20,107	—	—	55,500
1871	19,235	—	4,880	60,272
1872	57,730	23,176	4,880	68,400

1873	62,678	24,536	16,104	78,381
1874	82,269	31,303	15,616	91,902
1875	66,134	40,916	14,839	99,071
1876	68,203	39,771	14,893	105,147
1877	59,308	222,941	13,399	105,797

The figures audited afterward show that, in 1868, the total expenditure was 30,505 thousand yen, while the revenue amounted to 33,089 thousand yen, thereby making both ends meet. However, the revenue from taxes was in fact only 3,157 thousand yen, leaving almost all the deficit made up by the issue of "gold paper" to the amount of 24,037 thousand yen. The story was almost the same in 1869 (See Table 2.).

Table 2. Expenditure and Revenue in 1868 and 1869.
(in thousand yen)

	1868	1869
Total Expenditure	30,505	20,785
Total Revenue	33,089	34,438
of which Land tax	2,009	3,355
Other taxes	1,252	1,124
Paper money issued	24,037	23,962
Money borrowed from domestic merchants	3,838	811
Money borrowed from foreign merchants	894	100

(Note: the fiscal year 1868 covers 14 months from January the 1st to December the 31st, while the fiscal year 1869 covers the period from January the 1st to September the 30th)

The reason why the new government had to content itself with this small amount of tax revenue, is not hard to explain. It was in 1873 that the land tax was reformed from top to bottom. Before 1873, the land tax had been paid to the government in kind, especially rice. As a matter of fact, the feudal land tax was not distinctly separated from the ground rent in the modern sense of the word. The reform of 1871, whereby local lords had to yield feudal power in their clans and were supplanted by the new governors appointed by the central government, meant that farmers should be emancipated from feudal duties of any kind and be given the complete ownership of the land. The farmers were to have the right to sell their lands whenever they wanted, to cultivate them with whatever crops they liked, and even to abandon them and move into any other places they wished to go. In short, the rigid hierarchical mold and restrictions placed upon the peasants were abolished in principle. In order to raise a sufficient revenue from the land, the government leaders had to elaborate complicated plans to survey the acreage of lands throughout the country and to identify the owners of each parcel of land. It took a long time to perform these plans.

III. *The Land Tax Reform, 1873-1882*

Before the Land Tax Revision of 1873, the government had issued certificates of landownership to recognize the private owners of land in Tokyo where, despite the restriction upon alienation of land, it had been freely transacted and the private ownership of the land had been well recognized. The certificates were also given to those who had bought land since the removal of the ban against the permanent annexation of land. These certificates carried the price of the land according to its sales price. But, many difficulties arose as to the ownership and price of the land when the certificates were demanded from those in possession of it because they had not yet received them, for there were no exact records of land-right neither any reliable transaction price available in regard to it.

Together with these difficulties, the urgent need of larger sources of revenue, necessarily, lead to the fundamental reform of the land tax as well as the land system in Japan.

The basic ideas of the new land tax were :

(1) To assess the tax according to the value of the land. As I mentioned before, the tax had, formerly, been levied according to the normal harvest which was estimated officially by the agents of feudal lords every year at each village. The new land value was to be computed by capitalizing the net earnings (the money equivalent of crops minus the cost of seeds and fertilizer and the sum paid for both the central and the local land tax).

(2) To levy the tax at the unified rate of 3 per cent of the value of land thus computed. The rate was not to be subject to alterations which had, formerly, occurred according to good or bad harvests (The rate was reduced to 2.5% after the riots of 1877).

(3) To collect the tax in money.

Although there were many mistakes and inaccuracies as well as coercions in the demarcation, survey and classification of the land, the settlement of the land tax proceeded rapidly in 1876 and sometimes brought about so serious opposition among farmers as to force the government to reduce the rate of land tax to 2.5 per cent as in 1877.

In this connection, we should remember that the first consideration of the wise officials in the government was to establish a fiscal mechanism which could produce a revenue of not less than what the Tokugawa Shogunate had actually obtained before.

According to the final report presented in 1881, the results of the tax revision showed a 48 per cent increase in acreage of fields and estates.

Table 3. Acreage, Value and Tax of Land

	Wet field	Fire field	Curtilage
Acreage (in thousand cho)	2,630	1,862	348
Yield (in terms of rice, thousand koku)	33,209	7,536	2,922
Average price of rice per koku (yen)	4.185	4.185	4.185
Rate of interest	6.1%	6.3%	6.0%
Value of land (in million yen)	1,220	267	134
Land tax (in thousand yen)	36,604	8,018	4,037

Note : I cho=2.45 acres
I koku=5.12 bu.

In computing the value of the land and the land tax, government officials were ordered to follow the examples shown as follows:

First example (the case of owner farmers)

Rice yield: 1.6 koku	at 3.00 yen	4.800 yen
Cost of seeds, etc.	15 % of gross return	720 (—)
	(Net return)	4.080
Local tax	1 %	
Land tax	3 % 4 % of net return	1.632 (—)
		2.448
Capitalization at the rate of, say, 6 %		40.800

Second example (the case of sharecrop)

Rice yield: 1.6 koku		
Rent received in kind: 1.038 koku ...	at 3.00yen ...	3.264 yen
Local tax	1 %	
Land tax	3 % 4 % of rent received	1.632 (—)
		1.632
Capitalization at the rate of, say, 4 %		40.800
Land Tax	3 % of land value	1.224

Although the examples could be modified with respect to the rate of interest, price of rice and gross return, the officials seemed extremely faithful to them in preventing any decrease in tax payment. As the tax revision proceeded, the government gradually became self-confident in raising the revenue from the land. On table 4, we can find that the land tax steadily attained real importance.

Table 4. The Land Tax, etc., 1868-1877

	(A) Total Revenue in thousand yen	(B) Tax Revenue in thousand yen	(B)/(A) %	(C) Land Tax in thousand yen	(C)/(B) %
1868 (14 months)	33,039	3,157	9.5	2,009	63.7
1869 (9 months)	34,438	4,399	12.9	3,355	76.3

1870	20,959	9,323	44.5	8,218	88.1
1871 (13 months)	22,144	12,852	58.0	11,340	88.3
1872 (14 months)	50,445	21,845	43.3	20,051	91.8
1873	85,807	65,014	75.8	60,604	93.2
1874	73,445	65,303	88.9	59,412	91.0
1875 (6 months)	86,321	76,528	88.7	67,717	88.5
1876	69,482	59,194	85.2	50,345	85.0
1877	59,481	51,730	87.0	43,023	83.2

It is quite clear that most of the government expenditures were defrayed by peasants and farmers, who, though freed from the oppressive bondages, had to take pains in turning a considerable part of their crop into money so as to meet the land tax.

This was especially true of many small landowners who were living in the countryside with no easy access to the national or even the local market.

Whenever fluctuations in the price of rice took place, farmers without foresight were compelled to sell their own piece of land and became tenants of big landowners or went to the city. These farmers were, in most cases, small peasants, who usually could not wait for a rise in the price which was always low at the time of harvesting.

IV. *The Civil War of 1877 and its Impact on Public Finance.*

In the fiscal year 1875, about one third of the revenue was being spent for supporting the feudal lords and warriors whose hereditary stipend had been guaranteed by the new regime. The minister of finance made a recommendation to the government that all the stipend should be transformed into a one-time allowance in the form of a public debt.

It was foreseen that, with the abolition of the hereditary stipend, the last privilege upon which those out of office could hang on, would disappear. The strong fears of losing this privilege, together with the disappointment of hopes over a successful life in government, induced warriors to raise rebellions one after another until at last the government was compelled to fight in Kyushu against the uprising forces in 1877.

It was in this bloody struggle that the army of conscripts which consisted of common people proved for the first time its superiority over the warrior's army.

The civil war, however, was very costly to the Tokyo government. The war was entirely financed by issuing paper money. Government paper money was increased by 27,000,000 yen while the Fifteenth National Bank also issued bank notes for 15,000,000 yen and lent it to the government. The inflationary trend caused by the excessive issuance of paper currency,

was accelerated by the distribution of huge amount of capitalized pension bonds, which reached a surprising amount of 173,902 thousand yen.

From 1877 to 1882, Japan was under the pressure of inflation. Prices went up, imports exceeded exports, a substantial outflow of specie took place, and the rate of interest jumped, thereby causing a heavy fall in the bond market.

Table 5 shows the rapid increase in the amount of circulating money.

Table 5. The Amount of Circulating Paper Money, 1876-1881 (in thousand yen)

	Government Notes	Bank Notes	Total (A)	Specie Reserve (B)	(B)/(A) %
1876	105,147	1,744	106,891	15,171	14.2
1877	105,792	13,352	119,149	15,115	12.7
1878	139,418	26,279	165,697	17,837	10.8
1879	130,308	34,046	164,354	9,966	6.1
1880	124,940	34,426	159,366	7,166	4.5
1881	118,905	34,396	153,302	12,699	8.3

It is important to notice that, although the new banking system had been introduced after the American model in 1873, its workings were not satisfactory owing to the lack of capital funds that could not be overcome even with the protective measures pushed forward by the government. When the civil war broke out, the government gave permission to the Fifteenth National bank for issuing notes on the public bonds instead of specie. The bank notes issued thenceforth were borrowed by the government and spent for purposes of financing the civil war. This is why the circulation of bank notes showed a great increase from 1877 and afterwards.

With regard to the development of export and import, we have the following figures.

Table 6. Export and Import, 1876-1882 (in thousand yen)

	Exports	Imports	Balance
1876	27,711	23,964	3,746
1877	23,348	27,420	-4,072
1878	25,988	32,874	-6,886
1879	28,175	32,953	-4,777
1880	28,395	36,626	-8,231
1881	31,058	31,191	-132
1882	37,721	29,446	8,275

As mentioned before, the foreign trade had been unfavorable from the beginning since 1850's and almost every year the outflow of specie had been taking place. The exact amount of gold and silver that left Japan since the opening of the country is not available. Consulting the figures officially reported, we know that the total outflow of specie was not less than 70,000 million yen during the period of 1872-1881. And, needless to say, it should, to a great extent, be attributed to the adverse balance of foreign trade. In other words, Japan cleared the balance of trade with the gold and silver that had been accumulated in the country for two hundred and fifty years since the exclusion of foreigners from the country.

As for the heavy fall of public bonds market, the following table gives us the whole picture.

Table 7. The Rate of Interest and the Quotation of Public Bond

	Rate of Daily Interest (sen)	7% Capitalized Pension Bond (yen)
1878	2.85	83.495
1879	3.29	81.307
1880	3.59	71.851
1881	3.84	69.500

To evaluate the effects, which the fall of the bond market produced on the economic condition of bond-owners, we need to investigate how the original bonds had been distributed among the holders of the hereditary right to receive rice.

In 1875, the rice allowance amounted to 3,880 thousand koku, while in 1876, it was reduced to 30 thousand koku by the compulsory commutation of rice allowance. Warriors and lords were to be paid in money, which totaled over 17 million yen. This amount was, in turn, commuted to bonds. And those who were given bonds numbered around 313,500 people. Big lords attained large money fortunes, which provided enough capital for industrial or banking enterprises whereas hundreds of thousand of persons of low rank had to turn their meager share into money so as to finance their daily expenses. Within less than ten years, sixty seven per cent of the bonds were sold out by the original owners mostly at a low price.

Thus, many of the warriors, now deprived of a livelihood, struggled for jobs such as lower officials, policemen or officers under the new regime. No small number of warriors tried to find their way to new undertakings such as silk reeling, tea making, printing, farming, etc., though the projects were not always successful except that they provided a stimulus to local industries.

V. *The Liquidation of Paper Money and the
Public Debt in 1881-1886*

Under the pressure of the price inflation of 1877 to 1881, the real size of the public finance diminished rapidly. The index of the price of rice was 221 in 1881 as compared with 100 in 1873 when the land tax was revised. This great advance in the price of rice gave landowners the benefit of paying less and less tax. The division in the proceeds from the land proved to be a great disadvantage for the State (See Table 8).

Table 8. The Division in the Proceeds from the Land

	State	Landowner	Tenant	Total
Before 1868, when the tax was paid in kind	50 %	18 %	32%	100%
In 1873, when it was revised...	34 %	34 %	32%	100%
In 1878-87, when inflation took place	11.5%	56.5%	32%	100%

In order to overcome the financial and economic difficulties caused by the excessive issuance of paper money, the government tried hard to curtail expenditures and increase revenues. It was in that direction that the government gave up the cherished policy of fostering industries by establishing and operating model factories of various kinds, and that it raised the liquor tax as well as the tobacco tax and created many taxes such as the stamp-duty on the patent medicine, the exchange tax, the soya-sauce tax and the confectionary tax.

Resorting rigidly to a tight-financing policy, the Treasury accumulated a budgetary surplus to redeem paper money and to purchase specie. As the plan proceeded, the circulation of the government paper money was reduced to a reasonable level, thereby restoring the parity of specie and notes. A central bank was organized. The exclusive privilege to issue notes on convertible reserve was given to it. Most of the 153 national banks which had been established during the inflation period with a capital of less than half a million yen and a capital invested with hereditary stipend bonds, were liquidated.

Table 9 shows how drastically the whole economic picture was changed since 1882.

Table 9. Circulation of Notes, Price of Rice,
Exports and Imports

	Government and bank notes (in thousand yen)	Index of price of rice (1868 =100)	Exports (in thousand yen)	Imports (in thousand yen)	Balance of trade (in thousand yen)
1882	143,754	149	37,721	29,446	8,275
1883	132,275	105	36,268	28,444	7,823

1884	124,396	86	33,871	29,672	4,198
1885	118,500	109	37,146	29,356	7,789
1886	97,302	94	48,146	32,168	16,707
1887	84,419	84	52,407	44,304	8,103

Instead of a great rise in prices, a rushing outflow of species or a sharp fall in the bond market, now came a fall in prices, an inflow of species and an advance in the bond market. Taking due advantage of these new developments, the government completely succeeded in its plan to consolidate the public debt for the surprising amount of 175 million yen. All the loans bearing more than five percent interest were successfully converted into long-term 5% bonds. This conversion resulted in a decrease in the debt charges by three million yen a year.

But, the reverse side of the medal was not so bright. As the tight-money policy proceeded, even existing taxes became oppressive, to say nothing of the new taxes mentioned above. In other words, even if the taxes had not been raised, the Treasury would have been able to obtain a greater revenue in the deflationary period, because the land tax which formed an important part of the revenue at that time, was levied on the value of the land settled once for all. According to an estimate compiled by Dr. Yuzo Yamada, the national income produced was 794 million yen in 1881, as compared with 710 million yen in 1883. Contrary to this sharp fall in the national income, there was a considerable increase in the national tax revenue; it was 67,659 thousand yen in 1883 as compared with 61,675 thousand yen in 1881. As a result, the ratio of the national taxes to the national income rose from 7.8% to 9.5%. This was, needless to say, a heavy drain upon the source of taxation.

As will be seen soon, what aggravated the financial difficulties, was a continuous increase in the national defense expenditure. In spite of a vigorous demand for the land tax deduction, the rate was kept unaltered. Consequently, a fifty per cent drop in the price of rice in the depression period resulted in a two hundred per cent rise in the land tax payments.

It was reported that, from 1883 to 1890, there were more than 367,000 cases in which agricultural producers suffered forced sales for arrearages in the payment of the national or local land tax. The total amount in arrearages was only 114 thousand yen or an average amount of 0.31 yen, while the total amount of the loss caused by the confiscation or auction of the land was 3,155 thousand yen, or an average amount of 8.31 yen. In the single year 1884, the debt of the farmers increased by 150 million yen, and from that year to 1886, the sales of the land amounted to 180 million yen. The number of those who paid the tax from five yen to less than ten yen was 685 thousand in 1887 as compared with 877 thousand in 1883, showing a sharp decrease of 192 thousand, or 22%.

Under these circumstances, it was unavoidable that poverty prevailed among the small farmers. From 1887 on, the revenue from the land tax, too, began to show a decline in its absolute as well as its relative importance.

VI. *The Sino-Japanese War*

After a long depression period, Japan emerged as an apparently modernized country with railways, steamers, factories, a central bank, etc. And it is not too much to say that almost all the new establishments were either inaugurated or encouraged by the government funds coming from the land tax and the public debt.

The money of the government created not only essential public works and services such as telegraph and telephone systems, schools, hospitals, laboratories and libraries, but also a heavily equipped army and navy as well as the authoritative organizations of administration.

The political leaders laid much stress upon the national glory or the imperial expansion competing with the Western powers so that less attention was paid to the importance of the domestic market in the strict sense of the word. Instead of being encouraged by the endogenous demand in the home market, the transplanted industries were destined to seek either the exogenous demand arising from the government or the foreign demand from abroad. Although the peasant community was, to a considerable extent, dissolved by the increased planting of cash crops and the decreased home production of handiworks, especially of clothing, the impoverishment of peasants caused by the land tax payments and others placed a narrow limit upon the domestic market.

In 1894, the ten year old rivalry between Japan and China for the political and economic control of Korea, bursted finally into a war. To finance it, the Meiji government resorted again to the public loan in pursuance of the same policy as was employed during the civil war of 1877. The cost of the War reached a surprising amount of 200 million yen, approximately three times as much as the annual expenditure of the government. A loan of 125,000 thousand yen was raised in lots, and another temporary loan of 42,500 thousand yen was concluded with the Bank of Japan. What made up for the remainder, were transfers from other government funds and contributions towards the relief of soldiers.

It can readily be imagined that the government was confronted with great difficulties in floating this much loan in those days, when the accumulation of money capital was on such a low level that the total amount of bank deposits, excluding current deposits, showed less than 70 million yen. And yet, it was also impossible to negotiate a foreign loan,

since the domestic money market was not effectively connected with the foreign money markets owing to the fact that Japan was a silver-using country until 1897. This huge amount of 200 million yen raised exclusively from the money market within the country, therefore, had a great influence upon the economic development of Japan. Another inflation occurred with a large rise in prices, imports in excess of exports, the outflow of gold and silver, large investments of capital in those industries which had a close relation with war, and so on.

But, at the same time, we should remember that the general level of the industrial technique was not high enough to supply war-products to the army and navy. As a result, the government had to expand the state enterprises such as iron works, munition factories, railways, etc.

One of the most important results effected by Japan's victory over China, viewed from the financial aspect, was the reparation payments which amounted to an amazing sum of 355,980 thousand yen. China was compelled to float a loan on customs duties in London so that she could pay indemnities in gold in accordance with the demand made by the winner, who needed it badly to reform her monetary system on the gold standard.

While, in general, an unstable monetary and banking system is a phenomenon common to under-developed countries, it does constitute a fundamental obstacle to their economic development, and to break this vicious circle is not easy. Fortunately enough, Japan could afford the funds necessary to establish a stable monetary system on the gold basis in place of the silver basis, thereby she stabilized her foreign exchange rate.

In spite of the acquisition of large indemnities, the government was still in great financial difficulties owing to the necessity of expanding armaments, of improving transportation and communication, and of developing Formosa, an acquisition of the war. The largest single item was armament expenditure; Japan had to take measures in opposing to the Russian advance into the Far East. Thus, indemnities alone, were not sufficient to support many colossal projects for further developments, and the Diet approved government bills to create a registration tax and a business tax, and to raise the liquor tax. Also the tobacco monopoly system was inaugurated. The following table shows how the structure of tax revenue was changed after the war.

Table 10. The Structure of Tax Revenue,
1893, 1896 and 1899 (in thousand yen)

	Before the war	After the war	
	1893	1896	1899
Total expenditure	84,581	168,856	254,165
Total revenue	113,769	187,019	254,254
Tax revenue	70,004	81,764	145,535
Land tax	38,808	37,640	44,861

Income tax	1,238	1,810	4,837
Business tax	—	—	5,507
Liquor tax	16,637	19,521	49,009
Revenue from tobacco	2,640	2,977	7,557
Customs duties	5,125	6,728	15,936

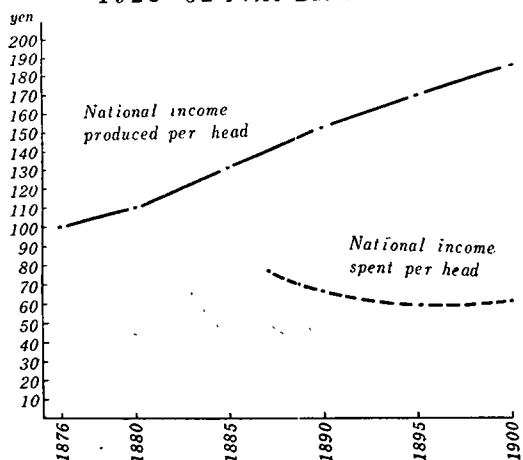
The importance of the land tax declined greatly, while that of indirect taxes advanced; the amount of the land tax was surpassed by that of the liquor tax in 1899.

VII. *An evaluation of the Effect of the Fiscal Policy on the Industrialization of Japan, 1868-95*

It is widely known that Japan showed a rapid economic growth during the period I am discussing. Within a quarter of a century, her national income had trebled (320%); it had been 540 million yen in 1875 as compared with 1,725 million yen in 1895. Although, if we take the advance of prices into consideration, the percentage of growth drops from 320% to 233%, despite of this, there is no doubt that the growth of the economy was amazing.

During the same period, the general as well as the employed population showed a great increase, from 33,111 thousand to 42,271 thousand and from 17,319 thousand to 24,257 thousand respectively. An increase of 128 % in the general population, however, did not materially affect the rising curve of productivity per head.

The level of productivity and consumption, 1928-32 Price Basis.



Yuzo Yamada, *Estimates of National Income of Japan*, Tokyo 1951, p. 143.

But, curious enough, the level of consumption per head (basis: general population) was becoming even lower so that a greater gap between production and consumption appeared. (See the chart on p. 26.)

This gap was the very sources from which savings and capital were pumped up. In this process, the fiscal policy played the most important role by distributing public bonds among the old leaders, floating loans, issuing notes, imposing the land tax in money, and acquiring a huge amount of indemnities. And, from the beginning, the government was able to collect funds for the ratio of more than ten per cent of the national income. The government expenditure was spent mostly for military purposes, or at least for those which are closely related with them. While the peasant economy remained almost unchanged in that most of the tenants had still to pay their rent in kind, large scale industries were transplanted either under Government auspices or even with Government funds.

We cannot deny that the Meiji regime was considerably successful in enabling Japan to emerge as a military power in the Far East, equipped with modern industries such as shipping, railways, spinning, steel-manufacturing, and so on. But, on the other side, we should notice that the exacting fiscal policy interrupted a normal development of the domestic market, and as a result, the enterprisers were bound to rely upon an exogenous market created, so to speak, artificially by the Government.

In the earlier stage of capitalistic developments, or mercantilism, it was widely observed that an active demand for munitions gave a great stimulus to the modern industries. In this sense, an exogenous demand was the mother of capitalism. But, in western countries, it was gradually accompanied by, and afterwards outgrown by an endogenous demand, whereas, in Japan, industrialization was constantly under the leadership of the Government. Unlike advanced countries, Japan could not wait and see things go their natural course. In addition, an unexpectedly easy victory over China renewed the self-confidence of the ruling class in assuming a responsibility to pursue the expansion policy which surpassed the economic ability of Japan.

Professor Nurkse states in his book (*Problems of Capital Formation in Underdeveloped Countries*, p.154), "Capital formation can be permanently successful only in a capital-conscious community, which is just as important for the continued maintenance as for the initial creation of capital, is promoted by a wide diffusion of investment activity among individuals. Nothing matters so much as the quality of the people." It is right to lay stress upon the quality of the people. But, it is also necessary to emphasize the structure of the domestic market which is bound to exert a definite influence upon the making of the people. If the productivity is improved mostly by means of an exogenous demand created by the government, it can hardly be helpful in raising the standard of living. And a

low standard of living is likely to reduce the ability of people to save and invest. Owing to the lack of both savings and endogenous demands among the people, businessmen are likely to rely more on government funds and their demands. It is not too much to say that the economic development of Japan is characterized by the activities of these businessmen.