AN UNREALIZED PLAN: THE VALUE-ADDED TAX IN JAPAN*

By Motokazu Kimura

Professor of Public Finance

Most of the problems involved in the value-added tax in Japan have already been discussed at great length by Professor Hanya Ito,[1] professor Martin Bronfenbrenner[2] and others. Consequently, the present writer endeavors to examine the value-added tax in its bearings on the socio-economic conditions of Japan. The tax was, upon recommendation of the Shoup Mission[3], enacted in July, 1950. However, the operation of the statute was postponed twice and then repealed in 1954 without ever being put into effect. Why was it recommened? How was it enacted? And, why was it repealed? These are the questions I wish to answer in this paper.

The outline of the Shoup Recommendations

The "Report on Japanese Taxation" may be said to be an elaborate display of painstaking scientific work. Objectives, that the Shoup Mission aimed at, were comprehensive. The Mission laid much stress upon the necessity to designate productive taxes to local governments, to check the overgrowth of plutocratic power, to avoid taxes not helpful in fostering responsible citizenship and democracy, and to satisfy the modern principle of taxation as much as possible—the principle of ability-to-pay as the standard of equity. At the same time, the Mission paid much attention also to the problem of how to encourage the accumulation of capital. In reconciling those objectives, the Report may be said to have given a remarkable coherence to the whole reform plan.

Thus, it should be remembered that the value-added tax, too, came under the recommendation as an integral part of the program. In other words, the

* This paper is the English version of "Un Projet inachevé: L'impôt sur value ajoutée au Japan" appeared in *Revue de Science et de Législation Financières*, Tome XLVIII, 1956.

[1] Cf. Hanya Ito, "The Value-Added Tax in Japan," *The Annals of the Hitotusubashi Academy*, Vol. I, Number I, October 1950; this article is contained in, Hanya Ito, *Essays in Public Finance*, Economic Series, No. 3, The Science Coucil of Japan, Tokio 1954. Hanya Ito, "Theorie und Techinik der Nettoumsatzsteuer in Japan," *Finanzarchiv*, Vol. 15, No. 3, Tuebingen 1955.

[2] Cf. Martin Bronfenbrenner, "The Japanese Value-Added Sales Tax," *National Tax Journal*, Vol. 3, No. 4, December 1950.

[3] The American taxation mission headed by Professor Carl S. Shoup came to Japan in May, 1949 and submitted a report to the Supreme Commandor of Allied Powers (SCAP) in August, 1949. Tax bills, national and local, were drafted by the combined efforts of the SCAP and the Japanese Government.

Mission emphasized that the reform should be effected without any grave departure from the recommendations as a whole. To visualize the extent to which the Japanese taxation was to undergo changes, I should like to insert the following table.

Table 1 Revenue Effects of Major Tax Recommendations
(in billions of yen)

A. National Government

	Fiscal Year 1949–50	Fiscal Year 1950–51	Difference
Personal income tax	310	290	−20
Corporation income taxes	27	35	+ 3
Tobacco monopoly profit	120	120	0
Liquor taxes	65	80	+15
Transactions tax	45	0	−45
Other internal taxes	68	51	−17
Total	**635**	**576**	**−59**

B. Local Governments: Prefectures

Inhabitant's tax	11	0	−11
Land and house tax	7	0	− 7
Enterprise tax, income basis	26	0	−26
The value-added tax	**0**	**44**	**+44**
Admission tax	5	10	+ 5
Amusement taxes	6	12	+ 6
Other taxes	22	5	−17
Total	**71**	**71**	**0**

C. Local Government: Municipalities

Inhatibant's tax	12	60	+48
Land and house tax	7	52	+45
Enterprise tax, income basis	26	0	−26
Admission tax	9	0	− 9
Amusement taxes	6	0	− 6
Other taxes	16	7	− 9
Total	**79**	**119**	**+40**

It is quite clear that a drastic change was introduced in the allocation of tax resources between the three levels of government, particularly in favor of municipalities, including cities, towns and villages. In accordanec with the objective to strengthen loal autonomy, municipalities, which had long been relying upon national or prefectural tax agencies in assessing such taxes as the inhabitant's tax, the land tax, the house tax, and the enterprise tax, were now to be given substantial resources independent of superior authorities. But, as for the Inhabitant's tax, municipalities were to be allowed to use the national income tax returns in checking the incomes of inhabitants.

It was also characteristic of the Shoup Plan that it extended the grant-in-aid system so as to reduce various subsidies to local units, for it feared that the central government would continue to control over local governments by dint of specific subsidies.

As will be seen later, the taxpayers were justifiably demanding to cut their burdens in 1949. Therefore, the Shoup Mission recommended to repeal the transaction tax, the tax on the transfers of securities and so on at the national level, and the real property acqusition tax, etc. at the local level. Reductions in the personal income tax rates and others were also recommended. But, as far as local tax revenues were concerned, they had to be either kept remained or increased. This was the major reason why the Shoup Mission contrived to reform the enterprise tax on income basis.

A value-added tax as recommended

As shown on Table I (p. 14), the enterprise tax was an independent prefectural tax yielding approximately 50 billion yen in 1949. The yield was shared with municipalities usually fifty-fifty basis, through the device of a municipal surtax. The tax base was net profits. They were usually those computed for the purpose of the national income taxes. Accordingly, the enterprise tax was in effect a kind of surtax on the national income tax. To make the matter worse, the basic exemption and dependency credits allowed for the national personal income tax were not applicable for the enterprise tax. Moreover, the individual proprietors of shops or small factories had to pay a prefectural-municipal inhabitant's tax, most of which was also based on their net profits. A great increase in the inhabitant's tax, as was planned by the Mission, would certainly make the cumulative effect of the three-fold taxes disastrous.

In order to avoid this danger, it was needed to contrive a new base for the enterprise tax. Thus, a value-added tax was, for the first time, introduced to Japanese people.[4]

[4] In the United States of America, a value-added tax had long been discussed by students of public finance such as Thomas S. Adams (1921), Gerhard Colm (1934), Paul Studenski (1940), Carl S. Shoup (1943) and so on. As to the development of theories of a value-added tax, see Hanya Ito, The Value-Added Tax in Japan, in the above-mentioned place. There is no doubt that the idea of the value-added tax was much influenced by those discussions.

According to the recommendation, value-added would be much simpler to compute than the net income, because no computation of depreciation needs to be made. And again following to the Report, the sum of profit, interest, rents and payroll, would be equal to the balance between total gross receipts and all the purchases from other firms, including the purchase of capital equipment, land and buildings.

An enterprise tax based on value-added was to be administered exluşively by the prefectures, which should obtain the entire yield of it. The rate of the new tax was suggested to be set at a level that yield the prefectures about 44 billion yen per year. Farmers were to be exempt, because they were coming under a substantial increase in the real estate tax, which was recommended to supplant the land tax and the house tax at the municipal level.

In fact, the rate was tentatively computed to be somewhere around 4–6 per cent.

Two other merits were attached to a value-added tax. First, it is free from the distorting, pyramiding tendencies of the transactions tax. The Report stated that the transactions tax, or turnover tax, was the least refined member of the sales tax family, and the least promising member of 'the present Japanese tax system.' While a retail sales tax would escape the defects, a nation-wide retail sales tax would not be practicable in Japan, 'for there are too many small retail shops whose accounting records are inadequate or non-existent.' The best solution was, the Report concluded, to transform the transactions tax into a tax levied upon the value-added.

The second merit attached to a value-added tax was the economic advantage that it does not discriminate against the use of capital, especially in the form of labor-saving machines.[5]

Codification of the value-added tax

The Shoup plan encountered bitter complaints all the more because taxpayers' hope for the reduction of their burdens was extremely great. Despite the pressure of the SCAP, grave objections were raised by those brought under heavier taxation. Almost all the devices elaborated upon the idea that Japan should have the best taxation system in the world, were subjected to criticism. For example, the net worth tax, the revaluation tax and other new taxes were sharply criticized by the businessmen. The inclusion of all incomes into the taxable income of the personal income tax, one of the most important cornerstones of the Shoup Program, likewise arose bitter complaints among the wealthy taxpayers. In the case of the estate tax, a great extension of the tax base caused unrest among businessmen, because the Shoup Mission planned also to

[5] It should be remembered that laborers and their leaders, influenced by the statement that the value-added tax is favorable to labor-saving, took a stand against the value-added tax.

include depreciating assets which were hitherto not subject to taxes into the tax base of the estate tax.

And yet, no other taxes were more heatedly argued than the value-added tax.

It was anticipated that the value-added tax would bring about a sharp change in the allocation of tax burdens. The new tax was deemed to be favorable to small enterprises, while business enterprises with heavy capital equipment already on hand were to be penalized, because no depreciation allowances were permitted on it. It was also expected that the tax would be disadvantageous to service industries such as banking, rail-way transportation, etc.

We heard bitter complaints and there were few supporting arguments. Let us look back some of the demands, reasonable and unreasonable, presented especially by business groups.

(1) The standard rate of the value-added tax should be reduced from 4 per cent to 2 per cent.

(2) A reduced rate should be applied to that part of the value-added tax which is levied upon payrolls.

(3) A special allowance should be devised for service industries.

(4) In view of the difficulty in shifting the value-added tax, a reduced rate should be permitted for public utilities that are under the regulation of price control.

(5) With regard to capital assets already on hand, depreciation allowance should be permitted.

(6) Interest received by banking facilities should be exempt, otherwise, double taxation would occur.

(7) Rent and rentals received by lessors should be exempt, if not, double taxation would appear.

Taking into consideration some of those demands, the Bureau of Local Autonomy drew up the Value-Added Tax Bill. The outline of the bill can be summarized as follows:

I. Tax base;

The balance between total gross receipts of a business enterprise in the wide sense of the words, and all amount paid to other business enterprises.

II. Computation of value-added;

A. Business in general:

i. Gross receipts: Total gross receipts from sales of goods and fixed assets, or from the performance of services, and receipts from related trade or business activities.

ii. Exclusions: Interest, dividends, rent and rentals received.

iii. Deductions: All amounts paid for the acquisition of fixed assets, commodities, semi-manufactured goods, materials, or supplies; Commission paid, storage, property insurance premiums, advertisement expenses, and taxes paid, except those levied on net income.

iv. Non-deductible: Rent, rentals and interest paid.

B. Financial business, including banking and insurance:
i. Gross receipts: Interest, dividents and others received.
ii. Exclusions: Rent and rentals received.
iii. Deductions: Interest paid.

III. Exemptions;
A. Farmers, lessors and forestry traders.
B. Business enterprises with the value added of less than 90,000 yen per year.

IV. Rates;
The standard rate of 4 per cent for business, and 3 per cent for professions, stock-breeding and fishery, the maximum rates being 8 per cent and 6 per cent respectively.

V. Allocation of the tax yield between prefectures;
In the case a concern does business in various prefectures, the tax base is to be allocated according to payrolls, but in the case of manufacturing, electricity supplying, gas supplying, etc. fifty per cent weight in the allocation is to be based upon payrolls, and the remainder on the value of fixed assets.

VI. Transitory provisions;
In order to avoid a sudden increase in the tax burden, a relief is given to banking business, insurance business, warehousing business and the like. Namely, notwithstanding the preceding provisions, the following percentages of gross receipts will be used as the tax base for the first year after the enforcement of the tax law:

45 per cent for banking business,
100 per cent for trust business,
15 per cent for life insurance business,
50 per cent for transportation (except railway) business,
40 per cent for warehousing and railway transportation business.

The new Local Tax Bill containing the Value-Added Tax Bill was presented before the Diet, but failed to secure the approval in its 7th session in March, 1950. As a result, a great financial vacuum took place in the local fiscs.

It was in June, 1950 that the Local Tax Bill was carried in the 8th session of the Diet. But, as far as the value-added tax is concerned, its operation was postponed until January 1, 1952. To fill the financial gap caused by this procedure, the Government arranged to restore the old business enterprise tax with slight modifications. Namely, the rates were reduced from 15 per cent to 12 per cent for corporated enterprises, and from 15 per cent to 10 per cent for private enterprises, and farming and forestry business were made exempt.

In the meantime, the Shoup Mission made a second visit to Japan in August-Spetember, 1950, and published a report again.

In the Second Report, too, the Shoup Mission stressed the sales tax nature of the value-added tax, and expressed opposition to the proposal to apply differentiated rates of 4 per cent for business enterprises and 3 per cent for professions. A plain objection was also expressed to the transitory relief provisions for specified business enterprises such as banking, warehousing, etc.

On the other side, the Report admitted that depreciation allowances should be permitted on capital equipment already on hand as of the date of the enforcement of the value-added tax. Another point that the Report recommended, was to introduce the addition method in computing value-added.

In the following year, 1951, the Value-Added Tax Act was revised slightly, but, the suggestions made by the Mission were hardly taken into consideration. The core of the revision was only to give corporated business enterprises the option to use either the subtraction method or the addition method, and the freedom to switch over from the one method to the other. In spite of the revision, the date of the enforcement was again postponed to 1953.

Why was the value-added tax postponed year after year till at last revoked altogether?

Theoretical ambiguity involved in the Recommendations

Although the concept of value-added had gradually been contrived in the academic circles, a value-added tax was not intelligible to the common taxpayers in Japan. Besides, there were some ambiguous points in the Report.

In the first place, it assumed that a value-added tax was a refined sales tax which can be shifted to consumers without having the distorting effect of pyramiding. Unlike a retail sales tax or a turnover tax, however, it is not easy for businessmen to compute at once how much their tax liability on a given sale or transaction will be, because a value-added tax as a percentage of gross sales differ between firms and industries. Businessmen rightly feared that their firms might be ruined, if they were compelled to pay the value-added tax when the business showed a loss.

In the second place, the Report maintained that a value-added tax was simple to compute. The sum of profit, interest, rents and payrolls, in short, the sum of factor costs, was deemed equal to the balance between total gross receipts and all purchases from other firms. By this reasoning, the Mission recommended to compute the tax base by the subtraction method. Similarly, the Second Report recommended to introduce the addition method for the convenience's sake, assuming that both the addition method and the subtraction method are bound to result in the same. But this assumption has been proved incorrect. As professor Ito[6] explained clearly, the value-added as computed with the subtraction method will not be equivalent to the value-added as computed with the addition method, unless a necessary adjustment is made to the concept of profit. If the profits as computed for national-income tax purpose is added to payrolls, interest and rental payments, the result will be different from the value-added

[6] Cf. Hanya Ito, Theorie und Technik der Nettoumsatzsteuer, *loc. cit.*, pp. 460–465.

computed with the subtraction method, because the net profit under value-added concept can only be obtained by specific accounting procedures as follows:

Net profit under value-added concept=*Net profit in its usual accounting term+Depreciation amount+ Decrease in inventories—Capital expenditure*

In the third place, the Recommendations left some ambiguity about the relation between the transactions tax and the value-added tax. As I mentioned before, the Shoup Report was strongly against the transactions tax, and recommended to repeal it only if total national government outlays are in fact reduced to the level of 646 billion yen. But the repeal of the transactions tax was not related to the introduction of the value-added tax, although, discussing the merits of the value-added tax, the Report made several references to the demerits of the transactions tax. Therefore, it was repealed as soon as budgetary expenditure showed an expected cut, in December, 1949. If the value-added tax had been connected with the repeal not only of the enterprise tax but also of the transactions tax, the case would have been brighter than it was.

In the fourth place, as to the theory that the value-added tax does not discriminate against the use of capital, room seems to have been left for doubt. The value-added tax increases the price of capital at least to an extent to which it is shifted forward. And in view of the increased rates of the municipal real estate tax which is levied on land, buildings and capital equipment, the theory has to lose some of its validity. Moreover, heavier capital equipment represents larger interest payments. Nevertheless, the statement that the vaue-added tax is to encourage the use of labor-saving machines, presented a good reason to the organized laborers for opposing the tax.

The factors which contributed to the repeal of the value-added tax in Japan

It is true that several ambiguous points mentioned immediately above had a considerable share in causing the abolition of the value-added tax, but reality was much complicated.

A. Inflation and Insufficient compliance

To begin with, the year 1949 is marked by a sudden transition from 5-year-old drastic inflation to deflation, or disinflation, as was officially proclaimed by the Government.

As a result of the unconditional surrender of Japan in 1945, her territory was reduced from 263,357 square miles to 142,224 square miles, with the population of 73,064,000, while the war damages amounted to as high as 25.4 per cent of the total value of capital equipment and durable consumers' goods which would have existed in Japan proper, had the war not been waged against the Allied powers. The defeat gave rise to a sweeping crack in the mechanism of war economy that had been kept working by a strict rationing program and price regulations.

A great majority of the Japanese people were directed by a mixed feeling in which despondence predominated. With fears, they watched how the SCAP put the occupation policy into effect. In fact, the SCAP ordered to purge undesirable Japanese from public offices, to dissolve the plutocracy, to redistribute lands among cultivating tenants, to restrict concentration in the business activities, and to enforece a captial levy.

Under these circumstances, a vicious circle of budgetary deficits and rise in prices took place, and people rushed to convert their money into goods. The follwing table shows how vehemently inflation progressed.

Table 2 National Budget Expenditure, Price Index, etc.

	National Budget (General Account) Expenditure (in million yen)	Public Debt (in million yen)	Paper Money (in million yen)	Effective Price Index*
1944	19,871	107,633	18,876	366.4
1945	21,496	140,811	56,658	1,529.0
1946	115,207	173,135	94,853	5,013.0
1947	205,841	209,462	220,870	12,982.0
1948	461,974	280,473	356,795	24,458.0
1949	699,448	391,397	357,969	28,368.0
1950	633,294	341,913	422,063	—

*1928–1932=100, prices at the black market being considered.
Figures are quoted from Yuzo Yamada, Estimates of National Income in Japan, Tokyo 1951.

Both the SCAP and the Government began to feel alarmed, when the Diet compiled additional budgets repeatedly as many as seven times for a single fiscal year of 1947. The situation was not improved in 1948. The inflation could not be checked without a balanced budget, because the inflation was not being caused by the fall in foreign exchange, as was the case in Germany in 1920's, but by budgetary deficits. During the inflation period, the taxation system in Japan was, as a whole, greately distorted by the nominal increase in incomes and the accumulation of black market profits. Enormous profits from the black market could no longer be kept accessible to tax collecting agencies, while wage-earners were forced to come under the higher and higher bracket of the rate of taxes. Taxpayers increased in number, causing a heavy burden upon tax collectors. For example, in the pre-war period, the number of taxpayers under the national personal income tax was less than a million people, while it reached an amazing figure of more than twenty-one million people in 1949.

Upon request of the SCAP, Minister Joseph M. Dodge came to Japan to tackle the problem. His plan was to close up every loop-hole, budgetary and monetary, which was leading to an overissue of paper mony and to raise more tax revenues by enforcing tax laws as strictly as possible. He urged the Government to reduce the total expenditure in the national General Account to 661 billion yen for the fiscal year 1949, as compared with 741 billion yen[7] for the previous fiscal year. Minister Dodge compiled an all-round budget consisting of the national General Account, the national Special Accounts, the Corporation Accounts and the local budgets, making a surplus of 211 billion yen for the redemption of various kind of public loans. Thus, the Dodge Stabilization Program not only checked the inflation but gave rise to a deflationary tendency.

The Shoup Mission had to perform a task at the moment when it became extremely hard to perform. The demand for tax cuts was vigorous, because the tight-money policy began to jeopardize the solvency of taxpayers. Organized laborers were made busy in coping with the unemployment problem. Nevertheless, considering the urgent necessity to meet what the Dodge Plan required, the Mission could not respond to the eager demand for tax cuts.

Taking account of a vicious circle created by high rates and high evasion, the Mission tried to cut rates. However, the tax rates recommended by the Mission were, as a whole, not sufficient to break the circle. Upon setting rates, the Mission was influenced by the opinion of the Finance Ministry of Japan who under-estimated the taxable income on the very existence of prevailing evasion and the lack of voluntary compliance and the inefficient tax administration.

The Shoup Mission tried to contrive a tax system which would be applicable to Japan as a permanent tax system, and which would be the best tax system in the world. As mentioned before, the Shoup Plan is a plan worked out logically. Its enforcement demands a high standard of technical competence and stabilized economy. But, Japan did not have these prerequisites at least at that time. Too many small businesses came under taxes. Tax offices were reinforced by too many inexperienced officials. Black market did not cease to exist. In view of the insufficient tax rates cuts recommended by the Shoup Mission, taxpayers still understated their incomes or transactions. They hated to suffer from visiting tax-collectors. Also they did not like to see their records gathered by the tax authority. For example, the extreme unpopularity of the national transactions tax was, to a great extent, due to the fact that a tax collector could check up income tax returns by means of the transactions tax payments.

As a matter of fact, taxpayers feared that a new tax would cause another vexatious contact with a tax collecting agency. This feeling, coupled with the fact that the rates of the value-added tax was set higher than actually needed, induced even the small businessmen, the major beneficiary of the enterprise tax on value-added basis, to participate in opposing the new tax.

[7] Budget estimate. The figure settled is 699 billion yen as shown on Table 2.

B. The lack of faith in local authority

That the value-added tax was designated to the local, prefectural governments, also had a considerable effect upon the repeal of that tax. For a long time since the Meiji Restoration in 1868, the prefectures had been organized as agencies of the central Covernment. The Cabinet had the exclusive power of appointing and removing the governors of the prefectures. Although many taxes were allocated to the prefectures, a great portion of prefectural revenues was raised by imposing surtax on the national taxes such as the land tax, the personal income tax and so on. Most of the independent prefectural taxes, minor in productivity, were levied according to external signs as the tax standard. Tax officials at the level of prefectural governments became accustomed to rely upon what the national tax agencies assessed and computed.[8]

Based upon the conviction that local autonomy is essential to democracy, the SCAP made an organized effort to destroy the long-established mechanism of highly centralized bureaucracy in Japan. The governorship of the prefecture was made elective, and thus the governors became responsible not to the Cabinet but to the inhabitants of each prefecture. It was along this line that the Shoup Mission introduced a new, independent tax to the prefecture, leaving it considerable scope as to the rate of the value-added tax, so that the tax can be fitted to differing local conditions. In order to strengthen the local source of revenue, a system of grant-in-aid, too, was introduced on a large scale.

However, in view of the fact that the reforms such as the creation of local police system, the extention of compulsory education period, etc. caused a great increase in the local expenditure, the situation was not promising. Warning was taken from the fact that, in April, 1949, the grant to the local governments, the prop and stay of the local finance, was reduced by fifty per cent so as to suit the convenience of the national finance.

It was expected, theoretically and practically, that a poorer agrarian prefecture would inevitably levy the value-added tax at a rate of more than 8 per cent. The taxpayers were apprehensive of being occasionally imposed a high rate of the tax, the base of which is likely to arise much dispute between them and the incompetent tax assessors.

C. The predominant influence of capital interest

As I mentioned before, the value-added tax, as recommended by the Shoup Mission, undoubtedly disfavors the big business groups. It has been estimated that, if the value-added tax were substituted for the enterprise tax, net profit basis, approximately half the burden would be shifted from the small enterprise group to the corporated enterprise group.[9] "A fifty per cent increse in tax burden?"

[8] Similary, municipalities had long been made accustomed to rely upon both the prefectural and the national tax agencies.
[9] Cf. Hanya Ito, Theorie und Technik der Nettoumsatzsteuer, *loc. cit.*, p. 477.

the big business group groaned, "that would cause incalculable harm to the very basis of Japanese industry."

With the conclusion of the Peace Treaty just ahead, both businessmen and politicians alike began to urge the necessity of lowering the costs of production, so that Japan may be able to compete with foreign countries on the world market.

After succeeding in postponing the enforcement of the value-added tax till Japnuary 1, 1952, the capital interest groups began to attack the core of the Shoup Plan.[10] First of all, the Government, influenced by the various business circles, gave up the principle of including all incomes, from whatever sources, into taxable income of the personal income tax. Accordingly, no measures were taken against the usual practice of concealing interest income by spreading deposits anonymously in large number of tax-free accounts. Nor was made any significant effort for the registration of the transfers of securities, the only effective device for including capital gains into taxable income. And it was as early as in 1951 that the Special Taxation Measures Act allowed specific key industries to write down fifty per cent of the price of machinery for two years including the year of acquisition, and permitted the enterprises to add fifty per cent to the normal depreciation allowance on ships and equipment useful for the industrial rationalization. Therefore, large-scale industries could save their corporation income tax payments, thereby reducing the local enterprise tax, net profit basis. The net worth tax, too, was abolished in 1953.

It may easliy undestood that the repeal of the value-added tax was not caused by the alleged defects of the tax itself, but by the strong influence of the capital interest groups.

The imperfectly adopted Shoup Plan and Japanese economy

In any capitalistic country, businessmen are given a preponderent voice in the matter of economic policy in general, and fiscal policy in particular, but, in Japan, the connection between the big business and the Government is based on the economic structure peculiar to this country. In view of the fact that Japan fought with the Allied Powers for four years, she must be a highly industrialized country. In fact, during World War II, she manufactured war stores of all kinds, includeing airplanes, battle-ships, etc. More than 5 million soldiers were mobilized and equipped with modern arms. But, eighty years ago, Japan was an overwhelmingly agrarian country with little trace of modern industry. How was this amazing progress possible?

The government played the most important role in introducing modern industry. It is not too much to say that industrialization of Japan was made possible only by the planned activities of the government.

But, on the other hand, we should notice that the exacting fiscal policy inter-

[10] Cf. Motokazu Kimura, "Taxation and Capital Accumulation," *The Annals of the Hitotsubashi Academy*, Vol. IV, No. 1, October 1953, p. 29 ff.

rupted an over-all, balanced development of the national economy. The growth of the domestic market was much retarded by high rate of the land tax and various excises. And, as a result, enterprisers were bound to rely upon an exogenous market created, so to speak, artificially by the Government.

In the earlier stage of capitalistic development, or mercantilism, it was widely observed that an active demand artificially created by the government gave a great stimulus to the modern industries. In this sense, an exogenous demand was the mother of capitalism. However, in most of the western countries, it was gradually accompanied by, and afterwards outgrown by an endogenous demand. In Japan, on the contrary, the transplanted industry had to seek a market developed in the form of colony abroad or procurement demand at home.

Success or failure of an enterprise, under these circumstances, depends more upon favor or disfavor of the government than the ability to compete with rivals on the free market. Thus, the traditional tenant farmings and domestic industries, countless in number, remained side by side with the great manufacturing industry. Traditionalism, favoritism, paternalism and many other semi-medieval ism's preserved among the farmers and craftsmen, to a greater or lesser extent, produced a formative effect upon the whole economy. The following table will illustrate a characteristic aspect of the Japanese economy.

Table 3 Population Distribution among Industries, 1930 and 1950
(in thousand)

	1930		1950	
Total population	69,341		83,200	
Those engaged	29,341	(100%)	35,626	(100%)
Agriculture	13,742	(40.8%)	16,102	(45.2%)
Forestry, Hunting	186	(.6%)	424	(1.2%)
Fishing	562	(1.9%)	682	(1.9%)
Mining	314	(1.1%)	591	(1.6%)
Construction	977	(3.3%)	1,531	(4.3%)
Manufacturing	4,702	(16.0%)	5,690	(16.0%)
Whole-sale, Retail sale	4,113	(14.0%)	3,963	(11.1%)
Financial, Insurance Business	194	(.7%)	362	(1.0%)
Transportation, Communication	289	(4.4%)	1,811	(5.1%)
Service industry	459	(8.4%)	3,056	(8.6%)
Public service	733	(2.5%)	1,376	(3.8%)
Unknown	71	(.2%)	27	(.1%)

It is characteristic of the Japanese economy that, out of those gainfully engaged, only 36.3 per cent are employed, the remaining 63.7 per cent being either self-employed or family workers. Self-employed farmers and retailers as well as family workers, mostly devouring one another, are making a bare living. Concealed unemployment are prevailing among those people. Under the pressure of this concealed unemployment, even the most advanced leader of a business enterprise would hesitate to dismiss his employees on account of occasional, financial difficulties. To dismiss an employee is often to derive him of his subsistence altogether.

The philosophy which underlies the Shoup Plan is that of competitive business relationship and efficiency. It is a necessary product of the American society, where everyone keeps his deposit account with a bank, pays by check, and keeps the record of his payments, and where banks are ready to lend money not only to the business but to house-wives. In Japan, the practice of paying by check is limited to a small number of well-off businessmen, and a bank is, viewed from the standpoint of a small enterpriser or a house-wife, not the place to get loan but the place to deposit money.

Unlike the United States of America where there is a good deal of social and economic mobility, Japan, under the pressure of increasing population, finds it hard to materialize the necessary conditions for adopting the philosophy of the Shoup Plan. The recent development shows a greater departure from the principles recommended by the Shoup Mission. There will be much more turns and twists in the future. Nevertheless, the objectives set by the Shoup Plan are, I believe, not in the wrong. If only the public expenditure be reasonably reduced, or what comes to the same thing, the national income be increased by an all-round, balanced development of the national economy of Japan, we shall be able to come up to the objectives.