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**Autor:** Revelant, Andrea

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Andrea Revelant

# Growth Strategy and War: Tax Dilemmas for Japan's Finance Ministry in the 1930s

**Abstract:** This paper addresses the question of continuity in the long-term development of the Japanese tax system, focussing on fiscal reform in the 1930s in order to assess the impact of war on policy making. Specifically, it tracks the response of bureaucrats in the Finance Ministry to the challenge of how to reconcile economic growth with tax increases and redistribution of the burden. The views of ministerial officials are investigated on the basis of classified documents issued by the Tax Bureau, which previous research has only partially examined. The analysis points out that, rather than looking at war as an opportunity to push through a structural reform, bureaucrats continued to follow policy guidelines that were rooted in the developmentalist strategy established in the Meiji period. This conclusion helps to explain the resurgence of some key prewar features of taxation in the contemporary system, despite wartime reorganisation and attempts at further reform during the American occupation.

**Keywords:** fiscal policy, bureaucracy, wartime Japan, tax equality, developmentalism

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## 1 Introduction

Since Joseph Schumpeter laid out the foundations of fiscal sociology in the early twentieth century, the evolution of tax systems has been studied from a range of theoretical approaches as an indicator of both socio-economic change and political power shifts.<sup>1</sup> In the case of Japan, scholars have investigated the development of taxation in an effort to trace the origin of some peculiarities of the postwar period. The most evident of these features was – and still is, albeit to a lesser extent – a low fiscal burden in terms of GDP share, compared to that

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<sup>1</sup> As a recent collection, see Martin et al. 2009.

of other industrialised countries.<sup>2</sup> Looking more in detail, this situation appears to have depended upon relatively light extraction of income and the absence (until 1989) of a general consumption tax.<sup>3</sup> These elements were already present in the prewar era as part of a broader capital-formation strategy, which aimed at fostering economic growth. These characteristics re-emerged after World War II, in a time of strong tax increases, despite attempts to carry out a structural reform during the occupation.<sup>4</sup> On the other hand, research has early pointed out that other aspects of contemporary taxation are a legacy of wartime measures, particularly the general reform of 1940.<sup>5</sup> The lasting effect of innovations enacted at that time is especially evident in the establishment of an equalisation system based on the allocation of national taxes, which had a major impact on the relationship between central and local finance.

Therefore, in order to understand the causes of historical (dis)continuity in the Japanese tax system, it is necessary to analyse in depth the pivotal phase of wartime reform. Did policy makers look at radical change as a forced deviation from the established path? Or did they rather think of war as an opportunity to create a more efficient and equitable system? Taking the 1930s as timeframe, this paper tackles these questions by focussing on the higher bureaucracy in the Ministry of Finance (MOF), which is a key actor in the drafting of legislation. The following section reviews the literature, pointing at the divergences in the interpretation of bureaucratic initiative among different authors. Analysis then proceeds in chronological order: first, the paper illustrates the framework of reform plans drafted in the early 1930s; next, it discusses the so-called Baba plan of 1936, which marked a turning point in terms of policy objectives; finally, it examines tax revision after the outbreak of the Sino-Japanese War in the summer of 1937. On this basis, the conclusion readdresses the issue of continuity between the prewar, wartime and postwar periods.

## 2 Planning reform: whose initiative?

The development of Japan's modern tax system has been the object of a number of studies, which have placed the accent on the structural defects that derived

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<sup>2</sup> For long-period OECD data, see <http://www.oecd.org/ctp/tax-policy/revenue-statistics-ratio-change-all-years.htm>.

<sup>3</sup> See Jinno 2009: 9–11.

<sup>4</sup> See Jinno 1999. For recent research that takes as focal point the Shoup Mission of 1949, see Brownlee et al. 2013.

<sup>5</sup> See, for instance, Hashimoto 1959: 93; Miyamoto 1968: 154.

from policy decisions made in the Meiji era (1868–1912).<sup>6</sup> Jinno Naohiko, in particular, has shown how the prevalent concern for economic growth led to heavy imbalances in the distribution of the tax burden, on both vertical (rich/poor) and horizontal (urban/rural) axes. At the socio-political level, this problem gave rise to tensions that worsened after the First World War, when the divide between cities and countryside became evident. Recurrent economic crises in the following decade further exposed the need for comprehensive reform. The same lack of elasticity that was at the root of burden inequality caused tax revenues to lag behind the growth of national income; consequently, natural increases in revenue proved insufficient to maintain the pace of public spending.<sup>7</sup>

Revision of tax legislation was carried out at successive stages in the inter-war years; these measures, however, were the product of difficult compromises and failed to solve structural imbalances.<sup>8</sup> Over the 1930s the problem became severe because, in addition to a long-term trend towards budgetary expansion, other factors contributed to an upsurge of government expenditure. On one hand, finance minister Takahashi Korekiyo adopted fiscal stimulus to fight depression at the start of his long tenure (December 1931 to February 1936, with a five-month interruption in 1934); on the other, a steep rise in military spending followed the invasion of Manchuria.

Concerning the specific role of the MOF, Jinno has reconstructed the process that led from tentative drafts in the early 1930s to the enactment of a fiscal overhaul in 1940.<sup>9</sup> In addition to government documents examined by previous research,<sup>10</sup> Jinno drew information from official papers formerly held by a mid-ranking bureaucrat who had served in the Tax Bureau in 1932–39;<sup>11</sup> these sources fill important gaps in the documentation stored at the National Archives. Jinno concludes that plans laid in the first half of the decade did not aim at structural reform, but just at improving the elasticity of the current system; moreover, the principal measures were conceived as temporary, first to give

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<sup>6</sup> See especially Miyamoto 1961; Jinno 1979a (Part 1): 131–144.

<sup>7</sup> On this point, see also Ide 2006: 262–265.

<sup>8</sup> See Kanazawa 1984; Jinno 1985; Ikegami 1991, 1993; Revelant 2013.

<sup>9</sup> Jinno 1979a, 1979b, 1981, 1987–88.

<sup>10</sup> Ōkurashō Shōwa zaiseishi henshūshitsu 1954, 1957. Hereafter cited as SZS. Documents cited in this seminal work, which are stored at the National Archives as *Shōwa zaiseishi shiryō* (SZSS), have been fully digitalised and can now be consulted online. Search portal at <http://www.digital.archives.go.jp>

<sup>11</sup> The collection, donated to Tokyo University in 1945, is now preserved as “Hamada Norimi shiryō” (henceforth, HNS). The numbering of documents cited here follows the catalogue compiled by Jinno (2000), Part I.

relief to the middle classes, who already bore the heaviest burden before the depression; then to increase revenue while recovery was on the way. An initiative for durable reform emerged only in 1936, after the attempted coup d'état of 26 February that claimed the life of Takahashi and other moderate statesmen. With the military exerting an increasing influence on political affairs, the MOF drafted a plan that combined a substantive upgrade of revenues with redistribution of the burden – the latter objective being functional to wartime mobilisation. This radical project, however, met with strong opposition from business circles; furthermore, even within the armed forces there were concerns that a sudden increase in the burden on urban capital might hamper industrial production. Therefore, instead of a comprehensive scheme, only temporary tax hikes were enacted in the next few years, to complement debt financing in a context of booming military budgets. Conservative opposition gave up only in 1940, once war had made postponement of reform no longer an option.

Building on Jinno's work, Ide Eisaku has analysed three plans drafted in 1933–34, noting that they included appreciable innovations.<sup>12</sup> In particular, Ide argues that finance officials intended to shape a modern tax system, centred on progressive personal income tax; the attempt failed because Takahashi rejected these proposals as premature, sticking to full economic recovery as his policy priority. It seems that Minister Fujii Sadanobu, who was briefly in charge in 1934, wanted to take steps towards a structural reform. Nevertheless, the negative reaction of markets reduced this initiative to one, limited measure, which was the extraordinary profit tax enacted in 1935.

Lastly, there is an essay by Mukai Yurio, which treats the whole interwar period but touches only briefly on the 1930s.<sup>13</sup> Mukai remarks that officials in the Tax Bureau tried to increase the burden on capital and make taxation more elastic, even though they lacked support from Takahashi. Their active stance in favor of a great tax increase would later translate into the Baba plan. This interpretation is instrumental to Mukai's thesis that bureaucrats always exerted influence as policy makers, since even in the 1920s they were able to respond to the demands of party cabinets in a way that did not conflict with their own goals.<sup>14</sup>

Research on tax policy has led, in sum, to considerably different evaluations of the role played by ministerial officials. The rest of this paper tries to shed light on the issue by retrieving evidence chiefly from the Hamada collection, which still contains a large number of unstudied documents. Additional information

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<sup>12</sup> Ide 2006: 266–269.

<sup>13</sup> Mukai 2000: 33–34.

<sup>14</sup> Mukai 2000: 32.

comes from press articles, in order to put the inner working of the Finance Ministry in context with the movements of markets and public opinion.

### 3 The early phase: cautious response

Between 1931 and 1934, the Tax Bureau prepared a series of plans for the revision of Japan's tax system (Table 1).<sup>15</sup> The first one was done on the request of minister Inoue Junnosuke. It consisted only of a temporary adjustment, after being stripped of its few innovative elements due to the opposition of the ruling party. It failed to reach the Diet because of the change of cabinet. In December, Takahashi formed again a ministerial committee, with an assignment to study a comprehensive reform aimed at both equality and a net rise in revenue.<sup>16</sup> Accordingly, officials drafted proposals for increases by the range of 50 to 300 million yen (with one exceptional proposal reaching 488 millions). It would have meant an increment of the current tax revenue by about 5–30 per cent, including revenue from state monopolies and stamp duties. All options focused on national taxes, leaving to the Home Ministry – as customary – the task of addressing the problems of local taxation. The Home Ministry, in fact, had already issued in August 1932 the first operative plan for an equalisation system, whose primary objective was fiscal relief to rural communities. It can be noticed, however, that this initiative lacked coordination with the Tax Bureau, as none of the drafts arranged by the latter assigned an adequate share of national taxes to the funding of state grants.

Most plans included an appreciable strengthening of income taxation. At the same time, though, there was the usual reliance on regressive indirect taxes, especially in the options with higher revenue target. This tendency was slightly corrected with the introduction of a tax on luxury goods. The most innovative provisions in some plans above 100 million yen, however, were a general consumption tax and a “provisional” property tax – again, in the attempt to strike a balance between the two objectives assigned for the reform. As noted by Ide, these new items disappeared after Takahashi made his well-known public statement against tax hikes on 5 July 1933.<sup>17</sup> Although the Tax Bureau continued

<sup>15</sup> The plan of 1931 is presented in SZS 5: 277–285. Jinno (1979b: 110–113) analyses the plans of 1931, June 1933 (200-million option by Ishiwata and Matsukuma), 24 October 1933 and 24 August 1934; Ide (2006: 266–269) comments on those of June 1933 (150-million option by Ishiwata and Matsukuma), 24 July 1933 and 24 August 1934.

<sup>16</sup> HNS 0-1-1, n. 2, “Kaichō (Ōkura daijin) no aisatsu 会長（大蔵大臣）ノ挨拶” [15 April 1933].

<sup>17</sup> Ide 2006: 268.

Table 1: Reform plans drafted by the Tax Bureau, 1931–34.

Date	Author	Net increase	I	C	P	S	L	T	SP	E	Catalogue number
June–Sept. 1931	not indicated	41	17	3	–	–	X	–	–	X	SZSS 8-17
26 June 1933	Ujije	50–300 (5 options)	25–53	7–70	0–50	0–100	0–10	0–5	–	0–30	0-1-3, n. 2,3
	Tanaka	50–200 (4 options)	32–60	17–21	0–80	0–60	13	–	–	–	–
	Matsukuma	50–200 (4 options)	17–33	18–58	0–80	0–60	10	–	–	0–48	–
	Taniguchi	50–500 (5 options)	0–44	22	0–80	0–300	15	–	–	–	–
27 June 1933	Ishiwata	50–200 (4 options)	15–29	21–41	0–70	0–60	0–10	0–8	–	–	–
24 July 1933	not indicated	50–150 (3 options)	44–69	10–72	–	–	0–10	0–8	–	–	0-1-5, n. 1,2,3,4
29 Sept. 1933	not indicated	no figures	?	?	–	–	–	–	–	–	0-1-5, n. 19
24 Oct. 1933	not indicated	[100]	52	30	–	–	–	–	–	–	0-1-5, n. 5,6,7,8
27 Oct. 1933	not indicated	[60–80]	15–30	38	–	–	–	–	–	–	0-1-5, n. 33
25 July 1934	not indicated	[200]	88	64	–	–	10	–	15	–	0-1-4, n. 1,2
8 Aug. 1934	not indicated	no figures	+30%	yes	–	–	yes	–	yes	–	0-1-4, n. 3
20 Aug. 1934	not indicated	300	113	156	–	–	6	–	10	–	0-1-4, n. 4
24 Aug. 1934	not indicated	100–150 (3 options)	51–78	31–69	–	–	5.9	–	10/20	–	0-1-4, n. 5,6,7
19 Oct. 1934	not indicated	70	58.3	–	–	–	–	–	–	–	0-1-4, n. 16

–Authors: Ishiwata was National Tax Section chief; the others were *jimukan* (higher officials not holding an executive position).

–“Net increase” refers to the approximate target in millions of yen, which does not correspond to the detailed estimate.

–(I) income taxes (corporations, individuals and interest on capital); (C) consumption taxes; (P) property tax; (S) general sales tax; (L) luxury tax or cosmetics tax; (T) tax on transactions in securities; (SP) special profit tax; (E) local equalisation grants. Estimated amount at full implementation, in millions of yen. (X) stands for measures expunged in the final version.

–All documents, excluding the first one, belong to HNS. Those of 25 July and 19 October 1934 are stamped “top secret”, all others “secret”.

to draft more modest proposals until October, none of them reached the cabinet. One of the involved officials, Matsukuma Hideo, later recalled that the minister rejected the drafts with the argument that it was better to “eat the cow after it has grown fatter”.<sup>18</sup> The situation seemed to change in July 1934, when Takahashi recommended Vice Minister Fujii to take over his post and accomplish the return to “normal” finance. Under Fujii, the Tax Bureau produced revised plans that featured a temporary tax on the “exceptional profits of industries of military supplies and other firms that benefit from the present circumstances”,<sup>19</sup> as previously done during World War I. There was, however, a declining trend in the overall target: in the end, the only bill submitted to the Diet was that for an extraordinary profit tax, estimated around 40 million yen. Takahashi, who had been compelled to come out of retirement to substitute an ailing Fujii, had a hard time defending a text that seemed to contradict his previous statements. The bill, nevertheless, cleared both Houses with a few amendments and a formal request to take care that implementation be not detrimental to business.<sup>20</sup>

As mentioned above, the failure to enact a comprehensive plan can be explained as the result of strong external pressure. Rumours of an imminent tax increase had caused a drop in stock prices in September 1934, followed by a second wave of financial panic when Fujii, on 29 October, publicly confirmed that revision was on the way.<sup>21</sup> Besides the reaction of markets, however, did other reasons lead the MOF to self-restraint? From the viewpoint of officials in the Tax Bureau, what kind of reform would have been most effective? An answer to these questions can be found in documents relating to the drafts presented above.

Let us start from a document that raises a basic question: what were the quantitative margins for tax hikes in Japan?<sup>22</sup> A preliminary consideration is that securing the foundations of public finance with a balanced budget requires either a reduction of expenses, a rise in taxes or other revenues, or both. If the goal is to be achieved through higher taxation alone, in light of present conditions and the expected upsurge of defence expenses, “an enormous increment” in revenue would be necessary. For example, would a 100 per cent tax increase result in the doubling of revenue (from about 800 to 1600 million yen)? A

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<sup>18</sup> Hirata 1979: 21.

<sup>19</sup> 0-1-4, n. 1, “Zeisei seirian 税制整理案”, top secret, 25 July 1934: 5.

<sup>20</sup> For a summary of the debate, see SZS 5: 303–314.

<sup>21</sup> See press sources quoted in Ide 2006: 270.

<sup>22</sup> HNS 0-1-5, n. 41, “Saikai shūshi kinkō to zōzei gendo 歳計収支均衡と増税限度”, top secret, undated (attached table dated 19 July 1934). An identical copy, not listed in Jinno’s index, follows n. 43.

detailed estimate indicates that the gain in fiscal 1934, net of losses caused by the shock to income and consumption, would be 514 million yen.<sup>23</sup> The adverse economic consequences of abrupt tax hikes were further stressed in another document,<sup>24</sup> which pointed out that, since 86.55 per cent of all indirect taxes and stamp duties were regressive, their increase would hit the lower-income classes and cause a contraction of consumption; therefore, no major fiscal gain could be expected from this quarter. Direct taxation had more potential to grow because it included a share of progressive rates that hit taxpayers with higher ability; however, as the current revenue from these sources amounted to just 118.7 million yen, an 800-million expansion was unrealistic. In conclusion, the hypothesis of a general doubling of tax rates was ruled out because “it is plainly clear that it would be utterly unsustainable for the capacity of the national economy”.<sup>25</sup>

From the above, it appeared to the Tax Bureau that the fundamental problem was how to bring public finance back on the track of balanced budgeting without harming the economy. Demonstrating the impossibility of a steady 800-million increase in tax revenues made an argument – implicit but obvious – that only a combination of tax hikes and retrenchment would do. This put financial officials in contrast with the military, above all, as the rise of “defence” spending since the outbreak of the Manchurian Incident was outstanding. It would also lead to conflict with those other branches of the administration that were riding the wave of fiscal expansion. As is well known, in his later cabinet meetings on the budget Takahashi held his ground against multiple requests for larger budget allocations. Fujii, too, put up a strenuous fight against his colleagues.<sup>26</sup> Given the premise that a substantive upgrade of fiscal revenues was unavoidable, the Tax Bureau had to find new revenues within limits such that an increase would not produce major counter-effects on the economy. It was necessary to consider not only the scale of tax hikes, but also their qualitative aspects.

Both dimensions of the problem are discussed in an untitled document, carefully crafted by means of successive additions.<sup>27</sup> Analysis starts from the

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**23** A much lower figure (361 million yen) appears in HNS 0-1-4, n. 26, “Sozei (senbai ekikin o fukumu) oyobi inshi shūnyū ni jūwari no zōchō o nasu baai no shūnyū mikomigaku taishō hyō 租税（専売益金ヲ含ム）及印紙収入ニ十割ノ増徴ヲ為ス場合ノ収入見込額対照表”, secret, 31 Aug. 1934. The estimate was further revised to 496.3 million yen in HNS 0-1-4, n. 28, same title as n. 26, top secret, 4 Sept. 1934.

**24** HNS 0-1-5, n. 40, “8 oku en zōzei shisan hyō 八億円増税試算表”, top secret, undated.

**25** HNS 0-1-5, n. 41.

**26** As reported in all major newspapers on 6–22 November 1934. See, for example, *Ōsaka Mainichi shinbun* 1934a, 1934b, 1934c, 1934d.

**27** HNS, 0-1-4, n. 27, top secret, 4 Sept. 1934. It is preceded by a draft with handwritten corrections. Other versions, apparently earlier drafts, are in 0-1-5, n. 39, 42–45; all top secret,

remark that an assessment of the limits of the fiscal burden must take into account the ratio between taxes and national income. To this purpose, recent data on taxation at both central and local level are provided, for a total of 1602 million yen. Regarding income, precise figures are available for earnings subject to individual income tax (1824 million yen in 1933), which pertain to about five per cent of all Japanese households.<sup>28</sup> The sum of other personal income should hence amount to several billion yen, “but these belong by large to mid-small farmers, fishermen, businessmen in commerce or industry, labourers and the like”.<sup>29</sup> In the light of current claims against heavy local taxation and the consequent issue of how to provide relief – the paper continues – it is evident that there is no margin for a large revenue increase from these classes. Therefore, in case of massive hikes, these will inevitably fall upon the present income taxpayers. What about corporations, then? Their recent profits amount to about 880 million yen, including 670 millions that are taxed again as individual income.<sup>30</sup> Hence, levying high rates on the residual sum would not only fail to bring a great rise in revenue, but also weaken the foundations of enterprises. As for “2nd type” income (320 million yen), which belongs for a large part to individuals earning less than 1200 yen per year, the same reasoning applies as for personal income tax. It remains to consider other capital income not included in “type 2”; as it consists mainly of yields on treasury bonds, it is doubtful whether taxing them would be to the advantage of national interest.<sup>31</sup>

Having thus reviewed the tax base, and noted that income up to 10,000 yen represents 87.4 per cent of the total for individuals, the document

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undated. Only n. 44 has a title: “Waga kuni kokumin shotoku to sozei futan no wariai ni tsuite 我国々民所得ト租税負担ノ割合ニ就テ”. Jinno (1979b: 111–112) quotes one of the untitled versions. Page numbers cited henceforth have been added later and are part of a longer sequence that spans over several papers.

**28** Details are in HNS, 0-1-5, second doc. after n. 43, “Shōwa 8 nenbun daisan shotoku kaikyū betsu hyō 昭和八年分第三所得階級別表”.

**29** As shown in table “Menzeiten ika no shokugyō betsu jin’in shotoku 免税点以下ノ職業別人員所得” and the preceding, untitled text in 0-1-5, fourth doc. after n. 43. The total private income estimated for 1934 is 11,188.194 million yen.

**30** Before the general reform of 1940, a flat rate was levied on corporate income, called “1st type”; once paid to stockholders, dividends were subject to progressive rates as personal income (“3rd type”), net of a 40-per-cent deduction. Income “type 2”, which is mentioned further, consisted of interest on securities and deposits and was taxed at source at a low flat rate.

**31** Bond yields were exempted from income tax during the Russo-Japanese War; they started being taxed again with the enactment of the capital interest tax in 1926, which applied to all securities. In this way, the state retained a competitive advantage over local government and private firms.

concludes: “If a massive tax increase is enforced, regardless of under whatever pretext, it is obvious that in the end it cannot but fall heavily on the so-called middle class between 1200 and 10,000 yen income; moreover, it would force a burden increase also over income classes below 1200 yen.”<sup>32</sup> Further evidence in support of this argument comes from the details on upper-class incomes: those above 50,000 yen totalled less than 83 million yen, with only seven households topping one million. Therefore, even raising rates “to the extreme”, the base would be too narrow to produce a substantive increase in revenue.<sup>33</sup>

Ide, who quotes part of this paragraph, argues that the authors’ conclusion was that personal income tax would be the most appropriate target for an increase in tax revenue; this can be considered the first step for the establishment of a progressive, modern tax system.<sup>34</sup> However, this interpretation may overstate the reformist intentions of the authors; after acknowledging that working-class people lacked the ability to sustain strong tax hikes, while the rich who could were too few, the document pointed at the negative effects of an aggravation of the burden on the middle class:

[these] incomes are the core of productive capital, which should grow year by year; moreover, at present they already bear [here follows a long list of taxes] In case a massive tax increase is carried out now, [...] it would obstruct the growth of production and there is a risk that it would destroy the middle class. In this way, the national ability to sustain the tax burden would decrease and it would be extremely difficult to obtain the tax revenues expected for the future.<sup>35</sup>

The above passage suggests that the wisest policy would be gradual cultivation of the tax base. This concept emerges more clearly in the next paragraph, which puts the Japanese case in international comparison. With taxes at about 15 per cent of national income in 1930, Japan occupies “a relatively low position” between Germany and the United States (Figure 1).<sup>36</sup>

The first impression, however, is immediately corrected by the following observations:<sup>37</sup>

<sup>32</sup> HNS, 0-1-4, n. 27: 196.

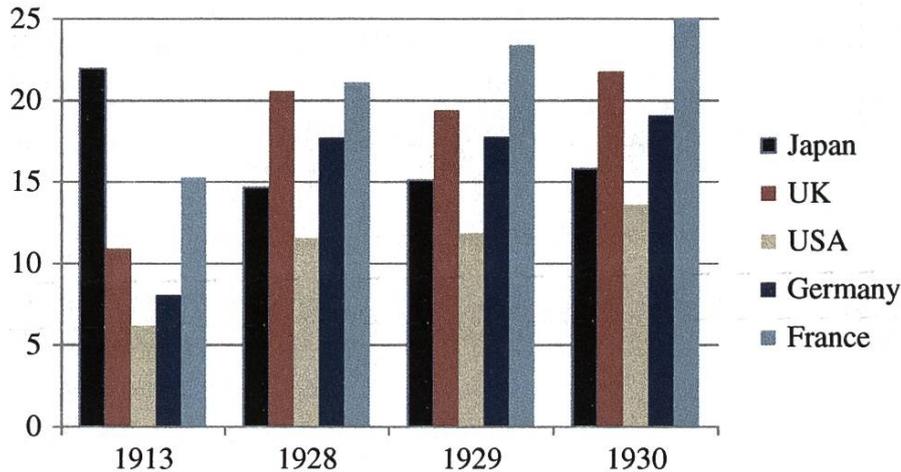
<sup>33</sup> HNS, 0-1-4, n. 27: 196–197.

<sup>34</sup> Ide 2006: 269.

<sup>35</sup> HNS, 0-1-4, n. 27: 197.

<sup>36</sup> A slightly higher figure (16.4%) is given in 0-1-5, Table “Rekkoku ni okeru kokumin shotoku tai sozei futan no wariiai (1930 nen) 列国ニ於ケル国民所得対租税負担ノ割合（一九三〇年）” after n. 45, undated. A similar document with data for 1932–36 (HNS 3-9-3, n. 4) shows that the rise in burden in the USA eventually left Japan at the bottom of this ranking.

<sup>37</sup> HNS, 0-1-4, n. 27: 199–201.



**Figure 1:** Taxes in percentage to national income.

Source: HNS, 0-1-4, n. 20, Kokuzeika chōsa gakari 国税課調査係, survey n. 10, “Kakkoku kokumin shotoku to sozei futan 各国国民所得と租税負担”, Aug. 1934. Statistical sources for each country are indicated in the legend of the original table.

1. Income per capita is much lower in Japan.<sup>38</sup> This means that the national aggregate is made mainly of low incomes with an “extremely weak ability to sustain taxation”.<sup>39</sup>
2. The current tax burden in foreign countries considered is an outcome of expenses caused by the European War (that is, World War I).
- 3,4. The economies of these countries “are already close to the limit of development”, while capital accumulation in Japan still lags behind them. Therefore, to raise the tax burden at their same level would hamper Japan’s economic growth.
5. Public expenditure for social policy, such as unemployment relief, is relatively low in Japan. One reason is the custom of mutual aid within families and local communities, which does not appear in tax data but must draw “a considerable amount” of private money.

All this considered, the tax burden in Japan cannot be defined as particularly light.

<sup>38</sup> Calculated in yen for 1930, the respective figures were: Japan 158, France 474, Germany 515, UK 874, USA 1155. HNS 0-1-5, Table “Kakkoku kokumin shotoku hitori atari (1930 nen) 各国国民所得一人当（一九三〇年）” after n. 45, undated.

<sup>39</sup> A similar statement appears in the previous paragraph, where it is also noted that the largest part of national income was likely spent in the consumption of essential goods. Another survey shows that the national share of high incomes (4.3%) was considerably smaller than in the foreign powers, starting from the USA (14.2%). See HNS, 0-1-5, Tables “Kakkoku kazei (shotokuzei) shotoku uchiwake (1928–1929 nen) 各国課税（所得税）所得内訳（一九二八一九二九年）”: 1 “2 man en o koyuru mono 二万円ヲ超ユルモノ”, 2 “5 man en o koyuru mono 五万円ヲ超ユルモノ”, after n. 45, undated.

The last section of the document presents guidelines for future action. The option of doubling taxes was promptly rejected because of its disastrous consequences on both the economy and fiscal revenue. In addition, it was noted that the only precedents for such a radical policy were in wartime,<sup>40</sup> while

in peacetime taxation must not obstruct the growth of national product, nor stifle the spirit of enterprise and saving of the people; tax revenues should increase gradually as the state prospers, together with national income. There is no doubt that this is a good policy. However, at present the situation of our country is not completely that of peacetime. Of course it is neither of wartime, though. Therefore, on the one hand we must take in consideration the growth of production, while on the other we must gather the fiscal resources to face large expenses.<sup>41</sup>

The document ends with the statement that, in order to respond to both needs, a tentative plan for a 300-million-yen tax increase has been drafted and attached.<sup>42</sup> It is a compromise solution, as “a certain sacrifice” will be unavoidable in terms of economic growth. The quantitative target finds a precise reason in another document: as the tax burden of the foreign powers considered averaged 19.35 per cent, Japan’s margin to reach the same level equalled about 300 million yen.<sup>43</sup> Also, in the public debate it was argued that at least 300 millions would be necessary to offset interest on recent bond issues.<sup>44</sup>

At this point, we have enough elements to outline the policy approach of the Tax Bureau. In the first place, it is clear that a rapid increase in fiscal revenues was not seen as desirable from the standpoint of either economic competitiveness or domestic welfare; it was a second-best choice, forced by a peculiar situation of “neither peace nor war”. Secondly, it was acknowledged that tax hikes would fall chiefly upon the productive middle classes, who already bore the heaviest burden; there seemed to be no immediate prospects for vertical equalisation. The idea of increasing pressure on corporate income and interest

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**40** The variation in tax burden for 1894–95 (Sino-Japanese War) and 1904–05 (Russo-Japanese War) is shown in HNS 0-1-5, n. 39, reference Table 2 [untitled].

**41** HNS, 0-1-4, n. 27: 202.

**42** This should be HNS 0-1-4, n. 4, “Zeisei seiri (3 oku en) 税制整理 (三億円)”, top secret, 20 Aug. 1934.

**43** HNS 0-1-5, n. 39, note to reference Table 1, “1930 nen ni okeru kokusai heikin ritsu 一九三〇年ニ於ケル国際平均率”. In the main text, this serves to reject either a 800- or 400-million hypothesis (both shown in ref. Table 3, “1930 nen o hyōjun to seru zōzeiritsu 一九三〇年ヲ標準トセル増税率”).

**44** Ogawa 1933: 57.

on capital got little consideration. Finally, international aggravation of the tax burden since the Great War – which stands in remarkable contrast with the reduction occurred in Japan thanks to the wartime boom – was perceived as an outcome of extraordinary conditions rather than of structural changes in public finance.

It is not surprising, then, that the plan drafted in October 1934 downgraded the target from 300 to 70 million yen.<sup>45</sup> As mentioned above, even the latter initiative was aborted before the coming Diet session. A justification appears in a separate document, which points that economic recovery, still under way, had been hampered by natural calamities.<sup>46</sup> The same document stresses that, as keeping interest rates low is fundamental to revive the economy, it is not a right moment for tax hikes on income “type 2” – nor on other kinds of income, because revision should be comprehensive. Moreover, amendments to national taxation would require first an adequate study of its balance with local taxes, which involved issues such as fiscal devolution and the establishment of an equalisation grant system.<sup>47</sup> In short, the Tax Bureau raised many reasons for not taking action and left decisions to an indefinite future. Some of the obstacles were temporary, as they related to cyclical factors; others, however, depended on the socio-economic structure of Japan as a developing country. If fostering growth and competitiveness was still the priority, it logically followed that the MOF would not actively champion a structural reform of taxation. In this respect, there is a neat contrast with the parallel initiatives of the Home and Agriculture Ministries.

Public opinion, however, seemed to lean towards more energetic policy. When the Tax Bureau conducted a press survey on the extraordinary profit tax bill,<sup>48</sup> it showed that many commentators were favourable to a drastic reform and criticised the MOF for failing to solve either the problem of inadequate revenue or that of burden inequality.

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45 HNS 0-1-4, n. 16, “7000 man en teido zōzeian yōkō 七千万円程度増税案要綱”, top secret, 19 Oct. 1934.

46 HNS 0-1-4, n. 18, “Ippan zōzei o okonawazaru riyū 一般増税ヲ行ハサル理由”, top secret, undated. Following heavy rain that flooded the Hokuriku region in July, a typhoon of exceptional strength (still remembered as the “Muroto typhoon”) had caused ingent damage in September.

47 HNS 0-1-4, n. 18,

48 HNS 0-1-13, n. 2–4, “Shinbunshi jō ni arawaretaru rinji ritokuzei ni kansuru hihyō 新聞紙上ニ現ハレタル臨時利得税ニ関スル批評”, Part I–III, 27 Dec. 1935, 15 Jan. 1935, 20 Jan. 1935.

## 4 A radical swing and conservative resistance

Coming as the culmination of a series of attempted coups that had shaken the country since the early 1930s, the 2/26 Incident created the political conditions for further advance of the military and “reformist bureaucrats” against the old liberal order. A sign of this turn was the appointment of Baba Eiichi as finance minister. Normally, for non-party men the choice would have been among former officials with a long experience in the ministry or central banking. Baba had served in financial offices for a short period at the start of his career, but had then climbed the ladder in the cabinet Legislative Bureau (1907–23), reaching the top post under the Takahashi administration. Appointed Peer by the next, Seiyūkai-backed cabinet, he had joined the largest group in the Upper House, the Kenkyūkai. Then, in 1927 another Seiyūkai cabinet had picked him for the presidency of the Hypothec Bank of Japan. His placement in the political world, therefore, can be defined as mainstream. However, heading an institution that was primarily engaged in rural development, Baba came to learn directly about dire conditions of farmers hit by depression; he then started to advocate greater commitment of the state in the economy, taking a critical stance towards established economic thought.<sup>49</sup>

In line with the new cabinet’s emphasis on national defense and stabilisation of the people’s living, Baba supported a great expansion of the budget on an indeterminate basis. As part of this programme, the minister announced that he would carry out “a radical reform of the tax system” holding both aims of raising revenue and achieving burden equality.<sup>50</sup> A thorough personnel reshuffle, including demotion of the Budget and Tax Bureau chiefs, accompanied this break away from the policy of his predecessor.<sup>51</sup> A ministerial committee, formed with the participation of officials from the Home Ministry and other branches of the administration, started working on tax reform in April; by mid-August, a comprehensive plan was ready for submission to the Diet. According to Matsukuma, who played a key role in the drafting of bills as section chief, Baba was determined to establish an elastic tax system, able to sustain expenditures in the event of war – a scenario that might turn real at any time, given the current

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<sup>49</sup> For a complete biography, see Kurihara 1945.

<sup>50</sup> See SZS 5: 343–350. For developments until discussion in the 70th Diet, see *ibidem*, 350–372. As the Baba plan is also analysed in Jinno’s articles, only essential information will be given here. Related documents in HSN occupy most of volume 0-1-7 and all the next three volumes.

<sup>51</sup> See Naiseishi kenkyūkai 1971, 1: 103–104. For detailed information, see Senzenki kanryōsei kenkyūkai/Hata Ikuhiko 1981: 355, 357–359.

international situation.<sup>52</sup> It was easy to comply with this order by retrieving ideas from previous “exercises” and assembling the pieces.<sup>53</sup>

The result was more radical than any previous plan. It would strengthen income tax as the pillar of national taxation, raising rates on corporations by about 80 per cent and embedding interest on capital into individual income. Rates on the latter would be remodulated so as to increase the weight on the upper brackets; at the same time, the tax base would be enlarged by lowering the exemption point from 1200 to 1000 yen. These measures would bring a total increase in revenue of about 30 per cent. Revision of other direct taxes would reduce the burden of small farmers and businessmen. To ensure an equitable assessment throughout the nation, the prefectural house tax would be nationalised. A property tax would be established as a flat rate on corporations (1.5/1000) and individuals above a 30,000 yen threshold (1/1000). Another significant addition was a tax on transactions in securities. As a counterpart to the reform of direct taxation, which focused on capital income and property, there would be higher extraction over a broad base through indirect taxes. This was to be achieved conventionally by raising excises, as on liquor and sugar, and by introducing a general sales tax that exempted only some essential goods. The expected increase in direct and indirect taxes over the next few years was, respectively, 480 and 130 million yen.

Concerning the relationship between central and local tax levels, the plan provided for a real revolution:<sup>54</sup> besides the transfer of house tax, there would be a major decrease in surtaxes on land and income and complete abolition of the controversial household tax, which had long been the symbol of inequitable extraction in rural districts.<sup>55</sup> In all, cuts would amount to about 300 million yen, or 44 per cent of the present total revenue. In compensation, local government would receive a nearly equivalent sum in state grants, whose allocation would depend on the fiscal needs and ability of each recipient prefectural and municipal administration. This equalisation system, in turn, would be supported by the increase in direct state taxes described above. Therefore, net of transfers, the treasury would boost its revenues of about 320 million yen.

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<sup>52</sup> SZS 5: 352–353; Hirata et al. 1979, 1: 32.

<sup>53</sup> As above. See also Naiseishi kenkyūkai 1971, 1: 121.

<sup>54</sup> For a detailed account, see SZS 14: 195–202. A recent analysis is in Takayose 2010: 99–113.

<sup>55</sup> Household tax (*kosūwari*) was assessed on both income and property and represented the principal autonomous tax of towns and villages. Its reduction, or complete abolition, was a central issue in tax debates through the interwar period. The reform of 1940 abolished it to replace it with a lighter resident tax.

The “Baba plan” received cabinet approval on 22 September; its press release followed immediately.<sup>56</sup> Public debates, however, had been opened since the spring by official statements and rumours. The gist of discussion can be reduced to the following points. First, there was a consensus about the goals of the reform: nobody questioned the inevitability of tax hikes to avoid a rise in expenditure to be backed entirely by debt; it was also acknowledged that a redistribution of the burden should accompany such hikes. As the liberal *Ekonomisuto* pointed out, domestic conditions were ripe for the structural changes, since the failed coups of 15 May 1932 and 26 February 1936 had crippled the supporters of the status quo.<sup>57</sup> It was also remarked that a reform in favour of farmers, small business and workers would prevent the recurrence of such “despicable incidents”.<sup>58</sup>

Precisely because there was a wide front favourable to tax equalisation, however, those elements of the Baba plan that seemed to contradict this objective received harsh criticism. Those who expressed appreciation for the rebalancing of direct taxes were also prompt to note that almost all measures for indirect taxation, together with the lowering of the threshold for individual income tax, would hit the mid-lower classes.<sup>59</sup> It was easy to locate the reason of this contradiction in the government’s urge to boost revenue, which made recourse to “mass taxation” unavoidable.<sup>60</sup> In this respect, all commentators basically shared the view of the Tax Bureau – as in the document already illustrated – about the constraints to tax redistribution that the structure of national income posed. Pushing further this critique, the *Ekonomisuto* concluded that Baba’s effort to achieve a “totalitarian centralisation” of fiscal resources in view of a possible war was “only full of sacrifice and scarcely effective in practice”.<sup>61</sup>

Among the major political forces, the conservative Seiyūkai expressed the strongest reservations against the Baba plan. In addition to criticism along the lines mentioned above, the party experts objected that fair assessment of the property tax would be arduous, while its unrelatedness to income could turn it into a heavy burden for the middle class.<sup>62</sup> This position is best understood as a

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<sup>56</sup> For a detailed presentation, see *Ekonomisuto* 1936a, 1936b, 1936f.

<sup>57</sup> *Ekonomisuto* 1936a: 24.

<sup>58</sup> Motoyama 1936: 1.

<sup>59</sup> See *Ekonomisuto* 1936b: 24; 1936c: 24; 1936d: 28–29; 1936e: 32–34; Abe 1936: 26–27; Andō 1937. Editorials from the main national newspapers are transcribed in *Seiyū* 1936. On the reaction of interest groups and the Socialist Mass Party, see SZS 5: 363–366.

<sup>60</sup> *Ekonomisuto* 1936a: 24; Ōguchi (former parliamentary vice minister of finance) 1936a: 8.

<sup>61</sup> *Ekonomisuto* 1936a: 25.

<sup>62</sup> Ōguchi 1936a: 11; 1936b: 18; 1936c: 8–9; Horikiri 1936.

defence of small landowners, who represented the prime electoral target for the Seiyūkai; since the 1920s, in fact, a weighty argument against the introduction of a property tax had been its alleged bias for easily detectable real estate.<sup>63</sup> The party, which had long advocated fiscal decentralisation in support of rural communities, was also sceptical of the benefits that would derive from suppression of a large share of local taxation: despite the government's promise to provide compensation in grants, the outlook for future growth of this kind of financing was uncertain.<sup>64</sup> Moreover, some executives cautioned the cabinet to reconsider the timing of tax hikes, since premature implementation might be counterproductive at both economic and fiscal levels.<sup>65</sup>

Given these premises, the passage of tax bills through the Diet appeared no simple task. However, shortly after the opening of the session the cabinet resigned due to internal disunity. The new premier, General Hayashi Senjurō, took office on 2 February 1937; the next day, the government withdrew both budget and tax reform plan, on the grounds that there had been no time for proper study. The incoming administration thus raised hopes in business circles that less radical policies would follow. The appointment of moderate Yūki Toyotarō (a former president of Yasuda Bank, previously holding executive posts in the Bank of Japan) as finance minister was an encouraging sign,<sup>66</sup> as was the consequent personnel reshuffle: Kaya Okinori, former head of the Budget Bureau whom Baba had moved to the lesser post of Financial Bureau chief, became vice minister; Ishiwata Sōtarō was reinstated as Tax Bureau chief in place of Yamada Tatsuo, who was demoted to Mint director.

The new minister had a package of emergency measures quickly prepared under the name of the Extraordinary Tax Increase Act. On one hand, this plan provided for hikes of income tax and other established taxes, particularly those on capital interest, extraordinary profits and liquors; on the other, it introduced four taxes selected from the Baba plan (on corporate capital, foreign-currency bonds, the transfer of securities, and gasoline). Compared to the withdrawn bills, this scheme did not feature such controversial innovations as the property

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<sup>63</sup> See Ikegami 1986: 48–49.

<sup>64</sup> Ōguchi 1936c: 6; Katō (former parliamentary vice minister for the colonies) 1936: 14.

<sup>65</sup> Ōguchi 1936a: 12–13; Yamamoto (former minister of agriculture) 1936. Similar arguments are already in Ōguchi 1933: 58–59. However, there was also support for tax increases without further delay (Horikiri 1936), which suggests the existence of some divisions within the party.

<sup>66</sup> *Ekonomisuto* 1937a: 11; 1937b; 1937c: 30. The editor's opinion, however, was that such expectations were ill-posed, because the cabinet's announced programme stood in continuity with that of the previous administration. The main difference could be that, while Baba would split tax hikes between rich and poor, Yūki would try to increase the burden on the latter only. *Ekonomisuto* 1937b: 13.

or sales taxes, nor the lowering of individual income tax threshold; it also expunged the incorporation of “2nd type” income into personal earnings and other measures that targeted financial capital. It refrained from applying great pressure on excises, which estimated increase was only of about 40 million yen. On the whole, nevertheless, expected fresh revenue from national taxes stood at the remarkable sum of 269 million yen. As this amount was not sufficient to finance a full-scale system of equalisation grants, cuts to local taxes would not exceed 70 million yen.<sup>67</sup> In this way, minister Yūki put a break on the reformist rush of the previous administration.

After intense debate, the Diet approved the plan with some amendments and an attached resolution; the latter included a list of desiderata for more equitable taxation (as raising the exemption point of the land and business profit taxes), but also two immediate requests: that extraordinary hikes be limited to fiscal 1937, and that “an authoritative advisory committee” be formed soon to lay out a comprehensive reform of the tax system. The Hayashi cabinet, however, was too short-lived to oversee this task: intolerant of parliamentary opposition, on 31 March the premier resorted to dissolution of the Lower House – a move that backfired, because the general election confirmed the supremacy of the established parties. Hayashi held on to office until June, when Prince Konoe Fumimaro finally stepped in. Konoe’s appointment raised great expectations for political stability, as he seemed the right man to hold the balance of an “iron triangle” of military leaders, big business and political parties.<sup>68</sup> The promotion of Kaya to finance minister upon Yūki’s recommendation, too, met with a favourable response from business circles. However, the return of the much-feared Baba as vice premier and home minister signalled that the reformist camp was still on the offensive – with the immediate effect of causing a fall in stock prices.<sup>69</sup>

## 5 Wartime taxation

In compliance to the Diet’s demand, on 16 July 1937 the Konoe cabinet appointed an advisory committee to discuss tax reform in view of the next

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<sup>67</sup> On the Yūki plan and related Diet debates, see SZS 5: 382–410. A detailed explanation is in *Ekonomisuto* 1937d. The draft is in HNS, 0-1-7, Part “Rinji sozei zōchō hōan 臨時租税増徴法案”. For comparison with the Baba plan, see Jinno 1981, Part I: 140–143.

<sup>68</sup> *Ekonomisuto* 1937e.

<sup>69</sup> *Ekonomisuto* 1937f, g. Baba, however, resigned in December due to failing health; he was replaced by admiral Suetsugu Nobumasa, a hard-liner faction leader in the navy.

ordinary session. In order to ensure a broad representation, non-cabinet members were selected from both houses of the Diet, business associations and other interest groups; some prominent economists, too, were to provide their expertise.<sup>70</sup> However, it soon became clear that the cabinet wanted to postpone discussion of reform and quickly enact emergency tax hikes, because of the renewed outbreak of hostilities with Nationalist China earlier that month. At the 71st special Diet session (25 July–7 August 1937), the government obtained approval for a gradual increase up to about 100 million yen over 1937–38, to be drawn chiefly from income tax rate revision and a new levy on dividends; the manoeuvre also included the imposition of a sales tax on a limited range of goods.<sup>71</sup> All these measures, to be regulated by a North China Incident Special Tax Act, would raise revenue earmarked for the Special Account for Extraordinary Military Expenses; the latter was created in September, while the battle over Shanghai raged on. When the tax committee held its first meeting, on 5 November, the cabinet urged members to restrict discussion to minor amendments to ordinary legislation and wait, for more substantive reform, until normal economic conditions be reconstituted after settlement of the “Incident”.<sup>72</sup> In the meantime, the MOF drafted an additional plan for temporary taxation, which would bring the total increase since the summer to about 300 million yen. Besides the recurrent accent on income and extraordinary profits, there was a significant upgrade of the sales tax and indirect taxation as a whole. Revenue from this China Incident Special Tax Act, which the 73rd Diet approved reluctantly in March 1938, was entirely earmarked to finance the ongoing military operations.

By that point, while resistance continued despite the fall of Nanjing and other major cities, it appeared to informed observers that chances for rapid victory were growing thin.<sup>73</sup> In the attempt to restrain dependence on debt, which was rising exponentially, further “temporary” tax hikes for nearly 200 million yen were enacted in March 1939. At the start of the year there had been another change of premier, but this had not brought disruptive turnover within

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<sup>70</sup> SZS 5:395. The full list is in HNS 0-0-2, n. 1, “Zeisei chōsakai meibo 税制調査会名簿”, Nov. 1937.

<sup>71</sup> See SZS 5: 413–421. Related documents are in HNS, volume 4-0-1, “HokuShi jiken tokubetsu-zei kankei shorui 北支事件特別税関係書類”. On developments outlined below until 1939, see SZS 5: 427–466.

<sup>72</sup> See *Tōkyō Asahi shinbun* (TA) 1937b. The main parties had already agreed on this position: see TA 1937a. For press reports on the other meetings, see TA, 7, 9, 10–12 November; 31 January 1938. The committee minutes are in HNS, 0-0-2, n. 6, 8, 9. The resulting tax adjustments were enacted in March 1938.

<sup>73</sup> *Ekonomisuto* 1937h.

the MOF: the top post went to Ishiwata, the former Tax Bureau chief who had served as vice under Kaya and Ikeda Shigeaki (Seihin). Compared to the previous years, the proportion between direct and indirect tax increases further shifted towards the latter (about 105 million yen), raising much criticism in the Diet. This time, the aim was not only to raise revenue, but also to limit the consumption of increasingly scarce commodities. Clearly, the claws of war were closing around the economy. At last, long debate in a mixed-membership advisory committee (April–October 1939) produced a plan for comprehensive reform that had many points in common with the Baba proposal; it cleared the Diet in March 1940.<sup>74</sup> The new system provided the foundation for further tax hikes in the next years, as the war's toll grew heavier.

As summarised above, for a few years taxation in Japan offered a peculiar case of parallel legislation: ordinary acts that remained in force with minor amendments; provisional increases under the Yūki framework, which preceded the outbreak of total war with China; and extraordinary taxation that related directly to the military campaigns. How did finance bureaucrats think of such a situation? Documents in the Hamada collection can help to shed light on the matter.

In “Considerations on the method of tax increases related to the Incident”, the Tax Bureau discussed the pros and cons of three alternatives: (a) to incorporate the tax increase of March 1937 into ordinary acts, while keeping a separate, temporary legislation to back military expenses; (b) to maintain the above as three distinct pieces of legislation; or (c) to unify all three.<sup>75</sup> The chief merit of the first option is that it prevented the Yūki increase, “whose content is unrelated to the Incident and was already necessary from a financial standpoint”, from being assigned automatically to the special account for the China campaign. Conversely, as tax acts enacted before and after the outbreak

<sup>74</sup> For a synthesis of the committee minutes and public debates, see SZS 5: 493–559. The plan is presented in SZS 5: 560–590. For further analysis, see Jinno 1981, Part 2; Takayose 2010: 115–162.

<sup>75</sup> HNS, 0-0-2, n. 13, “Jihen kankei zōzei no hōhō ni kansuru kōsatsu 事変関係増税ノ方法ニ関スル考察”, top secret, Oct. 1937. Option (a) also appears separately in HNS 0-1-12, n. 2, “Kihon zeihō to rinji sozei zōchōhō to o ikkatsuhō shi betsu ni rinji rippō toshite jihen kankei no zōzei o rippō suru an 基本税法ト臨時租税増徴法トヲ一括法シ別ニ臨時立法トシテ事変関係ノ増税ヲ立法スル案”, secret, undated. The latter document is followed by a draft copy with an alternative plan attached (HNS 0-1-12, n. 3, “(Betsuan) Shina jihen rinji zōchō hōan (別案) 支那事変臨時増徴法案”, undated), which proposes to merge the Yūki increase with China-related tax hikes, but keep them separate from ordinary acts. This solution is also discussed as an alternative to complete separation in HNS, 0-1-12, n. 7, “Zōzei no jiki o i ni suru baai ni okeru zeisei kaisei hōhō ni kansuru kōsatsu 増税ノ時期ヲ異ニスル場合ニ於ケル税制改正方法ニ関スル考察”, secret, undated.

of the Incident “differ in aim and nature”, it would not be appropriate to merge them. The Yūki increase was, in fact, “nothing but a revision of fundamental legislation” that was presented as provisional for lack of adequate time during the Diet session. The remaining alternative avoided the technical problems involved in the merger of laws, but in the end made the tax system more complicated. The plan finally published by the MOF, which adopted the “all-separate” option,<sup>76</sup> was therefore a compromise between the Tax Bureau’s preferred solution – incorporation of the Yūki plan only into ordinary legislation – and the one to be avoided, that is, a grand merger that would blur the line between permanent and emergency taxation, to the advantage of the military.

The next question, then, is to what extent measures enacted under Minister Yūki matched the durable arrangement that the Tax Bureau envisioned for the post-war period. From a quantitative standpoint, there is evidence that “for the coming tax adjustment” the aim was to make permanent the revenue increase obtained in early 1937. Hikes beyond that level, instead, were a temporary necessity.<sup>77</sup> Concerning the redistribution of the burden, however, there were no clear guidelines: while “to implement an adjustment that brings major changes to the tax system is impossible at present”, the only conclusion about prospective measures studied over the previous years was that “these are issues that involve much debate also in peacetime”.<sup>78</sup> The view about reform was not just that war has distorted both fiscal and economic conditions and that it was necessary to wait until these would be “back on a normal track”;<sup>79</sup> a detailed review of possible innovations also placed the accent on their intrinsic defects.<sup>80</sup> A property tax would be difficult to assess in a fair way and would provide a relatively small revenue compared to its administrative cost. Alternatively, a schedular income tax would bring abundant revenue, but might fall heavily on “the general masses” – especially urban labourers so far not subject to household tax – because of its low threshold and flat rates. Unified taxation of “2nd-type income” and other personal income would produce negative effects on capital yields and the placement of bonds.

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76 TA 1938.

77 HNS, 0-0-2, n. 16, “Zeisei seiri hōshin ni tsuite 税制整理方針ニ就テ”, secret, undated.

78 HNS, 0-0-2, n. 16: 4.

79 HNS, 0-0-2, n. 16: 2.

80 HNS, 0-0-2, n. 11, “Zeisei kaisei ni kansuru shuyō mondai 税制改正ニ関スル主要問題”, top secret, 1 Nov. 1937. Similar comments are in HNS, 0-0-2, n. 14, “Kōkyūteki zeisei seiri o kono sai okonau koto no konnan naru jijō 恒久的税制整理ヲ此ノ際行フコトノ困難ナル事情” (marked “Saigoan 最後案”), top secret, 26 Oct. 1937: 13–15.

With respect to local taxation, nationalisation of the prefectural house tax was considered prone to criticism as detrimental to local autonomy. As for the abolition of household tax, this would require in compensation some durable and elastic resources, as a higher income surtax; however, since for future national tax increases there was no choice but to focus on income tax, it would be difficult to impose a heavy surtax. Household tax could also be replaced by state transfers or decentralisation of national taxes, but then the problem would be how to compensate for the loss at central level – leading back to the question of property tax and special income tax. Another possibility would be the introduction of a general turnover (consumption) tax; this, however, would cause a hike in prices and provide unstable revenue, being dependant on fluctuations of the economy.

It seems, therefore, that finance bureaucrats remained at best cautious towards the prospects of structural reform. A certain continuity, nevertheless, can be detected between wartime measures and long-term policy from the standpoint of inequality reduction.<sup>81</sup> Since 1935, tax increases had targeted mainly corporations, businessmen and the holders of financial assets, leading to an attenuation of the horizontal bias. Measures submitted to the 73rd Diet went again in this direction (Figure 2). Officials noted that the urban/rural imbalance, “which had been a core problem in the adjustment of the tax system”, in recent times had shrunk considerably thanks to both legislative action and a rising trend in the price of agricultural products. For the future, the recommendation was to leave the rural populace out of the target of tax hikes, so as to further improve equality.<sup>82</sup>

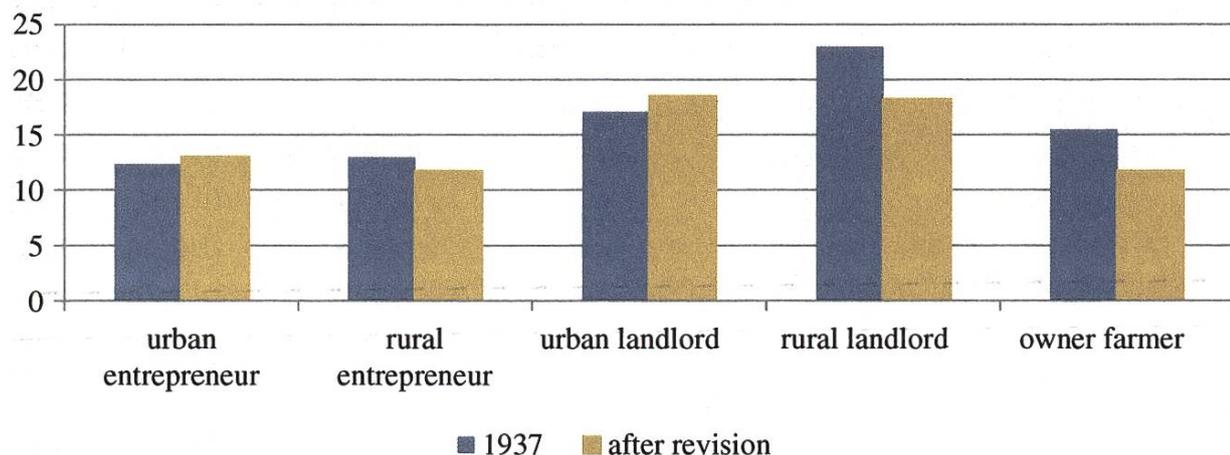
## 6 Conclusion

Classified documents of the Tax Bureau offer precious insight into the planning of fiscal policy in the 1930s. On one hand, it is possible to trace a change in the attitude of officials towards budgetary expansion. By 1937, what had been initially considered a temporary trend became accepted as a structural

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**81** Numerous surveys on this issue were submitted to the advisory committee of 1937. See HNS, 0-0-1, n. 1, Ōkurashō shuzei kyoku, “Zeisei chōsakai (dai ikkai) futan chōsa kankei shiryō 税制調査会（第一回）負担調査関係資料”, secret Nov. 1937; HNS, 0-0-1, n. 3, Ōkurashō shuzei kyoku, “Zeisei chōsakai (dai ikkai) kankei sankō shiryō 税制調査会（第一回）関係参考資料”, Nov. 1937; HNS, 0-0-1, n. 4, Shuzei kyoku kikakuka, “Shōwa 11 nenbun sozei kōka futan narabini kakeihi shishutsu (fu shōhizei) jōkyō shirabe 昭和十一年分租税公課負担並家計費支出（附消費税）状況調”, secret, 1937.

**82** HNS, 0-0-2, n. 14, 10–11.



**Figure 2:** Estimated effects of tax revision on the average burden of each profession.

Source: HNS, 3-9-3, n. 7, “Zōchō zengo ni okeru sozei kōka futan hikaku 増徴前後ニ於ケル租税公課負担比較”, secret, Feb. 1938. Average of eight income brackets between 400 and 5000 yen. Estimated effect of the Extraordinary Tax Increase Act, the China Incident Special Tax Act and revision of the taxable value of land.

upgrading of public spending. In this respect, Japan was proceeding in the same direction as the leading industrialised countries, where socio-economic transformations since the First World War were leading to the crisis of the liberal model of “small government”. Although war grew into the principal force inflating budgets, finance bureaucrats viewed this factor as fundamentally different from structural change. Even after the outbreak of all-out conflict with China, policy analysis remained tied to the idea of a “return to normality” in the long term. At the operative level, this objective was pursued by keeping a neat separation between the tax increase of March 1937 – which should be embedded in ordinary legislation – and provisional hikes that served to finance the war effort. Though largely ineffective, this decision was a significant act of resistance against military encroachment over public finance.

On the other hand, documents on the structure of taxation reveal a basic continuity with the developmentalist thought of the Meiji period. While the issue of burden inequality received a certain attention, it is clear that the priority goal remained that of supporting Japan’s international advance as an industrial power. Therefore, despite the acknowledgement that income taxes were the only fiscal resource adequate to sustain the gradual growth of government spending, there was no enthusiasm for a radical shift of the burden towards the urban and corporate sectors of the economy. This approach diverged from that of the Home Ministry, whose commitment to the rural question was closely linked to its institutional role of ensuring public order and efficient administration at the local level.

The question, then, is how to explain the breakaway from a conservative track at two successive moments, that is the Baba plan of 1936 and the general

reorganisation of 1940. The latter can be understood in light of the enormous pressure for reform exerted by war at that stage, in both financial and social terms. The fact that legislative approval arrived only after a decade of discussion (not to consider previous debates in the 1920s) is a telling sign of the resilience of the established order. The former rupture point, however, requires further reflection on the political role of the bureaucracy. With the fall of the last party cabinet in 1932, career officials certainly regained ascendancy as policy makers. Moreover, after Takahashi's demise there was a substantial hierarchical unity in the MOF, as observed here in the careers of Kaya and Ishiwata. Minister Baba represented an exception, as did later Mitsui CEO Ikeda Seihin (May 1938–January 1939) and former secretary-general of the Minseitō party Sakurauchi Yukio (January–July 1940), under whom tax reform was finally enacted. Baba's appointment, in particular, had the character of a hostile takeover that produced immediate effects on both personnel and policy guidelines. It has been shown, however, that this radical swing soon gave way to an accommodation of interests that better suited the polycentric structure of power.

In a broader perspective, the persistence of strong linkages between the Finance Ministry, the party in government, and business circles in the postwar era can help explain the resurgence of some pre-reform features in the national tax system. The elements that re-emerged, such as a preference for low fiscal pressure, were those most functional to the process of catch-up with more advanced economies. Therefore, it can be concluded that the postwar tax regime was born as a synthesis of deeply-rooted developmentalism and a relatively recent concern for redistributive issues.

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