Chapter 1 Fiscal and Monetary Policies in the Environment of Postwar Inflation

1. Political and Economic Conditions during the Period of Postwar Inflation

Between air raids and offshore shelling, the Allied forces wrought enormous damage on Japan's manufacturing and port facilities in their quest to destroy its military bases and military productive capacity. Estimates indicate that by the time the war had ended, Japan had lost 25 percent of its total assets, 80 percent of its ships, 34 percent of its industrial machinery and 24 percent of its buildings. The damage was not limited to industry: social overhead capital - ports, communications and transportation infrastructure - were also severely damaged. To this we must add the human loss. The army lost 1.14 million men to battle or disease; the navy 410,000. Air raids killed another 300,000 people. Total casualties when the wounded and missing are factored in reached 2.53 million, and probably closer to 3 million if Japanese colonists and expatriates are included.

Those who did not lose their lives often lost their livelihoods. Demilitarization policies brought 7.61 million soldiers back into the civilian population and turned 4 million workers in military industries (including 750,000 women) out of their jobs. Added to this were another 1.5 million people repatriated from former colonies.

The loss of the colonies resulted in significant shifts in the population structure as well. In 1946, the total population of 75 million included about 1.3 million former soldiers, former military workers and former colonists who required jobs. Japan was faced with the prospect of having 17 percent of its employed population suddenly out of work. Besides finding them jobs, Japan had to supply itself with sufficient food from an agricultural sector whose productivity had sharply declined. The "termination-of-the-war expenses" budget found work for many of the jobless in the businesses serving the U.S. forces or in one of the many public corporations that sprang up to control the flow of goods. But this was only a drop in the ocean, and unemployment worsened. Still, the job market was not flooded with people seeking work. Most of the former soldiers and colonists returned to their home villages and went to work on farms. Those that stayed in the cities often went into business by themselves.

Table 1-1 War Damage to National Wealth

(In millions of yen)

Assets	Total damage	National Wealth Existing at War's End	Damage Rate
	(A)	(B)	(A/(A+B))%
Asset national wealth	64,278	188,852	25.4
Buildings	22,220	68,215	24.6
Ports, harbors and canals	132	1,632	7.5
Bridges	101	2,773	3.5
Machine tools	7,994	15,352	34.2
Railways and tracks	884	11,618	7.1
Vehicles	639	2,274	21.9
Ships	7,359	1,766	80.6
Electricity and gas supply equipment	1,618	13,313	10.8
Telegraph, telephone and broadcasting facilities	293	1,683	14.8
Waterworks	366	1,814	16.8
Furniture and other treasures	17,493	63,448	21.6
Miscellaneous goods	1,243	4,964	20.0
Nonclassifiable	3,936		
Other national wealth	1,024		
Forest roads and trees	6		
Roads	243		
Historic and beaty spots	775		
Total	65,302		

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp. 14-15

A large infusion of money immediately after the surrender triggered high inflation during the early postwar years. The reason for this monetary infusion was high latent demand for money during the war, which erupted when the war ended in defeat. Among the direct causes of the increase in the money supply were extraordinary military expenditures (payments to returning soldiers, prepayments to war contractors) and expenditures to indemnify for losses stemming from the closing of businesses during the war, among others. After the surrender, the decision was apparently reached that the markets would need an infusion of cash if economic activities were to be maintained. Later, the demand for cash remained high as reconstruction commenced. Since the authorities failed to take sufficiently strong measures to deal with it, the postwar inflation continued. In 1947, active lending by the Reconstruction Finance Bank was one of the strongest money supply factors, producing the so-called “reconstruction inflation.” This period before the implementation of the Dodge Plan has occasionally been summed up with the phrase “Government in the red, companies in the red, and households in the red, too.” Between 1944 and 1948, in the course of the postwar inflation, average outstanding Bank of Japan notes increased 20 fold. During the same period wholesale prices rose 55.1 fold.

Defeat produced major changes in Japan's political and economic systems, many of which would not have come about - at least not so quickly - had it not been for the unusual political circumstances presented by the Occupation. These were, indeed, the most sweeping changes in the Japanese system since the Meiji Restoration. The policy-making in the first half of the Occupation concentrated on the political system. After the surrender was signed on September 2, Allied forces, led by the Americans, moved into areas throughout Japan, with SCAP Headquarters issuing orders and instructions to the Japanese government. On November 3, 1946, a new Constitution was promulgated.

Faced with inflation and food shortages, the postwar government introduced its first comprehensive economic policy - the Emergency Economic Crisis Policy - on February 16, 1946. Designed to free Japan from the punishing postwar inflation, these measures included a freeze on bank deposits, mandatory conversion to new Bank of Japan notes, asset checks, emergency food provisions, searches for concealed goods, price restrictions, job programs, incentives for higher industrial production and controls on basic household goods. This was followed by the June 11, 1947 announcement of Emergency Economic Policy. The policy objectives were to secure food supplies, establish orderly distribution of goods, reform the entire wage/price system, restore fiscal and monetary health, boost production and enhance efficiency in targeted industries, secure jobs and livelihoods for workers, and promote exports. A reduction of the fiscal deficit also resulted, and on July 5, Japan was able to adopt a new pricing system. Despite the fact that price controls were stricter during this period than at any time in postwar Japan, however, the policy was unable to suppress inflation.

Food programs were strongly emphasized during this period. As the holding of a “Food May Day” in May 1946 illustrates, maintaining food supplies was one of the most important challenges facing the government. It had begun using the Foodstuffs Control Special Account to manage virtually all foodstuffs in the country in 1942, and this system was held over in its entirety in the postwar period. With demand high and agricultural production in decline, the government embarked on broad land reforms in an effort to boost output by giving farmers their own land to work (rather than the sharecropping that was common prior to and during the war). Farm cultivation programs, which were enacted in part to provide jobs for returning soldiers and colonists, gave land of their own to those who wanted to cultivate it, and subsidized long-term loans if they worked it. These programs were not entirely successful, however. Agricultural production continued to decline, but the population of rural villages began to swell, which combined with inflation to squeeze the food supply further.

In the end, it was assistance from the United States that covered the shortages. In 1945 the U.S. Department of the Army began to provide Government and Relief in Occupied Areas - or GARIOA - assistance. Japan also received Economic Rehabilitation in Occupied Areas - or EROA - assistance in 1948 and 1949. The GARIOA funds were spent on food, fertilizer, oil, medical supplies and other basic necessities for survival, while the EROA funds were used for raw cotton, mining, raw materials, machinery and similar reconstruction purposes. At the time, Japan was forced to rely on imports for many of its needs, and the U.S. assistance went a long way toward alleviating the domestic shortages. By the U.S. 1951 fiscal year, Japan is estimated to have received $1,577 million in GARIOA aid and $285 million in EROA aid: a total of $1,862 million. Other U.S. statistics indicate that the United States supplied Japan with $575 million in wheat and wheat flour, $440 million in other foodstuffs, $240 million in raw cotton, $158 million in fertilizer and $143 million in oil. Until 1948 almost all of Japan's trade was conducted by the state, and during this period most imports were assistance goods. Indeed, until 1949, it was U.S. GARIOA assistance that kept Japanese imports afloat. Private-sector trade resumed in that year, however, and the volume of commercial imports rose in 1950, reducing the share of assistance in the total imports. Still, Japan was able to defer payments on the large debts it had run up with the U.S., which was in turn a major factor in its postwar economic reconstruction.

Table 1-2 Trade and Aid Import

(In thousands of US dollar)

Calendar Year	Export	Import	US Aid
Sep. 1945 - Dec. 1946	103,292	305,493	192,893
1947	173,567	523,562	404,433
1948	258,271	683,082	461,004
1949	509,700	904,845	534,750
1950	820,055	974,339	361,293
1951	1,354,520	2,217,377	180,341
1952	1,272,915	2,028,193	5,426

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp. 106-07

2. Fiscal Policies during the Period of Postwar Inflation

1) Budgeting during the Postwar Inflation Years

As soon as the Occupation began, SCAP ordered Japan to cease all payments from the Provisional Military Expenditure Special Account. In the fiscal 1945 budget, this special account was larger than the General Account representing the ordinary budget. Indeed, it dwarfed the General Account in terms of both revenues

Table1-3 General Account Budget Breakdown by Ministry and Special Military Account Budget

(In millions of yen)

Ministry	FY 1944 Budget	FY 1945 Budget	FY 1946 Budget
Imperial Household	5	5	5
Foreign Ministry	48	48	194
Interior Ministry	1,831	1,950	8,922
Finance Ministry	13,386	19,354	84,504
Army Ministry	1	—	—
Navy Ministry	1	—	—
First Ministry for the Demobilized	—	1	—
Second Ministry for the Demobilized	—	1	—
Justice Ministry	81	109	364
Education Ministry	487	648	2,192
Agriculture and Forestry Ministry	—	—	8,370
Commerce and Industry Ministry	—	—	4,114
Agriculture and Commerce Ministry	2,228	1,723	—
Communications Ministry	—	—	252
Health and Welfare Ministry	516	639	7,249
Greater East Asia Ministry	492	605	—
Munitions Ministry	1,944	3,265	—
Transport Ministry	819	811	2,821
Total	21,838	29,157	119,087
Special Military Account Budget	63,000	85,000	

Note: The budget for the Transport Ministry in FY 1944 was a budget after supplementation for the Transport and Communications Ministry.

Source: Ministry of Finance, Budget Statistics

(from bond issues and borrowings) and expenditures (for military purposes). Most of this represented revenue transferred from the General Account and expenses incurred by the Ministry of Military Procurements to buy weapons and other supplies. This was all part of the standard wartime budget. When the war ended, it was anticipated that many of the military expenditures budgeted for would not be necessary, while new fiscal demand would emerge: programs for former soldiers and colonists, hikes in public servants' wages to keep pace with inflation, and spending to cover deficits from the railways and the telecommunication service. Since this new spending demand had not been provided for in the initial 1945 budget, a supplementary budget was put together and passed on December 18, providing an additional ¥205 million for each of the General Account and Special Account. Also during fiscal 1945, the provisions for "Emergency fiscal disbursements" in Article 70 of the Imperial Constitution were invoked in order to fund payments from surplus revenues. These disbursements were used to cover expenditures not provided for in the original fiscal 1945 budget.

The Diet was dissolved in December 1945, and a purge of government officials delayed the general election, making it impossible to pass a budget for 1946 by the end of March. Article 71 of the Imperial Constitution provided for such a situation, stating that failure to pass a new budget would result in the re-use of the previous year's budget. This entailed problems, because 70 percent of the 1945 budget was for war-related expenditures, leaving the government with only 30 percent that it could administer, most of which had to go for debt servicing and other non-discretionary items. The Ministry of Finance (MOF) initially provided for unbudgeted expenses by drawing down its reserves, but as expenses mounted, it was forced to resort to "emergency fiscal disbursements." There were still expenses that could not be covered, however - a situation which led to the creation of a "provisional budget." Note that this provisional budget was not the same as the provisional budget described in the Public Finance Law; it was merely a name of convenience adopted by the bureaucracy. For that part of the non-military budget that could be administered, the Ministry created a "revised budget" covering the period from April to August. The initial 1946 budget was submitted to the Diet on

July 24, and it was finally passed on September 12.

This revised budget included “Economic stability expenses,” which came under MOF jurisdiction. Set up at the insistence of SCAP, this account was in reality money for public works. Other new accounts under MOF administration included more than one third of the “termination-of-the-war expenses” - primarily those concerned with labor, relief and use of private facilities - which, it was hoped, would contribute to employment programs. The job issue was of particularly high priority, and speeches by the Minister of Finance on fiscal policy had very Keynesian overtones.

Thus, budgeting and budget administration up to fiscal 1946 faced a plethora of problems. Japan were still required to function under the Imperial Constitution, which was not suited to dealing with the fiscal demands of the postwar period; the budget was an extension of the wartime budgets, which were slanted heavily in favor of the military; and as if these cracks in the system were not enough, there was an inflationary spiral as well. The revised 1946 General Account budget totaled ¥ 56,088 million. Lack of funding forced the government to divert ¥ 25,587 from the Capital Levy Revenue Special Account. The major spending items were termination-of-the-war expenses, public works, coal price adjustments and food price adjustments. The supplementary budget also included new compensation funds for the reconstruction and reorganization of financial institutions.

The new Constitution took effect in May 1947. The sections concerning fiscal policy endeavored to ensure that democracy would be respected. It gave the Diet responsibility for determining how national finances are administered, and required that it approve all Treasury spending and any debt undertaken. The fiscal policy provisions of the Constitution were extended into the Public Finance Law, which took effect on March 31, 1947. This law specified single-year budgets, required that taxes and public impositions have statutory grounding, placed limits on bond issues and borrowings, placed limits on Bank of Japan borrowings, required that a ceiling on government debt be determined in the general budget provisions, required that at least half of any surplus on the settlement of accounts be directed toward bond and debt repayment, required that asset management and administration have statutory grounding, specified the nature of provisional and supplementary budgets, and laid out the rules governing the carryover of budget surpluses to the following year's budget. The law also contained regulations on the establishment of special accounts.

One of the main thrusts of the Public Finance Law was to eliminate expenditures not made with Diet approval, a somewhat common practice under the old Accounting Law. This was in keeping with the strong budgetary authority given to the Diet under the new postwar Constitution. Having learned its lesson from the large wartime bond issues, Japan treated the law as an opportunity to limit government bond issues and borrowings to public works spending, and to regulate government debt the Bank of Japan was permitted to underwrite and finance.

The budgetary principles determined for fiscal 1947 were to prevent inflation and to encourage industrial recovery whenever possible, while maintaining an overall balance and, to the extent possible, a fiscal balance. In order to prevent a deficit budget in fiscal 1947, the government was again forced to dip into the Capital Levy Revenue Special Accounts to provide adequate funding. The initial General Account expenditure budget for the year was ¥ 114,504 million. Major spending items included termination-of-the-war expenses, public works, price adjustments and allocations of tax revenue to local governments. There was considerable upward pressure on the budget, however, not the least of which was inflation. A total of 13 supplementary budgets were passed during the year for the General Account alone. As a result, final expenditures for the year, with all the supplements factored in, totaled ¥ 214,256 million. It was a distinguishing feature of budgets after fiscal 1947 that all public works expenditures were recorded under the budget of the Economic Stabilization Board, and that they were to be examined by the office itself. This system remained in place until the fiscal 1952 budget.

The fiscal 1948 budget was initially proposed by the Cabinet, but had to be revised by the ruling party and revised again by the bureaucracy, before it finally passed on July 4. The “provisional budget” for the April-June period was created in line with the Public Finance Law regulations. The budgetary principles established for fiscal 1948 called for working toward mutual equilibrium between the budget and prices. In other words, the government hoped that the Revised Schedule of Official Prices implemented in June of that year would reduce the fiscal burden from price adjustment subsidies, while at the same time both restraining any spill-over effects on the budget from skyrocketing prices, and encouraging industrial production. The General Account budget totaled ¥ 414,462 million, with major spending items including termination-of-the-war expenses, price adjustments, public works, allocations of tax revenue to local governments and government enterprise rehabilitation. Rising prices necessitated two supplementary budgets during the year, however, in order to raise the salaries of public servants, and to provide more money for price adjustment subsidies.

2) The Termination-of-the-war Expenses

The U.S. forces stationed throughout Japan under the Occupation ran up expenses for base construction and civilian workers. At first, the U.S. proposed using “B military scrip” to cover the costs of the Occupation, just as it had done on Okinawa. Plans to use scrip on the Japanese mainland were abandoned, however, after strong protests from the government. In its place, the government of Japan agreed to shoulder the financial burden of the “Termination-of-the-war” expenses. During 1945, no termination-of-the-war expenses were included in the budget. Instead, ¥ 12,253 million was borrowed from the Bank of Japan’s Temporary Account to cover the costs. A decision by the MOF on September 14, 1945, resulted in a system in which costs were paid in advance by the BOJ. When the government received a request for materials or buildings, it would spend the amount required from the BOJ Temporary Account and deliver the requested items in-kind. By the end of the fiscal year, the total had reached ¥ 2,114 million, of which ¥ 414 million went on wages, ¥ 323 million on construction costs and ¥ 124 million on the procurement of goods.

Beginning in fiscal 1946, termination-of-the-war expenses were included as a separate budget item. Nevertheless, the BOJ continued to advance the funds to the government until October of that year because of budget shortfalls. During the fiscal 1946 budgetary process, SCAP requested a large boost in spending on housing for troops and similar items. The amount of the proposed increase was eventually reduced, and the revised budget contained a ¥ 19,000 million appropriation for termination-of-the-war expenses under MOF administration. This appropriation allowed the government to pay back the BOJ Temporary Account. The resulting pressure on the remainder of the General Account convinced the government to ask SCAP to reduce the termination-of-the-war expenses, but a supplement to the fiscal 1946 budget ended up increasing them instead. The government was forced to rely for revenues on deficit bonds underwritten by the BOJ and on direct borrowings from the BOJ. With the supplements added in, the termination-of-the-war expenses accounted for ¥ 38,300 million, or 32 percent of the total budget.

Japan refused to post a deficit in its fiscal 1947 budget, a position which strained funding for the termination-of-the-war expenses, in which SCAP demanded another increase. The initial budget contained a provision of ¥ 25,188 million for termination-of-the-war expenses. Until the initial 1947 budget, this item included both war reparations and Occupation costs. The MOF was largely unsuccessful in negotiating a downward revision in SCAP's requests in the fiscal 1947 supplementary budget. Supplements passed on November 1 and November 29 both contained large increases in termination-of-the-war expenses, which totaled ¥ 64,121 million for the year, or 29 percent of the General Account, making them the largest single spending item in the budget. It was in these supplementary budgets that reparations were first separated from other termination-of-the-war expenses as an independent expenditure.

The initial 1948 budget contained only a slight increase, but as the supplementary budget was being drafted, there were again requests for large hikes in termination-of-the-war expenses. When it was approved on December 22, 1948, the supplementary budget contained an additional ¥ 14,500 million appropriation for this item, bringing the total for the year to ¥ 103,300 million - 22 percent of the final General Account budget. As a percentage of the budget, termination-of-the-war expenses reached their peak in fiscal 1948, after which they declined steadily as the United States pulled out its troops. Beginning in fiscal 1948, termination-of-the-war expenses were no longer administered solely by the MOF. Each ministry had its own termination-of-the-war expenses budget.

Since Japan continued to pay termination-of-the-war expenses until fiscal 1951, it behooves us to say a word about the expenses after 1949. It was in fiscal 1949 that the Dodge Plan was introduced to restrain deficit spending. SCAP cooperated with this policy by reining in its budgetary demands, which, coupled with the significant draw-down of U.S. forces in Japan, reduced termination-of-the-war expenses to 16 percent of the final General Account budget for the year. What had been the largest spending item only a year earlier, was now even less than the price-adjustment expenditures. The fiscal austerity continued in 1950, and the account was reduced once again in 1951, dropping to ¥ 106,473 million in the initial budget for that year. Termination-of-the-war expenses now counted only fourth in terms of spending items. When the San Francisco peace treaty took effect in April 1952, the account was eliminated altogether and money for goods and facilities for the U.S. forces stationed in Japan was paid from the newly created defense expenditures.

3) Price Policies

Japan experienced its first price-adjustment policy during the war in 1940 with the inclusion of a price-adjustment subsidy for coal in the General Account. Subsidies were later extended to food, steel, nonferrous metals, electric power, oil and other items, but the largest went to coal and nonferrous metals. By 1945, the price subsidies had grown to 20 percent of the General Account. As it set about dismantling the wartime controls, SCAP demanded that these subsidies be eliminated. In addition, on November 20, 1945, the practice of publishing official prices for fresh foods was done away with as well. The elimination of price controls coincided with an increase in the money supply immediately after the war, triggering a price spiral for fresh foods. The resulting inflation prompted the government to enact “postwar” price controls, but in light of the absolute shortages that existed, it was forced to resort to its former policy of control through official pricing.

The publication of the Price Control Order on March 3, 1946, marked the beginning of what would come to be known as the “3/3 Price System” (from the date on which it took effect). Besides endeavoring to minimize price adjustment subsidies, the 3/3 Price System eliminated subsidies to industry entirely. The coal industry's production subsidies were restored in fiscal 1948, however, with the implementation of the Priority Production Plan. The 3/3 Price System was followed on October 1, 1946, by the Provisional Supply-and-Demand Adjustment Law, which became the other basic law concerning price controls. SCAP required that Japan should create a public rationing mechanism for basic materials and daily necessities, thereby wresting the authority to control distribution out of the hands of private industrial concerns. Japan complied, establishing public corporations to control the distribution and rationing of various goods. The capital for these companies came entirely from the government and their operating funds from the Reconstruction Finance Bank. Beginning in April 1947, several new public corporations were created, each with its own governing law and a mandate to adjust prices. They had three main tools for accomplishing this: “price leveling” in which prices were “pooled”; “transportation leveling” for goods for which transportation made up a large portion of the price; and price differential subsidies. Unlike the other public corporations, which merely rationed the goods they were responsible for, the Price Adjustment Public Corporation adjusted prices by buying goods from producers and then selling them back to the same producers.

By autumn, inflation had effectively broken the 3/3 Price System. With the gap between the official and black-market prices widening, a new official price schedule was published on July 5, 1947. The new schedule used cost calculations to set prices for mining and industrial goods and parity calculations to set prices for agriculture, forestry and fishing products. The July 1947 system contained wide discrepancies among goods, however, when viewed as a multiple of average prewar prices. To flatten these out, a limit, or “stability band,” of 65 times base-year prices was established for the consumer prices of priority industrial goods. Should producer prices rise above the stability band, price adjustment subsidies would be used to bring consumer prices back within limits.

Under this system, the range of items subject to price adjustments expanded dramatically. In 1947, stability band subsidies were paid for only three items - steel, coal and fertilizer - which received priority in the Priority Production Plan. The next year, the subsidies remained in place for these three items, but appropriations for the Foodstuffs Control Special Account and other special subsidies brought the total price adjustment budget to ¥ 22,511 million, or 10 percent of final General Account expenditures of fiscal 1947. Prices continued to climb, making it necessary to revise the official price schedules. In June 1948, Japan moved to yet another new price system that hiked national railway fares and communications charges, expanded the stability band to 110 times the base-year level, hiked the price of basic goods by 70 percent and consumer goods by 80 percent, and provided for ¥ 43,000 million in price adjustment subsidies for stability band goods.

On December 18, 1948, the Government of Japan was given the Nine-Point Economic Stabilization Plan by SCAP. On April 19, 1948, the government announced its Price Policy Guidelines, in conjunction with the implementation of the Nine-Point Economic Stabilization Plan, which formed its basic price policy guidelines under the single-rate foreign exchange market introduced with the Dodge Plan. These guidelines eliminated export subsidies, reduced import subsidies and mandated both a review of the items for which price adjustment subsidies were paid, and cuts in the amounts paid.

The price system was revised again in April 1949. The special subsidies were scrapped, but new import subsidies were provided, though this was because subsidies that had been hidden in the Trade Funds Special Account until the end of fiscal 1948 were moved over to the General Account. This led to an initial

Table 1-4 Price Adjustment Subsidies

(In millions of yen)

	FY1946	FY1947	FY1948	FY1949
Food	6,480	—	—	—
Coal	2,531	—	—	—
Oil	25	—	—	—
Stability Band Subsidies	—	16,612	53,786	97,928
Coal	—	9,957	18,119	21,675
Steel	—	3,873	21,372	46,375
Nonferrous Metals	—	808	2,392	1,803
Fertilizer	—	1,814	10,470	25,625
Sodium Compound	—	158	1,433	2,450
Major Food	—	5,542	—	—
Special Subsidies	—	355	8,713	—
Fresh Food	—	128	714	—
Crude Oil	—	73	—	—
Fiber	—	153	—	—
Reinsurance for Agricultural Mutual Association	—	—	500	—
Subsidies for Livestock Farming Funds	—	—	810	—
Coal Special Subsidies	—	—	5,950	—
Subsidies for Metal Mining Funds	—	—	289	—
Fertilizer (Loss compensation)	—	—	450	—
Import Subsidies	—	—	—	68,586
Food and Fodder	—	—	—	45,349
Fertilizer	—	—	—	11,878
Industrial Material	—	—	—	4,716
Fiber, etc.	—	—	—	6,643
Salt Import Subsidies	—	—	—	3,700
Total	9,036	22,511	62,499	170,214

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara kowa made*", Vol. 10, pp. 230, pp. 349, pp. 449, pp. 529

expansion in the size of subsidies on the General Account, but it was done with the understanding that the subsidies would soon be slashed. In September, the subsidies for coal, one of the stability band items, were eliminated, and in subsequent months subsidies for other items were removed as well. The fiscal 1950 budget contained sharp reductions in price adjustment subsidies, and by fiscal 1951 only the subsidies for imports remained. April 1, 1952, witnessed the lapsing of the Provisional Supply-and-Demand Adjustment Law, the cornerstone of Occupation price controls.

4) Tax Reforms, War Indemnity Special Measures Tax and Assets Tax Law

During the war, the Special Account for Provisional Military Expenditures was funded by a combination of tax hikes (including higher rates for income taxes, among many others) and new taxes, which produced more General Account tax revenues for allocation to the military expenditure account. After the surrender, the wartime tax system came up for fundamental review. A rescript issued on July 21, 1945, had already abolished the special tax on dividend and interest income, special tax on foreign currency-denominated bonds, building tax, electric power and glass tax and advertising tax, as no longer necessary. The special activities tax was added to the list of unnecessary taxes, and Law No. 14 of August 1946 formalized the repeals. This was followed in July 1948 by the lifting of the special corporate tax. The reforms of the tax system and the elimination of the wartime taxes can be seen as part of the transition from a wartime to a peacetime tax structure. Rates were lowered concurrently for those taxes which had been subjected to the steepest hikes during the war.

An amendment to the Income Tax Law passed on March 31, 1946, avoided an increase of the tax burden by raising the basic deduction and the untaxed income cut-off point to correspond with revisions in wages, salaries and prices made under the 3/3 Price System. The tax reforms of fiscal 1946, however, passed at the same time as the extremely late budget that year, raised rates on the classified income tax (covering asset income and the like) and the liquor tax, in order to account for the rise in nominal incomes due to postwar inflation. Faced with the need to make further provision for subsequent rises in nominal income, the Diet passed a full revision of the Income Tax Law in March 1947, that eliminated the distinction between the classified income tax and the aggregate income tax, replacing it with a single progressive tax rate, imposing a tax on income from the transfer of securities and other assets, and establishing 12 tax brackets with rates increasing incrementally from 20 percent to 75 percent. In 1947, the system was changed from one assessing results to one assessing anticipated income, and a temporary gains tax was levied on income from real estate, forest land, and transfers, in order to prevent a decline in taxes levied on income gains during 1946. A revision of the Income Tax Law on November 30 of that year hiked the maximum rate to 85 percent, in an effort to shift more of the burden to the high new-yen income groups, following the introduction of the emergency financial measures. This series of reforms led to steady growth of total income tax revenues, the number of income tax payers and income taxes per taxpayer.

The 1946 revisions divided corporate income for the purposes of corporate tax into "ordinary income" and "excess income." The Corporate Tax Law was completely rewritten on March 31, 1947, to require all companies to file tax returns with "ordinary income" taxed at 35 percent and "excess income" taxed in three brackets ranging from 10 to 30 percent, depending on the capitalization. Additional amendments passed on July 7, 1948, eliminated the tax on corporate capital and reformed the "excess income" tax to a system of three brackets with a maximum rate of 20 percent for all income in excess of 100 percent of a company's capital. Total taxable corporate income, the number of tax paying companies and the amount of corporate taxes paid per company skyrocketed due to inflation.

The new Constitution and the revised Civil Code led to a review of the legal and tax treatment of families, which resulted, on April 1, 1947, in a full revision of the Inheritance Tax Law. The new law did away with the former system of different tax rates for succeeding heads of households and other heirs. A gift tax, making the gift-giver responsible for payment, was also imposed, and a self-assessment system was adopted for inheritance taxes. In December 1947, a special tax on those who did not suffer from the war was imposed in order to even out differences between those whose assets were damaged by the war and those whose assets were not.

Japan passed the Transactions Tax Law in the midst of the postwar inflation spiral on July 7, 1948, introducing its first comprehensive indirect tax. The transactions tax resembled a general consumption tax, in the sense that it was a cumulative, stepped tax imposed on a broad range of transactions in goods, services, and even financial institution fees. As a result, the tax revenues rose to keep pace with inflation, which raised hopes that it would serve as a comprehensive indirect tax, precisely suited to the current economic conditions. Since income and corporate taxes were cut when the transactions tax was introduced, the tax was also expected to cover the revenue losses. It appears that the policy-makers, faced with high inflation, wanted to switch away from dependence on direct taxation in the system.

The transactions tax was levied at a rate of 1% on top of other indirect taxes such as the commodities tax. Thanks to its broad base, it yielded ¥ 20,813 million in revenues during fiscal 1948 and ¥ 33,707 million in fiscal 1949. There were also complaints that it was unfair, however, because the tax burden differed for integrated multi-level producers and single-level processors. The collection practices raised taxpayers' ire as well. Payment was to be made in the form of transactions tax stamps, and businesses were required to report their transaction values and tax assessments every three months. With no adequate

Table 1-5 Transaction Amount and Turnover Tax Amount

(In millions of yen)

	FY1948					FY1949		
	Taxable Transaction		Tax Amount			Taxable Transaction		Tax Amount
	Places of Business (in thousands)	Transaction Amount	Article 14	Article 17	Total	Places of Business (in thousands)	Transaction Amount	
Individual	5,395	1,038,935	10,328	60	11,381	6,990	1,003	10,378
Corporation	541	1,269,839	10,410	2,288	13,032	1,757	2,577	26,072
Total	5,936	2,308,774	20,738	2,348	24,412	8,748	3,581	36,450

Source: Ministry of Finance, "*Showa Zaiseishi: Shusen kara Kowa made* ", Vol. 19, pp. 291

collection organization in place at the time, faults began appearing in the way in which the tax was administered, and it was finally done away with altogether in December 1949 under the Shoup missions. Meanwhile, the commodities tax rate, which had been raised repeatedly during the war, was lowered in March 1946, despite the general rate hikes elsewhere, to bring the system in line with inflation. New reductions were introduced repeatedly in subsequent years.

In April 1947, the national government eliminated its business tax, land tax, housing tax, mining rights tax and entertainment tax, transferring them to local governments in order to provide them with independent funding and to promote local development. In July 1948 the hunting license tax and admission tax were also transferred to local governments, again as part of a program to ensure independent funding and adequate tax bases for local governments' fiscal revenue.

As this period began, some large assets had been frozen. Most were for indemnities paid to defense companies or corporations scrapped during the war. The release of these assets and payments in the years immediately following the war accelerated inflation, and the liquidity it produced was a factor in expanding the money supply. The MOF proposed cutting off the war indemnity and introducing a high assets tax in order to rebuild public finances after the war. SCAP's agreement was secured, and the War Indemnity Special Measures Law was passed on October 19, 1946, introducing a "War indemnity special measures tax" that effectively put an end to the payments.

Under this law, war indemnity paid after the surrender became subject to taxation based on claims against the government as of August 15, 1945. Military supply companies retained the right to claim subsidies and indemnity for losses suffered during the war, the right to file for war insurance was maintained, and

Table 1-6 Special Tax on Wartime Compensation Claims (accumulative total for FY 1946-1951)

(In millions of yen)

	Total		Corporations		Individuals	
	Number of cases (in thousands)	Value	Number of cases (in thousands)	Value	Number of cases (in thousands)	Value
Value of wartime compensation claims existing upon implementation of relevant law	302	12,087	161	10,924	141	1,163
Value of claims settled on imlementation of relevant law	1,971	63,812	475	41,831	1,496	21,981
Value of claims offset with present or advanced cash payments	568	11,083	209	9,373	359	1,710
Value of claims settled with special government borrowings or deposits	1,656	52,732	320	32,461	1,335	20,271
Present value of special government borrowings and deposits, etc.	1,673	47,007	316	27,600	1,357	19,407
Value of claims sold on implementation of relevant law	44	3,922	29	3,474	16	447
Value of claims cancelled before implementation of relevant law	57	1,802	26	1,386	30	416
Value subject to tax	2,250	75,900	631	52,757	1,619	23,144
Deduction under Article 10 of relevant law		333		59		275
Tax amount	306	57,537	111	49,061	195	8,475

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp. 280

claims for war indemnity (grants for business closings and the like, introduced in 1943) could still be filed. The tax rate for assets and claims against the government was set at 100 percent, with a deductible amount of between ¥ 10,000 and ¥ 50,000 per claim, depending on whether the party filing the claim was an individual or a company. Payment of the war indemnity special measures tax on war indemnity claims could be made by transfers: in other words, the credit and the tax were considered as offsetting each other. The taxes on special deposits were paid after withdrawing them from financial institutions. Taxes on other frozen deposits, securities and real estate could be paid either in kind or in cash, with a grace period of up to two years. Taxes were levied under the law on ¥ 52,757 million in corporate assets and ¥ 23,144 million in individual assets, bringing in revenues of ¥ 49,061 million from companies and ¥ 8,475 million from individuals. Most of the war indemnity special measures taxes were paid during the 1946 and 1947 fiscal years. Special deposits generated the largest revenues, followed by government special borrowings. The tax totaled ¥ 57,489 million by end of fiscal 1951. Payments in both cash and kind were seen, as were requests for extensions. Most payments in kind were made in the form of government bonds.

The Assets Tax Law of October 11, 1946, imposed a high, progressive tax on personal assets. Individuals and families living together were required to report the total all of their assets as of March 31, 1946, including chattels, real estate, mines, fishing rights, deposits and trusts, and to pay taxes on the amount less a deduction of ¥ 100,000. The tax was levied in fourteen brackets, ranging from 25 percent on assets in excess of ¥ 100,000, to a maximum of 90 percent for assets in excess of ¥ 15 million. Land and houses were valued as a multiple of rent, stocks and other investments at trading prices, adjusted for the company's asset position and profitability. The Financial Institutions Emergency Accounting Measures Ordinance provided for payment in kind of old-account deposits and other assets and gave extensions of up to two years where payment would cause hardship. Even the Imperial family was subject to the assets tax.

Table 1-7 Taxable Property Value (accumulative total for FY 1946-51)

(In millions of yen)

	Number of cases (in thousands)	Property value
Rice paddies	451	7,673
Dry fields	418	2,997
Residential land	567	13,570
Forests	238	2,900
Houses	570	24,372
Trees and bamboo	217	5,716
Government bonds	498	1,806
Shares and corporate investment	678	16,324
Bank and trust deposits	1,155	29,159
Postal savings, and other savings and deposits	1,250	9,451
Annuity insurances, etc.	771	3,574
Machines, equipments, instruments, tools, furniture	175	3,506
Goods, products, semifinished products and raw materials	131	3,327
Calligraphic works, paintings, antiques	39	1,102
Movable household properties	1,324	4,647
Others	155	1,189
Deductions	9,277	136,141
Taxes and public dues	359	5,082
Debt	234	7,007
Balance (including other deductions)	1,808	123,779
Other deductions	254	1,716
Net taxable property value	1,808	122,062

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made* ", Vol. 19, pp. 283

The largest taxed assets were bank and trust bank deposits, which amounted to ¥ 29,159 million. These were followed by houses at ¥ 24,372 million and residential land at ¥ 13,570 million. After the deduction of other tax liabilities and debts from the total of ¥ 136,141 million, ¥ 122.062 million in taxable assets remained. In terms of tax brackets, the concentration was heaviest in the 55-65 percent range, which accounted for assets exceeding ¥ 16,000 million. A similar trend was seen in tax revenues. In all likelihood, the assets tax hit those with taxable assets between ¥ 300,000 and ¥ one million hardest. There were only 48 applications of the maximum rate of 90 percent, and these represented tax revenues of only ¥ 5,147 million. Most people paid their assets tax in kind.

To manage revenues and expenditures from the war indemnity special measures tax and the assets tax, the government created a Special Account for Revenues from the Assets Tax, etc., on November 28, 1946. This special account generated revenues by selling off assets paid in kind in forms other than by government bonds. Unsold assets were posted as special account assets, while most of the government bonds were moved to the National Debt Consolidation Fund Special Account and redeemed. During fiscal 1946 the special account recorded ¥ 15,447 million in cash revenues from the assets tax and ¥ 706 million from the wartime indemnity special measures tax. These revenues provided the main source of funding for a ¥ 28,563 million contribution to the General Account, an amount roughly equivalent to the total General Account tax revenues for the year. The special account made a similar contribution to the General Account in 1947 as well. Cash revenues from the special account began to decline in 1948, and the account was abolished at the end of fiscal 1951.

5) Government Bond Issues During the Reconstruction Years

The government ran up a large cumulative debt through wartime bond issues, and the issuing of bonds continued after the defeat, leaving ¥ 170,811 million in outstanding government bonds (including foreign issues) at the end of fiscal 1945. The government had also borrowed extensively to fund foreign military expenses from 1943, leaving it with a balance of ¥ 55,280 million in borrowings at the end of fiscal 1945. Foreign borrowings had been switched to the Foreign Finance Bank after its establishment in March 1945. After the war, this bank was designated for closure, and repayment of the funds borrowed from it, by far the largest of the government's borrowings, was put on hold. Repayment would consequently not be an issue during the reconstruction period.

Table 1-8 Purpose of Government Bond Issuance

(In millions of yen)

Fiscal Year	Project Expense, Investment and Loans	Military expenditure	Revenue Covering	Gratuities and others	Deficit Covering	Total	Government Compensation Bonds
1945	1,057	22,353	4,700	61	0	28,173	62
1946	11,858	-	13,985	0	1,960	27,803	1,960
1947	10,625	-	-	△ 1	21,898	32,521	21,926
1948	26,135	-	-	0	44,397	70,533	44,397
1949	74,458	-	-	0	2,518	76,977	64,985
1950	-	-	-	0	879	879	879
1951	13,500	-	-	0	11,635	25,135	11,635
1952	16,038	-	-	65,452	6,277	87,768	87,768
1953	80,766	-	-	18,782	△ 3	99,545	85,375
1954	-	-	-	5,156	1	5,157	5,158
1955	-	-	-	2,583	△ 3	2,580	2,580

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp.315
Financial Bureau, Ministry of Finance, Annual Statistics of Government Bond

The growth in government debt after the war prompted SCAP to forbid any new bond issues or borrowing without its permission, effective January 21, 1946. While extraordinary military expenditure had ceased, however, there were new fiscal demands to be met in the form of termination-of-the-war expenses (primarily comprising Japan's contribution to the upkeep of the Allied forces), which forced the government to continue its reliance on bond issues. Domestic government bond issues proliferated. In fiscal 1945, the Deposit Bureau and Bank of Japan underwrote new bond issues to fund railways. Other bonds for railways and telecommunications were issued between fiscal 1946 and 1948. The Deposit Bureau and Bank of Japan underwrote the 1946 bonds, but the markets bought most of the 1947 issues, although the Bank of Japan underwrote some of these as well.

The Public Finance Law of April 1947 banned in principle the issue of government bonds to supplement revenues, Bank of Japan underwriting of government bonds, and government borrowings. Since the clauses on bond issues did not take effect until fiscal 1948, however, the Bank of Japan continued to underwrite government bonds until July 1947. Public subscription by commercial banks replaced Bank of Japan underwriting two months later, in September. Because these were public offerings within the context of the priority industrial lending program, the government instructed institutions to use funds in excess of their allocated lending ceilings for the purchase of government bonds.

Other issues of debt securities during this period included a conversion of Bank of Japan borrowings to government bonds underwritten by commercial institutions in 1945, and conversions of BOJ-held food securities and loans from the BOJ to BOJ-held government bonds in 1946 and 1947, respectively. To encourage the market to buy bonds in 1947, the government offered special 4-percent reconstruction bonds, which pushed the interest on public bonds upward from the 3.4-percent face value and 3.65-percent real value at which it had long held steady, to a 4-percent nominal and 4.6-percent real value. The interest on government bonds rose again in 1948, with the issue of 5-percent reconstruction bonds. Another special category of government bonds from this period was the “telephone bonds” of 1948, and everyone applying for a telephone line was required to purchase a designated and equal amount of these. SCAP instructed the government to terminate these issues in March 1949, and no new telephone bonds were issued thereafter.

The issuing of various government grant bonds continued after the war, among them bonds for war insurance-related war indemnity, indemnity for wartime losses by the Imperial Mining Corporation, Industrial Development Public Corporation and National Welfare Corporation, indemnity for losses related to the reconstruction and reorganization of financial institutions, and indemnity for losses in the coal mining and electric power industries. As part of the process of land reform, the government also issued farmland securities, beginning in fiscal 1948, the issue of which eventually declined and ceased in fiscal 1952. Finally, the government issued grant bonds during the 1948-1951 period as payment for concealed and hoarded goods. These bonds carried punitive 2-percent yields.

To redeem the government bonds, the National Debt Consolidation Fund Special Account Law required that one-third of 116/10,000 of total debt be set aside. The Public Finance Law required that half of all surplus funds also be contributed, beginning in 1947. The largest contributions to government bond redemption between fiscal 1946 and fiscal 1948 came, however, from write-offs of government bonds paid in kind to the Special Account for Revenues from the Assets Tax, etc. During fiscal 1946, this special account was the only contributor to the bond-sinking fund. Contributions from the General Account would not begin until fiscal 1948, when the account began to set aside surpluses as required by the Finance Law.

Let us touch briefly on government bond issues during the Dodge Plan years, which began in 1949. The 1949 budget was required to achieve an aggregate balance for the General Account and special accounts. In 1949 and 1950 government bonds for the telecommunications enterprise were underwritten by the U.S. Counterpart Fund Special Account and Deposit Bureau funds, and by 1951 all domestic government bonds were grant bonds. In 1949, the Reconstruction Finance Bank issued ¥ 62,467 million in investment grant bonds, which were purchased with the U.S. Counterpart Fund, allowing the bank to pay off earlier bonds. The grant bonds were then moved to the National Debt Consolidation Fund and redeemed. Grant bonds issued in 1951 included fishing securities, which were used to compensate the fishing industry. The buy-back of farmland securities began in March 1950 and eventually expanded to general government bonds as well. In order to consolidate the government debt issues, 95 issues of under ¥ 100 million each were repaid ahead of schedule. The repayment of outstanding issues and restraints on new issues brought the unpaid balance of government bonds steadily down from its peak at the end of fiscal 1949. The decline continued after the peace treaty took effect. The balanced budget remained a policy goal, and no new long-term bonds were issued, except for grant bonds.

3. Monetary Policy During the Period of Postwar Inflation

1) Emergency Monetary Measures

In November 1945 the government began to consider a package of strong measures, including freezing bank deposits and issuing new Bank of Japan notes, in order to control inflation. The final policies were embodied in the Emergency Financial Measures Ordinance and the Bank of Japan Notes Deposit Ordinance, both issued on February 17, 1946, effective immediately. At the same time, the government issued the Emergency Foodstuffs Measures Ordinance to secure food supplies, the Emergency Hoarded Commodities Measures Ordinance to bring concealed oil and textile stockpiles into distribution and the Extraordinary Asset Investigation Ordinance to set up an assets tax and special tax on war indemnity. The result of these orders was to rein in excess liquidity, hold down price increases and secure needed supplies of food and other materials.

The government also began to survey the bank deposits of individuals and corporations at this time. Under the Emergency Financial Measures Ordinance, Bank of Japan Notes Deposit Ordinance and the Executive Orders for both ordinances, the bank deposits and designated money in trust accounts of all individuals and corporations, except those maintained in the name of the central government, local governments or financial institutions, were frozen as of a designated time on February 17, 1946. Henceforth, there would be restrictions on withdrawals, and business transactions were to be settled with transfers between frozen accounts. Old bank notes would be void except for deposits until March 2, and new notes would be issued. On March 3, the balance of old notes would be written off in a special account at the Bank of Japan that would segregate the assets and liabilities involved in their disposal.

Among the restrictions on withdrawals were a monthly ceiling of ¥ 300 for heads of households and ¥ 100 for each additional family member that could be withdrawn from frozen accounts to cover living expenses. Companies could withdraw no more than ¥ 500 per employee per month to pay wages, plus such money as was required to pay communications and transportation expenses. In addition, the victims of wartime destruction could withdraw up to ¥ 1,000 per person or ¥ 5,000 per household for the purchase of necessary clothing and furnishings. Withdrawals were also permitted for the payment of medical bills (if a proper invoice was shown), to pay for weddings and funerals (up to ¥ 1,000 per person) and to meet educational expenses. After the accounts were frozen, savings in new BOJ notes were to be deposited in new “free deposit accounts.” The freezing of the accounts and the switch to new BOJ notes brought the balance of outstanding BOJ notes down from ¥ 54,342 million at the end of February 1946 to ¥ 23,322 million at the end of March, severely squeezing the money supply.

The Financial Institutions Emergency Accounting Measures Ordinance and the Company Accounts Emergency Measures Ordinance introduced in August 1946 enabled institutions and companies to segregate old and new accounts, using the old accounts to write off assets and liabilities from the war and the new accounts to continue operating their businesses. On August 11, 1946, the Executive Orders for the Emergency Financial Measures Ordinance were amended to divide frozen deposits into two categories. Personal deposits made after August 11 1946 were designated “Class I frozen deposits.” All other deposits, both “small” deposits under ¥ 3,000 and larger deposits, were grouped by household. Class I deposits also consisted of amounts up to the larger of ¥ 15,000 per household or ¥ 4,000 per household member, with a ceiling of ¥ 32,000. Anything in excess of this was classified as a “Class 2 frozen deposit.” For corporations, deposits of between ¥ 3,000 and ¥ 15,000 were assigned to Class I and the remainder to Class 2. The withdrawal conditions for Class I were the same as before, but withdrawals from Class 2 deposits were limited to such uses as payment of taxes and public impositions, repayment of existing debts to financial institutions secured with Class 2 deposits and, settlement of checks on frozen accounts outstanding as of August 11. Payments to “special deposits”, which were set up for settlement of business closings and improvement measures during the war to prevent government payments to companies from adding to liquidity, were suspended after the war and had been treated separately from frozen deposits under the Emergency Financial Measures Ordinance. The government permitted payment of the war indemnity special measures tax from the special deposits, and then transferred the balance to a Class I frozen deposit, quickly reducing the balance of special deposits as a result.

Table 1-9 Free Deposit Account and Frozen Deposit Account in National Banks (Balance)

(In millions of yen)

	Total	Free Deposit Account	Class 1 Frozen Deposit Account	Class 2 Frozen Deposit Account	Special Deposit Account
March 1946	135,751	14,518	94,450	-	26,782
June 1946	141,217	18,072	89,587	-	33,557
July 1946	142,580	19,936	87,679	-	34,964
August 1946	142,422	21,944	53,372	31,255	35,851
December 1946	142,422	39,751	82,507	20,936	1,675
March 1947	148,644	59,140	69,619	19,515	369
June 1947	154,807	78,981	58,779	16,862	183
September 1947	184,467	115,288	52,360	16,706	112
December 1947	234,375	170,065	49,714	14,519	75
March 1948	257,075	220,020	31,695	5,349	10
June 1948	292,544	262,705	29,838	-	-

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp.610

A comparison of frozen and free accounts at national banks shows a balance of ¥ 94,450 million in frozen accounts at the end of March 1946, as compared to ¥ 135,751 million in free accounts - figures which give some idea of the enormous impact the frozen deposits exerted in restraining the money supply. Since demand for reconstruction financing was also enormous, however, companies used frozen deposits to settle their bills, while individuals withdrew them for living expenses. The offsets caused by these withdrawals and business transactions gradually reduced the amount in the frozen accounts. In the meantime, the regulations on wage payments from frozen accounts were first relaxed, and then eliminated entirely. Similarly, a phased liberalization of business payments began in July 1947, further reducing the amount in frozen accounts. By June 1948, the frozen accounts only held ¥ 29,838 million, as compared to ¥ 262,705 million in free accounts. The Enterprise Rehabilitation and Reorganization Law and the Financial Institutions Rehabilitation' Law of October 19, 1946, resulted in the erasure of part of the Class 2 deposits in February 1948. The erased portion was counted as losses for deposit-holders, and the remainder was factored into Class I deposits. On July 21, 1948, Class 1 deposits were liberalized, bringing the system of frozen deposits to an end. The inflationary bias in the market remained a problem, however.

2) Reconstruction and Reorganization of Companies and Financial Institutions

After the war, companies found it almost impossible to recover foreign credits for investments, loans, accounts receivable or product exports, because Japan had relinquished all rights to lay claims to investments and credits in its former colonies and territories. Assets held against closed institutions - including investments, underwritten bonds, loans and accounts receivable against closed national corporations, colonial corporations and wartime institutions - also generated large losses, although the provisions for liquidation of these institutions did permit some assets to be recovered. Other companies came up for intermediary reparation, and they expected large losses from it. Added to this were losses from the erasure of part of the Class 2 frozen deposits and the termination of war indemnity as part of the postwar anti-inflation policy. The Company Accounts Emergency Measures Ordinance and the Financial Institutions Emergency Accounting Measures Ordinance of August 15, 1946, were enacted to enable companies and institutions to prepare for the termination of war indemnity.

Under these laws, designated special-accounting companies and financial institutions were to perform a “cut-off settlement” on August 11, 1946, at which time they would segregate their assets and liabilities into old and new accounts. Assets required for the continuation of business operations in which the company was actually engaged would be posted to the new accounts, while other assets would go into the old accounts. In principle, all income resulting from activities after the designated cut-off date would also be posted to the new accounts, while that from earlier activities would go to the old accounts. The companies would then nominate special custodians to oversee their assets in the old accounts. Special-accounting companies and financial institutions were defined as those which had already received war indemnity by the designated date, which had claims to indemnity or which had foreign assets. This was followed by passage of the War Indemnity Special Measures Law, legislation that provided for all wartime claims against the government to be abandoned as of August 15, 1945, and allowed the companies involved to record huge amounts of special losses arising therefrom.

By November, 1948, some 8,373 companies had come under the Company Accounts Emergency Measures Ordinance. Of these, 1,736 were approved for exclusion, and 1,523 were recognized as having suffered no special losses and allowed to merge their old and new accounts, leaving 5,114 special-accounting companies that would be required to submit corporate reorganization plans for approval. Some 47 percent (¥67,106 million) of the ¥ 142,422 million on national bank accounts, as of the end of August 1946, was shifted to the old accounts under the Financial Institutions Emergency Accounting Measures Ordinance. Roughly 25 percent of the total (¥ 35,851 million) was in the form of special deposits.

Both the special-accounting companies and financial institutions used the old accounts to write off abandoned credits. To make this possible, the Enterprise Rehabilitation and Reorganization Law and the Financial Institutions Rehabilitation Law, enacted on October 18, 1946, allowed the posting of special losses as of the designated date of August 11, 1946. Special losses included the war indemnity special measures tax, losses on foreign assets, Class 2 frozen deposit losses, write-offs of old credits and equities from the termination of the war or war indemnity special measures tax, losses on deferred assets, losses in the accounting year ending on the designated date, and aggregate losses in the old accounts. Profits to be recorded included profits for the accounting year ended on the designated date, reserves, profits in the old accounts, and profits on the revaluation of assets. Any losses remaining after offsetting against profits were deemed “special losses.” The special losses were repaid from profits, capital or abandonment of old credits. After recalculation of the special losses, the custodians appointed for special-accounting companies capitalized at ¥ one million or more were required to submit detailed business reorganization plans for approval. These concerned special loss calculations; the continuation, liquidation, or merger of the company; the establishment of a second “successor” company; and the disposal of assets.

From this time onward, the business activities of designated companies were recorded in new accounts, with the time from the designated date to the merger of the new and old accounts counted as one accounting year. On the date their business reorganization plans were approved by the competent minister, the companies were expected to finalize their special losses and the special-account companies to merge the balances in their old and new accounts after special loss calculation. Financial institutions were required to seek approval of final treatment from the write-off of assets, following which their old and new accounts were to be eliminated. Those unable to cover their finalized losses by writing off assets were eligible for government compensation up to a ceiling of ¥ 10 billion, including loss guarantees from the Deposit Bureau Fund.

The submission of business reorganization plans was delayed, however, because a higher priority was placed on policies designed to eliminate the concentration of economic power. It was not until December 1951 that all 4,762 companies submitted their reorganization plans. Of this number, 4,695 were approved, and 3,921 of those fully executed their reorganization plans. Others who had not implemented reorganization plans required long periods of time for reorganization.

Meanwhile, the reorganized liabilities of the financial institutions were transferred on December 1, 1947, bringing the reorganized liabilities of 48 banks into the new accounts as an interim measure. In addition, an amendment to the law made on March 27, 1948, gave institutions until the end of March to merge their old and new accounts. Under this amendment, all institutions were to collect unpaid capital. Those writing off capital were to increase their capital after merging their old and new accounts. Those writing off their entire capital were to continue with capital increases. The government would provide compensation for losses by moving institutional bank debenture holdings to old accounts retroactive to the designated date. New restrictions were placed on the establishment of adjustment accounts in order to finalize the institutions' accounting prior to corporate reconstruction and reorganization. And finally, the institutions were required to merge their old and new accounts at the end of March.

The results of the corporate reconstruction and reorganization show 3,637 companies continuing their business, as of the end of September 1952. The total losses added up to ¥ 46,339 million, with the largest coming from the war indemnity special measures tax, followed by losses from the old accounts. There were also profits from the old accounts, however, and from the revaluation of assets due to inflation. The final special losses for continuing companies consequently totaled only ¥ 6,194 million. The 1,058 liquidated companies registered old account losses of ¥ 44,977 million, primarily from the war indemnity special measures tax. Having little in the way of profits or revaluation profits, these companies recorded special losses of ¥ 23,729 million. To cover the finalized special losses, the shareholders of continuing companies paid ¥ 3,821 million, and former creditors paid a matching sum. Some 77 successor companies were created from continuing companies. The ¥ 23,729 million in special losses by the liquidated companies was written off with a charge of ¥ 7,838 million to the shareholders and ¥ 16,243 million to former creditors. Some 340 successor companies were created from the liquidated companies.

The Financial Institutions Rehabilitation Law was amended in July 1948 because of forecasts that government compensation for losses would exceed ¥ 10 billion.

Table 1-10 Special Losses of Special-accounting Companies and Disposal of Losses

(In millions of yen)

	Continuing Companies	Liquidated Companies	Total
Number of companies	3,637	1,058	4,695
Losses			
War Indemnity Special Measures Tax	21,527	16,083	37,610
Losses on Foreign Assets	3,543	5,069	8,612
Class 2 Frozen Deposit Losses	706	342	1,048
Losses of Old Credit, Equity, Reparations etc.	4,345	4,199	8,544
Deferred Assets	173	306	479
Current and Deferred Losses	3,278	3,202	6,480
Losses from the Old Account	9,773	10,790	20,563
Other Losses	2,118	4,903	7,021
Balance (Profit/Adjustment item)	876	83	959
TOTAL	46,339	44,977	91,316
Profits			
Current and Deferred Profits	1,493	259	1,752
Reserves	4,271	1,858	6,129
Profits from the Old Account	13,812	6,978	20,790
Other Profits	8,847	4,391	13,236
TOTAL	28,423	13,486	41,908
Revaluation Profits			
Fixed Assets Revaluation Profits	3,543	3,983	7,526
Liquid assets Revaluation Profits	8,179	3,778	11,957
TOTAL	11,722	7,762	19,484
Special Losses	6,194	23,729	29,923
Compensation for Special Losses			
Special Losses	6,194	23,729	29,923
Borne by Shareholders	3,821	7,338	11,159
Borne by Former Creditors	2,370	16,243	18,613
Total of Old Credits	43,804	32,153	75,957
Credits from Financial Institutions	26,662	16,762	43,424
Disposed Assets	7,453	8,124	15,577
Fixed Assets	6,285	5,969	12,254
Capital Increase or Decrease, Liquidation			
Official Capital	22,672	10,196	32,868
Paid-in Capital	19,089	8,703	27,792
Eventual Capital	68,665		68,665
Capital of the second "Successor" company		14,189	14,189
Capital Increase	49,472		49,472
Prior Capital Increase	24,971		24,971
Borne by Shareholders		7,338	7,338
Prior Capital Increase		1,820	1,820
Collected Unpaid Capital	2,822	1,019	3,841
Voluntary Collection	2,697	-	2,697
Special Losses Paid-in Capital Reduction	2,658	-	2,658
Capital Reduction	883	-	883
Merger	60	-	60

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 13, pp.903, Vol. 19, pp. 618

The amendments boosted the ceiling for government compensation, including Deposit Bureau Fund loss guarantees, to ¥ 16.3 billion, and this figure was raised further to ¥ 16.5 billion by a December amendment. Much of the finalized loss of ¥ 44,659 million for the financial institutions (of which ¥ 27,490 million was accounted for by banks) was offset by finalized profits, reserves, capital, reorganized liabilities and designated liabilities in that order. The shortfall was made up with ¥ 12,192 million in government compensation. Banks received only ¥ 367 million of the government compensation, and even then, only savings banks and trust banks received funds. Most of the compensation went to credit associations, insurance companies and prefectural credit union federations: institutions which had little in the way of profits, reserves or capital with which to offset their losses.

Table 1-11 Final Settlement of Financial Institution Reconstruction (at end of March 1948)

(In millions of yen)

Financial institutions	Fixed loss	Fixed loss coverage breakdown						Adjustment account profit (at September-end, 1952)
		Fixed profit	Reversal of reserves	Capital write-off	Restructured debt write-off	Specified debt write-of	Government comensation	
Banks	27,490	6,205	1,308	1,581	17,997	30	367	8,345
Special banks	7,687	500	278	237	6,669	—	—	—
Ordinay banks	15,441	3,838	947	1,331	9,339	—	1	—
Savings banks	1,747	323	15	72	1,079	—	241	—
Trust banks	1,253	71	66	123	858	—	124	—
Mutual loan firms	625	75	10	36	43	1	455	126
Credit cooperatives	743	69	36	93	175	1	323	72
Credit associations	4,563	38	12	147	116	1	4,268	1,784
Insurers	8,370	1,533	436	60	2,547	—	3,863	2,280
Prefectural agricultual cooperatives	2,868	164	50	109	25	2	2,509	—
Municipal agricultural cooperatives	—	—	—	—	—	—	403	—
Total	44,659	8,084	1,852	2,026	20,903	35	12,188	12,607

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made*", Vol. 19, pp. 616

Financial institutions that had erased all or part of their reorganized liabilities and designated liabilities set up adjustment accounts on April 1, 1948. The purpose of these accounts was to repay written-off deposit liabilities and the like from future profits. Interim allocations of profits to the adjustment accounts were made from January to July 1953 by 56 of the 65 banks establishing accounts. The write-offs of foreign assets and liabilities and the repayment from the adjustment accounts of written-off liabilities and the interest on them continued. The write-offs of war indemnity credits and defaulted foreign assets and liabilities enabled companies to carry only their sound assets and liabilities forward, thus laying the groundwork for high growth once the peace treaty was signed.

3) Priority Finance

The ravages of war and damage to production facilities resulted in serious shortages in the supply of manufactured goods, and these production shortages, in turn, spurred postwar inflation. The highest priority was placed on overcoming shortages in coal supplies, leading in December 1946 to a Cabinet decision on “priority production,” a system under which increases in coal production would be used to increase steel production. This increased production would then be used to achieve further increases in coal production, hopefully triggering a recovery of the economy as a whole. The decision made priority production the primary government policy for overcoming the postwar shortages, and all the government's resources were marshalled behind it.

The Emergency Financial Measures Ordinance provided the basis for support of the policy from the monetary policy side. Under this order, the MOF published its “Rules for Financial Institution Lending” on March 1, 1947, an action which marked the start of priority finance. A “Table of Priorities in Industrial Lending” was annexed to these rules. The practice of directing lending by setting priorities was similar to the capital investment financing controls imposed during the war under the Extraordinary Funds Adjustment Law. Postwar controls made good use of the Bank of Japan's experience in administering wartime controls. The major difference between the Funds Adjustment Law and priority finance was that priority finance fell under lending rules published by the MOF that could be revised frequently as circumstances required, enabling the system to keep pace with economic trends during the period of postwar inflation.

The lending rules defined “financial institutions” as banks, trust banks, insurance companies, the Central Cooperative Bank for Agriculture and Forestry

(Norinchukin Bank) and the Central Bank for Commercial and Industrial Cooperatives (Shoko Chukin Bank). The institutions were to restrain their lending voluntarily and to make an effort to absorb deposits, eliminate dependence on BOJ lending and manage their money as efficiently as possible to contribute to the rebuilding of the economy. The BOJ would set ceilings on increases in their outstanding lending, which they would be expected to obey strictly. In addition, the financial institutions were required to follow the priority table in their loans, lending top priority industries all the money they needed, then providing funding for other "urgent" industries, while deliberately minimizing lending in other areas. The rules applied to both capital investment funding and operating funds.

Four priority categories were identified in the rules A-1, A-2, B and C. Other funds designated by the Minister of Finance and commercial bills eligible for BOJ rediscounting were to be handled in the same way as A-1 loans. The Table of Priorities in Industrial Lending divided the capital investment and operating funding requirements for 460 sectors in 11 industries into these four categories. Top priority A-1 designation was applied to capital investments and operating funds in nine fields: coal, lignite, vertically-integrated steel production, ordinary iron, flat-furnace steel, cold-rolling mills, superphosphate of lime, ammonium sulfate and coal nitrogen. The A-2 designation was applied to capital investment in 60 sectors and operating funds in 147. The priority on coal, steel and fertilizer was clearly apparent.

By voluntary agreement, the lending ceiling was set at 50 percent of the institutions' expected increase in ordinary deposits. In point of fact, lending by national banks during the March to May 1947 period fell considerably below the lending potential. If potential lending is defined as the total of 50 percent of the expected increase in ordinary deposits, increases in bond issues, increases in financial institution borrowing, recovery of loans from old accounts and potential lending carried over from the previous month, then lending amounted to only 82 percent of the potential in March, 26 percent in April, and 32 percent in May. It would have thus been the exception rather than the rule for institutions to apply for permission to engage in "extra" lending (loans to cover assets taxes or underwriting of Reconstruction Finance Bank bonds).

Monthly lending growth figures indicate that lending to the top-priority A-1 sectors began to increase in August 1947. Lending to quasi-A-1 and A-2 sectors was also significant, suggesting preferential financing of other priority sectors outside the A-1 group. A reorganization of the public rationing system produced a gap between the Table of Priorities and actual circumstances, resulting in a revision of the lending rules on June 13, 1947. The revised rules defined 517 industrial sectors, of which only eight received an A-1 designation, while an A-2 designation was given to capital investment financing in 72 sectors and operating funds in 188 sectors. The rules were amended again on October 6, 1947. Effective in the third quarter, the amendments eliminated ceilings on capital investment financing for A-1 sectors. The Shoko Chukin Bank was later allowed to lend up to 100 percent of its ceiling on outstanding loan increases in an effort to ensure adequate funding for smaller businesses. The lending rules produced an increase of ¥ 32,939 million in industrial lending by national banks, during the October to December quarter of 1947, of which ¥ 2,104 million went to A-1 sector industries and ¥ 1,665 million to loans guaranteed by the Reconstruction Finance Bank. Lending to the government during the period totaled ¥ 6,026 million, of which

Table 1-12　Monthly Change of Bank Lending by Industrial Classification

(In millions of yen)

Period	Class A-1	Class Quasi A-1	Class A-2	Local Government	Distributing Organ	Class B	Local Government	Construction Industry	Class C	Total
April 1947	48	151	1,476	116	636	1	35	△ 146	△ 161	1,515
May	△ 540	759	1,454	70	433	801	39	54	145	2,619
June	△ 17	474	3,393	136	184	1,532	△ 138	627	32	5,416
July	2	△ 1,574	350	24	△ 841	1,946	296	△ 140	24	747
August	352	640	1,310	68	△ 1,336	1,904	699	314	431	4,639
September	614	1,114	3,872	88	△ 407	1,424	△ 136	299	317	7,342
October	△ 626	1,482	5,057	107	681	1,255	△ 204	71	649	7,819
November	565	971	4,555	74	821	2,572	537	424	711	9,374
December	2,627	1,212	10,202	81	2,695	2,049	△ 10	△ 348	1,227	17,320
January 1948	199	175	5,125	56	1,846	1,685	11	257	488	7,675
Total	3,224	5,404	36,794	820	4,712	15,169	1,129	1,414	3,863	64,466

Source: Ministry of Finance, "Survey on Bank Lending (Monthly change)"

¥ 2,401 million was used to purchase government bonds and ¥ 2,744 million to purchase Reconstruction Finance Bank bonds. The BOJ engaged in stricter supervision of banks that had not put at least 10 percent of their base level into government or Reconstruction Finance Bank bonds. Preferential financing did help to increase coal output, although production still fell far short of its levels during the war.

The preferential lending concentrated funding in priority industries and encouraged the repayment of BOJ loans, but this also impeded the market's ability to absorb government, municipal and Reconstruction Finance Bank bonds, with the result that government financial needs were not being sufficiently met. The lending rules were revised on July 21, 1948 (retroactive to July 1), to rectify this situation. The revisions changed the old system, under which 50 percent of regulated lending was considered the lending ceiling for ordinary companies, with anything in excess of that treated as “extra lending”, to be earmarked for government funding and priority industries. Under the new system, the anticipated increase in operating funds, as determined by the Minister of Finance, was defined as regulated lending, a set percentage of which would be earmarked for government fund-raising, with any remaining funds to be used for loans to ordinary companies. The “extra lending” was abolished at this time.

The government's priority in financial institutional funding was on the purchase of central government, municipal and Reconstruction Finance Bank bonds, and also on loans guaranteed by the Reconstruction Finance Bank. The rules defined the anticipated increase in operating funds as the anticipated monthly increase in deposits, less those from public corporations and other financial institutions, plus anticipated repayments of government lending. In July the banks were required to spend 35 percent of their anticipated increase on government finance. The trust banks, meanwhile, were required to spend 20 percent, the Shoko Chukin 0 percent, and all other financial institutions 10 percent. The banks were further instructed to allocate 10 percent of their government financing to central government bonds, 10 percent to Reconstruction Finance Bank bonds, 5 percent to municipal bonds and 10 percent to Reconstruction Finance Bank-guaranteed loans.

Nevertheless, the Table of Priorities was at a variance with the conditions in the trading field and other industries, leading to demands for revision from the industrial community. The lending rules were changed again on January 10, 1949, partly to solve this problem and partly to bring them into line with the Five-Year Plan for Reconstruction. The revisions reduced the classifications to just A, B and C and significantly relaxed the preferential lending regulations. From January 1949 onward, category A businesses received the overwhelming majority of bank lending, over 90 percent of which was for operating funds. Even in capital investment funding, however, the tilt to category A was marked. The priority production and financing programs resulted in a substantial recovery for coal production during 1948. They remained in place until the implementation of the Dodge Plan. On July 22, 1963, the Emergency Financial Measures Order and the lending rules were both repealed.

4) The Reconstruction Finance Bank

After the Emergency Financial Measures Ordinance of February 1946, the need for a system to supply industrial funding became apparent. The government studied the possibility of establishing a reconstruction finance institution modeled on the American Reconstruction Finance Corporation and decided to use a special account to manage reconstruction lending. With the cut-off of war indemnity in August expected to make it more difficult for companies to raise funding, emergency funding would be necessary to rescue companies and enable them to return to production. The Cabinet decided on June 25, 1946, to have the Industrial Bank of Japan float special reconstruction loans and to create a Reconstruction Finance Committee to review lending proposals as interim measures until a reconstruction finance system could be established. The Industrial Bank of Japan's Reconstruction Finance Department consequently took over the responsibility for overseeing reconstruction lending as determined by the committee, making funds available and drawing on loans from the BOJ when it was short of funds. The special lending began in August 1946. When it was terminated, the Industrial Bank of Japan's outstanding reconstruction loans totaled ¥ 4.1 billion, of which ¥ 1.25 billion was deficit lending to tide the coal industry over until government subsidies became available. Two-thirds of the lending was used for operating funds, which were in greater demand at the time than capital investment financing. Under the priority production system, over 40 percent of all lending went to the top-priority coal industry, primarily to cover deficits. The chemicals industry was next in line for funds, mainly for chemical fertilizer production. The Industrial Bank of Japan relied almost entirely on the BOJ for funding since postwar policy made bond flotation almost impossible.

The initial plan to provide reconstruction financing from a special account was eventually changed. Instead, a government finance institution was established for this purpose. The Reconstruction Finance Bank Law of October 7, 1946, provided for the institution to be established on January 24, 1947, with a government investment of ¥ 4 billion. In addition to employing capital underwritten by the government, the Reconstruction Finance Bank would also be allowed to issue bonds to raise funds. Once established, the Reconstruction Finance Bank took over the special reconstruction lending operations of the Industrial Bank of Japan.

The Reconstruction Finance Bank became the central institution in the priority finance system, and when it began full-fledged lending in fiscal 1947, it was swamped with requests from companies for both capital investment financing and operating funds. One reason for this was that private-sector institutions were still reconstructing and reorganizing and remained unable to lend as aggressively as they would have liked. The government continued to inject capital into the Reconstruction Finance Bank, but a lack of resources in the General Account forced it to rely mostly on bonds underwritten by the BOJ to finance its lending. The government capital was used to pay down those bonds as they matured. As the Reconstruction Finance Bank took the lead in priority finance, its lending, because it was funded by bonds underwritten by the BOJ, became a factor in encouraging inflation; so much so that the inflation of this time was nicknamed “Reconstruction Finance Bank inflation.”

The reconstruction financing expanded rapidly, with most of the money going for general industrial capital investment, although some was also used to provide operating funds and cover deficits. Coal, electric power, fertilizer and steel were given a particularly high priority in the lending. The priority financing policies placed the highest priority on coal production, and the industry accounted for fully 33 percent of total lending as of the end of fiscal 1947 as a result. Chemicals placed second. Loans for operating funds exceeded capital investment finance during fiscal 1947. A considerable portion of the operating fund loans stemmed from government policies to put a cap on inflation and hold down prices. The Reconstruction Finance Bank propped up companies by lending them the funds they needed to cover deficits and reduced liquidity. Companies in the electric power, steel and fertilizer industries also received deficit financing.

One point of note with respect to Reconstruction Finance Bank activities in 1947 and beyond involves lending to public corporations. The demand for funds was so high at public corporations that it was expected to exceed the markets' capacity. The public corporations were consequently instructed to rely on the Reconstruction Finance Bank for all their fund-raising needs. The Reconstruction Finance Bank had dealings with eight rationing companies (those responsible for oil, coal, fertilizer, foodstuffs, processed foods, feed, edible oils and liquor) and three other public corporations (the industrial reconstruction, shipbuilding and price adjustment public corporations). The balance of loans to public corporations at the end of 1947 was ¥ 18,199 million, an enormous 30 percent of total lending. This declined as a proportion during fiscal 1948, after the system allowing public corporations to issue validated bills was introduced in March 1948. Because the bills were eligible for BOJ rediscounting, they enabled the public corporations to raise short-term funding from private-sector banks.

The large bias toward industrial capital investment and operating funds in the Reconstruction Finance Bank lending drove its balance of lending, as of the end of fiscal 1947, to ¥ 59.5 billion, an amount equal to 25 percent of the outstanding loans to national banks. Coal continued to garner the lion's share of the Reconstruction Finance Bank's lending in fiscal 1948, although electric power emerged in second place. Then, in November of that year, the deficit financing was discontinued. The amount of lending of operating funds to public corporations declined, but capital investment loans to the Shipbuilding Public Corporation surged under government shipbuilding plans designed to revive the marine transportation industry. Outstanding loans on the Reconstruction Finance Bank's books totaled ¥ 132 billion at fiscal year-end. During the latter half of the year, SCAP began to see a need for reorganizing the bank because it was not adequately recovering its loans. The

Table 1-13 Lending Outstanding of the Reconstruction Finance Bank

(In millions of yen)

	Mar. 1947	Mar. 1948	Mar. 1949	Mar. 1950	Mar. 1951	Dec. 1951
Mining Industry	1,589	21,941	51,485	38,312	35,153	33,372
Coal Industry	1,036	19,874	47,519	35,484	33,333	31,933
Metal Industry	349	2,122	4,390	3,773	3,209	2,630
Steel Industry	291	1,858	3,526	3,203	2,818	2,273
Chemical Industry	1,222	5,155	10,060	10,455	7,716	7,232
Fertilizer Industry	561	3,751	6,030	6,734	5,577	5,072
Electricity Supply Industry	302	2,807	22,400	18,641	17,162	16,258
Machinery Industry	835	2,806	6,522	6,400	5,141	4,311
Agriculture	4	48	229	66	30	22
Fishery	491	2,839	5,302	4,048	3,731	3,237
Fiber Industry	45	711	4,984	4,759	4,183	3,652
Public Corporations	-	18,199	18,182	-	-	-
Others	1,149	2,835	8,412	19,452	10,544	8,533
TOTAL	5,986	59,463	131,965	105,906	86,869	79,247

Source: Ministry of Finance, "*Showa Zaiseishi--Shusen kara Kowa made* ",Vol. 19, pp.571-3

Reconstruction Finance Bank lending virtually ceased in fiscal 1949 following the publication of the “Nine-Point Economic Stabilization Plan,” in December 1948. The Bank subsequently concentrated on recovering its loans, after which it was disbanded.

4. The Handling of Postwar Economic Issues

1) Japanese Reparations payments

Japanese reparations were included in the Potsdam Declaration as an official policy of the United States government. After the Occupation began, the November 1, 1945 Basic Directive for Post-surrender Military Government in Japan Proper mandated reparations in kind and the creation of plans for the return of confiscated assets. Assets that Japan did not need and goods, factories and facilities not required by the peacetime Japanese economy or the Occupation forces were to be used for reparation. After Edwin Pauley, the U.S. delegate to the Trilateral Committee on German Reparations, completed his final report on German reparations in September, he was nominated to head the Japanese reparations mission. He arrived in Japan in November. A month later in December he completed the “Interim Pauley Report," which stated that the Japanese economy was not in such bad shape as people had thought.

In order to prevent a revival of Japanese militarism, Pauley recommended dismantling half of the country's machine tool production capacity, all its army and navy factories, 20 shipyards, its steel production capacity in excess of 2.5 million tons per year and half of all its coal-burning thermoelectric power plants. In addition, he wanted all foreign assets to be forfeited, all gold and precious metals sent to the United States for safe-keeping, and the assets of the zaibatsu to be moved to the fore among the reparations payments. Pauley's final report, containing much the same recommendations, was submitted to the President the following April. After some revisions, it was approved by the Far Eastern Commission in May 1946 and sent to the government of Japan in August in the form of a memorandum from

SCAP.

The armaments and military supply factories had already been designated for dismantlement on January 20, 1946, in line with the interim report. By August, another 1,005 industrial factories were also designated for reparations; the government of Japan was required to dismantle them and to remove and store the equipment. In terms of ministerial jurisdiction, this number included 851 factories to be overseen by the Ministry of Commerce and Industry, 134 military facilities with responsibility assigned to the MOF, 20 shipyards under the jurisdiction of the Ministry of Transport, and one research facility under the auspices of the Ministry of Education.

The Pauley Mission published its general report on November 17, adding new industries such as heavy electrical equipment, tools, copper and hydroelectric power, as well as railroad rolling stock and spinning equipment to the list in the interim report. Likewise, it called for a fuller dismantlement of the industries than the interim report.

The shock to Japan was enormous. One of the problems encountered at this time involved determining how to divide the assets slated for reparations payments in the interim report among the creditor countries. The countries concerned found the road to agreement to be rocky. A particularly sticky point was the Soviet Union's assertion that facilities removed from Manchuria were spoils of war, to which the United States replied that they ought to be counted in with the other facilities slated for reparations payments. The U.S. mulled over ways to enforce the provisions of the interim report, and, after negotiations between the Far Eastern Commission and the other countries, the U.S. government issued an order to SCAP in April 1947, instructing it to recognize claims to 30 percent of the assets confiscated for reparations under the interim report. China was to be granted 15 percent and the Philippines, the Netherlands and Britain 5 percent each.

After revaluation of the reparations assets to 1939 prices, the government of Japan was ordered to arrange the removal and shipment of the confiscated equipment for interim reparations in November 1947. The first divestment consisted of machine tools, with 13,000 machines worth ¥ 301 million shipped to the four countries beginning in January 1948. Second and third divestments followed. It took until May 1950 for the final deliveries of machinery confiscated under the interim report to be made. A total of 110 tons of machinery valued at ¥ 165 million had gone to the four countries for reparations. This was carried out in parallel to the destruction of weaponry and other specialized machines.

SCAP, which was more concerned with rebuilding the Japanese economy, asked the U.S. Department of Army to relax the reparations demands in the Pauley interim report. In January 1947, a special task force on Japanese reparations (the Strike Mission) was organized and dispatched to Japan. It submitted its first report in February, agreeing with SCAP that a priority should be placed on rebuilding a disarmed Japan and proposing that the current reparations plan be scrapped in favor of a new one. The gaps between the Pauley and the Strike reports required some sort of coordination, a requirement which delayed the Far Eastern Commission's decision. The second Strike report of February 1947 noted that the high cost of removing assets designated for reparations payments was an impediment to recovery, and opposed divestiture of all except military facilities. The Johnston Mission of April 1948 concurred, finally swaying opinion in favor of relaxing the reparations demands. The U.S. delegate to the Far Eastern Commission announced the suspension of interim report divestments in May 1949. The confiscation of assets for reparations purposes under the Occupation had come to an end. The emerging structure of the Cold War had convinced the United States to shift from a policy of severe punishment to a more lenient stance, which greatly reduced the burden that would otherwise have been placed on Japan.

2) The Dissolution of the Zaibatsu, Elimination of Economic Concentration and Land Reform

The “United States Initial Post-Surrender Policy for Japan,” a document compiled early in the Occupation and published on September 22, 1945, mandated the dismantlement of the zaibatsu. On November 6, 1945, SCAP issued a memorandum ordering the dissolution of holding companies, an order marking the beginnings of dismantlement. On November 24, a rescript on “Regulations on the Dissolution of Companies” forbade the zaibatsu scheduled for dissolution from attempting to liquidate themselves beforehand. A task force on the Japanese zaibatsu dissolution (the Edwards Mission) was sent in January 1946 to advise SCAP. It issued a report on March 14 asserting that any corporate grouping not in the form of a “family concern” should be considered a zaibatsu and dissolved. This led to the Holding Company Liquidation Commission (HCLO Order of April 20, 1946), that provided for the democratization of corporate ownership and management by requiring stocks owned by holding companies to be ceded to the HCLC. The HCLC would pay for the securities with registered government bonds with a maturity of 10 years or more to be distributed after all the shares had been sold off. It would also oversee the entire process until the holding companies themselves were disbanded. A rescript of November 25, 1946 on Limitations on Corporate Stock Ownership gave the commission all voting rights in the designated companies, their subsidiaries and their affiliates during the time in which the shares were being sold off.

The first round of company designations under the HCLC Order went forward on September 6, 1946. Mitsui, Mitsubishi, Sumitomo, Yasuda Hozen and Fuji Industries were named. The first four were the flagships of the major zaibatsu, while Fuji Industries was a military zaibatsu better known as Nakajima Aircraft. During the second round on December 7, a total of 40 companies were defined as medium-size or new zaibatsu and designated for dissolution, including Kawasaki Heavy Industries, Nissan, Asano, Furukawa Mining, Shibuzawa, Okura Mining and the Nomura Partnership. Round three on December 28 named 20 zaibatsu affiliates which were also deemed to have holding-company functions, among them Mitsui Mining, Mitsui Bussan (trading), Mitsubishi Heavy Industry and Mitsubishi Mining. On March 15, 1947, round four named two monopolies which had been set up for national policy reasons. Round five on September 26 designated 16 holding companies as smaller zaibatsu. On December 3, 1946, the commission designated 56 zaibatsu families and barred them from corporate management or principal ownership.

The HCLC's priority in disposing of the holding-company assets was to sell them. This was particularly true of shares in subsidiaries and to a lesser extent, of securities concerned with foreign assets or with closed institutions. A Securities Coordinating Liquidation Committee (SCLO) was established in June 1947 to oversee and encourage the disposal of securities. The Law Barring Zaibatsu Families from Corporate Control, of January 7, 1948, attempted to cut the personal ties that had forged the zaibatsu. An amendment to the HCLC Order implemented on August 19 prohibited holding companies and their subsidiaries from using the same trade names. On September 21, 1949, the government ordered 346 Mitsui companies, 205 Mitsubishi companies, and 160 Sumitomo companies to change their names and trademarks and barred them from using the old names for a period of seven years beginning in July 1951.

In light of the operations of the Mitsui and Mitsubishi trading houses overseas and the central role they had played among the zaibatsu, a government order on November 21, 1950, placed restrictions on the employment of their former directors. The HCLC did not have jurisdiction over the zaibatsu financial institutions, however. These were rebuilt under a different program. Many of the holding companies were also designated special-accounting companies under the corporate reconstruction and reorganization program, which meant that long periods of time were often required before they could be dismantled. The committee placed a priority on employee stock-holding plans when selling off shares. Some were also sold by open tender. By the end of March 1950, shares with a face value of ¥ 4,085 million had been disposed of for ¥ 6,802 million. Employee stock-holding plans accounted for 38 percent of the sales, followed by market sales with 27 percent. As of December 1, 1950, however, the HCLC still had shares with a face value of ¥ 2,668 million on its books waiting to be disposed of. The commission continued disposal.

An antimonopoly policy was embodied in the Law Banning Private Monopolies and Assuring Fair Trade of April 14, 1947 (generally referred to as the "Antimonopoly Law"). The Fair Trade Commission, established in July of that year, had responsibility for enforcing the law. In addition, the Law for the Elimination of Economic Excessive Concentration (usually referred to as the Deconcentration Law) of December 18, 1947, gave the HCLC jurisdiction over deconcentration measures. Under this law, the committee designated 257 companies in the mining and industrial sectors as having an excessive concentration of economic power, as of February 8, 1948. On February 22, it designated another 68 companies in the distribution and service sectors. The 325 companies thus designated included almost every major company in Japan, accounting among them for 65 percent of the paid-in capital of all joint-stock companies in the country, as of the end of 1947.

In May, 50 firms were taken off the list because no excessive concentration could be identified. There were other companies that were found to have a concentration of economic power but that were not thought to require reorganization. The total taken off the list, in fact or in practice, reached 225, leaving 100 companies subject to the Deconcentration Law. The "Four Principles for Eliminating Concentration" contained in a report submitted to SCAP on August 28 by the Deconcentration Review Board (DRB) which came to Japan in May 1948, resulted in an immediate and widespread relaxation of the deconcentration policies. More companies were taken off the list, and only 18 were actually reorganized in the end. These included Nippon Steel, Oji Paper, Mitsubishi Heavy Industries and Dai-Nippon Beer, among others. Six of the 18 were split up, and 12 were allowed to continue, after selling off some factories and stock (some also had to change their names). The enforcement of the deconcentration policy came to an end in April 1953, by order of the Fair Trade Commission. The dissolution of the zaibatsu was also winding down, and the HCLC was disbanded in July 11, 1951.

Landed interests, which had been expanding their property since the Meiji

Restoration, had come to own a considerable portion of Japanese farmland. Giant landlords were often in control of areas devoted exclusively to rice production. One of the goals of the Occupation was to eliminate this system. The government passed the "Law Amending the Agricultural Land Adjustment Law," on December 29, 1945. This measure became known as the "First Land Reform." Since it was not as far-reaching or thorough as SCAP would have liked, however, SCAP sent out a memorandum on December 9, before it took effect, ordering the government to submit a new reform plan that included buying out the lands of absentee landlords and returning the rents paid by sharecroppers via a long-term installment plan. The Allied Council for Japan also roundly criticized Japan's land reform policies. The Agricultural Land Adjustment Law was again revised on October 21, 1946, and with it were promulgated the Special Measures Law for the Establishment of Owner-Cultivators and the Special Account for Measures for the Establishment of Owner-Cultivators. The Special Account for Measures for the Establishment of Owner-Cultivators became operative on December 29.

The Special Measures Law for the Establishment of Owner-Cultivators provided a system under which the central government purchased land from landlords, and sold it to sharecroppers. It mandated the central government to purchase all share-cropped land owned by absentee landlords directly and any agricultural land in excess of a certain area owned by landlords residing in the same village. Landlords were to be compensated for their land with "farmland securities." Those purchasing the land were permitted to pay in annual installments, and the land was, in principle, sold off as soon as it was purchased. The government also bought uncleared land and pasture land. Purchases of land from the government came with a clause requiring that it be sold back should the buyers quit farming it themselves. Direct administration was ceded to municipal "Farmland Committees."

This program was referred to as the "Second Land Reform." Land purchases did not take place during fiscal 1946, but they did begin in 1947, during which year the government sold 255,000 hectares of land to sharecroppers; it sold an additional

1,473,000 in 1948 and 136,000 in 1949. Although the land reforms were for the most part complete at this time, sales of agricultural and uncleared land that had yet to be acquired continued, as did sales of agricultural land transferred from other accounts. Land purchases cost the government ¥ 1,164 million during fiscal 1948 and ¥ 1,060 million in fiscal 1949. Payments to landlords for land and other compensation and incentives above a set amount took the form of farmland securities from fiscal 1948 (grant bonds which were nontransferable for two years and which offered 3 .65 percent interest with equal annual amortization of principal and interest).

Agricultural land in other accounts was also employed in the owner-cultivator farm program. Much of this land had been paid in kind in lieu of assets taxes and was posted as assets on the Special Account for Revenues from the Assets Tax, Etc. Its transfer to the Special Account for Measures for the Establishment of Owner-Cultivators brought in ¥ 617 million in revenues between fiscal 1949 and 1951. The Special Account for National Forests, set up in fiscal 1947, also held land needed for the owner-operated farm program. Its transfer brought in ¥ 38 million in fiscal 1949 and ¥ 927 thousand in fiscal 1951. A small amount of land from the General Account - former military bases or uncleared land owned by the government - was transferred as well. ¥ 314.9 million in assets taxes was paid in kind by former landlords in farmland securities to the government, which were written off in the National Debt Consolidation Fund Special Account.

The Special Measures Law for the Establishment of Owner-Cultivators was amended on July 25, 1952, at which time its name was changed to the Agricultural Land Law. The initial goal of creating owner-cultivator farms having been achieved, the emphasis was now turned to general agricultural land policy.

It is worth pointing out that Japan achieved its goal of creating small, owner-operated farms in only six years, a feat rarely seen in land reform or land redistribution programs. The program gave farmers undisputed title to their land, which contributed greatly to improvements in agricultural productivity during and after the Occupation. Problems remained in the government land policies, however, the most significant of which was the lack of a system to conduct buy-backs of agricultural land when the owners decided to discontinue farming.