THE DEVELOPMENT OF WAR-TIME ECONOMIC CONTROLS

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I. THE SIGNIFICANCE AND CHARACTER OF WAR-TIME ECONOMIC CONTROLS

The aim of this paper is to describe the war-time economic controls implemented in Japan after the Manchurian Incident and to examine their characteristics as well as the course of their development. Control of Japan's war-time economy was begun by withdrawing from adherence to the gold standard caused by the imposition of the gold embargo in December, 1931 subsequent to the Manchurian Incident of September, 1931. Later, as the Manchurian Incident was escalated into the Sino-Japanese Incident, economic control was developed gradually until just before the outbreak of the Pacific War it reached full-scale when the Japanese economy was placed under almost complete war-time control. Even utilizing powerful state controls, however, it was impossible to sustain the economy from collapse in a world war which was beyond Japan's national strength, and the defeat of August, 1945 was inevitable.

In the period from 1931 to 1945 war-time economic controls were developed under the influence, on the one hand, of the military and, on the other, of domestic and foreign economic conditions. Since limited space does not permit a lengthy discussion of this process, it is expedient to divide the era of war-time controls into three periods; first, from the Manchurian Incident (September, 1931) to the Incident of February 26th of 1936; second, from the 2/26 Incident to just before the outbreak of the Pacific War; and third, for the duration of the war to August, 1945. While concrete descriptions of the economic controls in each period will be made in the relevant sections, the author will first touch briefly on the features of each period and on the general nature of economic control through the whole period.

The first period marks the starting-point of the war-time economic controls. Positive intervention of the state in the economy was carried out on the basis of withdrawal from the gold standard through fiscal and monetary measures which were dependent on such policies as deficit financing. However, these government policies were not solely for the military purpose of waging the Manchurian Incident but were also aimed at overcoming a panic which the economy faced at that time. In this period, therefore, economic control was still undeveloped representing only the initial stage of a war-time economy. However, the period is significant in that the basic paths for full-scale development of economic control were paved.

It was during the second period that war-time economic controls came into full swing. The Law for Temporary Measures on Exported and Imported Goods (September, 1937), the Temporary Funds Adjustment Law (September, 1937), and the National Mobilization Law (April, 1938) that were issued under the stimulus of the February 26th and Sino-Japanese incidents constituted fundamental legislation providing for control of Japan's economy on a war-time basis. The government, which was empowered to act on the authority of these laws, gradually intensified its intervention into various aspects of the national economy. Meanwhile, the Planning Board was established to draw up annual unified plans for the mobilization of resources. Because of the weaknesses inherent in the Japanese economy, however, these plans were frustrated in fact.[1] In this period, it must also be noted the Japanese economy was still linked to the world economy and intended to implement a war economy while stabilizing the yen exchange rates and maintaining a well-balanced position of international payments.

In the third period, the Japanese economy became a closed system under predominantly direct control. However, even this intensive economic control in which everything was concentrated on the sole aim of strengthening war potential came to naught because of the heavy burden of attrition incurred by war. It was inevitable that the economy decline in productive power. Before the end of war, the system of economic controls had already collapsed upon itself. Therefore, the third period may be characterized as the period not only of full-scale development of control but also of control breakdown.

Japan's war-time economic controls developed along the lines mentioned above. Before discussing the subject in concrete terms, we think it necessary to make some preliminary remarks on the characteristics

1 Limited space does not permit a sufficient discussion of the materials' mobilization programme. Detailed accounts of the subject will be found in Chap. 9 of Andō Yoshio 安藤良雄, *Gendai Nihon keizaishi nyūmon* 現代日本經濟史入門 (An Introduction to the Economic History of Modern Japan), Tokyo, Nipponhyōron-shinsha, 1963.

and forms of economic control.

First, let us consider the characteristics of the war-time economic controls. As stated above, Japanese capitalism in the period following the Manchurian Incident had been faced with two problems. One was to disentangle itself from a financial crisis which had not been resolved even after World War I, and which had been intensified by the Great Depression. The second problem was to wage a war which had been started as a measure for overcoming the financial crisis but which later gaining momentum had begun to move its own way. In the course of dealing with these two problems, Japanese capitalism heightened its dependence on and strengthened its linkage with the state. Thus, the state was able to intervene in the economy to an ever increasing degree.

It may be noted that it was in this manner that Japanese capitalism was converted into state monopoly capitalism.[2] The war-time economic controls enhanced the position of the government sector in the national economy, but they did not reject a capitalist system; rather they were employed in accordance with the logic of capitalism.

Second, in what form did state intervention in the economy take place? From the initial stage of capitalism in the Meiji era, the state had intervened in the economy and in the subsequent years a new system had been built. A major part of the system was comprised of a fiscal mechanism, by which the government adopted a system of managed currency and intervened in the economy through the use of fiscal and monetary policy, e.g., the procuring and dispensing of an enormous amount of funds. Under this mechanism, furthermore, such measures as the expansion of nationalized enterprises, direct control of trade, price control through an official pricing system, wage control, and consumption control were organized into a system of direct control ranging over the whole economy. In particular, direct control expanded without limit under the authoritarian régime which used direct means to maintain capitalism in the abnormal situation of the last stage of World War II.[3]

The war-time economic controls are of special importance in that

2 There are a variety of arguments concerning the formative period of Japan's state monopoly capitalism. The differences centre on whether to date the period 1931–32 or 1936–37. The author, who attaches importance to economic control by the state by means of fiscal mechanisms, adopts the 1931–1932 theory.

3 For forms of economic control by the state, see Makoto Takahashi 高橋誠, "Sengo ni okeru kokka dokusen shihon-shugi no tenkai" 戦後における國家獨占資本主義の展開 (The Post-war Development of State Monopoly Capitalism), in Ikumi Takuichi 井汲卓一 *et al.*, eds., *Gendai teikoku-shugi kōza* 現代帝國主義講座 (Lectures on Modern Imperialism), Vol. IV, Tokyo, Nippon-hyōron-shinsha, 1963.

through them were established both a state-operated fiscal mechanism in the monetary phase of finance and banking, and a direct system of control. These were continued essentially in the post-war period as "legacies of the war-time economic controls," and a structure of state economic control supported mainly by the fiscal mechanism has been reorganized. Direct control, meanwhile, has been modified or gradually abolished along with the reconstruction of capitalism.

Third, attention must be paid to the relationship between the war-time economic controls and the international economy. As mentioned before, a controlled economy, especially its most advanced form of direct control by authoritarian powers, is possible only under a more or less closed system and is incompatible with an open system. In other words, under a closed system, these forms of controlled economy seem to be essential in order to maintain the production level.[4]

The war-time economic controls in Japan should be considered in the context of this linkage with international economy. On the one hand, as is well-known, economic controls were strengthened in direct proportion to the tension caused by the expansion of war. This is, however, not all; the characteristics of controlled economy varied in accordance with how the Japanese economy was linked with the international economy. That is to say, the controlled economy of Japan, in its initial stage, was still limited in great degree by the characteristics of an open system and had not yet become a completely controlled economy. As the open system lost its integrity and approached a closed system, the controls were strengthened and, in the form of a completely closed system, spread widely in the form of direct control.

In July, 1941, with the enforcement of the freezing of Japanese assets by the United States, Britain, the Netherlands, and Canada, and with the counter-measures by Japan, Japanese economic relations with many countries of the world were ruptured completely. From this time on, Japan became a closed system. Until then, however, the foreign exchange rates of the yen had been kept stable somehow or other: a pegging rate policy had been adopted, in which the yen had been linked first to the pound sterling (1 shilling 2 pence) and later to the dollar (23 dollars 16.7 cents). In the years of this pegging rate policy, the control of the domestic economy was characterized by one measure to stabilize the foreign exchange rates of the yen.

4 Suzuki Takeo 鈴木武雄, "Nihon keizai jiyū-ka no zenshi" 日本經濟自由化の前史 (The Prehistory of Liberalization of the Japanese Economy), *Musashi daigaku ronshū* 武藏大學論集, Vol. XI, Nos. 1 and 3 (June and Dec., 1963).

Japan, in general, had to depend on foreign resources; thus, in order to carry out the Manchurian and the Sino-Japanese incidents and to strengthen her economic potential for national defence, she had to import not only such materials for immediate war use as petroleum, etc., but also raw materials used indirectly for the expansion of war potential. This was only natural, considering the structural characteristics of the Japanese economy.

After the floatation of bonds, etc., in foreign markets became impossible owing to the growing anti-Japanese sentiment following the Manchurian Incident, Japan had no other means to meet her import needs than to earn foreign currency through exports. In addition, Japan had to increase the import of raw materials if she wanted to increase her export, because her major export items consisted of textile goods made from such non-domestically produced raw materials as wool and cotton; thus a pattern of trade developed which consisted almost entirely of the import of raw materials which were processed and exported as finished goods.

Particularly, during the second period of the controlled economy, there was an increasing need for strengthening the war potential of the economy, and in this respect the role of imports became important. It consequently became more necessary to curb rises in import costs, than to stimulate exports and curb imports by lowering the exchange rates as had been done in the initial stage of the first period. Decline or instability of the exchange rates would become an obstacle to increasing imports for the defence economy and to increasing exports to attain that purpose. Thus, it became necessary to have the exchange rate of the yen stabilized at a somewhat lower level and an exchange rate pegging policy such as discussed before had to be undertaken.

For the Japanese economy, which was highly dependent on foreign nations, it was, however, extremely difficult to maintain this pegging policy of the yen exchange rates. Therefore, in order to stabilize the exchange rates at the low level, a favourable international balance of payments was to be maintained by reducing the import of "non-urgent and non-essential" goods other than those for military consumption or the like, and at the same time by appropriating for exports those raw materials and products which otherwise would have been used for domestic consumption. In this way, economic control was to be tightened in order to maintain the pegged exchange rates. At first, the control of exports, imports, and foreign exchange was taken as a measure to keep the balance of payments in equilibrium. But this alone proved insufficient. Thus it was inevitable that the direct control of the economy be extended by adopting such measures as the preferential apportioning of imported raw materials to munitions industries, the saving of imported raw materials by reduction of domestic consumption, the transfer of the disposal of those goods which were otherwise used for domestic consumption to export, the enforcement of official prices, and the control of investment in civilian industries.

In an economy like Japan's which depends on foreign resources for most of the raw materials and means of production it needs, the enforced expansion of munitions production would inevitably bring deterioration of the balance of payments and of the demand-supply situation of goods if the economy were left to itself. Therefore, state intervention in the economy was inevitable. The controlled war-time economy of Japan was infused with this characteristic, because of its dependence on foreign countries.

II. MANCHURIAN INCIDENT AND ECONOMIC CONTROL

At the time of the outbreak of the Manchurian Incident, the Japanese economy was stagnant due to both the deflationary policy connected with lifting of the gold embargo, and also the world financial crisis. The Manchurian Incident, a military action undertaken as an attempt to extricate the economy from persistent stagnation, gave Japanese capitalism an opportunity to request the state to take measures to rescue the nation from the crisis and to take further steps to settle the crisis. The economic control policy set forth under this situation demanding the relief of the nation from a crisis.

The withdrawal from the gold standard with the gold embargo of December, 1931 represented the beginning of the instituting of economic controls. Policy regarding state expenditures was employed by the government to overcome the crisis, and a low exchange rate policy for export promotion was also adopted. That is to say, the government increased expenditure for the Manchurian Incident, national relief, armament expansion, etc., on the one hand; and on the other, it adopted a policy in which deficit-covering bonds were issued to meet these expenditures. The Bank of Japan was compelled to subscribe the bonds. Such expenditure, moreover, was expected to result in an increased issue of inconvertible Bank of Japan notes and in a lower yen exchange rate that would help promote exports and curb imports.

Let us look more closely into the situation involved.

The financial policy in this period is known as the "Takahashi finance" after Takahashi Korekiyo 高橋是清, and represents a chapter in the financial history of Japan. It has significance in that it paved the way for the war-time finance and economy. The first characteristic of the "Takahashi finance" lay in increased government expenditure. For such items as the Manchurian Incident, general military requirements, and national relief, expenditures for all of which were growing rapidly to large proportions. These circumstances are projected in Table 1.[5]

The second characteristic of "Takahashi Finance" is to be found in the measures taken to increase revenue in order to meet the growing expenditures. The government did not attempt to increase tax revenue, which was left to the mercy of the natural movement of the national income. The issuance of deficit-covering public bonds was the only conceivable means of meeting the difference between expanding expenditure and current revenue comprised of taxes, etc. (See Table 1) The so-called open market operations were adopted as a method for the floatation of deficit-covering bonds. By this method, the Bank of Japan first subscribed the government-issued bonds; meanwhile, the government appropriated funds for the payment of its expenditures and after release of these funds eased the tight money situation, etc., the Bank of Japan sold the bonds on hand to withdraw the currency circulated. In order to

Table 1

I. Revenues (in million yen)

	Total (A)	Taxes	Government Bonds (B)	(B)/(A) %
1931	1,531	991	120	7.9
1932	2,045	940	660	32.2
1933	2,332	1,002	753	32.3
1934	2,247	1,114	742	33.0
1935	2,259	1,202	678	30.1
1936	2,372	1,361	610	25.7

II. Expenditures

	Total	Military	(For the Manchurian Incident)	For Temporary Relief Projects
1931	1,477	455	(76)	—
1932	1,950	686	(278)	163
1933	2,255	673	(196)	214
1934	2,163	943	(159)	145
1935	2,206	1,033	(184)	—
1936	2,282	1,078	(207)	—

5 Ministry of Finance, *Shōwa zaisei shi* 昭和財政史 (Shōwa Financial History), Vol. 3, Tokyo, Tōyōkeizai-shimpōsha, 1950.

facilitate this process, moreover, a low interest rate policy was employed.

This was a policy intended to solve the difficulty of floating vast sums of bonds which, given the monetary situation of the time, could hardly have been absorbed by such conventional means as public subscription or underwriting by the Deposit Bureau of the Finance Ministry. It aimed also at creating a smooth flow of money and increasing purchasing power by throwing additional Bank of Japan notes onto the market.

It must be noted that this method of open market operation, which commenced under the tenure of Finance Minister Takahashi, and was characteristic of Japanese financial policy throughout the war period, simplified the procurement of military funds and gave occasion to inflation. It represented a new procedure in that the terms of floatation were determined only by the government and the Bank of Japan rather than public subscription, this new procedure became a principal instrument of the war-time economic control structure of Japan. That is to say, the raising of vast sums of military bonds which supported Japanese finance for the period of ten odd years following the Manchurian Incident was possible mostly through this method. On this basis, furthermore, the government control over private banking proceeded along with transformation of the central banks into a governmental agency.

Again, it was this open market operation that marked symbolically the starting-point of the war-time economy and thus featured the succeeding economic control enforced during these days. Open market operations thus were an important part of the fiscal mechanisms used by the state for intervention in the economy. There was no intention to employ the method for any purpose other than to procure military funds through an inflationary policy. However, the economic situation under which the munitions industry had already considerably increased its role in the economy, made it impossible to achieve the expected effect of credit contraction with price rises and intensified inflation. After the second period, the method became an important tool for supplying inflationary money.

Financial policy in this second period is characterized by having become a major instrument of state intervention in the economy and, in particular, of economic control. Of course, financial intervention was active prior to this period as witnessed in the capital-saving financial measures. In that case, however, the measures taken by the government were to indemnify nearly-bankrupt capital from outside of the national economy and financial policy operated on the principle of autonomy of the economy.

However, in the post-Takahashi period, it was the practice under the economic control system to create effective demand, which had diminished owing to economic crises, by means of increases in temporary relief and military expenditures. This state intervention brought about a substantial change in the role of the government in financial policy; the financial policy thus changed to become another important part of the fiscal mechanism.

With the sharp decline in yen exchange rates caused by the reimposition of the gold embargo, Japanese exports exhibited phenomenal progress amid the depression of world trade. This provoked international criticism of "social dumping," induced a variety of boycott measures against Japanese goods, and helped sharpen international opposition. At first, Finance Minister Takahashi took a *laissez-faire* attitude towards this downtrend of exchange rates, but the Japanese economy, being highly dependent on foreign nations, was to encounter major obstacles in the imports of raw materials and munitions.

For these reasons, the government was compelled to adopt a policy for stabilizing the exchange rate at a low level and to meet this task by means of exchange controls; the result was the "Foreign Exchange Control Law" promulgated in March and put into force in May, 1933. This law was a successor to the "Capital Flight Prevention Law" and intended to stabilize the yen exchange rate under a managed currency system. The establishment of this law welded together the framework of fiscal mechanisms for state economic control in regard to foreign relations. Meanwhile, closely connected with this, the government carried out a policy of gold preference in order to maintain the credit of the yen, and at the same time purchased gold ingots at current prices. Although it played some role in reinforcing gold reserves, this purchase led to a lowering of the price standard in real terms and accelerated a decline in the credit of the yen.

III. THE SINO-JAPANESE INCIDENT AND ECONOMIC CONTROLS

Japan, as mentioned above, attempted to overcome her economic crises after the Manchurian Incident by means of fiscal expenditure and dumping exports based on a low exchange-rate policy. In that course of time the voice of the military grew at home and antagonism with the foreign powers was intensified, driving Japan towards war. The February 26th of 1936 Incident and the subsequent Sino-Japanese Incident in July, 1937 played a decisive role in this course; the two events motivated Japanese capitalism to shift to a war economy in co-operation with the military.

Baba Eiichi 馬場鍈一, Finance Minister of the Hirota 廣田 cabinet that was brought to power through the military's support immediately after the February 26th Incident, proposed a series of fiscal and monetary policies based on abandonment of the principle of gradual bond reduction, increase of taxation, and low interest-rate policy. This policy entirely discarded Finance Minister Takahashi's policy of gradual bond reduction which had been designed to curb the inflation which was at last coming to the fore, allowed the expansion of military expenditures, sought to raise military funds by the floatation of increased bonds and the imposition of increased taxes, and also confirmed adoption of a cheap money programme to facilitate implementation of the bond policy. The fiscal mechanisms and other systems of economic control whose role in the first period after the Manchurian Incident had been largely to overcome economic crises were thus rapidly remodelled into a war-time economic control system to strengthen national defence.

The "Baba finance" did not necessarily run its course along a straight and narrow line. The expanded budget for fiscal 1936 organized by Baba amounted to more than 3,000 million yen which represented a sharp increase of nearly one-third over the preceding year, so that a major tax increase amounting to 600 million yen and a bond revenue increase of over 800 million yen were planned. Although this budget satisfied the military's demands, it was impossible to have the budget supported by the Japanese economy, whose production power remained low. The arbitrary action of the financial authorities which attempted to force the impossible by the imposition of increased taxes and by the compulsory assignment of bonds created unrest and a sense of pressure among the business circles. In fact, the arbitrary action of the government resulted in rises of commodity prices and mounting calls for "correction of excesses."

With the establishment of the Hayashi 林 cabinet in February, 1937, Finance Minister Baba was replaced by Yūki Toyotarō 結城豐太郎. The task imposed on Yūki was to modify the Baba policies in such a manner as to suit the requests of the business circles. Also in compliance with the requests of the business circles, Ikeda Shigeaki (Seihin) 池田成彬 of the Mitsui 三井 *zaibatsu* was invited to take office as Governor of the Bank of Japan. The Yūki-Ikeda policy, termed "tie-up finance" of the military and the business circles, paved the way for compromise between the two.

One feature of the Yūki policy is that it came up with a "production power expansion programme" along with a huge military budget, both of which were required by the urgent need for the Japanese economy to make strong advances in response to the demand for vast sums of military funds and to the necessities of war industry. If it were impossible to meet these requirements with private funds alone, then they would have to depend either on government funds or on the creation of credit with the Bank of Japan. What the Yūki-Ikeda finance intended was to create an efficient supply of funds from financial and banking sources in order to meet the expansion programme. This was one of the major reasons for the appointment of Ikeda as Governor of the Bank of Japan. In any event, the significance of the Yūki-Ikeda policy was that it installed a fiscal and monetary structure on the axis of a war-time economic structure while materializing a tie-up between the military and capital which the Baba finance had failed to do.

This course was systematized by the Konoe 近衛 cabinet (June, 1937) which succeeded the Hayashi cabinet, and was accomplished by what were called the three financial and economic principles of Finance Minister Kaya Okinori 賀屋興宣. He called for the formulation of concrete plans to (1) expand production power; (2) balance international payments; and (3) arrange the demand and supply of goods. These three principles confirmed the theory that, in order to implement a war economy without a hitch, it was necessary to balance the account of international payments and to co-ordinate the demand and supply of goods, as well as the expansion of production power and the attainment of high economic advances.

That is to say, in an economy like Japan's that is weak itself and highly dependent on foreign trade, forced expansion of war-time industrial power would inevitably worsen the balance of international accounts or the demand and supply of goods if no intervention were made in the autogenous cycle of economics. Nor could it be expected that the expansion of production power would be achieved by the sole efforts of a capitalistic production aimed at profits. Therefore, these three principles indicated that direct state intervention in the national economy was necessary and that war finance had entered a new state in which it would not be able to operate to a sufficient degree unless connected with a national economy controlled entirely by the state. Thus, the three principles were a declaration of the coming into full play of war-time economic controls.

On the basis of the three principles, to begin with, both the "Law for Temporary Measures on Exported and Imported Goods," regarding the demand and supply of goods, and the "Temporary Funds Adjustment Law," a funds control law, were put into force in September, 1937. The significance of the two, as mentioned in Section I, lay in the fact that they directed funds and goods into war industries. Then, in January, 1938, the "War Industries Mobilization Law" and in February the "National Mobilization Law" were enacted. The enactment of the latter meant that *carte blanche* was given to the state for over-all economic control. That is, through these laws a structure of economic control relating to all aspects of the national economy had been now formed.

The "National Mobilization Law" is particularly meaningful in that it concentrated and systematized the economic controls which had steadily increased since the Manchurian Incident and whose pace had quickened after the Sino-Japanese Incident, to assume a growing war-time tone. This law intended to "utilize human and material resources to the full extent of the total power of the nation for the attainment of defence purposes." It empowered the government to control materials, production, financing, company management, prices, human resources, etc. Moreover, the law was of such an extensive nature as to give a death-blow to the Meiji Constitution which in itself only insufficiently recognized the people's rights; thus, the government endowed itself with powers which might almost be called almighty.[6]

The National Mobilization Law was passed by the Diet on the promise that it would "not be applied to the Sino-Japanese Incident," but it was applied thereto as early as May 5, just a month after the promulgation, and thereafter important Imperial Edicts were issued one after another. Thus, the law established a legal system by which to strengthen the control and intervention of state authority over various aspects of economy.

How did state intervention in the economy progress concomitant to the strengthening of this legal system for economic control? It is first necessary to examine the changes in the characteristics and functions of state finance. The establishment of a special account for emergency military expenditure in 1937 marked a definite shift to war-time finance. As shown in Table 2, the net total of the general account and the emergency military expenditure account, taking 1936 as a base of 100,

6 Of the National Mobilization Law, even the *genrō* Saionji Kimmochi 西園寺公望 is said to have stated, "I think this bill had better not pass the Diet because after all it ignores the Constitution. Isn't there any other way?" Harada Kumao 原田熊雄 ed., *Saionji kō to seikyoku* 西園寺公と政局 (Prince Saionji and the Political Situation), Vol. 6, Tokyo, Iwanami-shoten, 1951, pp. 249–250.

grew to 724.9 in 1941.[7] This vast expenditure was procured in part by tax increases but was supplied for the most part by government bonds. That will be apparent from the cumulative increase in the national debt during this period, (as seen from Table 2,) the amount of which rose from 6,200 million yen in 1931 to 10,600 million yen in 1936, and to 40,500 million yen in 1941.[8] The procurement of funds was, of course, carried on through the open market operation method; and inflation progressed rapidly.

Table 2

(in million yen)

	Net Total Expenditure*	Net Total Revenue (A)	Taxes & Stamps	Government Bonds & Borrowings (B)	(B)/(A) %
1936	2,282 (100)	2,372	1,146	610	25.7
1937	4,743	4,395	1,563	2,045	46.5
1938	7,766	7,406	2,113	4,357	58.8
1939	8,808	8,962	2,613	5,197	58.0
1940	10,982 (481)	11,644	3,789	6,323	54.3
1941	16,542 (724.9)	15,674	4,385	9,283	59.2
1942	24,406	22,457	6,788	12,945	57.6
1943	37,704	38,339	8,659	24,722	64.5
1944	51,941	80,728	11,655	63,423	78.6
1945	73,701 (3,227)	61,226	10,495	44,455	72.6

Notes: 1) * General Accounts plus Extraordinary Military Expenses.
2) Figures in parentheses are indices with 1936 as 100.

It need hardly be said that the Bank of Japan could not freely subscribe such a vast sum of bonds. Various measures were taken for the absorption of bonds by city banks. But the mobilization of funds from the masses was possible to only a limited degree in the inflationary situation while the funds of banks were also very limited because of loans for the expansion of the munitions industry. Thus, the funds to absorb bonds and the funds to finance the expansion of productive power were obliged to compete with each other. A new fiscal mechanism was required to adjust the relationship between the two.

The "Temporary Funds Adjustment Law" was a response to this need. The law placed the money market under direct state control since the existing indirect financial policy was inadequate to control the flow of funds. This was an attempt to adjust the funds for bond absorption and those for productive power expansion, prevent the outflow of industrial funds into non-munitions industries, and funnel these into munitions

7 *Shōwa zaisei shi*, Vol. 3.
8 *Shōwa zaisei shi*, Vol. 5.

industries through the Industrial Bank of Japan. In short, direct control over funds was added to the fiscal mechanism.

Being aimed mainly at private financial institutions, however, this financial control was subject to certain limitations in that it was always necessary for the private financial institutions to operate on a commercial basis. In order to compensate for this weakness, government financial institutions or agencies were to be created for the direct supply of funds, as will be discussed later.

Various measures were also taken for the war-time reorganization of industries. To begin with, subsidy and tax exemption or remission programmes for the munitions industries were carried out on the basis of newly instituted enterprise laws. This was because the war industries had been linked with financial authorities through increased war procurement orders and through an advance payment system. The enterprise laws relevant to the war industries included the "Synthetic Petroleum Enterprise Law" and the "Iron and Steel Enterprise Law" of 1937, the "Machine Tool Manufacturing Enterprise Law" and the "Aircraft Manufacturing Enterprise Law" of 1938, the "Light Metals Enterprise Law" and the "Shipbuilding Enterprise Law" of 1939. All of them provided for state subsidy of enterprises as well as for state supervision over private enterprises.

Now, despite this tightening of state control, as compliance by private capital with state policy frequently involved so-called managerial risks, the government set up new state-operated enterprises called "national policy companies," "public banks," or "public corporations"; examples include the Imperial Fuel Industry Company (1937), the Japan Power Generation and Distribution Company (1938), the Imperial Mining Development Company, and the Great Japan Aircraft Company (1939). As the war developed and war production came to a dead end, agencies of this sort were set up at random.

IV. THE COLLAPSE OF WAR-TIME ECONOMIC CONTROLS

Although the military productive power expansion policy pursued since the Sino-Japanese Incident temporarily increased war production, it imposed an additional burden on the national economy; consequently the productive power of the Japanese economy was bound to crumble. The production of mining and manufacturing industries moved downward following the peak of 1937.

The failure of the policies became clearer after the autumn of 1939.

The outbreak of the second European War in September, 1939, the expiration of the Japan-U.S. Treaty of Commerce in January, 1940, and the imposition of embargoes against Japan by the Anglo-American nations made it impossible to implement the war economy, which was entirely dependent on the economies of the advanced countries. For this reason, difficulties in obtaining raw materials and declines in the profit rate caused basic production activities to stagnate and robbed enterprises for some time of good future prospects. Meanwhile, the demand for and supply of goods became increasingly strained and it became necessary to reshape the "Materials Mobilization Programme."

The deadlock of the productive power expansion policy also affected fund planning. A variety of national policy companies had been established under the productive power expansion policy and the funds they needed had risen to enormous sums. However, since their earning power was in deep doubt, the city banks, anxious to maintain their profit-making status and stability, were reluctant to finance these companies, which therefore lacked a smooth supply of funds. This led to an increased load of compulsory loans on the Industrial Bank of Japan, whose burden had to be sustained by the credit of the Bank of Japan. The result was a swelling Bank of Japan note issue which accelerated inflation. At the same time competition intensified between the bond absorption funds and industrial funds. In brief, banking began to lose its function of easing evil influences upon the money market derived from the increased floatation of bonds, and it became necessary to reorganize the interrelationship between finance and banking.

As this deadlock fundamentally dislocated the production expansion programme and the materials mobilization programme, the government was urged to fundamentally reorganize the entire economic control system. From this came the "new economic system" plan advocated by the second Konoe cabinet in July, 1940. The war-time economic control entered a new stage. The course and direction of the new plan was announced in the "Principles of the National Policy Programme."

The fundamental characteristics of the "new system" may be seen in the following two points. First, Japan severed economic relations with the capitalist countries, as a result of which she became wholly independent on an autarkic economy. That is, her economic relations with her colonies and her occupied areas were forced to alter from one of reliance by the colonies on Japan to one of contribution to her; Japan was obliged to depend on the Greater East Asian Co-prosperity Sphere which "includes East Asia with Japan, Manchuria, and China as its core."

The second was the consolidation of a unified control structure. Through this structure it was attempted to tighten control concentrating on the consolidation of enterprises and the priority regimentation of industries by state authority.

The first step towards the projected unification of the control structure was "institution of control associations" by industrial classification on the basis of an ordinance for organization of key industries. A kind of compulsory cartel to fulfil production quotas, carry out assignments regarding materials and labour, and the like, the control associations were empowered as agencies of state authority to exercise compulsory control over individual enterprises or all business organizations. They were also endowed with authority as a sort of state organs directly belonging either to the Ministry of Commerce and Industry or the Munitions Ministry. On the other hand, however, these institutions were operated by representatives of the major *zaibatsu*, and virtually conducted on the principle of securing the interests of the *zaibatsu*.

Another part of the control mechanism was provided by the *eidan* 營團 or public corporations which held the status of government-owned and government-managed special juridical persons to deal with enterprises difficult to run on a private profit-making basis. Numerous such corporations were established after the outbreak of the Pacific War, including the Industrial Facilities Corporation, the Important Objects Control Corporation, and the Trade Corporation. These agencies took charge of direct state control over the phases of distribution and circulation of goods.

Concurrently the state controls over currency, financing, and banking were tightened. Based on the "Financial and Banking Basic Policy Programme" of July, 1941, fiscal mechanism was reorganized. Here the state tried to control finance and banking as an integrated whole instead of treating them as two separate entities. In reference to banking in particular the following reforms took place:

(1) establishment of a managed currency system on the basis of a revision of the Bank of Japan Law obliged the Bank of Japan to become the supplier of financial and industrial funds,

(2) formation of a Greater East Asia Financial Sphere on the basis of the setting up of the War-time Finance Bank and the Southern Development Bank, and

(3) establishment of the National Financial Control Association gathering financial capital into the control structure.

Along with these measures, meanwhile, public finance kept expanding due to the expansion of military expenditures, and in 1944 the aggregate of the general account and emergency military expenditures account exceeded the total national income. Thus the attrition of national wealth through the war became severer. Moreover, the issue of bonds accumulated steadily and the pace of inflation became faster.

In spite of the tightening of state control and management over the entire economic field, the Japanese economy saw its productive power quickly declining as the war advanced. As discussed before, the production index for mining and manufacturing industries which rated at 100 for the 1931–1933 period dropped, following the peak of 182.1 in 1938, to 147.2 in 1941, 121.5 in 1943, and 79 in 1944. The implication is that the Japanese economy had completely collapsed already before the surrender.[9]

Now, why did the war-time economic controls collapse in this manner? The collapse was, of course, due to the basic weaknesses inherent in the Japanese economy itself. Among the major flaws, the following are generally accepted.[10]

First, Japanese industries had a weak supply of raw materials, most of which came from overseas. As discussed at length in Section I, the expansion of war production necessitated imports of raw materials; but Japanese production, in turn, was at the mercy of an external situation, the economic blockade imposed by the Allied powers. Up to that time, Japan exported textiles and miscellaneous goods, the products of private industries or medium and small enterprises, and thereby imported raw materials. Under the new conditions, implementation of the war production had become completely impossible.

Second, Japanese heavy and chemical industries were meagre; Japanese industry had been centred on light industries. In spite of a policy for rapid industrial advances in the munitions industries after the Manchurian Incident, industrial potential was still insufficient for carrying out a modern war. This caused great confusion to the war economy of Japan.

The third was a widespread existence of medium and small enterprises; in other words insufficient development of large-scale, high productivity enterprises. This means that war production could only take place on a semi-manual industrial scale with low levels of technique and labour productivity, utilizing widespread groups of subcontract enterprise.

9 Bank of Japan, *Hompō keizai tōkei* 本邦經濟統計 (Economic Statistics of Japan).

10 Kajinishi Mitsuhaya 楫西光速, Katō Toshihiko 加藤俊彦, Ōshima Kiyoshi 大島清, and Ōuchi Tsutomu 大内力, *Nihon shihon-shugi no botsuraku* 日本資本主義の没落 (The Fall of Japanese Capitalism), Vol. 3, Tokyo, Tokyodaigaku-shuppankai, 1963.

The fourth was the *zaibatsu*-type monopoly system. Japanese enterprises were not organized on horizontally but rather vertically according to different capital groups. This strengthened antagonism rather than co-operation between enterprises and thus hindered economic operation on a planned basis.

The fifth was the political system in which there was no agency to assume unified responsibility for the controlled economy, while administrative responsibilities were scattered.[11] The government carried out economic control with powerful authority, but because of antagonism within its own ranks failed to conduct unified economic control. For example, the Planning Board was instituted as an agency to draw up war-time economic plans but it had no executive authority at all. Moreover, the army and the navy, having a mighty voice, persisted in their assertions. In addition, the military's build-up programmes were not made public, as they were secret. This secrecy principle, coupled with the competition between the two armed services, prevented even the last-minute establishment of a rational and united war-time economic programme.

The sixth and last was the shortage of statistical data and the immaturity of economic planning techniques.

11 *U. S. Strategic Bombing Survey: The Effects of Strategic Bombing of Japan's War Economy*, Over-all Economic Effects Division, U. S. Government, Dec., 1946.