Title	Shoup vs. Dodge : conflict over tax reform in Japan, 1947-1951
Sub Title	
Author	Brownlee, W. Elliot
Publisher	Keio Economic Society, Keio University
Publication year	2011
Jtitle	Keio economic studies Vol.47, (2011.) ,p.91- 122
JaLC DOI	
Abstract	The 1945-1950 mission of Cearl S. Shoup to Japan failed to accomplish its objective of reforming the Japanese tax system in comprehensive ways, making it more equitable and efficient. Scholars have suggested many reasons for that failure; this paper describes and analyzes the weak support of the American occupation authorities for the Shoup mission. Divisions within the occupation, and particularly the conflict between Shoup and Joseph Dodge, eaeh of whom had allies within GHQ, doomed Shoup. With greater support from GHQ, Shoup's recommendations might have had more time to win support from the Japanese government.
Notes	Special Issue
Genre	Journal Article
URL	https://koara.lib.keio.ac.jp/xoonips/modules/xoonips/detail.php?koara_id=AA00260492-20110000-0091

KEIO ECONOMIC STUDIES **47**, 91–122 (2011)

SHOUP VS. DODGE: CONFLICT OVER TAX REFORM IN JAPAN, 1947–1951

W. Elliot BROWNLEE

Department of History, University of California Santa Barbara, Santa Barbara, U.S.A

First version received April 2010; final version accepted May 2011

Abstract: The 1949–1950 mission of Carl S. Shoup to Japan failed to accomplish its objective of reforming the Japanese tax system in comprehensive ways, making it more equitable and efficient. Scholars have suggested many reasons for that failure; this paper describes and analyzes the weak support of the American occupation authorities for the Shoup mission. Divisions within the occupation, and particularly the conflict between Shoup and Joseph Dodge, each of whom had allies within GHQ, doomed Shoup. With greater support from GHQ, Shoup's recommendations might have had more time to win support from the Japanese government.

Key words: Shoup Mission, Joseph Dodge, taxation.
JEL Classification Number: H2, N45

The Shoup mission to Japan during the American occupation was one of the most ambitious efforts to reform the tax system of a major industrial nation. And, it had behind it the enormous power of the victorious United States. However, the mission failed to reform in a sustained way that nation's tax system.[1] Not all scholars have agreed with

Acknowledgments. I gratefully acknowledge the assistance of Michael Adamson, Akaishi Takasugu, Andrew Dewit, Fukagai Yasunori, Laura Hein, Ide Eisaku, Iju Morinao, Jinno Naohiko, Frances Lynch, Dale Shoup Mayer, Ajay Mehrotra, Mark Metzler, Muramatsu Ryo, Monica Prasad, Sekaguchi Satoshi, Joseph Thorndike, Dennis Ventry, and an anonymous reviewer.

[1] This has come to be the view generally accepted in recent years by scholars of public finance and political economy in Japan, where the history of the Shoup mission is of seemingly perennial interest. See, for example, Naohiko Jinno, "The 'Japanese-Model' Fiscal System," in *The Japanese Economic System and Its Historical Origins*, eds. Tetsuji Okazaki and Masahiro Okuno-Fujiwara (Oxford, U.K.: Oxford University Press), 1999. American scholars of public finance and political economy have rarely undertaken in-depth research on the Shoup mission, but two, separated by more than fifty years, have suggested the limited long-term influence of the mission. See Martin Bronfenbrenner and Kiichiro Koguku, "The Aftermath of the Shoup Tax Reforms, Part I," *The National Tax Journal* 10 (1957), 236–254, and W. Elliot Brownlee, "The Shoup Mission to Japan: Two Political Economies Intersect," in Isaac William Martin et al., *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective* (Cambridge, Eng.: Cambridge University Press, 2009). Bronfenbrenner was one of the central participants in the efforts of the American occupation to follow-through on Shoup's recommendations.

that assessment, but almost all who have done so attribute the failure to inadequacies in the Shoup mission and/or opposition within the Japanese government to the mission's recommendations. No scholars of the Shoup mission, however, have explored a potentially important explanation for that failure: the weakness in the commitment of U.S. occupation authorities to support the Shoup reform program.[2] That weakness had various components, but the most important was the opposition of the Dodge mission—the most powerful of all the occupation's economic missions—to many of the recommendations of the Shoup mission. This essay traces the development of this fracture within the occupation, discusses its sources, and assesses its effects and long-run significance.

I. SHOUP AND DODGE

This conflict within the occupation over the fiscal lifeblood of Japan was an example of bureaucratic warfare within the occupation—warfare which became more intense during the so-called "reverse course," or shift in occupation objectives and power structure often said to have begun in 1947. But the conflict was not simply the product of a major institutional shift or conflicting goals within the American occupation. Two talented, accomplished individuals—Carl S. Shoup, Professor of Economics at Columbia University, and Joseph M. Dodge, President of The Detroit Bank—contributed significantly to both defining and intensifying the conflict. The priorities of Shoup and Dodge conflicted in significant ways, and they each pursued their goals with great effectiveness.

Shoup was a gifted, well-trained, and experienced analyst of a broad range of central issues in public finance. In his intellectual life, he lived up to the tradition and standards of fiscal analysis that his mentors at Columbia, Edwin R. A. Seligman and Robert Murray Haig, had established. And, he was also a soft-spoken, disarming, polished, and adroit operative within the corridors of power in Washington. During the 1930s and 1940s, he had demonstrated great ability to organize interdisciplinary teams of experts from universities, professional organizations, and government agencies; to drive toward the outcome he wanted, and then to communicate the results of the teams' systematic research to both sponsors and wider audiences. He was a devoted New Dealer, and consistently sought tax reforms that expanded the ability of government at all levels to fund adequately programs of education, public works, and welfare. His central goal as a tax

[2] Japanese scholars have had difficulty in exploration this explanation because they have not had easy access to Record Group #331 in the National Archives and Record Administration (RG 331), the Carl S. Shoup Papers at Yokohama National University (CSYNU), and the Joseph Dodge Papers in the Detroit Public Library (JDDPL). Lack of access to the extensive documentation now available in these archives similarly limited Bronbenfrenner's ability to consider this explanation. Compounding this problem was the fact that he was never a formal member of the Shoup mission, and that his personal experience in the occupation working on tax matters was limited to the period between the departure of the "first" Shoup mission in September 1949 and August of 1950, well before the completion of Shoup's work during the "second" mission. In my previous research on the Shoup mission, I have also paid little attention the problems internal to the occupation. See Brownlee, *Ibid.*, and W. Elliot Brownlee, "The American Occupation of Japan, the Shoup Mission, and he Transfer of Tax Ideas, 1945–1952," in *Global Debates about Taxation*, eds., Holger Nehring and Florian Schui (London: Palgrave-Macmillan, 2007), 158–181.

reformer was to elevate tax equity about the other goals of taxation and, in fact, if possible to take it off the political table. By an equitable tax system, he meant one in which people with roughly equal economic power—defined as either income plus capital gains or as wealth—made roughly equal contributions to government. He believed this kind of equity would win broad public support in societies with both market economies and democratic political systems and was, in fact, necessary for adequate funding of government. Without equity, as he defined it, and the widespread perception of equity, public services would be either underfunded or paid for by rampant inflation. Like his Columbia mentors, Shoup was a moderate New Dealer, often attempting to shape the wide-ranging New Deal tax reforms in ways that were less burdensome to capital formation. In addition, he maintained a low political profile in order to build bipartisan consensus. Contributing to his moderation was his family background. His father, Paul Shoup, had been president of Southern Pacific Railroad, a close friend of Herbert Hoover, and then an important lobbyist for Southern Pacific in New York and Washington during the 1930s. Shoup consistently took positions on tax reforms between those of the most fervent New Dealers and those of his father, who was an outspoken and visible critic of important elements of the New Deal. At the time of Carl Shoup's work in Japan, he was at the height of his powers, and drew energy from the prospects for implementing a well-developed reform agenda that he and his intellectual mentors at Columbia had been largely unable to advance within the United States.

Dodge's intellectual interests were narrower than Shoup's, and, like Shoup's father, he had risen in the world without the benefit of a college education. But his mind was acute; his banking experience, which included an early career as a bank examiner as well as his extremely effective leadership of The Detroit Bank, was extensive; and his passion for understanding financial detail was phenomenal. And, despite his uneasiness with Keynesian economics, he valued the advice of professional economists. Like Shoup, he had a strong track record of bureaucratic accomplishment, including chairing the War Contracts Board and the Price Adjustment Board for the Department of the Army and influential work as a financial adviser to the U.S. Military government of Germany. During the years of the Truman administration, he provided much informal advice on banking matters to both Secretary of the Treasury John Snyder and Undersecretary A. L. M. Wiggins. However, he usually chose to work in a chain-of-command situation, and wielded a heavier hand in negotiations than did Shoup. He had been hostile to the New Deal, and especially skeptical of its spending on social welfare and public works. His political identity as a corporate Republican was crystal clear, but, like Shoup, he had a taste for bipartisan negotiation. The invitation to serve in Japan came directly from President Harry S. Truman. Also like Shoup, he vigorously his reform program with special enthusiasm because he hoped to see it emulated at home. He saw irony in working for the Truman administration in adapting fiscal and monetary policy to the control of post-war inflation in Japan while the administration seemed disinterested in domestic inflation-fighting.

These two formidable individuals developed a complex and troubled relationship in the context of two missions which began entangled over extended periods of time, received their authorization from different sources, and had agendas which overlapped.

II. THE "MOSS MISSION"

The Shoup mission began its work before the Dodge mission, and took up a project that had began even earlier. The Shoup mission was, properly understood, a continuation of an even earlier mission—one that perhaps ought to have been called the "Moss" mission, in recognition of its leader, L. Harold Moss, a Treasury expert on international taxation. The Moss mission was the very first of the post-1947 missions of experts charged with strengthening, in various ways, Japan's economic capacity. But while all the other post-1947 missions received their primary impetus from the National Advisory Council (NAC), an inter-cabinet agency chaired by the Secretary of the Treasury, the Moss mission was mainly the creation of General Douglas MacArthur, or SCAP (Supreme Commander Allied Powers). And, MacArthur's objectives for tax reform emphasized political democratization which was, at best, only a secondary goal of the reforms that the NAC advanced. To be sure, the Truman administration intended that the NAC curtail MacArthur's power, but MacArthur remained strong even in the contested realm of economic policy as a consequence of his popularity in the United States, his support within the Department of the Army, his control over much of the occupation bureaucracy, and the respect he commanded within his the Japanese government. While there was a change of direction in the occupation in 1947—the so-called "reverse course," MacArthur, retained substantial power over tax reform.

In 1946, MacArthur had established tax reform as a primary tool for the democratization of Japan. That year, MacArthur launched his effort to promote democracy through tax reform through the appointment of Leo Cherne, who took the leadership in designing a proposal for an anti-zaibatsu tax.[3] (For the timing of his appointment, and of many of the other key events discussed in this paper, see Table 1.) In 1947 MacArthur continued by promoting income tax reforms loosely based on New Deal models. But the new taxes, coupled with accelerating inflation, overwhelmed the systems for assessment and collection, leading in 1947 to taxpayer resistance and a wave of strikes by employees of regional tax offices. At the same time, MacArthur began to have doubts about the New Deal-style tax program, worrying, as Moss later recalled, that "it was going to be just a hodgepodge without any overall plan." In November MacArthur met with Moss, who had helped MacArthur with tax problems in the Philippines, and invited Moss to devise "an equitable tax structure, fairly administered irrespective of the level or rank of the citizen." Moss recalled that MacArthur insisted that the new system "had to be administered in a manner that would cause the taxpayer to respect his government." In a two hour conversation, MacArthur "reviewed the tax systems of about fifteen or twenty countries of the world, over a period of a couple centuries. Moss was "shocked and amazed at his knowledge." MacArthur, Moss remembered, "knew precisely what he

[3] Andrew F. Smith, *Rescuing the World: The Life and Times of Leo Cherne* (Albany: State University of New York Press, 2002). 37–41 and 51.

wanted."[4]

Table 1

Time Line for Shoup conflict Dodge over Tax Reform in Japan during the Occupation

August 15, 1945:	Japanese Surrender in World War and Beginning of Occupation
May 1946:	Tax Mission of Leo Cherne
Winter of 1947–1948:	Beginning of "Reverse Course" of the Occupation
November 1947:	Recruitment of Harold Moss by General Douglas MacArthur
April 1948:	Beginning of service of Harold Moss in SCAP
September 1948:	Recruitment of Carl S. Shoup by MacArthur and Moss
December 1948:	Declaration of nine-point program of Joseph Dodge (i.e., the "Dodge Line")
February 1949:	Arrival of first Dodge Mission in Japan
May 10, 1949:	Arrival of first Shoup Mission in Japan
September 15, 1949:	Transmission of report of first Shoup Mission to the Japanese government
October 1, 1949:	Proclamation by Mao Zedong of People's Republic of China
November 1949:	Return of Joseph Dodge to Japan for budget negotiations
January-March 1950:	Enactment by the Japanese government of many of the "Shoup Reforms"
May 1950:	Visit of Ikeda to Washington, D.C. and New York City
June 25, 1950:	Formal beginning of the Korean War
August 1, 1950:	Arrival of second Shoup Mission in Japan
September 14, 1950:	Announcement by President Truman of peace negotiations without the U.S.S.R.
September 15, 1950:	Transmission to Japanese government of report of second Shoup Mission
October 1950:	Return of Joseph Dodge to Japan for budget negotiation
January 1951:	Beginning of roll-back of Shoup reforms by Japanese government
July 1951:	Closing of SCAP's Internal Revenue Division; return of Moss to IRS in Washington, D.C.
April 10, 1952:	Firing of General MacArthur by President Truman

Moss arrived on the scene in Tokyo in April 1948, and, with MacArthur's unflagging backing, quickly became the dominant figure in managing tax issues within the Economic and Scientific Section (ESS) of SCAP. MacArthur carved out an Internal Revenue Division (IRD) from the Finance Division of the ESS and made Moss the Director of the IRD. However, these moves created a set of serious tensions within the ESS. The Finance Division, directed by Eugene M. Reed, resented the loss of control over SCAP's tax policy. And, Henry Shavell, an economist whom MacArthur had appointed as Tax Advisor within the Finance Division to assist Leo Cherne, was disappointed to lose his status as the leading tax specialist within the ESS. Shavell became Moss's Deputy Director and immediately began to try leaving SCAP. He became a secret, paid contributor to Cherne's newsletter, *Foreign Report*, and in late 1948 and early 1949 seriously considered an offer from Cherne of a permanent position within his Research Institute of America. But Shavell turned it down, deciding to mark time within the ESS until the end of the occupation when he might launch an international business career in Japan. He told Cherne: "I know that I'm giving up promotional possibilities, experience, seniority, and the mental satisfaction of being settled in a permanent organization. On the other hand, I will return from Japan with some 15,000 pesos in my pocket. I will also have opportunities there for foreign trade deals . . . which may or may not materialize.

[4] Interview of Harold Moss by Dick K. Nanto, July 21, 1973, Arlington, Virginia, in "Fiscal History News," Ministry of Finance, Japanese National Library. I am very grateful to Muramatsu Ryo for providing me with a copy of the interview transcript.

Thirdly, our way of life there will be more conducive to long life—maids, large houses, golf, billiards every lunch 'hour', etc." Shavell did not share Moss's enthusiasm and energy for fundamental tax reform, and was prepared to undermine his efforts.[5]

The bureaucratic tension worsened when Moss proceeded to implement plans to expand the capacity of the IRD. In the Spring of 1948, Moss proposed, and once again MacArthur approved, extending an invitation to "a special mission of outstanding tax economists" that would come to Japan in order to "conduct a comprehensive survey of the national and local tax laws." The mission would, Moss hoped, provide the intellectual resources the IRD needed to design a major overhaul of the Japanese tax system. The charge of the mission would be to submit, Moss wrote, "appropriate recommendations to bring about a more equitable distribution of the tax burden among the various groups of the economy; a reallocation of the revenue sources among the national, prefectural [county-like], and local governments; and such other modifications of the tax laws as were considered necessary for the democratization of the tax system."[6] Moss recognized that these reforms might result in short-term revenue losses. But he shared MacArthur's belief that democratization of taxation—especially in the form of a more equitable distribution of taxes among groups and an increase in tax revenues for prefectural and local government—was necessary to establish the political legitimacy of the tax system, win popular support for it, and, as a consequence, strengthen, in the long-run, the revenue capacity of the tax system.

MacArthur, supported by the Department of the Army, gave Moss effective control over the appointment of expert personnel for the mission, and he used his power in ways that would produce the kind of tax policy recommendations that he favored. At the end of September 1948 Moss had an extended conversation with Carl S. Shoup, and on October 1 Moss wrote to the Army indicating that Shoup would probably head the mission.[7]

III. INTERVENTION BY THE DODGE MISSION

At the same time that Moss advanced his reform program, including the organization of the Shoup mission, other economic missions also began to turn to tax reform, but under the aegis of the National Advisory Council (NAC), dominated by the Treasury Department and the Federal Reserve Board. These missions paid only limited attention to taxation, impressed by the success of both the 1947 reforms and SCAP's surveillance efforts to generate tax revenues and thereby contribute to inflation fighting.[8] In the Fall of 1948, however, just when Moss was finishing his organization of the Shoup mission, the NAC persuaded the National Security Council (NSC) to promulgate a directive that

[5] Henry Shavell to Leo Cherne, January 13, 1949, Leo Cherne Collection, Howard Gottlieb Archival Research Center, Boston University.

[6] Harold Moss, "Historical Summary of the Japanese Tax System," June 30, 1951, RG 331.

[7] L. H. Moss to Mrs. Wells, OAB, CPED, OSA, "Tax Mission to Japan," October 1, 1948, Box 2144, file folder: "Taxes, Shoup Mission 1949," RG 331.

[8] On the views of the most important of these missions, see "Report of the Special Mission on Yen Foreign Exchange Policy," Ralph A. Young, Chairman, June 12, 1948, copy in Series 4 No. 4, Folder 196, CSYNU.

threatened to preempt the work of the Shoup mission. The directive, which MacArthur and SCAP had to embrace, established a nine-point program, the core of which required budgetary stringency and an aggressive search for new tax revenues. A supplementary directive required the imposition of a single exchange rate for the yen. To implement this program, the Truman administration fast tracked a new mission, sending it into Japan ahead of Shoup.

The new mission arrived in February 1949, under the command of Joseph Dodge.[9] His appointment by President Truman directly, and the latitude which the NAC extended to Dodge, meant that he had great flexibility to pressure the Japanese Government, under Prime Minister Yoshida Shigeru, to implement the nine-point program, which became known as the "Dodge line." Dodge urged Finance Minister Ikeda Hayato to forget about ways to enhance tax equity, despite the fact that they might help to reduce taxpayer complaints. "While it is always advisable to eliminate inequities," he lectured Ikeda in early March, "it is even more desirable to have revenues under present conditions." Moreover, he believed that the transactions tax" which Ikeda wished to repeal, "was particularly appropriate to control consumption in an economy."[10] Later that month, Dodge grew even more concerned about lost revenues when Ikeda began talking about making tax administration less arbitrary.[11]

Moss could see a conflict coming between himself and Shoup, on the one hand, and Dodge, on the other hand. Moss knew that both Dodge and Secretary of the Treasury Snyder expected that the Shoup mission would focus on enforcing the Dodge line.[12] But Shoup, following the charge from Moss, sought tax reform that would promise to enhance democracy. That program aspired to strengthen revenues in the long-run, but Moss realized they might weaken them in the short-run. In the wake of Dodge's appointment, Moss took pains to protect both the independence of the Shoup mission and the prospects for tax reform. Moss confirmed the support of MacArthur, and in March 1949, in the General's formal announcement of the Shoup mission, he included a description of its assignment that went far beyond simply a reinforcement of the Dodge line. The mission, MacArthur declared, would work "closely with selected top Japanese tax specialists" and outline "a plan for the revenue of the Japanese tax system along more equitable, modernized, and productive lines." In addition, MacArthur mentioned an expectation that Dodge and Ikeda had never discussed in detail: developing a policy

[9] For excellent surveys of the Dodge mission, see Shigeto Tsuru, *Japan's Capitalism: Creative Defeat and Beyond* (Cambridge: Cambridge University Press, 1993), 46–54; and Howard B. Schonberger, *Aftermath of War: Americans and the Remaking of Japan, 1945–1952* (Kent, Ohio: Kent State University Press, 1989), 198–235.

[10] Joseph M. Dodge, "Summary of Meeting with Finance Minister Ikeda on the Japanese Government Budget held 3 March from 1400 to 1645," March 4, 1949, Box 5976, file folder: "Dodge Mission—Jan-May 1949 Meetings with Fin Min Ikeda," RG 331.

[11] "Summary of Meeting with Finance Minister Ikeda from 0830 to 0945, 24 March, and with Five Party Leaders from 0945 until Noon," Box 5976, "Dodge Mission—Jan-May 1949 Meetings with Fin Min Ikeda," RG 331.

[12] "Oral History Interviews with John W. Snyder, Truman Presidential Library, and http://www.trumanlibrary.org/oralhist/snyder47.htm#1927, 1405 and 1927.

for a drastic element of fiscal reform: reallocating "tax revenue sources among the national, local, and prefectural governments."[13] Early the next month, Moss felt confident enough to push Shoup in directions that even more clearly pointed toward conflict with Dodge. Moss encouraged Shoup to think hard about tax cutting, Keynesian analysis of the Japanese budget, and comprehensive tax reform, including a restructuring of local taxation. With this encouragement, Moss revealed that he begun to harbor doubts about the kind of aggressive assault on inflation that Dodge was launching.[14]

Simultaneously, Dodge elaborated and toughened his position on the budget. He was concerned that the interest of Moss and MacArthur in reform, coupled with pressure from MOF and Japanese public opinion for immediate tax cuts, would overwhelm Shoup, whom Dodge hoped would back up his tough anti-inflationary polilcies. Dodge issued a stern press release and advised the Army that SCAP should try to stiffen the backbone of the Shoup mission. The mission, he wrote, "will require thorough indoctrination" regarding "work already done here."[15] The next day the Diet adopted the stringent "Dodge budget" for fiscal 1949, and within a week Dodge announced the decision to adopt an exchange rate of 360 yen to the dollar. Dodge remained opposed to any tax cutting, and lacked interest in fundamental tax reform, which he thought was highly unlikely to occur. In fact, he ridiculed the democratization program of the occupation, describing its New Deal architects as wanting to turn the Japanese into "democrats by edict."[16]

IV. CRAFTING THE SHOUP RECOMMENDATIONS

The swift emergence of the Dodge mission left Shoup with little time to develop a strategy to cope with the latest mission. Shoup saw clearly the potential for conflict with Dodge over short-term tax changes, expenditure programs, and even tax reform. Shoup considered developing a personal relationship with Dodge, whom he had never met. Shoup was not intimidated by Dodge. Shoup had grown up in a circle of family and friends more powerful than Dodge, and in his New York and Washington careers worked comfortably in circles of power and wealth. But Shoup recognized that a closer relationship with Dodge might lead to reduced flexibility for the Shoup mission. Consequently, Shoup decided to keep his distance from Dodge, and to focus on indirect intelligence gathering in Washington, Tokyo, and Detroit.

13 Radiogram, SCAP to DEPT OF ARMY, "Shoup Mission," March 29, 1949, Box 6369, unmarked folder. RG 331.

14 Harold Moss to Carl S. Shoup, April 5, 1949, Box 7637 and Harold Moss, "Informal Memorandum for Mr. Shoup, April 13, 1949, Box 7637, file folder: "9 TR-60 Shoup Tax Mission," RG 331. Harold Moss had developed an interest in the use of taxation within the framework of Keynesian counter-cyclical fiscal policy. For a discussion of the growth of this kind of interest among experts within government during World War II, see Herbert Stein, *The Fiscal Revolution in America* (Chicago: The University of Chicago Press, 1969), 169–196.

15 Radiogram "For West from Dodge," April 19, 1949, Box 5976, file folder: "Dodge Mission—Jan-May 1949 Reference Folder," RG 331.

16 Quoted in Schonberger, *Aftermath of War*, 201.

Shoup went to Washington where he read the cables of the Dodge mission and conferred with Ralph Young, two members of the Dodge mission (including economist Audley Stefan of Rutgers University) and various NAC staffers. Shoup came away skeptical of both the anti-inflationary effectiveness of the Dodge fiscal program in the face of the policies of the Bank of Japan and Dodge's economic recovery strategy.[17] Shoup also sent ahead to Tokyo Jerome Cohen, an economist at New York University who was an associate member of the mission and had recently worked at the State Department on Asian economic issues. Cohen's tasks included scouting out the Dodge mission and studying the anti-inflationary effects of the Dodge program.[18] And, Shoup enlisted Columbia law professor, William Warren, Shoup's closest personal friend on the mission. In the middle of June, on his way to Tokyo, Warren stopped off in Detroit to interview Dodge.

Warren's visit was particularly revealing. He learned that Dodge not only stood firm behind his anti-inflationary line but had taken up interest in a tax reform program that differed greatly from one based on the principles of Robert Murray Haig. Dodge had recently broached these new ideas with Marquat. "It occurs to me," Dodge wrote to Marquat on June 1, "that there is possibility of doing something particularly constructive in connection with the question of stimulating industrial capital investment," particularly in export industries. "From the standpoint of the United States, this is particularly necessary." Dodge harkened back to America's policy of accelerating depreciation allowances for new investment during World War II. He told Marquat that "undoubtedly this idea will occur to Dr. Shoup and I certainly believe it is worth exploring." He added that this kind of "constructive program" might follow "a resolution of the problem of plant revaluation." In mid-July, Dodge wrote to Warren that he was watching "some of the programs conceived in Europe to stimulate capital investment and accumulation." He explained that both Belgium and England have adopted programs that accelerated depreciation," and enclosed an article from the *Economist* on the British program.[19]

During nearly all of the time that the Shoup mission spent in Japan in the spring and summer of 1949, the Shoup mission had no direct contact with the Dodge mission. In addition, Shoup did his best to avoid consultation with the elements of SCAP that were closest to the Dodge mission. That meant primarily the Division of Finance and its chief, Eugene Reed; Shoup had only one meeting with Reed, the day after Shoup arrived in Tokyo.[20] This may have given Shoup a greater sense of independence, but Dodge kept in touch with Shoup's progress through a powerful back-channel relationship he cultivated with Marquat.[21]

[17] Memorandum to Howard Bowen, Rolland Hatfield, Stanley Surrey, William Vickrey, and William Warren," undated (but post-April 28, 1949), Series 4 No. 4, Envelope 118, CSYNU.

[18] Jerome Cohen to Shoup, April 19, Cohen Series, 1 No. 1, CSYNU.

[19] Dodge to Marquat, June 1, 1949, Warren to Dodge, June 21, 1949, and Dodge to Warren, July 11, 1949, Japan 1949, Box 3, Correspondence Files, JDDPL.

[20] Audley Stefan to Dodge, September 3, 1949, Japan 1949, Box 1, Budget Files, JDDPL.

[21] On this relationship see, for example, Marquat to Dodge, June 19, 1949, Japan 1949, Box 2, Budget Files, Correspondence Files, JDDPL.

Shoup had to shift tactics, however, during his final drafting of the mission report, when a severe conflict over the macroeconomic landscape seemed possible. Shoup had assigned the macroeconomic analysis to William Vickrey, asking him to assess the "amount of tax revenue needed to avoid inflation and deflation." Shoup posed a pointed question for Vickrey: "Can we make any useful guesses on this, or must we accept a balanced budget as a rule of thumb—or should we assume as the Dodge mission seemed to do, that any surplus obtainable is all right." Thus, Shoup was positioning his mission to challenge in a direct fashion one of the central assumptions that guided the economics of the Dodge mission.[22] Vickrey's guesswork, based on estimates provided by the Ministry of Finance, did not satisfy Shoup but high unemployment rates and signs that deflation threatened made Shoup and his colleagues uncomfortable in adhering closely to the Dodge line on budget discipline.[23] But, they were not prepared to challenge Dodge directly. They preferred to determine what was the latest Dodge line regarding the budgetary parameters and, if there was a disagreement, engage in persuasion or find some way to work around it.

On July 9, Shoup sent a radiogram to representatives of the Departments of State and Treasury, and of the Federal Reserve Board, on the NAC. He reported that the mission had almost completed the "fact finding phase" of its work; that it had just spent a week "devoted chiefly to lengthy sessions" with MOF on the "entire range of tax problems;" that it was ready to formulate their recommendations; and that it needed further guidance with regard to the fiscal situation both in the United States and Japan. He noted that that the Japanese government proposed to reduce its net subsidies of food and raw material production by 100 billion yen in fiscal year 1950–51 and then suggested that unless Japanese taxpayers were not "given tax relief of about 100 billion yen"—relief that would offset the reduced expenditures on subsidies—there might be "too much deflation." For the first time, Shoup had asked Dodge and the NAC for advice.[24]

In response, alarm bells went off in Detroit and Washington, and what followed was a teleconference involving about 20 participants in Tokyo and Washington. In the extended and wide ranging conversation, Shoup and his colleagues discovered a wide gap in the details of economic policy between their mission and the NAC and Dodge. In the process, the Shoup forces exposed flaws and inconsistencies in the economic arguments of the NAC representatives, pointed out that they lacked adequate measures of the effects of either monetary or fiscal policy on price levels, demonstrated a superior command of the details of economic conditions in Japan, and suggested that the Shoup mission ought to address the expenditure side of the budget. The discussions revealed

[22] Undated notes by Shoup, Series 4 No. 4, Envelope 116, CSYNU.

[23] In his analytic endeavors Vickrey was handicapped by what Tsuru Shigeto called the inadequacy of the "woof" of the tax system. Tsuru wrote that "a tax system is like a woven cloth requiring both warp and woof. If the methodology is the warp, actual relevant statistical data constitute the woof; and the latter had to be provided by the Japanese bureaucracy." Tsuru, *Japanese Capitalism*, 53.

[24] Radiogram, Shoup to West, July 9, 1949, Box 7631, file folder: 9 TR-60 Shoup Tax Mission," RG 331.

a clear difference between Dodge (and the NAC) and the Shoup mission in their approach to fiscal and monetary policy. The Dodge group was more willing than Shoup and his colleagues to risk deflation, economic contraction, and unemployment for the sake of promoting capital formation. The Shoup mission also sought to promote capital formation but was more concerned about unemployment in the short-run and the undermining of consumer demand in the long-run. In their greater emphasis on maintaining the strength of consumption, both in the short-term and the long-term, the Shoup group was decidedly more Keynesian than Dodge and his colleagues. Shoup reported to his family back in New York that "we discussed (and argued) about the current financial situation in Japan–is it too deflationary or is inflation still the danger?"[25] Shoup did not get very far in persuading Dodge and the NAC of the risks of deflation, but he left the door open for tax reductions beyond the current fiscal year. And, he avoided any discussion, and hence unwanted consultation, over tax reforms that his mission might propose.[26]

The next day, Shoup briefed MacArthur as to the mission's tentative conclusions. MacArthur proved to be positive, "asking, then insisting, that our whole mission come back in a year for a short stay to check up on the results of our reform."[27] Shoup then immediately drafted a preview of his report's "preliminary" chapter, which discussed the fiscal implications of the mission's recommendations, and a "secret" set of "preliminary conclusions" for MacArthur. In both the chapter preview and the secret summary, Shoup and his group attempted to establish distance from the Dodge line. In the chapter preview, Shoup and his colleagues said they would follow the line by not recommending any tax reductions for the current (1949–1950) fiscal year. But they signaled their unease with this position by formulating two alternative budget scenarios tax programs for the next year (1950–1951). One of them was for tax cuts if "a strong deflation takes hold and unemployment becomes very large." Shoup's thinking was Keynesian: "taxes should be cut, to strengthen the public's purchasing power."[28]

In his final report, Shoup pitched his message to the Japanese people, hoping that the positive public reception that had greeted much of the democratizing agenda of the

[25] Shoup to his family, "Extracts," July 24, 1949. Carl S. Shoup, "The Tax Mission to Japan, 1949–1950," Paper prepared for the Center for International Development Research in the Institute of Policy Sciences and Public Affairs, Duke University, copy in Martin Bronfenbrenner Papers, Duke University, Appendix B: Extracts from Letters by Shoup from Japan, May–August, 1949 (subsequently cited as "Extracts"), July 24, 1949 entry. I have found none of these letters in the Shoup Papers in the Library of Yokohama National University.

[26] Department of the Army, Teleconference transcript, "Taxation in Japan—Ref. Cable 51322," July 23, 1949, Box 8355, file folder: "Shoup Tax Mission," RG 331.

[27] Shoup to his family, "Extracts," July 24, 1949.

[28] Moss described Shoup's chapter as establishing "the basic framework for his entire tax program." Harold Moss to Major General Marquat, "Analysis of Dr. Shoup's Draft Chapter on Revenue Needs," August 4, 1949, Box 7631, file folder: 9 TR-60 Shoup Tax Mission" RG 331; Shoup to SCAP, "Subject: First Set of Preliminary Conclusions," July 29, 1949, MacArthur series, CSYNU. Jerome Cohen also had reservations about the extent of "super-balancing." See Jerome B. Cohen, "Fiscal Policy in Japan," *The Journal of Finance*, 5 (March 1950), 115.

early occupation would extend to the mission's tax proposals.[29] In so doing, Shoup also laid the groundwork for a future break from Dodge's stringency. In particular, the mission proposed various cuts in national taxes—cuts in high marginal rates of personal income taxation, repeal of excess-profits taxation, and repeal of the transaction taxes—that the mission hoped would take effect during the 1950–1951 fiscal year. That year, according to the mission's projections, the cuts would reduce revenue about 100 billion yen in the national budget. And, Shoup went on to draw an exceptionally elaborate and intricate blueprint for a thoroughgoing reconstruction of the Japanese tax and fiscal system. The scheme for fundamental reform was extraordinarily ambitious—far more ambitious than Dodge dreamt it would be. And, the report presented all of its key recommendations, including the possible tax cuts, as integral parts of a single package of tax reforms.[30]

V. RESISTANCE TO SHOUP

Moss moved swiftly to get the report in print, wanting to make it public and get it into the hands of the Japanese government before American dissidents inside SCAP, particularly supporters of Dodge, found a way to weaken the force of the proposals. In fact, the most difficult political challenge Moss would face was selling the Shoup program within the American bureaucracies of occupation. When Moss wrote to Marquat on September 10th to announce his publication plans, Moss had not united ESS, or even his own division, the IRD, behind the report. Within the ESS Moss faced powerful antagonists, the strongest of which was Eugene Reed, who continued to act as Dodge's proxy, and Audley Stefan, who had become Dodge's closest economic advisor after service on his mission. Reed and the Finance Division took the position that the Shoup recommendations, particularly the value-added tax, would fail to produce adequate revenues for municipal and prefectural governments. Shoup's proposed cuts in, or repeal of, income, corporate, and transactions taxes also raised concerns. These tax reductions, coupled with inadequate value-added taxes, Reed and the Finance Division argued, might lead to excessive deviation from the deflationary Dodge line.[31]

The dissidents with the ESS included not only Reed but also Moss's own deputy Henry Shavell and other members of the IRD. They had various reasons for their lack of enthusiasm or hostility to the Shoup mission. The most talented members of Moss's staff were administrative technicians specializing in tax enforcement, and they often

[29] On the extent and significance of this public support, see Takemae Eiji, *Inside GHQ: The Allied Occupation of Japan and its Legacy* (New York: Continuum, 2002), xxxix–xliii, and 201–454 passim.

[30] In early August, after receiving a preview of Shoup's recommendations, Dodge did not offer any explicit support for them. He expressed some sympathy for "sound changes" in taxation and added a crucial qualification—his support for "appropriate changes" would be forthcoming only after the Japanese government had "successful maintained the Stabilization program." Dodge to Ralph Reid, August 10, 1949, Japan 1040, Box 9, File: Shoup Recommendations, JDDPL.

[31] Walter E. LeCourt, Japanese Finance Division, to General Marquat, August 27, 1949; Harold Moss to Major General Marquat, "ESS/FIN Memo re. Shoup Report, September 1, 1949, Box 7637, file folder: "9 TR-60 Shoup Tax Mission," RG 331.

had legitimate worries about the assessment and collection of new taxes. They, and the other critics within the IRD, tended to condemn particular elements of Shoup's program rather than oppose the entire package, focusing on one or more of its most innovative elements. Henry Shavell vigorously opposed three of the new taxes—the net worth, the accessions, and value-added taxes. His comments on the accessions tax pointed to friction between himself and William Vickrey, suggesting that he may have been suffering from a kind of professional jealousy or resentment over having been passed over for IRD Director.[32] The intellectual fire-power of the remarkable Shoup team could be intimidating, and several of its members experienced occasional lapses in applying the lessons in diplomacy which Shoup supplied.[33] In addition, Shavell and others within the IRD may have unenthusiastic about the steep political, bureaucratic, and technical mountains that had to be climbed in order to implement Shoup's program. Many of them were time-servers enjoying a comfortable life in the privileged status of occupiers. As Bronfenbrenner observed, at times they grumbled that the Shoup group was too "pro-Japanese.[34] Indeed, what united the dissident experts within the ESS with Dodge was their shared conviction that the Japanese government could not be trusted to balance budgets; that Japanese taxpayers were not ready for a system that relied heavily on voluntary compliance; and that Japanese administrators, particularly at the local level, were incompetent.

Dodge received information on the Shoup report from various sources, but one of the most important was the chief of the ESS, General William Marquat. As one of the "Bataan Boys," he was close to MacArthur, but lacked his boss's enthusiasm for tax reform. Even before the Shoup report appeared in print, Marquat wrote to Dodge that "I strongly urged that it [the Shoup report] not be published in detail in the public press until Washington had examined it." He explained that "I feel that there are a number of provisions in this report that are extremely academic which should be discussed with you before the program is carried out." The problem, he told Dodge, was Moss. He "seems to be in complete control." Marquat went on to encourage Dodge's future intervention. While "the 'green light' attitude seems to prevail" with regard to implementing the Shoup report, "of course we will not hesitate to battle on any issue found to be in need of readjustment." Marquat ended by reminding Dodge of the nature of their secret back-channel relationship: "Please, Joe, consider these letters confidential."[35]

On September 12, Dodge responded to what he heard from Marquat, Stefan, and members of the NAC and attempted to head off departures from the Dodge line that the Shoup report might prompt. "There is some concern among the authorities in Washington on two counts," he wrote to Moss. "First as to whether the recommendations, if

[32] Henry Shavell to File, "Exceptions to the Shoup Report – Accessions Tax, October 9, 1949, Box 7637, file folder: "9 TR-60 Shoup Tax Mission," RG 331.

[33] On one of these issues, involving Jerome Cohen, see Brownlee, "The Shoup Mission to Japan: Two Political Economies Intersect," 252.

[34] Martin Bronfenbrenner offered scathing criticism of the latter. Bronfenbrenner, "Marginal Economist," unpublished autobiography, Special Collections, Duke University, Chapter 15, 4–5.

[35] Marquat to Dodge, September 11, 1949, Japan 1949, Box 3, Correspondence Files, JDDPL.

completely adopted, will tend to be inflationary, and second, the celerity with which the Japanese politicians advocate a Special Session of the Diet to reduce taxes according to the recommendations." He ended on an ominous note: "Before he returns to Japan I expect to see Gene Reed. On the telephone I suggested to him that he should go to Washington and discuss the Budget problem with the men at the technical level at State, Treasury, and Army."[36]

The next day, Dodge warned Jerome Cohen in a similar fashion about the negative attitude developing within the NAC toward the intentions of the Japanese government and the prospects for tax reform. "There is some concern here about the way in which the Japanese politicians immediately turned the recommendations of the Shoup Report into an excuse for a Special Session of the Diet and proposals for immediate tax reduction." Dodge saw the signs of "a program designed to create a money crisis, and to use it to break the Budget." He concluded: "Regardless of the merit of the Shoup proposals, I believe we have to be careful about initiating any substantial tax reductions until the actual results of the operation of this year's Budget are known and the Budget for next year has been clearly established."[37] Dodge was, in other words, recommending against the Shoup approach of bundling budget authorization and tax reform into a single package. Dodge forwarded the letter to Marquat with the comment: "In Washington there is some concern that the Shoup proposals may be inflationary if enacted in toto and not after definitive accomplishment with respect to this year and next year's budget." He added the same warning he had given Moss: "Next week Eugene Reed is coming up from Cleveland to see me."[38] A few days later, another letter from Stefan reinforced Dodge's concerns. "Harold [Moss] must have sold a bill of goods to Shoup," he told Dodge. Stefan's general "reaction" to the Shoup proposals: "considerable fear that the balanced budget provided by the Dodge Mission has its days numbered."[39]

VI. BUDGET NEGOTIATIONS AND THE DEFEAT OF COMPREHENSIVE TAX REFORM

During September and October, quarrels intensified within both the IRD and the ESS regarding the Shoup program. They were sufficiently severe to force MacArthur, acting on Moss's recommendation of a diplomatic move: embracing the Shoup proposals "in principle" rather than endorsing specific proposals or issuing a directive for their enactment. Moss could not entirely contain the internal rifts, particularly over Shoup's more innovative proposals, even within the IRD, and Moss worried that the divisions might make it easier for Dodge to ignore the reform program. The timing was crucial because in early November Dodge would return to Japan in order to lead the negotiation of both a supplementary budget for the current fiscal year (1949–1950) and the regular budget for the following one (1950–1951). And, the NAC would continue to give Dodge broad discretion in negotiating budgetary details with the Japanese government.

36 Dodge to Moss, September 12, 1949, Japan 1949, Box 3, Correspondence Files, JDDPL.

37 Dodge to Jerome Cohen, September 15, 1949, Japan 1949, Box 1, Budget Files, JDDPL.

38 Dodge to Marquat, September 16, 1949, Japan 1949, Box 2, Correspondence Files, JDDPL.

39 Stephen to Dodge, September 16, 1949, Japan 1949, Box 9, File: Shoup Recommendations, JDDPL.

To improve the odds that Dodge would support portions of the reform program, Moss mobilized Shoup behind an effort to assure Dodge of his support for the hard anti-inflationary line. Moss prompted Shoup to write to Dodge expressing loyalty to the Dodge agenda and, for the first time, offering to meet in the same room with Dodge. But Dodge evaded Shoup."[40] Meanwhile, in late October, Moss reviewed with Dodge the key recommendations of the Shoup report, playing down the importance of the innovative taxes the mission had proposed. Moss asserted that there really was nothing new in the report. "The Shoup Mission, after an independent survey of the Japanese tax system," Moss wrote, "has in effect reached the same general conclusions previously held by this Division."[41] To the extent that Moss reviewed the details of Shoup's tax program, he emphasized pragmatic reasons for supporting it—the promise of the plan for the two-fold purpose of promoting revenue capacity and encouraging political stability. Moss first reminded Dodge of IRD's record of success. "For the past several years we have been bringing the revenue in through such unprecedented and unorthodox devices as Allied Military Government 'pressure-type tax surveillance," and through assignment of target dates and collection goals to each and every tax office." This has worked "beautifully" to bring in "the revenue." Moss then played the "Red card." These devices, however, "at the same time. . . aggravated, and seriously so, taxpayer morale, and gave aid and comfort to the existing full scale Communist Party championing of the 'over-burdened and under-privileged Japanese taxpayer.'" In sum, Moss wrote: "it is primarily to bring about a change from the existing 'black-jack' technique of bringing the taxes in to a more permanent, automatic, and more democratic tax system, that Dr. Shoup has directed his efforts." To allay Dodge's concern about the short-run decline in revenue that the Shoup reforms might produce, Moss reassured him about the success of the IRD's current efforts, including the adoption of civilian surveillance, to raise new revenues.[42] Tax collections grew persistently larger, despite the deflation that the Dodge line had help produced. The surveillance system that the American occupation and the Japanese government had jointly created was effective, at least in the short-run, in producing revenue. At the end of October, Moss told Dodge that he was optimistic about tax collections and the progress of tax administration "since your departure last spring." Buoyant revenues would increase deflationary pressures even further, Moss argued, giving Dodge more of what he wanted while removing a barrier to tax reform.[43]

During Dodge's budget negotiations in November and December, Moss provided no

[40] Dodge to Shoup, October 21, 1949, Joseph M. Dodge Series, Shoup Mission, Mission Correspondence, Series 1, Box No. 1, CSYNU.

[41] See Moss to Joseph M. Dodge, October 28, 1949, Box 7631, "9 TR-60 Shoup Tax Mission," RG 331.

[42] Harold Moss, "Memorandum for Mr. Dodge: Supplementary Budget Tax Changes," November 3, 1949, and Harold Moss, "Memorandum for Mr. Dodge: Tax Changes for Current Fiscal Year," November 3, 1949, Box 7637, file folder: "11 RF-11 Dodge Reports;" Moss to Joseph M. Dodge, October 28, 1949, file folder: "9 TR-60 Shoup Tax Mission," RG 331.

[43] Harold Moss to Mr. Dodge, "The Progress Report," October 31, 1949, Box 7637, file folder: "11 RF-11 Dodge Reports; Harold Moss to Jerome B. Cohen, November 18, 1949, Box 7631, "9 TR-60 Shoup Tax Mission;" and Harold Moss to File, "Historical Report for 1949 of Internal Revenue Division, ESS, January 20, 1950, Box 6836, file folder: "Taxation," RG 331.

information to Shoup about the nature of the agreements between Dodge and the Japanese government, and only vague information about the status of conversations between the IRD and the Japanese government over Shoup's most controversial proposals: the reforms of local taxation. Moss referred to major problems with "the Japanese proposed local tax bills." They appeared to be, Moss reported, "In many respects. . . down-right inconsistent with your report and the understanding we reached them with several weeks ago as to the principles to be followed in drafting the legislation."[44]

The lack of information about Dodge's negotiations, coupled with the warnings about threats to local tax reform, left Shoup and his colleagues agonizing well into January about what might be the results of the latest swoop of Dodge into Japan. Just after the New Year, Shoup sent the correspondence he had had with Moss to all the other members of the mission, alerting them to the threat to the reform program. Rolland Hatfield, the member who had the least contact with Shoup since the summer, was the boldest and most explicit in putting his fears in writing. After he read the circulated correspondence, he wrote that "the arrival of Mr. Dodge in Japan is certainly a serious matter as far as the ultimate success of your recommendations is concerned." He doubted that Dodge "understands what we were trying to do and because of the very considerable influence he has over Marquat I am very much afraid that some serious 'compromises' might be made." Your correspondence, Hatfield wrote, "reads like an old time drama. The villain is now in the center of the stage—and I am anxiously awaiting the next installment."[45]

Even before Shoup had signaled his colleagues, however, the next installment had already played out in Tokyo, and the reason for Moss's delay in reporting to Shoup became clear. Moss had suffered a major defeat. Just as Shoup had feared, Dodge had deliberately sacrificed tax reform in his negotiations with Ikeda. To be sure, Dodge bargained from strength in that an NSC directive backed up his "line." Nonetheless, he accepted cuts in the personal income tax that Ikeda wanted (even more generous and rapid than Shoup had recommended) and the repeal of the transactions without insisting on comprehensive tax reform. At the same time, Dodge agreed to Ikeda's request to cut support for the Tax Administration Agency by a million yen in fiscal year 1950, thus diminishing prospects for enacting all of the administrative reforms Shoup had proposed. Finally, Ikeda won support from Dodge for MOF efforts of the Ministry of Finance to use tax expenditures on behalf of industrial policy. For Dodge, this was no great concession, consistent with the kind of tax cuts he preferred. Partly as a consequence of his decision not to bargain for comprehensive tax reform, Dodge's negotiations with Ikeda sailed along smoothly, and Yoshida deftly finessed that lack of tax reform by

44 Moss to Shoup, December 15, 1949, Box 7637, file folder: "9 TR-60 Shoup Tax Mission." RG 331.

45 Shoup to Bowen, January 3, 1950, Bowen Series; Rolland Hatfield to Carl Shoup, January 17, 1950, Hatfield Series, Shoup Mission, Mission Correspondence, Series 1 Box 1, CSYNU.

announcing that the program of cuts "would follow the Shoup recommendations."[46]

In short, the coherent reform package that Shoup had recommended and hoped the Japanese would adopt "as a whole" fragmented during the Dodge negotiations in late 1949. One might be tempted to attribute this outcome of these negotiations to the reactions of the Truman administration and the NAC to important events in late 1949—most important, the fall of China and a slowdown in the process of framing a peace treaty. The explanation would be that the support for an anti-Communist Japanese government had become decisively more important to the American occupation than the democratization of Japanese society. But this obscures the central role of the ongoing hostility of Joseph Dodge, backed up by the NAC, toward the kind of tax reform that Shoup favored. Dodge had never been a supporter of comprehensive tax reform along the lines of the Shoup report, and, the dissidents within the ESS had reinforced his concerns. Even before Shoup and his colleagues had returned home in September 1949, Dodge and his supporters within the ESS had undermined MacArthur's ability to support their program, and comprehensive tax reform had little chance of success.[47]

Of course, even if Finance Minister Ikeda and his Prime Minister had accepted, in late 1949, unqualified reform as the necessary price for significant tax reductions, their hostility to the most democratic elements of the Shoup program probably might well have eventually proved fatal to such reform. But early adoption of the entire Shoup package would have created more time for Moss, Shoup, and the economist Martin Bronfenbrenner, who functioned as a de facto member of the Shoup mission after it returned home, to win support for the Shoup reforms among Japanese tax experts, inside and outside of MOF. Moss, Shoup, and Bronfenbrenner labored industriously to engage their Japanese colleagues in improving tax administration; devising practical methods of implementing value-added taxation and equalization grants; building an intellectual infrastructure within the Japanese tax-policy community that would advance base-broadening and democratizing tax reform; and generating greater public support within Japan for that program. Shoup's approach was to invoke the imprimatur of MacArthur (or Dodge) to jump start fundamental reform, but then to work closely with Japanese experts, inside and outside the government, and to engage in a public relations campaign to win the

46 For the much more harmonious conferences between Dodge and Ikeda, see Joseph Dodge, Meeting notes, November 4, 1949, Joseph Dodge, "Summary of the Principal Points of Discussions with Mr. Ikeda and the Taxation and Budget Sections of ESS on the Japanese Budget, November 5, 1949, Joseph Dodge, "Memorandum of a Meeting with Finance Minister Ikeda Saturday Evening November 6th, at the Imperial Hotel," November 8, 1949, "Memorandum of Mr. Dodge's Interview with Mr. Ikeda Thursday, 1 December 1:30 to 4:00 pm," and "Comment on the Supplementary Budget Tax Issue from the Weekly Tax Report of the Internal Revenue Division, ESS November 5, 1949," Box 5977, file folder: "Dodge Mission Nov-Dec 1949 Meetings." See, also, "State of the National Economy Speech by Finance Minister on the occasion of the introduction of the 1949–1959 Supplemental Budget, November 15, 1949," Box 5977, file folder: "Dodge Mission—November-December 1949 Memoranda,"RG 331.

47 Bronfenbrenner later criticized the IRD for not using the "promise of national tax reductions" to win Yoshida's support for local tax reform, but the decision to abandon tax reform was Dodge's, not Moss's. For Bronfenbrenner's criticism of the political tactics of the IRD, see Martin Bronfenbrenner and Kiichiro Kogiku, "The Aftermath of the Shoup Tax Reforms, Part II," 347.

support of the Japanese people for his program.[48] He hoped the demonstrable economic and fiscal results from implementing his program would also help in his program of persuasion. But Dodge had left Shoup, Moss, and Bronfenbrenner with little time and only limited political openings to advance fundamental tax reform in Japan.

MacArthur lacked the power to enact Shoup's reform progam in late 1949. And, MacArthur's support for the Shoup reforms weakened as a consequence of the dissension within the occupation. But he had by no means given up on the Shoup recommendations as instruments to build a strong democratic state. On January 1, 1950, MacArthur, in the ritual of his annual New Year's Day statement, or harangue, to the Japanese people, heralded prospects for tax reform, and base-broadening reform as both equitable and efficient. "The implementation of the Government's plans to establish a more equitable tax structure and a fair and more efficient system of tax administration, will equalize the burden and, it is my hope, will permit substantial future tax reductions over a broad base."[49]

VII. SHOUP AS POLITICAL ENTREPRENEUR

With MacAthur's support, in early 1950, there was still a glimmer of hope for the Shoup reform. And, under continuous pressure from MacArthur, the Japanese government quickly adopted a limited program of reform. By the end of March, the Diet enacted into law, with relatively few modifications, the major rate and base changes in the personal income tax that the Shoup mission had recommended. The legislation included a net worth tax and some administrative reforms. In addition, the Diet adopted a "succession tax" based on the accessions that Vickrey had drafted and the Shoup mission proposed. At the same time, the Diet also enacted nearly all of the Shoup proposals for reforming the national taxes on corporations, including repeal of the excess profits tax and adoption of the revaluation of assets.

The most difficult debates followed, however. In January, the consideration of local financial reform—the enactment of value-added taxation, a restructured local property-tax, the Local Government Commission, and the equalization grant system—stalled. The ongoing hostility of Reed's Public Finance Division and the latitude that Dodge had given the Japanese government largely accounted for the delays. The legislative process proved exquisitely complicated and tedious, but Harold Moss still moved it forward. With the support of Bronfenbrenner, Moss did so through earnest collaboration with the Ministry of Finance and the strategic mobilization of MacArthur who, in early 1950, generally came down on the side of Moss rather than Eugene Reed. In the complicated effort to cope with both the Dodge forces and the Japanese government, Moss also increasingly called on Shoup to become involved not only to provide technical advice but also to play a role as political entrepreneur, participating directly in the negotiations.

[48] On the character of Shoup's conversations with Japanese experts, see Brownlee, "The Shoup Mission to Japan: Two Political Economies Intersect," 250–254.

[49] "General MacArthur's New Year Day Statement," January 1, 1950, Press Release, Box 2144, File folder:"Equalization Grant," RG 331.

At the same time, Shoup began preparing for his second mission, even though it was six months or more away.

In this process of involving himself more directly in the Japanese legislative process, while at the same time planning to return to Japan, Shoup came into more direct conflict with Dodge. The most dramatic occasion came in the spring, when Prime Minister Yoshida sent Finance Minister Ikeda to the United States to negotiate directly with the Truman administration over economic policy.[50]

In March 1950 Dodge learned of Ikeda's planned visit. He also learned that Moss's and MacArthur's plan to bring Shoup back to Japan the following summer had jelled, and that continued success at income tax collection had led Moss to propose revenue-threatening tax reform.[51] Dodge suddenly faced the possibility that Ikeda's visit would increase Shoup's leverage, and, as a consequence, the likelihood of tax reform. In response, Dodge quickly took steps to make certain that Shoup would work within Dodge's ongoing program of "fiscal control." He finally made a definite plan to meet Shoup in person, asking Shoup to join him in Washington late in April during Ikeda's visit. At the same time, without consulting with Shoup, he floated the idea of adding his own experts—two experts, economists Audley Stefan of Rutgers University and Paul O'Leary of Cornell Univesity, both of whom had accompanied Dodge on his first trip to Japan—to Shoup's mission. Dodge later told Stefan that he wanted him "to check the Budget and the price and wage situation. He needed, he stressed, someone like you to make a down-to-earth evaluation." Dodge's goal was to make certain that his assumptions about the economic and fiscal needs of Japan constrained the Shoup mission. His tactic blithely ignored the control that SCAP had given previously Shoup over the membership of his mission.[52]

During Ikeda's American visit in May, Shoup avoided any extensive contact with Dodge. They meet only briefly, at a large, festive dinner in New York City. Dodge and a working group that Dodge had organized within the National Advisory Council dominated the formal conversations with Ikeda. But, on May 14, toward the end of Ikeda's visit, Shoup convened his own meetings at Columbia. In a seminar room at the Law School, Shoup gathered Ikeda, Vice Minister of Finance Miyazawa Ki'ichi, Vickrey, Warren, Moss, and Ralph Reid–the leaders of MOF, the three Columbia members of the Shoup mission, the head of SCAP's IRD, and the Assistant Secretary of the Army. With this gathering, the Shoup missionaries, in a much more serious way than when they were in Tokyo, advanced tax reform in Japan. In the process of negotiating directly with Ikeda and Miazawa, under the protective cover of Reid, who represented the Department of the Army, Shoup direct challenged Dodge's control over occupation fiscal policy.

50 The decision was made in February. Marquat to Dodge, February 26, 1950, Japan 1950 series, Box 3, correspondence file, JDDPL.

51 Ikeda Hayato to Dodge, March 19, 1950, Japan 1950, Box 3, Correspondence Files, and Moss to Dodge, March 19, 1950, Japan 1950, Box 4, Correspondence Files, JDDP.

52 Dodge to Marquat, April 19, 1950, Japan 1950, Box 3, Correspondence Files; and Dodge to Stephan May 18, 1950, Japan 1950, Box 4, Correspondence Files, JDDPL.

At Columbia, the discussions had a special intensity because at the end of April the upper house of the Diet had given the local finance bill a kind of pocket veto. This was the very first time during the occupation that the Diet had turned down a bill favored by SCAP—producing what a very pessimistic prognosis for the future of Shoup-style democratic reform. At the end of the Columbia meeting, the participants produced a memorandum reporting a formal recommendation "to Ikeda by Shoup with Moss, Vickrey and Warren in agreement." In this agreement, Shoup and his colleagues proposed that the Japanese Government delay the enactment of the value-added tax for one year. It would take effect in fiscal year 1951–1952, and apply to value-added during the calendar year 1950.[53] For Shoup, the deal was attractive because it put off a defeat in his effort to reform local finance, and to adopt the pioneering value-added tax. Shoup and his colleagues would have more time to iron out the technical problems facing adoption of the value-added tax, and for Shoup to persuade Japanese tax officials of the merits of the tax. Also attractive to Shoup was an opportunity to intervene in the fiscal negotiations with the Japanese government and, provide a recommendation directly to the government without going through either SCAP or Joseph Dodge. This was, in fact, the first occasion that the Shoup mission had taken such a step.

VIII. CONFLICT OVER SHOUP'S RETURN

Shoup's intervention moved Dodge to strengthen the parameters of economic assumptions which would govern Shoup's second visit to Japan. Dodge even tried to win Bronfenbrenner's political support for that effort, knowing that Bronfenbrenner took a harder line on inflation than did Shoup. Dodge wrote: "I am not convinced there is a firm assurance that the fight to conquer inflation is a complete and permanent victory." He concluded: "There is one point I believe we all have to keep in mind continuously. The almost frantic efforts of the Japanese to break the Stabilization Program suggest that we must be very careful in modifying it. They will drive an army through one paling knocked out of the fence and use any sign of weakness as a lever to reverse everything."[54] At the same time, Dodge put pressure directly on Shoup to agree to taking on members of the Dodge mission. He did not apologize for not having consulted Shoup earlier. Instead, Dodge reported that "General Marquat was very much in favor of the idea" and that he had already proposed the idea to Audley Stefan.[55]

On May 30, Shoup responded to Dodge with a deft move. On the one hand, he welcomed Dodge's two economists (O"Leary and Stefan). On the other hand, he told Dodge plainly that they would not be part of his mission. "I am delighted," he wrote, "at the idea of at least a part of the Dodge Mission going over to Japan along with the Shoup mission, and only wish more of your group could be making the trip at this time, especially yourself." He also made it clear that he was contemplating recommending greater tax cuts than Dodge envisioned. "It will be particularly helpful to have O'Leary

53 "Memorandum on Suggestions for Revision of Local Tax Bill," Envelope #201, 1 No. 1 Series, CSYNU.

54 Dodge to Bronfenbrenner, May 19, 1950, Japan 1950, Box 3, Correspondence files, JDDPL.

55 Dodge to Shoup, May 24, 1950, Dodge Series, CSYNU.

and Stefan available for consultation in view of the fact that the Japanese tax system is creaking badly under the (necessary) load that it has been carrying, and I should like to be able to recommend some further reductions in national taxes if the need for debt reduction at the rapid rate of the past year seems to have diminished somewhat, and if the Counterpart Fund has enough leeway to serve as backstop."[56]

Shoup anticipated a negative reaction from Dodge with regard to both the membership of the mission and the larger tax cuts Shoup envigaed, so he quickly wrote to MacArthur to line up MacArthur to support both this significant deviation from Dodge line and the reforms that Shoup was now planning to promote on his second visit to Japan. Shoup first took up local problems, asserting that among the "chief objections" of "Japanese officials and others" (including SCAP officials) was the "main issue" of "strengthening the local units on government." On this matter, Shoup declared, "no concession is possible." He then turned to "the particular taxes that our report recommended, especially the value-added-tax," and reported that "we are giving this recommendation a particularly careful review, and when we return to Japan toward the end of next month, Mr. Vickrey and I shall devote a large part of our time to prefectural and municipal finance problems." Shoup adopted a flexible tone, but noted that "so far. . . we believe the balance of advantage still lies with the value-added tax," and that "France, after decades of experimentation with various kinds of sales taxes, has this year enacted a value-added tax." Shoup next broached the subject of national taxation, immediately establishing some distance between himself and Dodge. "I believe that it would be very helpful if we could see our way to recommending further reductions in the national tax load, which is still pretty heavy for a country like Japan."

Shoup ended by returning to the theme of promoting democracy via the occupation. He played the card in his hand which he knew was most likely to influence MacArthur: "I am inclined to think that the most lasting, and ultimately the most beneficial, effect of our work may turn out to be the widespread interest in the ideas and techniques of taxation that has been aroused in Japan, chiefly because you authorized the printing and distribution of the full text of the report." Shoup laid on even more elaborate praise: "May I say that in no case have I ever encountered a more understanding attitude toward this problem of public discussion of a central civic problem than has been evident in your willingness to permit and encourage the extensive distribution of the document." It was, Shoup concluded, "a courageous and statesmanlike action on your part."[57]

Shoup's effort to marginalize O'Leary and Stefan, coupled with his expression of possible support for the Japanese Government in its efforts to reduce tax burdens, triggered an immediate, vigorous reaction from Dodge. Two days later, on June 1, Dodge answered Shoup, asserting that the appropriate role of missionaries like Shoup and himself was, in the face of lack of adequate data, to lean against "the frantic efforts of many of the Japanese to return to inflation, the political complications besetting the Japanese Government, and what appears to be a tendency of some of the SCAP people to be

56 Shoup to Dodge, May 30, 1950, Japan 1950, Box 4, Correspondence files, JDDPL.

57 Shoup to MacArthur, June 2, 1950, in Box 5980, File folder: "Shoup Tax Report-1949," RG 331.

panicked by inflation propaganda." Dodge emphasized his lack of trust in the Japanese government. He would be open to a modulated policy of "disinflation" rather than deflation, he wrote, but only if he were convinced that the Japanese Government was willing to abandon what he believed to be its inflationary strategy. "The Japanese," he wrote, "will want the tax reductions, the wage increases, increased public works expenditures, and increased expenditures by the local Governments, all of which will tend to maintain a high level of Government expenditure and taxation." In this letter, Dodge claimed that he had persuaded MacArthur to adopt the same policy. Dodge declared: "I do not doubt for a minute that his attitude is predicated on a thought mentioned in one of my letters—that concessions at this time would appear to be a confession of weakness on our part." Dodge ended by writing that the high-expenditure, high-tax policy of the Japanese government "is one of the reasons I am so anxious to have Doctors Stefan and O'Leary go, if they can." They were "complete realists on matters of this kind and in cooperation with you will substantially strengthen Bill Marquat's approach to these problems—not only with the Japanese, but with Headquarters.[58]

After he received Dodge's letter, Shoup quickly wrote to Marquat to confirm the composition of the mission team: "At Mr. Dodge's suggestion, I am inviting Stefan and O'Leary to accompany us. They will be coming as members of the Dodge mission, not my mission, but it will of course be helpful to be able to consult them on budgetary and other matters."[59] This message led Marquat to turn immediately to undermining confidence in the Shoup mission. Shoup was clearly making some headway in shaping the occupation's tax program, and Marquat needed to counter. "In connection with Ikeda's visit," Marquat wrote to Ralph Reid, "I was disappointed that Dr. Shoup wavered so extensively in support of his own program." Marquat said his concern was not for the future of value-added taxation or the larger tax-reform program. It was for the outcome of the budget negotiations in the special session. He explained: "As you know, given the least encouragement the Japanese are prone to construe any consideration as an excuse for abrogating the entire plan." Two days later, Marquat also warned Dodge. He told Dodge that the ESS expected to get the Japanese proposal of the new local tax bill within the ten days. "In view of Dr. Shoup's position, Marquat wrote, it will be probably be necessary to make various concessions." However, Marquat declared, "I have told the Japanese that the planned revenue contained in the budget must be forthcoming." Marquat stressed the importance of the forthcoming trip by the two members of the Dodge mission. "I shall be delighted to see O'Leary and Stefan during their visit here and I am sure that they will add a great deal of stability much needed by the Shoup group." A week later Marquat again wrote to Dodge. "To be quite frank," he told Dodge, I would prefer to have O'Leary and Stefan rather than the other members of the proposed [Shoup] mission."[60]

Dodge continued to look forward to the visit of the rump group of his mission. Paul

[58] Dodge to Shoup, June 1, 1950, Japan 1950, Box 4, Correspondence files, JDDPL.

[59] Shoup to Moss, June 5, 1950, Moss Series, CSYNU.

[60] Marquat to Ralph W. E. Reid, June 14, 1950, Japan 1950, Box 7, "Ikeda Visit" files; Marquat to Dodge, June 16 and 23, 1950, Japan 1950, Box 3, Correspondence files, JDDPL.

O'Leary had to drop out because of his wife's health problems, but Stefan, Dodge told O'Leary, "is really anxious to go.... Perhaps he can put a little more realism in some of the ideas of the Shoup group on fiscal policy. I am sure he will enjoy the struggle with them."[61] Meanwhile, cheers elsewhere in the ESS greeted the news of Stefan's return to Japan. Eugene Reed told Stefan that "we in the Public Finance Division are all looking forward to seeing you this summer and are very happy with your selection as an addition to the Shoup Mission... because of the very practical approach which you make to the problems of public finance, which to our minds seemed lacking in the original mission."[62]

In June, Shoup, energized by what seemed to be his growing influence, again attempted to engage Dodge directly in a dialogue. Shoup explained to Dodge in considerable detail the nature of his agreement with Ikeda, and the likely implementation of the local tax and finance measures. He carefully described his approach to local fiscal reform—a topic in which Dodge had never displayed any interest. Shoup went over carefully the part of his proposal that he believed that Dodge probably found most unsettling—a kind of contingency, or trigger, process that would open the way for a reduction in the rate of the enterprise tax (the prefectural business tax that the VAT would replace).[63]

Shoup's effort at persuasion fell flat. Dodge did not respond and turned up the pressure on Shoup through Marquat and Reed. Although MacArthur backed Shoup over the membership of the mission, Dodge won a major victory in the following round. In what amounted to the most significant defeat for Moss in advancing the Shoup agenda, Dodge gained MacArthur's permission to muzzle Shoup during his second visit to Japan. On August 5, Moss was forced to write to Marquat that "it has been suggested to Dr. Shoup and the members of his party that they should refrain as much as possible from indicating the probably direction of their recommendations with respect to tax rates, and tax increase and decreases." The goal, Moss wrote, was to avoid prejudicing "the flexibility of SCAP's present and future policy in Japanese fiscal matters." Moss assured Marquat that the IRD believed "that any recommendations which touch upon fiscal policy should be submitted only to GHQ." Moss asserted that there had been no shift in IRD policy toward Shoup's mission. It was simply that the economic environment had changed, becoming far more unpredictable as a consequence of the Korean War, which had begun at the end of June. "It is impossible," Moss explained, "reasonably to forecast developments in the financial field, which was not the case one year ago."[64]

Behind the defeat for Moss was the hard reality that MacArthur had lost interest in the tax reform project. The intensifying Korean War, and MacArthur's desire to turn Japan into a forward supply base, and possible even to remilitarize the nation, meant that the

61 Dodge to O'Leary, July 12, 1950, Japan 1950, Box 4, Correspondence files, JDDPL.

62 Eugene M. Reed to Stefan, June 30, 1950, Japan 1950, Box 4, Correspondence Files, JDDPL.

63 Shoup to Dodge, June 20, 1950, Dodge Series, Shoup Papers, CSYNU.

64 Moss to Marquat, "Weekly Tax Report," August 5, 1950, File folder: "Tax-Shoup Report," Box 10, Japan 1950, JDDPL.

immediate economic and political problems associated with the war had pushed long-term reform off of MacArthur's agenda. Moss and Shoup were now left with almost no ability to mobilize MacArthur behind tax equity and modification of the centralizing policies of the Japanese government.[65]

IX. SHOUP'S SECOND VISIT

On August 1, Shoup and his colleagues arrived in Tokyo. Despite their recent defeat, they did not act as if they felt depressed by the loss of their freedom to go public with their recommendations. In fact, they had decided to take on Dodge and his supporters within the ESS much more directly than they had a year earlier. They felt an urgency to do so because they believed the curtain would soon come down on the occupation. Shoup's estimated that only 12–18 months were left. Partly as a consequence of feeling less constrained by diplomatic considerations, the Shoup missionaries were more relaxed than during the first visit. The Japanese representatives of MOF who dealt with Shoup observed this and remarked later that Shoup did not seem to be carrying as heavy a weight of responsibility as he had the year before. They believed he listened more carefully to their opinions, and was more sympathetic to their tax cutting ideas.[66]

Even if Shoup confronted Dodge directly, the muzzle meant that Shoup would not be able to take his case to the Japanese public—a key element in his political strategy. In early September Shoup wrote to Robert Haig that he and his colleagues had "spent a month, now... talking with tax officials, governors, mayors, taxpayers etc. to see whether the new system, now on the statute books, is taking root, and will be effective." But Shoup was only moderately optimistic: "It looks like better than a 50–50 chance. It all depends on whether we have persuaded the Japanese that this is the thing to do."[67]

Shoup had not given up on making a public case for his reforms. During the first week of September, Shoup and his colleagues personally conveyed their tentative conclusions to MacArthur in the only meeting they had had with him during this "second" mission. At the same time, Shoup pleaded the case for allowing the mission to issue a public statement. In what became very tense situation, Shoup had "a nearly head-on-clash with General Marquat and ESS," according to a State and Treasury Department report.[68] Shoup prevailed. He managed to persuade MacArthur and Moss to shift their position a bit. They would allow the mission some additional leeway in making a formal, public report of their findings. As it turned out, however, Moss and Shoup ended

65 As early as July 1950, MacArthur took steps to increase Japan's military capability. See Takemae Eiji, *Inside GHQ*, 487 ff.

66 Interview with Hara Sumio, Study Group on the Financial Situation, "The Problem of the Revenue Sources for the Tax Cut," in Oral Materials of the Postwar Financial History, Part 7: Circumstances of the Shoup Report, 45–46. I am grateful for the translation assistance of Dr. Iju Morinao. This citation of this source, and those that follow below, are English translations.

67 Shoup to Haig, September 3, 1950, Box 126, Robert Murray Haig Papers, Butler Library, Columbia University.

68 Jerome Cohen to Shoup, October 30, 1950, Cohen Series 1 No. 1, CSYNU. In October Cohen was Chief of the South Asia Branch, Office of Intelligence Research, in the Department of State when he discovered the document and reported its contents.

their negotiations with different impressions of the ground rules for the press release. Two months later Moss recalled that he and Shoup agreed that the release would be "non-controversial," and not "comprehensive and lengthy." Shoup, however, remembered that he, Shoup, had "expressed a conclusion, after some discussion, that a truly non-controversial press report would be so thin that it would be a blow to the prestige of the mission and would give rise to some derogatory remarks by the Japanese."[69] He no doubt believed that he could couch his recommendations in terms that would minimize controversy.

In any case, both Moss and Shoup immediately acted upon their divergent understandings. Moss confirmed with Marquat the change in plans regarding a report by the Shoup mission. Moss noted that Shoup might "discuss certain non-technical aspects of his findings in a press conference a day or two prior to his departure to the United States," just as he had a year earlier. But Moss told Marquat that Shoup would limit the discussion "to such matters as self-assessed tax deficiencies, local government tax prospects, etc., and will exclude anything of a controversial nature which may directly or indirectly influence SCAP policy."[70]

Shoup, meanwhile, put the best face possible on what he knew would be significant disagreements with Dodge. Shoup wrote to Dodge that he wanted "to drop by Detroit or Washington" and discuss "the Japanese financial situation." On the one hand, Shoup discounted the significance of the changes they planned to propose. He advised Dodge that we "will leave behind a number of specific recommendations for the tax system, without advocating further major changes." On the other hand, he told Dodge that "We have tentatively decided. . . that it is very important that the load on the personal income tax be further decreased." The mission would make that recommendation "in order that effective administration can be achieved." Shoup explained that "the Japanese tax officials are getting reasonably close to that goal and it is important to make it possible for them to get there within a year or two." He ended on a conciliatory note regarding the collaboration that Dodge had wanted: "Audley and I have been keeping in close touch with one another; it has been a pleasure, as well as very helpful in our work, to have him along." Shoup did not mention, however, that they had never included Audley Stefan in any of their strategy sessions, including the final one they were about to begin.[71] Dodge did not respond.

The Columbia contingent (Shoup, Vickrey, and Warren) then retreated to a mountain resort for ten days to draft their report, now confident that it would become public. (Surrey had returned early to start the Fall semester at Berkeley.) The result was an elaborate formal report, disguised as a press release.[72]

[69] Moss to Shoup, November 14, 1950, Mission Correspondence, Series 2, Box 2, YNU; Shoup to Moss, November 30, 1950, Mission Correspondence, Series 2, Box 2, CSYNU.

[70] Moss to Marquat, September 6, 1950, File folder: "Shoup Recommendations," Box 7631, RG 331.

[71] Shoup to Dodge, September 6, 1950, Joseph M. Dodge series, Shoup Mission, Mission Correspondence, Series 1, CSYNU.

[72] "CIE Press Conference on Recommendations of Tax Mission," September 21, 1950, File folder: "Missions-Shoup, Dr. Carl S.-Tax Mission 1949 and 1950," Box 6740, RG 331.

In the press release, Shoup and his colleagues made strong recommendations for "substantial tax reductions," particularly in the personal income tax; for refinement of the value-added tax (which had not been implemented); and for major enhancements of the equalization grant system, which they believed had not represented a good-faith effort to implement the recommendations in their 1949 report. The recommendation for income tax cuts represented, in effect, a significant breach of the Dodge line, but they handled this issue with finesse. Their central argument was that the tax cuts were "necessary if tax officials and taxpayers are to be given adequate opportunity to complete the transformation of the income tax from its former status as an arbitrarily determined tax characterized by extreme evasion and great delinquency in payment, into a modern tax instrument that spreads the burden fairly under a law that taxpayers respect and administrators enforce." The problem was inadequate voluntary compliance. They found progress with regard to voluntary compliance during the last year had been significant, but "the greater part of the job sill lies ahead."[73] They wished to turn the Japanese income tax into an effective Keynesian counter-cyclical vehicle, but needed to improve voluntary compliance significantly before that could happen. Privately, they believed that the Bank of Japan ought to bear the major responsibility for containing inflation. Heretofore, "heavy taxation has been the shield behind which the Bank of Japan has allowed business firms to stock up and build plants, etc. without causing inflation. This may have been all right for the one year. But it is not a policy the tax system should be asked to conform to any longer."[74]

In addition to drafting the press statement, Shoup and his colleagues submitted to SCAP a "confidential report" amplifying their conclusions. Their goal was to keep what they regarded as their most controversial proposals from creating embarrassment for SCAP. For one thing, they expanded on the role of the Japanese tax system in future inflation, which was returning as a major concern in the midst of the expansion of the war in Korea. Shoup and his colleagues began by noting that "if the present system were a mature one—if it had been in force for many years and had become thoroughly accepted by the people," they would recommend that it "play a major role" in checking inflation. They explained, following the standard approach adopted by many American Keynesians, that "the progressive-rate nature of the existing system would automatically soak up a large-part of the newly created purchasing power; and increase in tax rates (and lowering of exemptions) would absorb still more." While they thought that the system could develop a capacity to contain inflation "within a few years," for now "an inflationary shock of great magnitude would probably cause it to disintegrate." They believed that "any attempt to check an inflation in the near future by a substantial increase in rates and lowering of exemptions would not have much success, except at the price of wrecking the equity elements of the system as frantic administrators used every device at hand to bring in the revenue." Instead, the missionaries recommended

73 "CIE Press Conference on Recommendations of Tax Mission," September 21, 1950.

74 For the private views of Shoup and his colleagues as they worked on the press release, see the preliminary draft of the press release, in Envelope #9, All No. 8 series, CSYNU.

that the Japanese government should resist inflationary pressures "primarily by control of credit, and, secondarily, by direct control of wages and prices." The missionaries understood, of course, that this recommendation flew directly in the face of the approach that Joseph Dodge and the Finance section of ESS were almost certain to recommend.

The missionaries also addressed the issue of forgiving tax evaders. Evasion and under-reporting of income constituted, Shoup and his colleagues wrote, "the most serious administrative problems in the new tax system"—problems which the new system "inherited" from the previous system, in which "the surtax rates reached 85 per cent." The problems resulted from the dilemma faced by "those taxpayers who underreported their incomes under the previous tax regime. On the one hand, "they can become honest and file a correct return, but they will then be in danger of being reassessed for four or five back years plus interest and penalties; bankruptcy would then be the inevitable result for many taxpayers." On the other hand, "they can continue to underreport and evade taxes on the theory that the government will not be successful in discovering their underreported income; these taxpayers will probably be successful in administrative investigation of returns." Such improvement would be impossible, so the mission concluded that the government should "break the spiral" of evasion by forgiving the taxes of "past years that were not reassessed as of January 1, 1951." This would, the missionaries believed, greatly increase the likelihood that "the desired substantial voluntary compliance can be achieved for future years." Shoup and his colleagues coupled this recommendation with a repetition of the call which they had advanced in their first report for an end to secret bank accounts. They emphasized again the importance of this matter and urged creation of a new information system coupled with a program of tax forgiveness to limit huge cash withdrawals from banks or sabotage of the system by bankers and brokers.[75]

X. A QUIET BURIAL FOR THE SECOND SHOUP REPORT

The press release was not as comprehensive and detailed as the report of the "first" Shoup mission. But it was, nonetheless, a formidable document and, just as a year earlier, Shoup and Moss did not leave much time for Marquat to review it. On September 19 one of his key economic assistants, Theodore Cohen, sent up a warning flag but it was too late to block the press statement. The next day MacArthur approved its release, although he did so only in an "informal" fashion.[76] Later in the day, SCAP forwarded a copy of the press statement to the Japanese government, one day before its release to the press. The very next day Shoup and his colleagues left Japan to begin the new semester at Columbia.

Moss knew that hostility that would to greet Shoup's report when it reached the Public Finance Division and Joseph Dodge. He despaired of the report having any influence on SCAP policy and, consequently, trimmed his sails. He immediately staked out

75 Shoup to SCAP, September 21, 1950, File folder: "Shoup Tax Report-1949," Box 5980, RG 331.

76 Theodore Cohen, "Second Report of the Shoup Mission, September 19, 1950; and Marquat to Chief of Staff, September 20, 1950, File folder: "Shoup Tax Report-1949," Box 5980, RG 331.

a cautiously neutral position, abstaining from offering any immediate support for the recommendations.[77]

As Moss anticipated, Eugene Reed quickly blasted the second Shoup report and tried to make certain that the Japanese government would not regard it as SCAP policy. Reed recommended "that the Minister of Finance be explicitly informed at the next regular meeting that, while careful consideration and study should be given to all recommendations contained in the recent report of the Shoup Mission, such recommendations are not to be considered as necessarily representing the position of ESS and that in developing its financial policy the Japanese Government is not bound by them."[78] The next week, in preparation for the imminent return of Dodge to Japan, Reed launched a substantive attack on both the scale and nature of tax cuts that both the Japanese government and Shoup favored. Reed asserted that the cuts would stimulate inflation and do nothing to enhance capital formation. "If there were to be tax cuts, they should come, Reed argued, in the corporate sector. This would stimulate capital formation and, by enhancing the supply of goods and services, relieve inflationary pressures."[79]

Here, Reed pursued an approach—one of looking for methods of stimulating capital formation—that Dodge and Stefan had promoted during Shoup's second visit.[80] The aspect of the "second" Shoup report which proved most embarrassing to this capital-favoring approach was its effort to tax more effectively secret bank accounts. These accounts housed substantial assets which Reed, Dodge, Stefan, and the Japanese government all wished to protect. Reed and Marquat they made certain that the sections on this topic in the technical appendices (sections which William Warren had drafted) never saw the light of day.[81]

Dodge arrived in Japan in late October even more obsessed with using fiscal policy to restrain inflation which, he correctly observed, threatened to become severe as a consequence of "the impact of the Korean procurement."[82] Nonetheless, he was open to some tax cutting, so long as it was matched by spending cuts, and supported Reed's mix of personal and corporate income taxes because of their supply-side benefits. Dodge

77 Moss to Marquat, September 26, 1950, File folder: "Shoup Tax Report-1949," Box 5980, RG 331.

78 Reed to Marquat, September 29, 1950, Japan 1950, Box 2, JDDPL.

79 Reed to Marquat, October 5, 1950, Japan 1950, Box 2, JDDPL.

80 During the simultaneous Shoup and Dodge (via Stefan) missions, Marquat gushed to Dodge: "I can't tell you how wonderful it has been to have Audley Sephan with us.... If the Occupation lasts long enough I am trying to sell Audley on the idea of taking sabbatical leave and spending a year with us. It would most comforting to have a man of his caliber around while we are putting the finishing touches on the Occupation effort pursuant to the historical Dodge Stabilization Program." See Marquat to Dodge, August 31, 1950, Japan 1950, Box 3, JDDPL. Stefan continued to consult on Japanese matters until early 1951, when he was killed in the crash of a military transport plane in the north Pacific.

81 Interview with Takahashi Mamoru, Study Group on the Financial Situation, "The Postwar Tax Administration," in Oral Materials of the Postwar Financial History, Part 7: Circumstances of the Shoup Report, 20–22. See, also, ESS/PF to IRD, "Release of Appendix Material for Shoup Report," October 20, 19050, file folder: "Shoup Report Local Government," Box 7604, RG 331. For the Warren draft see "Measures to Aid Enforcement," Envelope #6, Box #361, CSYNU.

82 "Dodge-Ikeda Conference of October 30, 1950," and Joseph M. Dodge, "Inflationary Pressures in Japan," undated, file folder: "Dodge Mission—October-December 1950 Memoranda," Box 5977, RG 331.

did not openly attack the Shoup recommendations, but privately, Dodge made his skepticism, and even hostility, quite clear.[83] While the Japanese government preferred tax cutting along Shoup lines, Dodge discovered interest within MOF in also adopting procapital tax cuts.[84] But Moss and the IRD, with MacArthur's support, succeeded, for the time being, in beating back this initiative.

There was no hope, of course, for any of the more dramatic Shoup recommendations in the face of Dodge's objections, which members of Moss's IRD staff shared.[85] And, the Japanese government had little interest in taxing what they called "transfer" income (capital gains from sale of assets) more heavily, breathing life into value-added taxation, or expanding the equalization-grant program. In short, the recommendations of the "second" Shoup mission played absolutely no part in the late 1950 round of budget discussions. With no dissent from MacArthur or Moss, the "second" Shoup mission received a quiet bureaucratic burial. SCAP never published its reports of the beyond issuing the press release. The publication of a formal volume was left to the fledgling Japanese Tax Association, which did so in 1951, including the press statement and the expurgated versions of the supplementary memoranda on the equalization grant, the administration of national income taxes, and local tax administrative problems.[86]

As he had in late 1949, Moss left Shoup in the dark about the progress of the Dodge mission and the status of the budget negotiations. Shoup had returned to Columbia in late September, and waited nervously for news about the reception of the mission's report until mid-November, when Moss finally wrote. Moss summarized some of what had transpired after Shoup returned to Columbia. He explained that some of the supplementary appendices, those "which were certain to raise further controversies (including the one on government property and enterprises), and which would have embroiled us in considerable and probably bitter arguments, have not yet been released." He did not mention, however, the excision of Warren's proposal for policing secret bank accounts, or the deletion of several sections discussing the desirability of "over-equalization," that is to say, expanding the equalization program to address the problem of poorer communities.[87]

Moss went on to explain the political circumstances, focusing on the September announcement by the Truman administration that it had decided to negotiate a peace treaty with Japan even if the Soviet Union did not participate. "At this late stage of the occupation, as you no doubt realize," Moss wrote, "SCAP does not want to give the appearance

[83] See his marginal notes on Moss, "Memorandum for Mr. Joseph M. Dodge," October 18, 1950, file: "Tax-Shoup Report," Box 10, JDDPL.

[84] Interview with Takahashi Mamoru, Study Group on the Financial Situation, "The Postwar Tax Administration," in Oral Materials of the Postwar Financial History, Part 7: Circumstances of the Shoup Report, 22.

[85] On the final agreement on the 1951 fiscal-year budget between Dodge and the ESS staff, see ""Memorandum For: Maj. Gen. W. F. Marquat, November 22, 1950, file folder: "Dodge Mission Oct–Dec 1950 Memoranda," Box 5977, RG 331.

[86] See *Second Report on Japanese Taxation by the Shoup Mission* (Tokyo: Japanese Tax Association, 1951).

[87] Moss to Shoup, November 14, 1950, Mission Correspondence, Series 2, Box 2, CSYNU.

of ordering the Japanese Government in matters concerning domestic affairs. Thus, unless an issue is considered to be extremely vital to the basic objectives of the occupation [Moss's emphasis], the entire Headquarters has refrained from adopting or taking any action that could be interpreted as showing SCAP control of Japanese Government affairs. The reason for this is obvious. The peace treaty is, apparently, relatively close at hand." If fundamental tax reform had ever been "extremely vital" to the objectives of the occupation, it had now ceased to be.

Moss admitted, however, that another factor—the severe opposition within the ESS—had contributed to Shoup's problems. Opposition had been strongest in the Public Finance Division, Moss told Shoup, but "quite a few individuals within IRD itself were not sympathetic to your views." Some "entities" protested that "the recommendations proposed touched on their responsibilities but they had not been consulted."[88] Moss blamed the problems in part on the controversial press release. He claimed that Shoup had departed from their understanding on the nature of the press release. "If we had followed the strategy we originally agreed upon, and issued a non-controversial press release, rather than the comprehensive and lengthy press report, I am included to think that we would have come out better in the final analysis."[89] Shoup responded to Moss in a good-natured way, but he denied misleading Moss with regard to the press-release.[90] With the exchange of letters, the professional relationship between the two individuals ended.

XI. AFTERMATH OF THE SHOUP MISSION

Shoup continued to consult informally with leaders of local reform in Japan, but he tried to move on, having already shifted his professional energies into a domestic mission—a major study of New York City finances that he co-directed with Robert Murray Haig.[91] However, a long, and uncharacteristically emotional, letter which Shoup wrote to MacArthur more than a year later, in April 1952, just after his firing by President Truman, suggested that Shoup still struggled to reach closure with the downbeat finale to the Japan mission. On the one hand, Shoup associated his own accomplishments with the greatest of the occupation. "When the record of the post-war period comes to be written in proper perspective," Shoup told, "your achievement in transforming the attitude of the Japanese people toward the goals of civic life will stand out as one of the most remarkable feats of which history has any record." That transformation included attitudes toward taxation, Shoup explained. "The fact that taxation is

88 The Public Finance division had weighed in strongly against Vickrey's disaster rehabilitation scheme as one that would "almost certainly in an inflationary impact on the national economy" and "would contribute little to the promotion of real local autonomy based on sound local finance." ESS/PF to ESS/IR, "Appendix to Shoup Report," October 6, 1950, File folder: Shoup Report Local Government, Box 7604, RG 331.

89 Moss to Shoup, November 14, 1950, Mission Correspondence, Series 2, Box 2, CSYNU. Two days later, Moss added more details. Moss to Shoup, November 16, 1950.

90 Shoup to Moss, November 30, 1950, Mission Correspondence, Series 2, Box 2, CSYNU.

91 Shoup to Moss, October 6, 1950, Mission Correspondence, Series 2, Box 2, CSYNU.

everybody's business, a fact that we take for granted in the United States, has been accepted by the Japanese people, and the importance of this mental transformation can be fully recognized only by those who saw what the attitude was before you decided to set in motion the steps leading to reform." On the other hand, while lauding their accomplishments, Shoup gave MacArthur, as if he were still SCAP, a detailed rendition of the problems his mission had stressed during its second visit to Japan—the problems of compliance with the self-assessed income tax, the excessive dependence on tax and budget policy for controlling inflation, and the lack of commitment to reform of local taxation and inter-governmental fiscal relations.[92]

Moss, meanwhile, continued to fight some of the battles that he and Shoup had begun during the mission. Moss could not advance Shoup's unfinished agenda, but he did work to protect Shoup's base-broadening reforms. But Dodge, Reed, and the Japanese government all favored using the tax code to stimulate capital formation, and they prevailed. Thus, in early 1951, Moss had to watch in disappointment as the Japanese government adopted accelerated depreciation rates for various types of corporate assets; special treatment for depreciation of machinery used in various heavy industries; repeal of the undistributed profits tax on non-family corporations; an extension of the deadline for corporate revaluation of assets; and further liberalization in the use of secret bank accounts. Later in the year another round of modifications, including enactment of a variety of special exemptions for bad debts, retirement salaries, and reserves for price changes, further weakened the Shoup reforms. All of this came before the end of the occupation.[93] In July 1951, the IRD was disbanded and the next month Moss returned to the Treasury.[94]

XII. SOME LEGACIES OF DODGE AND SHOUP

The Dodge mission continued until the very end of the occupation.[95] Dodge reveled in the contribution he felt his line had made to Japan's financial and economic strength, and he constantly reminded everyone of his budget-balancing and inflation-fighting accomplishments.[96] But, whatever Dodge's contributions to post-war Japan had been, they had not included the promotion of tax reform along the lines championed by Carl Shoup and Harold Moss, and supported by Douglas MacArthur throughout most of the

92 Shoup to MacArthur, April 12, 1951, Mission Correspondence Series 3, Box No. 3, MacArthur Series, CSYNU.

93 Dodge to Marquat, "Tax Measures to Encourage Japanese Production," January 27, 1951, Japan 1951, Box 7, JDDPL; Interview with Takahashi Mamoru, Study Group on the Financial Situation, "The Postwar Tax Administration," in Oral Materials of the Postwar Financial History, Part 7: Circumstances of the Shoup Report, 20–22.

94 Moss to Shoup, February 2, 1951, with enclosed "Weekly Tax Report, January 20, 1951," and Moss to Shoup, August 3, 1951, Harold Moss Series, Shoup Mission, Mission Correspondence, Box No. 2, CSYNU.

95 On the last phase of Dodge's ongoing mission, see Howard B. Schonberger, *Aftermath of War*, 230–234.

96 For an argument that Dodge was responsible for establishing a long-term budget-balancing preference in Japan, see James D. Savage, "The Origins of Budgetary Preferences: The Dodge Line and the Balanced Budget Norm in Japan," in *Administration and Society* 34 (July 2002), 261–284.

occupation. Truman, the NSC, and the NAC had provided Dodge with sufficient discretion to compel the Japanese government to adopt the full Shoup program, especially the democratic reforms, but Dodge consistently refused to use his power in that way. And, in 1950 Dodge used his influence to begin the process, carried on by the Japanese government after the end of the Occupation, of rolling back Shoup's base-broadening reforms, which Shoup had hoped would promote horizontal equity, economic efficiency, and democratic faith in government. Thus, Dodge's lack of interest, and even hostility, to the Shoup program of tax reform had first limited Shoup's reform accomplishments and then accelerated their erosion. Arguably, Dodge was even more responsible than the Japanese government for the problems that Moss and Shoup faced in enacting their program. If Dodge had been less intent on forcing Japanese budgets into a super-balanced condition, Shoup would have had more leeway for tax cuts that would have helped him win public support for the rest of his program and avoid exacerbating the kind of tax-cutting passion that had taken hold in Japan during an earlier phase of the Occupation, and turned out to have consequences still felt today. As it was, Shoup's program became tarred by the same brush that the Japanese public applied to the "black-jack" tax assessments of the early occupation and to the Dodge line.

One could argue, of course, that even if Shoup and Moss had prevailed over Dodge and succeeded in turning all of the Shoup recommendations into policy, the Japanese government would have quickly undone the ones they disliked, beginning in 1952. But this speculation runs the risk of ignoring the contingent nature of institutional change, and the seriousness of Shoup's commitment to working cooperatively with Japanese experts. Swift adoption of the more radical aspects of Shoup's recommendations would have bought more time for the kind of close, respectful collaboration that he favored, and pursued during 1949 and 1950 through his own efforts and the work of Martin Bronfenbrenner. If Shoup had been able to engage longer in a process of mutual exchange and social-learning with Japanese experts, and if his tax experiments in Japan had had more time to prove themselves, the Japanese government might have warmed to more of the Shoup program and the subsequent history of public finance in Japan might have been very different.

Despite the defeat of much of the Shoup program when pitted against both Dodge's line and his strategy for capital accumulation in Japan, Shoup achieved some successes. Most important, with MacArthur's protection, he was able to accelerate the pace with which post-war Japanese governments embraced income taxation, and to delay the massive expansion of tax expenditures through the income tax system. In the absence of the Shoup mission, the Japanese government almost certainly would have sought to expand quickly the use of indirect taxes, including consumption taxes.[97] And Joseph Dodge, who was focused on the super-balancing of budgets, the suppression of Japanese consumption, and the creation of incentives for investment, would have happily concurred.

[97] For evidence of this, see, for example, the testimony of Matsukuma Hideo, former Vice Minister of MOF, June 15, 1955, MOF Study Group on the Financial Situation, Part 15: The Changes in the Postwar Tax System, 20 ff.