

**A**  
**SHORT ECONOMIC**  
**HISTORY OF MODERN**  
**JAPAN**

**G.C.ALLEN**

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# A Short Economic History of Modern Japan

G. C. Allen

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Fourth Edition

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# Preface to the Fourth Edition

This book contains the fruits of a study of Japan's economic affairs which began during my time as a lecturer at the Nagoya Koto Shogyo Gakko between 1922 and 1925. Much of the material that forms the basis for Chapters 8-10 (Part I) was collected in the course of a visit to Japan in 1936 when I was investigating the industrial changes of the 1930s. I began to write the book in 1939, but the outbreak of the war compelled me to lay it aside, and the first edition was not completed until 1945. My object was to describe the evolution of the economy between the time when Japan first entered upon her career of Westernization and the beginning of the war with China in 1937. The main emphasis was on industrial and financial development and on economic policy, although the study was not confined to those subjects.

When I came to prepare the second edition of the book, published in 1962, I was able to benefit from the extensive research into Japan's economic history that had been carried out during the previous decade. I made some changes of substance and many of detail, without disturbing the original structure of the book. The chief new feature was a long Supplementary Chapter which traced Japan's economic recovery after the Second World War and her subsequent progress. In the third edition, published in 1972, the original chapters, as revised for the second edition, remained unchanged (except for minor amendments), but I added a fairly lengthy Introductory Chapter which called the readers' attention to some of the results of the most recent research into Japan's economic history and to the speculations of economists about it. This introduction was intended to fill lacunae in the previous text and to emphasize those features in the country's development that then seemed of outstanding importance. The Supplementary Chapter was completely re-written and covered the period from 1945 to 1970.

For the present edition (the fourth), I have replaced the former Supplementary Chapter that dealt with the history of the economy after the Second World War by six new chapters. These now form Part II of



the book and cover the years from 1945 to 1979. The economic developments of the period have been surveyed in greater detail than in previous editions and particular attention has been given to an analysis of the causes of Japan's achievements. I have left unaltered the substance and form of the chapters that trace the economic history of the country up to 1937. These now make up Part I of the book. The Statistical Appendix, which was designed to support the general statements in the text and also to provide a convenient assembly of figures, has been brought up to date. The bibliography has been revised and supplemented.

My late wife gave me invaluable help in preparing the first three editions for publication, and I wish to record my indebtedness to her in this, the last of them.

October 1979

G.C.A.

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# Introduction

Up to the Second World War the economic development of Japan was a field of study neglected by Western scholars and a subject little understood in Europe and America. In the last three decades, however, it has aroused the curiosity of a number of historians and economists in Western countries whose work has supplemented the extensive research of the Japanese themselves. The results of some of the recent research were embodied in the revised edition of this book published in 1962, but since then further advances in knowledge of the subject have been made. Although the latest work has not called in question the outline description and the interpretation of historical events given in the original text, it has necessarily revealed certain lacunae. It has also made available in English new information about events previously treated in summary fashion and has indicated where changes of emphasis are required. The present introduction is intended to bring to the notice of readers some of the chief modifications in the author's previous accounts of Japan's economic growth that now seem to be required. This is a limited purpose. To try to provide a comprehensive survey of the recent contributions to our knowledge of the economic history of Japan would, of course, be beyond the scope of a short introduction.

In accordance with the temper of the times, several investigators, by applying statistical techniques, have sought to make quantified statements about factors or phases in Japan's development hitherto described in general terms. Their work has led to an advance in precision, but in some cases, because of the uncertainty of the statistical data, it has had the effect of opening up new controversies rather than of solving existing problems. The reader's attention is called to some of these controversies, although the author has refrained from taking sides in them. Certain economists have tried to show how the facts of Japan's development can be brought into line with current theories of economic growth and to identify particular events in the country's modern history with categories distinguished by the analysts. Whether these efforts have really enlarged our understanding of what went on in the Meiji and Taisho eras is a debatable question. Some students may find the results

illuminating, or at any rate intellectually stimulating. Others may be conscious of the danger of moulding the facts of history into conformity with a scheme of thought. The more sceptical, especially students who stress the importance of institutional factors in economic progress, may conclude, in an echo of Schumpeter's comment on the trade cycle, that every case of economic development is a 'historic individual' and should be treated as such.

A question which many scholars have tried to answer is the extent to which Japan found herself at the beginning of the Meiji era equipped to enter upon her new role. In Chapters I and II, (Part I), it is shown that, despite some deficiencies, in many respects Japan was well-prepared. Recent research has confirmed this view. Indeed, it has pointed to at least one factor favourable to the rapid evolution of a modern society to which insufficient attention was given in the former editions of this book. A wide diffusion of formal education and the presence in the governing classes of well-trained and well-informed men may be expected to exert a powerful influence on the modernization of a traditionally organized society. It is now generally agreed that at the time of the Restoration 'there was a widespread and well-developed tradition of formal institutional education'. Probably nearly half the males and 15 per cent of the females at that time had received or were receiving some kind of systematic education. The total school attendance of commoners in the temple schools (*terakoya*) amounted to 1,100,000. The majority of the *samurai* and many of the merchants were completely literate.<sup>1</sup>

There can be little doubt that, from the outset of the modern era, the educational attainments of the Japanese did much to facilitate the communication of new ideas and technical methods. What is more, the ground had been prepared for further advances. The introduction of a system of universal education early in the Meiji era was a logical step forward and was accepted as such by the Japanese people. Throughout the modern period education, both general and technical, occupied a prominent place in the policies of successive Governments, and the proportion of the national income spent on it remained high in comparison with that of most other countries. In early Meiji times about one-third of the local authorities' expenditure went on education and this proportion did not change significantly throughout the era.<sup>2</sup> The payment of foreign teachers absorbed large sums of money and, in addition, the central Government spent heavily (see p. 34 *infra*) on foreign technicians and managers whose functions included that of training native successors. Nor did all the initiative spring from the

Government. Private persons, notably the famous Fukuzawa Yukichi, even before the Meiji Restoration, were enthusiastic advocates of the new forms of education. Business leaders founded schools, colleges and universities and a few introduced the practice by which a particular business house drew the bulk of the recruits to its managerial and technical staff from a certain university or college.<sup>3</sup>

It is now accepted by Japanese and foreign scholars alike that this investment in education was highly productive.<sup>4</sup> Japan assimilated new techniques and habits of thought with ease because her population was literate and well-trained technically. But it must not be thought that her educational achievements can be attributed solely to her success in following Western models. Her leaders brought with them into the new era a system of values based on the intellectual and moral discipline of the past, and the career of Japan owed much to this inheritance. It is true that in some respects the Confucian training of the upper class both in China and Japan made it at first unsympathetic to the scientific method and so to Western teaching as a whole. But it was the merit of Japan's intellectual élite that its members were able to surmount these obstacles under the persuasion of national needs and foreign example.<sup>5</sup> Their response to the West was in sharp contrast to that of the bureaucrats in China who failed to come to terms with the new scientific civilization. Furthermore, while the Japanese were able to free their minds from that part of their Confucian legacy that was in practice hostile to technological change, they carried into the new world traditional codes of conduct and habits of mind which served the cause of national power and economic progress. These codes and habits affected the relations between superior and inferior and the mutual obligations of those in authority and those subject to it. They reinforced the sentiments of patriotism and family and group loyalty. They encouraged frugality and assiduity. The outstanding business leaders, while active in pursuit of their own ambitions, seldom lost sight of national purposes.

Education and the intellectual tradition have a bearing on the origins of entrepreneurship in modern Japan, and here again recent research has enlarged our knowledge of the subject. As affirmed in the original text, business leadership in the Meiji era proceeded mainly from the *samurai*, but to this assertion certain qualifications must be admitted. First, many of the *samurai* who were among the most prominent leaders after 1868 came from families which had only lately acquired their privileged status. Secondly, important contributions to industrial development were made by men of lowly status who seized the opportunities offered by the new era. This has been a recurrent feature of Japanese society

which, though faithful to the principle of hierarchy, has been ready enough to admit movements between the different ranks. Some writers have drawn a distinction between the type of enterprise in which *samurai* were pre-eminent and that in which men from other social grades took the lead. The former type consisted of the banks, insurance companies and other parts of the infra-structure and the basic services of the new State. It included also the branches of the economy which touched on the prevailing sentiment of fervent nationalism. Resentment against the predominance of foreigners in the conduct of foreign trade, for example, gave a most powerful stimulus to such men as Eiichi Shibusawa, a typical *samurai* whose life was devoted to the task of making Japan economically independent and prosperous. It has been claimed by some commentators that the industries that lay within or adjacent to the public sector called on the strong sense of social obligation characteristic of the *samurai*. Men of other classes, who were more individualistic in outlook and far less inhibited by rigid standards of conduct, often took the lead in the more adventurous market-orientated activities. Although the contrast should not be made too much of, it is reasonable to conclude that '... the *samurai* laid the foundations for the "take-off" of the new economic order while others provided much of the dynamic stimulus'.<sup>6</sup> With the rise of the *zaibatsu* the nature of entrepreneurship was, of course, profoundly modified.

In the discussion of capital accumulation and the rise of manufacturing industry in early Meiji (see pp. 47 and 169 *infra*), attention was called to the institutional changes which led to the transference of feudal revenues to the State and so provided resources required for investment in new economic activities. Apparently the land tax reform kept rigid for a time the proportions in which the product of the land was divided among landlords, cultivators and the central Government's Exchequer. But land values rather than the crop values now became the basis of taxation and, while the tenants continued to pay their rents in kind, the landlords paid their tax in money. In these circumstances, the inflation of the 1870s brought great benefit to the landlords who were furnished with windfalls available for investment.<sup>7</sup> Their gains were, of course, at the expense of the peasants' standard of living.

A sharp controversy has arisen over these revenues from agriculture.<sup>8</sup> Some writers have held that there was a steep increase in agricultural production after the early years of Meiji (an average annual increase of 2.9 per cent between 1875 and 1900, according to Ohkawa and Rosovsky). This increase, it is argued, was the main source of the enlarged agricultural income which contributed so much to financing de-

velopment in other sectors of the economy. Other historians, who are sceptical of the reliability of the figures on which the estimates of production are based, deny that any sharp increase occurred. They contend that the growth in production after the Restoration represented merely a continuation of the improvement in agricultural efficiency that had begun in the later years of Tokugawa, and they suggest that the annual average rate of increase was of the order of 1 per cent. Difficulties in reaching agreement on this question are enhanced by evidence which points to the existence of marked regional differences. There is, however, no doubt about the large contribution made by agriculture to investment in the early stages of modernization, and from this point of view the *rate* of increase in production in the period under discussion is less interesting than the circumstances that enabled the surplus agricultural revenues to be directed to new and constructive uses.

It seems that agriculture's net contribution to the investment resources of the rest of the economy remained substantial until the second decade of the twentieth century. The magnitude of this contribution was determined partly by the rise in the income of the rural community and partly by their propensity to save a high proportion of it, a propensity which was attributable in some degree to the biased distribution of income from agriculture already referred to. The rise in agricultural incomes was not simply the result of increased efficiency in the production of the staple crops. It followed also from the additional remunerative opportunities provided by the new era for members of country families. Some of these opportunities could be regarded as falling within the sphere of agriculture (e.g. cocoon production), but others took the form of various by-employments in the manufacturing and service industries. For instance, supplementary incomes were earned both from the domestic production of pottery, textiles and many other wares and also from wage employment outside the home. Thus, one reason why the rural community was able to make so large a contribution to the capital needs of industry was because its incomes were being raised not merely by increases in agricultural productivity but also because of its own expanding industrial activities. It should be added that, as in most under-developed countries in the early stages of industrialization, there was in Japan until recent times no clear-cut distinction between the agricultural and the industrial sectors of the economy.

Throughout the Meiji era the rural landlords who emerged from the post-Restoration settlement took the lead in introducing agricultural improvements, such as new strains of seed and more efficient methods of



cultivation, including the extensive use of fertilizers. It now seems to be established, however, that by the early years of Taisho their enterprise showed signs of flagging. Some of the unrest among the peasants in subsequent years can be attributed to this failure on the part of the landlords to exercise their former functions. Leadership tended to pass to the central and prefectural Governments and the agricultural co-operative societies.

Some economists have argued that under-developed countries are justified in adopting ambitious programmes of industrialization not only because of the immediate contribution that the factory industries can make to the national product, but also because such industries can be expected to yield a surplus in the form of profits that can be applied for further investment. In other words, manufacturing industries are said to provide a means of accelerating capital accumulation in countries where the flow of savings from other sectors is likely to be small. The experience of Japan during the Meiji era affords little support to this argument. As already noticed, throughout that period the direction of the flow of new capital was from agriculture to industry, and the factories established by, or with the help of, the Government during the 1870s certainly failed to play the part which the economists referred to above would assign to them. Most of them earned no profits at all, and when they were eventually transferred to private enterprise, they were sold at a loss. Their contributions to Japan's development were of another kind. They gave a demonstration of new methods of technique and management, provided jobs for unemployed *samurai*, produced substitutes for imports (and so eased the strain on the balance of payments) and, finally, alleviated some of the regional troubles that attended the transition to the new order.

Recent research has added to our knowledge of the Government's rôle in development. Despite its intervention in many branches of the economy, as a direct employer of labour its importance was comparatively small throughout the Meiji era.<sup>9</sup> The ratio of public expenditure to the national income was also low. At the end of the century it was roughly the same in Japan as in the United Kingdom (12-14 per cent).<sup>10</sup> Subsequently, up to and including the Second World War, the ratio in Japan rose steeply, particularly during the various international political crises in which she was involved. After the Second World War the trend was reversed and during the last decade the public sector and the ratio of public expenditure to the GNP have been exceptionally small by international standards.

The conditions just described seem at first difficult to reconcile with



Professor Rosovsky's estimates of the Government's prominence as an investor. According to him, between 1889 and 1938 the gross national investment averaged 14.7 per cent of the net national product, and for that period as a whole public investment was responsible for slightly more than half the total.<sup>11</sup> The share of the Government varied widely from time to time, according to changes in political circumstances. For instance, it rose from the first decade of the century chiefly because of the expenditure required by the Russo-Japanese War and its aftermath, and again in the 1930s during the time of the *Junsenji Keizai*. Professor Rosovsky's estimates are not in fact inconsistent with the conclusion that during the Meiji and Taisho eras the Government was not of great importance as an owner of industrial and trading undertakings or as a direct employer of labour. After 1880 it retained ownership of very few undertakings in the consumption goods trades. Most of the enterprises in which it was directly engaged were capital-intensive, whereas the greater part of private industry remained labour-intensive and made demands on new capital supplies that were small in proportion to output and employment (that is to say, the capital-output ratio in that sector was low). The Government found other means of influencing or directing operations in the private sector, for example, through its association with the *zaibatsu* and through its command over the use of private savings.

The contrast between undertakings in the public and private sectors deserves further discussion. The creation of a modern society required heavy investment in the infra-structure, but in other parts of the economy capital resources were spread thinly. This was an allocation consistent with Japan's factor-endowment at that time. It is argued in Chapter 2 (see, p. 38 *infra*) that an infusion of comparatively small amounts of new capital and minor improvements in technical methods were sufficient to achieve marked advances in productivity in a number of the older industries, including transport. This economical use of capital by some trades left adequate resources for the new large-scale industries imported from the West where, for technical reasons, there was no practical alternative to capital-intensive methods. The continued progress of many of the older industries and the preservation of traditional techniques in them were a corollary of the people's faithfulness to habits of consumption inherited from the past. Japan brought with her into the new era a resistance to the corroding influence of foreign consumption patterns, or to what is called the 'demonstration effect'. Until recent times most articles in everyday use were peculiar to Japan and were turned out by small producers. It has been suggested

that this feature of her consumption expenditure was of considerable benefit to the country in her early period of growth, because increases in consumer demand in times of rapid economic expansion were satisfied largely from domestic sources. Consequently, such increases had less effect than in most countries in raising the demand for imports and so giving rise to difficulties with the balance of payments.<sup>12</sup>

Japan's consumption habits had an effect even on the durable-goods industries. For instance, the increase in national income per head during the modern period was not attended by any large increases in the demand for bigger houses or more elaborate furnishings. Even fairly well-to-do people remained content with dwellings of modest size, austere furnished by Western standards. As the house-building industry belonged entirely to the labour-intensive sector, the provision of residential accommodation for the rapidly expanding and highly mobile population made smaller demands on capital resources than occurred in similar circumstances in Western countries.<sup>13</sup>

The predominance of small firms and establishments was not confined to the traditional industries, for they were found in the manufacture of new products designed for both the home and the export markets. During the last half-century students of the Japanese economy have been impressed by the sharp contrast between the modern, highly capitalized sector and that composed of vast numbers of small firms. This contrast was to be seen not only in manufacturing but in distribution, transport and other branches of the economy. The wide disparities in productivity and wages between the two sectors gave rise to social and political problems which sometimes overshadowed their economic significance. Recent research has thrown light on how the duality came into being. In the Meiji era when the number of large, highly mechanized establishments was small the contrast was not yet obvious. Observers became conscious of it during the 1920s and 1930s with the expansion of modern industry.<sup>14</sup> A high proportion of the new capital was directed into that sector with the result that disparities in productivity and in wages and conditions of employment increased.

A full explanation of these structural differences cannot be given without reference to conditions in the labour market, and in this connection the evolution of the 'life-long employment system', which has been adopted by most large firms, must be considered. It is widely known that the typical Japanese factory-employer has been accustomed for many years past to recruit most of his labour from among school-leavers to whom he has offered permanent employment until they reached the age of retirement. At the same time he has assumed extensive