

TAXATION AND ACCELERATED INDUSTRIALIZATION*

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UNDERDEVELOPED ECONOMIES ARE typically caught in the so-called "vicious circle of poverty," a circle running from low income to small savings to small capital accumulations to a continuation of low income. Taxation can be used to break the circle by forcing a higher rate of savings from the meager income of these countries.

During 1928-36, a period of nine fiscal years, the Nationalist government of China committed itself to a program of accelerated industrialization of the economy. To help finance this program, numerous reforms were made in the Chinese tax system in the direction of increasing its revenue productivity. Yet, even as late as 1936, the combined tax collections of all levels of the Chinese government amounted to no more than 4 per cent of China's gross national product. This fact is surprising, since the corresponding percentages for other underdeveloped economies (e.g., India, Guatemala, and Chile) have been found to be considerably higher. Why, then, was the Chinese tax system during the Nanking period¹ unable to absorb a larger percentage of China's gross national product?

One possible answer to this query could be that the expenditures of the Chinese governments were not contributing much to the immediate consumption needs of the people. If that was the case, the proportionate taxable capacity would be low in a poor country like China. In this connection it is pertinent to note that the Chinese national government, which was financially far more important than the provincial and *hsien* (county) governments combined, devoted roughly 44 per cent of its total expenditures during the Nanking period to military purposes.

But, while the heavy military outlays of the Nanking government did lower China's proportionate taxable capacity, the tax system itself was the primary cause of its low revenue productivity. In China, as in the United States, taxes were levied by three levels of government: the national, provincial, and *hsien* governments. The

* A dissertation completed at Northwestern University in 1956.

1. For convenience, the period 1928-36 may be referred to simply as the "Nanking period," since during those nine years Nanking, not Peiping, was the capital of China.

national tax system, which was about two and a half times as important as the provincial and *hsien* tax systems combined, was very primitive in its structure. Over 90 per cent of its revenue came from taxes on commodities. In the order of their importance, the major taxes were customs duties, the salt tax, and excises on the production of five basic commodities. The system did not impose a tax on personal income until 1936, in which year income tax receipts accounted for roughly 1 per cent of national tax revenue. At the provincial and *hsien* levels, the financial pillar was the land tax, a proportional tax on agricultural income. In 1936 land tax receipts totaled \$188 million. That this was a meager sum becomes apparent when one realizes that in 1936 as much as 70 per cent of China's gross national product of \$25.9 billion originated in agriculture and that the land tax was the only tax directly reaching agricultural income. Even assuming that the land tax rested entirely on the agricultural sector, the relative burden as measured by the average tax rate would have been only approximately 1 per cent of the gross agricultural product. The study concludes, therefore, that the inability of the Nanking tax system to absorb a greater share of China's gross national product can be attributed largely to the lightness with which agricultural income was taxed.

Finally, in view of the preponderance of commodity taxes and the virtual absence of any tax on income, the Nanking tax system must be adjudged to be highly regressive in the distribution of its burden. The Nanking tax system, therefore, not only failed as an instrument of rapid capital formation; it was also highly inequitable.