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a kind that can be put into force without endangering the stabilization achieved with the aid of the recommendations made last spring by the Dodge Mission.

With respect to the long-term program, the Mission was faced with two possible choices. It could have recommended a rather primitive type of tax system, featured by external signs of income and wealth and business activity and not on carefully kept records and intelligent analysis of difficult problems. "Such a system could raise the required revenue," it is pointed out in the foreword, "but it would perpetuate gross inequities among taxpayers, dull the sense of civic responsibility, keep the local governmental units in uneasy financial dependence on the national government, and give rise to undesired economic effects on production and distribution." The alternative choice, and the one accepted by the Mission, was to recommend a modern tax system, which depends upon the willingness of business men and all taxpayers of substantial means to keep books and to reason carefully about fairly complicated issues of equity. For the small taxpayer, it was recognized that the task of filing returns and paying the tax should be kept a simple one.

The nature and scope of the comprehensive recommendations made by the Shoup Mission are summarized concisely in the following paragraph from the foreword:

"What we are recommending here is a tax system, not a number of isolated measures having no connection with one another. All of the major recommendations, and many of the minor ones, are interconnected. If any of the major recommendations are eliminated, some of the others will thereby become of less value, or even harmful. Consequently, we disclaim responsibility for the results that may follow the adoption of only part of our recommendations. For example, we have devised a tax system that avoids the double taxation of corporate income under the national income taxes, and at the same time blocks permanent tax avoidance. Among the essential parts of this system are the full inclusion of capital gains and the full deduction of capital losses, with permission to spread the gain over a series of years, and with exemption of large capital gains that are due merely to a change in the value of money. If capital gains and losses were to be included not in full but under some percentage plan like that now in effect, our set of recommendations for corporation and individual income taxes would have to be revised extensively."

II. Outline of Report and Appendix

The Mission's Report consists of 14 chapters, while the appendix contains information presented under four headings. The following headings of the chapters are suggestive of the thorough analysis of the Japanese tax system made by the Mission:

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<u>Chapter No.</u>	<u>Heading</u>
1	The Japanese Tax System;
2	Intergovernmental Fiscal Relations;
3	Prospects for Government Outlay, and Corresponding Tax Changes Recommended;
4	The Personal Income Tax: Rate and Exemptions;
5	Personal Income Tax: Other Problems;
6	Corporations;
7	Problems Common to the Personal and Corpora- tion Income Taxes;
8	Taxes on Gifts and Bequests;
9	Tobacco Profits and Liquor Taxes;
10	Other Indirect Taxes and Customs Duties;
11	The Inhabitant's Tax;
12	The Real Estate Tax (Land and House Tax);
13	Other Local Taxes;
14	Compliance, Enforcement, and Appeal Under the Income Tax.

The information presented in the appendix covers (1) the finance of local governments; (2) the treatment of irregular incomes under the personal income tax; (3) revaluation of assets; and (4) administration of the individual and corporate income taxes.

III. Need for Drastic Revision of Japanese Tax System

In its Report, the Shoup Mission repeatedly points to the need for drastic overhaul of the Japanese tax system and its administration. For example, it is pointed out (Chapter 1, page 18) that "the Japanese tax system is suffering from an accumulation of defective practices and provisions. No one of the defects is enough by itself to cause much trouble, but in total these faults are an impressive source of discontent, and even danger. It is as if a bridge across a large river, located at an appropriate place, and constructed of the correct materials, had been made almost unusable by a large number of small errors in the determination of the proper size of the girders at each of dozens of points."

Special attention is directed to the reference above to the fact that the faults in the Japanese tax system have given rise to popular discontent, a point that has been capitalized upon by the Japanese Communists. It may be added, parenthetically, that the insistence on equity in tax matters, a prime feature of the Shoup Mission's recommendations, has served largely to counteract the machinations of the Communists, who have put themselves forward as being vigorously opposed to the present inequities and irregularities which characterize the Japanese tax system.

The need for revision of the tax system is emphasized especially in Chapter 14, entitled "Compliance, Enforcement, and Appeal Under the Income Taxes," the analysis in which covers both personal and corporation income taxes.

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IV. Summary of Important Recommendations

The most significant recommendations made by the Shoup Mission were indicated in despatch no. 609 of September 3, 1949. For ready reference, these recommendations are reproduced herewith:

1. A much greater degree of fiscal autonomy, including much broader taxation powers, for local governments.
2. A substantial reduction averaging 30 per cent in the existing abnormally high personal income tax rates (with a top bracket of 55 per cent), this recommendation being designed to bring about a greater degree of voluntary taxpayer compliance and make effective tax enforcement possible.
3. Imposition of a "net worth" tax with rates ranging from 1/2 to 3 per cent on individuals with net properties in excess of Yen 5,000,000; this provision is designed to compensate for the reduced income tax rates in the high brackets.
4. Retention of the normal corporate income tax rate of 35 per cent but repeal of the excess profits tax.
5. Revaluation of assets in order to reflect realistic depreciation charges for tax purposes.
6. Substantial revision of real estate taxes, with the view to making them more productive and with anticipated revenues of 50 billion yen.

6/ A somewhat discursive but enlightening summary of the Mission's recommendations was given in the press statement issued on August 26, 1949, by Dr. Shoup, a copy of which statement was transmitted with the above cited despatch. A more concise summary, copy enclosed, containing a tabulation of the recommendations under appropriate headings, was released by the American Chamber of Commerce in Japan, Tokyo. This summary, which appears to be a competent piece of work, was made by Mr. K. YUASA, Japanese lawyer retained by the Chamber to give advice with respect to Japanese commercial and other laws. It will be noted that it was reviewed by the Chamber's Tax Committee and is said to be "O.K. as far as it goes, but does not touch on foreign investment or foreign nationals' problems."

V. Reactions of Press to Recommendations

Discussion of the full text of the Shoup Mission's recommendations highlighted editorial comment in the vernacular press on September 16, 17 and, to a lesser extent, also on September 18. Income taxes, re-appraisal of assets and local finances were the points evoking the most discussion, but many other aspects of the recommendations were also touched upon.

The Mainichi

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The Mainichi expressed some doubts about the recommendations, this daily stating that although Dr. Shoup "professedly has drawn up a plan for a permanent tax system, the recommendations are in perfect accord with the Dodge stabilization program which is only a short-range measure." In addition, the Mainichi observed, the recommendations "invite the criticism that they benefit capitalists while ignoring social policies. It concluded that the nation's economy should be re-studied after economic stabilization is achieved and that a "truly permanent tax system" embodying all the requirements of social policy be worked out at that time. A commentary in the Mainichi observed that, although the Shoup Mission had recommended raising land and building taxes in order to outlaw exorbitant land and house rents, the only satisfactory solution is to construct a sufficient number of houses.

The Tokyo Asahi asserted that the recommendations gave the higher income brackets "undue and preferential treatment." Emphasizing that the fundamental principle of taxation lies in the equity of tax burdens, this daily urged a close check of the Shoup Report and a correction of any shortcomings that might appear. The Asahi considered the basic reforms in the local tax system "highly desirable" but warned of possible problems arising from the inability of the present weak local tax offices to collect taxes. An Asahi commentary noted the "extremely vigorous attitude" of Dr. Shoup toward alcoholic beverages, which he defined as a "luxury." In this connection, the daily pointed out, "we should not forget that to working people a moderate quantity of alcohol offers comfort and rest after a day's work."

In analysis of the recommended reassessment of assets, the Yomiuri observed that the Shoup Mission appeared to be "too optimistic" over the deflationary trend in Japan's economy. The journal stated that it was not practicable in the present economic situation to carry out revaluation indiscriminately for all enterprises but declared it to be necessary to "take different steps according to actual conditions of individual enterprises." The Yomiuri feared that a compulsory reassessment would be likely to ruin enterprises instead of getting them on a sound footing. In a subsequent editorial, this daily observed with approval the wide interest in the Report, declaring that it "behooves the people to fully understand the Report" since their cooperation is required to rationalize the tax system. The Yomiuri thought it significant that the Report "elaborated many effective measures to eliminate disputes in connection with the assessment of taxes and to prevent tax evasion."

Although there are some unacceptable items in the recommendations, the Nihon Keizai pointed out, this is mainly due to the lack of adequate statistics. Unstable economic conditions are responsible for the present confusion in the Japanese tax system; it remarked, noting that the establishment of a stabilized tax system depends upon the taxpayers' cooperation and improved tax collection.

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Although the recommendations appear to be easy on the rich people, the Jiji Shimpō stated, Dr. Shoup assertedly explained that high tax rates would merely increase tax evasion. Citing the example of the corporation tax, the daily expressed the view that a proportionate increase in the tax rate would only cause corporations to consume their profits for "social extravagance." The Jiji expressed the opinion that the elimination of this "shortcoming of human nature" through tax reforms is "one of the most remarkable characteristics of the Shoup recommendations." While a commentary in this daily noted that some circles consider the recommendations unfavorable to small wage earners and bachelors, it remarked that the Report is "after all, nothing but recommendations." The writer went on to say that recommendations are recipes, while the Government and the Diet are the cooks. It is the people, however, who have to suffer the effects, he concluded.

The Hochi Shimbun stated that the "question of revaluation of fixed assets has been found to be contrary to expectation." Noting the hardships facing entrepreneurs on this issue, the journal asserted that revaluation will benefit only big enterprises with a high rate of profit and a high rate of operation. The principle of the "survival of the fittest" is too strongly demanded, the daily said. The Tokyo Shimbun, on the other hand, felt that reappraisal of assets would help place business on a sound basis but declared there are contradictions in carrying out such a drastic tax reform during the period of Japan's economic stabilization. The paper said that the most important point of the Report hinged on whether or not the existing taxation structure is able to meet the reform. The Yukan Chugai, however, termed the clear demarcation among the national, prefectural and city-town-village taxes the "highlight" of the recommendations. "The problem that remains is for Japan to eliminate unreasonable deals and irregularities regarding the collection of taxes," the daily added. The Naigai Times concurred in labeling the clear-cut division of taxes between the national and local entities the "most noteworthy" among the recommendations. However, it felt that the Shoup Mission had been over optimistic in predicating some of its recommendations on the belief that next year's national income would be larger than this year's.

Issuance of the two-volume appendix to the Shoup Report prompted the Nippon Times, Tokyo, to publish on October 7 an editorial entitled "Need for Cooperation," stating, in part, that "what now remains is for the recommendations to be translated into concrete legislation and for the people to grasp fully their significance." The daily went on to state that:

"Throughout the Shoup Report, emphasis has been placed on the need to overhaul the tax structure and to establish a comprehensive tax administration. The wonder has been... how such huge tax amounts had been collected up until now through a totally unintelligible system and by inexperienced and inefficient tax collectors. It was truly a miracle.

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"The recommendations of Dr. Shoup have pointed the way to overcome these deficiencies in Japanese taxation. But without the cooperation of the taxpayers, they will be of little avail. A thorough education of the people and their relationship to taxes and the government is necessary.

"The people have not yet discarded the old feudal notion that taxes are levied at the unilateral decision of those in power. It would not be an overstatement to say that most of the wage-earners realize how much tax they are paying and that the majority of people consider taxes as necessary evils. Many still do not understand that their taxes pay for the services rendered the people by the government. Positive cooperation of the people in establishing an efficient and fair taxation system here cannot be had if this lack of understanding remains and if the taxpayers are only interested in paying as little taxes as possible.

"Tax administration is the responsibility not only of the government but of the people as a whole. Fortunately, this has been stressed by the Shoup Report in pointing out the responsibility of the employee in collecting income tax at the source, in clarifying the method of collecting taxes on agricultural incomes, in establishing the blue income report forms, in setting up litigation courts, and in providing for heavy penalties for tax evaders. Through these means the people are expected to participate in the tax administration.

"It cannot be expected, of course, that the execution of the Shoup Tax Report recommendations will work miracles at once. But it must be deemed a great step forward if they will serve to bring a better understanding of the relationship of taxes to the people and their government. For a better tax structure and administration must go hand in hand with the cooperation of the people."

The problem of the revaluation of business assets was taken up by the Osaka Mainichi (English edition) in an editorial published on October 7, 1949. After pointing out that the "compulsory" revaluation of such assets, as recommended in the Shoup Report, "has rather proved a shock to the financial circles of Japan," the Mainichi states that, prior to release of the Report, Japanese quarters concerned had believed that reappraisal of fixed business assets should be carried out voluntarily in consideration of the respective positions of the various enterprises depending upon the durability of each category of such assets. The daily continued by stating that:

"In the Shoup Report, however, a greater emphasis is placed on such revaluation as a means of stabilizing general

commodity

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commodity prices rather than from the taxation point of view. More precisely, the Shoup Report strongly advocates rationalized management of enterprises in relation to stabilized economy after inflation is controlled. The Shoup Mission is quite justified in having assumed such an attitude because inflation is now gradually being placed under control and the Dodge policy for stabilized national economy is being pushed actively forward..... When, however, the revaluation is to be made compulsorily, the tax on the reappraised returns must necessarily be considered from a different point of view. Thus, the Shoup Report recommends a uniform rate of six per cent, much lower than the rate once predicted by Japanese circles.

"Another question that arises when business assets are reappraised compulsorily is that some enterprises which do not desire such revaluation of assets as much as some others may find themselves unable to withstand even a six per cent tax. As a matter of generalization, this six per cent rate will prove heavy to key industries equipped with assets of a comparatively long durability while it will be relatively more advantageous to such industries whose assets have a higher turnover. Thus, irrespective of a uniform rate of six per cent recommended by the Shoup Report, an appreciable elasticity will be required when translating it into practice in order that Japanese economy may be further stabilized instead of being adversely affected.

The Mainichi concluded its observations by asserting that "the revaluation must be completed as soon as possible in order to keep in line with the Dodge policy which aims at the quickest stabilization of Japanese economy."

VI. Reactions of Foreign Business Men

Issuance of the Shoup Report was greeted with scant enthusiasm by foreign business men, principally American, in Japan. Their concern, reported freely in the local press, was caused, in part, by the recommendation to the effect that the Japanese Government be authorized to commence collection of personal income taxes from United Nations nationals as from January 1, 1950, such nationals having since the surrender of Japan been exempt from payment of income taxes. Of greater import, however, were the recommended rates of taxation which, while calling for generally lower rates of income taxes, assertedly would have the effect of causing American business men to pay at least double the amount of taxes they would be obliged to pay in the United States on the same incomes.

Typical of some of the comment made by American business men are statements contained in the following extracts from a news report written by the United Press manager for Japan and published on September 18, 1949, by the Nippon Times, Tokyo:

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"American business men in Japan, after reading the text of the report prepared by Dr. Carl S. Shoup and members of his mission, were especially vocal in their objections to the recommendations concerning taxes on the non-yen incomes of foreign nationals and taxes on foreign firms. American business men said that it appeared to them that Dr. Shoup had failed to take a realistic view in recommending what they consider more drastic reductions in the tax schedule.

"The general feeling was that greater reductions than those recommended by Dr. Shoup would be necessary to encourage foreign investments in Japan and the establishment of foreign firms here which would benefit the Japanese economy.... One business man said that if the Shoup recommendations are adopted without change, a tax structure would be set up here that would be disastrous to foreign business men."

The American Chamber of Commerce in Japan appointed a special tax committee to make a detailed study of the Shoup recommendations, especially those which affect foreigners, with the view to submittal of the Chamber's criticisms to General Headquarters. Mr. Paul AURELL, president of the Chamber, was quoted in the Nippon Times on September 23, 1949, as stating that "Japanese and American business in Japan must prosper together. We want to see a tax structure established here that will be fair in all respects to Japanese and American individuals and firms."

Local chambers of British, French, Dutch and other business men took steps to join the American Chamber in its drive for reconsideration of the pertinent Shoup recommendations. However, rather than to continue airing their views in the local press, members of the American and other Chambers have held private discussions with concerned Japanese officials, including Finance Minister Hayato IKEDA, with the view of stressing the need for giving special consideration in tax matters to foreigners, especially from the standpoint of keeping taxes moderate in order not to drive foreign investors, actual and potential, away from Japan. According to responsible officers of the American Chamber, the Japanese officials in question have proved sympathetic to the suggestions put forth by the Chamber's spokesmen.

VII. Developments in Japanese Government Circles

Press reports indicate that the Japanese Government is now preparing legislation to implement various recommendations contained in the Shoup Report, such legislation to be introduced into the extraordinary session of the Diet which convenes on October 25, 1949. Whether or not the legislation will provide for wholesale adoption of the Shoup recommendations remains to be seen. Various news reports suggest, however, that considerable differences of opinion on that point are current in Japanese Government circles concerned. What appear to be primarily involved are the election promises made early in 1949 by the Democratic-Liberal Party, now in power, for large-scale tax reductions. In addition, the question of drawing up the Japanese Government's 1950-51 budget is also involved, a proposition complicated by necessity to adhere to the principles enunciated in the Nine Point

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Economic Stabilization Program as elaborated by the Dodge recommendations, and by the undertaking assumed by Premier Yoshida to carry out the Shoup recommendations.

Premier Yoshida has been quoted in the press on several occasions recently with respect to tax matters. On October 4, 1949, the Nippon Times published an article prepared by an United Press correspondent wherein the Premier reportedly stated to the correspondent that "to attract foreign capital for reconstruction, some of the tax levies will be even lower than those recommended by the recent Shoup tax reform report." During the course of a trip to the Kansai area shortly after, Premier Yoshida was quoted by the Osaka Mainichi as stating that he intended to have the Japanese Government retrench on expenditures to such an extent that tax levels will be reduced "even beyond the scope of the recommendations made by the Shoup Mission."

This Mission will expect to report further regarding steps taken by the Japanese Government to provide for implementation of the Shoup tax recommendations.

Respectfully yours,

For the Acting Political Adviser:

Carl H. Boehringer

Carl H. Boehringer
Economic Counselor

Enclosures:

- 1/ Volume I, Report on Japanese Taxation by the Shoup Mission (8 copies to Department);
- 2/ Volume II, Report on Japanese Taxation by the Shoup Mission (8 copies to Department);
- 3/ Insert entitled "Highlights from Japan Tax Report by Shoup Mission" published on September 16, 1949, by Nippon Times, Tokyo (15 copies to Department);
- 4/ Volume III (Appendix), Report on Japanese Taxation by the Shoup Mission (8 copies to Department);
- 5/ Volume IV (Appendix), Report on Japanese Taxation by the Shoup Mission (8 copies to Department);
- 6/ Memorandum entitled "Summary of Recommendations Suggested by the Shoup Mission" issued by the American Chamber of Commerce in Japan, Tokyo (15 copies to Department).

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NATIONAL FOREIGN TRADE COUNCIL, INC.

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Letter to Swingle drafted
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Mr. W. Walton Butterworth
Assistant Sec'y for Far Eastern Affairs
Department of State
Washington, D. C.

Dear Mr. Butterworth:

Enclosed are five (5) copies of a memorandum entitled "Recommendations Concerning Report of Shoup Mission on Japanese Taxation" which have been prepared by the Tax Committee and the Committee on Japan of the National Foreign Trade Council.

This memorandum supplements a memorandum entitled "Recommendations Concerning Reform of the Japanese Tax System", copies of which were forwarded to Mr. Willard L. Thorp, Assistant Secretary of State for Economic Affairs, August 5, 1949, and acknowledged by Orville J. McDiarmid, Acting Chief, Financial Affairs, August 22, 1949. The instant document records the views of the above-mentioned Committees as to the extent to which the Shoup Report meets, or would need to be supplemented to meet, the recommendations of the Council.

It is respectfully requested that a copy of this memorandum be transmitted to the proper officials in SCAP.

Yours truly,

William S. Swingle
Executive Vice President

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