Leader or Strategic Follower: What Role for the Japanese State?

Japan’s Capitalism: Creative Defeat and beyond by Shigeto Tsuru; Strategic Capitalism: Private Business and Public Purpose in Japanese Industrial Finance by Kent E. Calder; The East Asian Miracle: Economic Growth and Public Policy

Review by: John Zysman and Eileen M. Doherty


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What is missing from the picture here is some analysis of news content on key topics. The book relates the patterns of interaction between reporters and politicians without demonstrating exactly what sort of reporting this interaction produced on key subjects such as corruption, elections, or new taxes. The author collected a wealth of data to provide the clearest picture yet of the relationships between Diet members and newspaper people, but the book doesn't link these relationships adequately to newspaper coverage of specific issues. The characterization seems abstract in parts, not relating concretely the impact of the relationships that the book documents so well. The challenge that remains is to integrate the patterns of interaction between reporters and politicians with the substance of political news stories.

What the book omits is far less noteworthy than what it offers. Despite the paucity of anecdotes (the author is careful to protect his sources), readers will come away with the feeling that they have looked over the shoulders of some of Japan's most important political actors as they went about their work. The author's painstaking research has produced an intimate insider's account of the process of political reporting. The only major players to remain out of sharp focus were Japan's bureaucrats, who are evidently less prone than conservative politicians to bare their operations to the prying eyes of the press or foreign scholars.

LEADER OR STRATEGIC FOLLOWER: WHAT ROLE FOR THE JAPANESE STATE?


Reviewed by

John Zysman and Eileen M. Doherty
University of California, Berkeley

Those interested in the Japanese political economy must answer for themselves three questions. First, what model does one hold about the operations
of the Japanese political economy at the apex of its high-growth era? The demarcations of that era are admittedly fuzzy; nonetheless, students of contemporary Japan must have a baseline by which to compare Japan's political economy during its developmental heyday with that of today. One reference point is the period until roughly 1975, before Japan began to loosen its tight capital controls, thereby dismantling some formal instruments of protection. The model must depict the critical institutions and policies that defined a set of constraints and possibilities for the central economic actors. It must identify the "market logic" that emerged from the interplay of actors as they responded to that set of incentives and constraints. The growth model must also demonstrate how the costs and benefits of growth, the pain and gain, were allocated. How were the losers kept from interfering with the processes of development? If they were compensated or insulated, then how were the market incentives for winners kept sufficiently strong to generate new economic activities, firms, and sectors?

Second, with that baseline in mind, how substantially has the market logic that characterized the pre-1970s period changed? Certainly, formal government regulations have been loosened in Japan. More recently, the rise in the value of the yen has driven producers to reorganize production with significant operations outside Japan. Japanese imports have also increased. Yet for the most part, Japan's tightly woven supply networks seem to be firmly in place. Japanese institutions and practices have certainly evolved since the developmental heyday baseline, but which changes are significant?

Third, how extensively does the story of Japan intermingle with that of the rest of Asia? Until recently, Asia was neither a significant market nor a significant source of components and subsystems for Japanese firms. Increasingly, it has become both. What does the development of the Asian market imply for Japan's economic and political arrangements? And what does Japan's economic success imply for the rest of Asia?

*Japan's Capitalism* addresses the first of our three questions head-on and presents an exceptionally valuable discussion of the creation of the postwar Japanese economic system, how its critical mechanisms worked, and the market dynamics that resulted. Shigeto Tsuru, former president of the International Economic Association and professor emeritus of Hitotsubashi University, was also vice-minister of the Economic Stabilization Board in the immediate postwar years. He does a masterful job of combining the insight of an insider with the analytic tools of an academic professional.

Standing out in Tsuru's story of the reconstitution of postwar Japan is the influence of the U.S. government, which was determined to rebuild Ja-

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Japan as the “workshop of Asia” to stand against communism in the region. Equally apparent is U.S. naivety. For example, the decision to apply American civil service rules to traditional Japanese institutions reinforced the power of the elite bureaucrats, an ironic turn given the powerful influence that bureaucratic “administrative guidance” played in Japan’s postwar industrial growth. Similarly, with regard to exchange-rate decisions, Tsuru reminds us that although the yen/dollar rate was bound to be very low, the exceptionally low valuation of the yen was an American decision. That undervaluation amplified Japan’s industrial development.

Tsuru’s analysis of rapid growth includes, of course, a discussion of Japan’s high saving rates. But he pushes beyond the ritualistic to ask other basic questions. What were the major sources of demand that warranted the high rate of growth? What was the role played by the government to stimulate growth? What were the implications of postwar changes for Japan’s industrial structure? What was the evolution and consequence of business organizational structures? And what was the role of exports in driving Japan’s growth? The result is an argument about the critical role of exports, combined with domestic competition in an insulated market, in creating internationally competitive manufacturers in a series of sectors.

Tsuru’s most valuable contribution is that he discusses through the sophisticated eyes of a Japanese government insider the critical institutions of the economy and their interplay. For instance, he traces the recreation of the zaibatsu system (note that he uses the term zaibatsu rather than the less loaded postwar term keiretsu) but emphasizes the emergence of the “one-set” principle by which each corporate group established a firm in each major sector. Before the war, the major zaibatsu were specialized and hesitated to launch new industrial ventures. The one-set principle prompted diversification in the keiretsu, with banks as the major source of medium- and long-term finance for industries. This sparked a distinctive pattern of competition. Groups competed with each other by vigorously pursuing market share. The result was overinvestment and excess capacity, followed by the development of government strategies to manage competition.

Using the story of the sewing machine industry, a first instance of “targeting,” Tsuru suggests how distinctive features of Japanese industry emerged. Government subsidies—aimed both at assuring advanced production technology and at supporting exports—created a distinctive dynamic of domestic competition and aggressive exports in that sector: “Japanese government officials assisted and backed the sewing machine industry at every step of this process to become virtually the first successful export industry in the postwar years” (p. 81). In reviewing other sectors that became export staples—steel, autos, ships—Tsuru concludes that “we find that the basic element in the success story of the sewing machine industry—namely how paternalistic administrative guidance enabled it to strike a
happy balance between competition at home and government support for sales abroad . . . was essentially repeated in the leading industries too” (p. 82).

At the core of government action was a policy of administrative guidance. According to Tsuru, the ability of the government to direct or induce private firms or persons to take or refrain from taking certain actions has been a “more widely accepted and solidly established feature of government administration than in other countries” (p. 97). Tsuru discusses several of the administrative mechanisms used: privileged finance, tax arrangements, infrastructure investment, land reclamation, and even selective allocation of sugar quotas as a means of supplementary finance. “Window guidance” was the monetary arm of administrative guidance: a series of financial controls, incentives such as low-interest finance, and informal “suggestions” by the Bank of Japan designed to channel domestic savings into industrial investments. In the end, Tsuru shows us all the pieces of a system of protection and promotion that created massive production innovation and internationally competitive industries.

Not surprisingly, the strongest part of the book is the section on the immediate postwar period. The nuanced discussion of the reforms, political debates, and decision-making processes during the Occupation and high-growth years provides us with a rich understanding of the forces that produced the institutional foundations of modern Japan. Tsuru’s aim shifts slightly in his discussion of Japan's history since the 1972 oil crisis. Because his goal is to demonstrate the social problems inherent in Japanese capitalism, he devotes somewhat less attention to historical details and more to economic arguments about the welfare effects of high growth and the “pitfalls of affluence.”

Consequently, the book sheds little light on the specific ways Japan has changed since the high-growth era. The Japanese system has evolved, pressed by oil shocks, land-price inflation, corporate profits, financial scandals, and multiple yen appreciations. Although Tsuru touches on all these factors, those interested in understanding changes in the way Japan's industrial structure and political institutions shape economic outcomes must look elsewhere for their answers.

Strategic Capitalism: Private Business and Public Purpose in Japanese Industrial Finance, by Kent Calder, also focuses overwhelmingly on the first question we outlined: How did Japan’s economy work during the high-growth era? Calder presents a radically different picture of the logic of the developmental heyday. His focus is on the fractures inside the Japanese industrial policymaking system and the autonomous strategic capacity of the private sector in driving the creation of new sectors. Using credit allocation as his lens into public/private relations, he argues that the capacity of the state to strategically allocate capital has been constrained by rivalries within
the state and “by the nature of the private sector, the influence of party politicians, and occasionally by foreign actors” (p. 14). On the whole, “industrial strategists within the government have lacked the wide-ranging ability to shape the financial system to their vision of priorities” (p. 14).

It is not that Japan is a liberal market economy, argues Calder, but rather that the capacity for strategy and direction lies in “a formidable and distinctive set of private-sector institutions,” especially in the financial sector (p. 16). Japan’s economic success rests on a public-private system that is predominantly driven by private-sector decisions. In this simple form, and as a corrective to the sometimes overdrawn popular arguments that the Japanese government can simply impose outcomes on domestic and international markets, this book is useful. But the real question must be whether Calder provides a convincing argument regarding the extent of government influence. Here, analytic difficulties emerge.

Calder’s argument rests on the distinction between “strategy” and “regulation.” Government rivalries exist between the strategists (in this story essentially the Ministry of International Trade and Industry [MITI]) and the regulatory ministries (in this story essentially the Ministry of Finance [MOF]). MITI has the visions; MOF has the tools but a regulatory bias of maintaining financial stability. Calder argues that the strategists are institutionally constrained in their attempts to direct policy outcomes.

However, the distinction between strategy and regulation is far less clear than Calder suggests. Regulatory decisions and structures often reflect government purposes beyond maintaining market stability. More importantly, when ministries are responsible for regulating the industries they nurture, “strategic” goals (such as protection or industry support) are impossible to separate from regulatory functions. The Ministry of Post and Telecommunications is at once regulator and promoter of Japan’s telecommunications industry. The Ministry of Health, which includes the Japanese equivalent to the U.S. Food and Drug Administration, has regulatory goals that intermingle with the purposes of promoting the interests of the pharmaceutical industry. The fact that MOF is a regulatory agency does not mean it lacks strategic purposes or will not work to facilitate the purposes of others. There are many mechanisms for assuring the integrity of the financial markets. Different mechanisms have different objectives.

In addition to analytical problems such as the strategy/regulation distinction, Calder’s analysis suffers from his exclusive focus on credit allocation. Administrative guidance through finance is not simply a matter of the

initial allocation of loans. Mechanisms also exist that allow government actors to micro-manage crisis situations for troubled banks. The handling of the third world debt crisis revealed such mechanisms; the current economic crisis reemphasizes them. These mechanisms generate enormous influence for government actors. They often also require MOF to accommodate and strike bargains with other ministries. The point is that administrative guidance goes deeper than mere credit allocation decisions and is not always characterized by bureaucratic rivalry. Ministerial cooperation alongside rivalry is an important characteristic of Japan's political economy.

The importance of those interministerial arrangements is not reflected in Calder's discussion of Japan's "Bankers' Kingdom." Calder argues that the structure of Japan's financial system during the high-growth era was characterized by the predominance of indirect financing that made bank loans the major form of corporate finance, domestic interest rate controls, controls on exchange rates, an imbalance of liquidity between city banks and other parts of the financial system, over-lending from the Bank of Japan to city banks, and a bifurcated system of private financial intermediaries, with city banks lending to large firms and local banks to small firms (p. 136). The result, he argues, was a central and influential role for private financial institutions: a bankers' kingdom.

Perhaps. But while Japan may have been a bankers' kingdom, it was also an industrial development heaven. MOF regulations created channels and mechanisms that assured both high, stable margins for banks and low-cost, long-term investment funds to the industrial sector over several generations. The bankers' kingdom was characterized by channels that linked undercompensated savings to underpriced industrial investment; these were nonmarket mechanisms operating with administered prices. The array of interministerial decisions linking finance and industrial development were elements in the reciprocal bargains that characterize Japan.

If we focus our analysis on regulatory purposes and the interaction among ministries, we come to a very different conclusion than Calder, a conclusion consistent with Tsuru's history. The assurance of readily available industrial finance through the regulation of the financial system amounted to a crucial national strategic decision. A distinct industrial logic emerged from this combination of readily available low-cost capital, the assurance of banking profits, and the management of industrial risk so that lending losses would not disrupt either the financial system or particular financial houses. Japanese firms were able to pursue aggressive strategies aimed at capturing market share precisely because they had implicit and explicit government assurances that the risks of these strategies would be muted. As Tsuru notes, the structure of industrial finance had a logical consequence: excess capacity as a result of the rivalry of industrial groups and
their banking allies.\textsuperscript{3} That excess capacity pressed firms toward production innovation in order to gain new market share and to remain competitive. Excess capacity also encouraged the emergence of mechanisms to support aggressive export tactics.

Another difficulty emerges from Calder's assertion that government spending on infrastructure and traditional sectors is evidence that the strategic focus of lending was limited. There are two problems with this conclusion. One is an "accounting" issue; the other is one of politics. First, many of the categories of funds dismissed as nonindustrial categories are in fact used to support industrial ventures, and not just in Japan. When the French built seaside steel complexes in the north and south of the country, enormous investments in land reclamation, urban development, and rail and other transport links had to be made at the same time. Those were hugely expensive public investments. Similar investments were made for the Disney complex outside Paris. A similar argument can obviously be made for Japan.

Second, and as important, is the political story of how the promotion of rapid industrial growth was politically sustained. Economic development always implies social dislocations. Unless those who are dislocated and disadvantaged are bought off and co-opted through compensation (or simply beaten politically), an endless series of conflicts and disputes will disrupt the market. The policy trick is to contain opposition but not to subsidize the losers to such an extent that positive market signals are muted. We cannot dismiss the funding of the declining sectors as simple capture or as lack of strategic purpose. Before accepting Calder's argument that funding to infrastructure and traditional structures reflects the failure of strategic ability, we must be able to identify Japan's mechanisms for allocating the pains and gains of growth. As the government attempted to manage the political problems associated with economic winners and losers, what was the place of financial instruments, bureaucratic action, and political agreements?

In sum, Calder provides a richer and more complex picture of the actors in the Japanese industrial finance system, emphasizing their rivalry and the significant influence of private-sector actors in shaping economic outcomes. What is missing, though, is a sense of the politics in which the story is embedded. How did the market dynamic evolve over the years? Part of this omission is a conscious choice by Calder, who deliberately avoids writing a chronological account of Japanese industrial finance: "A chronological approach could not present a succinct critique of the developmental-state con-

cept. Such treatment would simply yield the unexceptional conclusion that the Japanese state is slowly losing control capabilities over time. The more fundamental point is... the surprisingly reactive character of the Japanese state and the contrasting activism of its private sector at any point in time” (p. 17).

Yet the conclusion that the Japanese state is slowly losing control is not “unexceptional,” as Calder claims. It is clearly true that the dynamics of the Japanese financial system have evolved. But other authors, such as Steven Vogel, have contended that the supposed financial deregulation hid a more fundamental reregulation that reasserted bureaucratic power rather than a loss of governmental control.4 As in the Tsuru volume, there are elements of change in Calder, but we cannot from his book derive a new model to understand how Japan’s finance game now operates.

More fundamentally, the book does not fully succeed in its primary goal: demonstrating the reactive character of the Japanese state. In his specific case discussions, Calder notes a broad range of instances in which government did act and act powerfully—despite his argument that private-sector actors were the primary catalysts for change. In the end, the reader cannot really assess from this account the role of the government in influencing private actors or in setting the terms on which the financial markets induced industrial behavior. It is not simply particular actions—assessments of whether the government did this or that—that matter. Rather, it is the structure of incentives and constraints that induced particular national market logics. By asking narrowly which actors were making particular decisions, Calder seems not to capture the character and dynamics of strategic competition within Japan and then in world markets.

It is the interplay of choice that is so powerful. If we adjust the story Calder tells for the types of concerns outlined above—such as the real successes of intervention noted even in this book, the mixed packages of government aid that obscured the accounting of industrial vs. non-industrial aid, the fact that limited intervention can powerfully affect corporate strategy, and the reality of promotion within a regulatory agency—we emerge with a very different picture of the government’s role in industrial development. We come back to a picture, albeit one taken from a different angle, of a developmental economic strategy filled with reciprocal consent by government and private players.

*The East Asian Miracle: Economic Growth and Public Policy* was pre-

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pared for the World Bank by a research team led by John Page (and supported at least in part by the Government of Japan). The book speaks directly to the third question outlined at the beginning of this article: How does Japan's story intermingle with the stories of other Asian countries? It is a significant contribution to broader debates about the role of government intervention in economic development.

For too long there has been a cartoon-like debate in which one set of scholars attributed Asian economic growth to strong government interventions, while another group of scholars claimed that growth occurred despite those interventions. That in turn encouraged some analysts to reconsider the interventions and conclude that either they had not happened or did not matter. The East Asian Miracle reopens these debates in a more sophisticated manner. Although the book suffers from inconsistencies and occasional contradictions (due perhaps to multiple authorship or perhaps to political compromises made at the World Bank during its writing), it stands as a landmark in the policy debates on developmental economics.

The book examines eight “high performing Asian economies” (HPAEs): Japan, Hong Kong, the Republic of Korea, Singapore, Taiwan, Indonesia, Malaysia, and Thailand. Its task is to outline the causes of rapid economic growth in these eight countries, which have since 1960 grown more than twice as fast as the rest of East Asia and three times faster than Latin America and South Asia. The report argues that the success of the HPAEs rested on two factors. First, the countries “got the basics right” with sound macroeconomic policies, high levels of saving and domestic investment, and expanding human capital. Second, governments pursued selective interventions in three broad areas: industrial promotion, mild financial repression, and export promotion.

The East Asian Miracle is clear in its conclusion that “getting the basics right” was the single most important factor in permitting Asian economic growth. It is less consistent in its assessment of government intervention. In parts, the tone is positive, suggesting that careful interventions were useful complements to sound macroeconomic policies. In other parts, it takes a more skeptical tone regarding the wisdom of market interventions.

Given the fact that the final version of the book was a political compromise, it is perhaps fitting that the book's primary contribution is also political. The East Asian Miracle has succeeded in introducing industrial policy as a legitimate area of inquiry in the policy community. According to Japan Overseas Economic Cooperation Fund Vice President Masaki Shiratori (who was one of the most vigorous campaigners for the World Bank to conduct the survey): “The World Bank is still dominated by neo-classicists. But I see a very tiny change. When I was at the Bank Board, and when young Japanese economists tried to talk about subjects such as directed
credit or industrial policy, they were put down. Now they can openly talk about the replication or application of these policies."

Consequently, even the lukewarm conclusions of the book are revolutionary in their attempt to bridge discussions of different national economies with analytic studies of growth. While the research team emphasizes, properly, the broad macroeconomic conditions of saving, investment, and the creation of human capital, the volume lays out a foundation by which very different analytical traditions may begin to speak to each other. A few themes merit comment here.

First, the volume begins to approach the notion that a particular mix of policies and institutions can create a market dynamic. But the authors stop short. For example, the volume acknowledges that most HPAs began industrialization with protectionist policies (although the authors also stress that most have also gradually embraced market-opening policies). During the high-growth era, participation in export markets pushed firms toward greater efficiency, while domestic protection simultaneously insulated them. According to the World Bank study, these “mixed trade regimes” created offsetting differences in the prices of exports and local goods: “Export prices were set in the international market and were often substantially less than current marginal or average costs. Losses on export production offset profits in the protected market, while competition in the international market ensured that the firm would not suffer from loss of cost discipline” (p. 295). In a mathematical sense, the combination of export subsidies and protection/domestic promotion may have resulted in relative price neutrality. But constructed neutrality and virgin neutrality are not the same thing. Protection/domestic promotion in large or relatively large markets creates a solid home base that encourages particular kinds of company strategies. The result is a new market dynamic that is not neutral.

In the case of Japan, domestic policies created internal “contests” that substituted for pure markets in honing the competitive development of national firms. Those contests rested, as Tsuru notes, on the broad availability of finance to rival zaibatsu or keiretsu groups. The resulting market dynamic generated a downpouring of exports (leading to enormous trade surpluses with North America and Europe); that new dynamic also pushed Japanese firms to compete for market share through continuous product innovation. The World Bank study does not offer a conceptual framework that traces the way these institutional arrangements and policy choices shape market dynamics in emerging Asian economies.

Second, the volume correctly notes that rapid growth and relative social equity have run together. To many Western observers, the political weak-
ness of Asian trade unions obscures the fact that the HPAEs have achieved low and declining levels of inequality compared to other regions. Although the solutions have not always been democratic, the relative income equality is certainly surprising. This opens a broader issue. The economic study of growth must be embedded in an understanding of how, like a simultaneous equation, the technical and political problems of growth are solved at once. In this regard, the Japanese experience becomes a model, an alternate understanding of how markets and governments can interconnect.

Third, it is critical to understand not only the ways that Japan is a development model, but also the limits of that model. The authors of The East Asian Miracle do an impressive job of exploring the similarities among the HPAEs. Yet their decision to group the eight countries together into one analytical whole obscures important differences among them. After all (and as the volume notes), Southeast Asian countries must pursue development strategies in a much different environment than other countries did. Both Japan and Korea benefited from U.S. economic and military assistance, as well as easy access to the U.S. market. The United States is no longer as willing to tolerate merchandise trade imbalances; nor is the U.S. government flush with foreign assistance as it was during the cold war.

Moreover, the technological requirements for competitive success have changed. In the past, it was possible to follow a development trajectory that utilized second-generation technology, along with low domestic factor prices, to be internationally competitive. Today, most developing countries see the electronics industry as key to their development. The technological learning, economic spillovers, and large export markets associated with electronics have propelled that sector into the center of national development policies all over the world. Yet the industry requires huge initial capital investments—and mistakes in capital allocation can be fatal for a firm. In such a competitive environment, Southeast Asian countries are finding it necessary to insert themselves into the international division of labor that has been created by the expansion of cross-border production networks of multinational corporations (MNCs) operating in Asia.

Domestic differences also make it impossible for Asian countries to embrace a “Japan-style” development strategy. Japan’s industrialization in the nineteenth century was based on domestic technological innovation. Taiwan and South Korea, by contrast, relied on achieving competitiveness through low wages, and their industrial expansion was based on learning rather than indigenous innovation.6 Southeast Asian countries constitute yet a different “third tier” of late developers. These countries do not have the history of

domestic manufacturing that developed indigenously in Japan and that was created through successful import substitution industrialization policies in South Korea and Taiwan. This lack of historical manufacturing experience renders Southeast Asian countries more dependent on MNCs for their industrial development.7

Thus, the World Bank study sets the stage for a series of conversations in the academic and policy communities about the ways the Japan case can shed light on the experiences of other Asian countries. These revolve around several themes: the ways governments can shape market dynamics; the ways governments can simultaneously manage the political and economic demands of industrialization; and the ways Japan's economic development serves as a model yet at the same time changes the policy options for "third-tier" Asian industrializers.

How have our initial three questions fared in these volumes? While it seems that we have a good model for the rapid-growth years, as proposed both by Tsuru and (more guardedly) by the World Bank study, the Calder volume certainly suggests that the debate is not closed. Because debates about that baseline will continue to provoke disagreement about optimal government policies (and will continue to fuel academic careers by encouraging "product differentiation"), the debate is likely never to be closed. Our second question—how government-industry relations change at the post-developmental stage—remains unanswered by these volumes. Indeed, the debate over the extent and character of change in the Japanese system is just beginning. As these debates progress, it will be critical to remember that outstanding disagreements regarding the high-growth years will inevitably affect our discussions and understanding of contemporary Japan. Third, with regard to Japan's role in Asia, the World Bank study lays out some interesting hypotheses—and themes for further discussions—about the lessons and "non-lessons" that Japan's development holds for other Asian countries. Just as important in those future discussions is the role of Asia in Japan's continued development. More must be learned about the way Japanese firms have responded to yen appreciations and other competitive pressures by reconstructing their production networks in Asia. These activities may fundamentally alter the international implications of Japan's postwar domestic market logic. For example, are Asian markets for final products expanding rapidly enough to absorb some of the exports currently targeted for North American and European markets? Increasingly, the place of Japan in Asia's economic development, and of Asia in Japan's continuing economic development, have become entangled stories.