

Is it true to say that what were formerly Japan's strengths ultimately became weaknesses?

From being a country in ruins after the Second World War, Japan's economy had within 30 years become the world's second largest in absolute GDP terms, and GDP per capita was, by 1988, 17% higher than that of the 'organic core' of capitalism in Western Europe and America. This dramatic growth - easily the most significant in the whole East Asia region - was led by exports to both America and the rest of the region. By 1980, transatlantic trade was surpassed by transpacific trade, and this itself was surpassed by intra-Asian trade, with Japan as the driving force behind it. The main reasons given for this success are the industrial structure, the labour market and the developmental state. During the 1990s the Japanese economy went into relative stagnation. The reasons given for this stagnation are often the same as the reasons given for its success, though not all of the latter can be blamed for Japan's decline. It is true to say that some of Japan's former strengths could now be construed as weakness - namely the *keiretsu* system and the role of the state - while others, such as the labour market and the unusually significant small-medium enterprise (SME) sector, continue to be strengths of the Japanese economy even now.

The Japanese *keiretsu* is an 'enterprise grouping' - a closely integrated network of companies, often including a bank as well. They are a successor to the *zaibatsu* - controlling kinship groups - which dominated the Japanese economy before and during the Second World War. American occupying forces aimed to break up these *zaibatsu* as they were seen as an 'un-American' way of organising capitalism, and had supported the Japanese government in its war effort. However, the old *zaibatsu* families repurchased all the stocks they had sold through banks which were largely owned by them. The *keiretsu* are still characterised by family ownership to a great extent, and also by extensive cross-holdings within the group (and virtually none outside it). In Toyota, for example, the ten largest shareholders hold 36% of stock, while in the USA the top twenty would normally hold under 10%. The concentration of power and control meant that businesses were easily manipulated, and were allowed to make long-term, stable plans which the West was seen to lack. While this was lauded in the 1980s, in the 1990s it has come to be seen as cronyism. Japan has tried to import the American corporatist culture and also the venture capital model which has been so successful in the USA, but has failed due to this massive

concentration of power. This concentration has also made business operate in a much more informal way, which may be allowable in times of economic success but in times of failure it prevents companies from understanding the situation they are in. For example, Japan has had to employ a great number of foreign accountants, as it has only one tenth as many native accountants as Britain.

Yet it is easy to exaggerate the importance of the *keiretsu* sector. Japan also has an extremely large SME sector. For example, in the mid-1970s over 50% of employment was in firms of under 300 employees, compared to around 20% in the UK and USA. The Japanese economy relied on a huge extent to its SMEs - there was a semi-feudal dependency between larger and smaller firms. It has been argued that this system had many advantages. Firstly, risk would be externalised in a recession - workers were laid off in the SME sector, while those in the *keiretsu* could keep their 'jobs for life' and the top layer would remain fairly stable. Secondly, innovation was also externalised. In America a motor company such as Ford would design and test a new part themselves, then put it out to tender and choose by price. In Japan a company such as Toyota would specify only the demands on the part, and leave the design to outside companies, thus guaranteeing competition on quality as well as on price. In 1973 the value added to finished vehicles by major Japanese car manufacturers was 18%, as opposed to 43% for the three main companies in the USA. In 1981 Toyota produced 3.22 million cars with 48,000 employees, while General Motors needed 758,000 employees to produce 4.62 million cars. Subcontracting in Japan is far more stable than in the West, and there is often overlap between firms and their subcontractors in staff employed and plant used. This means that the costs of subcontracting are lower - employment costs such as insurance do not have to be paid by the *keiretsu*, and frequently are not paid at all. An important addendum about subcontracting is that it has developed symbiotically with the abundant and highly competitive supply of labour in the wider East Asian region, leading Arrighi to remark that "Japan has done so well by specializing in the pursuit of profit in the East Asian region". It is hard to see how such strengths in the subcontracting system could have ever developed into weaknesses.

Another factor previously seen as a strength is the Japanese developmental state. Gerschenkron saw the Japanese state as exemplar in the promotion of businesses. The state constantly borrowed 'best practice' from other countries and gave the appearance of having more control over the direction of the economy. The state had two main roles, firstly as a regulator and coordinator of the market economy

through the Ministry of International Trade and Industry (MITI), and secondly as an investor through the Bank of Japan.

MITI created markets during the 1970s and 80s, setting out the conditions in which Japanese products could sell. It attempted to create an advantage in high-tech goods, controlling links between Japanese and international markets and stimulating domestic businesses. The state acted as a 'doorman to Japan', deciding which products and companies would be allowed into Japanese markets. Foreigners were forced to sell patents, licences and expertise - not just products - and were given a loyalty payment for doing so, which allowed Japan to learn from and copy Western production methods. Foreign direct investment was controlled, and stringent 'safety tests' and other blocking devices were imposed to exclude many foreign goods. Japanese consumers were encouraged to 'buy Japanese' and are reluctant to spend money on imports. A harmful consequence of these policies has been a huge current account surplus, which has led to constant upward pressure on the Yen and consequent deflationary effects. Certain industries such as automobiles were promoted, allowing Japan to move from the 140,000 cars produced in 1960 to over 8,000,000 in 1980. Okimoto explains this in political terms - the relationship between the bureaucracies, the Liberal Democratic Party and their grand coalition of supporters was crucial in deciding which industries would be promoted. There was great horizontal mobility between government and business leaders - it is estimated that 75% of bureaucrats ended their careers in private firms. The *keiretsu* were closely integrated into government - the ruling elite of *today-takkai-zaitai* ('Tokyo-Government-Business') allowed better planning. Businesses did not need to lobby the government as by and large they *were* the government. The state and market were seen not as rivals, but the state as the source of the market's success. This is now lambasted as cronyism. As the system weakens, self-interest turns into self-preservation and the ruling elite falls apart. The elite are reluctant to respond to outside pressure as this would weaken their own power base, and the government which engineered the 'economic miracle' still believes it has the resources to deal with Japan's problems. Yet Merton talks of the bureaucracy's 'trained incapacity for innovation' and Krugman claims that Japan does not understand the nature of its own problems; it seems that the close integration of government and business is as much a weakness now as it was a strength in the past.

The state in Japan also had an important role as an investor. The 'Pax Americana' meant that Japan did not have to concern itself with defence spending, and was

able to invest heavily in business. Government investment as a percentage of GDP in 1960-86 was 7.3%, compared to 1.9% in the USA and around 4% in Western Europe. Investment was mainly in large public service projects. Private savings were also encouraged through initiatives such as the Fiscal Investment and Loans program, and were sent to the Ministry of Finance for investment. This was seen as crucial to Japanese growth. Huge amounts of capital at low interest rates (set by the state) gave Japanese corporations a competitive advantage. However, as regulatory controls are removed, this 'edge' is being eroded. Banks are crucial to this role. The Japanese banks are very powerful, and controlled directly by the Ministry of Finance. Banks have been encouraged to lend to unprofitable industries on the grounds of 'social banking' - looking at the whole economy rather than the individual industry. In reality this created a 'black hole' of debt, leading to an 'over-leveraged' economy highly sensitive to external shocks such as the 1989 stockmarket crash, and eventually to a situation where the banks are effectively bankrupt.

There was also a belief that a degree of insecurity was needed to make people self-reliant, so welfare spending was kept low. As this insecurity increased during the 1990s decline, so savings also increased, from 24% in 1990 to 28% in 1998. At the same time, private sector investment has fallen from 26% in 1990 to 17% in 1998. In contrast, in the USA planned investment exceeded planned savings. A problem which faces Japan is that consumers simply refuse to spend, and businesses refuse to invest, so no amount of 'pump-priming' by fiscal policy has been effective. In Keynes's terms, giving the Japanese economy a fiscal boost would be like 'pushing on a piece of string'.

The labour market in Japan has also been seen as one of the factors in its success. The market is of a dualistic nature, with 'jobs for life' in the keiretsu and informal, flexible jobs in the SME sector. Much is often made of cultural values, such as the idea of the enterprise as a surrogate family and the provision of rewards (such as 'Employee of the Month' badges) for quality of labour. However this has been exaggerated and is an 'invented tradition'; lifetime employment is a very recent idea, originating in the 1950s as a response to the high turnover of skilled workers. Independent union power is very weak in Japan, as small-scale enterprise unions were established to undermine the traditional industrial unions, and wage-bargaining always occurred at a state-organised session - the *shunto* - every spring, where wage increases were based solely on the inflation rate, not on productivity. This type of labour market, seen as a strength in the 1980s, has not been singled out for criticism in the 1990s.

It appears that while some of the features of the Japanese economy, such as the labour market and the flexible SME sector, continue to be seen as strengths, other features which were lauded previously are now seen as having created present weaknesses. The *amakudari* or governing elite, including the once-admired *keiretsu* themselves, are seen as weak due to cronyism and a lack of capacity for innovation. At the same time, the state which once boosted Japan's economy through encouraging savings and stimulating exports must now be seen as partly responsible for its decline - banks were encouraged to make bad loans to business which are now bankrupt, a huge current account surplus has put upward pressure on the Yen and caused deflationary effects, while consumers have become so used to saving (even more so in times of crisis, and when state welfare provision is low) that they are now unwilling to spend the amount needed to put the Japanese economy on the road to recovery.