The Japanese Economy in Search of a New Identity: A Reappraisal of the so-called 'Japanese Economic System' and its Applicability to Emerging Capitalist Economies[1]

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Introduction

In the late 1980s, Japan was proclaimed as 'No. 1' by Ezra Vogel, one of the most famous Japanologists in the US. At the time, when the US was being forced into restructuring to respond to Japan's challenges, and the EU countries were suffering from high unemployment (as they are still today), Japan was still enjoying the highest economic growth among the most advanced industrial countries. Japanese economic and managerial systems, which used to be criticized by many Japanese for having non-European, pre-modern elements despite Japan's long process of economic development, were praised both inside and outside the country for contributing to the increasing international competitiveness of Japanese enterprises.

With the bursting of the 'bubble economy' in the early 1990s, the climate of the Japanese economic society turned to the opposite extreme – from the brightest to the darkest. The optimistic self-confidence, which previously was often arrogantly expressed, has largely disappeared. In its place, a market-fundamentalist or neo-liberal approach has gained the upper hand in the discussion of

1 The author expresses his profound thanks not only to the two discussants, Professors A. Uegaki and K. Nakamura, but also to Professors M. Uvalić, M. Sojka, V. Franičević, H. Kimura, N. Shimotomai, T. Morita and others, who made very stimulating comments on his paper. This revised version is also intended to reply and respond to those helpful comments.

economics and has had a decisive influence on policy-making, criticizing Japanese economic and management systems for eroding the competitive edge of Japanese industries. Taking the US of the 1990s as a model, market fundamentalists proposed sweeping economic, financial and social reforms in order to bring Japan out of the 'worst-since-the-war' recession and to restore the competitiveness of the Japanese economy under the slogan 'structural reforms and deregulation'. Having taken high economic growth and improving well-being for granted in all the period after the war, Japan's economic society seemed to have lost its confidence in its identity as the recession became more and more protracted. It was because of a kind of sentiment of defeat that the neo-liberal approach gained a dominant influence on the mass media and policy-making.

From roughly the third quarter of 2003, however, a bullish mood has been reemerging on the market both inside and outside. The strengthening mood is that the Japanese economy is now reviving, and even the short-term forecast of the Bank of Japan ('Tankan') for the first time in the last three years used the term 'recovery'. Influential foreign media, which hitherto took such a critical and negative view, have suddenly started to note appreciatively the recovery of Japan's economy[2]. Domestic business appears to be on an upward trend, mostly supported by favourable trends in exports and capital investment, which are in turn induced by the business recovery in the US and the robust growth of China's economy. The self-adjusting capability of many domestic enterprises should also be mentioned. However, these favourable trends are in evidence mostly in big manufacturing enterprises, while the non-manufacturing sector and especially SMEs are still suffering from a continuing slump. The economic situation in most local areas and cities remains very severe just as before. Overall, economic recovery is far from real and there is a fear about a possible 'polarization' of the Japanese economy. Therefore, in spite of

2 Take for instance; 'Die Sonne geht wieder auf', *Die Zeit* 10 (26 Feb. 2004); 'Japan – Flying again', *The Economist*, (12 Feb. 2004).

heated talk about the 'regained confidence' in the capability of the Japanese economy, the picture is still 'mixed' at best.

While the Liberal Democratic Party (LDP) had ruled the country for nearly 40 years since its foundation in 1955, the last decade saw two episodic 'intervals' when non-LDP coalition governments took power (headed by Prime Minister Hosokawa – for eight months and that headed by Hata – very short-lived, only for two months), succeeded by another coalition government (which included LDP as a coalition partner) headed by Socialist Party leader Murayama (for one year and five months). Despite the changes of government the main policy lines did not change so much, but with the formation of the current LDP government of Prime Minister Koizumi in April 2001, seemingly the change of policy lines has been pushed forward much more vigorously. One might assume, therefore, that the system must have changed much to meet the expectations of the proponents of 'structural reform', but it is not quite so in reality. We will discuss this problem in Section 4 of this paper.

The most important message from Japan's post-war development seems to be that institutional set-ups should be designed and constructed so as to meet the requirements of economic growth. This might be suggestive to most post-socialist emerging capitalist countries, which are faced with 'dual tasks': that of institutional transformations and that of catching up with the advanced West. The second task is one inherited from the past, as most of these countries were late-comers in capitalist development, but it has become more urgent in view of the widened gap as a result of the so-called 'transformational recession' in the 1990s.

But before discussing the 'applicability' of the Japanese model to these countries, we have to take a look at some typical types of 'misinterpretations' of the 'Japanese Economic System'.

1. Some Misinterpretations of the 'Japanese Economic System'

First, some economists, in order to stress the urgent need for reform, go to the extreme of regarding the post-war economic system as an extended version of the wartime (WW II) controlled economic system. Most outspoken in this regard is Noguchi Yukio, who has taken this view in his famous book (Noguchi, 1995).

In contrast to Noguchi, many seem to take the view that the Japanese economic system was formed over a fairly long time, say well over a quarter of a century, from the period between the two world wars to the first years of high economic growth after WWII. The most well-balanced view is represented by Nakamura Takafusa, who argues that, while in the mid-1930s there were a variety of new developments which were revived again in the post-war period, some institutions and practices formed in industries and people's life during the wartime were also transferred to the post-war period. Among a series of radical post-war democratization reforms which created a competitive environment for industrial and business organizations, of particular importance was the land reform which expanded the domestic market enormously. Coupled with the above changes, life-time employment practices took firm roots in the economy after the war together with the democratization of labour relations (freedom of trade-unions and introduction of a series of labour-protecting legislation) (Nakamura, 1993: Part II, Chapters 4 and 5).

As typical of the institutions formed during the war is usually mentioned the 'strong administrative guidance' exercised by the (former) Ministry of Industry and International Trade (MITI). Others are the Health Insurance System, sub-contract system, 'Financial Keiretsu', seniority wage system, and Food Control System which later became the foundation for the post-war land reform. There are very significant arguments which, adding the very controversial issue of corporate governance to a biased and stretched interpretation of the above-mentioned changes, try to trace the origin of the Japanese economic system back to the war economy of WW II. Noguchi is the most outspoken proponent of this school of thought.

Such arguments should be questioned for at least three reasons. First, even if the 'similarity' between the institutions and practices formed during the war and those which have existed for a longer time after the end of the war is admitted, the question should be raised strongly whether their substance and functions were quite the same. Second, if they were the same, the reason why they continued to exist for over half a century after the war should also be explained seriously. Third, there still remains the important question of how the reforms introduced by the US occupation authorities are to be properly interpreted.

As an issue related to the structure of corporate governance, one could refer to the wartime change that, while the status of managers and workforce went up, that of share holders went down. As evidence the fact is cited that the managers were appointed by the government as 'officers responsible for production', who were in a position to make important decisions without endorsement by the shareholders' general meeting. But it should be noted that in this case the government replaced the shareholders without introducing any changes in the structure of equity ownership and the commercial laws. So, there were still some cases in which big shareholders used their shareholders' right to dismiss enterprise executives. There is no doubt, therefore, that the control by the big shareholders of pre-war time would have come back, if it had not been for the post-war reforms introduced by the US occupation authorities.

The dissolution of the 'zaibatsu', enforced by the occupation authorities, resulted in the dispersion of equity ownership, and on the basis of this democratization of the stock and securities market a radical reform of commercial laws was carried out under the guidance of GHQ (General Headquarters of the Allied Forces). The reform was aimed at strengthening the rights of shareholders so as to change the existing laws to US type institutions. While adopting the legislation for protecting the minority shareholders, changes from Japanese to US type institutions were introduced in other spheres of the economy as well. In spite of this big move to US type institutions, however, stable shareholding relationships by means of cross-ownership of shares were created in the 1950s-1960s, which was quite alien to the US business world. Hence the cross-ownership of shares in Japan, so famous in the world, was a 'product' of post-war development, and not the other way round.

The same is true of the food control system which was aimed at giving incentives to producers to produce more under conditions of acute food shortage and the intention was to establish institutions for the equal distribution of basic food products. After the disappearance of food shortages in the mid-1950s efforts were made several times to abolish the system, but this time they were blocked by the organized strong countervailing power of farmers, which did not exist during or before the war. When the production-cost-compensation system for rice was adopted in 1960, the system was transformed under the same name into one to protect the interests of producers. This case shows clearly how, while retaining the same appearance, the substance and function of the system can change a great deal.

Third, Noguchi argues that there was another 'total war' waged in the name of 'high economic growth' in which the '1940 system' (the economic system formed around 1940, just on the eve of the Pacific War) worked quite well, as if the post-war Japanese economy were a wartime 'planned economy'. Almost the same view is shared by British economist Andrea Boltho who argues that 'Japan's government exercised a much greater degree of both intervention and protection than did any of its Western European counterparts; and this brings Japan closer to the experience of another set of countries – the centrally planned economies' (Boltho, 1975: 188-189).

True, since the 'Five Year Plan for Economic Independence'[3] worked out by the Hatoyama Government in 1955 and the economic plans drawn up through the 1960s were aimed at 'maximum' and/or 'high' economic growth, and control was maintained on foreign exchange and imports, we could say that distribution of imported goods was planned both in physical and money terms. This, however, was a phenomenon in the 1960s and cannot be used to explain the developments from the late 1960s on.

Noguchi refers also to the ideas of 'priority given to producers' and 'denial of competition' which were allegedly prevalent

3 For details about Economic Plans worked out in post-war Japan, refer to Hoshino (2003).

throughout the war and the post-war period, but it could be doubted how such a high economic growth could have been realized by denying competition. Noguchi refers to the practices of cartels, introduced by administrative guidance, and restrictions on competition in low productivity sectors as evidence of the denial of competition, but these were sectors left behind in the high economic growth and cannot serve as evidence that the '1940-year System' worked beautifully in the interest of high economic growth.

As another example, it is commonly asserted that life-time employment coupled with the seniority wage system led to a more stable workforce and contributed a great deal to higher productivity through on-the-job training of workers' skills. This is a commonly accepted view. But the question is: whether 'life-time employment' came into existence during the war or not? It did not. True, during the war the stability of the workforce decreased as a result of the laws on the restriction of movement of the workers, introduced in 1939 and 1940, but this was not 'life-time employment', but 'fixation' of employment by means of political power. So, no wonder labour mobility increased steeply after the end of the war. As a matter of fact, contrary to the above-mentioned misinterpretation, long-term continuous employment began to be established in the 1950s–early 1960s after the country experienced a series of Massenstreiks against the deflationary policy (the so-called 'Dodge Line' of 1949, named after Joseph Dodge, head of the US economic advisory group which recommended a drastic stabilization policy) which entailed a mass discharge of workers.

2. Discontinuity or Continuity in the Japanese Economic System in WW II and the Post-War Period

To sum up, the view that the Japanese economic system has its origin in the wartime period seems to be based, even though vaguely, on the supposition that the contemporary Japanese economic system is qualitatively different from the market economic system of Anglo-Saxon type, and the qualitative difference is to be found in the 'equality-orientation', strong intervention by the government and its 'planned' character. But this view seems to fail to understand the nature of the planning of the wartime 'controlled economy' itself.

It is true that, although the wartime 'planned economy', by the logic of war economy, widened the sphere of coverage by state intervention in response to the aggravation of the war situation, it was fundamentally a directive-type planned economic system, not so much different from the control system over SOEs in a Soviet-type economy, to which typical 'soft budget constraint' was applied. Still, it could not finally change the micro-structure of enterprises inherited from the pre-war era.

After the end of the war, distortions caused by this wartime 'planning' were rectified: direct control over enterprises was abolished; excessive concentration of enterprises was put right in the course of de-monopolization of concerns (zaibatsu); the conditions for soft budget constraint ceased to exist in the process of post-war 'de-mobilization' of industries and the cut-off of wartime compensation coupled with the introduction of the 'Dodge Line' imposed hard budget constraint on enterprises in a dramatic manner. To conclude briefly, there is no continuity between the war and the post-war period as far as the economic system per se is concerned.

Then the problem is how to understand the formation of the contemporary Japanese Economic System. When and How? Crucial in this regard were the 1950s. Although some subsystems were formed in the period between the world wars, some others during the war, and yet others were temporarily destroyed during the war, the contemporary Japanese economic system as a more or less coherent whole came into existence in the 1950s, with all main subsystems coming into existence together to make up the whole.

Of particular importance was the impact of the US. Not only were drastic reforms introduced under US occupation, but learning from the US enterprises was attempted very earnestly. This implied 'Americanization' of Japanese economic society is far more consistent than that of Germany, not to speak of Italy. It was the greatest 'experiment' in the history of capitalism, which cannot be adequately explained by such simple phrases as 'demilitarization' and 'democratization'.

But this 'Americanization' by means of reforms and voluntary learning from US experiences did not have quite the intended results, since it was constrained by the initial conditions of the country when the reforms were introduced. This could be called a kind of 'Japanization'. Typical in this regard, as stated earlier, was the formation of a 'stable shareholders' relationship' in the 1950s. At first the corporate governance structure was designed on the US model, but later, faced with the danger of take-over and constrained by the intra-firm promotion system, finally in the course of the 1950s a stable shareholders' relationship based on 'cross-ownership' of shares came into existence. This is also a clear illustration of 'path dependence'.

3. An Interim Conclusion

So, contrary to the view which stresses the 'continuity', we can confirm again that:

1) There is a big break or discontinuity between two periods: the war and the post-war period. A series of radical reforms was introduced under the US occupation: the land reform, which altered radically the landscape in rural areas and also contributed quite a lot to the expansion of the domestic market; the dissolution of *zaibatsu*, which led to more flexibility and competition in the market, giving more possibility of entry to emerging new enterprises; trade union freedom, which gave them a big bargaining power to press for the improvement of material conditions of the working force; universal suffrage extended to women; educational reform which extended the access to higher education to broader strata of young people: and so on. The post-war economic system was built on these foundations.

2) The 'continuity' view also fails to see the fact that, at least until the early 1960s, the post-war period was full of la-

bour-capital conflicts, the most typical being the so-called Massenstreik at Mitsui-Miike Mines in 1960. Characteristic features of the Japanese economic system, as mentioned earlier in Sections 2 and 3, were formed to a greater degree as a response to these conflicts. The 'Income-doubling Programme', advanced by the Ikeda Government early in the 1960s, was typical in this respect, since it aimed at avoiding social conflicts by absorbing and integrating working people into the ruling regime by way of higher economic growth.

3) So, the other side of the 'medal' of the Japanese Economic System was, quite paradoxically, a kind of 'social-democratic compromise', a specific version of the 'Sozialstaat', although most of the evolution in this direction was realized under the successive conservative LDP governments. Since in post-war Japan the shares of people in the fruits of economic growth continued to increase, high economic growth fulfilled, so to speak, the role of 'social security'. The ruling political system, represented by the ruling LDP, also worked in this direction. Naturally we could not say that the conservative LDP held up the idea of a (more –or less) 'equal share in the fruits of high growth' for the people as its policy ideal. The Japanese version of 'social-democratic compromise' was the consequence of two factors: first, the LDP had its political base mainly in such social groups as the rural population, which was left behind in the high economic growth, so it tried to redistribute the fruits of economic growth by means of the political system, while pushing forward the high economic development and allocating large sums of public money to protecting agriculture and to public works. As a consequence, income inequality between urban and rural areas disappeared to a greater extent; second, pressure from the labour movement as exemplified by annual Spring Offensives (so-called 'Shunto'), though sometimes of quite routine character, played no small role. The Japanese version of social-democratic compromise was a compound consequence of these two factors. So long as high economic growth continued, accompanied by an increasing

share in it for most strata of the population, the fundamental question 'what should be the principle and rule' for the distribution of wealth could be left aside. In this sense, high economic growth played the role of a social security system, a peculiar feature of the Japanese version of the 'Sozialstaat'.

So, seen from this angle, what is going on now in Japan is a trial aimed at saying 'adieu/farewell'[4] to this social-democratic compromise. The big difficulties, which Japanese society is now faced with finding a new way out, are not so different from those with which the European 'Sozialstaaten' (Germany, in particular) are now confronted. Careful examination will show quite a number of common features.

Secondly, there is also an erroneous view that the success of the Japanese economy from the latter half of the 1950s up to, at least, the 1970s-1980s can be directly, even solely, attributed to the Japanese Economic System, which is understood in terms of a mixture of administrative interference and protection policies. Here, too, several counter-arguments should be in place.

1) The economic system of Japan until the early 1930s was a free market one, quite close to the Anglo-American type. So, the wartime economic system, by the logic of the 'War economy' itself a strictly controlled one, was rather exceptional. True, some control was retained in the hands of the government after the war, the intervention and protection policy was gradually brought into conformity with the market forces, and became more market-friendly or market-enhancing over a long period.
2) Factors contributing to the success of the Japanese economy in the 1950-60s are manifold, 'models' being only one of them.

4 In this respect, I. Kabashima (2003), a well-known political scientist, was quite right when he wrote 'Shamin-shugi karano ketsubetsu!' ('Farewell to Social Democracy', in an essay published in *Yomiuri Shimbun* (Sept. 26, 2003), on the occasion of the reelection of Koizumi as the President of the ruling LDP.

a) Even before the war, Japan was an industrialized country and had a functioning administration.
b) There were 'positive' legacies of the war economy, which led to the structural upgrading of industries and to technological progress. Self-reliant production of machine-making-machines, which was the weakest point of the Japanese economy before the war, was a typical case in point. To cite a few other examples, Nikon produced optical weapons for the navy (typical in this respect was the world's largest ever rangefinders, 15.5m in length, for the two largest warships, *Yamato* and *Musashi,* ca. 71,000 displacement tons each), while Canon did the same for the army. When the war ended, these potentials were ready for the 'high jump'.
c) Japan had benefited considerably from the 'Cold War', first from the special procurements associated with the Korean War, which eased the acute shortage of capital for investment at a higher technological level. Import of new technologies was made easier by the alliance with the US.
d) Policy options were not so much constrained by the international organizations as they are today.

Combinations of various favourable factors, which are not present or fewer in number or weak in today's emerging capitalist economies, contributed to the success of the Japanese economy in the 1950s-60s, which South Korea and a few Asian countries were able to follow, though to a lesser degree.

4. Visions and Reality: To What Extent Has the 'System' Really Changed?

Now, as stated earlier, we have to examine to what extent the System has really changed as was expected by the reformers. There were several features usually associated with the Japanese 'system'. Let us consider some of them.

4-1. Life-time Employment

Market fundamentalists considered so-called lifetime employment as the no.1 enemy of the Japanese system which had to be terminated. In a protracted recession, companies can no longer afford over-employment, and are forced to reduce the size of the workforce by offering voluntary or early retirement, or by encouraging employees to find new jobs in other firms. Firms tend to hire mainly professionals with higher skills while firing common workers. According to this view, younger generations prefer job careers as professionals, moving from one firm to another in search of higher remuneration. Thus labour turnover should increase just as in the United States.

In reality, however, labour mobility did not increase to any meaningful extent in the 1990s. Looking back to past years, labour turnover was very high in the 1960s due to exceptionally high economic growth that resulted in a shortage of younger workers. Mainly because finding jobs was relatively easy, younger workers moved from one firm to another when they considered their present working conditions were not so good as desired. In the 1970s labour turnover rather decreased due mainly to the deceleration of economic growth. In the 1980s, it was surprisingly stable until the ‘bubble boom’ started. During the bubble boom it rose slightly, but was still very low compared to the 1960s. In the 1990s, it did not increase despite the assurances of proponents of neo-liberalism that higher labour mobility was not only inevitable but desirable.

The stable labour turnover in the 1990s suggests that so-called lifetime employment had not come to an end and that it had taken deep roots in economic society. Quite interestingly, while in Japan when firms are forced to reduce their workforce they usually invite voluntary resignation with some benefits attached to it, in the US firms try to constantly downsize the workforce to increase profitability even when the enterprise performance is good. Japanese firms still seem more friendly to employees than US ones.

4-2. Seniority Wage System vs. Performance-based Wage System

Proponents of market fundamentalism further argue that, for the same reasons, the 'seniority wage system', where wages increase every year with the length of service, should become less universal, as most firms can no longer afford to increase pay with age. To motivate employees to reach a higher performance level with limited financial resources, firms should now abandon this wage system and introduce a 'performance-based' wage system. A typical performance-based wage system is the annual salary system, a salary to be determined according to the assessment of an employee's performance over the previous year. A considerable number of firms introduced this system in the 1990s, but mainly for the managers.

As early as the 1960s, the seniority wage system was already criticized by Nikkeiren, the Japan Federation of Employers' Association, as pre-modern to be replaced by a modern one based on individual ability. Many big firms tried to follow this advice, introducing the so-called job-qualification wage system. However, in the early 2000s, employers still complained that wages were still so seniority-oriented that employees could not be sufficiently motivated. Indeed, the wage curve still remains a seniority one, although it is somewhat less steep than before. Quite recently, in the middle of 2003, failure of the performance-based wage system was reported in the mass media, according to which many firms were said to be terminating or softening the application of this system in order to deal with the mounting discontent of employees.

Why? To introduce a system is one thing, but to implement it effectively is quite another. The proponents of this system seem to have paid little attention to the fact that in Japan seniority still plays an important role in firms as well as in society at large. Of course the importance of seniority is declining, but only gradually. It turned out that wage determination, which does not pay due attention to the deep-rooted social structure, is not only unsuccessful, but tends to cause difficulties in management[5].

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5 In this respect, quite interesting is Nobuo Takahashi , a professor of busi-

The fact that life-time employment and the seniority wage curve did not change substantially in the course of the 1990s does not mean there were no changes at all in employment practice. Though certainly life-time employment has not yet come to an end, the irregular workforce, such as part-timer workers and illegal 'shadow' workers, increased significantly in the 1990s. In this sense, traditional employment practice is being weakened indirectly, but not so much as the proponents of market fundamentalists would like to see. The real picture seems to be that, although the wage system based solely on seniority is being undermined gradually, there is no effective model of performance-based wage system to replace it. Visions differ quite a lot from reality.

4-3. Unemployment

According to proponents of neo-liberalism, unemployment should have increased sharply because the employment stabilizing mechanism could not work during the prolonged recession of the 1990s. Labour hoarding in recession times, generally recognized as the most effective means of preventing unemployment from increasing, could not be sustained during the long recession. Due to the lack of flexibility in the labour market, those who left their jobs could not find new employment easily. It was high time, they argued, to deregulate the labour market, allowing private job placement and more varieties of employment as big firms were reluctant to hire new labour. According to their arguments, the 1990s should have been the time for rapidly growing small businesses and ventures to hire workers in large numbers, easing unemployment.

In the decade of deregulation, however, small and medium-sized firms rather decreased in number, with more firms leaving the marketplace than new ones being launched in the 1990s. Market fundamentalists seemed to have underestimated the fact that among small and medium-sized firms, high-tech firms still

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ness administration at the University of Tokyo, whose book (Takahashi, 2004) is now a best seller in economics which, criticizing the performance-based wage system, recommends returning to the traditional seniority wage system.

accounted for only a small number, while most were traditional firms including 'mom-and-pop' shops in the downtown area. The problem of the rapidly decreasing numbers of small shops in the downtown area has become so serious from the viewpoint of city planning, living standards, city variety and even sightseeing, that even some neo-liberal protagonists admitted the need for subsidies to support the most seriously hit areas.

Market liberals seem to have misunderstood the employment stabilizing mechanism in this country. They regarded labour hoarding in big firms in times of recession as being the most important mechanism. But it is only a part of the mechanism that keeps the rate of unemployment still relatively low, steadily around five per cent or less, which is, however, much higher than in the 1970s-80s when it was almost always under two per cent. An additional explanation for the low unemployment rate seems necessary.

According to the official definition of the unemployment rate, an unemployed person is a jobless person seeking a job. The problem is that there are jobless people who want a job but are not in fact seeking one. They are not unemployed according to the definition, but are called discouraged workers. Although unemployment in Japan is the lowest among industrial countries of the world, Japan has a high proportion of discouraged workers. They are part of a mass of 'peripheral' workers, moving between jobs and not 'in the labour force', without being registered as unemployed, including many (ca. 4 million) young 'Freeters' as they are called. Many of them are assumed to be 'voluntary unemployed'.

The self-employed and family workers are also part of the 'peripheral' workforce. In this respect, Japan was, and to a lesser extent still is, a 'Janus-faced' society. On the one hand, it is a highly industrialized society with many top high-tech industries, on the other, it has a relatively high proportion of self-employed and family workers. The rapid decline of the predominantly self-employed rural population in the process of high economic growth in 1955-72 was set off to some extent by the increasing amount of self-employed in the manufacturing industries and service sector. Also the increased number of female part-time workers especially in the 1970s and 1980s could be included in this 'peripheral' workforce category. In any case Japan has had enough peripheral workforce as a buffer to unemployment, although the situation has been changing in the last several years.

Largely due to the peripheral workforce and partly to labour hoarding in big firms, the unemployment rate in Japan has been low. But in the 1990s, as deregulation proceeded, the hitherto effective employment stabilizing mechanism was weakened gradually. Big firms reduced the number of regular employees in the process of restructuring and began to hire fewer new workers. The number of self-employed and family workers is on the decline together with the declining number of small and medium-sized enterprises. The pattern of the labour market is now changing. In this regard, the study by Genda (2004) is highly instructive in showing the picture of lost job opportunities in the course of the 1990s.

4-4. Corporate Governance and 'Cross-Ownership'

Closely associated with the eternal question 'Who owns the Enterprise?', corporate governance, the relationship between corporate management and its stakeholders such as shareholders, money lenders (banks, etc) and (enterprise) trade unions, has been one of the most important topics for economists dealing with the Japanese economy. 'Cross ownership' has been regarded as constituting Japan's unique corporate governance both inside and outside the country. Usually firms in the same *keiretsu* or their interested parties (such as banks and suppliers) hold each others' shares without any intention of selling them or for gaining special profit. They are assumed to hold shares in order to maintain a good business relationship.

As stated earlier in Section 2, the history of 'cross-ownership' belongs to the post-war period. The formation of cross shareholding started in the early 1950s, when the *zaibatsu,* business conglomerates such as Mitsubishi, Mitsui and Sumitomo, were broken up by the order of the US occupation authorities. But, in order to protect former group companies from hostile takeovers, firms, formerly belonging to the same group began cross-(mutual) shareholding, and the practice was followed by many other non-*zaibatsu* companies too. The undeveloped capital market at the time also played a big role in this regard.

Under cross-shareholding, major shareholders are usually 'silent' shareholders, giving commission to the management of the enterprise, as long as the firm continues to perform well. Thus, according to the theory of 'corporate capitalism', cross-shareholding is a 'managerial revolution' *à la Japonaises,* making enterprise management quite independent from shareholders, in a sharp contrast to the US practice. The independence of enterprise management, coupled with indirect financing by the main banks, it was argued, contributed a great deal to the high economic growth, giving wide scope for strategic long term-decisions at the management level.

Major stable shareholders are banks, insurance companies, *keiretsu* companies, business partners (suppliers and sellers) and shareholding associations of employees. In this sense, the enterprise is in a 'common ownership' of these stakeholders, which, to a considerable extent, explains the more 'friendly' relationship of the enterprise management with the employees. This, however, does not mean that these stakeholders are 'equal' in exercising their influence, especially when the enterprise in question has got into trouble.

In the 1990s, however, cross-ownership, so much praised in the past, has become the target of severe criticism both from outside and inside, as the nearly omnipotence of enterprise managers has led to many abuses and much fraud at the management level. Enhanced influence by the shareholders was called for, relying on the U.S. model as an alternative. Still changes in this direction are not proceeding so straightforwardly as some expected they world.

Although there are not statistical data available about the extent to which the number of 'stable' shareholders was reduced in the course of the 1990s, judging from the fact that the share of foreign investors (non-Japanese individuals and corporations/institutions) in total share ownership had only increased to 10.0 per cent in 1998 from 4.2 per cent in 1990, (although there are some noted enterprises in which the share of foreign shareholders exceeds 30 per cent), the number of stable shareholders seems to have decreased only gradually, which implies cross-ownership still remains dominant in Japanese corporations.

According to a very interesting study by Salacuse (2002), commissioned for the UN/ECE, there are two basic models of corporate governance, the Anglo-American Model and the Continental European Model, which could be summarized in a simplified manner according to several important factors of corporate governance:

ANGLO-AMERICAN MODEL	EUROPEAN MODEL
1. management dominated	1. controlling shareholder dominated
2. shareholder focused	2. stakeholder focused
3. wide public share ownership	3. narrower public share ownership
4. strong shareholder rights	4. weaker shareholder rights
5. unitary board structure	5. two-level board structure
6. single powerful leader	6. consensus or divided leadership
7. shareholder litigation culture	7. weaker litigation culture

Seen from the above comparison, corporate governance in Japan seems to be closer to the Continental European Model, though in points 1 and 5 it shows some similarity to the Anglo-American one. So far we could not say corporate governance in Japan will come closer to the US model in the foreseeable future.

4-5. Summing Up

The developments and changes in the 1990s give quite a contradictory picture: on the one hand, it has become clear that the familiar institutional set-ups, which had helped to produce high economic growth in the past, could no longer be sustained just as they were before, but, on the other, the changes are still gradual and evolutionary rather than radical or 'structural', at least not to the extent the proponents of market fundamentalism would like to see. The underestimation or misunderstanding of 'the economy embedded in the society' (K. Polanyi) may be responsible for the failure of their prediction. Still, coupled with the protracted recession in the 1990s, it led to the loss of confidence in the Japanese way of running the economy on the part of many people.

It seems clear from the above discussion that a certain 'balance' or compromise should be found between the 'embedded economy in the society' and the need for changes in the era of globalization, which is, however, far from insisting on changes towards the Anglo-American model as an universal one. But the real difficulty in the search for a new identity in Japan is that the old one was inseparably linked with higher economic growth and a rise in well-being for the majority of people.

Take, for example, the so-called 'Spring Campaign' of trade unions. This Japanese system worked well in the past. Trade unions demanded – often with threats of strikes – higher wages, longer leave, shorter working hours and other material improvements in working conditions and often gained some positive results. Through the spill-over effects, the benefits gained by major trade unions spread to the other strata of the population to some degree or other.

This conflict-avoiding practice worked rather well so long as the economy grew and enterprises produced good profits which could be distributed among the stakeholders. But when the economy ceased to grow at as high a rate as before and the demand for improved working conditions could now be met often through reducing employment, the system ceased to work any more. But finding alternatives is not easy either. In this sense Japan now finds itself looking for a 'new identity'.

5. 'Applicability' or 'Non-Applicability'

Polanyi's notions of 'the economy embedded in the society' and 'path-dependence' theory reject by the nature of their logic the 'applicability' of a specific model, which was successful at a particular time in a specific country, to other specific countries. The only possible course is to draw some general lessons from other experiences and learning with each other.

In my paper presented to our Forum just a year ago (Sato, 2002), I enumerated several 'lessons' to be reconsidered:

1) Systemic Transformation vs. Economic Growth
2) Sequencing of Liberalization
3) Some Neglected Aspects of ‘Privatization’
4) The Role of the State
5) The Neglect of ‘Moral’ Aspects

From these five combined together, you can easily see that I had in mind some features of the Japanese Economic System which contributed to the success of economic development, while not directly applying them to emerging capitalist countries, but as only as tentative lessons which might be suggestive for these countries.

Turning back to the problem of ‘administrative interference and protection’ policy practiced by Japanese governments in the course of rehabilitation and development in, say, the 1950s-1960s and which proved successful in the case of this country, it is wrong to regard it as specific only to Japan.

Looking back to history, we see that, without exception, all those countries now considered to be the most advanced went through a certain phase in which, in some form or another, they applied protection policies for their infant or still uncompetitive industries – and only after a certain period of time did they open up their markets to foreign competitors. Seen from this angle, Japanese policy of the 1950s and 1960s was not so unique and specific as some people would like to say.

In this regard Rodrik Dani (2001) seems quite right in pointing to the contradictory position of advanced countries of the West and International Financial Institutions (IFIs) which, taking up the job of advising countries undergoing transformation, sugested to open up all the ‘doors’ at the outset of ‘Transition’.

> No country has developed successfully by turning its back on international trade and long-term capital-flows… But it is equally true that no country has developed simply by opening to foreign trade and investment. The trick in the successful cases has been to combine the opportunities offered by world markets with a domestic investment and institution building strategy to stimulate the animal spirits of domestic entrepreneurs … almost all the outstanding cases

> have involved partial and gradual opening to imports and foreign investment. Multilateral institutions such as the World Bank, International Monetary Fund, and Organization for Economic Co-operation and Development regularly give advice predicated on the belief that openness generates predictable and positive consequences for growth. Yet there is simply no credible evidence that across-the-board trade liberalization is systematically associated with higher growth rates.

In this context, the experience of Japan in the field of 'industrial' policy deserves special attention. This should not be confused solely with the 'targeted' administrative type of industrial policy. Industrial policy in Japan evolved with the post-war economic recovery and development: from targeted administrative interference to a more market-friendly one. In some post-socialist emerging market economies of Eastern Europe, where there are structural distortions and regional imbalances left over from the past, it might well be naive to think that market forces alone will solve the inherited problems.

Some readers might object that in the era of globalization with many rules and regulations imposed by international bodies and organizations, the 'hands' of these countries are tied, leaving little room for independent policy-making. Here I feel deep sympathy with the notion of 'Policy ownership' coined by Daianu Daniel (2003), in which he stressed the need for more bargaining power in local negotiations with IFIs and other bodies. The author hopes that this is not beyond the bounds of possibility and will find favourable responses in the coming decade which might be crucial for these countries in proceeding through the second stage of transformation and also of a resumed catching-up process.

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The topic of this page has a wiki of its own: Capitalism Wiki. In common usage capitalism refers to an economic system where the means of production are privately owned and operated, and where the investment of capital, and production, distribution, income, and prices are determined not by government (as in a planned economy) but through the operation of a market where all decisions regarding transfer of money, goods (including capital goods), and services are voluntary. In capitalism, the means of Definition and features of a capitalist (free-market) economic system. An evaluation of the pros and cons with examples of the most capitalist economies in the world.Â Economic freedom. Individuals free to set up business and provide the goods and services they want. Consumer sovereignty. Consumers free to decide which goods and services to purchase. Limited government. Government intervention limited to the protection of private property and provision of public goods. Finance sector. Capitalism requires a developed banking and financial system which can provide loans to companies and banking services to households.