the party will be very different from what it was in 1955, both in its support base and in its policy directions. Many Japanese industries will undoubtedly continue to be exceptionally competitive within world markets; indeed corporate profits and market shares of many major Japanese manufacturers rose substantially after the worst of the post-bubble economic debris was swept away. But the economy as a whole is unlikely to return soon to its previous growth rates, and any use of the label "Japan, Inc." is sure to be an even greater misnomer than it was when Japanese economic institutions were at their most harmonious. The Japanese bureaucracy is almost certain to retain powers that in comparative terms will be quite substantial, but it is unlikely that either government agencies or civil servants will command the control over business, let alone the social support, that they enjoyed in the 1960s. Japan will almost certainly continue to maintain close strategic, military, and economic ties with the United States, but the United States is unlikely to provide the same level of unmitigated support that it gave to Japan during the height of the cold war; nor is it likely that Japanese elites will expect it.

And yet, despite the changes, Japan in the late 1990s has remained an outlier among the industrialized democracies. Although the evolution of prevailing policies, socioeconomic support, and political and economic institutions has eroded some of Japan's earlier uniqueness, the country hardly seems to be converging with other industrialized democracies toward some powerful magnetic core. The increased fluidity of international capital undoubtedly challenges the ability of national governments and individual corporations in powerful ways. Yet, numerous other aspects of any country's political economy, from its foreign policy orientations to its socioeconomic composition to its political and business institutions, remain far more subject to national differentiation. Certainly public policies, institutions, and socioeconomic coalitions prevailing in Japan at the end of the century give every indication of remaining far from the laissez-faire pluralism of the Anglo-American democracies, the corporatist social welfare systems of continental Europe, and the "reformed" parliaments of Italy. Japan's most likely equilibrium will involve a political economy with its own distinct configuration, the main features of which are discussed in the concluding chapter.

The central question that this chapter raises is, How and why did the conservative regime of the 1960s deteriorate with such speed and completeness? What accounted for the shift? As we shall see in the next chapter, conservative leaders made highly successful adjustments to changing conditions and hence retained great power to shape the Japanese political economy during the 1970s and 1980s. But at the same time, many of those adjustments set in motion shifts and tensions within the regime that eventually led to its downfall.

Chapter Six

Between Adjustment and Unraveling: Protection and Erosion of the Old Regime

In the last chapter I contrasted Japan during the late 1990s with Japan in the mid-1960s. Despite the headline-grabbing drama of the 1990s and some sharp breaks with the past, political and economic transformations neither happened overnight nor as the evolutionary conclusion of some tidy linear progression. Rather, the new political economy of the 1990s emerged from a jumble of successful adaptations and regime unravelings. In this chapter I examine these transformations with two separate purposes. First, I show how a series of adaptive changes kept the regime largely intact and in rough equilibrium for more than three decades—a story of successful conservative adaptation. Conservative control under the LDP was extended; the economy continued to advance exponentially; and security and defense policies remained largely unchallenged and insulated from debate. Second, I trace how several seemingly successful adaptations simultaneously exacerbated tensions that eventually opened the regime to splintering and failure. Adjustments that proved politically and economically positive in the short run contributed to harsh and abrupt alterations that eventually shattered the old regime. In this chapter I thus interweave two threads, regime adaptation and regime decomposition.

Neither process was inevitable. Adjustments that with hindsight seem to have been the result of brilliant prescience by conservative leaders could well have failed. Others that, in the disarray of the mid-1990s, appear to have foolishly positioned the conservative regime on a "slippery slope" downward could well have played out differently. In short, striking as certain linkages may appear in retrospect and internally reinforcing as many of the processes may have become, nothing in this analysis should be read as inherently deterministic.

I begin by examining three sets of challenges to the conservative regime that arose between the early 1970s and the late 1980s. One set came from outside Japan,
the other two were endogenous. Together they exacerbated intraregime tensions, undermining its previous smoothness and fluidity. In the second section I analyze the most important first- and second-order adjustments that were made to meet these challenges. Most adjustments sought to continue rapid economic growth while also bolstering the regime's political base. These were largely successful, but they proved to have long-term consequences that led ultimately to the regime's unraveling by the late 1980s and early 1990s.

Challenges to Conservative Dominance

As we saw in Chapter 4, three central dilemmas continually confront any democratic regime. First, a socioeconomic dilemma: diverse socioeconomic supporters want different things, and their power and influence keeps shifting. Occasionally, some single course of action can meet these competing and fluid demands. More often, coalition maintenance requires ongoing compromises, trade-offs, and deferred gratifications; temporary gains and losses are continually offset and counterbalanced. Second, a democratic or electoral dilemma: good politics is often at odds with good policy, and actions designed to enhance electoral viability frequently clash with what might be desirable for a nation's economic well-being or security. Third, an international dilemma: what works domestically does not always work internationally and vice versa. In Chapter 4 we followed the interplay of these dilemmas in Sweden, the United States, Britain, and Italy between the late 1970s and the early 1990s.

Even at its smoothest in the mid-1980s, the conservative Japanese regime was hardly devoid of internal frictions. Nevertheless, the nation's main political fault lines were unmistakably between the conservatives and the political left rather than among regime supporters. With time that split was resolved in favor of the conservatives. Embedded mercantilism, high economic growth, and a limited military posture all redounded to conservative electoral success. Conservative supporters collectively benefited from peace and prosperity, either directly or through side payments. The international arena was broadly conducive to the policy directions, institutions, and coalitional makeup of Japan's conservative regime.

During the 1970s and 1980s the conservatives' response to the three dilemmas became increasingly labored. Economic success and transformation changed the relative strengths and incentives of many important socioeconomic groups; new political parties, independent movements, and changes in voting patterns challenged the conservative electoral hegemony; and the international arena became far less hospitable to Japanese domestic regime arrangements. Consequently, intraregime politics and economics began to supersedes earlier left-right divisions, and the central concern within the conservative camp was preventing these changes from undermining the basic cohesion of the regime. Doing so, however, meant a continual balancing act between the increasingly conflictual goals of specific political actors and the broader goal of regime continuity.

Socioeconomic Challenges

Conservative dominance of the electoral process and governmental office generated public policies that strengthened the regime's socioeconomic base, discredited its political opponents, increased overall public support, minimized the need for compromises, and enhanced the conservatives' ability to control political offices. The result, as described in Chapter 1, was a "virtuous cycle" in which successes in economics and politics reinforced one another. Yet this same cycle brought socioeconomic changes that challenged the regime's equilibrium. Conservative economic policies transformed the nation's socioeconomic makeup, strengthening certain opponents and dramatically weakening many supporters.

Four changes were especially important: a dramatic reduction in the proportion of the population dependent on farming and small business, an extension of the life span, a tightening of the labor supply, and an urbanization that turned the majority of Japan's citizens into what Murakami Yasusuke has called "Japan's new middle mass."

In 1950 nearly half of Japan's workforce was economically dependent on agriculture and fishing; by 1970 this was about 17 percent; and by the mid-1990s, it was down to 6 percent. Meanwhile, employment in manufacturing accounted for only 22 percent in 1950; by 1970 it had risen to 35 percent, where it remained into the 1990s. The tertiary sector meanwhile expanded steadily from 30 percent to 48 percent to 60 percent over the same period.

In 1947 about 40 percent of Japanese worked in family businesses with another 20 percent self-employed. Only about 40 percent were employees of firms. By 1970 these figures were 16 percent, 18 percent, and 66 percent. Since 1985, firms have employed nearly 80 percent of Japanese workers.

As larger and more technologically sophisticated industries and service sector firms gained increasing prominence in the national economy, the agricultural and small-business sectors—earlier cornerstones of the conservative regime's electoral coalition, as well as sources of cheap labor, distributors of mass produced consumer goods, and employers of last resort—shrunk substantially in numbers and economic significance.

Simultaneously, improved health care and birth control reduced the size of the average family. Japan's once steep population pyramid flattened out. Immediately after the war, Japan had an unusually young population with only 5 percent of the Japanese population aged sixty-five or older. Even in the 1970s the figure was only 7 percent, well below that for other industrialized countries. But by 1995 those over sixty-five had increased to more than 14 percent. This twenty-five-year doubling had taken 115 years to occur in France and sixty-six in the United States. So rapid is the growth, furthermore, that the ratio of workers to retirees will increase from 7:1 in the 1970s to about 4:1 in the year 2000 and 3:1 in 2015.

Economic success and the changing age profile led to a tighter labor market. In the early postwar years, large numbers of returning war veterans and overseas repatriates—and, subsequently, baby boomers and an influx of rural residents—generated
an expanding, low-cost, young, and highly skilled workforce for manufacturing and urban service work. This expansion did not last, however, and as the labor market tightened bargaining power shifted from managers to labor, starting as early as 1969.6

All these changes in demography, economic interests, preferences, and opportunities undercut many long-standing policies and institutional arrangements. It became more difficult for the original coalitional arrangements of the old regime to remain intact. Although these changes ultimately had important economic effects, they were played out even more tangibly in the electoral challenge they posed for the LDP.

*The Electoral Challenge*

As semiautomatic conservative voting blocs shrank in sheer numbers, the mobilizational capabilities of previously powerful village associations, farming cooperatives, youth and female groups, and local business associations also declined. More and more voters, particularly those in their twenties and thirties, women, and longtime city dwellers, identified themselves as party independents. By 1974 such independents outnumbered LDP supporters.7

As the character of the Japanese electorate changed, so did the electoral options. The first few elections following the 1955 consolidation of conservatives and socialists saw the two largest parties taking over 85 percent of the total vote between them. As late as the 1967 election the two largest parties still won 86 percent of the seats. But the formation of the Democratic Socialist Party (DSP), the Clean Government Party (CGP) and then in 1976 the formation of the New Liberal Club (NLC), as well as the transformation of the Japan Communist Party (JCP) into a "lovable" party, all meant increased electoral options.8 An erosion of the dual monopoly of the LDP and the JSP followed. In 1972 the combined popular vote of the minor parties broke through the 25 percent barrier (giving them 21 percent of the seats).9 No longer could the LDP attract support simply by presenting itself as the nonsocialist alternative (nor could the JSP present itself as the only alternative to the LDP).

The increased number of parties meant that the relative strength of the LDP actually increased vis-à-vis any individual party, but the cumulative impact of the new parties was to threaten conservative electoral hegemony.10 Relative strength would count for naught if some combined opposition could forge a parliamentary majority.

As early as 1967 the LDP received less than a clear majority of the votes cast. Yet, gerrymandering and the biases in the electoral system awarded the LDP a sufficient bonus so that it still held 57 percent of the parliamentary seats.11 Nevertheless, a secular decline in LDP support throughout the late 1960s and the decade of the 1970s was unmistakable (see Fig. 1). LDP electoral primacy at the national level dropped below the 50 percent margin in seats by the end of the 1970s,12 leading to a period called hakuchu jidai, or relative equality between government and opposition.

Semiautomatic LDP dominance had long been a lubricant smoothing relations among conservative support groups. LDP dominance and opposition fragmenta-

![Electoral results of Lower House elections](image-url)


...tion minimized the need for compromises with nonconservatives, further helping to wed conservative politicians to the LDP. Moreover, 10 or 11 percent annual growth greatly facilitated congenial coexistence among conservative backers: technologically sophisticated and more backward industries, importers and exporters, urban and rural interests, and otherwise fractious bureaucrats, business leaders, interest groups, and politicians. Conflicts that might have become zero sum under less advantageous economics were more readily reconcilable through side payments, compensation, and trade-offs.

Most supporters of the conservative regime agreed on the need to meet the electoral threat to the LDP. Should the LDP lose its parliamentary majority, defeated conservative parliamentarians would obviously lose their parliamentary salaries, perks, power, and prestige. But more threatening to the regime as a whole, any imaginable alternative government would be unlikely to continue the strongly pro-business climate for Japan’s largest financial, brokerage, and insurance firms or to maintain policies so supportive of close security ties to the United States. Similarly, many senior-level bureaucrats—although their positions were nominally nonpolitical—would almost certainly find themselves out of favor, if not out of jobs, under a non-LDP government.13 On only the rarest of occasions, and with minimal support, was any serious consideration given among conservative regime members to abandoning the LDP in favor of some other political party. The electoral threat to the LDP thus captured the undivided attention of conservatives of all stripes.
Yet how to attract new electoral support was by no means self-evident. Two possibilities were obvious. First, although hardly a natural target given the long-standing ideological chasm between the conservative and progressive camps, the conservatives could attempt to draw organized labor away from its traditional support for the DSP and the JSP. Second, and more plausibly, they could seek to attract Japan’s “new middle mass,” that is, relatively unorganized and undifferentiated white-collar urbanites with weak or nonexistent loyalty to any single political party.

LDP strength in the cities had been on a downturn as urban LDP voters fell from about 32 percent of the party’s support in 1955 to 18 percent in 1975. Nonetheless, sheer numbers made urbanites a force that could not be ignored, particularly as the electoral evidence of the 1970s showed city dwellers were more likely not to vote than actively to support the opposition. Nonvoters in the cities rose from about 33 percent in 1955 to about 43 percent fifteen years later. As Ishikawa Masumi put it, “It is not that the progressives are strong in the big cities; . . . more important, the conservatives are far too weak there. And they are weak because they have missed the chance to gain large numbers of potential supporters among the nonvoters.” Closely linked to these nonvoters were the nonpartisan voters. Less indifferent to politics and parties than nonvoters, the nonpartisans voted but rejected any permanent party affiliation. Combined, the two groups represented vast numbers of potential LDP supporters within the metropolitan areas and the large cities.

What the party should do to attract such potential supporters, however, was by no means uncontroversial. Many of the most obvious policy options that might have appealed to workers, urbanites, and the growing middle class challenged existing conservative supporters. The result was an ongoing dilemma for the party.

Diminishing margins between the government and the opposition also reduced the guarantee that parliament could automatically be counted on to ratify cabinet-initiated proposals. As noted in Chapter 2, from 1955 until 1970 over 90 percent of all successful legislation in Japan originated with the government; less than 10 percent went through any amendment process. Government proposals rarely faced more than token resistance in the legislature. Intraparty politics was predominantly symbolic, marked by boring ritual debates and languid approval punctuated by brief outbursts of anaeorobic confrontation in the form of sit-downs, delayed balloting, seizures of the speaker’s platform, battles between burl party staff members, and threatened resignations.

During the 1970s all this changed. Private member bills (the key vehicle for opposition-sponsored legislation) increased by nearly 20 percent between 1965–75 and 1975–80 while the success rate for government bills fell from 78 to 70 percent. Government legislation fell from nearly 170 laws per year to about seventy-five. Of those passed in 1975–80, over 21 percent were amended. Parliament ceased to be the automatic ratifier of government proposals. Parliamentarians and party leaders were forced to cut deals not only within their own parties but across party lines.

Adjustment bred compromise, and all opposition parties dramatically reduced their votes against government bills. Approval rates in 1979 compared with those in 1966 show the following jumps in support: for the DSP, from 80 to well over 90 percent; for the CGP, from 80 to about 85 percent; for the JSP, from 63 to 75 percent; and for the JCP, from 10 to over 60 percent. To the extent that the LDP held less sway in parliament, key aspects of the conservative agenda were held hostage. The distinction between the LDP and the opposition began to blur on many policy issues, reducing the ideological chasms across the party system as a whole.

LDP electoral hegemony was also being challenged locally. Coalition candidates from a variety of progressive parties were enjoying electoral successes in local assemblies, large prefectures and major cities. Conservative candidates had won 83 percent of the prefectural governorships between 1964 and 1966 and 87.5 percent in the 1968–70 elections. By 1972–74 their success rate had fallen to 61.9 percent. Local-level shifts raised the possibility that opposition parties could build strong regional bases and gain governmental experience that would, as had happened in parts of Europe, enhance their ability to challenge national conservative continuity.

Finally, conservative control was challenged by an outbreak of citizens’ movements and student protests during the late 1960s and the early 1970s. Most took a nonparty approach to politics—demanding specific actions not linked to the policy programs of the established political parties. These movements had two important consequences: they raised new and problematic issues not previously on the political agenda, and they mobilized people around issues and at times that had nothing to do with the electoral cycle. During elections, of course, opposition parties were highly critical of the conservative agenda; electoral campaigns frequently probed issues that the conservatives preferred to ignore. But once the votes had been counted, the conservatives could claim a mandate to move their agenda forward at least until the next election. Until then the LDP could effectively argue issues out in parliament, largely under its own timetable. As noted in Chapter 2, except during elections politicians rarely sought to mobilize citizens on any issue, and citizens’ groups had limited powers to press most concerns. But protests by students and others ignored the electoral timetable and pressed numerous new issues, posing an undeniable threat to political predictability.

Thus the overriding conservative dominance of the electoral and legislative processes was challenged during the 1970s and 1980s. Meeting these changed circumstances presented an ongoing political problem for the LDP and its supporters during the 1970s; not until the elections of 1979–80 did the LDP appear to have dealt with them successfully.

International Challenges

From the end of the U.S. Occupation until the early 1970s international conditions were preponderantly benign for the conservative regime. From the “reverse course” onward, America’s hegemony within the capitalist world had been unchallenged, and U.S. foreign policy toward Japan had been directed toward the creation and maintenance of a regime that would align itself with U.S. foreign policy goals.
and follow capitalist economic policies. America systematically promoted Japan as an anticommmunist model of development while bolstering the country's prestige in Asia and the world at large.22

By the early 1970s the world had become much less hospitable to Japanese conservatives. External conditions challenged policies, threatened conservative socioeconomic support, and in several instances undermined existing institutions. Three such challenges were particularly critical. First, a mixture of challenges were posed to the existing insularity of Japanese exchange rate policies. Second, the international price of raw materials escalated, undercutting the profitability of Japanese mercantilism in energy-intensive manufactured goods. Third, recipients of Japanese exports, the United States in particular, began pressing for changes in various Japanese economic practices, and in defense and security policies as well.

Probably no short period in the postwar era presented more concentrated and fundamental challenges to Japan's conservative regime than the shocks associated with President Nixon's surprise visit to China, the breakdown of the Bretton Woods system of monetary exchange, the U.S. imposition of import tariffs—all in 1971—and the quadrupling of oil prices in 1973. These blows within a two-year period reverberated throughout Japan.

Nixon's July 1971 announcement about China struck Japan particularly hard. For the entire postwar period, Japan's conservatives had deferred to U.S. leadership on diplomatic matters. This had meant moving far more slowly than many Japanese conservatives had wished in improving economic ties with Beijing.

As late as 1968, Japan had supported a U.S. resolution allowing Taiwan to retain the "Chinese seat" in the United Nations. In the Sato-Nixon joint communiqué of November 1969, the two countries declared their common support for "maintenance and security in the Taiwan area." Twenty years of bilateral cooperation in support of Taiwan and isolation of the People's Republic of China were challenged when suddenly, only ten minutes before Nixon's television announcement, Prime Minister Sato was notified of a completely new American policy toward China. The wisdom of Japan's acquiescence to U.S. foreign policy leadership and the entire security strategy of the conservative regime was suddenly laid open to question.23

On August 15, 1971, President Nixon suspended dollar convertibility, leading to the breakdown of the Bretton Woods monetary system. The effect was profound throughout the industrialized world. In Japan, the breakdown had a massive impact on the standing exchange rate of 360 yen to the dollar. Within Japanese financial circles the number "360" had acquired talismanic (seiki) status.24 Originally justified on balance-of-payments grounds, the fixed exchange rate had gained additional potency by boosting Japan's exports, curtailing foreign entry into Japanese markets, and favoring Japanese manufacturers and producers over consumers.25 Consequently, Japanese government officials initially sought to bolster the dollar and protect the exchange rate.26 Government actions to protect a national currency from becoming stronger must be underscored as unusual. Governments often intervene to shore up currencies from weakening, largely in support of investors, importers, consumers, and national prestige. Keeping the national currency weak, however, did benefit Japan's export industries, though at the expense of enhanced consumer purchasing power. Nonetheless, the futility of Japanese government efforts became apparent as the run on U.S. gold continued, the value of the dollar plummeted, and the drain of Japanese foreign reserves became a flood. Between August and December the Japanese economy lost some $2.5 billion.27 When the yen was finally allowed to float, it appreciated by about one-third to a rate of roughly 240 yen by the mid-1970s.

Four major cycles of yen revaluation followed in the late 1970s, the mid-1980s, and the early and mid-1990s. As a result, the yen climbed from 290 to the dollar at the beginning of 1977 to 170 by October 1978—a 40 percent strengthening in less than two years—from there to between 110 and 120 yen as a result of the G-5 Plaza Accord of September 1985, and to just below 80 yen in 1995. The yen was by far the industrial world's most appreciated currency over the period from the Bretton Woods breakdown through the mid-1990s (see Fig. 2). Then between 1995 and 1998 it reversed direction to 145 yen to the dollar, making it one of the world's most rapidly depreciating currencies. No longer was it possible for Japanese conservatives to count on an undervalued currency to ward off foreign imports while simultaneously aiding Japanese exports. Equally important, the Japanese government's ability to control the value of the Japanese currency eroded, removing a major implement from its economic tool kit and making it tougher to use allocation of scarce foreign exchange as a way to shape business behavior.

If Bretton Woods was a hard body blow to the Japanese regime's midriff, the quadrupling of world oil prices in 1973 was an uppercut to the jaw. Japan's extreme
dependence on imported oil left it far more vulnerable to such shifts than other industrialized countries.28

During the 1950s, the Japanese government, facing both the higher costs of domestic mining and the militancy of unionized coal miners, had opted for cheap world oil as a desirable energy substitute to fuel the nation’s burgeoning industrial production.29 Low and declining world transportation costs further enhanced oil’s appeal. In a perverse way, Japan’s ingrained dependency on imported raw materials had suddenly turned into an unexpected advantage. Instead of relying on domestic sources of raw materials, with their potentially escalating costs and negative political consequences, Japan’s extensive network of trading companies could supply the needed energy at the best world prices from anyone willing to sell.

At the time of the oil shock, Japan relied on oil for 70 percent of its energy needs. Virtually all oil (99 percent) was imported, most of it (roughly 80 percent) from the Near and Middle East. Only Italy and Denmark came remotely close to such high dependency. Furthermore, because Japan had never supported Israel in the Arab-Israeli wars and major Japanese companies had deliberately stayed out of the Israeli market, its leaders were stunned when Arab countries announced a cut in oil supplies to Japan. Furthermore, Japan’s oil supply was delivered largely through the major American and British oil companies, and Japanese government officials were convinced that their country was short-changed by these majors’ favoring of home market customers.

The quadrupling of oil prices transferred some $14 billion from Japan to the oil producing countries in 1974 alone, a sum equal to about 3.1 percent of Japan’s GNP. And the oil crisis came at the end of a rapid economic expansion in which domestic inflation was already running high. The escalation in energy prices reverberated throughout the Japanese economy. In February 1974 wholesale prices were up 37 percent over the preceding year; consumer prices jumped 25 percent between the spring and fall; consumers began a frenzied hoarding of staples such as kerosene, soap, and toilet paper.30

Beyond inflation, the oil shock threatened Japan’s balance of payments, which had begun to turn positive for the first time in the postwar period. The dollar value of Japan’s 1974 imports rose some 50 percent over the previous year.31 Meanwhile, domestic productivity, especially in manufacturing, dropped sharply. By March 1975 Japanese manufacturing output was 20 percent below its peak, the sharpest drop among any of the major industrialized democracies. Declining productivity plus the rapid rise in domestic costs posed a critical threat to the continued success of Japanese exports; any serious rise in export prices threatened to erode the overseas market shares of all major exporters. Japan seemed destined for the same stagnation that was haunting most of the other industrialized democracies.

A second oil crisis in 1979–80 further increased world oil prices, this time about 2.8 times. Spread as it was over nearly two years, however, the shock was mitigated, and its inflationary impact was also less. Yet the continued threat to Japan’s early presumptions of an infinite supply of cheap raw materials further drove home the impossibility of continuing past policies.

Finally, a third set of international challenges was presented by the increasing pressures from the United States and to a lesser extent Europe to reduce Japanese import penetration of their markets. America’s early postwar foreign policy and anticomunism had privileged military and security considerations over commercial and economic concerns, even as priorities had been reversed in Japan. Nixon, although hardly rejecting the broad thrust of security-driven anticommunism, was the first U.S. president to challenge the bilateral basis of U.S.-Japan relations with any gusto. This was made evident in his textile negotiations with Japan and his imposition of a 10 percent surcharge on American imports in 1971. Nixon’s successors, alert to political considerations of industries and labor at home, for the most part continued to press for revisions in Japanese export and investment policies well into the 1990s.

The United States focused first on reductions in Japanese tariffs, import quotas, and various non-tariff barriers, very much in keeping with America’s “internationalist” view: encourage Japan to conform to more generally accepted trade rules. A series of GATT rounds led over time to a rapid reduction in Japan’s formal restrictions. Bilateral U.S.-Japan trade deficits continued to escalate, however, and U.S. pressures became increasingly bilateral and sector specific. For certain sectors, most notably steel, machine tools, and automobiles, and later computer chips, the United States pressed for so-called voluntary export restraints (VERs).32 Later, in response to a variety of domestic political interests, American policy shifted to measures designed to open the Japanese market, such as the MOSS (market oriented, sector specific) talks agreed to in January 1985,33 the Structural Impediments Initiative (SII) of 1989, the 1994 Framework Talks (and the Yen-Dollar Working Group that preceded it), as well as explicit efforts at “managed trade as a second-best alternative,” embodied in the bilateral Semiconductor Trade Agreement from 1986 to 1991.34 The U.S. government also exerted direct pressure on behalf of a bevy of specific U.S. companies or regions that were attempting to enter Japanese markets, such as Motorola; tobacco, auto, and medical technology companies; the Florida citrus industry; Washington apple growers; and New York wine merchants, to name only a few. In all these ways, the United States, and to a lesser extent European governments, mounted steady pressures for substantial changes in vital aspects of Japan’s economic policy profile and indirectly on the regime as a whole.35

Periodically, concerns over the apparent imbalance in the national economic successes of Japan and the United States spilled over from trade to defense. Thus, during the 1970s and 1980s, some U.S. officials began increasingly to contend that Japan was getting a “free ride” on defense. Maintaining U.S. troops in Japan was costly; so was America’s so-called nuclear umbrella. Because the Japanese government allocated only 1 percent of GNP to military spending, many American politicians concluded that if Japan spent more money on defense, the country’s civilian successes (and its own particular domestic political problems) would be diminished.

Western pressures typically ran counter to those of Japan’s Asian neighbors, particularly South Korea and China, which demanded that Japan do less militarily.
Continually reminding Japanese conservatives of the horrific experiences of their countries with Japanese troops during the prewar period, the Asian attitude served as an international counterweight to U.S. pressures for a more active and powerful Japanese military.

Competing pressures ebbed and flowed, but they became particularly visible during the Gulf War of 1991. As noted in the previous chapter, U.S. government officials pressed Japan to dispatch at least a nominal military force in support of U.S. troops. Some Japanese policy analysts argued that it would be rational and wise for Japan to send at least a small detachment of troops to the region, but they lost out in internal debates. The government, citing the standard norms against the use of Japanese troops abroad and cognizant of strong public opposition to such actions, demurred. Instead, Japan eventually contributed $13 billion. By the time the war had ended, however, debates within Japan made it clear that past policies of “separating politics from economics” and of keeping a “low posture” in security matters were no longer uniformly accepted within the conservative regime and would be difficult to sustain.

The equilibrium of the Japanese conservative regime was thus bombarded by external threats, challenges, and attacks. New economic and security conditions threatened the regime’s policy profile and exacerbated tensions among its key socioeconomic supporters. These pressures induced waves of adjustments over twenty-odd years.

Not surprisingly, intra-conservative responses to these disparate challenges were far from consensual and unidirectional. Instead, competing elements within the conservative coalition sent policies and politics caroming first in one direction and then in another in divergent attempts to meet their competing demands. Many of these shifts were minor first-order changes; others, more sweeping and reverberating, were of the second order. But all kept the regime largely intact and equilibrated. Continued conservative rule and ongoing economic successes seemed to promise that the regime would retain its cohesion, control, and direction. There were no sweeping overhauls of policy profile, coalitional arrangements, or institutions. Yet, in the long run the adjustments proved insufficient to ward off far more fundamental changes. Instead, they increased existing rigidities within the regime, failed to resolve internal tensions, and led ultimately to a cataclysmic shattering of the regime. But before examining their consequences, let us examine the changes themselves.

First- and Second-Order Changes: Between Adjustment and Undermining

First-order changes, it will be recalled, are shifts that largely affect only one of the three regime component elements of a regime, whereas second-order changes affect at least two. Adjustments of both types during the 1970s and 1980s—an often inchoate sequence of alterations—kept the LDP in power, the economy expanding, and foreign allies relatively happy. Examples of first-order shifts in the regime’s policy profile would include a movement away from U.S. policy on the Middle East toward a far more independent, pro-Arab position following the first oil shock; a variety of short-term shifts in monetary and fiscal policies; strict crackdowns on campus protests; and moderate adjustments that enhanced Japan’s military roles. Another first-order response involved the blind eye the regime turned toward illegal immigrants working in the country’s dirtier industries and tawdrier services. Despite the importance of many of these changes, few had major impacts on the regime’s coalitional base or institutions.

Various attempts to bolster the regime’s socioeconomic support also had limited repercussions. The introduction of the Small Stores Law in 1973 and its explicit strengthening in 1982 helped to protect Japan’s smaller distributors from both domestic and foreign department stores and merchandise. Incentives for farmers to produce high-value-added crops or specific administrative changes to keep the medical profession profitable had similarly limited impacts. None represented a redirection in the national policy profile or entailed important institutional changes.

There were also several first-order institutional changes: the creation of the Environmental Agency in 1971, the Natural Resources and Energy Agency in 1973, and the National Land Agency in 1974. Small additions were also made sequentially to the number of Diet seats in the lower house, thereby reducing the most egregious imbalances between urban and rural districts. Again, such changes had only limited impact on the regime’s policy profile or its coalitional base. They merely tinkered with narrow and specific items—dispatching short-term problems, rewarding friends, punishing enemies—or made minimal shifts in the regime’s internal cohesion and command of power. Since they did not seriously affect the regime’s stability, I shall not deal discuss them further.

Much more important were the second-order shifts that substantially altered the regime’s internal dynamics—much as the movement of one part of a mobile causes the others to swing. Here I will highlight the most important shifts and show how they both contributed to the regime’s continuity in the short run and sowed the seeds of its longer-term demise.

Six changes are worth discussing. First, numerous components of the previous policy profile became less tightly linked to one another; policies became less collectively conducive of cumulative national growth and increasingly operated at cross-purposes. Second, Japan moved even more strongly toward firm-level cooperation between management and labor, thereby weakening the national labor movement and reducing the ideological gap between government and opposition. Third, the government initially embraced, and then withdrew from, substantial deficit finance, aimed heavily at political, rather than economic, targets. Fourth, and largely in response to expanding deficits, the conservatives went through a phase of fiscal austerity and privatization, marked most notably by “administrative reform” and the 1989 introduction of a consumption tax. Fifth, many powerful Japanese firms, particularly in manufacturing, moved away from their traditional domestic
bases and became multinational producers and distributors. Finally, important changes occurred in defense and security policies.

This mélange had no uniform directionality. Its zigzags reflected intra-conservative battles over how best to adjust to the regime's problems. Often one direction would be initiated only to be reversed or altered as circumstances changed. Yet over time these ongoing adjustments undercut the regime's entire delicate balance.

The Politicization of Economic Policies

Politics would not be politics without special favors. Candidates for office offer competing promises of how they will “do more” for their supporters. While many voters undoubtedly cast their ballots for largely selfless reasons, that is hardly the norm. Major interest associations, large socioeconomic blocs, and big donors typically expect some quid pro quo for their support. In the mid-1960s the policy profile of the ruling conservatives was predicated on providing generalized benefits for broad sectors of society and on overall economic catch-up and developmentalism. This changed significantly by the late 1960s and even more so into the 1970s and 1980s, largely in response to the changing demographics of Japan, the challenges to LDP hegemony, and the increasing influence within the conservative regime of career politicians, particularly those linked to Tanaka Kakuei. As a result, many economic policies became more narrowly targeted and explicitly political.

One of the more important efforts to shore up the LDP through major policy shifts was MITI minister Tanaka Kakuei’s Plan to Remodel the Archipelago.36 Put forward in 1969, the proposal called for a major redirection of Japanese economic resources: the national priority of export success in high-value-added manufactured goods would give way to massive public infrastructural investment in virtually every region of the country. Japan had long led most other industrialized democracies in the amounts of money spent on pork barrel and infrastructure (see Table 2), and Tanaka’s proposal promised to widen the gap further. The plan was to make national economic growth more reliant on bigger government budgets channeled politically connected construction and real-estate sectors. Tanaka proposed to do for the nation what for decades he had done for his local Niigata constituency: deliver massive public works projects such as roads, tunnels, railways, senior citizens’ centers, and the like—all of which would stimulate the local economy, create jobs, improve life styles, and, not at all incidentally, generate huge amounts of cash for the LDP and for individual conservative politicians from the beneficiaries who carried out the remodeling. Also rewarded would be the underdeveloped geographical regions that had long been electoral mainstays of the LDP.

Tanaka’s plan never got off the ground. He took office as prime minister in August 1972, right in the middle of the “Nixon shocks” and just ahead of the oil shock. Consequently his proposal, in Gerald Curtis’s words, “turned into a nightmare of inflation, land speculation, and ballooning government deficits.”37 His popularity fell faster than that of any other prime minister’s—from a high of 62 percent when he took office to 27 percent only eight months later. And all before the 1973 oil shock, inflation, and subsequent revelations about Tanaka’s shady business dealings particularly in conjunction with Lockheed.

The sudden change in world economic conditions and the slowdown in Japanese growth rates meant that Japan’s governmental budget, which had previously generated automatic 10–15 percent increases annually, was forced into a holding pattern that made massive government expenditures far less electorally and economically feasible than they might have been five years earlier. Even so, over the next two decades the Tanaka faction continued to promote Tanaka’s effort to link the construction industry, public works, the national treasury, and the LDP—albeit on a somewhat smaller scale.

Important to note in this regard is that although Japan spends a considerably higher proportion of its GNP on public construction than most other industrialized countries, the results have not necessarily created a deeper infrastructure. Construction in Japan is almost twice as expensive as in these other countries, due to high rates of collusive bidding (dango) among construction firms, bribes and kickbacks to politicians, regulatory burdens, and the like.

The explicit politicization of economic policy reflected the rising influence and orientation of “career politicians” within the LDP and the relative waning of the “ex-bureaucrats.” In the Kishi, Ikeda, and Sato cabinets (1957–72), former bureaucrats typically held about 50 percent of the cabinet posts. In the first Tanaka cabinet in 1972 their numbers fell to 30 percent and remained low under the successor governments of Miki, Fukuda, and Suzuki. Moreover, many of the nominal ex-bureaucrats in the LDP began to enter politics not from the technical, economic, and administrative ministries such as Finance, International Trade and Industry, and Transportation, which had given early postwar conservative politics its technical-economic focus, but increasingly from the more “politicized” agencies such as Post and Telecommunications, Labor, Police, Construction, and Agriculture.40 In addition, these ex-bureaucrats of the 1970s and 1980s were more likely to have left the civil service in their late twenties or early thirties and to have taken up...
full-time political careers. In short, the character of the LDP’s leadership began to reflect a strengthening of the career-track politicians whose primary concern was their local constituency and their own reelection rather than macroeconomic growth.

Correspondingly, the development and institutionalization of personal support groups within individual electoral districts gave individual conservative politicians considerably more independence from the party leadership than had been true in earlier times. Time and institutionalization made these personal support groups sufficiently cohesive that they could be passed on from father to son (or to nephew, personal secretary, son-in-law, and the like). Between 1958 and 1990 the number of such seats rose from 34 to 105, or 36 percent of all LDP seats. Political careers increasingly took on the characteristics of family businesses, with professional politicians becoming ever more autonomous from their party.

Since local network development cost money, it had to compete with the needs of the LDP as a party, the need of the national economy, and the needs of individual candidates. The rapidly rising costs of Japanese political life soon made Japanese electoral politics among the most expensive in the world. One 1993 study showed Japan spending over three times more per capita for politics than any other leading democracy. Another showed that in 1992 a parliamentarian required ¥140 million ($1.4 million) annually for day-to-day activities even in non-election years. Salary and party subsidies were perhaps ¥400,000 annually, leaving the parliamentarian about $1 million in the red. Such costs, combined with the fact that most conservative parliamentarians faced their most serious electoral competition from other conservatives within the multimeber electoral district system, raised the stakes for individual parliamentarians to generate even more money. Faction leaders, responsible for helping their parliamentary supporters, faced even more enormous expenditures.

The obvious targets for fundraising were businesses and well-organized interests, not to mention the national treasury. But which groups would readily contribute and with what expectations in return? The major business federations and trade associations had long pooled monies collected from their members and made contributions to the LDP as a party. Yet as the costs of elections rose, many individual politicians began cultivating their own sources of money, and individual firms and sectors responded by parting with inordinately large amounts of cash in the expectation of special treatment beyond the generic benefits derived from a good macroeconomic climate.

This in turn greatly politicized the national bureaucracy and national economic policies. The budgetary process became increasingly subject to political interventions. Meanwhile Tanaka, and his faction eventually succeeded in “colonizing” a number of government agencies, most notably the National Land Agency and the Ministries of Agriculture, Transportation, Posts and Telecommunications, and Construction, ensuring that top civil servants in those agencies would have close ties to, and a serious regard for the particularistic policy needs of, Tanaka and his faction. Other LDP parliamentarians developed parallel connections with individu-uals in specific agencies who were willing to provide them with otherwise confidential details of ministerial affairs.

The result was the rise of individual parliamentarians known as zoku gin (literally, “tribal parliamentarians”). These individuals became experts on specific policy areas, usually those that involved substantial amounts of discretionary public spending. Using this expertise, such politicians would broker deals between interest associations, industries, or firms, and the agencies with which they had to deal. Thus, there was a construction zoku, a defense zoku, a Zuiko linked to the National Land Agency, a labor zoku, a communications zoku, an agriculture zoku, and so forth. The result was the enhanced sectionalization of politics and policy. “Iron三角关系 emerged in which politicians provided special favors from the regulating bureaucratic agency and/or the national treasury to particular interest groups, sectors, or firms. In the process, monies and other favors were regularly exchanged. As Chalmers Johnson has phrased it: the politicians “did not displace the bureaucrats or seek to have regulations reduced or eliminated. Instead, they simply enriched themselves by seeking and accepting bribes from businesses that needed to get around the regulations.”

Politicians developed a host of other fund-raising techniques. Direct cash contributions under the table came to be supplemented by elaborate schemes involving rapid land and property transactions, direct take-offs from public contracts, and somewhat bizarre techniques such as “ambulance stocks,” in which a single publically traded stock might be manipulated feverishly by contributing brokerage houses or firms, thereby guaranteeing suddenly cash-starved politicians the ability to buy low and sell high.

The cumulative result was an increased intertwining of the electoral needs of the LDP and powerful individual parliamentarians into the previously more nationally focused civil service, the increased politicization of the once unmediated relationships between agencies and interest groups that had prevailed in the 1960s, and the overt politicization of important aspects of economic policy. This process proved to be highly beneficial to the LDP and to individual conservative politicians in the short run. But ultimately these adjustments, like many others, came back to haunt the conservatives and to contribute to their toppling in the 1990s, largely as a result of corruption scandals and the increasing inefficiency of government economic policies.

Firm-Level Incomes Policy and the Moderation of Labor

Far less overtly political, at least in its initial formulation, was an attempt by government and business to head off the wage-price inflation generated by the rapid increase in the value of the yen in 1971 and the sudden rise in world oil prices in 1973. But the consequences for politics, as well as economics, ultimately proved to be profound.

As noted in Chapters 2 and 3, Japanese labor-management relations had been marked by high levels of conflict during the early postwar years, and during the late
1950s and early 1960s the conservative camp had successfully broken the backs of labor's most militant elements, at least within the private sector. Cumulatively, this led to a reduction in the power of the left and the simultaneous pacification of Japanese private-sector labor. By the 1970s, private-sector unions increasingly identified less with working-class solidarity than with the bottom lines of individual company balance sheets. As the national labor supply began to shrink and manufacturing productivity soared, workers in private plants gained enhanced bargaining power and substantial wage hikes.

The externally induced inflation of 1973–74 might have given labor both the incentive and the power to demand large wage hikes to offset rapidly rising domestic costs. Doing so, however, would have seriously undermined the price competitiveness of Japanese manufacturing firms and exported goods, thereby threatening national economic growth. Quickly, a three-way "de facto incomes policy" was arranged. Private-sector labor agreed to moderate any wage demands in exchange for government guarantees of job security and retraining programs for union members, while the government guaranteed low taxes, anti-inflationary policies, and financial support for worker retraining and industrial reorganization.

This arrangement quickly stemmed wage-price inflation and enabled Japan to become the first industrial country to snap back from the economic shocks of the early 1970s with only a minor hiatus in its growth. Government resources, managerial concessions, and labor linkages to firms proved to be key ingredients in warding off what might have been a severe challenge to national and company export competitiveness.

The agreement also strengthened ties between management and unionized blue-collar workers in the country's large private firms, which weakened latent appeals to class on the part of the union movement and the political left. It also diminished the interest of private-sector labor in national politics; labor's battleground increasingly centered on plant-level concerns. In contrast, many public-sector unions continued to stake out ideological positions on the far left, widening the wedge between private- and public-sector unions. Ultimately the private-sector unions won the internal battle, and as we noted in Chapter 4, the labor movement reorganized into Rengo, a single peak federation with a largely nonpolitical, economic agenda. As economic interests shifted, so did electoral behavior, with significant numbers of blue-collar workers moving to support conservative candidates.

Labor-management adjustments thus had sweeping impact on the regime. The bargain of the mid-1970s certainly solved the stagflation problem that was besetting the rest of the industrialized world; it also kept Japan's economic growth vibrant. But beyond economics, it profoundly fragmented the already disillusioned labor opposition, brought greater tranquility to labor-management relations, softened the ideological divisions within party politics, and garnered additional voter support for the LDP. The new support for the conservative's socioeconomic base entailed no loss of existing conservative supporters. Labor's increased conservatism came at no real expense to the conservative socioeconomic infrastructure, at least in the short-run.

**Deficit Finance to Enhance Social Infrastructure**

A different set of changes involved "quality of life" enhancements—efforts undertaken to enhance the conservatives' appeal to urbanites, to broaden the electoral base of the LDP, and to co-opt this potentially important issue from the political left. Two decades of rapid economic growth had generated major shifts in urbanization, in environmental pollution and congestion, and in the age pyramid. Underlying all these was a broad public sentiment that Japan's growth should be reflected in improvements in the lives of contemporary citizens, not simply those of unborn future generations.

Conservative economic policies had initially focused on economic growth and national catch-up. Social welfare problems related to sickness, unemployment, old age, disability, and the like were taken to be the responsibility not of the state but rather the family, the village, and, to some extent, the firm. Aside from family or village assistance, Japan's system of occupation-based welfare had historically been the principal source of most individuals' old age and medical help.

Moreover, rapid economic growth on Japan's crowded main islands had been driven by heavy industry, particularly chemicals, petrochemicals, steel, electric power plants, and closely configured industrial complexes, most of which were put in place with little regard for their environmental impact. Economic success and consumerism also generated increased automobile use with its consequent polluting effects. Although Japanese conservatives were slow to take up these environmental questions, once they confronted the massive citizen movements noted above as well as court decisions favoring pollution victims, the government introduced strict emission standards. It also began underwriting part of the cost of manufacturing and purchasing antipollution equipment and, as we shall see in more detail below, encouraged the overseas relocation of the worst polluting industries.

Steps were also taken to revise national policies on social welfare. An important catalyst for this reassessment was the conservatives' desire to co-opt opposition issues and deflect the appeal of progressive local governments that were instituting widely popular social welfare and pollution control measures. Even Japan's larger businesses, whose firm-level advantages would be partially undercut by any comprehensive national program, urged government action to increase welfare as a way to ward off potential conservative electoral defeats.

Social welfare took top priority in the national budget in 1973, which the government proclaimed "the first year of the welfare era." Free medical care for the elderly, initially offered by progressive local governments, was introduced at the national level. The proportion of total national medical expenses paid by the two public insurance programs was increased from 17.2 percent (1966–72) to 27.3 percent (1973–75). Payout levels in both the Employee Pension System and the National Pension System were also substantially enhanced. The employee benefit was nearly doubled to about 45 percent of the average income; the national pension was increased proportionately. More important still, indexing to the cost of living was introduced into both systems.
These measures came, obviously, from a conservative government anxious to forestall electoral challenges rather than from a social democratic government desirous of institutionalizing egalitarian citizen rights. As such, they were more Bismarckian than Beveridgean. As a proportion of both the national budget and GNP, spending on social welfare increased steadily from 1973 until the early 1980s. Even so, as late as 1980, social security transfers in Japan remained low at 10.9 percent of GNP (compared to 22.9 percent in France, 15.3 percent in Germany, and 15.8 percent in Italy). Modest as they were, they provided an important improvement for many citizens and generated a positive electoral response. They also began to account for a growing share of government expenditures.

If this "era of welfare" had lasted for a decade or so, Japan's welfare mix might have moved decisively toward a more "institutionalized" welfare state based on citizenship rights. Occupational welfare might have been reduced, which in turn would have weakened management's control over employee benefits and narrowed the differential access to social welfare. Welfare reforms, however, came face to face with a reassessment of fiscal austerity beginning in the mid-1980s. To appreciate the trade-off, it is necessary to examine the funding of social welfare—and that of pollution control and other urban and lifestyle improvements as well.

Policymakers initially expected Japan's twenty years of dramatic economic growth to continue, thereby providing the needed funding for new social programs (as well as Tanaka's remodeling plan). But the very first year of Japan's new "welfare era" coincided with the oil crisis, and prospects for Japanese growth dimmed quickly. Slower growth and lower government tax revenues, combined with the weakening political position of the LDP, meant that the new programs would have to be funded through higher taxes or deficit budgeting. The unpopularity of taxes made the political choice an easy one. In 1970 Japan's deficit dependency ratio had been just over 4 percent; in 1971-74 it rose rapidly to 11-16 percent, climbed to just below 30 percent in 1976 and 1977, hit 37 percent in 1978, and peaked near 40 percent the next year.

Deficit financing had the obvious advantage of being far less visible to the general public than major hikes in taxes. But as public deficits mounted, the idea of emulating Western-style welfare programs came under withering attack, particularly from the business sector and the MOF. Furthermore, policy changes had preempted the opposition's ability to exploit pollution or welfare as issues to attack the conservatives. Indeed, in the 1979 lower house election the LDP finally stemmed its twenty-year decline in vote share. Then in the famous "double election" of 1980 its proportion of seats jumped from 49.3 to 57.9 percent and the opposition parties were effectively brushed to the sidelines. The electoral turnaround for the conservatives allowed a return from "lifestyle policies" to "fiscal restraint."

Administrative Reform, "Japanese-Style Welfare," and Fiscal Restraint

The conservatives' renewed electoral strength, the increased marginalization of the opposition parties, and a renewed close affinity between private-sector unions and management combined to leave the conservatives in a much stronger electoral position than they had been in the mid-1970s. As a result, conservative regime supporters who had initially opposed the radical departure from fiscal austerity to fund the new programs were poised to roll back the minimalist welfare and lifestyle programs that had barely been introduced.

Conservative intellectuals argued that excessive welfare services led to outbreaks of "advanced-country disease" or the "English disease." Expansion of public programs, it was contended, encouraged people to depend excessively upon the state, discouraged their desire to work, and weakened their incentives to invest and improve productivity. Furthermore, demographic models had already shown that Japan was destined to become an even bigger spender for health and retirement programs as the population continued to age. Such high long-term costs argued for a reversal of past trends. Drawing on the theme that Japan was different from other advanced democracies and that welfare should be left primarily to the family and the firm, these conservatives advanced the notion of building a "welfare society with vitality" and creating a "Japanese-style welfare society."

As early as the mid-1970s, LDP and government rhetoric adopted this new perspective. The Policy Affairs Council of the LDP released its "Lifetime Welfare Plan," which recommended that welfare be based on self-help and warned of the dangers of expanded public spending for welfare. The Economic Planning Agency issued a 1977 report which, for the first time, officially employed the catchphrase "Japanese-style welfare society." Prime Minister Ohira argued for just such a focus in his January 1979 policy speech to the Diet. With the publication of the government's New Economic and Social Seven-Year Plan in August of that year, the goal became official governmental policy.

Contending that free medical care for the elderly had turned hospitals into "old people's salons," the government passed an Old People's Health Bill in 1982 which introduced co-payments and pressured local governments to stem any initiatives to improve medical care for elderly patients. In 1985 the Employees Pension Plan was revised to slow down benefit increases, raise contributions, and reduce government subsidization. The pension system was made explicitly two-tiered, with a base pension for all citizens topped by a wage-linked pension tied to occupation. Pensions for government employees were similarly slashed.

In all these ways, government costs were slowed or reduced, reversing the trend that had begun in the 1970s and reinstituting wide differentials in the retirement benefits provided by firms of different sizes in different sectors. But the changes also effectively capped the climbing expenditure on social security and medical care. Such spending plateaued at about 27 percent of the national budget during the 1980s, while spending for health and income security dropped slightly from 18 percent in 1982 to 16.3 percent in 1990.

It was within this context that administrative reform began under the Suzuki cabinet in the early 1980s. Administrative reform was delegated to the Second Provisional Administrative Reform Commission (Rincho), created in March 1981 by Nakasone Yasuhiro, then director-general of the Administrative Management Agency
(and subsequently prime minister). Picked to head Rincho was Dokio Toshio, a business elder who had earlier served as chairman of the Keidanren. Dokio's austere personal lifestyle and reputation as a man of high moral character lent particular credibility to his role as national skinflint. His critics invariably looked selfish and devoid of concern for the national well-being. Staffing the commission were many close allies of Nakasone, giving it added political clout. Throughout the commission's deliberations, Nakasone and Dokio worked closely to promote its goals and deflect its opponents.

Administrative reform involved a fundamental intraregime shift to appease business and bureaucratic constituents who were upset with the radical jumps in government costs and with the potentially even greater deficits implied by automatic entitlement programs, who resented the government challenge to the ways in which firm-level benefits linked workers to their companies, and who feared that the "unique Japanese national character" would be undermined.

Rincho was strict in its attacks on budget deficits and government entitlements. As noted in Chapter 2, Japanese government expenditures had been stable in the low 20 percent range of GNP until 1970; subsequently this figure had expanded to nearly 35 percent. The bond-debt ratio rose sharply as a result, and massive debt servicing costs became a built-in part of the annual budget. Debt servicing rose from 0.12 percent of GNP in 1966 to 0.39 percent in 1970 to 1.56 percent in 1978 and 2.94 percent in 1982. To curtail this expansion, national budgets during 1982–84 were kept at zero, low, or negative rates of growth, thereby dramatically reducing program expansion and costs, as well as civil service growth.

The tightening was far more politically neutral. Individual agency requests were coordinated with LDP zoku members; MOF budget making was coordinated with the top three leaders in the LDP; and despite the overall cutbacks in the budget, subsidies for public works continued to increase.

Beyond its budgetary focus, Rincho also embarked on a substantial privatization of the railways, the telecommunications industry, the tobacco and salt monopolies, parts of Japan Airlines, and other public corporations, further reducing the size, scope, and cost of Japanese governmental activity. Not at all incidentally, privatization substantially undercut the political and economic power of many of the militant public-sector unions.

Administrative reform, consequently, served multiple purposes. It met demands from the business community and the MOF for cutbacks in government expenditures; it returned the country to relatively strict macroeconomic fiscal policies; and simultaneously it hamstring the public-sector union movement, one of Japan's last redoubts of Marxism, anti-American foreign policies, and the politics of confrontation. Ironically, despite its belt tightening, the administrative reform program also enhanced the conservative regime's popularity by creating a mood of national solidarity and demonstrating fiscal responsibility.

Congruent with Rincho's fiscal tightening was the introduction in 1989 of a broad-based 3 percent consumption tax. In 1987 Japan along with the United States, remained the only OECD countries that did not have some form of national consumption tax. Japan's introduction of such a tax meant a major shift in the revenue stream for government budgets, giving the MOF a valuable weapon in its fight for fiscal tightness and allowing it to reduce the budgetary dependence on personal and business taxes. As commentators at the time pointed out, and as the subsequent hike of the tax rate to 5 percent in 1997 made clear, such a system allows for relatively easy expansion (although hardly without political cost) when government officials determine the need for greater revenue.

Ironically the consumption tax had the effect—not immediately perceived—of reducing the tax burdens of urban salaried personnel and corporations while increasing those of farmers and small businesses. (In its initial implementation, however, the LDP allowed small businesses a massive loophole under which they could collect the tax but simply "estimate" their sales for purposes of payment to the government, the result was an extensive, if short-term, windfall for small businesses.) Few urbanites welcomed the tax shift, however, and ultimately it proved to be an electoral disaster for the LDP in the 1989 House of Councilors election, which took place only three months after its passage. That election, in turn, proved to be the beginning of the electoral split in the LDP.

In sum, once conservative electoral fortunes improved, largely as a result of quality-of-life programs funded through public deficits, Japan's conservatives returned to tighter fiscal policies. But a serious outgrowth of the changes was an exacerbation of intra-conservative tensions over the relative burdens and benefits of those shifts.

**Overseas Investment**

A weak position in foreign exchange during the 1940s and 1950s had led the Japanese government to institute strict measures discouraging direct overseas investments by Japanese companies except in ventures linked to the extraction of raw materials. From 1951 until 1971, consequently, Japanese direct foreign investment totaled just over $4 billion, with nearly 60 percent of that total coming in the years 1969–71. Through fiscal 1972, nearly three-quarters of Japan's limited overseas investments were in nonmanufacturing ventures.

The rapid escalation in the value of the Japanese currency reconfigured government and business incentives regarding foreign investment. The stronger yen offered an automatic incentive for many firms to invest abroad; so did rising protectionist barriers against Japanese imports in the United States and Western Europe. Setting up production facilities in those potentially closed markets allowed Japanese-owned firms to bypass potential barricades against Japanese imports, while the rising value of the yen made it considerably cheaper to expand overseas. A tightening Japanese labor market further stimulated foreign direct investment, as did domestic demands for a cleaner environment. For many manufacturing firms producing for export, expansion of their overseas facilities became highly desirable.

For the government as well, liberalizing conditions for foreign direct investment allowed it to meet changing business demands and placate powerful foreign critics.
of Japanese trade policies in a manner that posed few threats to continued conservative dominance at home. The interests of the Japanese government and many private Japanese businesses thus resonated with the world's new monetary and trade conditions.

Large current account surpluses in 1971–72 had led the government to liberalize certain conditions for foreign direct investment by Japanese firms. As the yen appreciated, government constraints were softened further and Japanese firms responded with alacrity. A dramatic expansion in capital outflow and overseas investment ensued. Total investment for 1973–76 was nearly double that for the preceding twenty years. This investment continued to escalate. Some $4.7 billion was invested in 1980, $12.2 billion in 1985, and $47 billion in 1988, ten times the figure of eight years earlier.

Japanese investments occurred in virtually all sectors of manufacturing, not to mention massive equity, bond, and government note holdings in Europe and the United States. Japan's larger financial, commercial, and manufacturing institutions moved abroad; large numbers of subcontractors and other small firms followed. By the late 1980s, Japan was the world's largest creditor and its second largest overseas investor, behind only the United States.

The investment boom had wide consequences. Overseas operations (particularly in Asia) allowed Japanese-owned firms to reduce their labor costs while investment in North America and Europe enhanced their access to upscale markets. Overseas operations allowed many Japanese firms to come out from under governmental oversight. Within Japan, organized labor was further weakened. Meanwhile many secondary and tertiary subcontractors were left without markets for the components or services that they once supplied through vertical keiretsu contracts. In what was to prove an important development in the keiretsu as well, many manufacturers began to loosen their dependence on deficit financing and on their main banks. In short, expanded overseas investment brought sweeping changes to Japanese economic structures, to links between government and business, and to the labor market within Japan.

Greater overseas investment by many sectors of the Japanese economy widened the gaps between segments of the Japanese economic community. Those that expanded overseas were forced to confront international market conditions far more directly than when they operated largely within Japan. Most underwent internal adjustments to enhance their competitiveness. Other sectors—that continued to focus primarily on production and sales within Japan—could resist making such adjustments by relying on oligopolistic networks, extensive regulation, and government protection.

If conditions for the movement of Japanese-owned firms out of Japan were liberalized quickly, the movement of foreign products and companies into Japan was far slower to change. Foreign pressures for greater access to the Japanese market had led the government to reduce tariffs to an average of 2.5 percent. This meant, as the government was quick to report in virtually all its official publications, that formal tariff barriers in Japan were below the 2.7 percent level for the European Community, the 3.5 percent for the United States, and the 4.2 percent level for Canada.

Residual import restrictions were also reduced. In the 1960s Japan had restrictions on some 490 product categories. By February 1975 the number had dropped to 29 (7 in manufacturing and 22 in agriculture). By 1992 agricultural restrictions were down to 13 and manufacturing restrictions down to 1, fewer than in other industrialized countries.

Yet such reductions in formal barriers did not entail a wholesale rejection of embedded mercantilism, nor did Japanese business leaders or government officials suddenly embrace laissez-faire market philosophies and unfettered trade. Into the early 1990s, two major areas of import illiberalism remained conspicuous: high-level manufactured goods and agriculture.

Imported manufactured goods expanded rapidly in the late 1980s but from such a low base that they continued to constitute an inordinately low ratio of Japan's total imports. Rarely imported were products in categories where Japanese-owned firms were exporters; until the late 1980s imported manufactured goods rarely competed in the domestic market against Japanese exporters. Moreover, the rise in overseas investment by Japanese manufacturers, as well as the development of regionally integrated production facilities in Asia with Japanese firms at their core, meant that much of the rise in Japanese manufactured imports was simply the result of Japanese-owned plants overseas involved in intra-company transfers or sales back to facilities or markets in the home country. True foreign penetration was a much smaller part of the changing import picture.

As noted in Chapter 4, changes in the Foreign Exchange and Control Law in 1980 had allowed foreign firms to invest directly in Japan. Long-term Japanese giants like IBM-Japan, Coca-Cola, and Nestlé were joined by Western brokerage houses, banks, catalogue sales operations, food franchises, and firms selling a variety of consumer nondurables. Many achieved high levels of profitability by the early 1990s. So did a number of high-prestige brand-name goods from Royal Dalton to Mercedes-Benz. But important pockets of protection remained, including insurance, construction, energy, air transport, and telecommunications. As with manufactured imports, widespread foreign penetration remained the exception. Even into the late 1990s, the Japanese economy remained, on a per capita basis, much less penetrated by foreign investment than any other industrialized nation.

In agriculture as well, Japan hardly embraced free trade. Japan is one of the industrial world's largest importers of many agricultural products. Food and agricultural goods make up some 15 percent of total Japanese imports. Japan is by far the best market for U.S. agricultural exports, buying more than America's second, third, and fourth largest markets combined. Moreover, in the late 1980s Japan liberalized once highly sensitive items including beef, citrus fruits, processed cheese, canned pineapple, and orange juice. All required politically painful concessions to Western pressure at the expense of the conservative regime's own rural supporters. Rice, however, remained a noteworthy exception. Japan remained steadfastly opposed to
any liberalization of imported rice until the end of the Uruguay Round, insisting on a policy of “not one single grain of imported rice.” Following Uruguay, Japan began moving toward the eventual tariffication of rice, and even the sacrosanct rice market began to open slowly.

Changes in overseas investment and trade opened chinks in the armor of embedded mercantilism. Many government-to-firm and bank-to-firm connections were weakened, and some economically less competitive sectors of the economy—many of them normally supportive of conservatives—faced serious economic threats. Nonetheless Japan remained one of the countries in the industrialized world most closed to foreign direct investment—proof of embedded mercantilism’s pervasive stickiness. But the overall expansion in overseas investment, combined with even the modest openings of the home market, began to undermine the socioeconomic support base of the LDP and to loosen the once rigid bonds holding the conservative regime together.

Defense and Security

From the 1970s and into the late 1990s Japan’s conservative regime continued its commitment to low military spending, its minimalist security posture, and its reliance on the U.S. Security Treaty, the American nuclear umbrella, and the Seventh Fleet. Except for the radical left, fewer and fewer Japanese challenged this continued commitment. Overall support for these policies grew among the public. Indeed, several decisions during the 1970s and the early 1980s reaffirmed the long-standing Yoshida line: the Three Non-nuclear Principles, limits on arms exports, the continued commitment to spending no more than 1 percent of GNP on defense, and the Nuclear Nonproliferation Treaty. Prime Minister Nakasone in the 1983 Williamsburg economic summit went so far as to declare that “the security of our countries is indivisible.” And in 1996 President Clinton and Prime Minister Hashimoto reaffirmed their two countries’ commitment to the Security Treaty, with a revised set of defense guidelines being promulgated in September 1997.

Yet several shifts occurred that both kept the regime largely on course and sowed seeds for change. Prime Minister Nakasone sought to move Japan toward a more active military role in world affairs; the Japanese Self-Defense Forces expanded slightly their military mission; in 1988 Japan and the United States entered into an agreement to share military technologies; many government and business officials emerged to champion enhanced domestic production of arms equipment. Overall, however, the adjustments that Japan’s conservatives made in defense and security remained within the broad framework that had prevailed since the 1950s.

One noteworthy deviation came with the adoption of a policy of “comprehensive security.” Responding to the oil and energy crises, as well as to U.S. pressures for an increase in Japan’s defense spending, “comprehensive security” moved the discussion of defense beyond matters of guns and alliances into the arenas of energy, food security, and foreign assistance. The policy crystallized in 1980 when, under Prime Minister Ōhira’s initiative, a study group put forward the Report on Comprehensive Security. Claiming that American military supremacy had ended and that the United States could no longer guarantee support for all its allies, the report went on to argue that Japan’s security depended on more than military prowess and included economic well-being and access to natural resources. It argued that Japanese defense policy be conducted at three levels: overall efforts to create a positive climate in world affairs, self-reliant efforts to cope with external threats, and a reliance on closer ties with those countries that shared Japan’s ideals and interests.?

The result was a new perspective on national security, weaving together foreign aid, energy and raw materials, food, sea transportation, science and technology, economic planning, military affairs, and diplomacy and placing them all under the nominal umbrella of security. The policy underscored the official commitment to advancing foreign policy through nonmilitary means. At the same time, it provided a justification allowing numerous Japanese government agencies to tie their missions to “security.” Simultaneously, Japanese officials could deflect attention away from the country’s low commitment to military security and point instead to Japan’s larger “burden sharing.” In particular, the policy deflected American criticisms of Japan’s “free ride on defense,” since Japanese foreign aid was increasingly directed toward political goals congruent with U.S. foreign policy.

Since “comprehensive security” resonated less with the rhetoric of the 1930s and 1940s than did “alliances,” “defense,” or “military spending,” the policy also defused some of the pacifist appeals of the traditional left. By including enhanced foreign aid as an important component of Japanese security, Asian criticisms of an alleged “Japanese militarism” were also mitigated. One further consequence was also important: by connecting Japanese economic and security interests so closely, the policy tightened some hitherto loose connections among various conservative groups, even though it involved only minimal deviations from past policies and institutions.

In short, then, adjustments and shifts occurred in various aspects of the conservative regime’s policy profile, coalitional arrangements, and institutional base during the 1970s and 1980s. These both ensured the continued political and economic success of the regime and undermined many aspects that had held it together during the 1960s. Before examining the conservative regime’s collapse, we need to highlight how it appears to have successfully adapted by the late 1980s.

Intimations of “Successful” Adjustment

During the late 1980s Japanese conservativism appeared to have made the kinds of adjustments that would ensure continuity and success for the prevailing regime. This was especially true at the electoral level. The LDP attracted substantial new socioeconomic support—from white-collar voters, urbaniates, and segments of organized labor—that did not dramatically undercut core conservative support in the
well-organized sectors of agriculture and small business. Not until the very late 1980s did the government begin taking policy actions that began to hurt these former core supporters. The public increasingly perceived the LDP as the only party capable of maintaining macroeconomic success; good economic performance over the years reinforced the party’s political hold.

In the 1979 and 1980 elections the LDP reversed its twenty years of linear decline, and the 1980s became a decade of unchallenged LDP dominance. The JSP drew less than 20 percent of the total vote and none of the other minor parties were able to win over 10 percent in two consecutive elections. In the 1986 lower house election, for example, the LDP drew 51.3 percent of the vote and won 59.8 percent of the seats.

Equally notable was the apparently successful economic adjustment. The oil shocks and the labor shortages had been dealt with far more successfully than in other countries. Major manufacturing firms had emerged far stronger. The rapid rise in the yen had encouraged many of them to shift their focus from “exporter” to “investor.” Consequently, numerous Japanese firms prospered despite the oil shocks, the stunning escalation in the yen, and the rise in overseas protectionism. Asset holders were particular beneficiaries. Between 1986 and 1990, land prices and Tokyo stock exchange values soared. Japanese tourists, toting wads of the ever more valuable yen, roamed the world filling Louis Vuitton suitcases with foreign goods. Glitzy Ginza tea shops catered to the nouveaux riches by offering chocolates sprinkled with shards of real gold. Japanese journalists delighted in noting that the book value of the five-kilometer circle of land that housed the Japanese Imperial Palace had a value greater than the entire state of California. A wave of worldwide trophy purchases came under Japanese ownership. Real growth rates averaged 4.5 percent per year from 1985 to 1989, a full percentage point or more ahead of any other industrialized democracy. Trade boomed, current accounts ballooned, foreign reserves expanded geographically. Nine of the world’s ten largest banks were Japanese. Flush with capital, Japan became the world’s largest creditor nation. The economy seemed to defy comparative economic experiences and business cycles. Triumphalism swept the nation.

The combination of LDP electoral victories and the continued success of the Japanese economy, particularly its phenomenal performance in the last half of the 1980s, suggested that the reconfigured and suitably adjusted conservative regime would remain in power, that foreign policy problems would be minuscule, that Japan’s economic performance would continue to outstrip that of all other major democracies, and that the LDP would continue its dominance without interruption. But these appearances proved deceiving. As we saw in the preceding chapter, the 1990s were marked by the bursting of the economic bubble and a seemingly endless cycle of debt, deflation, declining demand, and deindustrialization. Politically, the fragmentation of the LDP and the party’s replacement by a coalition of “everyone but the LDP” made it unmistakably clear that the old regime had ended. But the question remains why the collapse was so stark and sudden after what would have appeared to have been a decade of successful adaptation.

The LDP Split and the Bursting of the Bubble: Regime Collapse

The bursting of the economic bubble and the split within the LDP shattered the long-standing equilibrium of Japan’s conservative regime. Underlying both events were two central tensions that regime adjustment and recalibration had exacerbated rather than eliminated: a widening division within the regime’s socioeconomic support base and an increased institutional fragmentation.

On the first point, as noted above, conservative electoral adjustments during the 1970s and 1980s attracted new supporters without alienating old ones: the socioeconomic base of “conservatism” was continually expanded but never reigned. Moreover, as the ideological division between government and opposition narrowed, more and more voters ceased to identify firmly with one or another party bloc. The result was the rapid growth in the number of nonaligned voters.

During the 1980s the LDP had been able to attract significant segments of these new constituencies, but it had been unable to provide an institutional framework or consistent economic policy profile that would enmesh them in regular and continuing support for the party. By the end of the decade, therefore, LDP support was broad but shallow. So long as hard policy choices could be skirted, and so long as the economy performed well, the shallowness was unproblematic. But as economic problems deepened and hard choices became unavoidable, winners and losers under alternative scenarios became much more apparent.

Consider five such trade-offs. As noted above, the electoral system for the lower house discriminated severely against urban areas. Any reconfiguration of the electoral system to provide greater weight to urban areas was deeply opposed by incumbent conservative (and opposition) politicians. The promise of lower prices—of great appeal to urban voters and organized labor—posed the threat of reduced protection for domestically produced agricultural and food products, a significant deregulation of cartitized industries, and a reduction in the import and investment barriers against foreign consumer goods. Such moves were directly counter to the interests of core conservative supporters such as the farmers’ cooperatives, many major businesses, utilities companies, many small businesses, and those conservative politicians whose specific electoral prospects depended on strong organizational ties to such organizations. Furthermore, any such policy shifts posed a direct threat to those government agencies whose power rested on the organization and implementation of protectionist policies.

Tax reform was similarly divisive. Japan’s tax system was widely criticized as being a 9–6–4 system: wage and salary earners paid about 90 percent of the taxes they owed, small businesses only 60 percent, and agricultural households a mere 40 percent. (Cynics often referred to the system as 9–6–4–1, with the final 10 percent figure being the rate presumably paid by politicians.) Any tax reform favoring salaried employees would obviously increase the burden on core conservative support groups. And the imposition of any new taxes such as the 1989 value-added tax, regardless of its redistributive effects, was inherently unpopular.
Expansion of public welfare benefits also divided conservative supporters. The expansion of so-called “social wages” has historically been an appealing substitute for direct improvements in income or reductions in prices. While certain government agencies, such as the Ministry of Health and Welfare, obviously favored such measures, governmental largesse had led to substantial deficit financing and was resisted by Finance Ministry bureaucrats, the private financial and corporate sector, and by farm groups and small-business organizations whose members would be least likely to benefit from such programs.

Even cleaning up the environment and providing healthier, cleaner surroundings had been problematic, despite its electoral desirability. While no political actors overtly favored “pollution,” most divided widely over how to target specific toxins and wastes, which by-products were truly noxious, how to pay for cleanups, and the like. Dirty manufacturing industries viewed the issue quite differently from small, clean businesses. Labor, too, was divided: workers in jobs and industries targeted by antipollution measures were far more concerned about their jobs and their companies’ profits than about carbon in the air or mercury in the water. Nor was it inherently clear just which specific locations should be the sites of nuclear plants, toxic waste dumps, garbage processing facilities, airports, highways, or railways. In Japan, as elsewhere, a strong NIMBY (“not in my backyard”) mentality generated numerous protests by those opposed to “best interest” solutions.

Equally important in undermining the old regime was the way individual LDP parliamentarians strengthened their district-level support bases (kôenkai) by buffering them against voter shifts that might affect the LDP as a whole. These individual power bases often worked against the collective interests of the party, increasingly decoupling the electoral fortunes of individual LDP backbenchers from those of the party and its leadership.

Just as the electoral problems of the LDP opened up a variety of intra-conservative tensions, so did the international economic and security challenges. The decline in currency autonomy, rising oil prices, and U.S. pressures against Japanese exports challenged the regime’s commitment to embedded mercantilism as they exposed the conflicting economic interests of its members. For example, the rising yen meant a relative drop in the costs of imported raw materials, including oil. Correspondingly however, the cost of Japanese manufactured products around the world increased. The rising yen thus threatened earlier business harmony as it divided exporters from importers and high energy users from others. Furthermore, combined with Western protectionism the rising yen enhanced the incentives for many Japanese firms, particularly in manufacturing, to expand abroad: by producing overseas, firms could lower their labor costs, get closer to end markets, and skirt potential trade barriers. Other firms with far less flexible production capabilities, such as construction, utilities, and aluminum, lacked that option. Meanwhile investments abroad often led to job losses and fewer business opportunities at home.

Many U.S. demands for opening the economy might have been strategically wise for the national economy, and many would have been economically beneficial to large numbers of urban consumers and hence been electorally advantageous as well. But any substantial liberalization of the Japanese home market would have had uneven consequences for the business community. Internationally competitive industries such as automobiles, electronics, fiber optics, and semiconductors were better positioned to undergo liberalization than were less competitive sectors such as textiles, aluminum, most of the distribution sector, agriculture, construction and cement, and the financial sector.

Divisions within the business community also emerged over the relative merits of continued government economic regulation. Generically, such controls were often used to impede foreign imports, but as such they hurt not only foreign firms but also those Japanese industries that might have benefited from cheaper imported components. Moreover, those businesses that had become competitive domestically and internationally increasingly chafed under existing regulatory policies.

As just one example, yen revaluation posed a serious regulatory problem since banks, trading companies, and major manufacturers confronted vastly greater foreign exchange vulnerabilities under a floating yen. Many were anxious to eliminate government restrictions that would prevent them from utilizing internationally accepted hedging strategies to minimize those risks. Many new firms not directly associated with Japan’s corporatist keiretsu structures, including major manufacturers such as Sony, Canon, or Honda, also opposed government controls, as did discount retailers like Aoki International and Aoyama Trading, private brand retailers like Daiei, and a number of upstart cosmetics firms.

Just as many other industries, however, were quick to embrace government oversight. Firms and sectors that had never enjoyed international competitiveness, or had lost it, welcomed government-approved protection cartels. Government restriction of corporate freedom was more than offset by the benefits such cartels provided for long-term market shares and overall profitability. Many firms and sectors desired regulation and foreign exchange controls in order to protect their market shares and profitability.

Even such seemingly unexceptional goals as fiscal austerity became controversial. Appealing as austerity was to MOF bureaucrats, it threatened such politically popular measures as across-the-board tax cuts, program expansions, subsidies for important constituent groups or regions, public research and development and support for high-tech and public works.

Consequently, the relative harmony that had prevailed within most segments of the conservative regime during the 1950s and 1960s increasingly gave way to diverse sectoral and firm-specific pressures during the 1970s and 1980s. The conservative regime was rife with often conflicting views over how to meet the challenges it faced. Devising economic policies that could satisfy all segments of the conservative support base became increasingly difficult as groups pulled in opposite directions—more protection versus less protection, more pork-barrel politics versus tighter fiscal restraints, high yen versus low yen, and so on.

Linked to these socioeconomic divisions was a second important problem, namely, the splintering in the once airtight institutional cohesion of the old regime. Economically, the fiscal health of many Japanese blue-chip firms, overseas investment, fiscal
deregulation, the decline in the role of the main banks, the growing role of equity markets, and a host of other changes had undermined connections within business and between business and the government. Numerous Japanese firms began to operate in accord with individually determined business plans, which meant the pursuit of increasingly competitive strategies not always in accord with government policies or the needs of other businesses or sectors. As ideological lines blurred between government and opposition, the LDP thus lost much of its cohesion. Ideological and policy differences between it and the other parties became blurred; socioeconomic support groups divided sharply over goals and strategies; and individual LDP parliamentarians with strong local support and independent funding grew less dependent on the party for their electoral success.

The unraveling of the conservative regime ultimately came down to three simple propositions: (1) the economic bubble proved unsustainable, (2) corruption and economic failure threatened the LDP as a party, and (3) many individual LDP members, fearful of going down with a sinking ship, opted to break ranks and reorganize conservatism on a different socioeconomic basis with new policy goals.

The economic bubble and its end is a complex but increasingly well-told story. It started with the massive run-up in the value of the yen after the Plaza Accord of 1985 and the consequent shifts in Japanese exchange rate and monetary policy. These overlapped with a number of peculiar characteristics of Japanese banking.

As we saw in Chapter 4, the Reagan Administration had pursued a policy of increased government spending, particularly for the military, combined with sweeping tax cuts. When those tax cuts failed to increase government revenues as had been promised by monetarists, America’s expanding budget deficit had to be funded. Japanese institutions including insurance companies, trust banks, casualty companies, and regional banks all stepped in, investing vast sums in U.S. treasuries. This investment was made possible by expanding national surpluses that rose with Japanese export success. By recycling dollars received for Japanese exports into a funding of the U.S. debt, the Japanese government partially defused American vehement over the bilateral trade imbalance and also helped to keep down U.S. interest rates. But ultimately, as the yen strengthened geometrically, dollar-denominated holdings actually decreased in value for Japanese holders.

Fearful of the effects of a strong yen on the profitability to both U.S. debt holders and Japanese exporters, and simultaneously anxious to maintain the politically positive aura of an expanding consumer economy, the MOF opted for an exceptionally loose monetary policy designed, among other things, to drive down the value of the yen. Finance “ordered the Bank of Japan to open the monetary floodgates while the ministry injected massive amounts of fresh spending into the economy via a series of fiscal packages and the expanded investment of postal savings funds.”

With the official discount rate at a postwar low of 2.5 percent, asset markets predictably skyrocketed. Commercial property values soared. The Nikkei Dow tripled in value between 1985 and 1989, turning the stock market into an endlessly spewing cash machine. Securities firms were feverish in their churning of stocks, in some cases promising their favored clients (often bigwigs in politics and organized crime) that the brokerage house would guarantee them against any losses. Individual companies flush with cash engaged in complex financial schemes known as zaiteku (financial high tech). Some, such as Toyota, began reaping more of their profits through zaiteku than through manufacturing. “Free money” could be made by issuing Eurobonds with warrants on rising stocks and by swapping the dollar exposure back into yen.

Banks, meanwhile, having lost many of their normal blue-chip borrowers due to financial liberalization and the opportunities that major firms had for raising monies on either domestic or foreign equities markets, began lending to increasingly less well-established clients. With the government exerting little control over interest rates, banks and businesses borrowed and lent heavily, collateralizing their loans with rising land and stock values. Vast sums were poured into increasingly dubious ventures, often linked to politicians, the agricultural cooperatives, land speculators, construction firms, and organized crime.

The belief was widespread that cheap money could indefinitely continue to support the white-hot economy. A popular slogan said that if everyone crosses the street against the light, then no one can get hurt. As with many aphorisms, the grain of truth was lost in oversimplification, but the slogan reflected the extent to which national hierarchies had translated Japanese “uniqueness” into “invulnerability.”

Only after five years of unprecedented prosperity did the Bank of Japan, in May 1989, finally tighten credit. By August 1990 rates had been raised from 2.5 to 6 percent (a 140 percent jump). The upward economic spiral quickly turned down. Firms cut back on their capital expenditures; land prices collapsed quickly; the stock market fell from ¥38,915 at its height on the last day of 1989 to ¥14,820 by 1992. Meanwhile, as a result of the recently installed minimum capital requirements of the Bank for International Settlements (BIS), Japanese banks were increasingly forced to liquidate assets, usually at sharply deflated prices. The spiral continued; numerous property companies and several major banks failed; a massive government liquidation was required for the juisen; major securities firms underwent sweeping purges of top management; international rating agencies such as Moody’s and Standard and Poor’s downgraded the creditworthiness of Japanese banks; international markets placed a “Japanese premium” on borrowing by the country’s institutions; foreign mutual funds dumped Japanese securities; and so it went. As of mid-1998, no significant letup was in sight at least for the financial sector.

As the bubble burst, the underlying corruption that accompanied it became increasingly apparent, thereby undermining the once unquestioning public and business trust in the ability of the Japanese bureaucracy and the LDP to govern the economy. Nor did it help that the bubble had such wide effects across Japanese society: land owners and stockholders had seen their net assets blossom; others, lacking such assets, fell immediately into arrears. Not surprisingly, the bubble reversed Japan’s once highly egalitarian Gini index, revealing growing disparities in Japanese income levels. And when land and stock prices fell, those who lost their newfound money looked to extract political retribution. The consumption tax meanwhile had made conservative politicians particularly unpopular.
Corruption had always been a problem for conservative politicians. But the bubble burst and the consumption tax came at a time when several scandals were gaining high visibility. The Recruit and Sagawa Kyūbīn scandals proved undeniably that politicians and senior bureaucrats had systematically accepted bribes in exchange for making exceptions to Japan's nominally rigid regulatory rules. Coming in the midst of economic chaos, these scandals could no longer be shrugged off by the suggestion that corruption was but a small price to pay for policies beneficial to the nation as a whole. While “cleaning up” Japanese politics had surfaced with predictable regularity every decade or so, it had previously disappeared with equal speed. This time demands for structural overhauls to clean out the Augean stalls of Japanese politics gained tenacity and persistence.

Both the bubble and corruption worsened the underlying tensions among conservative support groups. The LDP had long deflected the problem of how to restructure its electoral and socioeconomic base; electoral successes and the party's expanding base during the 1980s deferred the need to make hard choices. A catchall approach seemed ideal. Increasingly competitive international economic conditions and the economic decline brought the issue to a head, however. Liberalization would benefit consumers, labor, and urbanites; protection was essential for agriculture, utilities, many troubled industries, small businesses, and oligopolies. Conservatives could no longer promote both. Should the party leave farmers, small business people, and declining industries to the mercy of international competition while siding with urbanites and blue- and white-collar workers? Or should it resist foreign pressures and perhaps take the consequences in the form of retaliation against their exported manufactured goods? Who should pay to bail out the banks and the jūken? Could pork-barrel politics continue unabated during a long recession? How should corruption be dealt with—through structural changes or smoke and mirrors?

Continued economic success had long been a safety valve that reduced the pressure on conservatives to force adjustments within Japan's less competitive sectors. Some measures to liberalize these segments of the economy had been introduced, albeit reluctantly. As one of the major targets of U.S. pressures under the Structural Impediments Initiative in 1990, the so-called Large Scale Retail Store Law had been revised, despite strong opposition from owners of small businesses. Larger supermarkets, chain stores, discount outlets, mail order shops, and large leisure centers all flourished. While some small shopkeepers adjusted to the new system, far more did not. But overall, numerous pockets of protected industrial inefficiency remained throughout the economy.

Meanwhile, farmers confronted even more drastic changes. The food control system had been restructured, rice subsidies had been reduced drastically, imports of meat and citrus fruits had been liberalized, and an active land diversification program sought to move farmers off the land or into non-rice crops. While Japan in the Uruguay Round sought to protect its agricultural sector to the very end, the groundwork was laid for the eventual tariffication of rice that would undercut the well-protected heart of Japan's farm population.

Agricultural coops urged their members to break with conservative candidates in the 1989 election as a means of protest. Subsequently, proposals surfaced for an all-farmer Agricultural Party. Farm votes were the largest bloc to shift in the 1989 election. Coming as this did with more widespread reactions to the consumption tax and to the growing corruption scandals, the result was a disastrous loss of the LDP's majority in the upper house.

Within the party, the upper house defeat dissipated any lingering convictions among individual politicians that the party was invulnerable and that unswerving loyalty would somehow assure them a lifetime career. A Darwinian struggle for individual survival broke out. For many, the multiform party district system was presumed to be the source of corruption because of the vast amounts of money poured into intra-conservative battles within the same district. Its replacement became tantamount to reform. For others, electoral reform offered a way to revive the support base of the party. Still others, more idealistic, sought a sweeping weakening of the links among money, politics, and policy.

The Japanese Supreme Court had declared the existing electoral system to be unconstitutional because of the vast overrepresentation of Japan's rural electoral voters, which had reached 4:1 proportions in the worst instances. The court, however, did not call for any specific new system, so the decision fell to politicians. The LDP leadership had long preferred an electoral system with single-member districts, which most projections indicated would be highly favorable to the party. The smaller opposition parties, realizing that their survival depended on some form of proportional representation, were opposed. No politician from any party wanted reforms that would cost him his career. Consequently, conspicuous movement on electoral reform was difficult to generate. Prime Ministers Kaifu and Miyazawa foundered on the issue. After promising electoral reform, neither was able to deliver a reform bill that could pass parliament.

It was in this context that the LDP split widened. As noted, the 1989 election had convinced many individual LDP politicians that sticking with the party was no longer a guarantee of permanent political employment. The result was an explosion of political entrepreneurship by clusters of conservative politicians. In many efforts they found ready allies in groups such as Rengō, the labor federation that earlier conservative-led changes had empowered. If corruption was unpalatable, these entrepreneurs would embrace "reform." If government economic policies were unpopular among core constituents in their home districts, then they would oppose them. If the bureaucracy appeared inept, they would come out for administrative reorganization. Widespread party system desegmentation was the consequence.

Three separate groups left the LDP initially. Hosokawa Morihiro and those who won seats as members of the Japan New Party were largely idealistic reformers. Primarily urban and genuinely disturbed by the deep-seated corruption, they sought a more responsible party politics, a more deregulated economy, and a more internationalized Japan. A second orientation existed among the thirteen to fifteen relatively young Diet members who split to form Sakigake (Harbinger Party). All had
rather secure "second-generation" seats and strong kōen'ai that essentially ensured their reelection; all were committed to sweeping reforms, particularly to ending the spread of corruption at the core of the civil service. They favored the creation of a single-member district system in the somewhat naive belief that this would reduce the need for large campaign funds. They split from the party primarily when their demands for cleanup were ignored by most senior party leaders (with the exception of a small number including Gotoda Masahara and Itō Masayoshi). Finally, a third group was headed by Ozawa Ichirō and Hata Tsutomu. Ozawa, it was argued, was one of the rare politicians in the LDP concerned with the long-term prospects of the nation. As such he stated his opposition to the extensive use of the spoils system, economic protectionism, and a low international posture. Instead, he sought, in the phrase widely associated with him, to make Japan into "a normal country." The Ozawa group generally favored a single-member district system. But Ozawa was also a classical "money" politician. He had learned his politics from men like Takeshita and Kanemaru, both of whom were deeply involved in the emerging scandals. A Japanese Machiavelli, he had been LDP secretary-general and a major fund-raiser, and his policy positions were closely tied to his desire to gain national control. Party realignment seemed to offer him that opportunity.

The splits by these groups proved to be only the first wave of defections, and the LDP fragmented further in subsequent months. It was Hosokawa, in a pivotal position, who was chosen to head Japan's first non-LDP government since 1955. Despite strong support from the general public and the widespread sense that the time was ripe for change, however, Hosokawa's reign proved to be short lived. In April, unable to pass a series of electoral reform proposals and simultaneously plagued by allegations of financial improprieties analogous to those of the LDP members from whom he had sought to distance himself, Hosokawa was replaced by a member of his own cabinet, Hata Tsutomu of the Renewal Party (Shinsen'itō). Then, after only two months in office, Hata's coalition split as its largest single member, the Social Democratic Party of Japan (SDPJ, or Shinkōtō), bolted from the anti-LDP coalition and leaped across the ideological spectrum to form a hitherto imponderable coalition with the remnants of its long-standing nemesis, the LDP. The resulting new government, an ideological idiosyncrasy united more by its fear of losing power than by any coherent program or direction, held together into 1996.

Japan's seventh prime minister in five years, Murayama Tomiichi, was a socialist, the first prime minister from his party since 1947; after completely gutting the JSP program, he resigned and was replaced by the LDP's new head, Hashimoto Ryūtarō. Eventually, in the October 1996 lower house election, Hashimoto engineered a return to single-party government under the LDP (even though the party lacked a parliamentary majority in both houses of parliament). The chance for radical political overhaul seemed to have passed with the end of the reform governments, the splintering of the opposition, and the return of the LDP. But the underlying structural pressures for change continued, albeit far less dramatically.

Japan's new electoral system, only the second since 1928, passed the legislature in late January 1994. Elections for the House of Representatives combined two systems. Three hundred representatives are selected from single-seat, first-past-the-post districts; another two hundred are chosen from party-selected slates according to proportional representation in eleven regional districts. Citizens have two ballots, allowing them to split their votes in ways that will protect smaller parties. In its first use during the October 1996 election, at least four parties competed as "conservatives." The LDP won a plurality, and most other conservative groups retained roughly the same number of seats with which they entered the election. The biggest loser was the SDPJ, the former JSP. However, while the LDP was back in government by the mid-1990s, its hold was far from secure; party realignment threatened to continue, and the party system had been undeniably transformed.

The uncertainty of the LDP's electoral hold was underscored by its stunning 17-seat loss in the Upper House election of July 12, 1998. Nearly 60 percent of the eligible voters turned out, and the LDP won only 44 of 126 contested seats—well short of its target of 61–65. This loss led to the resignation of Prime Minister Hashimoto and the likelihood of further intra-party defections.

As of mid-1998, the Japanese political economy was in a state of flux. While there is obvious risk in making short-term prognostications during periods of high political mutability, it seems clear that the era of one-party LDP dominance has ended and that the Japanese economy will not return soon to any unparalleled string of successes. To that extent, the previous regime has ended.

The shape of any new regime will depend on the new alliances that socioeconomic groups form, on the new institutional arrangements they develop to hold themselves together, and on the particular mixture of public policies that they devise. The major possibilities for these changes will be broached in the concluding chapter. But for the present, the process of change and reform is under way on fundamental, rather than superficial, grounds. As Herman Schwartz has phrased it in a different context, "reorganizers are engaged in a strategic politics that attempts to change the rules of the game rather than just seeking their preferred outcome in the context of extant rules." Far more fragmentation, realignment, and false starts are likely before any new equilibrated regime can be identified. Indeed, there is no guarantee that such clarity will emerge for some time. More like Sweden and Italy than Britain or the United States, Japan has no new and stable regime yet in place. Two things seem eminently clear, however: no political party is likely in the near future to regain the kind of unbridled hegemony that the LDP enjoyed over the preceding four decades, and the national economy will not return easily to the unmitigated successes it enjoyed at the height of "embedded mercantilism." To that extent the ancien regime has definitely passed.