



Japan in the 1960s: Conservative Politics and Economic Growth

The mid-1960s were the golden age of Japan's conservative regime. The Liberal Democratic Party (LDP) was dominating elections and public policy, the economy was expanding at white hot speed, and problems of foreign policy were either absent or casually ignored. The regime's components were meshing with a silky smoothness that gave the nation's political economy an aura of effortless achievement. In the process, Japan was growing more and more distinct from the other industrialized democracies.

This chapter addresses three central questions: What were the key traits of the conservative regime during this glorious period? What allowed the regime's various elements to interact with such fluidity and mutual reinforcement? and How did the conservative regime in Japan differ from those in the other industrialized democracies?

The Well-Oiled Conservative Regime

Japan's conservative regime was unusual in four important ways. First, its economic institutions were dramatically different from those of the other capitalist democracies, and its economic performance was vastly superior. Second, its politics were marked by the industrial world's longest—and least compromised—dominance by a single political party. Third, despite long-term rule by nominal conservatives, Japan's political economy showed far greater egalitarianism than did conservative regimes elsewhere. Fourth, Japanese foreign and security policies were bilaterally tied to those of the United States, setting the U.S.-Japan relationship apart from the more interwoven and multilateral alliances that linked the United States to most other democracies. Simultaneously, Japanese foreign policy con-

fronted no serious international crises that might have undercut its smooth and purposeful domestic predisposition.

To appreciate the complicated mosaic of Japan's early postwar regime, we might examine a few of its component pieces at a single point in time. Most appropriate is 1964–65, when key aspects of the conservative regime were in full relief and the regime was functioning at its smoothest.

Begin with the Olympics. Perhaps no single event in the postwar period was more symbolic of Japan's transformation from prewar authoritarianism, international isolation, and early postwar economic devastation than Tokyo's hosting of the 1964 Summer Games. The International Olympics Committee had awarded the 1940 Games to Tokyo but then revoked the invitation following Japan's 1937 invasion of China. Regaining the venue was thus demonstrable evidence of Japan's postwar transformation and its international acceptance. Few Japanese could oppose the Olympics and the spirit of national unity and optimism it embodied.

Japanese filmmaker Ichikawa Kon's *Tokyo Olympiad* provides a stunning metaphorical linkage of the Olympics, Japanese economic growth, and national pride. The film opens with shots of men clearing land and tearing down the old Tokyo to begin construction of the new athletic facilities. Mount Fuji provides the backdrop for single runners carrying the Olympic torch across the country. The final torchbearer, Sakai Yoshinori, runs up the stadium steps, breathing hard, his heart pounding, and lights the Olympic flame. Produced using 164 cameramen with 1,031 cameras at a cost of over \$1 million, the film resonates with echoes of Japan's nationwide economic cooperation and success over the preceding decades.¹

Some five thousand athletes gathered in Tokyo in 1964, the first time that an Asian nation had hosted the Games. Over 3.5 million Japanese citizens applied for the sixty thousand tickets available for the opening ceremonies. National pride peaked as the Japanese women's volleyball team, an exceptionally well-disciplined—some would suggest robotic—team, captured the gold medal. For many Japanese, the team's success symbolized how the country had impressed itself on the world.

The Games themselves climaxed the more comprehensive development sweeping through the entire economy. For example, in January 1964 the Building Standards Law was revised to eliminate the thirty-one-meter height restriction on Tokyo buildings; subsequent construction of the Hotel New Otani and the Kasumigaseki Building began the age of Japanese skyscrapers. On October 1, the Japan National Railroad opened the Hikari Shinkansen (bullet train) for passenger traffic between Tokyo and Osaka.² Capable of speeds in excess of two hundred kilometers per hour, well beyond anything in the world at the time, the new train chopped travel time between Japan's two largest cities to three hours.³ The first section of the Tokyo Metropolitan Expressway also opened in 1964. Along with the bullet train it provided a political justification for obtaining land, hiring contractors, speeding up work schedules, and mobilizing the citizenry for a national interest project.⁴

Mirroring these triumphs, Japan's GNP in 1964 surpassed that of Italy and the United Kingdom and drew close to that of West Germany, putting Japan on track

to become the third largest economy in the world, behind only the United States and the USSR. Essential to this catch-up was export success, and 1964 also marked the last year in a twenty-year string of unfavorable balance of payments for Japan. As world trade tripled between 1955 and 1970,⁵ Japanese products garnered ever larger shares, leading eventually to massive national surpluses.⁶

In 1964, numerous Japanese firms including Matsushita Electric, Sony, Hayakawa Electric, Toyota Motors, Sanyo Electric, and Nissan Motors registered between ten- and twentyfold increases in sales and profits over the preceding decade. (In contrast, Ford Motor Company, even in its most flourishing ten-year period during the 1920s, did not achieve such spectacular advances.)⁷ For the most part, success in the automobile industry and the electrical and electronics industries was based on firm-driven innovations, quality production, and exceptional international competitiveness.

In 1964 Toyota's "just-in-time" plant at Motomachi and the Nissan plant at Opama began producing the country's first truly internationally competitive automobiles. Symbolically, national bicycle and motorcycle production leveled off; production of three-wheeled vehicles fell to one-third of what it had been in 1963, and the number of automobiles exceeded 500,000 units for the first time. (In 1967 the figure was up to 1.4 million; in 1968 it topped 2 million.)⁸ As late as 1960, Japanese-based firms had only 1 percent of the world market in automobiles; by 1970 this share had rocketed to 20 percent.⁹ By 1972, Japanese firms were producing 4 million units per year, over one-quarter destined for export.¹⁰

In contrast to such privately engineered successes in automobiles, government industrial policy figured heavily in the computer industry. For example, Fujitsu—in conjunction with NEC and Oki and in coordination with a government project directed by the Ministry of International Trade and Industry (MITI)—produced the FACOM 230–250, Japan's first joint government–private-sector machine. Also in 1964, MITI began another computer project involving the nation's six largest producers and aimed at developing specialized integrated circuits.¹¹ The HITAC 5020 was installed at Tokyo University as the nation's largest mainframe computer,¹² and Japanese computer manufacturers' share of the national market leaped from 29.7 percent in 1963 to 42.8 percent in 1964, up from less than 7 percent only five years earlier. In 1965, this trajectory of indigenous control went to over 52 percent, distinguishing Japan as the only industrialized nation in which IBM did not hold a majority stake in the national computer market.¹³ There, the government's role in developing the computer industry was constant and critical.¹⁴

Government efforts to restructure many Japanese industrial sectors fell largely to MITI. That agency's efforts also peaked in 1964, with the introduction of the Special Measures Law for the Promotion of Designated Industries.¹⁵ As the brainchild of MITI's Sahashi Shigeru, the law's aim was to enhance the agency's capacity to reorganize "designated" industries, such as had been done in computers. From the MITI-Sahashi perspective, Japan's economy continued to be dominated by an excess of protected enterprises, too many small factories, and too little capacity to generate true international competitiveness. Private-sector collaboration under

MITI's leadership was deemed essential to modernize sectors critical to the long-term enhancement of the national economy. Without such coordinated modernization, MITI argued, Japan as a nation would remain highly vulnerable to the deprivations of international competition.¹⁶

The LDP and the Ikeda governments had approved the bill for submission. Critics, meanwhile, castigated the proposal as little more than another effort to enhance the already oligopolistic character of Japanese firms, making them even more subject to bureaucratic oversight and correspondingly less responsive to consumer interests and international competition. The battle over this proposed law, which eventually resulted in its quiet demise in mid-1964, was a microcosmic reflection of the broader regime orientation toward industrial policy and sectoral reorganization; it was also one of the high points of Japanese bureaucratic efforts to oversee the national economy.

Japanese consumers were both catalysts and beneficiaries of the nation's rapid rise in productivity. In the mid-1950s hardly any Japanese owned electric vacuums, washing machines, refrigerators, or television sets; by 1964, 27 percent had vacuums, 61 percent had washers, 38 percent had refrigerators, and nearly 90 percent had televisions. Similar jumps occurred in transistor radios, cameras, radios, and sewing machines.¹⁷

Marking Japan's new level of manufacturing and financial sophistication, the country joined the OECD and advanced to Article 8 status in the International Monetary Fund (IMF) during 1964, effectively ensuring its acceptance as a full-fledged member of the community of industrialized democracies. Japan's new stature was recognized as well by the fact that the general meeting of the IMF and the World Bank, with some 1800 representatives from 102 nations, was held at the Hotel Okura in Tokyo during the fall of 1964. Japanese Prime Minister Ikeda gave the keynote address just as his plan to "Double the National Income in Ten Years" was at its midpoint and well ahead of its scheduled 9 percent per annum growth rate. Ikeda proudly noted that postwar Japan had achieved in twenty years what had been impossible for prewar Japan to achieve in eighty.

Overall, as Table 1 demonstrates, the 1960s were, statistically, phenomenal years. The rates of economic growth, investment, and labor and manufacturing productivity were all at their high points during this period.

At the same time, the conservative political regime involved more than simply "economic success," "picking winners," and "increased competition." It also sought to improve conditions in those sectors that such an economic whirlwind might otherwise leave behind. For example, in agriculture—one of Japan's least competitive sectors but also one of the conservative regime's primary sources of support—1964 saw LDP backbenchers force through a substantial 14 percent increase in the price paid by the government to rice growers. This price increase, the largest ever in a single year, demonstrated the ability of farmers to extract high prices for their inefficiently produced goods.¹⁸

The year 1964 was also marked by the highest number of textile bankruptcies in the postwar era.¹⁹ The government responded with a textile bill under which the

Table 1. Selected economic indicators for Japan

	1945–50	1950–55	1955–60	1960–65	1965–70	1970–75	1975–80
Growth rate	9.4	10.9	8.7	9.7	12.2	5.1	5.6
Investment rate	8.3	10.8	8.7	18.5	18.5	17.8	14.7
Relative price	0.89	1.37	1.45	1.25	1.02	0.98	0.86
Labor productivity growth	9.4	10.9	8.7	9.7	12.2	5.1	5.6
Increase in manufacturing productivity	—	12.0	9.6	7.9	12.3	2.0	7.0

Source: Yutaka Kosai, *The Era of High-Speed Growth: Notes on the Postwar Japanese Economic System* (Tokyo: University of Tokyo, 1986), pp. 5, 7.

Japan Development Bank offered ¥1 billion to textile firms so they could reduce “excess capacity.” In addition, the Agency for Small and Medium Sized Industries was directed to help such firms with low interest loans. Over the next two years, the government provided subsidies totaling ¥6.3 billion (U.S. \$17.3 million).²⁰

Agriculture and textiles were not alone. The coal industry was in serious decline.²¹ Steel minimills had several more years before serious troubles set in, but they too were showing signs of declining competitiveness. In short, although segments of the Japanese political economy during 1964 were growing rapidly and becoming more competitive internationally, declining and uncompetitive industries were posing serious problems. The government responded with cartelized reorganization and subsidization.²²

The tremendous expansion of the economy, the improving lifestyles of citizens, and the generous compensation for those not favored by “the market” combined to fracture opposition to LDP rule. As recently as 1960, the opposition parties and their allies had mobilized huge segments of the population, bringing the capital to a standstill for two months and nearly toppling the Kishi government. But the previously united opposition quickly fractured as dissident groups in the labor movement split from the then dominant federation, Sōhyō, and eventually formed Dōmei—a more moderate, largely private-sector federation. In addition, 1964 saw the formation of the IMF-JC (International Metal Workers’ Federation—Japan Committee), an economically oriented federation that was to become a voice for depoliticized unionist activities in subsequent decades. When Tekkō Rōren (Federation of Steel Workers’ Unions) joined IMF-JC two years later, the organizational and strategic division between public-sector and private-sector unions was essentially complete; Sōhyō and its largely public-sector affiliates pursued a radical class and political agenda while Dōmei, the IMF-JC, and their private-sector affiliates opted for more moderate economic unionism.

In parallel, union membership, which had been as high as 50 percent of the workforce in 1950, had fallen to 33 percent in 1964; from there it continued to drop steadily over the next three decades.²³ Yet, in 1964, strikes, days lost to labor dis-

putes, and total numbers of workers involved in strikes were all at historic highs.²⁴ Relations between business and labor remained brittle and fractious, hardly foretelling the “labor-management harmony” that subsequently captured so much international attention.

Opposition to the LDP was further diluted by the formation in November 1964 of the Clean Government Party (CGP—Komeitō). Heavily dependent on the support of Sōka Gakkai, the religious movement, it represented a second “party of the center” along with the Democratic Socialist Party (DSP), which had formed in 1960. These two small, centrist parties marked the beginning of the end of the two-party competition that had prevailed since 1955.²⁵

Two other emblematic political events from 1964 warrant mention: first, the unprecedented third election of Ikeda Hayato as the LDP’s party president in July, and then less than six months later his retirement and replacement by Sato Eisaku. Both men had been long-term bureaucrats before entering electoral politics. Both were also singularly committed to, and deeply associated with, a political economy of high growth, close ties to the United States, and a minimal tolerance for the ideological confrontations that had earlier divided Japanese society. Indeed, 1964 also saw an end to the Commission on the Constitution, which had for a decade been considering the highly charged issue of constitutional revision. The combined twelve years of executive control by Ikeda and Sato was the background for what Yamaguchi has labeled the “Golden Age of LDP Politics.”²⁶

The LDP benefited at the polls from the economy’s stellar performance, its own internal leadership coherence, the fragmentation of its political opponents, and the compensation for those slow to adjust economically. Intriguingly, a 1963 public security report recognized the key role played by national economic success in the electoral turnaround of the early 1960s, noting that economic growth had defused the political appeals of the Japanese left and given rise to a more pervasive ideology of GNP-ism.²⁷ A mere three years after the 1960 toppling of the Kishi government, the LDP won 55 percent of the vote in the lower house elections and over 60 percent of the parliamentary seats, while the main opposition party, the JSP, drew only 29 percent of the vote.²⁸ In the upper house, the conservatives held 142 of 250 seats (56.8 percent) compared to only 66 seats (26.4 percent) for the JSP.²⁹ No other political party in the industrialized world commanded such a dominant electoral position.

Turning finally to international affairs, 1964 was also the year in which China first tested nuclear weapons and entered the five-nation “nuclear club.” Although China was Japan’s major geopolitical counterweight in Asia, and the White House concluded that China’s testing would lead Japan to respond by “going nuclear,” in fact the Japanese government’s commitment to a low military posture remained unshaken. The country continued to trust its defense to the U.S.–Japan Security Treaty, the American nuclear umbrella, U.S. troops on Japanese soil, and a powerful U.S. Seventh Fleet. In 1964, Japan’s national defense expenditures were only 1.2 percent of GNP; three years later they fell below the 1 percent mark where they remained for another twenty years. Overt shifts in the Asian power balance were

either not perceived as such by Japan's leaders or not deemed sufficiently threatening to alter the country's commitment to low military expenditures and its focus on economic growth.

This policy balance was captured in one 1964 issue of the prestigious journal *Chūō Kōron*. An article entitled "Japan as a Maritime Nation," by Kyoto University professor Kosaka Masataka, touted the wisdom of Japan's low military budgets and the national focus on economic advances: "From a strictly military point of view, Japan's 'neomercantilist' diplomacy has been adequate for two reasons: First, the development of nuclear weapons has greatly lessened the ethical justification, as well as the effectiveness, of military power. Second, since Japan has been fully protected by the U.S. Seventh Fleet, in terms of defense her own rearmament would have been superfluous. From a political point of view, Yoshida's 'neomercantilism' has harmonized with Japan's postwar democratization."³⁰

Congruent with this viewpoint, the U.S. Department of State, in conjunction with Japanese Ambassador Edwin O. Reischauer, sent to the White House a secret policy paper on the future of Japan. Urging continued top-level U.S. support for Japanese economic goals, the report recommended a "firm Executive Branch resistance of American industry demands for curtailment of Japanese imports."³¹ America's anticommunism became the justification for keeping the American market open to support Japan's export drive.

At best, such snapshots capture only freeze-frames of highly complex interactions. What happens outside the frame, or before or after the picture is taken, may well be vital to understanding the events depicted. Any attempt to capture Japan's political economy by summarizing a dozen or so events at any single point in time is obviously selective and impressionistic. By adding dynamics and change, however, snapshots can turn into something like a video that highlights and contextualizes key aspects of the regime.

I noted in Chapter 1 that a regime has three critical components: a public policy profile, political and economic institutions, and a socioeconomic coalitional base. Focusing on the mid-1960s, I shall now examine each element in detail and emphasize how it differed from its counterparts in other industrialized democracies. Because public policies are typically the most visible and malleable elements of any regime, they provide a fruitful starting point.

The Public Policies of Embedded Mercantilism

The conservative regime's policy profile, particularly in regard to economics, was simultaneously the glue holding the conservative regime together and the lubricant smoothing interactions among its components. Otherwise fractious groups with diverse and competing agendas became fused into a singular "conservative" bloc through the benefits each received. The result was the continuing agglutination of the socioeconomic alliance undergirding the conservative regime and the insulation of prevailing institutional arrangements from serious political challenges.

Underlying Japanese policies was a pervasive economic nationalism that had dominated elite thinking since the arrival of Perry's Black Ships in 1854. Yet, for the first time since the Meiji Restoration, Japan could pursue its economic agenda without being involved in, or preparing for, war. Japan's postwar economic nationalism was decoupled from past links to high levels of military spending. Postwar policy involved a mercantilistic, rather than a militaristic, economic nationalism; the samurai surrendered to the salaryman.³² It is a complex that can best be characterized as "embedded mercantilism."

Mercantilism seeks to advance the macroeconomic interests of a nation-state through catch-up policies involving the protection and nurturance of domestic industries. Japan's mercantilism stood in stark contrast to the more internationally pervasive doctrines of laissez-faire and economic liberalism, which promoted easy market entry, price competition, and the short-term economic choices of individuals. Because Japan's protectionism was intended to develop export industries, however, its mercantilism differed from standard import substitution policies such as were pervasive in much of Latin America, which focused primarily on domestic autarky. Finally, Japan's mercantilism departed from continental European economic policies, which invariably included strong elements of social welfare benefits and individual citizen protection.

Japan's policies were straightforward: macroeconomic success through ever more internationally competitive Japanese firms in high-value-added industries. Achieving that goal required two broad transformations. First, the economy had to be converted from its heavy reliance on agriculture and small industry to one that was more capital intensive and that produced ever more technically sophisticated products, particularly in manufactured goods. Vital to this effort were improvements in the national economic infrastructure, including port and road facilities, industrial water supplies, rail networks, electricity generation facilities, and the like, along with human infrastructural improvements such as higher levels of education, improved health, and better workplace training.

Second, production and organization methods within Japanese firms had to be upgraded to make them more internationally competitive. Doing so required investment capital, new production technologies, fewer bottlenecks among suppliers, producers, and distributors as well as a host of microeconomic firm- or sector-specific improvements. Positive results at this level required a fusion of macroeconomic government policies and changes in the microeconomic behavior and organization of individual firms.

Official governmental policies designed to achieve these goals were sweeping, complex, and interrelated. For analytic purposes, however, it is possible to think of Japan's mercantilism as a fabric woven from three main threads.

First, domestic markets were almost completely sealed off from foreign competitive imports in such areas as agriculture, basic materials, and the sophisticated manufacturing industries in which Japan sought to gain international competitiveness. Most of the Japanese market was thus restricted to competition among products made within Japanese-owned plants. In addition, the Japanese capital market

remained under domestic control, which prevented easy foreign takeovers of Japanese firms and allowed broad domestic control over savings, monetary policy, and national capital utilization.

Second, mercantilism enhanced the international competitiveness of numerous firms and products. With key sectors buffered from outside competition, the government pursued an aggressive industrial policy, which in conjunction with private-sector actions reshaped many of Japan's manufacturing industries. Yet while the Japanese market was heavily insulated from unwanted external penetration, the country hardly pursued autarky; improved sales were sought not just in the domestic market but worldwide. Walled-off domestic markets were intended to generate export strength, not just to prevent foreign competition.

The third thread involved strict limitations on domestic government expenditures. In addition to encouraging household savings and limiting individual consumer purchases, the government kept the tax burden low, pursued tight fiscal policies and held down expenditures for social welfare and defense. The national civil service also remained small.³³

Although these policies all appear to be congruent with "economic common sense," despite their departure from neoclassical economic theory, one additional component was economically at odds with the logic of mercantilist growth: the government provided, for obvious political reasons, generous side payments to many politically important but economically inefficient sectors of the economy and regions of the country, thereby creating a broadly egalitarian thrust to Japan's economic transformation that left the country with far fewer personal and regional inequalities than all but the most committed social democracies.

Each thread blended with the others when woven into the fabric of the conservative regime's overall public policy profile. For analytic purposes, however, each can be examined in relative isolation.

Insulation of the Domestic Market

At the end of World War II, productivity in the United States was approximately three times what it had been during the prewar years. The nation's GNP was fully six times greater than that of the second-ranking economy, Great Britain (by the mid-1990s it was less than twice as great). American corporations emerged from the war untouched by bombings and invasion, leaving them with an international competitiveness vastly greater than most of their overseas competitors. This comparative imbalance allowed numerous American firms to expand their foreign operations and to gain important market shares throughout the world. In the 1950s and 1960s, U.S. products and U.S. capital dominated world markets to an extent reached neither before nor since.

Yet, in contrast to most Western European and Latin American countries, Japan remained virtually unpenetrated by U.S. (and other) foreign capital. Even though Japanese firms were in dire need of capital and technology, most were wary of surrendering managerial control to foreigners. Unlike many of their European coun-

terparts, Japanese business and political leaders had long been suspicious of significant foreign penetration of the core of the Japanese economy. As David Landes observes in his comparative study of Japanese and European industrialization in the nineteenth century: "In Japan, industrial growth was unmistakably the answer to the menace of foreign domination. In Europe, there was strong dissent on this point right into the twentieth century."³⁴

How quickly foreign dominance could be gained over an entire sector had been made clear by the ease with which Western firms penetrated the Japanese oil refining industry during the U.S. occupation as well as by the unbalanced treatment forced on Japan through both aviation and fisheries treaties.

Economic barbed wire was consequently erected around Japan, preventing penetration of the domestic economy by foreign firms, their products, and their capital. Only a few narrow gates were left open for essential imports such as the raw materials and the machine tools needed for domestic manufacturing. Equally insulated were the nation's capital markets; transactions by potential investors and borrowers were confined within the nation's borders; foreign money was essentially kept out, Japanese money kept in.

Critical to the maintenance of these barriers was the Foreign Exchange and Control Law (FECL) and the Foreign Investment Law (FIL) which imposed a strict quota system over the allocation of foreign currency used for imports. The FECL was also based on a "negative principle" whereby all foreign exchange transactions were effectively prohibited, except for those explicitly allowed by the government. As James Horne phrases it, "The operation of the law, and the cabinet orders, ministerial ordinances and notices which set out the details in practice, reflected the belief of government that it, and not the market, was the best judge of how to maximize the benefits that could be derived from available foreign exchange."³⁵

In practice, only a handful of foreign-owned subsidiaries were approved in Japan during the 1950s and early 1960s. Accordingly, during the 1950s Japan was a less popular host for U.S. foreign investment than any other industrialized country, as well as such less appealing markets as Columbia, Peru, and the Philippines.³⁶

Balance of payments considerations provided the initial rationale for these restrictions. Subsequently, other concerns were introduced; for example, investment was allowed only if it did not unduly challenge small-sized enterprises, seriously disturb industrial order, or severely impede the advancement of Japanese technology.³⁷ A series of liberalizations took place in 1963 when Japan was preparing to join the OECD; others followed in July 1967, March 1969, September 1970, and August 1971. But the burden of proof continued to fall on potential investors, who had to convince Japanese officials—invariably dubious—that the proposed investment would not be detrimental. Into the early 1970s, with few major exceptions, Japan was a country almost devoid of significant foreign direct investment.³⁸ As late as 1970, despite being the largest foreign noncommunist market, Japan still ranked eleventh among recipients of U.S. foreign direct investment, well behind many European countries as well as behind Venezuela, Brazil, and Mexico.³⁹

Tariffs and quotas played an initial role in limiting imports. Tariff rates rose with technological sophistication, from virtually zero on raw materials to over 60 percent on finished items such as automobiles. In addition, during the 1960s Japan retained import restrictions on some four hundred product categories. Only in 1962 did the government replace its short list of items which *could* be imported by a list of items which were explicitly prohibited. Until 1960, some 84 percent of Japan's total imports were subject to one form of restriction or another. In 1964, when Japan achieved Article 8 status in IMF, many of these overt measures of protection were discarded.⁴⁰ But a number of provisional tariffs were introduced, and overt export promotion policies were replaced by newer and more subtle policies such as extra depreciation for exports and overseas market development reserves.

The limits on foreign direct investment meant also that intracompany trade contributed little to foreign imports. Extensive restrictions on the import of most manufacturing goods and the high degree of manufactured exports from Japan left the country with one of the most skewed import-export balances in the industrial world.⁴¹

Until 1968, all technologies brought into the country were also governmentally screened, leaving Japan as the only OECD nation with such restrictions at that date. Until as late as 1974 restrictions were maintained on numerous technology imports. Furthermore, the government typically insisted that no single domestic company be allowed to enter into monopoly use agreements with holders of foreign technologies.⁴² Foreign investment rights were typically surrendered only when the new technology was shared by several Japanese companies and only when it would increase exports from Japan.

Protection of Japan's manufacturing sector was complemented by national insulation from world capital markets. Because Japanese firms and citizens were essentially prohibited from investing abroad and foreign capital was controlled through the FECL, the nation's capital markets were buffered from fluctuations in worldwide interest rates and capital movements. Moreover, capital restrictions hindered foreign takeovers through stock accumulation or direct buyout.

Nor did Japanese capital flow outward. Thus, from 1951 until 1971, total Japanese direct foreign investment totaled just over \$4 billion, with nearly 60 percent of that total coming between 1969 and 1971.⁴³ Through fiscal 1972, nearly three-quarters of Japan's limited overseas investments were in nonmanufacturing sectors. In effect, Japanese firms were not terribly active as overseas investors, and such investment as did occur was primarily for the acquisition of raw materials linked to the export of manufactured goods from the home islands.

Insulation from foreign capital markets also permitted the Ministry of Finance to maintain a low value for the Japanese yen. From 1949 until the breakdown of the Bretton Woods system in 1971, the yen was kept closely pegged to a rate of 360 yen to the U.S. dollar. As Japan's economy grew in strength and its balance of payments became increasingly positive, the yen became ever more undervalued. While this obviously undercut the comparative purchasing power of the Japanese consumer (and of Japanese importers as well), it provided an additional barrier to foreign imports. The ¥360 exchange rate made foreign goods extremely costly in Japan.

Capital market insulation also limited the options available to Japanese savers. For individuals, the most logical place to deposit their savings was the postal savings system. The system's interest rates, exceptionally low by international standards, were set by the government, making for negative, if tax-free, real rates to savers. Since Japanese personal savings rates, for a host of reasons, were among the highest in the world, vast sums thus became available to the government and the banking system for subsequent lending to corporations at exceptionally low rates.⁴⁴ Japan's economic growth thus rested heavily on a massive transfer of funds from Japanese households to Japanese corporations.

The sweeping restrictions on foreign competition served several purposes. The home markets of Japanese firms were insulated against direct competition from foreign firms enjoying much more sophisticated levels of production, particularly in areas such as steel, automobiles, cameras, and consumer electronics. Meanwhile, with little choice but to "buy Japanese," domestic consumer purchases provided in-country stimulation for numerous domestic producers. Given the large size of the Japanese domestic market, with its 110 to 120 million citizens, the "hothouse" strategy of nurturing domestic firms by home market protection worked exceedingly well for many Japanese manufacturers and for the national economy as a whole. Relatively secure home bases enabled many Japanese firms to develop market positions abroad, secure about their home flanks in ways that many European firms never were.

In effect, long after the war, Japan had a home "market" that was closed off from most significant foreign competition. Somewhat like a minor league in sports, Japan was kept insulated from foreign competition until such time as the local players had demonstrated sufficient capability to move up to the more competitive major leagues, the international market. Hosting little foreign investment, purchasing relatively few foreign manufactured and consumer goods, and with a capital market effectively shut off from foreign monetary movements, Japan was less like the other advanced industrial democracies and far more like many of the developing economies of the world.

Moreover, unlike countries where there was a substantial cadre of self-interested business leaders who could profit economically by markets open to foreign direct investment, for the most part, Japan had few powerful compradors willing to cast their economic and political fortunes with foreigners at the risk of alienating the domestically oriented Japanese elite. A compelling economic nationalism and the homogeneity of Japan's political and economic elite worked as a strong counterbalance to any potential short-term interest particular firms might have had in greater foreign investment or manufacturing imports.⁴⁵

Industrial Policy, Economic Concentration, and Export Promotion

From behind this protective barbed wire an extensive domestic industrial reordering was carried out through industrial policy, economic concentration, and export promotion. When the war ended, Japan had an exceptionally limited domestic base

for production and international competition. Industrial restructuring and export promotion were logical choices. Japan's economic bureaucrats and business leaders rejected the philosophy of laissez-faire, "free trade," or "open markets" prevalent in Britain or the United States. To them, as Charles Kindleberger has suggested more generally, these concepts conveyed little more than protection for the economically powerful and the established exporter: "the headstart is regarded as a divine right, and [protection] to let a foreign industry gather strength to meet import competition as an offense against morality."⁴⁶ Rather than accepting the inevitable "comparative advantages" described in Riccardian economic theory—advantages that would have directed Japan toward production based on its extensive supply of cheap labor—Japanese economic bureaucrats sought to use activist policies as a means of generating "competitive advantages" for Japanese firms.⁴⁷ To carry out this transformation, a bevy of policies were put into place.

A series of economic plans issued by the Economic Planning Agency provided broad guidelines within which national industrial policies were shaped. Actual industrial reorganization was carried out primarily by MITI through sector-by-sector restructuring. In the earliest stages, the targeted industries involved such basics as steel, electric power, coal, shipbuilding, and chemicals as well as such quality exports as binoculars, simple electronic equipment, and motorcycles. Gradually, as technology and production processes improved and domestic markets developed, resources and attention were redirected toward more complicated manufacturing processes for automobiles, heavy machinery, and more complicated consumer electronics.

More concentrated oligopolistic structures were one result. During the 1960s, more than five hundred major and minor mergers occurred each year; by the end of the 1960s and the beginning of the 1970s this figure was over a thousand annually.⁴⁸ In 1960, 93 percent of Japan's companies had been capitalized at less than ¥500,000; by 1974 this figure had dropped to 76 percent, while the number of corporations capitalized at over ¥1 billion had more than quadrupled. Industrial concentration continued steadily. By 1974 five corporations or fewer controlled 90 percent or more of the markets in the steel, beer, nylon, acrylic, aluminum ore, automobile, and pane glass industries.⁴⁹ The capstone of MITI's "merger mania" took place in 1968 with a huge merger in the steel industry. New Nippon Steel, built out of the fusion of Yawata and Fuji Steel, became the world's second largest producer with 36 percent of domestic market share.⁵⁰

While many mergers took place at MITI's initiative, not all of its consolidation efforts were successful, including attempts to bring about greater cohesion in automobiles and electronics. MITI's power, real as it no doubt was, had its limits. Mergers involved more than simple government fiat. Congruence with business and financial goals was critical to most MITI successes; government and business were engaged in a process involving what Richard Samuels has labeled "reciprocal consent."⁵¹

Governmental control over scarce capital was one of its major tools for reorganization. Targeted use of this capital was critical. Thus the Ministry of Finance, starting in late 1957, began a policy subsequently known as "window guidance,"

under which individual banks, through linkages to the Bank of Japan and the ministry, were "encouraged" to lend to specific firms or types of firms. While basic monetary policy remained tight, specific exceptions were made for designated industries. Between 1963 and 1967, equity financing provided only 6.2 percent of the new capital for nonfinancial corporations, compared to 57.3 percent from public or private loans and 30.5 percent in trade credits.⁵²

Financial assistance to targeted firms came in the form of low-interest loans, aid in securing loans from private banks, accelerated depreciation, and tax-free reserves. Moreover, through the FECL, MITI used selective allocations of scarce raw materials and scarce foreign exchange credits to further its industrial targeting goals. MITI also assisted favored firms in acquiring overseas technology, duty-free equipment, tax subsidies, and sweeping exemptions from the country's ever weakening antimonopoly laws. A good deal of the authority to carry out these policies rested on formal legal provisions, but a not insignificant amount grew out of the less formal power associated with "administrative guidance."⁵³

The successes that resulted for Japanese manufacturing are widely known. Japan moved from producing approximately one-tenth of the world's ships in 1950 to one-half in 1972. Technological improvements in steel production were so rapid as to preclude foreign steel from entering Japanese markets, allowing Japanese steel producers to more than double their output between 1953 and 1959, almost double it again by 1962, and to become the world's third largest manufacturer by 1964. Petroleum and coal products, also government targeted, expanded at the rate of 17.9 percent per year between 1953 and 1971. Chemicals expanded at nearly 15 percent per year during the same period.

Massive spillovers occurred to sectors not subject to explicit government targeting. As late as the 1950s, Japan had virtually no meaningful automobile production capability; by 1972 it was producing 4 million units per year, of which nearly one-half were destined for export. As late as the mid-1960s, Japan's companies were barely coming to grips with the simplest of computer chips; by the end of the 1970s they controlled about 40 percent of the world market in 16K RAM chips. Although the specifics differ, the picture is similar in 35 mm cameras, home electronics equipment, watches, calculators, small trucks, machine tools, and dozens of other products.

A great deal of this success came from the economies of scale achieved by reorganization and oligopolization advanced by MITI and carried out by individual firms. Improved production processes, personnel practices, technology developments, and the like were also essential to the overall success. Indeed, several of Japan's most successful industries (e.g., 35 mm cameras, household appliances, and consumer electronics), as well as several of its individually most successful firms (Sony, Matsushita, and Honda), were not the targets of explicit government assistance. All the same, government actions in a host of industries, particularly those that provided important forward or backward linkages, contributed unmistakably to the overall improvement of the national economy.⁵⁴ Perhaps most important was the pervasively pro-business climate generated by government policies, conducive

to a firm's risk taking and expansion whether or not it was a direct recipient of government largess.

Two central points are clear. First, Japanese policies were not designed in accord with any sacrosanct abstraction called "the market," nor were they designed to advance "consumer interests." Government officials took their central task to be the shaping of the economy in ways they deemed beneficial to the national interest, and this was measured largely in macrostatistics rather than in enhanced consumer choices or lower prices. Second, in manipulating market forces, the formal and informal tools in the governmental tool kit were plentiful. The result, as I have argued elsewhere, was that the Japanese government became the doorman determining what came into and went out of Japan.⁵⁵

Government protection to specific firms or industries typically creates at least two problems. First, as most neoclassical economists are quick to point out, protection and guaranteed domestic markets reduce the pressures on sheltered firms to modernize equipment, engage in extensive research and development, improve product quality, pursue most effective production methods, and continue technological upgrading. Why improve efficiency and consumer responsiveness when there are few incentives to do so? Second, when governments seek to create "national champions" at home, these champions are often absolved of the need to achieve competitiveness beyond the nation's borders. Instead, the political temptation is strong to make such firms the high-paying employers of last resort for inept cronies. Politicians mandate prices so as to benefit end users of the national champion's products. Producers who dominate domestic sales can revert to high prices and poor quality, making them dubious competitors in the international marketplace. In short, a host of inefficiencies are built in.

Japanese industrial policies avoided both problems. When specific industrial sectors were restructured, several manufacturers were aided simultaneously. Government policy encouraged individual firms to pursue the most sophisticated technologies, internationally best practices, high research and development, and continual upgrading of facilities.

Competition among major firms thus remained vigorous if compartmentalized and domesticated. Although they rarely competed on price, firms still had strong economic incentives to pursue continual innovation, improved products, better service, and a host of other characteristics. In turn, this made many of them highly competitive internationally. Moreover, firms competing internationally had every incentive to become as sophisticated and as cost- and quality-conscious as possible. Cooperation and coordination were made compatible with competition.⁵⁶

Because Japan in the late 1980s and early 1990s was widely seen as a "trading state,"⁵⁷ it is well to remember that in 1960 Japanese exports accounted for only about 3 percent of the world's total exports (imports were only a slightly higher 4 percent). In 1965, imports and exports combined represented less than 10 percent of Japan's total GNP.⁵⁸ Nevertheless, a major goal of governmental cartelization and industrial policies was the promotion of Japanese exports. Thus, under the Export and Import Trading Act of August 1952, the Japanese government explicitly

permitted exporters to enter cartel agreements on price, quality, design, or other matters connected to the export of their products. During the same year, the Export Income Deduction System allowed companies to take a straight tax deduction for a portion of their net income from export sales.⁵⁹ A host of export incentives were also offered: special tax deductions, exemption from anti-cartel provisions, preferential access to scarce credit, lower borrowing rates, more rapid depreciation on equipment, customs exemptions for specified imported machinery, special tax status for firms with substantial increases in exports, tax deferments, and in some cases overt subsidization.

In addition to such firm-specific measures, the government established the Japan External Trade Organization (JETRO) as a quasi-official export promotion body to aid overseas market research activities, as well as trade centers and advertisements for Japanese products. Also funded from the national budget was the Japan Plant Export Association, designed to foster the export of heavy machinery and entire factories by performing international consultation services. At least another ten research centers, promotion projects, and export associations were governmentally funded during the late 1960s and early 1970s.⁶⁰ All provided generic export assistance to any Japanese firm seeking to its help.

Japan's wartime reparations also stimulated development of overseas markets. Reparations payments to several Southeast Asian countries began in the early 1950s. Typically involving export credits, tied loans, plant exports, and long-term investment projects that relied on Japanese capital, these opened markets for Japanese firms as well as providing tremendous opportunities for personal profit by many Japanese business and political leaders.⁶¹ The reparations experience subsequently became the model for Japan's broader efforts at "foreign aid" to the region. Until 1972 Japanese aid was typically tied to the purchase of Japanese goods. Untied Development Assistance Committee (DAC) aid from the Japanese government remained exceptionally low by comparative standards.

In addition to Southeast Asia, Japan's other major export market was the United States. Here, U.S. governmental policies were at least as critical as Japanese policies in the development of markets for Japanese companies. Emerging from World War II as the major economic and strategic hegemon of the Western world, and committed to an economic system based on open markets and economic linkages, plus a system of alliances designed to "contain communism," the U.S. government welcomed Japanese imports on both economic and political grounds. U.S. governmental policy for at least the first thirty years following the war remained focused primarily on the strategic and military aspects of the bilateral relationship, demanding little in the way of economic reciprocity through the opening of Japan's markets to U.S. products.

This combination of economically dominant trade links to Southeast Asia and politically constructed trade links to the United States left Japanese exports headed in two directions—south and west to Asia, or across the Pacific to North America. During the mid-1960s, approximately 30 percent of Japan's exports went to Southeast Asia and another 27–28 percent went to the United States. In contrast, Europe

took only about 10 percent, Africa 7–8 percent, and Latin America about 5 percent. With the exception of Canada, no other industrialized democracy had such a heavy reliance on so few markets.

Balanced Budgets and Small Government

Tight fiscal policy and small government were the third key element of the conservative Japanese regime's overall policy profile. From the end of the occupation until 1965, Japan pursued exceptional fiscal austerity, often generating overbalanced budgets.⁶² Such austerity meant an exceptionally low utilization of public-sector bonds, which limited private competition for scarce funds. Since private firms dominated the market for scarce capital, their overall capital costs were lowered. Tight fiscal policy also permitted the government to hold down the overall tax burden. Indeed, in many years, the budget was sufficiently overbalanced to allow for tax cuts, an exceptionally popular political measure in any nation.

Japanese budgetary politics is a well-told tale. Every year, the Ministry of Finance would issue guidelines that set upper limits on requests from individual governmental agencies. Initially, these limits were rather generous; they were constricted over time. Consequently, individual ministries, despite their most ardent desires to begin new programs, could do so if and only if they could submit a budgetary proposal that did not exceed ministry guidelines. This normally meant that each agency continually had to revise its priorities, scrapping or reducing its less favored programs to allow for new or expanded activities somewhere else. The zero sum game of agency-to-agency competition in budgeting was thus reduced.

The two largest budget items for most industrialized democracies during the postwar years were defense and social welfare. Japanese budgets kept both items contrastingly small, typically the lowest of any major industrialized country. From the 1950s to the early 1970s, the United States devoted between 7 and 9 percent of its GNP to military expenditures, and most of the major Western European countries were spending at least 4–5 percent. In contrast, from 1956 on, as a matter of policy, Japan's military budget rarely consumed more than 1–1.3 percent of that country's GNP.⁶³

Not that the choice of a civilian orientation was completely autonomous. Demilitarization policies under the U.S. occupation had completely dismantled Japan's war machine, while pacifist sentiments had been institutionalized in Article 9 of the Constitution. Serious disagreements about this policy arose at various times within conservative political ranks (these are detailed elsewhere). But during the mid-1960s significant increases for military expenditures had no effective support within the conservative camp. As a proportion of the total budget, military expenditures fell sharply. In 1950, they accounted for 19.8 percent of the government's general expenditures; by 1960 this was down to 10 percent, and by 1970 it was just over 7 percent. As a percent of GNP, military expenditures fell from 1.8 percent in 1955 to 0.79 percent between 1955 and 1970. Low expenditures for defense in turn

meant more money and talent for the civilian sector, lower government expenditures, and a reduced demand for scarce capital.

The contribution of low military expenditures to Japan's national growth has been estimated by Hugh Patrick and Henry Rosovsky. They conclude that if Japan had spent as much as 6 or 7 percent of GNP on defense, the national growth rate would have dropped by as much as two percentage points annually. In this sense low spending translated to a 30 percent increase in the total economy during the period 1954–74.⁶⁴ Without question, 30 percent slower growth would have made for a substantially less prosperous, and undoubtedly politically quite different, Japan.

The Japanese governmental budget was sparing in social welfare as well—quite a different pattern from the one emerging in Europe. Unlike Japan's low military expenditures, which were markedly inconsistent with prewar practices, low expenditures for social welfare measures represented a historical continuity. The Japanese government had long avoided sweeping and costly nationwide programs in health care, retirement benefits, or other social welfare measures. Instead, occupation-based systems were supplemented by a thinly woven, publicly funded "safety net" that offered low levels of benefits for those who would otherwise be ineligible for occupation-linked benefits.

The Employees Pension System (EPS) and the National Pension System (NPS) were established in 1954 and 1959 respectively. These were paralleled by the National Health Insurance (NHI) and Employee Health Insurance (EHI) programs. The two "employees" programs (EPS and EHI) were linked to job status; the "national" programs (NPS and NHI) provided government safety nets. Unlike most Western European systems, neither health care nor retirement benefits were treated as "rights of citizenship."⁶⁵ Essentially, the public programs remained small and residual; they provided low benefits and, in the case of the pensions system, required a long period of contributions to gain eligibility.

Public welfare expenditure in Japan during the early 1960s thus accounted for only 7 percent of GDP, while the comparable figure was 17 percent in France, 16.5 percent in Germany, 13.6 percent in Italy and Sweden, 12.6 percent in the United Kingdom, and 10.3 percent in the United States. Income maintenance expenditure also showed no substantial change throughout the 1960s. Japan spent 2.1 percent of GDP for such programs in 1962 and 2.8 percent in 1972, only a third of the OECD average.⁶⁶

Retirement pensions for the noncontributing elderly were minuscule even into the early 1970s.⁶⁷ Only about 3.4 million Japanese were eligible for benefits as recently as the early 1970s. As Japan moved into the 1970s, it was clearly the industrial democracies' most conspicuous "welfare laggard."

At the same time, despite the absence of a European-style welfare state, Japanese citizens had universal access to reasonably good health care. The elderly were typically cared for by families. Labor market policies were designed to provide neither unemployment checks nor public relief jobs.⁶⁸ Instead, a proactive labor-market policy fusing government and business activities put in place a market-oriented

nexus of job training policies. These in turn helped sustain relatively full employment and, more important, avoided measures that might otherwise have resulted in a permanent or semipermanent underclass of unemployed. Thus, despite limited public-sector welfare spending, Japan's national unemployment rate remained among the lowest in the industrialized democracies while its infant mortality rate dropped and the life expectancy of its citizens rose to among the highest in the industrialized world.

Finally, keeping government small entailed freezing or shrinking the number of government officials. Few countries have demonstrated any sustained ability to reduce the size of their civil services. A series of administrative reforms starting in the early 1950s made Japan an exception. Bureaucratic reform combined outside political initiative with a great deal of latitude for individual ministries and agencies in the specifics of their restructuring. Curbing bureaucratic sprawl aided conservative efforts to maintain low-cost government. It also bolstered the overall competitiveness, efficiency, and esprit of the agencies and personnel still in place.

Thus, in two critical areas, military expenditures and social welfare, the conservative regime's spending policies were exceptionally low by comparison to the other industrialized democracies, but they fit into the much broader national pattern of balanced budgets and minimalist government. Government size was kept down, furthering inexpensive government. Low-cost government in turn meant more and cheaper capital for private (typically manufacturing) interests. Once the economy began to grow at double-digit rates, government revenues increased automatically, allowing expanded government activities along with frequent, and politically popular, tax cuts.

Side Payments

These first three elements of Japan's policy profile are consistent with "pro-growth" efforts. They also help to explain Japan's tremendous economic performance. Yet, equally integral to the conservative regime's economic policy profile were policies that had a political rather than an economic rationale. These involved side payments to the country's less economically advanced sectors: rice farmers, the small-business sector, geographical regions lacking high-growth industries, and, increasingly, industries in decline.

In the mid-1960s agriculture played a minuscule role in Japan's total economy. At the time of the Meiji Restoration, approximately 80 percent of Japan's employed population was involved in farming. As late as 1908 agriculture contributed just under 30 percent of Japan's total net domestic product. Immediately after the Second World War, farming still engaged over 50 percent of the population,⁶⁹ and in 1953 it accounted for some 17.5 percent of the net domestic product.⁷⁰ By the mid-1960s these figures had dropped to about 15 percent of the population and 8 percent of the NDP.⁷¹ Furthermore, between 1960 and 1965, the farm population was falling by about 5 percent per year.⁷²

By this time, Japanese farms were highly efficient in productivity per acre but hardly economical in total returns. In the mid-1960s, Denmark, France, and West Germany all had farm outputs *per unit of land* that were only 21–31 percent of Japan's, yet their output *per laborer* was from three to four times higher.⁷³ Japanese farming had become intensive horticulture on Lilliputian plots.

The vote from farmers and their families nevertheless remained vastly more important to the electoral fortunes of many individual LDP parliamentarians than any contribution they might make to the national economy. Meanwhile, the Ministry of Agriculture had its Food Agency, an extensive food control system with twenty thousand employees; crop prices were a critical component of the Ministry's budget and activities. Hence strong political and bureaucratic pressures continued for government programs to subsidize rice farmers.

Under the food control system put in place during and immediately after the war, there was effectively no private market for rice sales. Instead the government bought all the rice produced within the country at one price and then resold it to consumers at a different price. Originally the two prices were relatively close. By the 1960s, however, the gap had widened considerably, providing an extensive subsidy program for rice farmers.

As Michael Donnelly has noted, one of the unique features of this program was that government policy sought to remunerate family labor in farming at levels "substantially equivalent to average wage rates in manufacturing."⁷⁴ If rice farmers could not increase their efficiency through labor-saving devices, the government would compensate them by buying their rice at high prices. And because the setting of the price of rice took place outside the normal budgetary process, rice subsidies were not subjected to the same tight Ministry of Finance controls as the annual budget. Producer prices doubled between 1960 and 1967, leaving official deficits linked to the program of rice prices at record highs.⁷⁵

Similarly, the rapid growth and technological modernization of Japan's larger businesses in the mid-1960s still left the Japanese economy "teeming with small-scale family enterprises, more so than any other advanced industrial country."⁷⁶ From then to now, Japan's has been simultaneously an economy of a few giants striding above numerous pygmies, the latter often linked to the former through extensive subcontracting arrangements.

Not surprisingly, such small businesses were also the object of compensatory policies, again because of their electoral clout. Generally speaking, most such businesses relied heavily on low wages and labor-intensive operations. Higher wages in the country's rapidly expanding larger firms put great pressure on the smaller ones to modernize or to raise wages. The governmental response was essentially twofold: policies to help smaller firms upgrade and modernize, and policies to sequester these firms from "excessive" market competition.

Many measures to encourage modernization came from the Basic Law for the Modernization of Small and Medium Sized Enterprises, enacted in July 1963, which set standards for product design, quality control, plant modernization, and

product specialization and rationalization for these smaller firms. The government offered special subsidies, tax exemptions, and preferential financing from a special corporation set up to aid smaller firms in reaching these goals. In the early to mid-1960s some twenty industries were so designated; by 1966 the number had expanded to sixty-eight, and by 1974 it was up to 118, covering some 70 percent of the sales volume of smaller and medium-sized firms.⁷⁷

Simultaneously, a sequence of measures protected slower moving firms from economic disaster. Most typically these occurred in sectors unamenable to easy modernization, for example, traditional commerce, retailing, services, and some manufacturing. Of particular note was the Small and Medium Enterprise Law of 1957, which allowed “business unions” aimed at preventing “excessive competition” and infiltration by larger firms.⁷⁸ Meanwhile the Large-Scale Store Law, originally passed in 1956 and revised in 1973, gave smaller firms, acting through their local Chambers of Commerce, the *de facto* right to prevent larger stores from competing against them in their local markets.

Also benefiting both sectors was the government’s laxity toward farmers and smaller businesses on matters of environmental pollution, labor standards laws, tax collection, and zoning. In effect, an implicit bargain was struck between conservative politicians and the two sectors: “support us and we won’t tax you.”⁷⁹ Although it was not until much later that the phrase gained popularity, Japan had a “nine-six-three” tax system: wage earners paid 90 percent of the taxes they owed, small business 60 percent, and agriculture only 30 percent.

Regional policy was a third area in which political rationality trumped economic rationality. Japan’s most successful firms were disproportionately concentrated in a relatively narrow industrial belt that ran along the Pacific Coast between Tokyo and Osaka. The country therefore developed several programs targeting specific regions for industrial development. In 1962 fifteen “new industrial cities,” largely outside the Pacific coastal belt, were identified for special development funds; in 1964 six “special areas for industrial consolidation” were added. The result was a transfer of capital from Japan’s major cities to its most underpopulated and industrially disadvantaged areas.

Conservative politicians also used the public works budget and various regional development schemes to transfer huge sums to their home districts, further distributing public pork. During the mid-1960s public works expenditures accounted for between 15 and 19 percent of the national budget—roughly twice as much as other major industrial countries.

Thus while Japan’s economy modernized at warp speed in many sectors, other sectors and regions were actively protected, thereby warding off the worst consequences of rapid growth. Normally, rapid growth widens gaps in income and wealth; in Japan, politically driven policies of compensation reduced such gaps. Such compensation policies served as exceptionally powerful income levelers.

Two things are especially striking about the public policy profile of Japan during this time. First, policies typically dovetailed rather than operating at cross-purposes. Protection from outside competition complemented industrial policy and export-

led growth; low-cost government allowed the concentration of scarce public resources on targeted industrial sectors; capital insulation gave government a powerful weapon in industrial restructuring; the undervalued yen aided exports, and so on. The cumulative consequence was an ever deeper embedding of the entire nation in the complex of mercantilist policies.

Second, this policy profile had, unsurprisingly, a political rather than simply an economic logic. Political supporters of the conservative regime who did not benefit directly from the high-growth policies were amply rewarded from the public coffers. As a consequence, so long as exports brought high growth, economics and politics reinforced each other: there was little political incentive for government to dismantle protectionist barricades or for economic sectors to view their political interests as dramatically at odds.

Mercantilism and protectionist catch-up were widely accepted by most Japanese institutions and socioeconomic sectors. Erstwhile domestic critics of various features of the Japanese economy rarely challenged its broader mercantilist thrust. Unlike so many other industrialized democracies, therefore, Japanese elections were never seriously fought over issues of open versus closed markets; exporters and importers rarely clashed over macroeconomics; and powerful government agencies were uniformly tolerant of the nation’s economic thrust. Japan’s embedded mercantilism thus stood as a stark exception to the “embedded liberalism” that John Ruggie correctly argues permeated the OECD countries as a whole.⁸⁰

The Socioeconomic Underpinnings of Embedded Mercantilism

Critical to the character of any regime is its underlying socioeconomic base. How do the major segments of the economy ally with or oppose one another? Japan’s underlying socioeconomic alliance structure during the 1960s was unique among the postwar democracies, resting as it did on a coalition among three key sectors—big business, smaller businesses, and agriculture—in support of the prevailing conservative regime, while organized labor was systematically excluded from government and formed the principal socioeconomic support base for the main opposition to the conservative regime.

As I noted in Chapter 1, soon after World War II labor and business within most major democracies had largely reconciled their most extreme differences. For countries such as Italy and to some extent France, this simple picture was complicated by a divided labor movement, only part of which was cooperative with business, and by the enduring socioeconomic power of small farmers. In land-rich countries such as the United States, Australia, New Zealand, and Canada, agriculture remained economically powerful because of its strength in world markets, but even there some form of business-labor accord was in place.

In Japan, no such business-labor alliance emerged; rather, business and agriculture forged an antilabor alliance that relied, not on open domestic markets, but on

the embedded mercantilist policies described above. The next chapter examines the process whereby this unlikely alliance was constructed. At this point, it suffices to say, the policies generated under embedded mercantilism both were aided by the alliance and served to keep that alliance intact.

Although portraits of Japan as socially homogeneous are overdrawn, cleavages in race, ethnicity, language, immigration, or religion were far less critical in Japanese politics than they were in many other industrialized countries. Instead, Japan's politics during the early postwar years pitted self-styled "conservatives," with their relatively fixed socioeconomic alliances, against self-styled "progressives" and their own support base. Even though there were several parties in the opposition, as late as 1976 they buried their differences on major issues in the interests of opposition unity. Their confrontations played out primarily over two issues. First, there was the standard business-labor division that had critically shaped the political economies of Western Europe, North America, and Australasia from the beginnings of the Industrial Revolution well into the 1950s and 1960s. Overlapping this split, second, were the deep divisions over defense and security that prevailed in many democracies during the cold war. Divisions on these two big issues set the dominant and opposition coalitions into stark relief, untempered by significant cross-cutting cleavages that might have muted the differences. Japanese politics during the early postwar years was a game of high stakes poker with no wild cards. Winners would shape the country to redound to their long-term benefit, and losers would go home in their ragged ideological underwear.

The gap between the two camps was particularly wide on security matters, to which the Japanese left devoted much of its energy. Hindsight makes clear that the JSP's dominant concern—judged by their actual efforts rather than their policy statements—was security, not the economy. Successful mobilization of large numbers of Japanese citizens during the 1960 protests against revisions of the U.S.-Japan Security Treaty, along with the radicalism of the party's grassroots cadres, enhanced that focus. Unionization, economic distribution, social welfare, and environmental problems were downplayed as issues to which the left was willing to commit time and energy. Into the late 1980s, the JSP continued to support a "dictatorship of the proletariat," even as national economic policies virtually eliminated all who might qualify as proletarians and as private-sector unions focused on factory-level efforts to capture the economic benefits of high growth for their members.

The benefits of embedded mercantilism to the alliance's participants were undeniable. For example, by the end of 1960 Japan's net fixed capital stock was ¥14,353 billion (in 1965 yen); by the end of 1971 it had grown 327 percent to ¥46,880 billion.⁸¹ Moreover, because government restrictions limited competition from technologically and managerially sophisticated, capital-rich overseas firms, Japanese products dominated the expanding domestic market, securing for Japanese manufacturers a solid home base from which to expand their markets internationally.

In a similar vein, the export-driven economic success, the protective fortress for agriculture and small businesses, and the continued stream of direct subsidies, tax incentives, pork barrel projects, land use policies, and side payments all fostered the

continued collaboration of these two key sectors. Moreover, small-business owners also benefited from direct assistance programs as well as from a politically driven laxity in the enforcement of labor, environmental, and tax laws.⁸² As late as the early 1970s, agricultural expenditures as a proportion of total government spending were typically four times greater in Japan than in France, Britain, the United States, or West Germany.⁸³ Incomes for farm families remained as high as those in urban and manufacturing areas while regional income disparities were also kept low. Farm subsidies were so extensive that "rice farmers and agricultural cooperatives had become political wards of the state."⁸⁴ Continued high growth was essential to maintaining such costly economic inefficiency.

As Chapters 5 and 6 will show, continued high growth and the consequent socioeconomic transformations ultimately confounded the bipolar simplicity of the socioeconomic clarity that prevailed in the mid-1960s. High growth in Japan, as in so many other countries, worked to defang erstwhile radicals, particularly because growth led to tangible and broadscale improvements for most citizens. In Japan, unlike many other countries, a rising tide *did* lift most boats. An expanding middle class, largely working in the service sectors, began to blur the once clear lines between business and labor. In the mid-1960s, however, the alliance structures of the two major camps were cleanly drawn, and the gap between them was wide.

To understand how Japan's socioeconomic cleavages were structured, we must turn to the final component of the conservative regime, the institutional arrangements that undergirded the regime of embedded mercantilism.

The Institutional Framework of Embedded Mercantilism

An interlaced network of political and economic structures held the socioeconomic alliance together and helped to shape the public policy profile. At the national governmental level, two institutions were especially relevant: the Liberal Democratic Party (LDP) and the national bureaucracy. The entire state apparatus remained under relatively unchecked LDP control for some thirty-eight years. Meanwhile, state bureaucratic powers, although less arbitrary and absolute than during the pre-war period, remained formidable.

Meanwhile, interests and sectors tied to the LDP and to bureaucratic agencies had regular and steady access to power; anticonservative interests or nonaligned citizens found it correspondingly difficult to organize and to operate. As a result, conservatives could mobilize governmental power with singular cohesion in the interests of whatever agenda they set.

From its formation in 1955 the LDP was a vote-gathering wonder. The party typically captured 55–60 percent of the seats in both houses of the parliament and dominated most prefectural and local legislatures and executive branches by even greater margins. Conservative control over the country's executive and legislative institutions was virtually absolute. Concomitantly, conservatives held control of such key state organs as the police, the military, the tax offices, government-owned

media, communications, and a vast array of public-sector corporations. Virtually all aspects of social life requiring governmental registration, permission, or licensing were thus under conservative control.

The vast majority of these tasks were administered by a well-entrenched state bureaucracy with extensive powers and a strong predisposition toward the active pursuit of the national interest. Particularly during the 1950s and 1960s, when so many other arenas of public life had seen their elites completely discredited, the national civil service attracted a large pool of Japan's "best and brightest."

Senior career officials were the product of a long trial by educational fire, most typically culminating in four years at the University of Tokyo's Faculty of Law.⁸⁵ Competitive exams for senior civil service positions were intense; during the 1960s, twenty thousand or more applicants competed annually for roughly fifteen hundred positions.⁸⁶

Individual agencies had sweeping powers to affect specific sectors of society, in large measure due to their extensive licensing and regulatory powers. For much of the postwar period, despite slight reductions over time, some ten thousand regulations by various Japanese government agencies were in effect.⁸⁷ Moreover, in Japan, it is extremely difficult for interest associations to form and to function *without explicit approval from one or another government agency*. Strict qualifications on size of staff, financial resources, office space, memberships, and tax-deductible contributions limit the number of Japan's truly autonomous, critical, and free-floating interest associations.⁸⁸

As noted above, the national bureaucracy played an active role in the care, nurturing, and structuring of the economy. Two agencies were particularly active and powerful in this arena. Japan's Ministry of Finance (MOF) had sweeping *de jure* and *de facto* responsibility over monetary, fiscal, and taxing activities, powers normally divided among several agencies in most countries. In one U.S.-Japan comparison, for example, the authors observed:

The MOF combines the functions of the U.S. Treasury, Office of Management and Budget, Internal Revenue Service, Securities and Exchange Commission, Commodities Futures Trading Commission, Office of the Comptroller of the Currencies, activities of the Justice Department and Federal Trade Commission related to the financial system, state banking and insurance regulators, supervisory functions of the Federal Reserve, Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, Federal Home Loan Bank Board, National Credit Union Administration, and state credit union regulatory agencies.⁸⁹

The United States is clearly more governmentally decentralized than Japan and provides a less-than-ideal comparative standard. Still, MOF carries out multiple tasks that in Germany and continental Europe are also divided among several bodies. Not surprisingly, Japan's Finance Ministry has been dubbed "the world's most powerful bureaucratic institution."⁹⁰

Unusually valuable to MOF was its control over the Fiscal Investment and Loan Program (FILP, or *Zaisei Tōyūshi Keikaku*), often referred to as "Japan's second budget." The monies in the FILP come from the extensive national postal savings system (administered by the Ministry of Posts and Telecommunications) and from various special accounts such as welfare insurance and national pensions. Japan's postal savings system is the largest financial institution in the world; during the mid-1960s FILP monies alone constituted somewhat over 5 percent of Japan's total GNP.

During the early 1950s the FILP supplied 21 percent of the total funds used for heavy and export industries and 37.2 percent for the four basic industries of electric power, shipping, coal, and iron and steel.⁹¹ In addition to financing such critical industries at a time of major reorganization, the FILP was a key contributor of public capital for toll roads, ports, airports, irrigation facilities, subways, railways, public housing, and other critical infrastructures.

If MOF had preponderant control of Japan's money, MITI exerted its greatest powers over industry. It had the authority to allocate foreign exchange, raw materials, and overseas technologies to companies as well as to shape industrial reorganization. Like all agencies, MITI had both formal authority and powers of "administrative guidance."⁹² It also had oversight responsibilities for twenty-two *tokushū hōjin*, or special legal entities—quasi-public corporations with extensive authority in specific sectors of the economy, such as shipbuilding, automobiles, petroleum, and specific types of firms. This was eight more corporations than the next largest ministry and two to five times more than most other agencies.⁹³ MITI also exercised extensive control over various industrial trade and export associations,⁹⁴ as well as the legalized bicycle and motorcycle racing associations, profits from which were used to promote various industries.

Thus, when the conservative regime was functioning at its most fluid, both MOF and MITI had at their organizational disposal an array of tools with which to shape the nation's financial and industrial sectors.⁹⁵ Other government agencies enjoyed less sweeping powers, but, overall, Japan's bureaucracy had considerable influence and jurisdiction, particularly with regard to the national economy.

Japan's parliamentary-cabinet system was thus structured to allow virtually unlimited powers to any elected majority. With the LDP holding majorities in both houses, controlling cabinet positions, and almost always voting as a bloc, there were no formal impediments to the exercise of collective conservative will. The cabinet also had strict control over the court system, whose top judges were appointed by the LDP. Once agreement was reached within conservative ranks, subsequent executive-bureaucratic dominance was comprehensive. Government bills dominated the parliamentary agenda; amendments were rare; nongovernment bills had limited chance of success. Once the bureaucracy drafted its legislation, LDP solidarity voted it through parliament.

Although governmental institutions were united in support of a proactive agenda, private business and agriculture provided a vital underpinning for economic action.

At least five business structures demand attention: the individual firm, trading companies, the financial system, the *keiretsu*, and peak business organizations. Also critical were Japanese agriculture and its organizational structures. What is striking about all of them is their high degree of sectoral integration and their tight linkages with the conservative political world, both political and bureaucratic.

Business Structures

The basic economic building block of Japanese capitalism was the individual company. Despite the popularity of such stereotypes, there is no "typical Japanese firm." In the mid-1960s, for example, the large firms that dominated the business headlines were capitalized at more than ¥1 billion, employed more than a thousand workers each, and together accounted for roughly one-quarter of the nation's productivity. Yet these firms constituted only 1 percent of Japan's firms. In contrast, firms with fewer than three hundred employees accounted for nearly one-half of total manufacturing shipments, 44.1 percent of wholesale and 79.6 percent of retail turnover, and 38.6 percent of total exports.⁹⁶

Firms also varied palpably in the range of their activities, from the small and relatively inefficient mom-and-pop groceries, sake shops, and cosmetics outlets to the medium-sized cement, paper, or machine-tool producers with their higher levels of productivity, to the complex auto manufacturing or shipbuilding operations that were among the most productive in the world.

While far from identical, Japan's largest and most competitive producers of goods or services had several features in common. One of the more important was the workforce. Clichés like "permanent employment" miss the realities of how the workforce in most Japanese firms was typically organized. Most large firms (though rarely smaller and medium-sized firms) had a core workforce, almost exclusively male, the bulk of whose members were hired soon after completing their formal education. Most stayed with the firm until "retirement" in their mid-fifties. Salaries were composed of three main elements: a base amount; add-ons for family size, commuting distance, children's educational expenditures, and the like; and a biannual bonus. Permanent workers could also avail themselves of a wide variety of company services including vacation spas, health care facilities, and in some cases even marriage counselors.

The bonus typically involved payment of two, three, or even four or five months' salary biannually. This provided delayed, if involuntary, savings for workers as well as a cheap mechanism for capital hoarding by firms. Formally negotiated between management and labor, the bonus also provided management with a mechanism to link labor costs to company profitability.

The core workforce was often "white collarized": blue-collar workers enjoyed long-term employment, company-related skill development, and wages linked to company profits.⁹⁷ This contrasted sharply with countries where blue-collar workers were among the first fired or laid off in the event of a company's short-term financial setbacks. Core workers in Japan rarely faced layoffs; in periods of financial

stress their bonuses might be reduced, the oldest workers might be "tapped on the shoulder" and encouraged to take early retirement, or workers might be reassigned to new jobs. For most large firms, these workers were treated as a long-term investment rather than a short-term cost of production. Although it constituted probably no more than 30 percent of all workers, this core group formed the basis for most observations about "permanent employment" in Japan.

Conditions for this protected core, however, did not apply to the rest of the (typically nonunionized) workforce made up of part-time and temporary workers—often predominantly female—nor did it apply to subcontractors. Their wages were dramatically lower and their job security varied from short-term to nonexistent.

A visual image of the contrast between these two types of worker is presented in Robert Wood's description of the "silver helmets" and the "yellow helmets," two groups of workers at Nippon Kimitsu Steel. The former were permanent employees with the consequent salary, benefits, and prestige; the latter, with no such guarantees, lower wages, and the dirtiest jobs, were subcontract workers.⁹⁸ And outside the gates of Kimitsu were the "grandfather subcontractors," small companies that typically employed between ten and ninety-nine workers, in a "grime-covered corrugated metal and cement building with amenities limited to perhaps a Ping-Pong table in a grubby recreation room."⁹⁹ Of Kimitsu's twenty-six thousand workers, just over one in four wore the privileged silver helmet.

Company practices designed to retain the "core" workforce and to enlist worker support for new management practices and technologies had been adopted by Japan's largest firms as early as the late 1950s, particularly in shipbuilding, chemicals, and heavy industries. In addition, as demand for manual labor and machine operators decreased and automation and managerial oversight functions increased, so did the firms' emphasis on intrafirm retraining programs, supervisory selection based on technical knowledge and leadership, and personnel management by line workers. Work-group leaders who might well be union members were enlisted in the tasks of supervision, information transfer, and personnel maintenance. Joint consultation between labor and management at the plant level, as opposed to explicit collective bargaining, was a major outcome. One survey by the Japan Productivity Center showed that by the early 1970s, 80 percent of the sixteen hundred major companies listed on the Tokyo Stock Exchange had established some form of permanent system of joint consultation at the enterprise level.¹⁰⁰ Only if such consultations did not successfully resolve issues did unions push for them to become part of collective bargaining. The consequence was an increasing overlap between the interests of managers and the core workforce.

Three central features of this picture deserve underscoring. First, both financing and personnel practices provided strong incentives for the firm's leadership to take the long-term view in business strategizing. And this was certainly easier when politics was almost guaranteed to be under conservative control. Second, management had a variety of ways to contain labor costs short of laying off core workforce members. Third, the employment of semipermanent core workers and the development of plant-level joint consultation allowed management to wean

core workers away from the agendas of their more radicalized and politicized national union federations.

The second important business structure was the trading company, another unusual and instrumental economic organization with only a few counterparts elsewhere.¹⁰¹ Japan has some six thousand trading companies, but only about forty are truly world players. The ten major ones in the 1960s had sales and personnel figures comparable to other companies in Fortune's International 500. The most prominent include Mitsubishi Trading, Mitsui Bussan, C. Itoh, Marubeni, and Nissho Iwai. Beyond the brokering function implied by the term "trading company," these organizations provide an array of comprehensive services including research and development; location of markets, components, and raw materials (particularly overseas); third-party trade; major overseas construction; resource development; planning and development; and joint ventures. During the 1960s, the top ten companies handled between 50 and 60 percent of all of Japan's trade, as well as 20 percent of domestic wholesale business. The total value of their operations was typically twice the national budget and 30 percent of GNP.¹⁰² Moreover, trading companies played a key role in advancing trade credits to firms involved in the export of goods, generally providing about one-third of the capital used by nonfinancial corporations.¹⁰³

The third and fourth key structures—the financial system and the *keiretsu*—are interlinked. Most of Japan's larger firms, including the major trading companies and virtually all commercial banks, have been members of broader industrial groupings known as *keiretsu*. Several trace their origins and nomenclatures to the prewar *zaibatsu* holding companies, the three most prominent being Mitsui, Mitsubishi, and Sumitomo; three others—Fuyo, Sanwa, and Daiichi Kangyo Bank—are bank-centered groups developed primarily after the war.

Keiretsu structures are complicated. Although analysts have grouped them differently,¹⁰⁴ two structures of *keiretsu* can be readily distinguished. In one, the links are horizontal; in the other, vertical.

Horizontal *keiretsu* typically have from twenty to forty or more firms of relatively similar size that operate in different functional areas or markets. At the hub is the group's main bank and, normally, a trust company, an insurance company, and a trading company, all of which provide diverse financial services for the companies.¹⁰⁵ Such *keiretsu* links are like a wheel: financial institutions form the hub, while other firms, around the rim, have spoke-like connections to the hub as well as links to one another.

The main horizontal *keiretsu* accounted for a substantial portion of the total economic activity in Japan during the high point of conservatism, as they continue to do today. Although they represent only 0.1 percent of Japan's total companies, the top six have consistently accounted for roughly one-quarter of the national GNP during the postwar period. Furthermore, they account for roughly three-quarters of the value of all shares on the Tokyo Stock Exchange.¹⁰⁶

The main bank has been critical to the financing of the *keiretsu* as well as to the overall financing of business operations throughout Japan. After the end of the war

until the early 1980s, Japanese firms raised needed capital, not through the equity or bond markets, but through rolled-over loans from these main banks and other financial institutions. Predictable repayment of loans plus interest provided substantial and regular profits to the financing body. Simultaneously, since corporate dividends were taxed while capital gains were not, borrowing from banks freed the individual firm from the short-term need to produce dividends for coupon-clipping stockholders. This symbiotic relationship meant that financial institutions had a steady supply of high-quality customers, ensuring a steady stream of borrowing and interest payments, while the nonfinancial borrowers were ensured regular and low-cost access to scarce capital.

Japanese capital institutions have been highly concentrated. Whereas the United States has over 14,000 commercial banks, Japan has 158. The United States has over 1,550 insurance companies, while Japan has 24. In contrast to the 1,775 property and casualty companies in the United States, Japan has only 23. Four securities companies account for over 60 percent of all stock trades.¹⁰⁷

While the horizontal *keiretsu* involve ties among putative equals, the vertical *keiretsu* involve connections from the large firms at the top of a pyramid down through as many as five layers of ever smaller and more specialized subcontractors, distributors, and capital-dependent firms.¹⁰⁸ In just one instance, "a single large automaker typically deals with as many as 170 primary subcontractors, which in turn consign parts manufacturing to 4,700 secondary subcontractors. The secondary concerns enlist the help of 31,600 tertiary subcontractors even further removed from the parent automaker."¹⁰⁹

These smaller firms constituted a far larger portion of the total national economy than did similar firms in other industrialized democracies. In the mid-1960s, for example, only 2.4 percent of Japan's manufacturing establishments had more than a hundred employees, accounting for 38.4 percent of total Japanese employment. By way of contrast, the figures were generally much higher in France (2.7 and 59.6 percent), Germany (3.4 and 66.4 percent), the United Kingdom (16.8 and 81.3 percent), and the United States (10.9 and 76.7 percent). Only Italy with 1.1 and 45.5 percent bore any similarity to the Japanese pattern. Furthermore, wage differentials among smaller and larger Japanese firms within the same industrial sectors showed significantly wider gaps than in other industrialized countries.¹¹⁰

Ultimately, power was concentrated at the top of the hierarchy. Contractors typically divided orders among several subcontractors to gain multiple alternative sources for needed parts while keeping relatively small inventories and thus holding down fixed costs. They could shift contracts among subcontractors as rewards or punishments for past loyalties, current pricing problems, quality performances, or personal whim. Still, most contractor-subcontractor relationships rested less on simple, short-term bidding and market pricing than on fixed, well-established linkages established over time—connections that Ronald Dore aptly calls "relational contracting."¹¹¹ The vertical *keiretsu* often provided vital connections for smaller firms, whose fortunes were structurally fused with those of the larger high-value-added firms and sectors of the economy. Parent firms often assisted subcontractors

technically, financially, and managerially. Such assistance not only bound the smaller firms to the larger but also allowed them to upgrade their practices and technologies, increase their productivity, and meet changing marketing and technological needs. Many of Japan's smaller firms thus fulfilled what Michael Piore and Charles Sabel have called a "tradition of permanent innovation and organizational plasticity."¹¹² These interdependent relations reduced the competitive gap between Japan's larger and smaller firms, since export success by large firms typically meant contracts, jobs, and profits to those lower down in the pyramid. The result was a tightening of the bonds between large and small business and within the conservative socioeconomic alliance.

Finally, individual industries and *keiretsu* in Japan, as elsewhere, pursued common goals through trade associations, sectoral groups, and of course lobbying bodies. These form the final important facet of Japanese business organization and structure. In Japan there are some 14,000 business organizations, or 11.1 per 100,000 citizens, whereas in the United States there are slightly fewer total organizations in a country with twice the population—5.1 per 100,000 citizens.¹¹³ More than six hundred product-specific trade associations exist in industries such as chemicals, steel, textiles, electronics, heavy machinery, shipbuilding, and insurance. Dominated for the most part by their larger members, these associations gather a wide range of data and provide technical information and market development strategies for their members. At various times they have served as enforcers of cartel agreements, spokesmen for the collective interests of individual sectors to both the media and the government, consolidators of members' opinions on matters of government policy, and conduits between government officials and firm members.¹¹⁴

Several national associations of businesses serve almost exclusively political functions. Roughly one hundred of the major trade associations and about 750 of the largest public and private corporations in Japan are organized into the Federation of Economic Organizations (FEO, or Keidanren), which maintains a substantial permanent staff and lobbying apparatus in Tokyo enjoying regular contacts with both elected officials and bureaucrats on all manner of business and economic policies.¹¹⁵ Three other national federations address different aspects of the business community's national political concerns. The Japan Committee for Economic Development (JCED) has a membership of roughly fifteen hundred top business leaders. The Japan Federation of Employers' Associations (JFEA) is essentially the business community's antilabor arm. Finally, the Japan Chamber of Commerce (Nissho) is perhaps the most broadly representative business association in both the size and geographical scope of its membership.

In all of these ways, Japanese business groups were generally well organized, highly integrated, and structured to enhance long-term productivity while keeping labor costs low and adding to the international competitiveness of Japanese products. Large and small firms, as well as firms with divergent interests, were often linked together through the *keiretsu* system. Banking and manufacturing were also fused, principally through mutually beneficial capital transactions. In these numer-

ous ways Japanese businesses became solid supporters and beneficiaries of the conservative regime.

Agriculture

Japanese agriculture was even more internally cohesive than Japanese business. One of the most important organized economic interests in the conservative regime was Nōkyō, an acronym for the National Association of Agricultural Cooperatives. A vast and comprehensive organization, Nōkyō has national, prefectural, and some ten thousand local organizations whose members include 99 percent of the farm families in the country. At the village level, cooperatives provide purchasing, marketing, and credit facilities, crop spraying, and equipment. They run banks, insurance companies, and small credit bureaus, as well as driving schools and mail-order bride services. Total sales from Nōkyō-affiliated businesses rank them second only to Toyota, and include a major trading company, Japan's seventh-largest bank (Nōrin Chūkin) and the world's largest insurance company (Kyōsairin). From an electoral point of view, the cooperatives were also important as a tool for voter mobilization, almost exclusively for conservative politicians.¹¹⁶

In addition to their "pressure group" tactics, including pressing for higher government support prices and against agricultural liberalization, the agricultural cooperatives performed a wide range of semigovernmental tasks for the Ministry of Agriculture, Forestry, and Fisheries. They were long essential to the government's food purchase program under the Food Control Agency, handling 94 percent of all rice marketed each year.¹¹⁷ The government meanwhile provided regular fees to Nōkyō for the storage and delivery of agricultural goods. As Donnelly notes, "The cooperative system is fundamentally a creature of the government and retains political rights to 'functional representation' in national policymaking. The relationship between the nation's most significant farm group and state officials is one of reciprocal influence since government ministries rely heavily on the cooperatives as an administrative mechanism and political means to organize the rural sector behind national policy."¹¹⁸

Not all economic interest groups were so extensively woven into the fabric of the conservative regime. The agricultural cooperatives were hardly unique, however. Various associations of doctors, dentists, and other professionals, along with such noneconomic groups as veterans' and educational groups, shared many of the same traits.¹¹⁹

The Conservative Regime's Internal and External Relations

Considerable attention has been devoted to assessing the relative power of bureaucrats and politicians, on the one hand, and of bureaucrats and businessmen on the other. The implication is that these groups remained internally cohesive while involved in zero-sum games with one another.¹²⁰ Nothing more distorts the realities

of Japan's conservative regime during the mid-1960s, particularly with regard to its policy of embedded mercantilism.

Without a doubt, even when the conservative regime was at its most harmonious, conservative politicians, career bureaucrats, and businesspeople frequently operated from different motivations, career orientations, personal skills, and organizational loyalties. The politician's electoral vulnerability and the civil servant's career security have distinct consequences. The civil servant can claim a "national" perspective while the politician can retort that he is closer to "the people." Business leaders must "meet a payroll"; civil servants and politicians do not.

Such differences were not irrelevant to political conflicts. But far more pervasive were the extensive ways in which all three spheres mutually supported and depended on one another, particularly as regards the broad agenda of an embedded mercantilist economy. Moreover, when conflicts did emerge within conservative ranks, these were far more likely to follow functional and structural lines than clearly defined political, bureaucratic, or business lines. This was particularly true during conservative dominance in the 1960s.

Politicians have formal control over civil servants and top civil service promotions are subject to cabinet (and hence political) oversight.¹²¹ On the other hand, only two political appointees, the minister and the vice-minister, oversee most government agencies; these have rotated in and out of office almost annually. The result is thus a limit on day-to-day political oversight of the civil service. Moreover, investigations of public problems are typically initiated and carried out within the bureaucracy rather than in the parliament, and such investigative committees are disproportionately staffed by bureaucrats and former bureaucrats. Parliamentarians have small staffs and are rarely in a position to challenge bureaucratic expertise. Furthermore, the civil service has virtually no paths for horizontal entry, limiting the utility of patronage as a tool for politicians.

Elected officials have often forced changes in proposals offered by one or more agencies in the civil service, particularly when these have gone against electorally favored constituent groups.¹²² At other times, civil servants have shown remarkable ability to frustrate the efforts of elected officials to whom they are nominally responsible.¹²³ As in most countries, top civil servants in Japan are invariably "political bureaucrats."¹²⁴ Rarely can they ignore "political realities." Nor can politicians ride roughshod over the frequently better informed civil service.

Further adding to the mutuality of the relationship, many retired bureaucrats actually became politicians. From the late 1950s through the early 1970s Japan's prime ministers were all former bureaucrats. Kishi, Ikeda, and Sato reigned from 1957 until 1972; also powerful within the party at the time were Shiina Etsusaburō, Fukuda Takao, and Ōhira Masayoshi. And within the cabinet, ex-bureaucrats occupied no less than 45 percent, and often as much as 55 percent, of the cabinet positions from the first Kishi to the third Sato cabinets.¹²⁵ Approximately one-quarter of the LDP's members were also former civil servants.¹²⁶ The result during the period was a blurring of the line between elected officials and career civil servants.

Meanwhile, even though many individual conservative politicians gained some degree of specialized policy expertise, almost all depended heavily on the civil service for information, policy know-how, initiative, and the day-to-day running of the government. Most politicians, in Japan as elsewhere, are more focused on maintaining their electoral viability than on governance per se. It is primarily when bureaucratic actions threaten electoral viability that politicians and bureaucrats clash.

There have been undoubted conflicts between governmental agencies and the business world on many specifics of regulation, allocation of government funds, business cooperation with government plans, and the like. But far more striking is the extent to which these two components of the conservative regime complemented one another's activities and cooperated in pursuit of the regime's key goals of high growth and marginalization of the opposition.

One important means by which these interests were fused was the well-known *amakudari*, whereby senior civil servants would typically retire in their mid-fifties and would gain subsequent employment in private corporations or in the trade associations of those firms. During the late 1960s, 40 retirees from the Ministry of Finance, 26 from International Trade and Industry, 21 from Transportation, and 17 from Construction would annually make such moves. Even larger numbers joined the managerial ranks of various public corporations while still others entered local governments (as well as those smaller numbers noted above who sought national elective office as members of the LDP).¹²⁷

In addition, business-bureaucratic ties were bolstered by the mutual sharing of information and the joint development of policy positions. Japanese firms were required by law to supply far more detailed information to government agencies than was true in most other countries. Moreover, an extensive network of about 250 formal advisory committees and discussion groups, and three or four times as many informal ones, regularly brought together extensive cadres of businessmen, bureaucrats, academics, and journalists to prepare policy proposals. Most large corporations, likewise, would detail one or more of their senior managers to spend two to three hours daily at the government agency responsible for overseeing the firm's activities, providing an ongoing exchange of information.

In finance, the extremely limited amount of negotiable debt, the limited private capital market, and the power of the Bank of Japan (BOJ) to increase or decrease the money supply made the latter the single tap through which virtually the entire Japanese monetary and credit supply had to flow. In the mid-1960s, the BOJ was less a "lender of last resort" than virtually the sole lender. Borrowing from the BOJ was a privilege, not a right, which made even Japan's largest and presumably most independent banks deeply sensitive to BOJ and MOF policy preferences.

The high debt-equity ratio of Japanese corporations meant that slight changes in BOJ monetary policies could rapidly shift priorities and incentives for numerous actors within the Japanese economy as cash was pushed through the city banks or withheld from specific sectors or firms. Modest alterations in the discount rate that might take months to be felt in other countries had an almost instant effect in Japan.

The Japanese government, from the MOF through the BOJ and the city banks, thus had the capacity to exert tremendous leverage over Japan's many debt-ridden corporations. But such actions demanded government-business collaboration.

The broadly cooperative relations between business and the bureaucracy can be traced back to a common set of economic goals and a politics based far more on consensus building and cooperation than on formally outlined legal powers coupled with extensive punishments for the noncompliant. For the Japanese bureaucracy to lead in the economic arena, it had to forge a consensus, not issue a command. In the bureaucratic oversight of the economy, John Haley argues, "few adversarial issues arose, and those that did could be resolved cooperatively. For this reason, the inadequacy of formal legal sanctions seldom posed a problem. Most governmental actions were designed as benefits and therefore the question of how to compel compliance rarely surfaced."¹²⁸

Consequently, it was always the individual firm that remained the key decision-making unit in the Japanese economy—no matter how responsive the firm was to government economic policies during the 1950 and 1960s, no matter how much it benefited from integration into financial and manufacturing networks, and no matter how much its destiny was shaped by broader macroeconomic policies beyond its control. Ultimately, national economic successes and failures reflected the sum total of the successes and failures of myriad individual firms. As Fritz Scharpf puts it, "Since market economies are by definition highly decentralized, the goals of government economic policy cannot be directly realized by government action. They are produced by the innumerable microeconomic decisions of producers and consumers, employers and workers, capital owners and investors. All of them are generally assumed to pursue their own microeconomic goals, and they are not directly concerned with the impact of their choices on the overall performance of the economy."¹²⁹

Business simultaneously maintained close connections to the LDP primarily through financial backing of the party, its factions, and its individual members. While most large firms did not get directly into the process of voter mobilization, many smaller businesses and professional associations did so.

If a number of broad linkages brought business leaders, bureaucrats, and conservative politicians together, the structural separation of parliament, the LDP, and various executive agencies was often a source of conflict within the conservative regime. But such structural divisions fell almost exclusively along common functional lines. "The Japanese bureaucracy," for example, is in fact a jumble of agencies, ministries, bureaus, divisions and sections, line agencies, and quasi-public corporations. Each has its own jurisdictional sphere; each acquires political resources through interactions with other bureaucratic and private entities, and each is staffed by individuals whose motivations are conditioned in large part by discrete structures of rewards and tenure.

Similarly, parliamentary committees and committees within the Policy Affairs Research Council of the LDP were similarly organized along functional lines, making it hard to talk about any real policymaking role for the LDP as a whole. Indi-

vidual politicians and civil servants with compatible functional interests and responsibilities typically interacted with one another on an ongoing basis.¹³⁰ Intra-conservative conflicts consequently fell most often along functional or sectoral lines—finance versus education, foreign affairs versus regional development, telecommunications versus international trade and industry, and so forth. Mixtures of politicians, bureaucrats, and interest associations were aligned on either of the two (or more) sides of most economic issues; rarely did these generate clear-cut divisions between the two types of careerists or between a unified business community on one side and a governmental community on the other.¹³¹

There is no denying the divisions, conflicts, and disagreements that have occurred within the top ranks of the conservative regime even when it was most harmonious. This is to be expected in any high-stakes political situation. But such skirmishes must be balanced against the broad agreement between the business sector and the executive and legislative branches.¹³² In stark contrast, groups and individuals outside the conservative circle were the regime's constant critics, although their influence was typically marginal.

At its height, the conservative regime's coherence was enhanced by the lack of countervailing powers from nonconservative or independent interest associations. Rarely were members of the conservative camp seriously tempted to break ranks and ally themselves with members of the opposition. Far more frequently, actual or potential opponents were drawn into the ambit of the conservative regime, for, except in the rarest of exceptions, it was only by cooperation with conservatives that they could ensure the achievement of even a small portion of their goals. As noted, interest groups in Japan require official recognition. But few groups, once recognized, sought to maximize their political leverage by distancing themselves from either the government or the LDP. Instead, the long-standing conservative dominance compelled most associations—with the notable exception of labor unions, student associations, and peace groups—to enter into some form of regularized alignment with the conservative party or with a government agency. The most typical pattern would be for a newly formed group to forge links with the LDP and then, as it gained political acceptance, to build ever stronger ties with the bureaucratic agency most immediately responsible for its particular sphere of activities.¹³³

These ties to a specific authorizing bureaucratic agency were developed and maintained through corporatist arrangements. Japanese interest groups have typically functioned within well-institutionalized and interdependent networks of cooperation with one or more specific government agencies.¹³⁴ These ties were established through a variety of means: legal statutes that empowered particular interest groups to perform a range of quasi-governmental administrative tasks and provided them with government financing, the creation of public corporations and extradepartmental groups (*gaikaku dantai*) that fused official and quasi-official tasks, and regularized contacts through advisory committees, official surveys, post-bureaucratic jobs (*amakudari*), and the like.¹³⁵

If most interest groups were largely ineffective as counters to the conservative regime, the media has only rarely been an independent voice of criticism. The press

clubs' narrow membership, their consensual nature, and their tendency to report uncritically the views of the particular government agency or politician they cover have made independent and critical journalistic judgments of government actions from the establishment press rather rare. Television news, long dominated by NHK—the government-run public broadcaster—long tended to follow a predictable pattern: Japan faces problem X; government agency Y is in charge of dealing with X; advisory committee Z, under agency Y's aegis, has been assigned to examine X; the committee has just issued this report: new legislation is pending; problem X is resolved. In short, the media covered events largely as a stimulus-response model: problems were stimuli to which the government responded. The citizen, meanwhile, should be comforted by the knowledge that "appropriate authorities" were coping.¹³⁶

Labor was the socioeconomic sector most excluded from the ties forged by the conservative parties, the national bureaucratic agencies, big finance, big industry, and the smaller and medium sized firms. During the 1960s, when labor was playing substantial and even commanding roles in the political economies of other democracies, Japanese unions were marginalized at the level of national politics, and at the plant level were integrated largely under management's agenda.

At the national level, labor was marked by diffusion rather than cohesion. Union membership was not especially high by the mid-1960s; roughly 35–38 percent of the workforce was unionized (well below the Swedish level of over 90 percent and Britain's roughly 50 percent, but comparable to West Germany's 37 percent and well ahead of the United States with only 25 percent). Hence, 60 percent or more of Japan's labor force was nonunionized. Furthermore, nearly 40 percent of the 12,500 unions in Japan lacked any affiliation with a national federation. Only six unions had memberships of over 100,000; over 2.1 million of Japan's 12 million union members were in organizations with fewer than 300 members.

Labor's voice was further dissipated by competition among the major federations for union affiliation. The largest of these, Sōhyō, represented only one-third of the nation's union members, and the bulk of its affiliates were from public-sector unions. The next largest federation, Dōmei, represented only about 15 percent of the unionized workforce, and it was made up largely of private-sector workers. Moreover, three political parties—the JSP, DSP, and JCP—all claimed to be the genuine political representative of labor. A substantial portion of the total number of parliamentarians from these three parties have been active or retired labor unionists.¹³⁷

It was these labor federations, and the political parties of the left, that most actively articulated a political voice for Japanese labor. Aiding this effort at unity was a tactic known as *shuntō* (spring offensive), an annual ritual of wage bargaining. Furthermore, the political parties of the left sought to identify themselves with "the interests of the working class." Yet, as Ōtake has argued in regard to the JSP—but as was more widely true of the JSP, JCP, and Sōhyō—these groups placed the bulk of their political attention on matters of defense, security, and criticisms of American bases and landing rights in Japan, as well as what they perceived as a

growing Japanese militarism. All were far less quick to articulate pragmatic economic policies challenging those of the conservative regime.¹³⁸

Meanwhile, as early as the mid-1960s, individual unions were gradually being integrated into conformity with managerial objectives at the level of the individual firm. If management deemed an individual enterprise union too radical, it would frequently encourage and endorse a so-called "second union," staffed by more moderate workers. Management would then use this second union to isolate and sidestep the more radical union. Radicalism gave way to what Dore has referred to as "amiable social contacts" between the new unions and management.¹³⁹

Most important, Japanese unions were almost exclusively formed along enterprise, rather than craft or industrial, lines. Hence, in the private sector at least, labor's interests could easily be treated by management, and be seen by workers, as congruent with those of the firm. Horizontal linkages among workers as a class carried less weight than did vertical links among "Asahi employees" or "Seibu Railway workers." Bread-and-butter unionism, rather than class consciousness or national politics, became private-sector labor's dominant orientation. For a much longer period, public-sector unions remained far more politicized, but even more economically marginalized.

In these ways, then, Japanese labor developed along a unique historical trajectory. Individual unions were structured in ways that maximized close identification with firm interests, while at the national level no political party with substantial backing from organized labor managed to gain even the slightest foothold in the executive branch of government (except for the essentially irrelevant six months when the socialists held power under the U.S. occupation in 1947–48, and when policy control rested with the Americans not with the Japanese). Consequently, organized labor could be, and usually was, highly marginalized in the formation of national economic policies.

Most challenges and criticism of the conservatives were consequently left to diminutive opposition parties at the outermost boundaries of the politically acceptable. Rarely were opposition groups effective day-to-day players in the give and take of policy resolution.¹⁴⁰ Citizens and unrecognized interest groups were relegated to positions even further out on the periphery.

Neither from within the regime nor from without were serious challenges posed to the broad policy outlines of embedded mercantilism. Instead, virtually all important segments of Japanese society and all major political institutions either supported the policy or remained neutral; opponents were ineffective in changing it. The result was Japan's singular political economy.

The portrait of Japan in the mid-1960s is of a country pursuing an economic policy mixture of embedded mercantilism, a policy dependent on a closed market at home and on extensive barriers to the import of both manufactured and consumer products as well as to most foreign direct investment. It also depended greatly on a strong governmental bureaucracy actively attempting to catalyze growth in the private sector through a host of oligopolistic and export-oriented policies.

The political bases of these policies at home were clear. Interlinked policies permitted key elements in Japan's conservative coalition to engage in mutually profitable back-scratching. Most businesses, but especially large businesses, benefited tremendously from economic policies during this time; they in turn were often closely linked to smaller contractors and distributors, while both groups rewarded conservative politicians with financial contributions. Agriculture and smaller businesses benefited from state subsidies and protection from foreign competition. The tradeoffs meant extensive electoral support for the LDP. With powers derived from an extensive tool kit of laws, regulations, and ordinances, most governmental agencies also profited from such policies, even if it meant being formally under the supervision of politicians from the LDP. The regulatory powers of agencies were reinforced while their budgets grew. Bureaucrats who worked closely with conservative politicians, private business, and financial firms could look forward to promotion within their agencies and to profitable and rewarding jobs upon retirement. And ultimately, the LDP benefited from high levels of electoral support at home, support from the United States in most international matters, and from the talented policymaking efforts of its national bureaucracy.

In numerous ways, then, the conservative regime in Japan was quite unlike that of any of the other industrialized democracies. Certainly, it bore few similarities to Swedish corporatism, U.S.-style pluralism, or two-party British politics, despite the ways in which bits and pieces of the Japanese political economy may have resonated with elements in one or the other. Certain similarities to Italy are somewhat more striking, but Italian labor was stronger, conservative electoral dominance was far less pervasive, parastatals and patronage were far more sweeping, and Italy's overall economic success paled in comparison to that of Japan.

From the standpoint of the 1990s, the Japanese conservative successes of the mid-1960s to mid-1980s seemed foreordained, as did the rather unusual character of the Japanese regime. However, this was not the case in the 1950s, when Japanese politics and economics were far more fluid and open to alternatives. To appreciate the difficulties inherent in creating the conservative regime, it is essential to revisit that period and reexamine the chaos and confusion that prevailed prior to the conservative hegemony.



From Chaos to Cohesion:

Formation of the Conservative Regime

During the mid-1960s, when the conservative regime was functioning at its smoothest, Japan's combination of conservative political dominance and economic strength seemed an inseparable composite of logic and inevitability. The interlocking spiral of continuous electoral and economic successes make it difficult to imagine the Japanese political economy operating in ways fundamentally different from that described in the previous chapter.

At its height, the regime interacted with a fluidity that was indeed overly determined, mutually reinforcing, and relatively unproblematic. The Liberal Democratic Party fostered a persistently positive climate for economic growth; continued economic success reinforced the LDP's electoral hammerlock over the Japanese voting public.¹ In the phrase of Kozo Yamamura, the links between politics and economics were a "marriage made in heaven."²

Logical or inevitable as the relationship appeared with hindsight, the smooth-flowing regime of the mid-1960s was far from historically inevitable. Nor was Japan's postwar political conservatism and rapid economic growth simply a logical resumption of the country's "interrupted" prewar economic or cultural trajectory. The postwar Japanese regime was far too different, politically and economically, and the first ten to fifteen years after the war were far too pregnant with alternative possibilities to treat Japan's subsequent conservative regime as either endemic or inevitable. Rather, Japan's postwar miracle machine was new, politically constructed, and historically contingent.

The overarching questions for this chapter concern how the various pieces of Japan's postwar regime came together. How did Japan develop such centralized institutions in its political economy? How did it create an electoral politics with such limited control over national policy formation? How did conservatives weave together such an unusual socioeconomic coalition, fusing big and small business with