



## Japan in the 1990s:

### Fragmented Politics and Economic Turmoil

Japan in the mid-1960s was a country characterized by rapid economic development, rising standards of living, a close military and economic relationship with the United States, an exuberant summer Olympics, and a conservative electoral dominance in a sharply bifurcated left-right spectrum. The mid-1990s contrasted fundamentally. The stability of the old regime had been substantially undermined, and although no new equilibrium had been established, a new regime of undetermined shape was forcing its way onstage.

Japan's transformation was manifested in many ways. First, enduring institutions of conservative political dominance had been reconfigured. The previously stable party system had been completely deconstructed and the once sharp left-right division between government and opposition had disappeared. Parties broke apart and combined with total disregard for policy or ideological differences. Of the parties that existed in the 1960s, only the LDP and the JCP remaining nominally intact, and the former had undergone substantial internal fragmentation and lost its dominance in July 1993. The electoral system, once a vital underpinning of conservative electoral success, was also new. The once vaunted Japanese bureaucracy plodded through a range of problems mired in red-tape-laden ineptitude, popular mistrust, the sweeping reorganization of various agencies, the loss of numerous powers, and the promise of even further change.

Second, Japan's seemingly endless string of economic achievements ended with the puncturing of an economic bubble. The simultaneous collapse of both stock and real estate prices ushered in eight years of limp growth,<sup>1</sup> a staggeringly expanded national debt, a systemwide financial crisis, and a destabilized yen that strengthened from 120 to 80 yen per dollar between 1993 and 1995, only to be pierced by a massive intervention in September 1995 that sent it tumbling back toward 145 yen by mid-1998.

Meanwhile, the warm, fraternal, and dependent relationship with the United States, solidified by their common cold war opposition to the USSR, China, and communism, had given way to technonationalist competition in a host of economic sectors. Moreover, Japan's long-standing policy of avoiding activist diplomacy and use of its troops abroad had changed in a strategically insignificant but ideologically monumental way when Japan agreed in 1991 to allow Japanese military personnel to participate in UN peacekeeping operations overseas.<sup>2</sup> Then, during the Taiwan Straits crisis of 1996, Japan deployed a Naval Self-Defense Forces cutter as part of a show of force against China. And finally, with only the most minimal domestic debate, Japan redrew the lines of its security arrangements with the United States to expand Japanese military commitments.

Finally, from a socioeconomic standpoint the 1990s were strikingly different from the 1960s. Organized labor, the unquestioned source of support for parties of the left in the 1960s, continued to decline in membership, abandoned its class rhetoric, and had been incorporated into a plant-level economic unionism that reduced its role as an ideological partisan. Internal divisions arose, meanwhile, among once stalwart conservative support groups. Farmers became politically divided in the face of a threatened liberalization of agricultural imports. The business community meanwhile showed signs of internal divisions between, on the one hand, internationally competitive firms and sectors anxious to reduce the burden of bureaucratic regulation and taxation and, on the other, less competitive firms and sectors anxious to retain those bureaucratic regulations and tax benefits that provided them with extensive public subsidization and protection from foreign competition.

As this chapter will show, by the late 1990s Japan's old conservative regime had undergone such fundamental changes as to warrant the designation "regime shift." This is not to deny a number of real and important continuities. To cite only the most vivid, Japan still enjoyed "conservative" governance. Party reorganization was not the result of massive voter mobilization; it did not sweep out an old political elite and replace it with new personalities. Indeed, as of mid-1998 a reconstituted LDP enjoyed a slim majority in the Lower House and controlled all cabinet positions. Meanwhile, the national bureaucracy retained considerable power, particularly in regard to the regulation of both economy and society. In Steven Vogel's terminology, Japan had undergone "reregulation" but not "deregulation."<sup>3</sup> And despite many shifts in economic policy, numerous Japanese firms were highly profitable, Japanese foreign reserves were the highest in the world, and Japan's home markets remained among the most closed in the industrial world.

To many, such continuities were by far the most important *honno*, or realities, about Japan in the 1990s; such changes as appeared were little more than superficial *tatema*. Determining when changes are "real" or "superficial" is obviously a matter of the standards one sets. In the case of Japan, for many observers, "real economic change" hinges on the extent to which the country undergoes privatization, deregulation, and greater sensitivity to international market forces. Political change is similarly "meaningful" only if the country moves toward two-party competition,

less dominance by filthy lucre, higher minded policy debates, and a greater degree of party and citizen control over haughty bureaucrats and corrupt politicians. Finally, “real change in security policy” would require policies that emerge from a more nationally conscious and self-confident Japan—a Japan that had strengthened its military capabilities and displayed increased military and diplomatic activism in Asia and the world.

Such formulations misstate and oversimplify the problem of change, posing standards for a “truly changed” Japan that are implausibly out of touch with Japanese realities. Social changes rarely result in transformations as dramatic as those of the frog who, upon being kissed by the princess, turns instantly into a handsome prince. Few important socioeconomic changes ever completely sever links to the past, as the regime shifts in Sweden, the United States, Britain, and Italy make clear.<sup>4</sup> Social transformations are still path dependent, even when those paths involve sharp turns. To expect otherwise ignores the more nuanced ways in which alterations in any political economy occur. Change in Japan typically has been a matter of two steps forward and one step back. Vestiges of the past are interwoven with foreshadowings of the future. As the analysis below will show, substantial and ongoing changes in Japan are putting into place a new regime whose eventual equilibrium will be quite distant from that which prevailed in the 1960s.

I begin with a sketch of prominent events of the early to mid-1990s. These events and those of the 1960s (discussed at the start of Chapter 2) epitomize what I believe are two fundamentally different regimes. I then examine the three key regime components—public policy profile, socioeconomic coalitions, and political and economic institutions. Although some features of all three retain significant elements from the regime outlined in Chapter 2, the more compelling picture is one of change and transformation. I conclude with several observations on the continuing tensions whose eventual resolution will shape whatever stability emerges from the present uncertainty.

### The 1990s: Conservatism's *Anni Horribili*

If 1964 was something of an *annus mirabilis* for Japanese conservatism, then the 1990s represented a succession of *anni horribili*. Following a massive stock and land price collapse that began with the first day of the decade, the next five years saw the Japanese economy growing at a sluggish 1.9 percent per year; the last two years saw growth below 1 percent; and by the end of 1997 GDP was actually falling, with economists predicting growth at or below 2 percent for 1998. Manufacturing productivity for most of this period remained below the index level of 1990; only in 1997 did it begin to show a return to growth.<sup>5</sup> Japan's stock market languished 58 percent below its record high on December 31, 1989. Corporate bankruptcies exploded. Included were a number of huge firms, once thought “too big to fail,” such as Yamaichi Securities, Hokkaido Takushoku Bank, and Nissan Mutual Life Insurance. The result was to drive the value of total bankruptcies in 1995 to

nearly double their previous high. Public-sector debt was close to 100 percent of GNP and greater than in virtually any other industrialized country; when private-sector debt is included, the figure soared to over 200 percent of GNP. The 1990s marked the longest period of economic sluggishness in Japan's postwar history and mired the country at or near the bottom of the industrialized democracies, the opposite pole from that which it had occupied during the 1960s.

Developments in the 1960s portended enhanced international competitiveness for Japanese firms in cutting-edge industries. Developments in the 1990s suggested just the opposite. In a few industries, such as automobiles and consumer electronics, Japanese firms continued to lead their international competitors; for example, in 1997 Toyota introduced a mixed electric-gasoline engine car vastly ahead of any of its competitors, and Honda introduced a zero-emissions model. New carbon-fiber technologies, digital telecommunications, cell phone standards, ground-wave digital television, and even point-of-sale retailing from companies as diverse as Toray Industries, NTT Mobile Communications, Matsushita Electric, and Ito-Yokado led the world. But the competitiveness of Japanese industry more broadly was suffering. For example, the World Economic Forum in 1997 ranked Japan only fourteenth in international competitiveness, a dramatic contrast to its glory days as recently as 1990, when it stood in first place.<sup>6</sup> Japan lagged in key industries: cable access was among the lowest in the industrialized world; personal computer use was only one-third the per capita rate of the United States and lagged behind countries such as South Korea and Singapore; only 10 percent of Japanese used computers at work, and of these only 13 percent were connected to networks. Japan also had lower internet traffic per capita than almost all OECD members, as well as Israel, Hong Kong, and Taiwan.<sup>7</sup> Japanese firms lagged significantly behind European and American firms in mobile telecommunications, while in finance the once dominant Big Four brokerages saw their share of domestic equity sales fall to 25.8 percent in August 1997, putting them below the 32.4 percent share held by the Tokyo Stock Exchange's twenty-one biggest foreign brokerages.<sup>8</sup> Establishment clients like Nippon Telephone and Telegraph allowed their European bond issues to be underwritten by Merrill Lynch and Morgan Stanley without any Japanese brokerage participation. Even the Tokyo government was regularly using foreign syndicates to underwrite its municipal bonds.

Overall, the character of the Japanese economy had become less closely tied to the performance of exclusively Japanese-owned firms operating in, and dominating, the domestic market. Instead, many nominally “Japanese” firms had become truly multinational, moving beyond a pattern of export from behind the protected Japanese market, into overseas production, financing, research and development, and technological alliances. As a result, their successes and failures became decoupled from the tight bureaucratic controls of the 1960s. Elsewhere, the result was global partnerships between Japanese-owned and American- or European-owned firms—alliances such as Mazda and Ford, Toshiba, Motorola and Siemens, Hitachi and Texas Instruments, Mitsubishi and Daimler-Benz. In still others, it involved substantial outsourcing of production by once exclusively “Japanese” firms like

Honda, Sony, Toyota, Canon, and Hitachi. And in still other instances, it has meant the penetration of core Japanese domestic industries such as insurance, finance, brokering, and telecommunications by non-Japanese firms such as Merrill Lynch, American International Group, World Com, Dresdner Bank, Jardine Fleming Holdings, and the like. The sacrosanct boundaries that had marked the Japanese economy in the 1960s had become vastly more permeable by the 1990s. Moreover, the competitive pace within Japan was frequently being set by foreign-owned firms, such as Microsoft with Windows 95, Citicorp with twenty-four-hour ATMs, or GE Capital in insurance.

Economic transformation was the backdrop to the more comprehensive breakup of the old regime. The long-ruling Liberal Democratic Party split in July 1993, its thirty-eight year control of government giving way to a series of coalitions which over the next three years saw eleven different political parties sharing power and four individuals holding the office of prime minister. Among the new chief executives was Murayama Tomiichi, then leader of the conservatives' *bête noire*, the Japan Socialist Party. Political change was unmistakable.

The LDP was also mired in corruption scandals. These were hardly new to Japan or to the LDP, but the Recruit scandal (1988–89), which forced Prime Minister Takeshita to resign, made it unmistakable that massive amounts of money were suffusing electoral politics. The subsequent Sagawa Kyūbin case added to the perception. Longtime political godfather and LDP Deputy Prime Minister Kanemaru Shin was arrested on March 27, 1993, in conjunction with a payoff of ¥500 million from an up-and-coming trucking company seeking special treatment from transportation regulators. The Kanemaru scandal made particularly good television coverage when public prosecutors dragged some ¥3 billion in anonymous bond certificates, tens of millions of yen in banknotes, and some 100 kilograms in gold bullion from his various offices, town houses, and suites. The scandal also implicated several former civil servants in local governments, high-level officials from a series of construction companies, and a former minister of construction, Nakamura Kishirō, who became the first politician in twenty-seven years to be arrested while the parliament was in session.

In addition, media revelations streamed out about brokerage houses making payments to favored customers, thereby “guaranteeing” particular rates of return; massive donations by corporations at “encouragement parties” held by politicians; shady to undeniably illegal ties among brokerages, organized crime, and LDP politicians; massive local government expenditures for entertainment of national officials; bid rigging for public construction projects; and a host of other examples of “money politics.”<sup>9</sup> While the net of inclusion of Japanese elites was somewhat less comprehensive than Italy's *Tangentopoli*, the unceasing Japanese scandals spread ever wider revealing a level of systematic corruption far deeper and more pervasive than any hinted at in earlier Japanese corruption cases.

Large-scale Japanese businesses were particularly upset by the extent of the corruption. The costly structure of doing business within the country—with its political bribes, high entertainment costs, and irrational and often whimsically inter-

preted regulations—led to demands for political reform. When it became clear in 1993 that the LDP, under Prime Minister Miyazawa, would not back the reforms demanded by business, the major business association Keidanren cut off automatic contributions to the party.

As the climate of criticism grew, a number of conservative politicians, but most notably Ozawa Ichirō (himself ironically a close ally of Kanemaru and a major recipient of monies from Sagawa), jumped on the “reform” bandwagon. The issues of corruption and astronomical electoral costs became fused with the call for what many conservative politicians had long hoped for: a replacement of Japan's multimember electoral system with some version of a single-member district system. The implicit, though unsupported and perhaps unsupportable, claim was that Japan's multimember district system inherently required vast sums of money which a single-member district system would reduce. A revised electoral system became equated with “political reform,” and in 1994 a new system was enacted.<sup>10</sup>

The LDP was also mauled electorally. In the April 1995 Tokyo gubernatorial race seasoned ex-bureaucrat Ishihara Nobuo, despite the endorsement of every major noncommunist party, lost to a former actor by roughly a half-million votes. Simultaneously, in Osaka, another ex-bureaucrat fell to a former television comedian. Retired bureaucrats did poorly in the 1996 lower house elections as well. In the Upper House election of July 1998 the LDP was pummeled, winning less than 35 percent of the contested seats.

The previously cozy ties between cabinet and bureaucracy also were ruptured. Long tradition had kept promotions and retirements within the Japanese civil service relatively insulated from direct political interference. But on December 16, 1993, a member of Ozawa's *Shinseitō*, Kumagai Hiroshi, took over as MITI minister and, as one of his first acts, forced the retirement of the leading candidate for the highest nonpolitical position in the ministry, Naitō Masahisa. This explicitly partisan effort by the new, non-LDP government, shattered one of the key institutional arrangements of the previous conservative regime, namely, the “nonpartisan” treatment of all bureaucratic promotions.<sup>11</sup>

During the mid-1990s the national bureaucracy was mired in a series of gaffes and unparalleled ineptitudes that dramatically undermined its credibility as the stalwart guarantor of national success. Several of the more outrageous examples convey the general problem.

In January 1995 a massive earthquake struck the port city of Kobe and killed more than six thousand people. Lacking any emergency preparation or central control facilities, government officials took days to mobilize help. Meanwhile, national and international astonishment grew as bureaucratic agencies enforced seemingly absurd regulations that, among other things, prevented Swiss body-searching dogs from entering Kobe for rescue efforts without first undergoing six months of quarantine, denied an offer of free mobile telephones for use in rescue work because the phones lacked appropriate “certification labels” for the Kobe region, refused foreign blood and emergency supplies as “unnecessary” despite the apparent inability of the

government to mobilize and deliver the proffered items, and kept emergency Self-Defense Force personnel out of the city because of real or imagined antimilitary sentiments by local politicians. Response to the Kobe earthquake showed the Japanese civil service at its “bureaucratic” worst.

Two months later, a different batch of agencies revealed their own ineptitude. On March 20, 1995, a group of religious zealots from the Aum Shinrikyō sect unleashed sarin gas at the Kasumigaseki subway stop in Tokyo, killing several and affecting over 5500 others. The attack was the culmination of a series of activities by the cult over several years that had included murders of its critics and those seeking to escape its network, the purchase of multimillion-dollar arsenals of weapons from the United States and Russia (including an MI-17 helicopter), a similar gas attack in the town of Matsumoto during June 1994 that killed seven and injured six hundred, and a series of thinly veiled warnings from a radio station the group had purchased in Vladivostok and was using openly to broadcast its apocalyptic intentions within Japan. Throughout that period neither the Japanese police, the Japanese Customs Office, nor various security agencies gave any hints of detecting anything to arouse their suspicions or help them prevent the subsequent attacks.

The Ministry of Health and Welfare had its own scandal as it was revealed to have colluded with commercial suppliers to allow HIV-contaminated blood to be donated to Japanese patients, primarily hemophiliacs. Both the ministry and the suppliers had ignored new and safer blood treatment procedures in an effort to avoid the costly destruction and replacement of the tainted blood. At the end of 1996, the ministry was again in the news as Administrative Vice Minister Okamitsu Nobuharu resigned amid charges that he had been given membership in a country club worth ¥16 million, along with other expensive favors, by the owner of a company that operated a string of old-age homes and had been seeking ministry subsidies of ¥9 billion to build new facilities. Okamitsu proved to be just the tip of an iceberg that eventually expanded to include seven additional agency officials. Ironically appointed to the ministry’s top job in order to clean up the HIV mess, Okamitsu was eventually arrested in early December, the highest level civil servant to suffer such a fate in the postwar years.

The most spectacular of all of these mishaps was the ineptitude of the Ministry of Finance. The bursting of the economic bubble revealed that the Japanese financial sector had amassed a stunningly large collection of potentially unrecoverable loans. Officially acknowledged problem loans in November 1995 totaled ¥37.4 trillion, of which ¥18.3 was deemed unrecoverable. This meant an average of 6 percent of the loans outstanding by private-sector banks were in doubt.<sup>12</sup> By 1998 it became clear that bad bank loans totaled at least \$600 billion, plus billions more off the balance sheets of government bodies and corporations, and further billions in underfunded pension programs.

The ministry first sought to cover up the extent of the problem only to find that the good faith and credit of all Japanese banks was subject to international punishments: Moody’s, the international rating service, issued a report in June 1995 that

downgraded the credit worthiness of Japanese banks to an average rating of D (uncertain), while international money markets imposed a so-called Japan Premium of several tenths of a percent on the cost of short-term funds to Japanese banks.<sup>13</sup> Furthermore, the Bank for International Settlements (BIS) required all banks to retain at least 8 percent of its total capital in hard assets, and Japanese banks consequently found themselves having to liquidate stock holdings or property, thereby further depressing domestic markets. Through it all, the Bank of Japan continued to keep the official discount rate at absurdly low levels (0.5 percent at some stages), transferring huge sums from Japanese savers to the financial bailout.

These transfers were explicit in the so-called *jūsen* problem. *Jūsen* are housing loan companies closely tied to the farming cooperatives and nominally under the regulatory control of the Ministry of Finance, with some responsibilities assigned to the Ministry of Agriculture. At the high point of the bubble economy, the *jūsen* had been aggressive lenders, allowing borrowers to use rapidly rising land and stock prices as collateral for loans. Not coincidentally, many of these borrowers proved to have close ties to organized crime as well as to elected officials. When land and stock prices collapsed, some \$40 billion in loans became unrepayable. Several banks failed, for the first time since the 1920s, and the government eventually pushed through a program to use some \$6.5 billion from the supporting banks and the Deposit Insurance Fund to liquidate seven failed *jūsen*.<sup>14</sup> The use of public money as part of the closure scheme attracted public outcry. It was widely seen as a means of covering up the greed or ineptitude of government bureaucrats, elected officials, mobsters, LDP-connected farming cooperatives and banking corporations.

The bureaucratic sleaze affected national and local officialdom as well. Officials in twenty of Japan’s forty-seven prefectures were revealed to have squandered millions of dollars by wining and dining one another along with officials from Tokyo. Fabricated and padded expense accounts, bogus trips, and nonexistent staff were exposed as deeply entrenched “norms.” At least three governors quit and some thirteen thousand officials were disciplined.<sup>15</sup> Numerous arrests were made of mid- to upper-level bureaucrats in several agencies, and in March 1998 the arrests reached the top echelons of the Ministry of Finance as Sakakibara Takashi, a deputy director in the Securities Bureau, became the first career MOF bureaucrat to be arrested since 1948.

Arrests were paralleled by a declining technical competence of public officials, most of whom had been trained as generalists and lacked the economic, computer, and technical skills to monitor effectively the increasingly complicated and fast-moving private-sector developments in derivatives trading, currency transactions, telecommunications, and the like. In the 1960s, bureaucratic and budgetary actions had targeted the most sophisticated segments of the Japanese economy; by the 1990s they were increasingly concerned with its least sophisticated—witness such costly public works as the virtually unused ¥45 billion Fukui Port, the ¥180 billion breakwater at almost empty Hitachi-Naka, or costly “agricultural” bridges such as the ¥20 billion bridge connecting the island town of Azumacho to the mainland to allow the island’s 353 residents an “agricultural path” to easier markets.

All of this was in stark contrast to the civil service that had long burnished its reputation for consummate anticipatory skills and selfless dedication. A 1997 Mainichi poll showed that only 10 percent of respondents thought government officials were seeking to fulfill the public good.<sup>16</sup> Politicians had always been viewed as corrupt; that the bureaucracy was little better was new and shocking.

Japan also looked inept on the diplomatic front. No sequence of events dramatized this more fully than Japanese governmental reactions to Iraq's August 1990 invasion of Kuwait. Following the invasion, Japan spent four days doing what the United States did in ten hours—impose a trade ban on Iraq. Facing a choice between Iraq, the oil-producing country from which Japan got some 12 percent of its oil, and America, the country to which Japan sent some 27 percent of its exports and on whom it relied for its overall security, Japan really had no choice but to line up with the United States. But the government stumbled through a series of indecisive and contradictory moves around financial aid and the dispatch of personnel. Eventually Japan made a substantial economic contribution to the action, but the government's initial indecisiveness suggested an effort to buy off the United States rather than to pursue any systematic or considered strategy of foreign policy.

As the *Economist* noted at the time, "It is Japan's fluffing of its first—and maybe most telling—chance to show that in the new world order it will occupy something more than a narrow economic niche. Less abstractly, Japan's behavior has for now laid to rest the idea that it deserves the permanent seat on the UN Security Council it so covets."<sup>17</sup> At a minimum the Gulf crisis revealed a Japan whose foreign and security policies were far less safely ensconced in the clear network of relationships and priorities that had made it so easy to ignore China's testing of nuclear weapons in 1964. Instead, with the Gulf War, the ambiguities of Japan's international aspirations and abilities were laid bare.

Finally, in what is admittedly an artificial but symbolically important symmetry to the international successes of the mid-1960s, in 1996 Japan lost its bid to be the sole host of the World Cup and produced an Olympic embarrassment in the Nagano Winter games of 1998.

Japan had introduced a professional soccer league in May 1993. Within a few years, soccer jumped from being a poorly attended club sport to a well-funded and highly profitable professional association. Soccer matches in the newly formed J. League systematically drew more fans in both the stadiums and on television than did many baseball games<sup>18</sup> But for a last-minute draw won by the Iraqi team, Japan's national team would have made it to the 1994 World Cup, an unexpected and almost miraculous performance by a relative newcomer to international competition. The Japanese home television audience for the games from Qatar was well over 30 percent, and more than 50 percent of Tokyoites watched the final part of the last game. Clearly, soccer had added an entirely new internationalism to Japanese athletics.

This background set the stage for Japan's bid to host the World Cup in 2002. In the summer of 1994, a coalition of fifteen Japanese cities seemed absolutely assured

of gaining the Federation of International Football Association (FIFA) bid to host the Cup. Each of the fifteen had either constructed or were prepared to construct new soccer stadiums for the expected games. Each had also put up ¥235 million for the lobbying effort being undertaken by Japan's national committee. Two years later, Japan found itself, for the first time in World Cup history, reduced to co-hosting the games with longtime national rival, South Korea.

Then on the Olympic front, Nagano had won the rights to the Winter Games for 1998, in large part because of the promise of massive financial support pledged by Japan's government during the height of the bubble. But unlike the 1964 Summer Games that had so highlighted Japan's growing prosperity, the 1998 Winter Games drew attention to the nation's economic problems. With the bursting of the bubble and the downturn in the economy, sponsorship fell off, construction fell behind schedule, and the International Olympic Committee issued sweeping criticisms of athletic housing, excessive regulation, bid rigging, and the character of competitive facilities. By the late 1990s Japan's overall stature in international athletics stood in dramatic contrast to what it had been at the height of the 1964 Olympics, reflecting the far broader decline in Japan's international and economic prestige.

Indicative of Japan's international standing was its failure to acquire a permanent seat on the UN Security Council. For decades, Japan had worked quietly behind the scenes to gain permanent membership. In the late 1980s, its chances appeared good, but by the mid-1990s the entire issue had been shelved, in large part because of Japan's fall from economic dominance, as well as its fumbling of the Gulf War situation.

The broad contrast is clear. The 1960s showed Japan making massive economic and foreign policy strides under a politically unified conservative party. A conservative regime that rested on a cohesive socioeconomic coalition, a particular mix of political and economic institutions, and a public policy profile of "embedded mercantilism" were all well entrenched and enjoyed great stability. That stability benefited from a positive cycle of politics, international relations, and economics. By the 1990s the cycle was spiraling downward.

The contrast between the late 1990s and the 1960s is clear in all three regime variables: the public policy profile of the country had changed, important economic and political institutions had been reconfigured, and the predominant socioeconomic base, as well as the main lines of socioeconomic cleavage, had shifted.

This is not to suggest that all residues of the earlier regime had somehow been swept into history's dustbin. Neither politics nor economics moves in straight lines. As noted earlier, changes in Japan—as anywhere—involve untidy blendings of old and new. As the next chapter will suggest, many of these changes have been evolutionary, with few visible cataclysms marking the shifts. In other instances, there have been short-term and radical alterations, but almost always the new and the old have been cobbled together. In short, change in Japan has been path dependent; the past has continually insinuated itself into the present. But the results have been to move the country's regime far away from its earlier moorings.

### Public Policy Profile: Disembedding Mercantilism

In Chapter 2, I characterized the public policy profile of Japan's conservative regime as "embedded mercantilism." This broad-brush label covered several components of public policy including economic policy, social welfare policy, labor-management relations, and foreign policy. During the 1990s all four showed sharp breaks from past patterns.

#### *Economic Policy*

"Embedded mercantilism" involved macroeconomic policies that, for approximately the first twenty-five years after World War II (1945–71), rested on "developmentalist" catch-up. These policies included extensive economic planning; industrial reorganization; protection of domestic manufacturers, financial institutions, and agriculture; limits on foreign penetration of Japanese markets as well as on Japanese firms moving abroad; and strictly balanced budgets and fiscal tightness.

The policy tools serving these goals were many: high tariffs and restrictive quotas on most manufactured imports, tight controls over domestic consumption, restrictions on capital and technology flows into and out of Japan, a systematically undervalued yen that made Japanese exports cheap in world markets, a very restricted corporate bond market, policies to encourage high personal savings by citizens, and a strong reliance on foreign technology purchases. Furthermore, the government maintained a tight fiscal policy that kept taxes down, government small, and public expenditures low. In addition, deliberately low levels of defense spending freed up investment capital for use by domestic industries.

There was little dissent from this broad quilt of policies supporting embedded mercantilism. Political parties did not divide sharply on most of them. Although specific policies affected socioeconomic sectors differently, they provided generalized benefits to most groups. Most individual citizens enjoyed improving lifestyles while personal incomes remained relatively egalitarian in comparative terms. In short, Japan's 1960s mercantilism was indeed deeply embedded throughout the polity.

By the mid-1990s, many of these policy directions were dramatically different. Japan's capital markets and its currency had become deeply integrated into world markets. The Japanese yen, fixed at 360 to the U.S. dollar from 1947 until 1971, had more than quadrupled in value to about 80 at one point in 1995 and then, just as suddenly, had reversed course and fallen to 145 by mid-1998; MOF's ability to set exchange rates had become vastly superseded by international markets and currency speculators. Meanwhile, Japanese financial markets had been substantially liberalized, particularly with the revision of the Foreign Exchange and Control Law (1980) and the deregulation of the corporate bond market. Individual Japanese companies and financial institutions were, in the mid-1990s, free to issue bonds abroad in whatever was the most suitable currency and then swap the proceeds into yen. Japan had become the world market's major supplier of capital.<sup>19</sup> And indeed,

individual Japanese corporations by the late 1990s were choosing to finance even domestic business deals denominated in dollars—further evidence of both their corporate autonomy and their independence from MOF oversight.

Even in the late 1970s, Japanese investors accounted for only 6 percent of direct investment outflows from the major industrial nations, 2 percent of equities outflows, 15 percent of bond outflows, and 12 percent of short-term bank outflows. By the late 1980s, these figures had swollen to 20 percent of international foreign direct investment, 25 percent of equities, 55 percent of bonds, and 50 percent of short-term bank loans.<sup>20</sup>

Individual Japanese firms were also far more heavily invested abroad. This in turn altered the export character of many Japanese manufacturers. From 1990 to the first quarter of 1996, exports from the Japanese islands grew by only 4 percent, the lowest rate in one fifteen-country OECD survey. (During this period, eight countries had export growth of 25 percent or more.)<sup>21</sup> Even more symbolically, in 1995, Japanese-owned firms manufactured more overseas (¥41.2 trillion) than they exported from the home islands (¥39.6 trillion).<sup>22</sup> Although Japanese-owned companies were often still international export powerhouses, their products were no longer manufactured exclusively—or in some cases predominantly—within Japan.

Formal trade barriers and limits on foreign direct investment had also been largely eliminated. Foreign brokerages, as was noted above, not only held seats on the Tokyo Stock Exchange but had acquired a total market share surpassing that of Japan's Big Four. A number of foreign banks were involved in government-bond underwriting while others had entered trust banking. Japanese imports, including imports of manufactured goods, increased substantially from the 1960s. Many Western firms had become \$1 billion companies within the Japanese market, including IBM, Coca-Cola, Schick, Motorola, Texas Instruments, Nestle, Olivetti, Warner-Lambert, Mercedes Benz, and Amway. Coca-Cola in the 1990s, for example, drew a higher share of its world profit from Japan than from the United States, with "profit margins per gallon" at four times the U.S. rate. Also successful have been direct sellers to consumers such as Wella, Eddie Bauer, Compaq, Dell Computer, Proctor and Gamble, McDonalds, and Häagen Dazs. Large department stores stocking foreign products were more widespread. The service sector continued to show surplus sales for foreign firms. And by the late 1990s, the banking, insurance, and brokerage industries all had multimillion-dollar foreign participants. Clearly, the Japanese market had shed much of its earlier mercantilist character.

Japanese fiscal policy had also been transformed. During the 1960s government revenues had come largely from corporate and personal income taxes, while the Ministry of Finance pursued "overbalanced budgets" that kept down government expenditures, allowing conservative politicians to declare periodic and popular tax cuts. As a consequence, in 1964, the budget was balanced with only 1.35 percent of the general budget devoted to debt service. By 1995 nearly one-quarter of the government's revenues were derived from consumption taxes, over one-quarter of the budget was financed by borrowing, and debt service had risen to 18.6 percent.<sup>23</sup>

This latter figure put Japan ahead of the United States (13.9 percent), the United Kingdom (17.5 percent), Germany (10.7 percent) and France (17.9 percent).<sup>24</sup> Even more remarkably, Japan's cumulative public debt in 1997 had reached nearly 100 percent of GNP. Among the OECD countries only a few such as Belgium, Canada, and Italy confronted bigger gross debts.<sup>25</sup>

Monetary policies were also quite different. Trying to cover the fallout from the bubble, in 1992 the government had moved sharply away from previous monetary restraint, driving down official rates to 0.5 percent by the middle of the decade, the lowest levels in Japanese history. Moreover, the government launched a series of huge supplementary budgets between 1992 and 1995, which in total exceeded ¥70 trillion, while also dramatically expanding spending by the Fiscal Investment and Loan Program. Both monetary and fiscal policies had become far looser than ever before in postwar Japan.

On privatization and deregulation as well, Japanese policy had changed. In the 1990s once nationalized industries such as the Japanese National Railways (JNR), Nippon Telephone and Telegraph (NTT), International Telegraph and Telephone (KDD), and the Tobacco and Salt Monopoly had been substantially privatized. Other industries such as the airlines, energy, the finance sector, and various pension systems had undergone varying degrees of deregulation.<sup>26</sup> Numerous areas of the once highly protected Japanese economy had thus become more open to influence by stockholders on the one hand and to foreign corporations and investors on the other.

Finally, whereas during the 1960s government effort and energy was focused largely on assisting Japan's high-value-added, technologically sophisticated firms to gain greater international competitiveness, by the end of the 1990s far more official effort was being directed toward Japan's declining industries. MITI was particularly active in supporting cartels in such industries as aluminum, cement, and petrochemicals,<sup>27</sup> while in other oligopolistic industries with high employment such as steel, shipping, and textiles, MITI policies encouraged economic adjustment but within a still protected domestic market.<sup>28</sup> MOF, in turn, was devoting its efforts in banking to protection of the inefficient rather than promotion of the competitive.

Perhaps the most striking difference from the 1960s was the lack of cohesiveness and singularity in economic policy, which was instead characterized by internal contradictions. The passage of the Fiscal Structural Reform Act in November 1997 aimed at reducing the issuance of deficit-covering bonds and capping major government spending. It was congruent with the rise in the consumption tax from 3 to 5 percent. Yet, almost immediately afterward, the government moved to create a completely contradictory fiscal policy involving ¥2 trillion in tax cuts and a massive expansion of public works spending. Exceptionally low interest rates allowed banks to borrow cheaply to work off their bad loans, but devastated the earnings of insurance companies. Government economic policies were no longer a cohesive strategy directed at national improvement, but rather an eclectic mixture of ad hoc efforts to plug holes in competing economic dikes.

Many of the newer policy directions in Japanese economic policy parallel those being undertaken in major Western European and North American countries. Among them: the reduction of barriers to inward and outward trade and capital flows, the coordinated floating of the national currency, the increase in outgoing foreign direct investment, the support for declining industries with political clout, and technological and investment arrangements transcending national boundaries. In all of these areas Japan's economic policies by the mid-1990s had moved considerably closer to those of the other industrialized democracies, thereby reducing some of Japan's erstwhile uniqueness. But the policy shifts hardly involved unidirectional convergence.

Despite the changes in economic policy, Japan in the late 1990s still differed from the other industrialized democracies in two important ways. First, Japanese markets for imports remained skewed against high-value-added manufacturing goods competitive with Japanese-made products. Japanese data show that manufactured goods in the late 1990s made up 21.7 percent of total imports, compared to only 5.4 percent in 1955. This seems a major change. Yet, much of the jump in imports is related to a relative decline in the import of oil and other raw materials, while another large portion is the result of intracompany trades from Japanese-owned multinationals manufacturing abroad, particularly in Southeast Asia.<sup>29</sup> In the mid-1990s, for example, nearly 40 percent of Japan's imports came from Japanese-owned subsidiaries abroad.<sup>30</sup>

The still rather closed character of the Japanese market is made even clearer by a second point, namely the limited amount of foreign direct investment in Japan. According to one comparative study, in 1986 only 1 percent of Japan's assets were owned by foreign-controlled firms, and just 0.4 percent of its workers were employed by them. In the United States, by way of contrast, foreign-controlled firms owned 9 percent of the assets, employed 4 percent of the workers, and accounted for one-tenth of all sales. And even the United States looked autarkic in comparison with the major European countries. In Britain foreign-controlled firms accounted for 14 percent of its assets, one-seventh of its workers, and one-fifth of the nation's sales. In West Germany foreign-owned companies held 17 percent of assets and accounted for 19 percent of sales, while in France foreign dominance was greater still.<sup>31</sup>

Even more striking, cross-national data for 1995 show that the United Kingdom had foreign direct investment averaging \$3400 per capita; the figure for France was \$2200; for the United States, \$1700; for Germany, \$1500. In contrast, foreign direct investment in Japan remained a lowly \$135 per capita, or well below one-twelfth the average for the other four large economies.<sup>32</sup>

Thus even if the changes hammered out in Japan's macroeconomic policy portended a fundamentally more open economy, the old wine of mercantilism filled much of the new bottle of internationalism. Two facts do seem unassailable. First, although the Japanese government and Japanese firms had not fully abandoned their earlier mercantilist orientation, numerous components of the Japanese public policy profile were drastically less so than those of two decades earlier. Second, despite

such changes, numerous remnants of Japan's earlier structures and orientations remained in evidence keeping Japan quite distinct from most other democracies.

### *Social Welfare Policy*

The social welfare component of Japan's public policy matrix, like macroeconomic policy, showed continuities with the past. Social welfare continued to mark Japan as an outlier among industrialized democracies, although welfare rollbacks in other countries were bringing them closer to Japan's minimalism. In the 1960s the Japanese government had developed health insurance and public pension programs that were universal in coverage but low in payout levels. Long waits for pension eligibility and high co-payments for medical benefits restricted recipient benefits and minimized government costs. Thus, public spending on social policy left Japan unchallenged at the bottom of virtually all comparative statistical compilations of public spending for social welfare for the world's industrialized countries. As late as 1967–69, Japan's total public expenditure for social welfare as a percentage of GDP averaged only 19.2 percent, by far the lowest figure among the industrialized democracies; only Switzerland and Australia were spending less than 30 percent.<sup>33</sup>

Income maintenance expenditures were also low. Japan spent 2.1 percent of GDP for income maintenance programs in 1962 and 2.8 percent in 1972, both of which were only a third the OECD average.<sup>34</sup> Such minimalist governmental support for a variety of social welfare programs was very much in keeping with the broadly conservative character of Japan's government. By and large, conservatives treated social welfare as an unwarrantedly expensive frill likely to impede a fluid and inexpensive labor market, worker loyalty to firms, and overall economic growth. Meanwhile, workers in large firms drew their principal health and retirement benefits from the companies where they worked. Programs for such workers were relatively generous and were tied to the maintenance of a stable employment pool and a loyal company workforce.<sup>35</sup>

Social security policies in the 1990s had expanded in inclusiveness and total cost to the government. Moreover, extensive cross-subsidization had reduced the widespread differences in benefits under the more varied programs of the 1960s. But, on balance, little change had occurred in the policies' fundamental orientation. Corporate occupational welfare remained far more generous, comprehensive, and important than government programs. Japanese social welfare policies remained heavily residual, dualistic, and segmented by occupational status. Privileged "insiders" in large firms averaged benefits that were 30 percent higher than "outsiders" from smaller companies or workers with irregular employment contracts.<sup>36</sup> The retirement allowance for a male worker with thirty-five years seniority was three times higher if he worked for a large firm (1000 or more employees) than for a smaller firm (30–90 employees); and on average, university graduates received 20–25 percent more than those with only secondary diplomas.<sup>37</sup> Government employees were similarly privileged.

Meanwhile, welfare programs not directed toward the male breadwinner such as family benefits, child care, maternity leave, sickness, unemployment, and job promotion expanded only slightly from the 1960s, remaining modest in comparative terms and accounting for less than 2 percent of GNP, compared to 8 percent in the European Community and the other OECD countries.<sup>38</sup>

Overall, Japanese spending for social security at ¥455,000 per capita still left the country at the bottom of the OECD countries. Japanese government programs allocated only 11.9 percent of GNP for social welfare, well below Sweden (40 percent), Germany (27.6), France (30.9), the United States (21.3), Italy (25.8), and England (27.8).<sup>39</sup>

The appearance of simple continuity between 1964 and 1994 however must be qualified by three important caveats. First, by the 1990s Japan was facing tremendous underfunding of both its national life insurance and pension programs as well as numerous corporate pension plans. High levels of economic confidence during the years of the bubble economy had led to excessive public and corporate promises with regard to pensions without adequate reserves to meet them. Net Japanese pension liabilities had risen to over 100 percent in 1996, compared to 25 percent in the United States and less than 5 percent in the United Kingdom while assets in private pension schemes were underfunded by as much as 40 percent. Most such programs had been structured around expectations of between 5.0 and 5.5 percent rates of return, while in reality return rates on the government's long bond were much lower and the insurance companies which were the recipients of about one-third of these funds were renegeing on promised payouts and offering returns of only 2.5 percent.<sup>40</sup> These serious problems in social welfare policy were new.

A second challenge to the notion of simple continuity is that during the 1970s and into the early 1980s Japanese social welfare policies made substantial breaks from the policies of the 1960s. New programs were introduced; different patterns of cross-subsidization were created; qualifications and co-payments were liberalized. All were part of what the government labeled a "Japanese-style welfare society." By the late 1980s, however, many of these efforts had been substantially rolled back as part of the administrative reform effort, leaving policy in the 1990s looking less like a thirty-year continuation and more like a return to an earlier pattern following a lurch away.

A third important qualification about the 1990s is that many government agencies were confronting Japan's "aging problem." Demographic data showed that Japan would undergo substantial demand for retirement and health benefits by the early decades of the twenty-first century. In the 1990s government agencies were scrambling to deal with the consequent welfare concerns. Overall, Japan continued to retain a broad governmental bias against the creation of a European-style social welfare system. At the same time, demanding simply that individual citizens or their families and companies provide for the massive numbers of new elderly was clearly no longer an option. The country was poised to consider substantial changes in past policies in recognition of future inevitabilities.



Having gone through a rollback of entitlement programs in the 1980s, Japan was in many ways less structurally committed to costly programs than were many other democracies. At the same time, given the incredible underfunding of its public and private pension programs and the expectation of vast jumps in the number of retirees and elderly, public policies designed to narrow the gap between promise and potential were almost certain to require a profound long-term increase in the tax burden.

### *Labor Policy*

Labor-management policies were largely confrontational in the 1960s but cooperative in the 1990s. They had been especially vitriolic from the end of World War II well into the mid-1960s, when, under labor leaders such as Takano Minoru, Ōta Kaoru, and Iwai Akira, Japanese national union federations pursued either Marxian socialist or communist directions.<sup>41</sup> Japanese government and business, particularly Nikkeiren, had retaliated with a wide variety of union-busting and wage-reduction efforts. Well into the 1960s, Japanese politics at both the national political and the individual factory level were characterized by severe left-right, and business-labor confrontations.<sup>42</sup> The incidence of strikes was one of the few statistics where, in comparative terms, Japan was not a major outlier; here Japan looked like many other industrialized countries. Walter Korpi and Michael Shalev found that from 1946 to 1976 Japan ranked sixth of eighteen industrialized countries in strike involvement.<sup>43</sup>

Yet by the 1990s Japanese labor relations had become quiescent both at the level of the plant and in national politics. The ideological moderation of most unions and the broad inclusive character of the new labor federation, Rengō, led to far less confrontational labor policies. In the 1990s, as a result, Japan had one of the industrialized world's lowest strike rates, and a comparison of rates for the early 1990s with those for 1960–67 shows Japan had the second steepest decline (–240 percent) in the OECD. Only Austria, beginning from a much lower baseline, saw a sharper percentage drop. For the period after 1979 alone, strike participation fell by over 200 percent, by far the steepest decline among the major industrialized countries.<sup>44</sup> By the early 1990s, Japan's strike rates were as low as those of corporatist Sweden.

Most notably, Japan's once highly militant public-sector unions had pulled in their Marxian horns. As will be noted below, the vast majority of Japan's unions had become members of the moderate national federation, Rengō, and few sought to advance their aims through political confrontation. This moderation is particularly intriguing in comparative terms, since low strike rates have been most closely associated with national institutions of corporatist bargaining between business and labor such as are found in Austria, Norway, Sweden, or Germany. But at the national level no such institutions were present in Japan.<sup>45</sup> In fact, much of the locus of Japanese labor-management policy had devolved from the national level to the plant level, in the process fragmenting and deradicalizing the national Japanese labor movement even more than had been true in the 1960s.

Thus, even without such national corporatist institutions, both government and business policies toward labor had become far more cooperative and co-optive during the 1990s. Labor union representatives sat on various government advisory boards, and unions were involved in national- and plant-level consultation bodies. Personal contacts by union leaders with government officials and conservative party leaders were on the rise, as were measures of mutual trust and confidence.<sup>46</sup>

In addition, as the result of new legislation in the mid-1980s, the average number of hours worked by Japanese employees, which had been roughly four hundred hours per year higher than most other industrialized democracies (or ten extra weeks per year), fell to levels roughly comparable to those of the United States or the United Kingdom (although all three countries were still substantially higher than France, Germany, or most continental European countries).<sup>47</sup> Moreover, Japanese females had at least a nominal legislative equality in the workplace—which they had not enjoyed three decades earlier—even though males tended to do far better than females in wages and in positions of power.

In the general reduction of labor-management hostility, particularly in its reflection of the reduced bargaining power of labor, Japan does not look so unusual. In fact, it appears to be something of a leader for those countries attempting to enhance global competitiveness by reducing fixed labor costs and increasing labor productivity. This too was a much different profile from that of the 1960s.

### *Foreign Policies*

Defense, security, and foreign policy have always been critical elements of Japan's political economy. This was true in the 1990s as it had been in the 1960s. The prevailing policy orientations in these areas remained similar in two important areas, different in three others, and mixed in yet another. But overall they pointed to a tentative move away from international passivity and toward greater international activism.

Most strikingly similar over the two periods is the continued reliance for military security on the United States. The U.S.–Japan Security Treaty provided the broad definitions of military and security ties between the two countries with few significant changes since its ratification in 1960. Close ties between the two countries were reflected in the continuation of U.S. bases on Japanese soil, institutional links between the two countries' militaries,<sup>48</sup> joint military exercises, technology-sharing and co-production agreements, extensive intelligence exchanges, and the like. Japan provided substantial cash support for the American military presence. By the early 1990s this involved about \$45,000 per year per U.S. soldier, a figure higher than that of any other country where U.S. troops were stationed. Indeed, by paying 73 percent of the nonsalary costs of these forces, Tokyo made it cheaper for the United States to keep these troops in Japan than to bring them home. In 1996, despite serious anti-base protests on the most heavily militarized part of Japan, namely Okinawa, the United States and Japan reaffirmed the basic outlines of the

alliance; and the alliance seemed unlikely to be seriously challenged politically in either country in the near future.

Also strikingly consistent was Japan's low level of military expenditures. A succession of governments, for the first thirty years following the end of World War II, held military expenditures to levels well below those of the other industrialized countries. The reasoning always hinged on attention to civilian industrial production, on deep levels of public pacifism, and, less frequently, on constitutional and legal limitations. Thus, the Japanese budget in 1964 provided less than 1 percent of GNP for military expenditures; that figure was almost identical in 1995.

Time and national economic growth meant, of course, a substantial jump in the absolute amounts spent, as well as in the sophistication and capabilities of the Japanese Self-Defense Forces.<sup>49</sup> While normally not thought of as a major military power, Japan by the mid-1990s deployed more tactical aircraft throughout Asia than did the United States, and it operated nearly twice as many destroyers. Such changes in mission and capability, however, involved no substantial reassessment of the basic principle of keeping a low military posture.<sup>50</sup>

Policies regarding indigenous production of military hardware by Japanese companies were more mixed. Japan's defense industry was gutted at the end of World War II, and well into the 1960s it was exceptionally limited in size, sophistication, and political influence.<sup>51</sup> Yet by the mid-1990s "technonationalism" and the "indigenization" of foreign technologies contributed to the greater sophistication of Japan's defense industry.<sup>52</sup> Domestic procurement of military equipment (*kokusanka*) as a proportion of total procurement was over 90 percent (versus about 75 percent in the early 1960s).<sup>53</sup> Nevertheless, Japanese defense industries remained far from autonomous, particularly in the production of sophisticated military equipment including fighter aircraft, Theater Missile Defense, antitank missiles and the like. Moreover, defense production remained a minuscule proportion of the total economy, accounting for well below 1 percent of Japan's total industrial output.<sup>54</sup>

Yet Japanese defense manufacturers had become important players in the overall development of sophisticated, high-value-added, "dual use" technologies. Japan's most advanced civilian electronics firms had, for example, "spun on" various applications to Japanese military products, just as defense production had often spun off technologies for commercial use.<sup>55</sup> The mixture of world-level sophistication in some areas of production and glaring gaps in others resulted by the 1990s in a series of joint-development projects by Japanese and American military producers.

Two things are important in this development: Japanese military production had become substantially more sophisticated, and production had moved away from pure "indigenization" toward greater collaboration with other (particularly U.S.) developers. A real shift occurred in the denationalization of much of Japan's defense industry. Even in the highly "nationalistic" area of weapons production, there was greater cross-national cooperation.<sup>56</sup>

Where Japanese policy change was unmistakable, even if somewhat low key, was in the greater willingness to take a more active leadership on a variety of interna-

tional problems. For the most part, however, this leadership was exerted through economic rather than military or diplomatic efforts, and it typically involved not unilateral action but actions taken in collaboration with other countries or within international institutions. It consequently captured far fewer headlines or public attention.

In the 1960s Japan's unmistakably low posture in international relations grew out of efforts to regain world acceptance and to concentrate on domestic economic transformation. By the 1990s Japan had moved into notable roles in a number of regional organizations such as the Asia Development Bank, APEC, Pacific Economic Cooperation Council (PECC), the Pacific Basin Economic Council (PBEC), and the Pacific Trade and Development Conference (PAFTAD).

Furthermore, the country had taken leadership on Third World debt problems, as was the case, for example, with the Miyazawa Plan (subsequently the Brady Plan of 1989). This involved the development of a range of novel ways for major banks to deal with the exploding levels of Third World debt. Debt-equity swaps, exit bonds, and other techniques allowed the banks to reduce the debt service burdens of borrowers. The program also helped to restore greater financial confidence in the management, stability, and prospects of the borrowing countries. But, more important, the plan was critical in averting an international banking crisis in the 1980s.

Japanese diplomatic leadership was also demonstrated in its defusing of tensions surrounding North Korea's efforts to develop a nuclear weapons program. While the United States responded largely in military and strategic terms, Japan joined with South Korea and the United States to provide energy guarantees to the North in exchange for mutually satisfactory guarantees that any nuclear military potential the North had would be eliminated.

In the same vein, increased Japanese internationalism was also shown through overseas assistance. During the 1960s Japan had no significant foreign aid program. What existed was niggardly in size, almost exclusively bilateral, and tied to the subsequent purchase of Japanese goods or services. By the early 1990s all that had changed. Japan's share of official development aid made it the largest or the second largest contributor worldwide. In the 1990s, an increasing portion of Japanese aid was given via international financial institutions such as World Bank and Asia Development Bank. Moreover, by 1989 only 17 percent of Japan's bilateral aid was fully or partially tied, in contrast to the OECD group average of 39 percent and the United States average of 58 percent.<sup>57</sup> (At the same time, Japanese companies continued to do well as a result of governmental aid projects; in the year ending March 1992, for example, Japanese firms won 31 percent of the contracts financed by Japanese assistance. This figure probably understates the linkage since it does not include joint-venture partners of Japanese firms or infrastructural projects that subsequently benefit Japanese companies.)<sup>58</sup>

Moreover, Japanese aid had become more "international" in its targets. In the 1960s virtually all Japanese aid went to Asia; by 1993 less than 60 percent did. Moreover, four of Japan's largest ten recipients were non-Asian countries (Egypt, Jordan, Peru, and Turkey), and two others (India and Sri Lanka) are in South Asia

and not within Japan's traditional definition of Asia. In short, foreign aid offered some important hints of a greater internationalism in Japanese foreign policy.

Far and away the most dramatic shift came with Japan's willingness to allow its troops to be used overseas. This change followed internal debates about Japan's possible dispatch of troops for the Gulf War of 1990. Under previous official interpretations of Article 9 of the Constitution, such actions would have been violations.

Following a wrenching domestic debate, Japan in 1991 passed legislation (the United Nations Peacekeeping Operations Cooperation Bill) allowing its troops to be used—under very constrained conditions—in UN-sponsored, noncombative peacekeeping activities abroad. As a result, Japanese minesweepers moved into the sea lanes in the Persian Gulf after the fighting between the United States and Iraq had ended. Japanese military personnel subsequently participated in UN peacekeeping operations in Cambodia, Mozambique, and the Golan Heights. Undertaken under United Nations' auspices, these actions were deemed constitutionally legitimate—certainly a dramatic reinterpretation of Article 9. They would have been politically impossible in the mid-1960s, given the strength of the left, its commitment to resisting any hint of "Japanese militarism," and the broad support such a commitment enjoyed among the general public. While Japanese troops were hardly in the midst of major combat, and indeed while military personnel worldwide were collectively amused at the timidity of Japanese actions, the parameters surrounding such activities had shifted dramatically.

Perhaps most important for understanding Japan's regime shift is the entire array of defense- and foreign-policy-related issues that, after polarizing Japan in the 1960s, had become largely nonissues by the mid-1990s. When JSP leader Murayama Tomiichi became prime minister, he renounced virtually every element of the long-standing JSP platform concerning defense, the Constitution, and the security arrangements with the United States. He accepted the constitutionality of the Self-Defense Forces; he agreed to the legitimacy of the U.S.-Japan Security Treaty and to the stationing of U.S. troops on Japanese soil; he accepted the conservative interpretations of Article 9. He oversaw the introduction of a host of patriotic measures, once opposed within Japan's schools. Essentially, Japanese foreign policies, once the most contentious item in Japanese party politics, while hardly consensual, no longer generated the kind of divisiveness among the leaders of Japan's major parties and interest groups that they had three decades earlier.

The composite public policy portrait that emerges from the above description suggests two major conclusions. On the one hand, there are clear breaks from earlier policies—especially in macroeconomics, the internationalization of the Japanese currency, industrial production, the loosening of fiscal policy, the underfunding of various pension funds, the more cooperative labor-management relations, and the shifts in foreign and defense policies. The policy nexus that prevailed under the conservative regime of the 1960s had undergone a substantial transformation. However one characterizes the current mix of policies, "embedded mercantilism" is surely inappropriate. On the other hand, important legacies from the past remain, most notably in the barriers to foreign direct investment, the retention of an

occupationally based social welfare system, close ties to the United States, and in a generally low official commitment to using military means in advance of national goals.

This mixture of shifts and continuities has, however, not brought the country into close similarity with other industrialized democracies. Rather, they have left Japan's public policy with a highly individualistic profile, as an examination of the institutional components of the Japanese political economy in the mid-1990s will confirm.

### Institutional Fragmentation at the Conservative Core

During the 1960s the centripetal bias of political and economic institutions contributed greatly to conservative stability. By the 1990s many of these institutions had lost their power to centralize and hold. Fragmentation, division, and differentiation were far more in evidence. Meanwhile the party system and the electoral system, which had been so sharply polarized and had worked so favorably for conservatives, no longer fragmented opponents of the conservatives or made it so difficult to mobilize voter opposition to the LDP.

Consider first the split in the LDP. Even though the party returned to government less than two years after its split, and even though it gained the largest number of seats in the lower house of parliament following the October 1996 election, the party no longer served as the single vehicle within which conservative politicians would contest national elections. The party's defeat in 1993 was less a defeat for "conservatives" and more a defeat for the party. By the mid-1990s the once vibrant political left had, in fact, surrendered to conservatives on most of the issues that had once divided the two camps, and conservatism as a broad philosophy had undeniably triumphed over socialism in a way that was unlikely to be reversed. Parties that espoused a left-of-center agenda had lost most of their appeal.

At the same time, the election of 1993 represented an institutional loss for the LDP, reflecting as it did the party's inability to retain the loyalty of its members and to be the single institutional beneficiary of the decline by the Japanese left. Except for the relatively minor split by the New Liberal Club in the summer of 1976 (involving only six parliamentarians), the LDP had consistently been the sole electoral vehicle for politicians identifying themselves as conservatives. The party consistently avoided situations under which conservative political entrepreneurs would bolt the party's ranks and strike out on their own—in new parties or altered alliances. That was no longer the case after 1993.

In the 1993 election three new conservative parties—the Japan New Party, the Japan Renewal Party, and the New Party Sakigake—all competed with the LDP for conservative votes.<sup>59</sup> Those who nominally "supported" the LDP in principle had consistently correlated with actual party voters at levels of between .859 and .884 in the elections held between 1980 and 1990. In the 1993 election, this correlation fell to .756; LDP supporters were clearly deserting the party.<sup>60</sup>

The continual recombination of political parties during the next few years witnessed further conservative fragmentation, entrepreneurship, and reorganization. The new electoral system contributed to this political fluidity and entrepreneurship. Replacing the multimember district system for the lower house was a system in which three hundred parliamentarians were selected from single-member districts and an additional two hundred were chosen from eleven regional districts on the basis of party lists and proportional representation. The roughly four-to-one rural bias of the old system was dramatically reduced, and within the single-member districts, at least, a premium on two-candidate competition had replaced the previous competition among five or more relatively viable candidates.

In the first election held under the new system, in 1996, six parties won ten or more seats; four of these drew the bulk of their members from the pre-split LDP. Although the LDP as a single organization did the best of all the parties, and indeed increased its postelection seat total by 28 despite a shrinkage in the total number of lower house seats by 11, it was by no means the cohesive electoral vehicle for conservatism that it had once been.

The LDP won nearly 48 percent of the seats, but other conservative parties drew 42 percent. And while the LDP won 53 percent of the seats contested in single-member districts, it won only 35 percent in the proportional representation districts. The other three conservative parties—including the Democratic Party, formed only weeks before the election—won a much more impressive 47.5 percent.<sup>61</sup>

In contrast, the old Socialist Party was cut in half (from 30 seats to 15), and several of the minor parties that had previously taken 7–10 percent of the vote merged into larger groupings. (The Japan Communist Party remained the only significant exception to this generalization, nearly doubling its numbers from 15 to 26.) More than anything else, the 1993 and 1996 elections showed the decimation of the parties of the left.

Three broadly conservative parties, the LDP (239 seats), the New Frontier Party (156), and the Democratic Party (52) had become the principal players. Overall, nearly 90 percent of the lower house could be categorized as conservative. The new government-opposition divide no longer fell along traditional left vs. right, business vs. labor lines, but instead was a division between conservative government and conservative opposition, with little issue clarity dividing the two.

Simultaneously, the former niche parties found it virtually impossible to win seats in the single-member districts. And even the proportional representation districts made smallness a disadvantage. The contesting parties hardly articulated clear-cut and distinctive policy positions, as many advocates of the new electoral system had predicted would be “inevitable.” Rather, the conservative parties vaguely emulated one another’s rhetorical positions on key issues. Consequently, even though the new single-member districts gave voters the chance to vote unmistakably for or against individual candidates, voter turnout was the lowest it had ever been in the postwar years, falling to below 60 percent.<sup>62</sup> In effect, electoral contests of the mid-1990s had lost the power to animate citizen involvement. A substantial

party realignment was in process, but one that had crystallized more around personalities than around fundamental issue differences; and the key personalities generated little national voter appeal.

Voter support for the various political parties had also gone through a striking realignment. In the 1960s fewer than 10 percent of Japan’s voters identified themselves as “independents.” By the 1993 election that figure was up to 38 percent, and in January 1995 it was 50 percent.<sup>63</sup> Voters were available to be mobilized, but only if and when a particular political party or candidate could provide them with sufficient motivation. In the 1996 election, few found that motivation. But with roughly 40 percent thus “available,” it seemed likely that parties would recombine in a continuing effort to reposition themselves to draw deeply from that pool.

Erstwhile conservative interest associations had also become more fragmented and less inherently loyal to the LDP. In 1960 the total number of interest associations in Japan was just over 10,000. By 1991 this had more than tripled to 36,000. Business associations also tripled from 4,600 to nearly 14,000. And meanwhile, political associations rose sevenfold from 169 to over 800.<sup>64</sup> Within this context, the agricultural cooperatives had stopped automatically supporting LDP candidates. Meanwhile, the major business federation, Keidanren, had grown increasingly divided internally and had ceased its automatic contributions to the LDP in 1993. Finally, there was a large increase in non-party-linked citizen groups, semipublic associations, and miscellaneous organizations. By 1986 this category had become the largest in Japan, moving ahead of the once predominant business-linked associations.<sup>65</sup> The cumulative effect was to make the process of political coordination—for both conservative political parties and bureaucratic agencies—far more complicated than it had been when there were fewer and generally more comprehensive organizations. Linkages among interest groups, parties, and bureaucratic agencies became far less automatic and predictably conservative than was true at the height of conservative power.

If conservative politicians were no longer united under a single electoral umbrella, and various interest associations had lost some of their earlier institutional unity, the national bureaucracy no longer stood together behind any hegemonic project in the way it had once united behind rapid economic growth. Japan’s government agencies have long been noted for their reluctance to cooperate with one another.<sup>66</sup> Yet, rapid growth had induced considerable agency-to-agency cooperation in the 1960s; such cooperation around an overriding agenda had disappeared by the 1990s.<sup>67</sup>

By that time, several agencies (particularly the Ministries of Posts and Telecommunications, Agriculture, Transportation, Construction, and Home Affairs) had become heavily colonized by conservative politicians, in large measure through the LDP’s Policy Affairs Bureau (Seimu chōsakai), the actions of so-called *zoku* politicians (politicians with special connections to the interest associations and government agency concerned with some particular functional area of policy), and most especially by the Tanaka-Takeshita political machine. Generally, agencies with the

largest influence over highly lucrative sectors of the economy and those ripe for pork-barrel politics attracted the closest of these “iron triangle” links among politicians, interest associations, and government agencies.<sup>68</sup> Increasingly, their once general economic missions gave way to the particularistic ambition of generating benefits for conservative politicians and their allies.

Other agencies (International Trade and Industry, Finance, Foreign Affairs, and Education, to mention only the most prominent), while somewhat less prey to such political penetration and iron triangles, were caught up in the extensive competition over “turf.” Numerous battles divided agencies over their respective responsibilities for emerging technologies such as biotechnology, development and regulation of high-definition TV, computer usage in schools, telecommunications, and the like.

Moreover, high-level bureaucrats began to show their political colors more clearly. Several former MOF officials, for example, resigned to run on the platform of Ozawa's *Shinshintō* in 1993, while the coalition government of 1993 attempted to purge certain senior bureaucrats deemed too close to the LDP. By the late 1990s, intra-conservative battles over deregulation and bureaucratic reorganization saw particular agencies linking their fortunes to one or another party presumed most likely to champion the agency's interests.

Not surprisingly, these shifts fed the overall demise of the bureaucracy's image as “above politics” and operating in the “national interest.” The scandals noted in the first section of this chapter revealed that large numbers of high-ranking civil servants had been deeply enmeshed in extensive bribery schemes and closely tied to particular LDP leaders or interest groups. Meanwhile, many of the tools of bureaucratic power lost their earlier potency. This was particularly true of the power to control interest rates and to channel low-cost capital to targeted industries or firms. In addition, the mailed fist of arbitrary discretion, concealed inside the velvet glove of administrative guidance, was reduced by requirements for the publicized transparency of all government directives.

All of this contributed to the long-term demise of bureaucratic prestige. A very simple measure of this decline can be found in the competition rate for positions in the senior civil service. At the height of conservative dominance and high growth, as many as forty-three individuals competed for every one who was successful. By the early 1990s, this was down to fewer than fifteen candidates for each opening.<sup>69</sup> More and more of Japan's best and brightest were opting for jobs in other arenas.

While disintegration of conservative institutions was most institutionally transparent in the political sphere, there was also substantial disintegration within conservative economic institutions. Three warrant particular attention.

The most important single change was the greater internationalization of many Japanese firms. A major contributor to this trend was the rapid escalation in the value of the yen. *Endaka*, as the rising yen was called, made it economically suicidal for Japanese firms not to invest abroad. Continuing to manufacture at home became comparatively more costly in yen after the rest of the world's land prices, labor

rates, and corporate evaluations had effectively been slashed by one-half or more. Business leaders were forced to ask themselves: how can we best take advantage?

Foreign direct investment by Japanese firms in the mid-1960s had been minuscule; by 1993 cumulative Japanese investment abroad totaled some \$260 billion, making Japan the world's second largest overseas investor (behind the United States at \$549 billion).<sup>70</sup> Once subject to heavy MITI and MOF directions designed to ensure conformity to various government industrial plans, firms became far freer to pursue their business strategies out from under the club of government capital controls. Technology transfer agreements leaped across national boundaries with nary a governmental signature. Profitable companies were free to finance activities through retained earnings. Others could raise capital through domestic equity markets, overseas warrants, international currency swaps, and domestic bond issues, leaving firms far freer to pursue strategies determined primarily by internal, company-specific needs rather than external government directives or national industrial policy proscriptions.

As larger numbers of Japanese firms, including many of their subcontractors, became more truly multinational, many also entered into strategic alliances with foreign-owned firms.<sup>71</sup> This marked a further fragmentation in the internal linkages among Japanese firms and *keiretsu*. At the core of the once privileged banking sector, Swiss Credit Bank forged an alliance with Japan's Long-Term Credit Bank involving an investment of one billion Swiss francs (\$671 million), while Société Generale and Mitsui Trust teamed up, allowing Mitsui to market mutual funds from the French institution. Other tie-ups linked foreign and Japanese insurance firms and brokerages. Japan Air Lines joined an alliance with American Airlines while All Nippon Airways joined forces with Lufthansa and United. Meanwhile in manufacturing Toyota was teamed up with GM and Kia among others; in electronics, Fujitsu, NEC, Hitachi, and Toshiba all had alliances with American and European companies; NTT and KDD had done the same in telecommunications; Softbank and TV Asahi had various partners in software and commercial television; Mitsubishi Heavy Industries was in a venture with Daimler Benz, while Kawasaki Heavy Industries and Ishikawajima Harima Industries also teamed up with foreign partners in a variety of military production technologies. These were merely the tip of the international alliance iceberg. Indeed, Canon went so far as to adopt as its corporate slogan for the 1990s “Symbiosis with Global Partners.”<sup>72</sup> The very nationality of many nominally Japanese firms came into question on both ownership and the place and nationality of the workforce.<sup>73</sup>

Though these changes were taking place in many segments of Japanese business, they were by no means universal. Many other firms in industries such as cement and construction were either unable to unwilling to invest abroad or to partner with foreign firms, enmeshed as many were in domestic public works projects pressed on their behalf by Japanese politicians. Similarly, while some of the subcontractors of Japan's larger manufacturers did follow them in setting up overseas operations, far more, particularly the smallest, remained in Japan only to watch their market shares

dwindle. The number of manufacturing jobs in Japan fell by over one million in 1992–95 alone, catalyzing a national fear about the possible “hollowing out” of Japan.

Many of the most protected industries, including those within important service sectors such as insurance, brokering, and even commercial banking, remained unable or unmotivated to compete internationally. They remained locked into the domestic market, contributing heavily to the financial crisis of the 1990s.<sup>74</sup> The result of all of these shifts was to drive a series of wedges into a business community that had once been almost uniformly supportive of, and the automatic beneficiaries of, the politics of “embedded mercantilism.”

Of particular importance to both the *keiretsu* and to various firms was the broadening of capital-raising options for nonfinancial firms. Deregulation of the corporate bond market was a key part of this process. As late as 1979 only two companies, Toyota Motors and Matsushita Electric, were qualified to issue unsecured convertible or straight bonds. A decade later some three hundred firms were able to issue straight or warrant-attached bonds, and five hundred could issue unsecured convertible bonds.<sup>75</sup> Deregulation also allowed many corporations to shift their sources of debt financing from the main banks to bonds. Thus bonds, including those issued abroad, gained an increased role. In 1965 Japanese industrial companies issued ¥391 billion worth of bonds, none overseas. In 1989 that figure was up to ¥9,284 billion domestically, while an even larger ¥11,129 billion was issued overseas.<sup>76</sup>

Hence, in the 1960s, most Japanese firms were raising the bulk of their needed capital through borrowing, primarily from their main banks, and the debt-to-equity ratio for Japanese firms in 1965 was nearly 90 percent for new inflows. By 1995 this ratio had fallen to 69.4 percent. Bank borrowings, which made up nearly 77 percent of total corporate finance in 1965–69, had dropped to 42.5 percent in 1990–91. Bond issues, which had been below 10 percent, jumped to 42.5 percent during the same period. Quite obviously, all of these changes reduced the dependency of manufacturing firms on the Japanese banking sector, but they also began to diminish the internal cohesion among the *keiretsu* as a whole.

Additionally, capital demands on both financial and nonfinancial companies, combined with the growing ability of individual firms to raise money abroad as well as the declining paper value of the stocks themselves, led to a substantial sell-off of once-sacrosanct cross-held shares, further eroding the internal cohesion of *keiretsu* and other corporate connections. As late as 1987, approximately 72 percent of the Tokyo Stock Exchange capitalization involved such relational cross holdings. By 1996 this proportion had fallen to 60 percent, and it was dropping at the rate of about 4 percent per year.

Meanwhile, in the financial crunch of the late 1990s, main banks cut off credit to over 12,000 firms. These changes also reduced the internal cohesion among the *keiretsu* while allowing individual firms, whether *keiretsu* members or not, far greater autonomy in their capital generation and business strategies.

By the 1990s, consequently, large numbers of Japanese-owned firms were no longer producing in and exporting from Japan; they had moved to international

production and global investment and financing strategies. Japan had ceased to be an export platform. Individual firms and business groups had also gained considerable freedom from the capital controls they had experienced three decades earlier. While frequently of great benefit to individual firms, these moves contributed fundamentally to the conservative regime’s fragmentation and loss of cohesion.

Not to be ignored in the focus on economic institutions is that labor had gained a degree of national unification. Japan’s most radical unions had ceased to exist, and the once radical national labor federation, *Sōhyō* (Japan Confederation of Trade Unions), had been absorbed by the far more moderate *Rengō*, giving Japan the largest single labor federation in the world.<sup>77</sup> Yet labor cohesion was no longer inherently anti-conservative, and on many economic issues, individual unions were far more divided on a sector-by-sector basis than they were united with other unions.

The extent to which labor had made its peace with conservatives, bridging the once giant abyss between them, was perhaps never clearer than on May 1, 1996, when Prime Minister Hashimoto attended May Day celebrations, which during the 1950s and 1960s had been the single most antigovernment and anti-conservative occasion on the Japanese political calendar. At a similar level of symbolic significance on November 5, 1993, the president of *Rengō*, Yamagishi Akira, and the chairman of *Nikkeiren*, Nagano Shigeo, jointly visited Prime Minister Hosokawa to make a joint business-labor demand for a tax cut of ¥5 trillion designed to boost the Japanese economy.<sup>78</sup> Such business-labor cooperation on national economic policy had been unheard of in the 1960s.

Although Japan in the 1990s had traveled far from the 1960s, its institutional changes, like its policy changes, were mixed in that they moved Japan both toward and away from the other industrialized democracies. This same pattern is visible in the shifts in socioeconomic coalitions.

### The New Socioeconomic Division

For most of its existence, the conservative political coalition did not have to make particularly hard choices among its potential supporters. Under the LDP the conservative camp from 1955 on was a socioeconomic coalition of big and small business, manufacturing and finance, diverse geographical areas, agriculture, and other socioeconomic support groups and organizations. Organized labor—and to a lesser extent intellectuals, urbanites, and students—constituted a competing, if flaccid, socioeconomic alliance. Despite the differing priorities of socioeconomic sectors at different times, the conservative regime’s prevailing political institutions and policy profile made it by far the most attractive choice for a wide swath of Japanese society.

Moreover, when the conservative socioeconomic coalition did change, most shifts involved the adding of new support, not the jettisoning of old constituents. High levels of economic growth continued to generate expanding resources, making such additions comparatively easy from the 1960s into the late 1980s. The LDP

became increasingly a “catch-all” party, while alternatives to conservative policies became decreasingly attractive to most groups.

By the early 1990s, consequently, the socioeconomic support base of the conservative regime had broadened substantially. Four changes are of particular note. First, as was noted earlier, organized labor—once the heart of the oppositional alliance—had abandoned its unmitigated hostility to the conservatives and no longer stood uniformly and automatically outside the regime. Second, agriculture and small businesses were providing substantially less support for, and less automatic identification with, the conservative camp. In many instances fragments of both sectors had actually broken ranks with the conservatives. Third, urbanites and white-collar workers had become significantly more important socioeconomically, although they were neither unambiguously pro- nor anti-conservative. Fourth, big business had become vastly more internally fragmented, dividing over the desirable character of post-1990s conservatism.

Organized labor had been the single most important socioeconomic sector hostile to the original conservative coalition. In the 1990s the new labor federation, Rengō, was a critical supporter of the anti-LDP coalition government of 1993; it helped to bring to power the first labor-backed government in Japan since the late 1940s.<sup>79</sup> At the same time, labor in the 1990s stood far closer to conservatives on numerous issues than it had three decades earlier. The radical left within the labor movement had become increasingly marginalized, and by the mid-1990s there was virtually no serious support for any dramatic moves away from private ownership; close security relations with the United States were accepted, albeit reluctantly; and business-labor divisions had given way to sectoral differences that pitted business and labor in single industries or firms against business and labor in others. In short, labor had long since surrendered its earlier anti-regime posture and become sufficiently moderate ideologically so that it could deal with virtually any plausible Japanese government.

Electoral support patterns by blue-collar workers reflected this narrowing gap between progressives and conservatives. Whereas in the 1960s conservative party support by union members was quite thin, by the 1990s significant proportions of labor were voting for the LDP.<sup>80</sup> In 1965, for example, 27 percent of industrial workers supported the LDP; by 1985 the number had risen to 49 percent, representing 12 percent of the total LDP support.<sup>81</sup>

Agriculture and small businesses also occupied different positions in the 1960s and the 1990s. Longtime electoral supporters of the LDP, farmers and small shopkeepers had enjoyed extensive protection through such measures as farm subsidies, import quotas on key agricultural goods (including a 100 percent ban on rice imports), low or no interest loans to small shopkeepers, and an “anti-supermarket law” that effectively gave local chambers of commerce veto power over any large stores proposed for an area.<sup>82</sup> In response to the liberalization of agricultural imports, farmers swung strongly against the LDP in the 1989 upper house election, with farm support for the party falling from 56 percent in the 1986 election to 41 percent in 1989.<sup>83</sup> This was the LDP’s biggest loss from any socioeconomic group.

Although farmers and small businesses continued to be disproportionately strong supporters of conservative candidates electorally,<sup>84</sup> both groups had also shrunk in size, in economic significance, and in the electoral support they could provide for conservative politicians. In the 1955 election farmers made up 43 percent of the LDP’s support; by 1965 the figure had dropped to 29 percent; by 1985, only 13 percent. Support from small businesses fell during the same period from 27 percent of the LDP’s total to 19 percent,<sup>85</sup> shifts that made it clear that neither group could ensure the kind of conservative electoral hegemony that they had once delivered. Furthermore, their share in the nation’s total economic activity had also dwindled. Consequently, both groups became less central to partisan (including conservative) electoral strategies and to national economic strategies, and both became far more vulnerable to economic changes from which the regime of embedded mercantilism had long protected them.

In 1960 just under sixty million Japanese lived in large cities; by 1990 this figure was up to ninety-five million, or over three-quarters of the total population.<sup>86</sup> Yet conservative electoral support in the large cities dropped precipitously between the 1960s and the 1990s.<sup>87</sup> It was their continued success in the less urbanized areas of the country that kept the LDP in power.

The loss of the electoral support from farmers and small businesses posed a serious threat to conservatives, and especially to specific conservative politicians in particular locales.<sup>88</sup> Because both groups had been such strong LDP supporters, it was by no means easy for the party or individual candidates to drop them in favor of some more numerous group, such as urban salaried workers. Hence, agriculture and small businesses retained disproportionate influence in specific electoral districts and with specific politicians, particularly through their links to personal support groups.

At the same time, the long-term trend was that of ever greater numbers of voters living within the metropolitan and suburban areas of the country. Although the LDP had made some electoral inroads into even the largest metropolitan areas, it was becoming increasingly clear that any candidate or party seeking to attract urban support was likely to lose support within the more traditional and rural sectors. Whereas the LDP had been able to expand its base throughout the 1980s, in the 1990s it could no longer do so. Economic policies that could keep all new add-ons happy without upsetting long-term supporters were no longer possible; trade-offs among potential constituencies were essential.

Trade-offs also divided the business sector. Business interests had cohesively supported embedded mercantilism during the 1960s. By the 1990s no such support existed. Numerous Japanese firms stood out as highly competitive by any international standard, particularly large manufacturers in areas such as electronics, machine tools, and automobiles. Yet the closed domestic economy had spared many other Japanese business sectors from ever confronting international competition. By the mid-1990s Japan’s big business community had really become two different communities—one that was predominantly high-tech, internationally competitive, and highly profitable, relying on little or no direct governmental assistance, and

another that was much less competitive and looked to the government for protection from foreign competition and guaranteed profitability within the domestic marketplace. Whereas high growth and protection had allowed the conservative regime to serve both constituencies effectively in the 1960s and 1970s, increased economic openness and slower growth made this problematic in the 1990s. Sharp internal cleavages arose within the Japanese business community over, among other things, deregulation, exchange rate policies, taxation, fiscal stimulation through government procurement, and overall protection and oligopolization of utilities, banks, the insurance industry, and holding companies.

The intra-conservative socioeconomic divisions of the early 1990s culminated in the actual split within the party in 1993. The LDP split reflected to some extent the urban-rural and competitive-uncompetitive divisions within conservatives. Even though many who split with the LDP, such as Ozawa, Hata, and Takemura were from rural areas, many of the younger dissidents who followed them were not. Moreover, the eventual anti-LDP coalition, with its inclusion of the Clean Government Party and Democratic Socialist Party had a distinctively more urban character. In the 1996 election, for example, the LDP won 51.7 percent of the single-member seats in towns and villages, compared to only 28.6 percent in cities of over 100,000 and 30.5 percent in the thirteen metropolitan areas. In contrast, the New Frontier Party (NFP) won only 17.8 percent of the rural seats, but 26.5 percent in the cities and 21.9 percent in the metropolitan areas. In the proportional representation districts the LDP did even worse in the cities and metropolitan areas, whereas the NFP did even better.<sup>89</sup>

The remnants of the LDP began to emerge as preponderantly rural and oriented toward pork-barrel politics, whereas the conservative opposition had become more urban, international, and antiregulatory. This division became even more apparent over the issue of deregulation. In August 1996 *Bungei Shunjū* published a poll of lower house parliamentarians. It showed a distinct gap in the orientations of the LDP and the NFP. Given a choice between "moving quickly toward socioeconomic regulation even though this will mean a coup de grace for the weaker elements in society" and "protecting the weaker members of society by taking a cautious approach to deregulation," 56 percent of the LDP members chose the more protectionist approach in contrast to only 23 percent of the NFP members and 24 percent of the Sakigake Party members. The overwhelming majority of the last two (76 percent of the NSP and 71 percent of Sakigake) preferred rapid deregulation despite its potential social costs.<sup>90</sup>

The same pattern emerged in the 1998 Upper House election when the LDP failed to win any seats in metropolitan districts such as Tokyo, Osaka, Kyoto, Aichi, Saitama, or Kanagawa. Its overt rural, pork-barrel focus meant the loss of urban support.

Japan's earlier webs of socioeconomic solidity were unraveling in another important way, namely, the growing income gap among Japanese citizens. In the mid-1960s Japanese income inequality was low; Japan was as economically egalitarian as many of the Scandinavian countries. In the mid-1990s, a widening gap

opened between rich and poor. The Gini index, for example, crept steadily upward.<sup>91</sup> Unemployment rose steadily through the 1990s, with its strongest effects felt by new employees, older workers, and females. It became less obvious that all Japanese were riding in the same economic lifeboat. While Japan did not move as far toward class division as the United States or Britain, it was more economically divided in the 1990s than it had been three decades earlier.

In the 1990s, then, the conservative regime's once stolid socioeconomic base, previously held together through positive-sum politics and economics, had become zero sum: benefits to one socioeconomic sector increasingly meant the probable loss of benefits by another sector. Economic liberalization, currency shifts, overseas production, and market openings had driven wedges between agriculture, small business, and big business. The bursting of the bubble economy diminished the public treasury resources available to reward inefficient sectors. This in turn further exacerbated intra-conservative tensions over basic policy directions. During the 1990s a succession of conservative governments attempted without great success to accommodate the demands of their increasingly strange socioeconomic bedfellows in an ever shrinking futon.

### Conclusion: Conservatism in the 1990s

The above analysis points to the numerous ways in which the once tightly integrated conservative regime had given way to far greater policy, institutional, and socioeconomic fragmentation. The previously vaunted Japanese economic growth machine had become mired in a bog of bad debt and collapsed consumer confidence; the once unbeatable conservative electoral machine was running out of fuel; and the once harmonious domestic and international linkages were acrimonious. Previous conservative institutions had lost their earlier fluidity and internal cohesion, leaving Japan in the midst of an unmistakable regime shift and struggling to find a new stability and equilibrium. What would replace the old regime was, as yet, unclear. Socioeconomic recombinations were still under way; so was the process of party system realignment and electoral recalibration. Institutional reorganization, particularly the reconfiguration and reregulation of the national bureaucracy and the financial sector, were principal items of debate. No public policy profile with anything like the clarity of embedded mercantilism and high economic growth had yet come into view. Japan in the late 1990s resembled in some respects the former communist regimes of the Soviet Union and Eastern Europe: that the old regime had been displaced was clear; that transition was under way was beyond question; but precisely how that transition would play out, and what new equilibrium would replace the old, was less evident. What was clear, however, was that, like Humpty Dumpty, the old regimes in Japan just as in the former communist countries could not be put back together again.

An observer of Japan in the late 1990s contemplating the next decade might reasonably assume that although the LDP may retain some measure of electoral success,



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

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

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



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

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

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

I begin by examining three sets of challenges to the conservative regime that arose between the early 1970s and the late 1980s. One set came from outside Japan,