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Japan, Refutation of Neoliberalism

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No-one wants to talk about Japan these days. The conventional wisdom is that the bloom went off Japan's economic rose around 1990 and that the utter superiority of neoliberal capitalism was vindicated by the strong performance of the American economy during the 1990s. Furthermore, everyone is now convinced that China – whose economy is 1/8 the size of Japan's – is the rising economic power and therefore the appropriate object of attention.

But Japan is, despite everything, still one of the master keys to understanding the future of the world economy, because Japan is the clearest case study of why neoliberalism is false. Simply put, Japan has done almost everything wrong by neoliberal standards and yet is indisputably the second-richest nation in the world.

This doesn't mean that neoliberalism is wholly meritless as an economic theory or as a development strategy, but it does mean that its claim to be the *only* path to prosperity has been empirically falsified. Japan's economy is highly regulated, centrally-planned by the state, and often contemptuous of free markets. But it has thrived.

What follows is for space reasons necessarily a sketch and exceptions, subtleties, and refinements have been left out. Facts have been homogenized and caricatured to make structural fundamentals clear. But a reader who bears this in mind will not be misled, as detail analyses are available elsewhere.

Are We Lied to About Japan?

Contrary to popular opinion, Japan has been doing very well lately, despite the interests that wish to depict her as an economic mess.

The illusion of her failure is used by globalists and other neoliberals to discourage Westerners, particularly Americans, from even caring about Japan's economic policies, let alone learning from them. It has been encouraged by the Japanese government as a way to get foreigners to stop pressing for changes in its neo-mercantilist trade policies. It has been propagated by

corporate interests who gain from free-trade extremism with respect to Japan. And it is promoted by ideologues committed to the delusion that only a *laissez-faire* economy can prosper.

This is a formidable set of potential liars, equipped with money, technical expertise, transnational reach and state power. The Japanese government is centralized, elitist, and quite capable of fudging statistics if it wants, particularly since there are few Westerners who understand Japanese accounting. National accounting is notoriously susceptible to creative accounting anyway, as the world learned at the time of the Asian Crisis of 1998. So the assumption that the standard published figures about Japan's economy are true is dubious at best.

Japanese culture puts a premium on maintaining "face" and other forms of polite public presentation that constitute literal falsehoods, or at least fictions, so it is a natural instinct for the Japanese to tell the West what it wants to hear about Japan's economy. Japan's government is heir to a Confucian tradition in which the public is told only what the rulers deem it should know. Journalists and academics, who in America or Europe would have challenged its version of the economy by now, are loyal collaborators of the system, not its critics. So from a Japanese point of view, there is nothing immoral, unusual, or terribly difficult about misrepresenting Japan's economic performance. In fact, because it is in the national interest, it would be unpatriotic not to.

A Crisis Invented to Fit a Theory

The idea that Japan is thriving is not so different from the received wisdom as one might think. The Western press has over the last few years been full of stories about Japan's deep gloom, but in point of fact, the *admitted* state of the Japanese economy – let alone its actual state – is simply not that bad and in any other country would be producing mild expressions of concern, not brazen crowing about a crisis sufficient to force change in the fundamentals of the system.

Even the Japanese government admits that Japan is not actually declining economically, but rather growing at about 1% a year (which has ticked up to 2% since these words were first written.) This is a better performance than many other nations in recent years. So even if one accepts the official statistics, Japan is not in anything like the death-spiral that *laissez-faire* mythology supposes. It is, at *absolute* worst, accepting all the public mythology, stuck in a gentle stagnation of slow growth. And that it may now be emerging from this simulated rut (partly because the truth was getting too hard to conceal between the cranes on the Tokyo skyline) only reinforces this argument.

And this stagnation, even if one believes in it, is (or was) at the top of a very high plateau of aggregate and per-capita GNP, so Japan is hardly suffering by any reasonable international standard. It is, *even according to the official figures*, the second-richest country in the world. It is doing far better than other economies which get better press because they conform more closely to the globalist model of what an economy ought to be. It is a vastly richer nation, for example, than Britain, which globalist magazines like *The Economist* like to depict as an economic leader because it genuflects, at least in theory, to the right neoliberal theories.

Furthermore, the Japanese system is deliberately designed to contain the usual forms of economic stress that produce shocks to the political system, like inflation and unemployment, so Japan's (quite mild, really) economic problems are miles away from having the political consequences needed to cause the radical revision of the system that see-what-they-want-to *laissez-faire* ideologues suppose. Is 5% unemployment, in the context of a family structure more intact than in any Western nation, a crisis? In what other nation would 5% be considered a crisis level?

Nevertheless, we are fed a neoliberal fantasy that Japan is in a state of economic crisis and that this crisis is forcing her to revise her economy to conform to the world-conquering American version of capitalism.

Penetrating the Illusion of a Failing Japan

It is not hard to see through the illusion of a failing Japan if one knows where to look. The key is to look at indicators not susceptible to manipulation by the Ministry of Finance in Tokyo. First among these are export statistics, which are hard to conceal as they show up as imports in the statistics of other nations. Some key facts, not denied by the mainstream media, that make clear that Japan's economy is thriving:

1. Japan's net exports for the decade of the 1990s, when she was supposedly in decline, were 240% of those in the decade of the 1980s, when everyone admits she was booming. How is this possible if her economy is falling apart? We are being asked to believe that in an export-centered economy, exports are booming and yet the economy as a whole is failing.
2. The standard of living in Japan rose significantly during the supposedly stagnant 1990's, so that the Japanese are now among the world's greatest buyers of high-end consumer goods of all kinds, a fact visible in the shopping districts and parking lots of every Japanese city.
3. Japan's foreign assets have continued to grow rapidly. IMF figures indicate they nearly quadrupled in the 11 years to 2000, an inevitable consequence of her relentless trade surpluses.
4. Although a declining Japanese economy would imply a declining yen, the reverse has been the case.
5. Japan is the world's largest exporter of capital, enabling her to play the leading role in shaping the development of other nations. Americans ideologues who crow about the "spread of capitalism" ignore the fact that in large areas of the world, including its fastest growing region, East Asia, it is Japanese-style capitalism that is spreading, largely through the subsidiaries and suppliers of Japanese corporations.
6. Japan's supposed problems with its government budget are in a category all their own when it comes to misunderstanding. First, Japanese government accounting is very different from European or American government accounting, and that what have sometimes been reported

as deficits are in fact surpluses. Second, although Japan's ratio of national debt to GNP is indeed somewhat large, it is not grossly out of line with other nations whose economies are not characterized as being in crisis, and given Japan's higher savings rate, she can finance this debt easily.

7. Western press reports about the supposed crisis in the Japanese banking system are based on the false assumption that Japan's banks are similar to banks in the US and Europe. Because of their complex structural relationships to Japanese industry and to government, explained below, they are nothing of the kind. They have sources of stability to tide them over temporary difficulties that Western banks do not, and their rare failures cause far less disruption.

Japan's Economic System Only Makes Sense as a Whole

The Japanese economic system does not make sense when viewed in parts, as the significance of any one part of an economy is determined by its relations with the other parts. Westerners naturally assume, when looking at one part, that it exists in a context similar to the one it would inhabit in the American capitalist economy. But in Japan, it frequently does not.

For example, the Tokyo stock market, unlike the New York one, is an economically-minor sideshow to the real action, because most capital is allocated by banks, even when they use the stock exchange as a forum to execute this. Its failure to be a real capital market is made clear by the fact that the Ministry of Finance has on occasion forced the shares of individual companies to hover at arbitrary levels for various reasons.

The key to understanding the Japanese economic system is that it is not just a system of economics, but a system of *political economy*. This term – Adam Smith never used the word “economics” – is an older one and enjoys the key advantage of not covertly implying that the economic system is an autonomous sphere of human activity operating, at most, within a loose cage of politically-enforced property rights. This erroneous conception tends to further the *laissez-faire* delusion that state power is something alien that intrudes upon economic activity from without, and that the only important economic choice is between more and less state control.

A Non-Socialist Centrally Planned Economy

Japan is something that is virtually impossible by definition within the frame of reference of neoliberal economics: a non-socialist state-directed system. To over-simplify a bit, it is a centrally-planned capitalist economy.

Neoliberal economists are dimly aware of the fact that fascist and Nazi economics were centrally-planned but not socialist, but they tend to dismiss these economic systems because of the attendant political horrors and have made precious little effort to develop rigorous theoretical accounts of how they worked. As we shall see, the Japanese system has achieved many of the things the fascists wanted.

Modeling the Japanese System

The best way to model the Japanese system is to start from the conventional models of free-market capitalism and centrally-planned socialism and discuss how it differs from both.

In order to grasp what the Japanese have done, it is worth comparing it to Western attempts to achieve the same thing. For example, the Japanese have understood that the ambition of the advocates of the “mixed economy,” like Hugh Gaitskell in the UK, to socialize the “commanding heights” of the economy, has some rational basis, in that it embodies the desirability for some government direction of the economy without a total Gosplan-style takeover.

But this aspiration was misinterpreted in classic socialism, which understood the commanding heights to be basic industries like coal, steel, and railways. The problem with this, however, is that these industries do not *command* anything. Important though they are, they do not constitute a lever by which the economy as a whole can be controlled; they do not issue orders to the rest of the economy which determine how it behaves. The supply of capital to business, however, does, and this is under state control in Japan. One way to think of the Japanese system is as a capitalist economy with socialized capital markets.

Capitalism Without Plutocracy

Another case in point: does capitalism require plutocrats? The classic capitalist answer is that somebody has to own productive assets with a view to maximizing their profit, some of those who do will succeed brilliantly, therefore somebody must be rich.

But the Japanese see this as wasteful, so their system is designed so that corporations, in essence, largely own themselves. Even when there are nominal outside owners, corporations are managed so that the bulk of the wealth generated by the corporation flows either to the incomes of present workers or to investment in the future competitive strength of the company, making the workers and the company itself the *de facto* or beneficiary owners.

Most corporate capital in Japan is owned by banks, and the banks are principally owned not by shareholders, but by other companies in the same *keiretsu* or industrial group. And who owns these companies? Although there are some outside shareholders, majority control is in the hands of the *keiretsu's* bank and the other companies in the group. So in essence, the whole thing is circular and private ownership of the means of production has basically been put into the back seat.

Actually nationalizing the means of production would produce all the problems that led to the wave of privatizations in many nations in the last 20 years, and is unnecessary anyway. The Japanese system makes a sly mockery of both capitalism and socialism.

Forcing Growth by Forcing the Accumulation of Capital

One key way in which the Japanese system differs from American capitalism is that it squarely faces a fact that neoliberal economists admit, but tend to do nothing about:

The rate at which any economy – capitalist, socialist, feudal, fascist or what have you – can grow is dependent on how much of its production is saved and invested, rather than consumed.

America does almost nothing to increase its very low savings rate. Japan has a very high savings rate and this is a result of deliberate government policy and the lynchpin of the entire system.

How do they do it? The architects of the Japanese system understood that the socialist and communist way to produce high savings, i.e. outright confiscation of wealth, is destructive of people's incentive to work (not to mention its other problems) so they did not implement it. They understood that by definition, savings = production – consumption, so they focused on repressing consumption.

This means, for example, deliberately restrictive zoning policies that keep Japanese houses small, and it means not having the various devices in place by which America subsidizes borrowing and makes debt easy to assume. As a result, the populace of Japan is forced to save a far higher percentage of its earnings than Americans do.

It is a mistake to attribute Japan's savings rate, or many of its other key aspects, to "culture," as Japan had the same culture before WWII, when her savings rate was low. It is the interaction of culture with deliberate state policies, *not* culture itself, that is key. The use of "culture" as a catch-all explanation by foreign analysts of Japan is an evasion of serious analysis.

Controlling the Economy by Controlling the Accumulation of Capital

The Japanese government deliberately channels savings into a limited number of financial institutions under its control simply by making sure there is nowhere else to put the money. For example, it has seen to it that the Japanese cannot just open a brokerage account at Merrill Lynch and invest their money in the American stock market.

This huge torrent of savings flows to a handful of major banks, which the government has under its thumb because banking is extremely regulated in Japan, enabling regulators at the Ministry of Finance (MOF) to crack down on any bank at any time they see it doing something they don't want it to. So the banks are subject to the whim of the government, which then controls the economy by controlling how the banks allocate all this capital.

The net result is that the world's second-largest pool of private investable capital is subject to the control of a few hundred elite bureaucrats in Tokyo. The leverage they exert by controlling where this capital goes is the key to all their power.

How Japan Avoids the Problems of Soviet-Style Central Planning

The real genius of this system is that it is so indirect. These MOF bureaucrats are not stupid. They have read von Hayek, watched the Soviet Union struggle, and understand perfectly well that classic Gosplan-style central planning is unworkable. So they do not even remotely attempt this.

They understand quite well that the day-to-day detailed operation of the economy is best left to the invisible hand, just like Adam Smith said. They do realize, however, as Adam Smith didn't, that it is possible to manipulate an economy that is 99% capitalist into being, essentially, a centrally-planned economy *if* the state controls the right 1%. And this "right 1%" is the allocation of capital, especially big capital.

The MOF uses its stranglehold on the allocation of capital to make the banks into willing servants of its mission to control the Japanese economy. The banks, which in this respect (but not others) function similarly to the classic universal banks of Germany, handle almost all the detailed work of figuring out which companies should be loaned money and for which projects. The MOF essentially sits back, audits their performance, and rewards or punishes as appropriate.

This elitism in the MOF's control of the Japanese economy explains why so many outside observers fail to see it at all, though if one approaches the literature on Japan with this in mind, one quickly sees which observers have grasped the game.

In the early days of the Japanese system, the government had to be more involved in the details of deciding which industries to finance, because the banks had not developed the necessary sophistication, and so a far larger role was played by the Ministry of International Trade and Industry, the famed MITI, which actually did perform the classic industrial-policy functions of picking winners *et cetera*. But as Japan's private-sector banks have become more sophisticated, the need for this has diminished, and the MOF has become the key to the system. (MITI is still around, because there are some more speculative parts of the economy that the banks are not expert in and so the government still needs it sometimes.)

What is All This Capital Seeking?

As noted above, the MOF's key role is to audit the performance of the banks in allocating capital. But what counts as performance? In a conventional capitalist system, that's an easy question: maximizing return on capital. But in the Japanese system, this is not so.

For a start, the capital in question, although nominally privately owned, is "captive" capital in that it has nowhere else to go if it is unhappy with its return. This seemingly minor fact changes the whole dynamic of the entire economic system, because it means that capital, rather than chasing the highest return, can be made to obey political directives. Obviously, from the point of view of enriching individual investors this makes no sense, but this is not the MOF's objective. The investors don't have their money stolen from them – Japan is not a Marxist society – and they certainly get *some* return, but they do not get the maximum possible return.

What the MOF *does* want is to supply huge quantities of cheap capital to Japanese industry to

build up its long-term productive capacity. The MOF *wants* capital to be paid a low return so that Japanese companies will enjoy the competitive advantage of access of cheaper capital than their European, Asian, and American competitors. In capital-intensive industries like the advanced manufacturing in which Japan specializes, this is a huge advantage.

From the MOF's point of view, neoliberalism is designed to selfishly benefit the investors at the expense of the nation as a whole. And the investors themselves lose in the long run as their greed for high returns bleeds industry by imposing on it a high cost of capital, undermining these industries in the long run. In the Japanese analysis, the return to society as a whole of having strong industries (high wages paid, secure employment, a strong balance-of-payments) is more important than returns to individual investors, though these must be respected to some extent.

A Successful Planned Economy

The natural question a neoliberal economist asks at this point is, how can the MOF make rational capital-allocation decisions? Isn't it an article of faith, vindicated by years of experience, that governments are bad at this and markets good?

Well, yes, which is why the MOF intervenes at only the very highest levels of this process, most of the work being done by banks and the large corporations beneath them in this hierarchical system. Banks in Japan are attached to large industrial groups called *keiretsu*, meaning that they are both tied into sophisticated networks of industrial expertise and have several layers of administration below them to do the detail work.

Much of the Japanese system operates similarly to similar corporate structures in the West, though it faces a deliberately altered set of incentives. Because these incentives are just a fact of life to most of the corporate managers facing them, they don't even have to know where they came from or why. Most of the system doesn't even know that it's centrally-planned, and doesn't need to.

If there is any question as to whether they have been able to make these high-level decisions correctly for the last 50 years, one has only to look at Japan's relative economic performance, which has made her by all accounts the second-richest nation in the world and possibly soon to be the richest.

Simply put, *laissez-faire* theory is just plain empirically wrong: a planned economy can work. Period. Empirical facts trump abstract theories.

Unfortunately for the political left, Japan's success equally makes a mockery of socialism, which may explain why her system has attracted so little affection in the West. It does not flatter anyone's ideological religion, left or right.

Wall Street Works, But Isn't It Awfully Expensive?

Essentially, the architects of the Japanese system looked at the classic capitalist economy and

reached the exact same conclusion as the average member of the Western world: that most of it is rational, but that an absurdly high proportion of national income is wasted rewarding the tiny elite that performs the capital-allocation function. Wall Street types do their jobs reasonably well, but why not replace them with elite bureaucrats who will perform the same function for \$90,000 a year apiece, rather than people who earn ten, or even a hundred, times that? After all, one can teach bureaucrats the same technical skills of economic analysis.

In the Japanese view, investment banking is a business which, because of its structural monopoly on extremely valuable information, tends to produce grossly excessive returns for those engaged in it. The capital allocation function is irrationally priced because the intrinsic bottlenecks of information make it impossible for new entrants to drive down returns. Therefore the market cannot be relied upon to rationally price it. Capitalism, paradoxically, is rational except at its very pinnacle.

But Aren't All Bureaucrats Idiots?

At this point in the argument, neoliberal ideologues object in one of two ways:

1. By making some snide comment about the rule of elite bureaucrats.

An acceptable point, but one should not confuse the effectiveness of economic bureaucrats with the cultural and social mischief perpetrated by bureaucrats in other areas of government. The cold fact is that even the economies of those nations that most closely conform to neoliberalism, like the United States, are regulated by elite bureaucracies such as the Federal Reserve Bank, the Financial Accounting Standards Board, the Treasury Department, and the Interstate Commerce Commission.

2. By claiming that without paying the elite bureaucrats at the MOF huge returns directly proportional to the performance of the businesses they allocate capital to, they have no incentive to do their jobs well.

This is just empirically false. The performance of the Japanese economy shows that they do their jobs very well, and the key to this is something the architects of the Japanese political economy have understood that American economics tends to lose sight of:

Economic rewards are not the only effective incentives for economic action.

Exploiting the Power of Non-Economic Incentives

The Japanese are well aware that a successful economy requires the motivating effects of pay differentials and opportunities to accumulate private wealth. They are not living in a hippie socialist fantasy. But they have understood, as neoliberal economists, with their purely economic view of the economy, have not, that economic rewards operate in a social context and that social rewards for economic achievement can be as effective as cash.

In fact, because of the diminishing marginal utility of money, it is *irrational* for an economic system to rely on purely economic incentives. If all you pay people in is money, it gets awfully expensive to maintain their motivation as you go up the income scale. How much money does society have to dangle in front of a billionaire to get him to allocate another five hours a week from leisure to the work needed to run the part of the economy he owns?

That is to say, money is an efficient motivator (measured in terms of what society has to pay relative to what it gets for its money) under some circumstances, which is why we have capitalism, but inefficient under extreme conditions (which is why the Japanese deliberately limit it.) It is no accident that Japan has one of the lowest levels of economic inequality of any major nation at the same time as it has one of the most hierarchical cultures. The incomes of the top fifth of the Japanese population are only 2.9 times that of the bottom fifth, compared to 9.1 times in the US.

The income differential between a Japanese CEO and an assembly-line worker in his company is much less than in America, but the social-status difference is much greater. This does not consist in a system of static class differences not identical with economic differences, as in Britain, which the Japanese rightly see as producing class antagonisms which harm social cooperation. It consists in a *dynamic* social status system embodied in such oddities as the fact that Japanese grammar itself expresses the difference in status between the interlocutors, the Japanese reverence for hierarchy, and a lot else.

The Japanese have understood that what people are largely pursuing in the workplace is not so much money as the respect of the people around them, and therefore maintain a sophisticated – indeed, bizarrely over-elaborate to the Western eye – economy of *respect* in addition to the economy of money. They have understood that a large part of what money-seeking individuals really want is just to spend that money on purchasing social respect, though status display or whatever, so it is far more efficient to allocate respect directly.

Did you really think people as obviously intelligent as the Japanese were doing all those odd-looking bows for nothing? Sure, these behaviors are derived from tradition, but there's a reason they kept these traditions and the West hasn't. Interestingly, this understanding on their part of the need for unapologetic status differentials contradicts the emphasis in Western socialism on a *culture* of equality.

It also follows that if society is to maintain status differentials without suffering withdrawal of social cooperation due to the resulting resentment of low-status individuals, society must contain these status differentials within strong overarching sentiments of social unity. Naturally, the Japanese are famous for this, too. It all fits.

Platonic Guardians of an Eternal Japan

Why are Japan's bureaucrats so effective? Well, an American can start by looking at those American bureaucrats who are generally conceded by most people outside the far left to be effective: the military. The two salient characteristics of the military hierarchy in the US are that it has a governing ideology of nationalism and it is motivated by non-economic rewards.

Japanese bureaucrats at the MOF are the same. Like 5-star generals, they are no more than reasonably paid, but their real reward is in the form of status: they are recognized everywhere as outranking people hundreds of times richer than they are. They can demand to be recognized as equals by anyone in their society and as superiors by all but a few.

Plato would have recognized such men as Platonic guardians, who were produced in his *Republic* by a process the Tokyo University men who run Japan would recognize: an elite education, followed by long apprenticeship and combined with relative material asceticism, ruthless scrutiny by the other guardians, a tight in-group *esprit de corps*, and a guiding ideology of nationalism. Anyone who knew the pre-1960s Jesuits will also understand what is going on here.

The Long Time Horizon

One of the key advantages of Japan's system is that it enables the imposition of an exceptionally-long time horizon on economic decision-making. Few American corporations think more than 5 years ahead; the Japanese routinely think 15 years ahead and the architects of the system obviously thought 50 years ahead. Because capital is allocated, at the end of the day, by MOF bureaucrats and not impatient shareholders and mutual funds, there is no pressure for short-term returns. MOF bureaucrats know they will be judged by whether they succeed in building up Japanese industry in the long term, so this is what they aim for.

What Does it Mean to Build up Industry?

The key thing the Japanese have understood, which America, among others, has forgotten, is that a nation's long-term ability to pay high wages to its citizens depends on its having a strong position in monopoly industries. Monopoly industries are industries that have the strongly-entrenched competitive positions that enable them to charge superior prices on the world market. Boeing and Microsoft are the classic examples in the USA.

The core Japanese belief is that the benefits to society at large – in the terms of classical economics the positive externalities – of having these industries are so large that the free market on its own will misprice their value and not produce enough of them. Therefore it is rational for government to artificially direct capital into them, whether or not they produce the best short-term return to investors.

The Usefulness of Cartels

If one's objective is a strong competitive position for the industry as a whole, cartels immediately recommend themselves as a means to this end. Cartels are a device of industrial policy that has essentially been repudiated by neoliberal economics, for two reasons:

1. Within a neoliberal framework, profits from a cartel will just be captured by private interests, so there is no public interest in allowing them.

2. Neoliberal economics has an *a priori* obsession with vindicating free competition as the best policy.

Because the Japanese system, as noted above, forces the profits of monopoly industries into either paying its workers well or building up the industry so it can do so in future, reason #1 is inoperative, and reason #2 simply never interested them. Once one has these two factors out of the way, the many benefits of cartels can be tapped into:

1. They enable the individual firms in a monopoly industry to avoid fratricidal competition that would only benefits foreign customers, not the Japanese producers.
2. They enable the extraction of additional investment capital from the domestic consumer market by imposing higher prices.
3. They enable scale economies in research and development and standards-setting, crucial advantages in high technology.
4. They enable Japanese industry to avoid bidding wars in buying foreign technology and raw materials.
5. They enable Japanese industry to share out scarce sales in times of recession, avoiding bankruptcy of weaker firms. Naturally, these firms will pay a price in terms of losing control and will be whipped into shape, but they, and their workers, will not incur the traumas and layoffs of bankruptcy.
6. By enabling government-led control of prices and profits, they enable the government to pump in subsidies to favored industries with the confidence that these will go to building up the industry and not simply “wasted” as private profits to the shareholders.

Naturally, the Japanese are wise enough to the benefits of some competition that they don't simply agglomerate entire industries into “national champions,” as several European nations have sometimes tried to do. A regulated cartel delivers the best of both worlds.

Manipulating Corporate Behavior Through Corporate Structure

Japan's key banks each sit at the apex of a pyramid of cross-shareholding companies called a *keiretsu*. This has a number of important consequences, each coordinate with the overall aims of the system.

1. Because each *keiretsu* links companies with their upstream suppliers and downstream customers, this biases customer-supplier relationships towards long-term relationship-based, rather than short-term transaction-based, profit-seeking. The former is a key advantage in high-tech industries in which companies must make huge irrecoverable investments in research and development that will only pay off if they can count on stable relationships with customers and suppliers. Compare this to the American bias in favor of short-term business relationships, a

bias that then leads to short-term business thinking that is mutually-reinforcing.

2. The *keiretsu* system helps force companies to select their suppliers from within the *keiretsu*, not from foreign companies who may offer lower bids. Although this is superficially inefficient, because it deactivates the “exit” option American-style companies have in their dealings with their suppliers, it is in the long term efficient because it enhances the “voice” option Japanese companies have to enlist the aid of the entire *keiretsu* in whipping an underperforming supplier into shape.

3. Because each *keiretsu* contains within itself companies in a wide range of industries, the bank at its apex can draw on a wide range of reliable and proprietary expertise concerning appropriate allocations of capital.

4. Because each company in the *keiretsu* is on a leash to its bank, policies that the bank (puppet of the Ministry of Finance) wants imposed, can be. For example, policies to keep desirable high-value-added jobs in Japan. When Japanese jobs move to China, they are jobs that the MOF wants Japan to shed so her workforce can move up into ones with higher value-added and thus higher sustainable incomes. Naturally, pressure from the bank alone isn't enough to bring this about, and this policy depends on all the other policies that combine to make it economically feasible to pay Japanese wages for these jobs.

5. Because the *keiretsus* in effect create a monopsony for the purchase of elite executive labor, they can avoid the problem that American companies have of getting into expensive bidding wars for executive talent. This helps drive down economic inequality without all the problems of redistributing income through taxation. The emphasis in Japan on teamwork and consensus decision-making also helps prevent the accumulation of valuable proprietary knowledge inside any one head, which would then have excessive leverage to extract wealth.

Taking State Capitalism Seriously

State capitalism (of one degree and structure or another) is not unique to Japan. What is unique to Japan, or taken to its greatest extreme there, is serious thinking-through of what state capitalism means and what is required to make it work.

The French government, for example, would dearly love to be able to order companies to keep their plants in France open to serve its full-employment goals. But, consciously or unconsciously infected with a socialist class-struggle mentality, it considers the cost of doing this “the company’s problem,” not its own, with the predictable result that it barks orders at companies that simply cannot afford to do what the government wants them to.

The Japanese government, by contrast, understands that if it expects companies to provide full employment, it must provide them the wherewithal to achieve sustainable competitive advantage, and it does so by guaranteeing them a supply of cheap capital, as explained above, by protecting them from foreign competition, and by other means.

Sustainable Competitive Advantage In Hard Industries

I have thus far only described Japan's economy in the abstract. The concrete consequence of her policies is an emphasis on advanced manufacturing as a sector, because:

1. Advanced manufacturing is that sector which is most able to pay sustainably high wages to ordinary workers.
2. Advanced manufacturing is that sector which is most susceptible, because of the proprietary know-how involved, to the acquisition of sustainable competitive advantage.
3. Advanced manufacturing is that sector whose produce is most exportable, a key consideration for a nation that must import most of its raw materials and energy.

Lifetime Employment Aligns Incentives

Japan's famed lifetime employment system for core workers seems to the neoliberal eye inefficient, as it supposedly interferes with efficient hiring and firing. But it has a key benefit in a system designed around maximizing long-term rather than short-term success: it aligns the interests of the worker and the company to a much greater degree than under a hire-and-fire system. (Of course, Japanese companies have ways of disciplining bad employees short of firing them.) And since their long-term orientation leads to an emphasis on maintaining sales, not profits, in slack times, they tend to avoid the layoff cycles that Western companies endure.

Lifetime employment also gives companies an incentive to invest in giving their workers expensive technical training, since they know the workers won't just jump to a competitor once they have it. Since a highly-trained workforce is one of the absolute keys to success in any advanced sector of the economy, this is very important. And lifetime employment forces *executives* at the company to care about its long-term success, rather than just to pump the company for quick profits during the few years they are there.

Furthermore, the architects of the Japanese system understand that as a sociological and political matter, providing lifetime security to a core group of male "breadwinner" workers confers stability to society as a whole, especially when combined with a traditional male-dominated society that has stronger inter-generational obligations (to care for the old, for example) than most contemporary Western nations.

Ending the Marxist Curse of Alienation

Lifetime employment helps nourish the emotional bond between the worker and the company, which is also expressed by such things, which seem silly to Western eyes, as company songs. These make perfect sense within the context of Japanese culture.

Americans tend to forget that Marx wrote so much about alienation, (which we tend to associate with teenagers with purple hair, not with serious economic questions) for a reason: he saw this

as the key *psychological* phenomenon, in the head of the individual proletarian, that makes him a revolutionary. Alienation is important.

The Japanese were acutely aware of the Marxist challenge to capitalism, and they internalized this problem by taking seriously the elimination of alienation. The West really has not, choosing to smother it with consumerism while doing nothing about the phenomenon itself, resulting in the central weirdness of Western culture since the 1960s: the fact that our culture, from rock music to academia, is centered on the institutionalization of rebellion.

Unsurprisingly, Japan had no "60s" on our scale, and maintains levels of traditional morals (their traditions, remember, not ours) and deference to authority that remind most Americans and Europeans of the 1950s. This achievement is under certain stresses, as Japan is not immune to the corrosive forces of modernity any more than any other society, but it remains intact to a remarkable degree.

Fascism Without the Fascism

If the use of non-economic incentives sounds familiar, it is because the last time this issue was seriously addressed in the West in the context of a modern economy was by Peter F. Drucker in his 1940 book *The End of Economic Man*, which discussed how the Nazi system was based on creating a non-economic power structure to resolve the social conflicts that had been irresolvable within capitalist European society. This, in his view, was the sick genius of Nazism and the reason it had been able to come within a hair's breadth of creating a world-conquering social system.

The political economy described above is the product of thinking that originated among Japan's colonial bureaucrats entrusted with the industrialization of Japan's colony of Manchuria in the 1930's. They published their *Economic New Structure Manifesto* in 1940 as a result of their experience of the inefficiency of traditional capitalism as a development strategy. In the short run, the elite *Zaibatsu* capitalists of Japan vetoed their ideas, but in the long run, partly as a result of the American occupation's assault on the big property owners, a product of their New Dealers' conviction that industrial concentration was an abettor of fascism, they were able to triumph.

One way to describe the Japanese achievement is to say that they have achieved what the Nazis wanted to achieve but didn't, largely of course because they were mad serial killers obsessed with a lot of things other than economics. Ironically, Asiatic Japan comes closer than any nation on earth to what Hitler wanted. It is a socially conservative, hierarchical, technocratic, orderly, pagan, sexist, nationalist, racially pure, anti-communist, non-capitalist and anti-Semitic society.

Of course, it would be unfair to describe contemporary Japan as Nazi-like in any of the senses that are notorious (though one cannot help observing that she has never been contrite about her WWII actions the way Germany has.) More correctly, the architects of the Japanese system learned from their disastrous experience in WWII that the kind of society they wanted could not be achieved through a totalitarian predator-state and they calculated that it could be achieved

through the forms, though not the content, of liberal democracy, which is how Japan presents itself.

The Japanese Model Makes Democracy (Almost) Irrelevant

One of the consequences of Japan's long-term orientation that is least palatable to the Western liberal mind is that it has the effect of making democracy almost superfluous. The reason is simple: if the objective of the government is the long-term well-being of the nation, the means to this end have already been figured out, and execution has been entrusted to a bureaucracy with a track-record of success, then *there is very little for democracy to do*. What is there for the elected representatives of the people to debate? Particularly since serious debate about these questions turns on economic expertise they do not possess.

As a result, the Japanese Diet is essentially relegated to the "Tammany Hall" functions of a democracy: interceding with the bureaucrats on behalf of individual citizens and co-opting potential troublemakers by dispensing corruption. In fact, the bureaucrats, who control the spigot that dispenses the grease, like to keep the elected officials corrupt so that they can be disciplined at any time by the threat of running to the police. As a result, the supposed "democracy" in Japan is a trivial and compliant rubber stamp for the bureaucratic elite, who operate under enabling laws that give them the legal basis to do as they see fit. Since anyone seriously interested in running the country went into the bureaucracy long ago, there are few representatives in the Diet with any inclination to challenge this system, which gives them the perks and popularity that elected officials really want.

Japan is not Really a Liberal Democracy

In terms of the fundamentals of contemporary political philosophy, the key issue this all raises is whether Japan has refuted the idea that running an advanced society requires freedom. This assumption, which is not without evidence, is the absolute cornerstone of the contemporary Western assumption that the increasing economic development of the world may be presumed to have an ultimately benign political outcome. It impinges on a whole host of crucial issues too numerous to discuss here.

Japan has preserved, of course, the nominal forms of liberal democracy. But she has systematically drained them of content, just as she has drained capitalist institutions like the stock exchange of content. But if these forms are not necessary to the system, then both Peter F. Drucker, who has argued that an advanced society must be a free society, and Francis Fukuyama, who has argued that liberal democracy is the ultimate state of human ideological evolution, are wrong. The significance of this is incalculable.

Japan is thus a far more important example of the famous Asian "soft-authoritarian" model made famous by Singapore, and the challenge of this model is far more profound than people realize. This is particularly so given that China is desperately trying to construct a sustainable regime without risking the national disintegration that she quite reasonably fears attempted democracy would cause.

Theoretical Implications

Not only has economic history not stopped, but the range of alternatives exceeds the conventionally assumed one between capitalism and socialism. Perhaps the Japanese system is capitalism of a sort, but if so, it is a capitalism in which private capital is not the dominant organizing principle of the economy, so I would dispute this.

As nationalists, the Japanese only want their system to serve them and have no interest in winning ideological arguments. They will not make significant efforts to disabuse foreigners of their economic theories, especially when these theories make foreign nations accept their trade surpluses.

Japan's economic achievement refutes the proposition that neoliberalism is the only route to economic success. This does not mean, however, that all neoliberal theory is false. Clearly, within rationally-defined limits, much of it is true.

Practical Implications

This does not all mean that nations setting economic policies can ignore neoliberal prescriptions willy-nilly and expect not to pay a price. The Japanese system is a sophisticated construct that requires some of the world's most skilled economic managers. Outsmarting capitalism is not a game for amateurs.

The Japanese system is a *system*, so one cannot just copy any piece of it and expect it to work outside its original context. But some pieces depend upon things that are sufficiently similar in other economies that they are plausibly imitable. For example:

1. Any nation can usefully increase its savings rate, not necessarily by Japan's means.
2. Any nation can prop up working-class wages by not importing cheap foreign labor.
3. Advanced nations can benefit from carefully relaxing anti-cartel laws to allow cooperative R&D, as in the Sematech consortium in the US.

Other policies, like lifetime employment and cartel price-fixing, would clearly be a disaster if simply imposed, because they need constraints supplied by the rest of the system to ensure that the benefits are socially diffused and not just captured by narrow interests.

The lynchpin of the system, politicized capital allocation, probably cannot work in a democracy, as it would just result in plants being built in the districts of powerful parliamentarians and would not make investments whose payoff exceeded one election cycle. Naturally, kleptocratic oligarchies wouldn't be good at it either; politicized capital allocation is only likely to work under highly Platonic systems like the MOF. And even then, there is no guarantee: power still corrupts and one can easily imagine such a system becoming inbred and perverse. Japan's

achievement is an empirical fact, not a guarantee to all eternity.

Other policies fall in between the imitable and the inimitable, like the emphasis on advanced manufacturing, an extremely complex topic.

Still other policies, like protectionism, can only be rationally evaluated in the context of a general debate on the topic of which the Japanese case is but an important part.

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