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INTRODUCTION

Since the term "Japan, Inc." was first coined by a journalist in 1971,[1] Japan has been viewed as a supreme example of an economic machine that produces results. In the purest form of the concept, the government performs the function of top management in a corporation by making strategic decisions on where and how much to invest, while the business sectors, like divisions in a corporation, faithfully implement the assignments, but with government support in terms of financing, subsidies, and trade protection.

Over a period of time, the concept of Japan, Inc. has been broadened and refined. The government-business relationship now encompasses the relationship between management and employees, thereby giving birth to the concept of the "Japanese management style." It also extends to big and small businesses, thereby giving birth to the concept of the

1) In a cover story, the weekly magazine *Time* (10 May 1971) discussed the dangers of a Japanese business invasion typified by the success of Sony. The cover story article on page 50 was entitled "Japan, Inc.: Winning the Most Important Battle." Ohara and Yoshida credited the Magazine with the invention of the term. See Ohara and Yoshida (1972), which is a Japanese translation of *Japan : The Government-Business Relationship,* published by the Bureau of International Commerce of the U.S. Department of Commerce, 1972.

"subcontractor system." Concurrently, efforts have been made to discern factors that brought about the peculiar vertical and horizontal relationships in Japan. Studies tend to conclude that cultural heritage, which includes a combination of Confucianism, Buddhism, and Shintoism, has contributed to the formation of the relationship pattern during a period of at least 300 years dating back to the Tokugawa period.

Once an ideal economic development model has been established, the logical next step would be an attempt to transplant such a system to other economies. Developing countries for obvious reasons wanted to copy the success story of Japan, and developed countries also joined in this attempt. In business circles and business schools in the United States, William Ouchi's *Theory Z : How American Business Can Meet the Japanese Challenge* became mandatory reading for anyone interested in imitating Japanese management (Ouchi 1981). The well-known Japanologist Ezra Vogel in his *Comeback : Building the Resurgence of American Business* presented the case for government coordination and protection of domestic industries as a means of promoting the resurgence of American business (Vogel 1985).

After more than a decade of the "let's learn from Japan" trend, it is becoming increasingly evident that not all of the newly industrializing countries (NICs) have been successful. The fact that only Korea and Taiwan have closely approached the economic performance of Japan has prompted some observers to claim that cultural traits deriving from a shared cultural heritage—notably Confucianism and the use of Chinese characters for communication—constitute the most important factors for rapid economic development. This culturalistic view is a compelling explanation for the cross-sectional differences in economic performance that have

distinguished the Asian NICs from the Latin American NICs during the 1980s. At the same time, however, this view fails to account for the nagging question of why the Asian NICs remained underdeveloped for so long to start with.

At this point, we need to reevaluate the patterns of relationships between government-business interaction and performance. A simple two-by-two relationship matrix is presented in Figure 1. According to the stereotypic view of Japan, Inc., benevolent and competent government intervention in an imperfect market has contributed to the rapid economic growth belonging to cell A. Cell B represents the conventional classical view that the economy is best left in the hands of the private sector and that invisible hands will ensure the optimal allocation of resources. Cells C and D are shadow images of B and A, respectively. To depict empirical situations where actual government intervention (or non-intervention) resulted in less than maximum success, however, we need independent cells. Economic underdevelopment in planned economies belongs to cell C, and the economic underdevelopment resulting from the inability of many developing countries to form governmental economic bureaucracies belongs to cell D.

It is noteworthy that the concept of Japan, Inc. originated in the West and was expanded by Western scholars who were

Figure 1. Patterns of government-business interaction and performance

Performance	Intervention	Nonintervention
Maximum success	A	B
Less than maximum success	C	D

brought up and educated in a system that discouraged government intervention. To them the close interaction between government and business in Japan seemed novel and fascinating. As Japan achieved both surprising economic recovery and development during the postwar period, it was only natural for Western scholars to perceive a relationship between the two phenomena.

Japanese scholars, on the other hand, tend to take a different approach. It is true that even Japanese scholars admitted that the Japanese management style is distinctively different from the American style. For a time, they regarded the lifetime employment and seniority systems as distinctively Japanese and even believed that the Japanese practices were superior. These beliefs are rapidly fading in Japan, however, because Japanese firms are beginning to discard the lifetime employment and seniority systems. As for the first leg of Japan Inc., Japanese scholars have never been very comfortable. And as the foreign governments attributed the huge trade surplus of Japan in the 1970s and 1980s to the close interaction between government and business in Japan, they have begun to claim that Japan, Inc. never really existed or that, if it did exist, it was a very short-term phenomenon in the immediate postwar period. Tsuruda (1986) rejects the Japan, Inc. model in explaining the industrial policies during the rapid economic growth period of the 1960s. Horiuchi (1984) also claims that the governmental intervention or influence on the industrial portfolio of bank lending was already insignificant as early as the latter half of the 1950s. These scholars sound more like followers of the neoclassical economics depicted in cell B.

There is even a group of scholars who admit that the government did intervene for a short time and claim that the

blind pursuit of economic achievement produced side effects in income distribution, pollution, and sacrifice of social welfare. Thus government intervention was not really a success and was not a conceptual movement from cell A to cell C. These scholars do not go as far as claiming that Japan would have achieved an even higher growth rate without government intervention, but they do highlight noneconomic side effects. Their view in the taxonomy of Figure 1 would belong to cell C. Thus, before committing to imitate the Japanese model of economic growth—or the Japan, Inc. concept—it is important to remember that the final verdict on the evaluation of the Japanese example is still pending.

The object of this paper is to reevaluate the concept of Japan, Inc. For the sake of simplicity, I assume that Japan did perform better than any other country. I will therefore concentrate on examining the involvement of government in the market economy to a degree that warrants branding the Japanese experience as Japan, Inc.

The first part of this paper traces some of the historical interactions between government and business in establishing a capitalistic society. Special emphasis is given to the applicability of Japan, Inc. in describing the prevailing relationship pattern in five different time segments from the 1868 Meiji Restoration to the present. Followers of Japan, Inc. tend to emphasize the influence of the time-invariant behavioral modes of the Japanese on the formation of government-business interplay. This paper, however, does not discard the possibility that the pattern of interplay may be a result of situation-specific economic realities. In the second part, the interplay among government, financial institutions, and business in financing industrial investment will be examined for each of the time segments. The paper concludes

by suggesting a model, in reference to the experiences of Japan, for interplay among government, financial institutions, and business that will serve Korea well in the 1990s and beyond.

GOVERNMENT AND BUSINESS INTERPLAY IN ESTABLISHING A CAPITALIST ECONOMY

In terms of the rules of the game, the relationships between government and business can be classified broadly into three patterns: laissez faire, mercantilist, and constitutionalist. The role of government in the laissez faire pattern is restricted to the maintenance of social order. Accordingly, the government should not intervene in business activities. In this case, competition among private businesses is supposed to bring about the optimal allocation of resources. By contrast, governments that adhere to either the mercantilist or the constitutionalist pattern believe that economic matters are too important to be left solely in the hands of the private sector. The mercantilist government, believing than it can plan and operate business affairs better than the private sector, plays a supportive role and provides subsidies against foreign competition. The constitutionalist government, on the other hand, plays the role of regulator and functions as a kind of filter that will represent interested parties (such as labor and consumers) who might otherwise be sacrificed in an imperfect market.

In the implementation stage, a mercantalistic government may or may not use its discretionary powers to decide which industry or company will receive government subsidies and protection. The "window guidance" from the Bank of

Japan and the "administrative guidance" from Japan's Ministry of International Trade and Industry (MITI) are good examples of discretionary intervention. It is generally believed that such intervention is strongest when it is exercised with discretion.[2)]

The formation process and degree of national commitment, be it to economic development or to social development, are also very important. Most developing countries find it difficult to form a national consensus for economic development. In this regard, it is useful to review the Japanese experience. As will be shown, in addition to being a rule setter, the Japanese government has sometimes acted as a player in business by running government enterprises. A vital lesson to be drawn from this study is that the art of deciding when to run and when to privatize is very important.

In this section, the roles of the Japanese government during the 120 years since the Meiji Restoration—as rule setter or player or both—will be examined together with the roles of the private sector in accommodating and sometimes initiating the drive for economic development. The discussion will be divided into three parts covering the period prior to World War II, with two additional parts covering the periods prior to and after the first oil shock in 1973-74. Although the years 1868 to 1945 might be treated as a single 78-year period, this time span is simply too long, eventful, and heterogeneous, and has therefore been subdivided into three distinct periods. The

2) Jones and SaKong (1980) developed a government-business interplay model that applies better to developing economies. In a two-by-two matrix, the implementation mechanisms are divided into field manipulation and command, while compliance mechanisms are subcategorized into discretionary and nondiscretionary intervention. They claim that government involvement is highest in the command-discretionary cell.

examination of each period will begin with a description of the general economic and social situation, followed by an analysis of the roles of governmental and business in meeting the challenges of the times, and of the communication channels between them.

Transition to a Capitalist Economy, 1868–80

After the lower-class samurai from the western part of the country triumphed during the Meiji Restoration in 1868, Japan was in a precarious position both economically and militarily. It is true that the heritage of the preceding Tokugawa period included an efficient, centralized bureaucracy and human resources characterized by a high literacy rate and practical education from the temple schools (*terakoyas*). But in terms of technology, capital resources, and the availability of entrepreneurs, Japan was underdeveloped. The Western superpowers were, moreover, competing to colonize China. Japan, like her neighbor, was forced to sign an unequal treaty and thereby lost the options of earning more custom duties and protecting her infant domestic industries. Under these circumstances, it is not difficult to see why the national slogan of this period was to "enrich the country and build up military power."

Role of government During this period the government functioned both as a rule setter and as a player. As a rule setter, the government's greatest contribution was the formation of a national commitment to economic development. The consensus was not formed through a democratic opinion poll but was imposed on the people by an enlightened

leadership. The government leaders themselves, however, were not all in agreement on the question of industrial development. In fact a leading figure in the government —Saigo Takamori—argued for greater emphasis on the military build-up and for an invasion of Korea. The infighting among government leaders persisted for ten years and was finally settled only by the 1877 Satsuma War. If the militarists had won the war, Japan probably would not have achieved the transition to a capitalist economy.

Once the development-minded leaders were in control of the government, even before the war, they monopolized the name of the emperor in initiating the necessary social changes to transform the feudal society into a capitalist one. The common people were allowed to adopt family names and were given the freedoms of travel and marriage. Most important, the feudal social class structure was dismantled. After the national conscription system was adopted, the samurai class lost its traditional monopoly as the sole supplier of soldiers, and the commutation of the feudal pension was a hard blow to the feudal nobility.

Such dramatic social changes were possible partly because of the ages and status of the leaders in power. They were former lower-class samurai who had suffered econmically because of the low stipends they had received during the later Tokugawa period. They were young, mostly in their late thirties or early forties. From the traditional perspective, in the feudal and Confucian context, they lacked the legitimacy to rule in terms of both social status and age. If the Meiji Restoration government had been dominated by older and higher class nobles, the social changes would probably not have been so dramatic. The leaders' lack of legitimacy to rule was conveniently counterbalanced by carrying out the

reforms in the name of the emperor.

The government, however, did not totally destroy the Tokugawa heritage. The former samurai were called upon to assume a new type of leadership in economic development. The samurai provided the driving force in the development of Hokkaido. They were the main equity participants in national banks and railways, and their daughters were encouraged to work in government-operated textile mills. The government was keen to utilize the established image of the samurai as a vehicle for educating the people and orienting them toward economic development. If the government had failed to solicit the help of the samurai, it would have found it very difficult to persuade the people to move in the direction of industrial development.

In addition to its role as a rule setter, the government also functioned as a player. The government founded and ran various industrial mining, textiles, and armaments enterprises. It must be remembered, however, that the Meiji government did not invent the system of government enterprises. Toward the end of Tokugawa period, the shogunate (*bakufu*) and the local feudal clans (*han*) managed the public mining and shipbuilding industries. After the restoration, these enterprises were handed over to the Meiji government. In fact, most leaders in the new government were previously involved in the operation of the pioneering industrial projects of the feudal clans. Their practical experience, however, did not necessarily give the new leaders a preconceived bias toward state control of businesses. To the contrary, from their observations about Western countries, these leaders learned the value of private businesses. The government enterprises thus were partly the legacy of the Tokugawa period and partly the result of deficiencies of capital, technology, and

entrepreneurial spirit. The existence of government enterprises during this period therefore does not necessarily imply that the leaders truly believed that the government could run businesses better than the private sector in the long run.

It was not enough simply to found new industrial enterprises. Japan at the time lacked the technical skills needed to run them. Thus the government initiated an all-out drive with the slogan, "Let's learn from Western countries." The outward-looking spirit engendered by this movement was a complete reversal of the xenophobic stance taken during the restoration movement against the shogunate. The leaders took a practical approach to the situation, and their commitment to the drive was surprising. Immediately after the restoration, when the remaining pro-shogunate followers were still rioting in various corners of the country, a group of the new leaders departed on a two-year tour to the United States and Europe. Their mission was ostensibly to renegotiate the unequal trade treaties signed by the shogunate, but in reality they were undertaking a valuable study tour. On their return, as a symbol of the new age, they began to wear Western-style suits and persuaded the emperor to wear a Western-style military uniform. In addition, the government engaged an army of foreign advisers for a westernization program that cost 15 million yen (equal to U. S. $15 million). The fact that total investment in government enterprises at that time was only 35 million yen shows how serious the government was to secure the transfer of technology. Salaries granted to foreign experts were often more than double the salaries of high government officials(For detailed information on the number and monthly salaries of foreign advisers, see Table 2.29 in Ando 1978 : 55). The government also spent 5 million yen to send Japanese students abroad for

higher education.

Role of the private sector In contrast to the pioneering spirit of the government, the private sector initially offered little help. During the immediate post-restoration period, this sector comprised only merchants and no industrialists. The Tokugawa-era class structure of samurai, peasants, artisans, and merchants made no provision for private industrialists. During the Tokugawa period, the wealthier merchants made their fortunes by running warehouses and exchange companies (*ryogaeya*). They supplied loans to the samurai and the individual feudal states (*daimyo*), thereby becoming the creditors of the feudal system.

Because the merchants belonged to the lowest social class, they were not initially bound by Confucian ethics, and accordingly they could openly seek material gain. As the merchants became richer, however, they began to enjoy social recognition, and their change in status forced them to conform to the restrictions of Confucian ethics. The fact that they were heavily reliant on the government for their business activities also forced them to share the Confucian culture of government bureaucrats. They began to enjoy a profitable and stable relationship with the government, and the house rules of the most important merchants began to emphasize loyalty to the country and to the feudal state (Hirschmeier and Yai 1981 : 40-43).

As the merchant class became increasingly imbued with Confucian attitudes, they adopted a stance of extreme commercial conservatism. One leading merchant established a rule that specifically forbade embarking on any new venture. The prevailing ultraconservatism among merchants must have been the primary reason why the merchants as a group

did not play an important role in the industrialization drive of the early Meiji era. Before making financial commitments themselves to entirely new and untested ventures, they preferred to wait and observe the results of the government enterprises. It is also important to remember that some of the merchants lost part of their fortunes after the restoration, as a result of de facto defaults on their loans to the former feudal states, and were therefore suffering from a deficiency of capital.

The government alone was neither intellectually disposed nor financially able to operate all industrial enterprises. Despite the disappointing response of the merchant class, the government had to find some means of persuading the private sector to participate. The society needed a link between government and business. Eiichi Shibusawa was just the man. He was a former samurai and was one of few Japanese who had visited Western countries. After the restoration, he joined the Ministry of Finance and helped to build the new monetary and banking system. Both he and his immediate senior, Kaoru Inoue, left the ministry to enter the private sector. Inoue later returned to the bureaucracy and remained at the center of power for a long time. Shibusawa, on the other hand, opted to remain in the private sector and was instrumental in founding and managing more than 500 new ventures in banking, cotton spinning, railways, shipping, breweries, and fertilizers.

Shibusawa was a strong proponent of the system of joint stock companies, since he could not fund new enterprises by himself. During the Tokugawa period, industrial enterprises were operated as family ventures and were funded exclusively by their respective family members. Day-to-day business was occasionally delegated to nonfamily managers, but the

head of the family always wielded the ultimate managerial authority. By contrast, the joint stock company was to have a wider base of financial support and was to be run by professional managers such as Shibusawa. In this regard, the system was an early attempt in Japan at separation of ownership from management. The private funding sources available at the time were merchants, landlords, and samurai with commutation bonds. These people, however, had neither the managerial experience necessary for running industrial enterprises nor the entrepreneurial spirit to assume by themselves the risks inherent in the new industrial ventures. Shibusawa played a critical role in mobilizing and amalgamating these potential financial sources to fund new industrial ventures.

Communications channels There was no systematic communication channel between government and business during the years from 1868 to 1880. Communication was maintained on a personal basis between politically oriented business managers and pro-business government leaders. Mitsui, for example, was designated as the financial agent of the new government, and Mitsubishi became the sole shipper of soldiers and military goods during both the Taiwan expedition and the Satsuma War. The fact that such arrangements were made through personal contacts fostered the suspicion that businessmen with close political connections (*the seisho*) were predominant in government and business relationships at that time.

The Tokyo Chamber of Commerce was founded in 1877 as an official channel of communication. It should be noted, however, that this early Japanese commercial association differed in character from its counterparts in Western coun-

tries. In Europe the chamber of commerce was organized by private-sector initiative to represent the interests of business vis-à-vis the government. The Tokyo Chamber of Commerce, on the other hand, was originally founded by government initiative as a means of establishing leverage for official efforts to renegotiate the unequal commercial treaties signed in 1858 (Yamada 1980 : 168-69). Acoordingly, Shibusawa was a very suitable choice as its first president. The private sector, however, did not respond enthusiastically to the activities of the organization.

Takeoff of the Capitalist Economy, 1880–1929

The period from 1880 to 1929 is characterized by the withdrawal of the government's direct involvement in the market economy. The government reversed its inflationary financing strategies and sold its pilot enterprises to the private sector. There was still some protectionism in the shipping industry, but the economy was basically driven by private enterprises. The private sector accumulated valuable managerial and financial strength during the three wars that took place during this period—the Sino-Japanese war, the Russo-Japanese War, and World War I. Also during this period, the peculiarly Japanese business groups (*zaibatsu*) were founded and gained importance.

Role of government Printing inconvertible government money during the previous had been an easy way—and in a sense the only way—to fund government expenditures. But it had certain undesirable side effects. Prices rose and people were hesitant about financial savings. To remedy the

situation, the government—more specifically Matsukata, then minister of finance—launched some of the most dramatic financial measures in Japanese history. The government restricted the money supply by 30 percent during the six-year period 1879-85 (Goldsmith 1983 : 27-29). This change does not represent a reduction in the growth rate of the money supply but rather an absolute reduction in the money supply itself. Consumer prices dropped by about 30 percent during the three-year period from 1881 to 1884. As the people gained more confidence in their financial assets, there was a surge in the development of national and private banks. The establishment of a stable financial system opened an important channel of funds to industrial ventures.

Even the beginning student of economics understands the need to contain inflation as a precondition for sound economic development. But whether a government has the will and political strength to carry out the necessarily stringent monetary and fiscal policies is an issue of political economy. The vicious cycle of inflation in present-day Latin American countries is all too familiar, although economists have a prescription for solving the problem. But, because governments cannot always demand the necessary sacrifices from their people, such problems remain unsolved and may become worse. The Matsukata deflation itself was not sufficient to contain Japan's inflation, which resumed in the latter 1880s. But the spirit of the Matsukata deflation has persisted throughout recent Japanese economic history. MITI—or its various predecessors, the Ministry of Industry, the Ministry of Agriculture and Commerce, and the Ministry of Commerce and Industry—pushed for rapid economic development through government supports in terms of planning, subsidies, protectionism, and preferential funding. For these reasons,

observers of MITI's behavior are likely to conclude that the government in Japan, Inc. has a bias toward expansion (Johnson 1986). But every time sings of inflationary pressures or trade deficits or both appeared, the Ministry of Finance habitually applied the brakes and adopted a contractionary monetary policy. The existence of interministerial conflicts necessitates a modification in the perception of Japan, Inc. as a monolithic entity in which the government consistently promoted the expansion of the economy(Vogel 1977 : 16).

The second important measure taken by the government early in this period is the privatization of government enterprises. As noted earlier, the government launched many pilot industrial ventures. But most of these enterprises recorded losses and became heavy burdens on the national budget. The government's decision to sell its enterprises and transfer them to private hands provoked another interministerial disagreement. The minister of industry opposed the change, whereas the minister of the interior, whose views ultimately prevailed, was a proponent of privatization.

Most of the government enterprises were sold at prices that were lower than the cumulative government cash investments in them. This "discount sale" gave birth to a general suspicion that the government was providing a kind of subsidy to the private sector (and especially to the businessmen with close political connections) to give them a head start in new businesses. This sale of government assets is frequently cited as an example of the close relationship between government and business and thus of Japan, Inc. But were the government enterprises really sold at a discount? (For the selling price and conditions of government enterprises, see Table 2.35 in Ando 1978 : 57). The economic value of a company equals the sum of expected future income flow adjusted

by an appropriate present-value discount factor. The economic value has little to do with historical cash investments in the venture. The government enterprises were sold at discounts from the historical cash investments. But who would want to buy a commercially unprofitable venture at historical value? In fact, when the first offer of government enterprises was announced, even at deeply discounted prices, the government failed to attract any buyers. The significance of the privatization measures therefore does not lie in providing subsidies to the private sector but rather in the modification of the government's perspective—that is, a change in attitude in favor of a market economy run by the private sector.

The privatization measure did not necessarily mean that the government had abandoned its efforts to promote domestic industries. The government may simply have changed tactics. Instead of leaving the enterprises to be run by the government and to record big losses, officials decided to let private businessmen run them, with government subsidies if necessary. Since the government was still bound by the terms of the unequal trade treaties, it could not erect tariff barriers to protect domestic industries. Instead, it resorted to the use of subsidies.

Roughly 75 to 80 percent of all subsidies paid out by the government during this period went to the shipping and shipbuilding industries. There was an obvious military bias in the selection of these industries, because the country fought three major wars between 1880 and 1929. This bias toward supporting the import-competing basic industries more than the existing and emerging foreign-exchange earners became something of a tradition in Japan. During the years before World War II, comparatively little government

support was given to industries such as silk reeling and cotton spinning, even though these industries were contributing greatly to foreign-exchange earnings. Similarly, in the period after World War II the motor vehicle and electronics industries received relatively small shares of preferential financial support from the government. These findings suggest that the general conception of a Japan, Inc. biased toward export promotion should be re-examined and possibly revised.

The size of the subsidies was significant (Teratani 1980: Table 1, 71). The subsidies often exceeded the operating profits of the companies concerned; some companies would have become bankrupt without them. Hindsight suggests that Mitsubishi was the greatest beneficiary of the subsidy program. In contrast to the previous period, however, when the selection of Mitsubishi as the sole carrier of military goods was a matter of political influence, Mitsubishi now had to face stiff domestic competition to qualify for the subsidies. All companies now had equal access to the subsidies so long as they met certain strict criteria, including minimum tonnage, siting of shipyards, and regularity of shipping routes (Teratani 1980 : 62-69). These conditions definitely favored big companies such as Mitsubishi. At that time, however, Mitsubishi was competing with an even bigger government-run shipping company for subsidies and market share. Only when Mitsubishi proved that it could manage the business better than the government did the government transfer the business to Mitsubishi. Thus one must always keep in mind that the trend in Japan, Inc. is not necessarily anticompetition. To the contrary, excessive competition has always been a characteristic of the Japanese economy (Komiya 1986 : 12-16).

Role of the private sector The most noteworthy phenomenon of this period was the emergnece of Japanese business groups. The zaibatsu was a very specific type of business group that must be clearly distinguished from its postwar successor (called *keiretsu*) and from an American conglomerate. The zaibatsu was vertically organized. It had a holding company at the top, which was wholly owned and managed by one family. The holding company was the sole owner of three or four big companies (*chokukei gaisha*), each of which had subsidiary companies (*ko gaisha*). The latter, in turn, had subsidiaries of their own (*mago gaisha*).

In terms of business structure and management style, the zaibatsu resembled the old Tokugawa merchants houses. Two leading zaibatsu—Mitsui and Sumitomo—had in fact been merchant houses during the Tokugawa period. As mentioned, Shibusawa promoted the joint stock company system in which management and ownership are separated and the company is owned by the populace at large. In spite of his personal efforts, the legacy of the Tokugawa merchant tradition did not disappear overnight but resurfaced in the zaibatsu.

Holding companies of the zaibatsu were formed on the eve of World War I, and the zaibatsu grew rapidly during the war. Their trading companies in particular made great fortunes from international trade. The trading companies made the most out of the vacuum created by the retreat of European competition from international markets. During the postwar depression in Japan, the zaibatsu continued to grow in absolute volume of sales and relative shares in the domestic market, because of their ability to pursue managerial and financial rationalization in the depressed markets of the

1920s.

Mitsui Gomei, for example, which was the holding company of the Mitsui zaibatsu, expanded its paid-in capital almost fourfold during World War I—from 50 million yen in 1914 to 190 million yen in 1920. The absolute increase of the paid-in capital was not as great, however, during the economically depressed 1920s, and by 1930 Mitsui's paid-in capital had risen to only 247 million yen (Dogai 1978). Taking into account the decrease in absolute terms in paid-in capital of the nation as a whole during the depression period, the superior performance of the zaibatsu is readily apparent. Mitsui's growth was even more dramatic in terms of the number of companies in the zaibatsu. The four related companies prior to World War I increased to 19 in the postwar period and eventually to 97 during the depression.

An equally important aspect of the rapid growth of the sizes and market shares of the zaibatsu was that such growth was self-financed without government help. In fact the zaibatus member companies were net depositors in their member banks. During the rapid economic growth period after World War II, Japanese companies relied heavily on external funds, and consequently the debt-to-equity ratio was very high. By contrast, the rapid growth of the zaibatsu during World War I and the depression was internally financed, and the debt-to-equity ratio remained low. As the zaibatsu became increasingly confident of their abilities to operate without government assistance, they became wary of government intervention. The government neither led, planned, nor supported the growth of big companies during this period. Instead, the growth was partly the result of opportunities abroad during World War I and the superior ability of the big companies to rationalize during the

depression.

Along with the reduced role of the government in deciding the fortunes of big companies, the loyalty of businesses to the country began to fade rapidly, at least in the sense of Shibusawa's entrepreneurial nationalism. In its place, managers became loyal to the zaibatsu. The Confucian heritage of loyalty remained, but the target changed. The managers began to behave as if they believed that "what is good for the zaibatsu is good for the country." The consequence of the change in loyalty is most clearly illustrated by the failure to form effective cartels during the depression. Although the government encouraged the formation of production cartels, the member companies of each zaibatsu refused to cooperate with their counterparts in the other zaibatsu, persisting instead with competition in order to enlarge their shares in the depressed markets.

Admitting that the emergence and the rapid growth of the zaibatsu were the most noticeable characteristics of the period, one must not neglect the importance of the other market participants of the time, namely non-zaibatsu business entities and the government. The zaibatsu, even though they had enlarged the industrial portfolios of their operation, were most active in peripheral industries such as mining, trading, and banking. The silk reeling and cotton spinning industries were two of the most important foreign exchange earners at the time. But the presence of the zaibatsu in these industries was minimal. This strange phenomenon might be just another manifestation of the survival of Tokugawa merchant traditions among the zaibatsu. The absence of zaibatsu companies was felt in heavy industries, which the government at the time tried hard to promote. The government founded the Yahata Iron and Steel Mill in 1901. But this

enterprise by itself could not meet the sudden increase in the demand for iron and steel during World War I, and as a result private companies began competing to found iron and steel mills. The zaibatsu mostly remained aloof from this competition. When the short-lived war demand ended, overcapacity became a problem, and the government and private iron and steel mills suffered big losses. In hindsight, the zaibatsu were wise not to join the movement to set up iron and steel mills during the war boom, because Japan still lacked the technological skills necessary to compete with European companies in the international market. But the fact still remained that the zaibatsu did not follow the leadership of the government in its effort to promote heavy industries. Despite government leadership, the highly conservative zaibatsu ventured only into commercially profitable industries. The machinery of Japan, Inc. was therefore virtually inoperative during this period.

Communications channels The Federation of Chambers of Commerce, formed in 1892, was the only official communication channel between business and government until the establishment of the Industrial Club (Kogyo Kurabu) of Japan in 1915. The federation was led by Shibusawa, who was still the leader of the business community (*zaikai*). It organized a movement to oppose plans for a corporate tax but failed to prevent the introduction of this tax.

Immediately after the Sino-Japanese war of 1894-95, the government formed temporary commissions to engage businessmen directly in discussions concerning postwar economic problems and the proposed adoption of the gold standard. The Japanese temporary commission, as an advisory committee for government economic policy formulation,

differed in composition from the royal commissions of Great Britain (Nakagawa 1980 : 226). Whereas the British commissions exclude bureaucrats to ensure objectivity, the Japanese commission included both government officials and businessmen directly involved in the issue. It was only after 1927 that disinterested parties, such as university professors and journalists, were admitted to the commission.

In this period businessmen also participated directly in politics. Yatalo Iwasaki, the owner and manager of the Mitsubishi zaibatsu, collaborated with prime Minister Katsura to form the Minseto Party, while the Mitsui zaibatsu helped to form the rival Seiyukai Party. Many politicians in the Diet were funded by zaibatsu. Under the parliamentary system that began in 1890, the financial power of the zaibatsu influenced politics greatly. Naturally the Industrial Club of Japan under the leadership of Dan Takuma, chairman of Mitsui, wielded considerable power in representing the interests of big businesses to the government. This was a golden age of big business. In a sense, business ruled the government.

World Depression and the Rise of Fascism, 1930–45

Among the general public, young bureaucrats, and military officers, there was growing antagonism against the government leaders and big business. Parliamentary government and big business initially resisted the spread of fascism, but in the end the military took control of the economy and led the country into the disastrous Chinese and Pacific wars.

Role of government The depression of the 1920s significantly eroded public confidence in the capitalist econ-

omy and in the legitimacy of big business. Since the parliamentary government was showing favoritism toward big business and the capitalist economy, the government was also beginning to lose the respect and loyalty of the public.

The government was, however, not responsible for all the misfortunes of the period. Postwar economic depression and the great earthquake, for example, were obviously beyond any official control. At the same time, the government made many policy mistakes that aggravated the situation. The finance minister's misinformed announcement in the Diet concerning a bank failure ignited the first round of bank failures. The ill-considered decision not to save the central bank in Taiwan, which issued its own banknotes, brought about the second round of bank failures. The untimely return to the gold standard in 1930, a few months after the great stock market crash in the United States, exposed the Japanese economy to the full after effects of the coming depression. Provisional efforts to defend the fragile gold standard led only to massive speculation in U.S. dollars by big business.

It was rumored at the time that the dollar long position of the big businesses was equivalent to 760 million yen. Because the dollar appreciated by about 20 percent relative to the yen immediately after Japan abandoned the gold standard in 1932, the estimated foreign exchange gains through speculation amounted to 140 million yen. The largest share among big businesses was held by Mitsui, through the zaibatsu's bank, trust, and trading companies.

Mitsui had a logical explanation for its dollar long position. Mitsui claimed that the zaibatsu was holding a dollar balance in preparation for dollar payments in international trade. Considering that the zaibatsu had suffered a big

loss because of the depreciation in the pound sterling, the purchase of U.S. dollars may have been a prudent managerial decision to hedge against exchange risks. The public, however, did not believe this explanation and regarded Mitsui's dollar transactions as an example of unpatriotic behavior by a zaibatsu at the expense of the poverty-stricken public. Mitsui thus came to be regarded as "public enemy number one." The government—or more specifically Finance Minister Inoue, who permitted the Yokohama Bank to sell dollars to the zaibatsu—also came under fierce attrack. It is not surprising, therefore, that Dan Takuma, the chairman of Mitsui, and Inoue were the first victims of an assassination movement led by extreme right-wing military officers.

In 1930 the Temporary Industrial Rationalization Bureau was established in the Ministry of Commerce and Industry to help rationalize the iron and steel industries, which were badly hit by the worldwide depression. The bureau recommended that the state and private iron and steel industries be amalgamated, and in the process Nihon Iron and Steel Company (Nittetsu) was founded in 1933. This effort by the government is often quoted as a supreme example of Japan, Inc., in which government and business were of one accord in pursuing a national objective. In reality, however, the amalgamation measure was not very effective (Udagawa and Nakamura 1980 : 85-91). Nittetsu succeeded in soliciting the cooperation of iron producers. But more than half of the steel producers refused to join the centralization measure, even in the face of outright threats from the government.

The failure of the amalgamation measure could be attributed partly to timing and partly to the contents of the measure. Government and private iron and steel companies had already experienced drastic rationalization. Beginning

with more than 200 companies in 1920, the industry shrank to only ten companies in 1926. The private companies were already confident of their ability to carry out the necessary rationalization on their own. Secondly, the Manchurian incident in 1931 and the yen depreciation in 1932 ignited a sudden rise in the domestic and foreign demand for iron and steel products. Thus the contractory bias of the amalgamation measure was not congruent with the underlying economic situation of the time. And indeed the government switched its policy from rationalization to promotion of iron and steel production after the war began in China in 1937. Furthermore, the government failed to provide a package with sufficient financial incentives to induce voluntary participation by private companies.

There is abundant evidence to show that the big zaibatsu were initially not very cooperative in the government's plan to develop heavy and chemical industries. In addition, the older zaibatsu, such as Mitsui and Mitsubishi, refused to venture into the motor vehicle industry, despite continuous urging by the government. The vacuum was eventually filled by two new zaibatsu—Nissan and Toyota. It is important to note, however, that the new zaibatsu's entry into the automotive industry was a result of neither government invitation nor government help. Both companies began almost independently, and their founders were technicians-turned-entrepreneurs. They were nationalistic in that as technicians they wanted to prove that the Japanese could produce passenger cars as well as America's Ford and General Motors, which dominated the Japanese passenger-car market at the time. Nissan and Toyota remained outsiders to Japan, Inc., however, until their existence finally came to the attention of the government, which was growing dismayed by the continued

refusal of the older zaibatsu.

After the promulgation of the comprehensive mobilization law in 1938, the government began to extend its control over every aspect of private business, including finance, investment, production, manpower, and marketing.

Role of the private sector Early in this period, the old zaibatsu were not cooperative in following the government's lead into heavy and chemical industries. The previous 40 years of experience had instilled in them the habit of disliking any kind of direct intervention by the government in their affairs. Resistance was strongest againest the government's intentions with regard to the automotive industry. The creation of a Japanese automobile industry would have required a mass-production system and huge cash investments. Furthermore, it was obvious that Japan did not yet have the technical capacity to compete against the American automobile manufacturers. The refusal by the zaibatsu to risk their own money in this new industry was therefore based on sound commercial logic. It was contrary to the traditions of the old zaibatsu to embark on a new venture with less than a fair chance to make a profit. Thus the conservative and capitalist philosophy of the zaibatsu was in direct confrontation with the nationalistic and militaristic mood of the time.

The assassination in 1932 of Dan Takuma, chairman of Mitsui, was a real shock to big business and to Mitsui in particular. Businessmen now perceived the seriousness of the antagonistic mood against their business groups, especially after the dollar speculation scandal. The zaibatsu leaders subsequently initiated a process of "conversion" (*tenko*) in their business philosophy. It will be usefull to examine the nature of the "conversion" movement closely, because many

of the voluntary measures included in this movement are similar in spirit to the measures taken during the dissolution of the zaibatsu by the Allied army after World War II. Because Mitsui was regarded as "public enemy number one," its conversion measures will be examined in detail (Dogai 1978 : 107-32).

Mitsui's conversion was initiated by Shigeaki Ikeda, the executive manager of Mitsui Gomei, the group's holding company. The conversion consisted of five important measures. First, over a period of four years from 1933 to 1937, Mitsui donated 60 million yen to charity—a sum equal to one -quarter of the total wealth of the Mitsui family at the time. Equally important, the money was not used to found a charity organization but was spent entirely for charitable purposes. Second, all Mitsui family members resigned from active managerial positions in related companies such as Mitsui Bank, Mitsui Trading Company, and Mitsui Mining. The Mitsui family retained the presidency of only the holding company. Third, some of the member companies' stocks were sold to the public. Fourth, the executive director of Mitsui, Yasugawa, who symbolized shrewd and unpatriotic management, was removed from office. Finally, the principle of a mandatory retirement age was adopted. Ikeda, who initiated the conversion program, retired in accordance with this rule.

The conversion movement was the final effort of the zaibatsu to distance themselves from direct government intervention. After the war began in China in 1937, however, their efforts became meaningless. From 1938, under the mobilization act, the government began to control all business activities, although it did not destroy the zaibatsu. To the contrary, in order to run the war economy, the government needed the manpower, organization, and financial

strength of the business groups. Thus the zaibatsu experienced enormous growth in terms of both their absolute size and their relative weight in the national economy. For example, the number of related companies in the Mitsui group increased from 56 in 1937 to 273 in 1946. During the same period, the paid-in capital increased from 670 million yen to 3,523 million yen. There were also changes in the industry portfolios of related companies. The weight of heavy and chemical industries in the industry portfolio of the Mitsui group increased from 46.3 percent in 1937 to 72.1 percent in 1946.

The sudden increase in size also forced changes in the characteristics of the zaibatsu. To fund the expansion, they had to sell their stock holdings to the public and rely on government financial institutions. Mitsui was forced to sell 25 percent of the stock in the Mitsui Trading Company, thereby ending the era of the pure zaibatsu, because the holding company no longer owned 100 percent of the related companies' stock. The reliance on borrowed funds also represented a departure from the long tradition of the healthy debt-to equity ratio previously maintained by the zaibatsu.

Communications channels Communications between the government and business were not initially as unidirectional as expected under the mobilization law. The military government frankly admitted that the zaibatsu leaders were more capable than the government in running the economic side of the war. Therefore, leading businessmen were invited to join the government and to assume ministerial positions in commerce and finance.[3] Ikeda, who initiated the conversion

3) In spite of their influence over political parties, it is very rare that business leaders assume cabinet posts in Japan. Only in the 1940s,

movement, became the minister of commerce and industry. He also served as minister of finance in the war government. These business leaders-turned-ministers did not, however, abandon their liberal ideology. The military government did not accept their view that business should not be subjected to government intervention, and as a result the ministers resigned.

As the war progressed, control over the private sector was tightened. Businesses had no option but to meet fixed production quotas. Because the government assumed responsibility for all aspects of planning, the role of senior business leaders in private companies was significantly reduced. In their place, middle-level managers rose in importance because they were responsible for the paperwork required for communications with the government in fulfilling production quotas.

The Period 1945–73

This period began with the political and economic democratization movements under the guidance of the General Headquarters (GHQ) of the Allied Forces. Postwar economic suffering was severe, but the GHQ was paying more attention to democratization than to economic recovery. The GHQ did not believe in the value of economic aid from the United States to Japan or from the Japanese government to private businesses.

The growing tension between East and West in the late 1940s contributed to the sudden changes of GHQ policies. The

during and immediately after the Pacific war, do we observe an exception (Hirschmeier and Yui 1981 : 40-43).

Japanese government took this opportunity to revert to the close government-business relationship pattern that had prevailed during the war. Direct government intervention, however, was short-lived. Beginning in the early 1960s, the Japanese government evinced signs of departure from the pure form of Japan, Inc.

Role of government The democratization adopted by the Japanese government under the guidance and pressure of the GHQ included both political and economic measures. The adoption of a new constitution best characterized the political democratization measures. The new constitution provided for full political democracy, including free elections, freedom of the press, and separation of religion and the state. The emperor remained the symbolic head of state, but he was not given a role in the administration of the country. To prevent Japan from becoming a military power in the future, the constitution fixed an upper limit on military expenditures. The new constitution apparently succeeded in dismantling the imperialistic ideology and the central figure that had contributed to the formation of national cohesion. The spirit of collectivistic pursuit, however, remained unchanged—only the target had changed. In place of military objectives, economic development became an almost religious pursuit. Initially it was a straightforward means of survival and recovery from the ruins of war, but later it became a means of self-realization.

The economic democratization measures consisted of three major elements: the dissolution of the zaibatsu, land reform, and the promotion of the labor union movement. Initially the leftist factions in the labor movement prevailed. But from 1947 the GHQ began to suppress disruptive strikes,

and the "red purge" in 1949 was a fatal blow to the extremists. In place of the relatively militant industry-wide labor unions, more harmonious company-specific unions began to emerge. Under the land reform program, the government bought all the land from absentee landlords and sold these lands to the actual cultivators. The reform improved the distribution of wealth and the farmers' purchasing power, thereby contributing to the formation of a stable domestic market base for the emerging consumer-product companies during the ensuing period of rapid economic growth.

Following the same procedure used for the implementation of other measures, the GHQ asked the Japanese government to draft measures for the dissolution of the zaibatsu. But unlike in other political and economic measures, the Japanese government was not very cooperative in this dissolution measure. Leaders of government needed the organization and business experience of the zaibatsu to salvage the country from economic ruin. Considerable pressure was exerted on the Japanese government, however, partly because the GHQ regarded the zaibatsu as major war criminals and partly because the GHQ economists were followers of the classical school and had a deep-rooted distrust of economic monopoly powers. The Japanese government reluctantly drew up plans to dissolve the zaibatsu. The measures included dissolution of holding companies, purges of zaibatsu leaders, and public offerings of stocks previously held by the holding companies.

The organization that assumed responsibility for implementing the measures was the Holding Company Dissolution Committee (Mochikabu Gaisha Seiri Iinkai) (Umetsu 1978 : 90). Theoretically, therefore, only the holding companies should have been the targets of dissolution. In reality,

however, other large companies also were targeted, and 325 companies were designated initially for dissolution. However, as a result of the Japanese government's opposition and also a change in GHQ policy, the measures were eventually applied to only 18 companies. It is important to note that the banking arms of the zaibatsu were left untouched, and these banks later became nuclei for the formation of the postwar Japanese business groups called *keiretsu*.

About 3,600 top executives of large companies, including the owner-managers of the zaibatsu, were removed from their managerial positions and were forbidden to resume their positions during the next ten years. Initially this measure seemed to be a severe blow aimed at an already ruined economy that needed all available managerial expertise —including the former zaibatsu leaders—for postwar economic recovery. In hindsight, however, this provision was a blessing in disguise. The wartime managers, reflecting the long direct control by the military authority, became too formalistic and unimaginative to lead companies in a new environment. In fact, when this restriction was lifted, very few of the purged managers returned to their original positions, because younger and more competitive managers had already successfully filled the gaps.

The zaibatsu families were forced to sell their share holdings in their respective industrial groups' companies to pay long overdue inheritance taxes. This measure signified the end of the feudalistic and conservative control by the zaibatsu families over the leading Japanese companies. Their former share holdings were sold to the general public, and the resulting separation of ownership and management gave the new leaders of big companies a freer hand to adopt a more aggressive managerial style.

The impact of the dissolution measures on the Japanese economy can be assessed in different ways (Shibagaki 1971 : 118-24). One can naively believe that the measure at one stroke contributed to the separation of ownership from management and to the dissolution of the monopolistic or oligopololistic market structure, especially in light of the fact that the dissolution measures were followed by the enactment of a very strict antimonopoly act in 1947. History has a surprisingly resilient habit of repeating itself, however, and its course cannot always be changed by a single bold measure. The momentarily dispersed owners flocked back to one center to create "corporate capitalism" in Japan. Meaningful application of the antimonopoly law, moreover, was delayed thirty years(The 1977 revised act is discussed below). Although the dissolution measure eliminated the names of zaibatsu families from the rolls of corporate management and ownership, this trend had already started in the voluntary conversion movement of the 1930s. Therefore, it can be argued that the much vaunted dissolution measures merely succeeded in hastening and expediting certain existing trends and, accordingly, that they did not contribute to the reemerging pattern of close government-business relationships.

A similar lesson can be drawn from another liberal economic measure of the GHQ, namely the Dodge guidelines. Japan experienced its worst period of inflation from 1945 to 1949. During these four years, consumer prices rose as much as 80-fold, due to the huge deficit in government spending and to the initial postwar reductions in the production volume of agricultural and industrial goods. Joseph Dodge, a Detroit banker who had gained fame for helping to contain postwar inflation in Germany, was invited to Tokyo in 1949 to advise on the Japanese inflation problem. His proposals

included a balanced budget, the reduction and eventual abolition of government subsidies, and the suspension of new loans by the Reconstruction Bank. As a follower of the classical school of economics, Dodge compared the Japanese economy to a structure built on stilts, with one leg representing dependence on American aid and the other leg representing the dependence of business on the government. His belief, which came to be built into GHQ policies, was that the fastest and perhaps only way to teach a child to swim is to throw him into the water unassisted. Accordingly, the policies adopted by the GHQ strongly discouraged government intervention in private business. But the Japanese government at the time was not persuaded by this liberalism and continued to pursue government-led economic recovery.

Strong intervention by the government lasted until 1960. But during this 15-year period, the focus of industrial policies changed from reconstruction to rationalization and then to promotion of new industries. The tilting production method (*keisha seisan hoshiki*) from 1946 to 1948 best represented the reconstruction effort. The logic of the tilting production method was as follows. First, increase coal production. Second, tilt the distribution of this coal toward the steel industry. Third, the steel industry will, in turn, tilt the distribution of its products back to the coal-mining industry. The concerted effort to develop these two key industries was believed to pay off in promoting mining and industrial production later on. To support the program, the government allocated special funds from the Reconstruction Bank to these industries. The government also subsidized the steel industry to support below-cost sales of steel products to the coal industry. In 1948 the subsidies to support the low price amounted to 23.8 percent of the national budget. The tilted

production system was the main target of the proposal in the Dodge guidelines to reduce government subsidies and halt borrowings from the Reconstruction Bank.

Since direct government subsidies to strategic industries was prohibited by the Dodge guidelines, the focus of industrial policy was shifted from protection to rationalization of the target industries in 1950. Instead of subsidies, tax incentives and a fiscal investment and financing program (*zaisei toyushi*) were widely used. Tax incentives included accelerated depreciation and tax exemption of import duties on essential machinery. In 1955 the waivers for these purposes amounted to 5.7 percent of corporate tax revenue.

From 1955 the focus of industrial policy changed again, from the rationalization of existing companies to the promotion of emerging companies. The Five-Year Plan for the Promotion of the Synthetic Fiber Industry of 1953 was a little ahead of the trend. The plan provided a package of guaranteed government purchases, favorable tax treatment, priority allocation of electric power, research subsidies, and a supply of capital funds. In 1957 the Electronics Industry Promotion Temporary Measures were enacted. This package of measures included grants for experimental research institutions, provision of long-term low-interest funds from the Japan Development Bank, and wide application of special depreciation standards. Even though some fiscal incentives were included in the packages mentioned above, tariff barriers and preferential import of foreign capital, technology, and machinery were more important policy means to promote target industries.

The government's practice of selecting target industries and providing them with preferential subsidies and protection against foreign competition for 15 years gave ample

ground to argue for dominance of the Japan, Inc. spirit. Indeed, the ideology and actual behavior of the government supported the argument. However, even here I need to state some reservation about the generalization of Japan, Inc. The Japanese government did support specifc industries, but it did so only to the extent that the precarious trade balance permitted. MITI was always in favor of providing subsidies and preferential fund allocations to strategic industries. But at the first sign of inflation or a trade deficit, the Ministry of Finance resisted MITI's expansion bias. Second, the governmental protection and subsidies were by necessity given to a small number of industries and companies. This meant that the majority of industries were outside Japan. Inc. and had to survive on their own. It is informative to note that the automobile industry, which became the leading industry of Japan in the 1970s and 1980s, was an outsider and thus did not receive much financial help from the government. The rapid economic growth in the 1960s was driven more by such outside industries than by the target industries.

In 1962 the Temporary Measures Act to Promote Designated Industries was drafted by MITI and submitted to the Diet for enactment (Tsuruda 1986 : 63-65). The bill intended to specify such industries as motor vehicles, petrochemicals, and machinery as "disignated" industries and stipulated measures for promoting their development through encouragement of standardization, specialization of production, establishment of joint stock companies, and mergers. The law obliged private businesses to comply with these measures in return for government help in devising requisite monetary and tax measures with the banks supplying the necessary funds. This act, however, failed to pass in the Diet for several reasons. First, there was intergovernment dis-

agreement between MITI, the proponent of the bill, and the Ministry of Finance, which was concerned with the bill's inflationary effects. Second, the automotive manufacturers refused to merge or to specialize. Third, the private banks lobbied heavily against the proposals. This draft act provides clear documentation that MITI still believed, even at this late date, in the spirit of Japan, Inc. MITI's failure to get the bill enacted, however, signifies that the spirit of Japan Inc. was no longer shared by other sectors.

It is interesting to note that, despite the active sponsorship of Prime Minister Ikeda, the bill still failed in the Diet. Only two years earlier the prime minister had announced his ambitious plan for doubling the national income within the coming decade, and he is often cited as the most important person behind the rapid economic growth. He was so pro-business that the president of France once referred to him as "a transistor salesman."

In 1964 Japan became an International Monetary Fund(IMF) Article 8 country and joined the Organization for Economic Cooperation and Development (OECD). Thereafter, the government could no longer employ strong trade and foreign-exchange control policies, at least not outwardly. Government intervention became softer, and MITI began to rely more on "administrative guidance." But since MITI's carrot-and-stick leverage for control over business was growing smaller, it had difficulty in soliciting cooperation from the private sector. Beginning in 1965 Japan became a trade surplus country. As the size of the trade surplus increased in the late 1960s, and as foreign pressure mounted to liberalize the Japanese market and do away with government subsidies to exporting industries, MITI's power to target industries for special governmental help was further limited.

Creeping inflation, a slowdown in growth, and the pollution trial in the early 1970s created an anti-growth mood. The Tanaka government in 1972 made the last attempt to restore growth momentum, but failed because of inflationary pressure immediately before and after the first oil shock.

Role of the private sector The zaibatsu as business entities were broken up by the GHQ. But in their place six big business keiretsu emerged—Mitsubishi, Mitsui, Sumitomo, Fuyo, Sanwa, and Dai-Ichi. The first three were resurrections of their namesakes from the zaibatsu era. Each of the latter three, moreover, was a grouping of two or more of the samller zaibatsu companies. Fuyo, for example, was built around the former Yasuda group of companies, and Dai-Ichi inherited many companies from the Fujisawa and Kawasaki groups.

The modern keiretsu look similar to the old zaibatsu because they perpetuate many of the old company names, most prominently the names of member financial institutions and general trading companies. They differ from the zaibatsu, however, in many important respects. First, a keiretsu has neither a holding company nor a controlling family. Stocks in member companies are cross-held, and thus the relationships among the member companies are horizontal (as opposed to the vertical zaibatsu structure). Presidents of member companies assemble once a month at a joint meeting, but no individual dominates the discussions. In this regard, keiretsu represent models of democratic cooperation among equals. Second, the banking arm of the keiretsu plays a far more important role than its zaibatsu counterpart. Although the zaibatsu bank was one of the related companies, the other enterprises within the group seldom relied on it for funds,

because the holding company distributed funds to group companies. Within the keiretsu group, on the other hand, the member bank is most often the main bank of the member companies. Third, "one setism" emerged as a feature of the keiretsu. Zaibatsu families tended to be conservative with respect to enlarging the industry portfolio and refused to embark on new and risky ventures. Keiretsu managers, by contrast, were not risking their own fortunes and thus became less risk-averse. The competitive spirit, fueled by their willingness to launch new businesses and increase production capacity, encouraged them to diversify horizontally, so that each business group would comprise a complete set of companies representing every major field of economic activity.

The "one setism" and inter-keiretsu rivalry ignited a competitive and aggressive war of expansion in every important industry. Private businesses were always ahead of the fainthearted plans and forecasts of the government—and even of most economists—and served as the driving force behind the rapid economic growth of the period. The expansion war naturally entailed the risk of overcapacity, which MITI always feared. In reality, however, the domestic and export markets grew so fast that problems of overcapacity seldom materialized. In rare cases when they did occur, MITI extended a helping hand in the form of cartel assistance and production coordination. The asymmetric nature of rewards and penalties made the managers more expansion-minded.

At this juncture, it is important to study the second echelon of Japan, Inc. The first echelon, as discussed so far, represents the relationship between government and business. The second echelon represents the relationship between management and employees on the one side, and the relation-

ship between a big company and subcontracting companies on the other side. Japan is said to have a unique Japanese management style in dealing with employees. The characteristics of this style cited as the most important are the lifetime employment system, informal consensus building (*nemawashi*), and the company as a welfare unit.

The lifetime employment system may derive from a national cultural trait, namely collectivism. In essense, collectivism in Japan means that once an individual becomes identified with a certain group, it is very difficult for him to switch to another group. It is noteworthy, however, that the lifetime employment system encompasses only the core of Japanese employment (about 15 percent of total employees) and is characteristic only of the big companies. Therefore, this aspect of Japan, Inc. affects only a samll proportion of Japanese employees. The tradition of permanent employment can be traced back to the 1910s when businesses needed to protect themselves from predatory scouts who were enticing scarce skilled workers to switch from one company to another. In the 1930s, when the big companies came under serious attack for their unpatriotic pursuit of profit, this system became a useful public relations tool, which allowed companies to proclaim that managers and lesser employees shared a common destiny. In the postwar period, when unemployment became a serious social problem, the labor unions pressed for job security measures through a permanent employment system. During the ensuing period of rapid economic development, companies again needed to retain a stock of employees skilled in production and management technologies. In terms of risk-reduction, the lifetime employment system facilitated huge investments in human capital formation, because it guaranteed that trained employees

would stay with the company. Thus, the modern lifetime employment system is as much a result of time-contingent needs of both the company and its employees as it is a result of the country's cultural heritage. It can be argued, moreover, that the seniority system operates in terms of payment and promotion merely as a subset of the lifetime employment system.

In its original, literal sense, *nemawashi* refers to the process of cutting off tips of tree roots before transplanting. The term is used by management, however, to refer to the formation of an informal consensus prior to taking formal action or convening a formal meeting. This procedure for consensus building among decision makers is used in conjunction with the *ringgi* procedure, in which a draft proposal begins at the bottom and secures seals of approval as it is passed up the hierarchical ladder of the company. This combined system is supposed to guarantee the democratic participation of subordinates in the decision-making process. Without due delegation of authority, however, these procedures can easily degenerate into a system in which subordinates simply try to guess what the top management has in mind. Although similar methods for soliciting the opinions of subordinates have evolved in other countries, the Japanese system seems to be the most successful.

It is often observed that Japanese employees place higher priority on their personal performance for their companies than on their family responsibilities. The company is not simply their source of livelihood but rather the foundation of their entire lives. Japanese society is not very kind to an outcast or to an outsider, and for cultural reasons it is therefore important to belong to a social group. The family is not a social organization in this sense and does not fulfill this

need. A company is the smallest such social unit to which an individual can belong. From the company's perspective, on the other hand, employees are not simply cost items. The company tries to promote a close circuit of relationships through its "welfare" programs, which may include dormitories and resort facilities. As employees can afford to buy their own houses or plan their own travel, however, a certain deterioration in the sense of belonging to the company may become apparent.

The subcontract system is most widespread in the automotive and electronics industries. It is a vertical system but the relationship is not necessarily based on stock ownership. The subcontractor provides funds for invesments and technological assistance with regard to setting standards, maintaining quality controls, and ensuring purchases even during a downturn in the market. This system is not a specifically Japanese invention, nor is it practiced exclusively in Japan. Its successful implementation, however, depends greatly on mutual trust.

In this respect, the perfection of the system in Japan is due in part to a type of patron-client relationship that is part of the Japanese cultural heritage. Traditionally, the patron or boss (*oyabun*) must be able to protect as well as guide his followers or underlings (kobun). The latter, in turn, must demonstrate absolute loyalty to their patrons. This tradition, which is based partly on mutual responsibilities, exerts fundamentally beneficial effects on economic expansion. The acid test, as yet unfinished, is whether this system can survive in a stagnant or contracting economy. After the rapid yen appreciation in 1986 and 1987, signs of deterioration in this system seem to be emerging, at least from the patron side.

Communications channels During the postwar period, the interests of the business sector have been represented officially by four economic organizations. Three of them are chambers of commerce and the fourth is a labor -relations organizations (Curti 1977 : 33-51).

The two original chambers of commerce, the Keidanren and the Nissho, represent the interests, respectively, of the big companies and of smaller businesses in Japan. Because the rapid postwar economic growth was led by big business, the activities of the Keidanren have attracted greater attention. Among the members of the Keidanren are more than 100 industrial, commercial, and financial associations and more than 700 leading corporations. The role of the Keidanren was strongest during the Ikeda government up to 1964. Prime Minister Ikeda's strong bias in favor of big business is vividly illustrated by the political furor that arose when he remarked : "I wouldn't care whether ten or more small businessmen committed suicide. We need big business to lead economic development." No secret was made of the frequent geisha house meetings between the leaders of the Keidanren and the prime minister. But as the business conglomerates increased in size and as their conflicts of interest grew, the Keidanren began to have problems in coordinating disagreements among the member companies. As a result, each conglomerate began to circumvent the organization and to establish its own direct channels of communication with the government.

A third chamber of commerce, the Keizai Toyukai, was founded by younger executives as a counterpart to the Keidanren, which they regarded as too dominated by the old-timers of the financial world. The new chamber formed an Industrial Problems Research Council in 1966, which has become the most prestigious business policy group. But it too

has its limitations with respect to coordinating the ever-diversifying interests of member companies.

The fourth of the postwar economic organizations is the Nikkeiren, the succeesor of an organization founded in 1931 and known as the Zensanren, whose purpose was to coordinate labor-dispute strategies. Under a famous slogan, "Employers, be righteous and strong!", the organization fought in 1950 with Sohyo (the General Council of Trade Unions) and was instrumental in purging more than 10,000 communists from business. Nowadays, the activities of the organization are limited to helping the business circle in the annual round of wage negotiations.

Formal government-business communications are facilitated by informal ties through the employment of former bureaucrats by the larger companies. Suitably high positions on boards of directors, for example, are frequently provided for newly retired officials, who may have reached the effective limits of promotion within the bureaucratic hierarchy. Such shifts from the public to the private sector, popularly termed "heavenly descent" (*amakudari*), have become virtually institutionalized in Japan.

Government bureaucrats retire at the still productive age of 55. After retirement they are invited to assume important managerial positions in business. Their personal ties with colleagues still in office and their firsthand knowledge of the government's decision-making processes enable these bureaucrats-turned-businessmen to serve very effectively as translators of big-business interests vis-à-vis the government. In the zero-sum game of soliciting preferential governmental help, not all companies can win. When "heavenly descent" becomes too widespread, it evolves into a defensive rather than an offensive mechanism. Once each

of the major conglomerate companies has acquired one or more former bureaucrats, neither of them may benefit very much. In this situation, there is only a net penalty for both —that is, not retaining such a person on the payroll entails a large risk.

The Period from 1974 to Present

By the late 1960s, Japan had already accomplished the task of catching up economically. Gradually the external cost of the blind pursuit of economic development began to attract the attention of policymakers and the general public. The most publicized social issue was the industrial pollution of water and air that had already taken hundreds of human lives. The bullet train (*shikansen*), which began operations to commemmorate the 1964 Tokyo Olympics and was a symbol of Japan's advanced technology, became a target for noise-pollution control. The once watertight common agreement to pursue all means for economic development was finally broken. Externally, the rapid rise of the trade surplus and Japan's accumulation of foreign exchange reserves ignited protective measures by importing countries and foreign pressure to open up the Japanese market in terms of trade and capital flow.

The sudden drop in capital investments by the corporate sector after the first oil shock also changed many characteristics of the Japanese economy. The reliance of the cooporation on banks for capital funds was reduced, which in turn decreased the reliance of the banks on borrowings from the central bank. At the same time, the government was transforming itself from a promoter of economic

development to a regulator, thereby providing greater representation for the interests of consumers and employees.

Role of government Once a stereotype is formed, it is very difficult to break the biased perspective, even when contradictory evidence begins to accumulate. The concept of Japan, Inc. that developed in 1971 was based on the patterns of government-business relationships in the late 1940s and early 1950s. Non-Japanese observers, without making an objective investigation of available evidence, have subsequently tended to believe that the same relationships prevailed in the 1970s and 1980s.

Saxonhouse (1983 : 253-73) successfully freed himself from the stereotype and presented convincing documentation that Japan, Inc. no longer operates in the contemporary Japanese economy. Saxonhouse investigated whether industrial targeting is still practiced in Japan and examined the extent to which the government was using certain instruments for that purpose. His review included direct protection from foreign competition through tariffs ; import quotas and other nontariff measures ; direct subsidies and grants ; subsidies granted through the tax code, including tax credits and special accelerated depreciation ; preferential access to credit or preferred terms of credit ; and special aid through government procurement.

On every point Saxonhouse concluded that the Japanese government provided less protection to or promotion of specific industries than was the case in the United States and Western European countries. The Japanese tariff rate (2.9 percent on average) was lower than the rates of its competitors. The special tariff barrier relating to the manufacture of computers and intergrated circuits was abandoned in 1979.

Japan had fewer import quotas and applied no special standards except for pharmaceutical products. Although certain government subsidies remained, they more often than not went to the agricultural sector or to declining industries such as mining and aluminum rather than to current or emerging export industries. Research and development grants were also lowest in Japan. Public resources as a share of private research and development expenditure was 1.9 percent in Japan, compared to 15.8 percent in West Germany, 25.3 percent in France, 30.9 percent in the United Kingdom, and 35.3 percent in the United States. The system of accelerated depreciation allowed in the automotive industry in the 1950s was no longer practiced in the 1970s. And the biotechnology industry, which was believed to hold the greatest promise, received no preferential financing from the Japan Development Bank or from any of the small business finance corporations. Since the defense budget was constitutionally limited to less than 1 percent of gross national product, the Japanese government also had some limitations as a buyer.

In the 1970s and 1980s Japan constantly recorded a huge trade surplus. To minimize the risk of foreign protective measures, Japan had to advocate the principle of free trade that is incorporated in the General Agreement on Trade and the Tariff (GATT). The Japanese government was therefore not in a position to target an industry for government protection.

After the first oil shock, various production and price cartels emerged. To prevent further proliferation of cartels, the legislation dealing with monopolies was revised in 1977. Cartels had been made illegal under the Antimonopoly Act of 1947, which was a subset of the GHQ's measures against big business. The act was revised in 1953, under the government's

efforts to promote big business as an engine of rapid economic development. Even so, the outright formation of production and price cartels remained illegal, and MITI used its technique of "administrative guidance" to achieve the same goals. In 1980, however, the high court in Tokyo ruled that competition-reducing administrative guidance should also be illegal and should not be permitted in the future. This was the beginning of a constitutional relationship between the government and business, in which the government acts as a regulator with minimum discretion in the implementation of set rules. But the government in reality did not totally give up administrative guidance designed to form competition-reducing cartels. Cartels continued to be formed for declining industries, understandably with minimum resistance from the market participants and the general public.

As Japanese labor costs rose with economic development, a few industries in Japan became internationally uncompetitive. Industrial adjustment became an important policy issue. The first oil shock accelerated the process of industrial adjustment in that the sudden rise in oil prices also added the energy-intensive industries to the problem list. In May 1978 the government promulgated the Temporary Measures Act to Stabilize Designated Depressed Industries. Designated industries included aluminum, synthetic fibers, shipbuilding, chemical fertilizers, and cotton spinning. The reasons for depression differed from industry to industry, but the rising labor and energy costs on the production side and the stagnating domestic and international demands were the most important factors. Under the act, the government was charged with drawing up a basic blueprint for orderly reduction of production capacity, application of production quotas

in the interim, establishment of funds to finance employees' exit from the industries subsidy programs for retired employees, and other areas directly hit by the adjustment. Before the effects of the act materialized, Japan was struck by the second oil shock. To assist the industries that had not yet undergone industrial adjustment prior to the second oil shock and others such as paper manufacturers and petrochemicals that became depressed after the second oil shock, in May 1983 the government promulgated the Temporary Measures Act to Improve Industrial Structures of Designated Industries. The first set of measures had emphasized an orderly exit from the depressed industries, whereas this second set emphasized rationalization within the industries through mergers and new investment to improve productivity. Here we can observe some features of Japan, Inc. in action. But such close interface between the government and depressed industries to mitigate the adjustment shocks was also widespread in other countries as well. Thus this example should not be used to generalize that the spirit of Japan, Inc. still dominates the Japanese economic scene.

Role of the private sector The most pronounced environmental changes of the period for private business derived from the internationalization of the Japanese economy. The rapid economic growth of the 1950s and 1960s owed more to the rapid expansion of the domestic market than to international trade. But after the first oil shock, the growth of the domestic market slowed down significantly; accordingly, reliance on foreign markets increased.

Virtually all industrial-product imports were liberalized. Direct and indirect investment in Japan by foreigners was entirely liberalized in 1973.[4] In the same year, the value of

the yen began to float freely against foreign currencies. The days of a closed economy in which the government protected the domestic industries were gone forever, and with them the last traces of Japan, Inc. The fortunes of Japanese companies began to depend upon the policy choices of other governments as much as those of the Japanese government. Admittedly, the Japanese government negotiated with foreign governments to protect the interests of Japanese companies. But when the Japanese companies began to establish their global networks of production facilities, it became increasingly difficult even to define the "interests" of Japanese companies.

Up to the mid-1970s, Japanese foreign direct investment (FDI) went mainly to lesser developed countries. Faithfully following the logic of Raymond Vernon's product life-cycle theory of FDI (Vernon 1979), the labor-intensive industries in Japan moved to neighboring Asian countries to save on labor costs. The early Japanese pattern of FDI differed from that of the United States, which tended to be capital—or technology—intensive. Based on this difference, Kojima(1977) concluded that Japanese FDI was trade-promoting whereas American FDI was trade-replacing. But before long, scholars realized that he had made the mistake of drawing a broad generalization from a limited time-contingent phenomenon. In the late 1970s Japan began to invest more in developed countries, including those in North America and Western Europe, in response to rising trade barriers.

4) The liberalization of inward capital movement was carried out in five stages starting in July 1967. As each stage advanced, the limit of foreign ownership was progressively loosened until May 1975, when 100 percent foreign ownership was allocated in all industries for direct and indirect investment.

Japanese FDI was as capital—and technology—intensive as its American and European counterparts.

With the growing importance of international trade and domestic production in many countries, Japanese companies were forced to take a global perspective in evaluating the business environment. In the process, they built a formidable international information network and became less and less dependent on government assistance as to what companies must do to survive in new times of uncertainty.

MITI, even after losing its real powers of intervention, continued its established practice of characterizing each new decade with a slogan. Accordingly, the 1980s were christened by MITI as the "decade of creative knowledge-intensive industry." The announcement by a MITI officer that there will be no MITI slogan for the 1990s or afterwards was therefore not only startling but also a confirmation of the demise of the old Japan, Inc. habit of government planning for private companies.

Communications channels The organizational structure of MITI is both vertical and horizontal. Its four vertical divisions are concerned with basic industries, machinery and information industries, subsistence industries, and energy -related industries. The horizontal divisions are in charge of trade, trade policy, industrial policy, and matters relating to industrial siting and pollution. Up through the 1960s the most powerful divisions were the vertical ones, and legislation was drafted with specific industries in mind. From the 1970s onward, the horizontal divisions were the most active in initiating legislation, which tended to affect industries across the board (Komiya 1986 : 20-21).

The tradition of participation by businessmen in govern-

ment advisory commissions (*shingikai*) remains unchanged. Such commissions function mainly as a forum for the exchange of information between interest groups and the government. There are currently 250 of these commissions, 32 of them in MITI alone.

During this period, the previously narrow communication channels between government and business were widened to include the Diet as a new actor. Since some of the more important members of the Diet were former bureaucrats, they were familiar with both bureaucratic procedures and business affairs, and they played an increasingly important role in sponsoring specific legislation. Under these circumstances, it was no longer possible for division chief in the civil service to overawe Diet members with his bureaucratic and technical knowledge.

INTERPLAY AMONG GOVERNMENT, FINANCIAL INSTITUTIONS, AND BUSINESS IN FINANCING INDUSTRIAL INVESTMENT

The government's desire to lead the economy as hypothesized in Japan, Inc. was a phenomenon quite distinct from the challenge of securing voluntary cooperation from the private sector for the implementation of government plans. In a capitalistic society, there were limits on the extent to which the government could invoke ideas from cultural heritage, such as collectivism and patriotism. Thus the Japanese government developed, it was believed, an integral system of trade, fiscal, and financial policies to induce private corporations to follow its lead. This section will evaluate the role of the government in facilitating financial flows to strategic industries, and the responses of the financial institutions and private business to the lead of the government.

The following are some of the commonly held beliefs about Japanese financial habits, which have become even more stereotyped than the overall view of Japan, Inc.

1. The savings rate (especially the household savings rate) is very high because thriftiness is Japanese cultural trait.

2. Indirect financing predominates. Japanese households prefer to make deposits in banks rather than to buy stocks and bonds of private corporations. The corporations, in turn, overborrow from banks for their external funds.

3. As a consequence of item 2 above Japanese companies maintain a high debt-to-equity ratio.

4. The government, through the central bank, overloans to commercial banks and uses window guidance to channel these funds to strategic industries.

5. Government financial institutions serve as powerful intermediaries through which the government gains further leverage to channel preferential funds to strategic industries.

This section will test the validity of these beliefs by reviewing recent Japanese financial history. Among the factors to be examined are the historical development of savings rates, degree of financial intermediation, debt-to-equity ratios, overloans from the central bank, and the weight of governmental financial intermediation. At the same time, an attempt will be made to delineate the relationships between the above characteristics, on the one hand, and the intentions and abilities of the government to channel funds to strategic industries.

Conspicuously absent from the stereotyped view of "financial Japan, Inc." is the role of foreign savings. If the government really wanted to push for economic development at any cost, financing through foreign savings would have been the easiest way. In fact many newly industrializing countries in the 1970s and 1980s relied on foreign loans even though this reliance ultimately led to a worldwide debt crisis. Furthermore, if the government wanted to channel the flow of funds to specific industries or to specific companies, foreign savings would have served as the strongest mechanism for achieving such an objective, because foreign loans are subject to government approval on a project-by-project basis. Employment of fiscal and monetary policies to avoid trade deficits and thus reliance on foreign savings by

itself meant that the government was willing to sacrifice its leverage for intervention, to a certain degree, to ensure sound and sustained economic growth. Much of Japanese financial history can be depicted as a succession of conflicts between MITI (Or its predecessors) and the Ministry of Finance. MITI, owing to its concern with immediate economic development, regularly proposed expansionary monetary policies and preferential fund allocations to strategic industries. The Ministry of Finance, on the other hand, characteristically intervened at the first signs of inflationary pressure or trade deficit. Hence Japan, Inc. was by no means a monolith in terms of financial policies.

Following the chronological classification established earlier in this work, the interplay among government, financial institutions, and business in financing industrial investment will be divided into five separate time periods for discussion. Even though historical data on Japan are relatively abundant, there is still much disagreement among scholars concerning the interpretation of financial data, especially for the early Meiji period. The discussion that follows may therefore suffer from the risk of generalizations drawn from specific examples.

The Period 1868–80

From the moment it was launched in 1868, the Meiji government was awash with official debt. The new government inherited not only all the assets but also the liabilities of the shogunate and the feudal states, which were deeply indebted to the merchants. Even after defaulting on these liabilities, the government was still faced with the problem of creating

a more widely based revenue system as a foundation for the national budget. The sole existing source of revenue, however, was the land tax, which was inadequate to cover even the stipends paid to court officials, feudal lords, and the samurai. In consequence, government officials made a valiant effort to place government finances on a sounder fiscal base by creating a new national currency, monetizing the land tax, and commuting feudal pensions.

When the yen became the national currency in May 1871, the silver standard was adopted. The new paper currency was theoretically convertible into silver, but the flood of inconvertible government bank notes soon threatened the viability of the system. However, because the price of silver in relation to that of gold showed a downward trend throughout the latter part of the nineteenth century, the silver standard resulted in continuous depreciation of the yen, which in turn helped the exporting industries.

In 1873 the land tax was monetized to ensure the stability of tax revenues in monetary terms. Since one wing of the restoration army had earlier promised a reduction in land tax, the new government was not in a position to increase land tax rates. Thus the monetization by itself did not contribute to any increases of land tax revenue. On the contrary, during the ensuing inflation the land tax revenues decreased in real terms. The monetization of the land tax nonetheless helped to promote the monetization of the economy.

The commutation of feudal pensions was finally carried out in 1876, after a few earlier attempts had failed. The government issued commutation bonds totalling 190 million yen, which were approximately equal to all the money then in circulation or to the total amount of government revenues

received during a three-year period. The determined opposition of the samurai to this unpopular measure was manifested in the unsuccessful samurai revolt against the government the following year. The commutation did, however, help to reduce the fiscal burden of stipend payments. The accumulation of financial assets in private hands also facilitated private industrial investment in banking, textiles, and railways.

Immediately after the restoration, ordinary revenue was less than 50 percent of government expenditure. Initially, therefore, ambitious government investments in pilot plants had to be financed by issuing paper money and borrowing from rich merchants. By 1875, as a result of the measures mentioned above, revenues rose to more than 96 percent of expenditures (Hirschmeier and Yui 1981 : 81).

The Meiji government also made a continuous effort to create a viable financial system. The National Banks Act was promulgated in 1872 to promote the establishment of American-style national banks. Like their American counterparts, the Japanese national banks were neither founded nor financed by the government ; thus "national" did not have a literal meaning. These banks were allowed only a narrow spread between borrowing and lending rates ; they were permitted, moreover, to issue only convertible notes which, in an inflationary ecnonomy, was a severe restriction. The act failed to stimulate enthusiasm, and by 1876 only four banks had been founded (Goldsmith 1983 : 25). A pioneering businessman, Shibusawa Eiichi, was instrumental in mobilizing large investments from the Mitsui and Gonou families to found the First National Bank. It is noteworthy that the Mitsui family broke with the Tokugawa tradition by taking part in the establishment of a joint stock

company.

The National Bank Act was revised in 1876 so that the national banks could issue inconvertible bank notes and be allowed a wider spread. Also, commutation bonds were accepted at face value if used as equity investments in the banks. This measure precipitated a rush by merchants and samurai to found national banks. Within three years there were 151 national banks in Japan with a paid-in capital of 41 million yen—roughly equal to the annual national budget at the time.

There are no dependable data on savings rates for the early Meiji period. Given the economic and financial system of the times, it would be safe to estimate that the rate was no higher than the 6 percent recorded in the immediately ensuing period. The low savings rate in this period, which continued up to World War II, casts some doubt on the proposition that the postwar Japanese savings rate is attributable to thriftiness as a Japanese cultural trait.[5] Japan did try to borrow from foreign countries to support the import needs of pilot plants for capital goods, but was unable to do so because of low creditworthiness. This unfortunate experience turned out to be a blessing that helped the country learn the importance of balanced trade.

The Period 1880–1930

This eventful period began with the Matsukata deflation,

5) Noland and Balassa (1986) compared the historical savings rates in the United States and Japan. They reveal that the Japanese savings rate up to the 1920s ranged from 5 percent to 11 percent and was always lower than that of the United States.

which was followed immediately by the creation of the central bank and government financial institutions. The rise in the savings rate and the financial deepening during World War I boosted the development of Japanese financial intermediaries. But the postwar depression and the great earthquake brought about a chain of bankruptcies.

To finance the Satsuma War in 1877, the government borrowed 15 million yen, equivalent to one-third of the annual budget, from the Fifteenth National Bank in Tokyo. The price index (based on 1873=100) rose to 161 in 1881—the year in which the new minister of finance, Matsukata, began to recall inconvertible currency and eventually secceeded in bringing inflation under control. By 1885 the price index declined to 110, and in 1886 it declined further to 104 (Tonedachi 1986 : Chap. 3).

In 1882 the central bank was created. Although Japan had previously followed the American practice of allowing the national banks to issue their own bank notes, the Japanese government adopted the European system for the central bank, modeling it more specifically on its counterpart in Belgium, the Banque Nationale de Belgique. The main building of the Bank of Japan is, in fact, a replica of the Belgian central bank. The central bank was to provide funds to commercial banks through discounts of bills, and it became the sole issuer of bank notes.

The government stopped granting bank note issuing licenses to national banks in 1879 for fear of inflation. Starting the same year, competitive private banks were founded without the right to issue bank notes. After the Bank of Japan was founded, the older national banks also lost this right. All of the banks then became commercial banks specializing in short-term business finance. The entry

barriers for establishing new banks were very low, and the number of commercial banks expanded rapidly, reaching a peak of 1,867 at the turn of the century. Afterward, some of the smaller banks were consolidated, and the number stabilized at around 1,600 until the bank crisis in the 1920s. It is noteworthy that the zaibatsu began operating their own banks during this period.

This period was also the beginning of the specialized banks in Japan. In 1880 the government founded the Yokohama Specie Bank to specialize in financing international trade. Unlike other financial institutions, which were modeled on the Western financial system, this specialized institution was a Japanese invention. Although the name was changed to the Bank of Tokyo after World War II, it continued to serve as a special bank for international activities. During the six years from 1897 to 1902, the government founded a network of special banks for long-term credit. The first such bank, designed for the promotion of industry, was the Nippon Kangyo, founded in 1897. Within the next three years 46 agricultural and industrial banks were founded, one for each prefecture in Japan. In 1900 a special bank for opening up new land, the Hokkaido Takushoku, was founded to promote economic development in the northern island. Two years later, the Industrial Bank of Japan was founded. By 1913 the loans from these banks had risen to a level of about one-fourth that of the commercial banks, although this ratio fell to about one-sixth by 1920 mainly because of the phenomenal increase in commercial banking activity (Goldsmith 1983 : 55). These long-term credit banks were financed by long-term bank debentures, a substantial portion of which were absorbed by the Deposit Bureau.

The Deposit Bureau was created in 1896 as a division of

the Ministry of Finance. It managed funds collected through the postal savings system, which was gaining in importance. In 1913, the deposits at the postal savings system amounted to 204 million yen, or about one-quarter of deposits in the commercial banks. After World War II, the Deposit Bureau was renamed the Trust Fund Bureau.

During World War I, the Japanese economy experienced phenomenal expansion, and the financial institutions were no exceptions. Between 1913 and 1921, the assets of commercial banks rose from 2.4 billion to 10 billion yen. At the commencement of the war, there was a general shortage of funds because every company was expanding.

Two series of bankruptcies took place during the 1920s. Although the first was easily contained, the second had long-lasting effects on the financial sector.

The second series of bankruptcies derived from the financial crisis that arose in 1927 when Suzuki Shouten, which at one time exceeded Mitsui and Mitsubishi in sales, declared bankruptcy and left the Taiwan Bank with a nonperforming loan of 250 million yen. A special bill to salvage the bank was drafted by the government but was rejected in the Diet. The public became alarmed at the government's failure to act, because of the importance of the Taiwan Bank as a bank authorized to issue bank notes, and a stampede of withdrawals ensued. The rapid withdrawal of deposits from the smaller banks sparked off a chain of bankruptcies. The crisis was finally contained by means of special loans from the central bank—500 million yen to commercial banks and 200 million yen to the Taiwan Bank.

As deposits were withdrawn from the smaller banks, they were shifted to the big banks. The concentration of deposits in the five biggest zaibatsu banks—Mitsui, Mit-

subishi, Sumitomo, Yasuda, and Dai-Ichi—was only 24 percent prior to the crisis. The ratio climbed rapidly in 1927, 1931, and 1932, respectively, to 31 percent, 38 percent, and 41 percent (Tonedachi 1986 : Chap. 6). In addition, the bankruptcies resulted in takeovers and mergers, both during and after the crisis. This process of consolidation brought about another dramatic structural change, as the total number of commercial banks fell from 1,422 in 1926 to only 466 in 1935.

This rising concentration of deposits facilitated the intervention of the Ministry of Finance in the activities of commercial banks. Even earlier in the crisis, however, the government promulgated the Banking Act of 1927 and raised entry barriers to the banking business. Banks henceforth had to be incorporated and have a minimum capitalization of 1 million yen.

Nationwide data for the debt-equity ratio of private business are available only from the 1930s onward. According to Bank of Japan data, the ratio between equity and total assets during 1928-35 was 57.5 percent—a debt-to-equity ratio of 0.739 (Bank of Japan 1966 : 336-39). The capitalization ratio was even higher than that of present-day American corporations. When the funding behavior of the zaibatsu is subjected to close scrutiny, it becomes easier to understand why the debt-equity ratio was so low in this period.

The Mitsui group was the biggest among the zaibatsu. Mitsui Gomei, the holding company of the Mitsui group, was founded in 1909 with paid-in capital of 50 million yen, most of which was invested in the stocks of the Mitsui group's companies. Four years later in 1913, when the total assets of the holding company amounted to 73 million yen, the company's bank borrowing was only 4.5 million yen, and the

debt-equity ratio was only 0.06. During World War I the capitalization was raised to 200 million yen and total assets controlled to 285 million yen. The debt-equity did not change, however, and the company's bank borrowing was a meager 19 million yen (Dogai : Table 1-2, 44).

The process of capitalization increase among the holding company and other companies within the group is interesting. First, the related companies paid dividends to the holding company, which in turn paid dividends to the zaibatsu family. Second, the family invested in the holding company, which in turn invested these funds in the group's companies. The holding company thus served as a collector and distributor of excess liquidity of the related companies. The related companies—Mitsui Trading, Mitsui Bank, and Mitsui Mining—maintained huge profits during World War I, and for that reason the group as a whole did not need external funds for expansion.

A temporary credit squeeze existed on the eve of World War I. It is generally believed that the Mitsui Bank called back about 10 percent of its loans and channeled these funds to Mitsui Trading Company. Such reliance by zaibatsu member companies on the member bank was, however, an exception to the rule, since the main bank of the Mitsui Trading Company was the Yokohama Specie Bank. During the 1920s the Mitsui group companies were net depositors in the Mitsui Bank, which invested and loaned the money primarily outside the group, for example to the electric power industry and other unrelated companies

The savings rate temporarily rose to two digits during World War I but returned to the more usual range of 5 to 6 percent during the 1920s. When compared with savings rates in Japan after World War II or with the American savings

rates of the post-World War I period, therefore, the Japanese savings rate was not high. To fund the Russo-Japanese War of 1904-5, the government for the first time borrowed heavily from the international market. This loan was repaid with the surplus foreign exchange earned during World War I. Thus reliance on foreign savings for industrial purposes remained low.

The Period 1931–45

The period from 1931 to 1945 was characterized by the reflation of the economy through an increase in the money supply and deficit spending by the government. The Takahashi reflation, which was a drastic departure from the earlier Inoue deflation, was initiated in 1932 in response to global economic depression. The reflation succeeded in revitalizing the economy up to 1936. With the enactment of the Total National Mobilization Law in 1938, the economy shifted from a civilian to a military pattern and was further reflated by channeling funds to unproductive and inefficient military uses. Besides the ultimate military losses due to the war, Japan also lost a sound economic base.

It is useful to note, however, certain changes in financing methods and banking that had an important bearing on the characteristics of the postwar Japanese financial system. These changes included a deepening concentration of commercial banks and governmental intervention in their loan portfolios; a deteriorating debt-equity ratio among private businesses; the growing importance of government financial institutions; and the rising savings rate.

The process of concentration among the commercial

banks that began in the 1920s continued and accelerated during World War II. The number of commercial banks continued to decline—from 466 in 1935 to fewer than 200 in 1941 and to only 72 in 1944 (Goldsmith 1983 : 119). Among these, the five biggest zaibatsu banks became even more dominant. This trend toward banking concentration was not discouraged by the government, partly because it was easier for the government to monitor and control a few big banks than a larger number of small ones.

During the period of military control, the government pushed the zaibatsu to rapidly expand their production capacity of war-related goods. For the first time, the zaibatsu were forced to expand beyond their financial means and thereby to break with the old tradition of conservatism and close-circuited financing methods. This change not only brought about a deterioration in the debt-equity ratio but also made businesses dependent on the government for special allocations of funds. The loss of financial independence in turn provided further room for government intervention in investment behavior. Internally generated funds as a share of the total supply of funds was as low as 36.8 percent between 1931 and 1940, and the ratio declined to 28.6 percent during the early 1940s (Minami 1986 : 353).

Since the sudden rise in demand for funds could not be met by the commercial banking system, the demand was met instead by increases in the relative sizes of government financial institutions. The assets of the Yokohama Specie Bank, for example, represented less than one-tenth of total commercial bank assets in 1930, but this ratio increased to more than one-quarter by 1944. During the same period, the ratios between the assets of other government financial institutions and total commercial-bank assets likewise rose dra-

matically: from one-sixth to one-quarter among the long-term credit banks, from one-seventh to two-fifths in the postal savings system, and from one-fifth to one-half in the Deposit Bureau (Goldsmith 1983: 122).

It is difficult to interpret the meaning of the savings rate during wartime. The net savings rate for the period 1931 to 1945 exceeded 15 percent, thanks mainly to the high net savings rate in excess of 20 percent of income during the war itself. The tradition of a high national savings rate, fueled by an even higher household savings rate, was established during the war and, after the war, became the most important contributing factor to rapid economic growth.

The Period 1945–73

Like Japan, Inc. in the broader sense, the stereotype of "financial Japan, Inc." was founded on observations about Japanese financial characteristics that prevailed during the period of rapid economic growth. This section will evaluate the role of the government in forming the often discussed features of the Japanese financial system and its effective channeling of funds to strategic industries. The most important topics in this regard are the high savings rate (especially household savings), the dominance of indirect financing, overborrowing by the private sector, overlending with window guidance by the central bank, and the allocation of funds through government financial institutions.

As stated earlier, the Japanese savings rate was not always high. In fact, it first jumped to two digits during the war and thereafter continued to increase until a peak was reached in 1974. Although numerous articles have been

written about these relatively recent trends, the authors are not in agreement about the factors that have contributed to the high savings rate. Some scholars (Ishikawa and Ueda 1984) have cited the bonus system and target savings based on consumption cycles as the most important factors, but other scholars have questioned the statistical validity of the results. A topic of inquiry that has become more fashionable recently is the "intergeneration transfer motive" (Hayashi 1986), in other words, the bequests of each generation to the next. For the purposes of this paper, however, only the factors over which the government exerted any control will be examined.

Preferential tax treatment of interest income from deposits is often cited as a contributing factor in the household savings rate. Under the "Maruyu" system, the government provides a tax exemption on interest income received from certain deposits; the government specifies the maximum principal to which this provision applies, on a per capita or per family basis. This tax incentive came to be widely abused, because some individuals opened different accounts in defferent names, thereby evading taxes on interest income. However, the opportunity to save on tax was overshadowed by the government's low-interest policy on deposit accounts. Return on investment in real estate was always higher than the tax-free return on deposits.

Limited mortgage and consumer credit has also been cited as contributing to high household financial savings (Sakakibara, Feldman, and Harada 1982 : 22). In 1965, for example, the ratio of housing and consumer credit to gross national product was only 0.023, compared to 0.608 in the United States. It is a matter of conjecture whether the government, in an effort to channel funds to industrial

development, actually discouraged commercial banks from making consumer loans. It is clear, however, that the Japanese government was not as active as its American counterpart in promoting mortgage loans.

The dominant character of indirect financing is another feature of the Japanese financial system. The story has two sides to it. First, households must have an incentive to choose bank deposits over investment alternatives in bonds and stocks. Second, corporations likewise must have incentives to choose bank borrowing over direct financing methods.

In addition to the tax incentive and limited availability of consumer credit to divert an investment portfolio to housing, the low financial ratio is believed to have contributed to the skewing of bank deposits. The financial ratio, defined as the share of financial assets over gross national product, rose continuously during the prewar period—from 1.148 in 1910 to 2.455 in 1944 (Sakakibara, Feldman, and Harada 1982:11-18). The plummet to 0.391 in 1948 is attributed mainly to hyperinflation immediately after the war. At this extremely low financial ratio, investors had a tendency to give higher priority to the security and liquidity of an investment rather than to the expected level of return from the investment. In this regard, the most attractive investment alternative was the bank deposit. Since the zaibatsu were dissolved and the emerging new businesses had not yet become household names, the purchase of bonds and stocks seemed risky. The near bankruptcy of one of the biggest security houses in 1965 reminded investors about the risk of investment in stocks. The absence of government bonds due to the Dodge guidelines also explains the low level of bond transactions. Unlike the prewar experience of

frequent bank failures, the postwar government employed many safety measures to ensure the solvency of banks, although there is no system of deposit insurance. As a result, no big bank has failed in the postwar period.

"Overborrowing" is a Japanese-English term denoting heavy reliance by a corporation on bank borrowing. It should be noted at the outset that overborrowing is not an established tradition in Japanese financial circles. Prior to the war, as discussed earlier, the debt-equity ratio was not high. Overborrowing after the war may simply have been a necessity of the times. The aggressive investment behavior related to the "one setism" among the big corporate groups posed financial challenges that could not be met by internally generated funds. In view of the limited demand for corporate bonds and stocks, the private companies had to depend on bank borrowing out of sheer necessity. The presence of a bank within each corporate group promoted overborrowing, moreover, because the close contacts between the corporate managers in the bank and in other group companies reduced the asymmetry of information and facilitated fast and reliable credit analysis.

It should be noted, however, that the corporations also had automonous reasons for preferring bank borrowing to stock issues. Under the classical corporate tax system, in which interest expenses are tax-deductible whereas dividend payments are not, the cost of debt is much lower than the cost of equity, until the debt-equity ratio rises to the point of threatening bankruptcy. In the United States, for example, companies with a high debt-equity ratio are believed to be risky, especially during business downturns, because there is no certainty about revolving the credit and the companies would have to pay fixed interest irrespective of profitability.

The debt-equity ratio has a somewhat different meaning in Japan. Under the Japanese system, in which each large corporate group has its own group bank, the corporations have an implicit guarantee of automatically credit revolving and negotiated deferrence or reduction in interest payments, in the event of a business downturn. Thus a high debt-equity ratio is not automatically correlated in Japan with a high risk of bankruptcy.

Dividend payments, however, often became a fixed liability. To remain at the first section of the stock exchange, corporations had to maintain a history of consistent payment of dividends higher than a certain level. In fact, it became a rule that corporations must pay a fixed dividend, equal to the time deposit rate on the face value of the stock, regardless of annual fluctuations of profit. A dividend payment was therefore as binding a cash payment as the fixed interest payment on bank borrowings. If we further take into account that a stockholders' meeting rarely lasts more than five minutes, whereas the bankers intervene in every aspect of a company's management, it may be more advisable to exchange the numerator with the denominator when interpreting a Japanese debt-equity ratio. A high debt-equity ratio in Japan may be equivalent to a low debt-equity ratio in the United States.

The "overloan" is another Japanese linguistic invention. The term refers to the borrowings of commercial banks from the central bank, or the lending by the central bank to commercial banks. Only the thirteen city banks with national branch networks have overloan privileges, and therefore not all commercial banks benefit from this facility. Local banks did not need to borrow from the central bank, because they were already net suppliers of funds to the city

banks. The ratio of the overloan to the outstanding loans of the city banks rose from 0.93 percent in 1955 to a peak of 12.74 percent in 1961. The ratio remained in the range of 5 to 10 percent during the in 1960s, but fell to less than 2 percent after 1974(Ratios were computed from Table 8.43 in Ando 1978 : 175). In absolute terms, 38.6 billion yen were added to the monetary base through these loans during the 1950s, and an additional 185.3 billion yen were added during the 1960s. In the 1970s, however, there was a net reduction of 2.4 billion yen in the outstanding balance of the central bank loans (Minami 1986 : 357).

The overloan facility was one of three policy instruments that the central bank could theoretically use to manipulate the money supply. The others were reserve requirement rate changes and open-market operations. Adjustments of the reserve requirement ratio had limited effects in Japan, which has also been the case in Western countries, and they were used only for fine-tuning purposes. The Bank of Japan also had difficulties in open-market operations due to the deficiencies of outstanding government bonds in the 1950s and 1960s. Up to 1965, under the influence of the Dodge guidelines, the Japanese government maintained a balanced budget, and only minimal government bonds were issued. At least up to 1965 the overloan facility was the only way to increase the money supply to meet the rising liquidity requirement in a rapidly expanding economy. The heavy reliance on the overloan facility was therefore a necessity, in the absence of better alternatives, rather than an intentional policy of the central bank to retain leverage to influence the lending behavior of the commercial banks. Indeed, as early as 1962 a new system of monetary control was proposed as a means of shifting from the overloan system to open-market

operations. Until 1965, however, discussion of the proposal was purely academic because there were no government securities with which the central bank could maneuver.

In the late 1960s the government began to issue bonds to finance the growing imbalances in the national budget. One natural consequence of these issues was a reduction in the importance of the overloan facility as a control mechanism of the money supply. Indeed, in the 1960s as a whole, the monetary base was increased more through the purchase of securities and bills than through the overloan facility.

Beginning with the 1970s, the central bank used open-market operations almost exclusively. The term "open" in this context must be interpreted carefully. Since the interest rates on government bonds remained below the market rates until the late 1970s, the bonds did not appeal to the public. Instead, the commercial banks were forced to acquire the bonds each year, with a promise that the central bank would buy them the following year. In actual practice, therefore, the operations would more correctly be termed "closed-market." The system survived because the volume of bonds was not large and the commercial banks had to cooperate, even if unwillingly, with the central bank. But as the volume of government bonds increased in the late 1970s, these closed-market operations reached their limits. To digest the rising volume of government bonds, the government was forced to liberalize the interest rates on them.

Whether the Bank of Japan used "window guidance" to induce the commercial banks to lend to strategic industries is an unresolved issue. Since the reliance on the overloan facility was high, there is a lingering suspicion that the commercial banks were influenced by the central bank's guidance on credit allocation. However, one should not

confuse window guidance with the real powers wielded by the Bank of Japan. As the central bank, it maintained the power to influence the total money supply and thus influenced the credit availability for commercial banks and for private companies. Since the Bank of Japan, in collaboration with the Ministry of Finance, showed a strong aversion to signs of either inflation or trade deficit, it was very often in policy conflict with MITI. It is instructive to note that the central bank adopted a contractive monetary policy in the early 1960s when the government announced its ambitious plan to double incomes within the decade.

In addition to the inherent power of the central bank as a controller of the money supply, the Bank of Japan intervened in industry-specific credit allocations in the immediate postwar period. The bank's Order of Priority in Industrial Loans, which was legally based on the 1946 Emergency Ordinance on Financial Measures, required private financial institutions to restrict their loan portfolios to designated industries such as mining, metalworking, chemicals, electric power generation, gas supply, and transportation. Deviations from the priority list were allowed only with the prior permission of the Ministry of Finance. The Bank of Japan was empowered at the same time to monitor the ways in which the funds it loaned to city banks were being used. The Loan Mediation Bureau at the central bank was also instrumental in arranging cooperative financing packages for the important industries. In addition, the Bank of Japan retained a system of Investigation of Corporate Bonds Eligibility. The Bank of Japan extended the discount facility only to the bonds and securities of eligible companies.

The powers and intentions of the central bank to intervene into industry-specific allocation of funds were largely

terminated by 1955 (Horiuchi 1984 : 20-21). Loan mediation by the Bank of Japan was discontinued in 1954, and the eligibility-test system was abandoned in the following year. By this time, therefore, the Bank of Japan had already lost its almighty powers to direct the flow of financial capital. Against the tide, the government in 1955 prepared an ambitious draft on Temporary Measures for Adjusting Financial Institutions' Funds Supply. The measures, if enacted, would have authorized the Ministry of Finance to order private financial institutions to invest a prescribed portion of their incremental deposits in public bonds and bank debentures of the government-controlled long-term credit banks. The draft, however, was rejected in the Diet. This draft and the aborted effort by MITI to enact the Temporary Measures to Promote Designated Industries in 1962 represent the government's last futile attempts to maintain direct control over the loan portfolios of private financial institutions.

After 1955 the government used advisory committees to maintain communication channels with private companies and banks and to guide investment and financing priorites. Bankers, private businessmen, and government bureaucrats were represented on these advisory committees. The Ministry of Finance had the Financial Institutions Funds Council, and MITI had the Industrial Finance Committee. Undoubtedly, the committees served to facilitate communications among the participants, but the government had already lost the power to dictate to the private banks what to include in their loan portfolios. Window guidance by the central bank temporarily provided another communication channel between the central bank and the private banks. But after 1955 the Bank of Japan had neither the intention nor the power to intervene in industry-specific lending by the com-

mercial banks.

One of the distinctive features of Japanese financial system is the compartmentalization of the financial institutions. In addition to the American-style division of commercial banks from security houses, there are divisions between commercial banking and trust business; between short-term and long-term financing; among banks for big companies, for medium-sized and small companies, and for farmers; between the city banks and local banks; and between private commercial banks and the government-operated postal savings systems. In reality, the lending behavior of these financial institutions did not differ as much as the compartmentalization might imply. The city banks dominated every aspect of funds supply, but the contributions of government-run long-term credit banks should not be neglected, because of the industrial concentration of their loans. Three of the special long-term credit banks founded at the turn of the century—the Yokohama Specie Bank, the Nippon Kangyo Bank, and the Hokkaido Takushoku Bank—became private city banks after World War II.

No doubt exists about the government's control over the loan portfolios of government financial institutions. The relevant question in this case is the industrial composition of the funds. Advocates of the elusive financial Japan, Inc. would claim that the government funds were mainly channeled to export companies to improve international competitiveness. The historical record, however, does not support this claim. According to a study by Akiyoshi Horiuchi (1984 : 43), an extremely high proportion of government funds went to industries such as coal mining, agriculture, forestry and fisheries, and water transportation, which were hardly the high-growth or export-leading industries during

the postwar period of high economic growth.

It has also been argued that the mere presence of government institutions in loan syndications, regardless of how low the actual monetary commitments were, served as a signal to the commercial banks. This hypothesis, too, is refuted by Horiuchi's empirical study, which showed very little causal relationship between portfolio changes of governmental and private financial institutions (Horiuchi and Masayuki 1987).

The Period from 1974 to Present

After 1974, the country was no longer concerned with industrial financing problems. To the contrary, Japan became the leading net supplier of savings to the international capital market.

Domestically the trend acceleration in the savings rate ended at the turn of the decade and, since 1975, the net savings rate has fallen below 20 percent. The household savings rate remained firm at the 12 percent level, but corporate savings declined from 11 percent in 1970 to 1 percent or nil in the 1980s. Government savings also declined from 6 percent in 1970 to a negative figure starting from the mid-1970s (Hayashi 1986 : Tables A-1 and A-2).

On a net basis, the government now became a larger deficit unit than the corporate sector from 1975. After the oil shock, the economic growth rate fell to the 5 percent level, and corporate demand for external funds was accordingly reduced. In its place, the government began to run a large budget deficit to sustain reasonable economic growth and to support the ever-increasing demand for social overhead and welfare investments.

The commercial banks could not absorb the rising volume of government bonds. Thus, to entice private investors to buy government bonds, the interest rate was liberalized. The resulting differential between the still controlled bank deposit rate and the market-determined higher rate of government bonds ignited financial innovation in Japan. To solve the divisibility problem in the purchase of large denomination government bonds, various mutual funds specializing in government bond investments were formed by security houses. One of the most famous and successful mutual funds is the Medium-Term Government Bond Fund. Some of these mutual funds even established business ties with commercial banks and began to offer check-writing facilities to the stockholders of the funds. To compete with the securities houses, commercial banks began to offer certificates of deposit and money-market funds. The competitive introduction of new financial instruments by both the securities houses and the commercial banks made it increasingly difficult to maintain a dividing line between the two types of financial institutions. At the same time, the other aspects of compartmentalization—for example, the divisions between long- and short-term financing, between city and local banks, and between banks for large companies and those for small and medium-size companies—were all becoming less and less meaningful. The internationalization of the economy exerted additional pressure to accelerate financial liberalization and innovation in Japan.

The financial characteristics of this period are best represented by the popular term zai-tech—a derivation of the Japanese word *zaimu*("financial") and the English word "technology"—which provides a counterpart to the concept of "high-tech." The rapid economic growth of the 1950s and

1960s was led by the production of technology-intensive (high-tech) industries. Thus at the time, the early development or importation of production technologies was the most important concern of management. In balance-sheet terms, it was a period when the future cash flows from fixed assets, as a determinant of sales, were most important in the profitability of an industrial company.

When the growth rate fell after the first oil shock, however, sales volumes no longer increased as fast as before, and thus the importance of fixed assets decreased. In place of fixed assets, financial management of monetary assets and liabilities became more important to the bottom-line profitability of the company because of the wide fluctuation of interest and exchange rates and the rising share of monetary assets. The share of monetary assets rose rapidly due to the reduction in new physical investment in the comparatively stagnant economy. Zai-tech is particularly concerned with the selection of investment instruments with higher expected returns or of funding instruments with lower interest charges. When the selection of the investment and funding instruments goes beyond the national boundary of Japan, as is the case in contemporary Japanese companies, zai-tech can easily become more important than high-tech in determining the profitability of industrial companies.

Households likewise caught the zai-tech fever. The financial assets held by the household sector as a percentage of gross national product rose from 0.46 in 1953 to 1.54 in 1982. As the wealth in financial assets rose, the householder became increasingly sensitive to the interest differentials among investment securities. In this new environment, financial institutions began to competitively introduce high-return investment securities. Commercial banks could no

longer remain an enclave of low-interest demand and time deposits. Against the risk of possible reduction in intermediation margin, the commercial banks themselves began to ask for a complete elimination of interest controls on bank deposits.

CONCLUSIONS AND LESSONS FOR KOREAN ECONOMIC DEVELOPMENT

Ever since 1954 when Ruth Benedict published *The Chrysanthemum and the Sword : Patterns of Japanese Culture* (Benedict 1954), which has become a classic on Japan, there has been a pronounced tendency to view every incident in Japan from a culturalistic view. The culture-bound perspective turn has stimulated a dangerous tendency to filter historical facts into stereotyped views about Japan. The concept Japan, Inc. is one among many outgrowths of this tendency.

The main theme of this paper is that Japan, Inc. has not been as time-invariant or monolithic as generally perceived. Admittedly, the government-business relationship was very close in the early Meiji era and immediately after World War II. In the postwar period, the government also intervened heavily in the lending portfolios of private financial institutions, as a means of channeling funds to strategic industries. Indeed, the concepts of Japan, Inc. and "financial Japan, Inc." derived from the close postwar ties among government, businesses, and financial institutions. Associating the stereotyped Japan, Inc. with rapid economic growth, some observers even ventured to claim that government guidance is indispensible to rapid economic development.

This paper has examined the less sensational side of Japan, Inc. It has attempted to highlight facts and historical

incidents that are inconsistent with the stereotype and, consequently, have been conveniently omitted from most Western writing on the subject. There is evidence as early as the 1880s, for example, that the Japanese government was persuaded that the private sector could operate enterprises better than the government. In fact, the prewar Japanese economy (with the obvious exception of 1931-45) was led by independent initiative from private business. There is also evidence that the government conceived but failed to establish institutions designed to link government, business, and finance more intimately. This failure is demonstrated by the Diet's rejection of two major bills—the 1955 Temporary Measures for Adjusting Financial Institutions' Funds Supply and the 1962 Temporary Measures to Promote Disignated Industries. Thus, by the early 1960s the government was no longer able to achieve the consensus needed to continue the postwar practices of intervention in private business and private financial institutions. There is also evidence of strong interministry disagreements in both the prewar and postwar periods. In particular, the pro-growth views of MITI often came into conflict with the Ministry of Finance's concern about trade balances inflation.

Historical facts also contradict the popular perception of financial Japan, Inc. The high savings rate, for example, was a postwar phenomenon. The savings rate prior to World War II was not only low but was even lower than the rate in the United States. Simple statistics thus suffice to explode the culturalists' myth of a high propensity to save among the Japanese. The debt-equity ratio among private businesses was likewise not always high. It was, in fact, extremely low prior to World War II. At the same time, the government lacked both the intention and the ability to influence the

lending portfolios of prewar financial institutions. The evidence cited above demonstrates conclusively that the relationships among government, business, and financial institutions were neither time-invariant nor monolithic. Accordingly, students of economic development in Japan should not be led to believe that the Japanese government had a cultural prerogative to intervene in private business activities or that government intervention is always conducive to economic development.

Although there is a danger in making a purely monolithic or culturalistic interpretaion of Japan, Inc., there is also a striking degree of interaction between the government and the private sector in Japan. The periods of direct government intervention in the private sector were of brief duration, but modern Japanese economic history is nonetheless characterized by continuous exchanges of information and dialogue between the government and the private sector. Special commissions to advise the government in policy formulation can be found in many countries, but the advisory committees in Japan excel in number and quality. The government-business relationship in these committees is not a vertical one (as implied in Japan Inc.), but instead the government plays the role of intermediary among interest groups. It is also noteworthy that both government and business in Japan independently enjoy the respect of the people in terms of legitimacy and ability to carry out their assigned roles in a capitalistic society. This respect derives more from the performance of the players than from the cultural heritage of collectivism.

During the two and half decades since 1960, Korea has likewise achieved impressive economic growth, which in many ways is comparable to Japanese economic perfor-

mance. Following the common prescriptions of Japan, Inc", the Korean government formulated plans for and intervened in every aspect of private business activities. Not surprisingly, the economic success and close government-business relationships gave birth to the concept of "Korea, Inc.", which further strengthened the belief that government guidance is an indispensible ingredient in economic development.

This paper does not deny that there is a need for governmental guidance in economic development. Indeed, such guidance in early Meiji Japan and in the immediate postwar period was conducive to Japanese economic development. The hard lessons and seccess stories from Japan demonstrate forcefully, however, that timely severance from excessive government control is essential. Although the Korean government intervention in private business activities during the 1960s was a necessity, the continuation of such intervention had become unwarranted by the late 1970s. The Korean economy might have benefited more if tighter government control over private businesses had been maintained during the presidency of Syngman Rhee (1948-60) and if the governments of President Park Chung Hee (1961-79) had phased out their intervention during the mid-1970s.

In 1980 the Korean government began to emphasize the role of the private sector in a capitalistic society. In terms of macroeconomic policies, the new government deviated greatly from the path followed by its predecessors. The consistent implementation of restrained fiscal and monetary policies was successful in establishing sound economic infrastructures to contain inflation and create a favorable balance of trade.

In terms of microeconomic policies, however, government control is still absolute. The lending portfolios of

domestic financial institutions and the import channels of foreign loans are still closely supervised by the government. Politicians and bureaucrats still tend to be followers of the popular version of Japan, Inc. and sincerely believe that they can plan better than the private sector. By clinging to the real historicla basis of the myth without absorbing its lessons of timely withdrawal, intervention in the Korean case has been prolonged to the verge of overkill.

Advisory committees in the government should be given the opportunity to function properly. The committee chambers should function not as places where completed government drafts are read to committee members for approval, but rather as a forum for formulating consensus and exchanging information. One may argue that the cultural heritage of Koreans—in particular, the tendency to insist upon their arguments to the bitter end, at one extreme, or to submit blindly to their superiors, at the other—is not conducive to consensus building in committees. The author personally belives that Korean politico-business behavior is in the process of rapid change. Even if some features of this behavior have not yet changed, we have to continue our efforts to form consensus among varied interest groups.

The era in which a benevolent but omnipotent government could efficiently dominate the industrial sector has passed into history. In this respect, Korean bureaucrats and politicians alike would benefit by studying the Japanese experience with the art of timely withdrawal. The government must transform its role from that of benevolent planner and controller to that of coordinator. In the process, a new basis for government-business relations must be established that will ensure continuous consultation, discussion, and interaction among all interest groups.

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