

Globalization and the Origins of Japanese Developmentalism

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RESÜMEE

Welche langfristigen politischen und ökonomischen Leitlinien charakterisiert das japanische Entwicklungsmodell? Unter welchen Umständen entwickelte sich das japanische Modell von Entwicklung bis zur Mitte der siebziger Jahre? In diesem Beitrag wird argumentiert, dass das japanische Entwicklungsmodell in engem Verhältnis zur Globalisierung im 20. Jahrhundert steht. Entsprechend nimmt der Beitrag zunächst Globalisierungsschübe des 20. Jahrhunderts in den Blick. Anschließend wird gezeigt, dass das japanische Entwicklungsmodell der Zeit vor und während des Zweiten Weltkrieges als eine von drei Strategien interpretiert werden kann, mit denen Staaten auf die globale Wirtschaftskrise und auf Prozesse von Entglobalisierung reagierten. Die für Japan charakteristische Version eines militärischen Entwicklungsregimes wurde in der Nachkriegszeit abgelöst von einer langfristigen Strategie, die sich am System von Bretton Woods orientierte.

What were the origins of Japanese developmentalism? Under what historical conditions had Japanese developmentalism evolved up to the 1970s? In this chapter, I argue that the evolution of Japanese developmentalism needs to be understood in relation to the long-term movement of globalization. To illustrate my point, I first discuss the two waves of globalization in the 20th century. Then I demonstrate that most of the major features of Japanese developmentalism, a military version, emerged during the Great Depression and World War II as one of the three patterns among industrialized countries responding to the down-turn of the first wave of globalization. I further show that in the postwar period this military version of Japanese developmentalism was transformed into a trade version during the up-turn of a new wave of globalization sustained by the Bretton Woods system and the General Agreement on Tariffs and Trade.

The Institutional Nature of the Two Waves of Globalization

In the existing literature, globalization is considered as a structural process characterized by the free flow of goods, capital, technology and labor (in the form of immigration) across national borders. Many scholars have used the ratio of global trade against global GDP as the major measurement of globalization. I argue that globalization is also an institutional process because the international economic order has played a crucial role in the ups and downs of the trade ratio against the world GDP in the twentieth century. Without highlighting the importance of international monetary and trade regimes to the process of globalization, we cannot fully explain why the postwar expansion of trade and production occurred in the first place, how capitalist economies sustained social protection in the 1950s and 1960s, why the expansion of trade and production shifted toward an expansion in finance and monetary activity, and why efforts directed toward social protection were replaced by efforts to release market forces.

The last wave of globalization in 1870–1913 was sustained by the international gold standard and various international treaties on tariffs. Both monetary and trade regimes were backed up by British hegemony. In the international gold standard system, the Bank of England used its discount rate to influence the movement of gold both domestically and internationally. The stability of the gold standard relied on two things: a hierarchical structure in which London was the most important financial center in the world, and confidence in the continued convertibility of sterling and other major currencies into gold at par value.¹ In the international trade regime, the Cobden-Chevallier Treaty of 1860 between Britain and France not only yielded reciprocal tariff cuts but also led France to sign tariff treaties with other European countries and the German customs union.²

The downturn in the movement of the ratio of trade against world GDP did not start naturally as a structural process. Rather, it was triggered by the collapse of the gold standard in 1914. In the same year, World War I broke out. These two events ended what John M. Keynes called an “extraordinary episode in the economic progress of man”.³ At the Genoa conference of 1922, the major powers agreed to establish a gold exchange standard in which currencies would be exchanged at fixed parities. Britain returned to gold in 1925, with an emphasis on sterling-dollar convertibility, but left gold again in 1931 during the Great Depression. Japan tried to follow the British lead, but the attempt quickly failed. Between 1931 and 1944, there was no comprehensive and agreed-on set of rules or norms governing international monetary arrangements.⁴ The First World War, the peace settlement, and shortsighted policies disrupted trade patterns in international trade, and protectionist pressures began to build up everywhere. As major industrialized

1 Robert O. Keohane/Joseph S. Nye, *Power and Interdependence*. Boston 1977, 67–71.

2 Peter B. Kenen, *The International Economy*. Englewood Cliffs, NJ 1989 [1985], 213.

3 Dani Rodrik, “The Debate Over Globalization: How to Move Forward by Looking Backward.” Unpublished paper 1998. Quoted with permission of the author.

4 Keohane/Nye, *Power and Interdependence* (note 1), 73–76.

countries adhered to the so-called lifeline theory, they fought over markets, materials, and resources trying to establish their spheres of influence. These conflicts led to World War II.

The Down-Turn of the Last Wave of Globalization and the Rise of Japanese Developmentalism

Most of the major features in Japanese developmentalism, both ideological and institutional, emerged between 1931 and 1945, as a response to the down-turn of the last wave of globalization through the practice of managed economy. The profound changes in the international economic regimes provided the dynamics for the changes in the Japanese economic system. The collapse of the gold standard in 1914 triggered a series of crises for capitalist economies on a global scale. To a large extent, the evolution of Japanese developmentalism had been driven by two major events in the period between 1927 and 1945, the Great Depression and World War II. In responding to these two major crises, coordination and stability emerged as two major principles for Japanese developmentalism.

The focus on coordination resulted from the effort of preparing for wars, as the collapse of the international order greatly intensified the conflicts of interests among nation states. According to the popular life-line theory at the time, each nation state in time of chaos had to maintain its control over certain geographical areas as the source of its materials and the market for its products in order to survive. To achieve this goal, great powers often sought military solutions. This brought about the birth of the total war theory. The total war theory argued that

*In modern war victory or defeat is determined directly not only by the fighting strength on the battlefield, but mainly by the strength of industries that made weapons ... [the state must] utilize every economic instrument, to devote all available materials, and to fight to the last minute in order to survive.*⁵

In 1931 Japan engaged in the military occupation of Manchuria, the northeast region of China; in 1937, in the full-scale invasion of China; and in 1941, in direct confrontation with the United States. During this period, the economy was perceived as the foundation of national defense. During this process, a drastic institutional re-composition occurred in Japanese capitalism. Influenced by the German theory of total war, the ideology of the managed economy resembled the orthodox doctrine of mercantilism, which regards wealth as the essential means to acquiring military power and views military power as an important means of acquiring wealth.⁶

5 Hiromi Arisawa, *Sangyō dōin keikaku* (Planning industrial mobilization). Tokyo 1938, 18, 80-81.

6 David Williams, *Japan: Beyond the End of History*. London 1994.

The focus on stability resulted from the effort of countering the shocking impact of the Great Depression, which produced massive bankruptcies and layoffs. The rise of the Japanese managed economy occurred during a turning point of history where states in all industrialized countries strengthened interventions in order to survive the Great Depression. Thus, its historical significance needs to be understood in a broader historical context. According to Karl Polanyi, the evolution of capitalism was driven by two opposing movements:

One was the principle of economic liberalism, aiming at the establishment of a self-regulating market, relying on the support of the trading classes, and using largely laissez-faire and free trade as its methods; the other was the principle of social protection aiming at the conservation of man and nature as well as productive organization, relying on the varying support of those most immediately affected by the deleterious action of the market – primarily, but not exclusively, the working and the landed classes – and using protective legislation, restrictive associations, and other instruments of intervention as its methods.

Polanyi believed that “the protective countermovement was not external; rather, it was essential for the vitality of a capitalist order”⁷.

Although all industrialized countries witnessed the protective countermovement in the 1930s in the downturn of globalization, “the emerging regimes of fascism, socialism, and the New Deal were similar only in discarding laissez-faire principles”.⁸ State intervention reflected an epochal dynamic of the 1930s, which was shared by all industrialized countries. What was singular in fascism? I argue that the impact of fascism on the Japanese managed economy in 1931–1945 can be identified in three areas of ideology, which shaped the pattern of institutional transformation of Japanese developmentalism.

First, the economy was bestowed with strategic significance. As Polanyi pointed out, the failure of the self-regulated market in the 1930s not only resulted in the rise of state intervention. The collapse of the gold standard had a direct implication to international politics because “the balance of power system could not ensure peace once the world economy on which it rested had failed”.⁹ Shared with the Germans and Italians, the Japanese believed that the collapse of the international economy after World War I would inevitably lead to military conflicts. This changed Japanese economic thinking profoundly. In the ideology of managed economy, the end of the economy was not derived from economic perspective but from political perspective. In other words, the economy was no longer the end itself but a means of the nation-state in international politics.¹⁰ Different from state intervention practiced by liberal capitalism in the United States and Britain in the 1930s which primarily aimed at combating the Great Depression, the state intervention in Japan, similar to that in Germany and Italy, from early

7 Quoted in Fred Block, *Postindustrial Possibilities*. Berkeley 1990, 39.

8 Karl Polanyi, *The Great Transformation: The Politics and Economic Origins of Our Time*. Boston 1957 [1944], 224.

9 *Ibid.*, 4.

10 Tōa Keizai Chōsakyoku, *Nachisu no keizai seisaku* (Nazi's economic policy). Tokyo 1935, 23.

on was a strategic measure to prepare for war. The states in these three countries paid a special attention to the development of heavy-chemical industries in order to ensure the munitions production.

The strategic view of the economy inevitably changed the role of the state. Chalmers Johnson points out that

*It is true that industrial policy in one form or another goes back to the Meiji era, but it is also true that after the turn of the century the government moved progressively away from its former policies of interference in the domestic economy (if not in those of the colonies or dependencies), and that for about thirty years an approximation of laissez faire was in vogue.*¹¹

Driven by the pressures of the Great Depression and war mobilization, the Japanese state emerged as the “economic general staff.” It not only began to make long-term plans to promote production and upgrade the industrial structure of the economy, but also exercised a tight control in resource allocations, adopting a discriminatory policy to ensure the supply of materials and capital to the munitions industries. The General National Mobilization Law enacted in 1938 gave the state bureaucracy unprecedented power to carry out the managed economy in the form of administrative decree. From then on, the state bureaucracy could issue orders directly to the private sector without consulting the Diet.

Second, although both liberal capitalism and fascism tried to constrain the market forces in the 1930s, the ideology of Japanese developmentalism had a strong anti-capitalist orientation which was sustained by nationalist ideology. This ideology rejected the assumption of economic man. The freedom of individuals and the property right of private ownership were challenged by the claims of the “national interest”, which referred to “economic strength, independence in the world, military power”.¹² Ideologically, fascism aimed at

*creating a social order that modulated the profit-seeking impulses of the capitalists and the wage-seeking impulses of the proletariat by simplifying the social structure, and by eliminating the market mechanism as the principal means for the allocation and distribution of social goods. They wished to achieve social harmony and consensus with institutional reforms that contained and redirected individual materialistic motives in the name of higher collective purposes rather than through appeals to traditional ‘collectivist’ values.*¹³

As Preston points out,

11 Chalmers Johnson, *MITI and the Japanese Miracle*. Stanford 1982, 33.

12 S. J. Woolf, ed., *The Nature of Fascism*. London 1968, 128.

13 Peter Duus / Daniel I. Okimoto, *Fascism and the History of Pre-war Japan: The Failure of a Concept*, in: *Journal of Asian Studies* 39 (1979), 39-64, here 69-70.

*fascism's control over the economic order proved ultimately to be for a non-economic purpose, even an anti-economic purpose. Communist effort has been consistently geared to economic development, with military power as an important concomitant objective but deemed a temporary necessity rather than a goal in itself. Fascism placed military preparedness at the forefront of its objectives from at least 1935 on.*¹⁴

To restrain the market forces, the state encouraged the development of non-market governance structures, such as cartels, control associations, and the main bank system. Before the Great Depression, cartels had not fully developed in Japan; control associations did not exist; the indirect financing constituted only about 30 percent of the total capital supply in contrast to 90 percent at present.¹⁵ During the Great Depression, the Japanese state started a program of industrial rationalization. Cartels were established in each industry to control production in order to ease economic hardship by preventing private companies from going bankrupt. The state enacted the Important Industry Law in 1931. According to this law, when two thirds of the companies in one industry joined a cartel, the state had the authority to force the rest of the companies to follow the agreement set by the cartel. If a cartel agreement contradicted “public interest”, the state could change or eliminate it. In the 1930s, the state also enacted a series of industry laws, which made every element of business activity in that industry subject to state licensing. This marked the beginning of intensive government regulations that have lasted until present day. On the eve of the Pacific War, the Japanese state promulgated the Important Industry Association Ordinance, which resulted in the establishment of control associations in more than twenty industries. These associations were entrusted by the state with administrative power but were operated by the private sector. They had the authority to decide not only the amount, varieties, and methods of production, but also terms, prices, partners, and timing of transactions. They also had the power to determine profits, dividends, and bonuses.¹⁶ In order to ensure the capital supply to the munitions industries, the main bank system evolved. By the end of World War II, this practice spread into the non-munitions industries as well.¹⁷ The development of these non-market governance structures indicates that the Japanese state not only directly intervened in the economy by itself. It also encouraged the development of non-state institutions that constrained the market forces and placed them under its control. The private sector, under the pressure of

14 Nathaniel Stone Preston, *Politics, Economics, and Power: Ideology and Practice Under Capitalism, Socialism, Communism, and Fascism*. New York 1967, 210.

15 John O. Haley, *Law and Society in Contemporary Japan*, Dubuque 1988; Tetsuji Okazaki/Masahiro Okuno, eds., *Gendai nihon keizai shisutemu no genryū*. Tokyo 1993, 1-34; Kamekichi Takahashi, *Nihon keizai tōseiron* (On Japanese economic control). Tokyo 1933.

16 Masanori Nakamura, “1950-60 nendai no hihon” (Japan in the 1950s and the 1960s). In Asano Naohiro, Amino Yoshihiko, Ishii Susumu, Kano Masanao, and Hayakawa Shōichi, Iwanami Kōza: *nihon tsūshi*. Vol. 20. Gindai I. Tokyo 1995, 3-68.

17 Tetsuji Okazaki/Masahiro Okuno, eds., *Gendai nihon keizai shisutemu no genryū*. Tokyo 1993, 145-182; Jūrō Teranishi, *Meinbanku shisutemu*, in: Tetsuji Okazaki/Masahiro Okuno, eds., *Gendai nihon keizai shisutemu no genryū*. Tokyo 1993, 61-96.

nationalism during the war, had to compromise with the state in accepting the state's supervision in order to protect itself from more serious state intervention.

To oppose the profit principle, the state exerted strong pressure on private companies. Before the managed economy, Japan's economic system

*was very different from its present form ... job was separated from permanent employment. There was a high priority toward capital return to share-holders and reward to managers. The present practice of keeping profits within the company for investing in equipment almost did not exist.*¹⁸

As the state strengthened its control over business activities during the war, the profit principle encountered great challenge. This control was achieved not only through directing the flow of capital into the munitions industries, but also through constraining the property right of shareholders in private companies. The increased indirect financing and the bureaucratic control over dividends gave managers strong autonomy. Through a series of administrative orders by the state following the outbreak of war against China, the job transfer of individual workers was no longer allowed; the starting salary of employees was under the control of the state, and all employees' salaries were raised together once a year.¹⁹ Meanwhile, an industrial patriotic association was established in each company. Unlike the pre-1937 period, where white collar and blue collar workers had belonged to different unions, these industrial patriotic associations included both groups as their members. Thus, "the attempted elimination of the opposed interests of capital and labor were unique to fascism, a deliberate contrast to the class concept accepted by both capitalism and communist Russia".²⁰

Third, the ideology of Japanese developmentalism in the era of the managed economy, shared with German and Italian counterparts, also had a strong anticommunist orientation. As an alternative protective countermovement to liberal capitalism, fascism represented "a revolutionary tendency directed as much against conservatism as against the competing revolutionary force of socialism". It was both "counterrevolution and nationalist revisionism." S. J. Woolf points out that

[d]espite the sporadic protests of the fascist left wings against big capital and absentee landowners, the regimes rapidly abandoned any attempt radically to change the existing structure of economic power, and endeavored instead to turn this structure to the service of their politically motivated economic aims... The governments in Italy, Germany and Japan had little desire to nationalize industries, for ideological as well as political rea-

18 Okazaki/Okuno, eds., *Gendai nihon keizai shisutemu no genryū*, 18-19.

19 Hideo Kobayashi/Tetsuji Okazaki/Seiichirō Yonekura, 'Nihon kabushiki kaisha' no showashi (The showa history of Japan Inc.). Tokyo 1995; Yukio Noguchi, 1940-nen taisei (The 1940 system). Tokyo 1995; Kōnosuke Otaka, Nihonteki rōshi kankei (The Japanese-style labor relations), in: Tetsuji Okazaki/Masahiro Okuno, eds., *Gendai nihon keizai shisutemu no genryū*. Tokyo 1993, 145-182.

20 Woolf, ed., *Nature of Fascism* (note 12), 137.

sons... The policy of the regimes was rather to leave the industrial sector in private hands and ensure that it acted in accordance with national 'needs'.²¹

This character resulted from the politics of practicing industrial policy. A direct control was asserted and pursued by segments of the state. Due to the constraints of the economic situation and resistance of the private sector, however, many policy measures were altered or even failed. The rise of Japanese developmentalism in 1931–1945 did not occur peacefully and the process of transformation was full of resistance and conflicts.²² As a result, in comparison with the socialist program adopted by the Soviet Union, the control of the Japanese state over the economy did not take the form of nationalizing property right, and the operation of the managed economy was still based on the private ownership. In comparison with New Deal, however, the Japanese state established much stronger control over the economy through both direct bureaucratic intervention and non-market governance structures, no matter how incomplete it might be. This character of Japanese developmentalism in 1931–1945 has some important contemporary implications.

The Postwar Wave of Globalization and the Transformation of Japanese Developmentalism

In the postwar period, the Bretton Woods system and the GATT were established under the leadership of the United States. Both the new international monetary regime and the trade regime became the institutional foundation sustaining a new wave of globalization. Between the late 1940s and the end of the 1960s, the Japanese economic system was reconfigured to cope with this new international economic order. The transformation of Japanese developmentalism in this period, however, can still be divided into two stages. Between the end of World War II and the end of the 1950s, Japan and many West European countries suffered from a shortage of dollars. As a result, they all adopted protectionist policy to guard their domestic markets in order to balance their international payments, despite of the fact that the GATT was in place. Beginning from the second half of the 1950s, the United States began to push the liberalization of trade. A new regime of free trade was finally emerging in the international economy, sustained by the hegemony of the Pax Americana. As Japan joined the International Monetary Fund (IMF) and the General Agreement on Trade and Tariffs (GATT), it was required to liberalize its imports and foreign currency exchange. Against this new development in the international economic order and the process of globalization, Japanese developmentalism accomplished its final transformation to a trade version by the end of the 1960s. Japanese developmentalism was transformed from the military version to a trade version in the postwar period. Unlike the

21 Ibid., 129, 136.

22 Akira Hara, *Nihon no senji keizai-kokusai hikaku no shiten kara* (Japan's wartime economy-from a comparative perspective), in: Akira Hara, ed., *Nihon no senji keizai*. Tokyo 1995, 3-44.

military version, which had a strong inward orientation, the trade version was aggressively outward. This outward orientation, however, was not cosmopolitan, but nationalistic. The strategic view of the economy still dominated Japanese industrial policy, though serving for a new national purpose. In the 1950s, this orientation aimed at strengthening the nation's power through engaging in international competition. In the 1960s, the strategic view of the economy in Japanese developmentalism was raised to a new level.

Although Japan lost World War II, Prime Minister Yoshida Shigeru held that "A defeated nation, by analyzing and exploiting the shifting relations among world powers, could contain the damage incurred in defeat and instead could win the peace."²³ The fall out between liberal capitalism and communist Russia, who used to be the ally in World War II against fascism, provided Japan with a great opportunity to maneuver. Facing the Cold War environment, Yoshida designed a grand strategy for Japan: take the U.S. side politically and militarily in exchange for economic aid and military protection, and in the meantime concentrate Japan's resources on economic growth, while minimizing the spending on national defense. This nationalist economic strategy, however, was challenged by both the conservative who asserted rearmament and the amendment of the constitution, and the progressives who advocated keeping distance from the United States.

In the 1950s, the development of heavy-chemical industries remained the top priority in Japanese industrial policy. Although these industries were no longer centered on the production of weapons, they were still regarded as the foundation, or the strategic components in the industrial structure of the economy, which would maximize Japan's gain in international trade. As the slogan "export or die" indicates, in the 1950s the promotion of exports was directly related to 'national survival'. Japanese economic ideology revised the classical definition of comparative advantage: this no longer meant rich resources or cheap labor that had been given naturally to an economy, but denoted production technology that would add values to products and thus generate more benefits for the nation in international trade. Even Japan did not have this comparative advantage at the time; it had to be obtained by human effort. Production technology was perceived as Japan's only alternative in the 1950s to military force in building the nation's power. Although technology had always had strategic implications to Japan's national security, it was of central importance in Japanese economic ideology in the 1950s, because after learning about the achievements of technological development in the United States, many Japanese concluded that their defeat in World War II was a result of losing the competition in technology.²⁴

In this policy paradigm, the state changed its way of intervention. During the war, the ultimate goal of Japanese industrial policy had been to support the military. The state directly controlled the distribution of materials and prices. The function of the market

23 Kenneth B. Pyle, *The Japanese Question*. Washington, D.C. 1992, 21.

24 Bai Gao, *Economic Ideology and Japanese Industrial Policy: Developmentalism from 1931 to 1965*, New York 1997.

in resource allocation was largely replaced by bureaucratic control and non-market governance mechanisms. This trend was further strengthened in the occupation period to combat the economic crisis. After the implementation of the Dodge plan in 1949, in contrast, the state still controlled, but by organizing the market competition. It abolished the control over material distribution and prices, and changed the control over credit from direct to indirect. As a result, the market resumed its function and private companies, who had been heavily protected by the state in the managed economy, were forced to the market and had to ensure the supply of capital, materials, and the marketing channels by themselves.²⁵ Beginning in 1950, the principle of rejecting competition was transformed to restraining “excessive competition.”

In contrast to the policy focus on the promotion of competitiveness of Japanese companies in strategic industries in the 1950s, the interpretation of the national power of production was further extended in the 1960s to the high growth rate of the entire economy. It aimed not simply at sustaining economic growth or adjusting for market fluctuations, but at “achieving economic growth at a much quicker pace than other countries.” In this policy paradigm, macro-financial policy was directly tied to industrial policy. Government planning and public spending were regarded as important means to sustain economic growth. The state increased public spending aggressively in an effort to promote infrastructure, human capital, social welfare, and science and technology, and to upgrade the industrial structure of the Japanese economy by moving quickly toward the heavy-chemical industries. The high growth policy distinguished Japanese developmentalism from liberal capitalism. After World War II, Keynesian economics became influential in state policy in most industrialized countries. Although the application of this economics had often gone beyond the short-term adjustment of market fluctuations, the policy objectives in Western industrialized countries were basically full employment, a welfare state, or economic growth in general. In the Japanese case, however, macro-financial policy was directly applied to sustain high growth, upgrade the industrial structure of the economy, and to strengthen the national competitiveness in international trade. These differences suggest that when Western economic ideas were diffused throughout Japanese policy making, they were often applied in a “developmental” way. The strategic view of the economy was further reflected in the state’s effort to mobilize the whole country into the “new industrial system” (*shinsangyō-taisei*).

The anti-capitalist orientation, measured in restraining market competition and the profit principle, reemerged in new forms in the postwar period after they had been strongly challenged during the occupation. Although the Japanese economy of the 1950s is often called a “free economy” (*Jiyū keizai*) in contrast to the managed economy, it was considerably different from the Anglo-Saxon type of liberal capitalism. To be true, the dissolution of zaibatsu and the enactment of the antimonopoly law in the late 1940s encouraged market competition. To promote exports, however, the state revised the an-

25 Hideo Kobayashi, Okazaki Tetsuji and Yonekura Seiichirō, *Nihon kabushiki kaisha' no showashi* (The showa history of Japan Inc.). Tokyo 1995, 238.

timonopoly law twice, providing the legitimacy for business reorganization. As a result of democratic reforms, the prewar type of holding companies, which had the power to control capital and personnel of their subordinates, did not come back, and in comparison with the prewar period, the order of market competition became more unstable.²⁶ Nevertheless, cross-shareholding and the exchange of personnel, which had been prohibited in the 1947 antimonopoly law, became legal again. Former zaibatsu companies, represented by Mitsubishi and Mitsui, began to reorganize themselves into keiretsu after temporary dissolution during the occupation. These keiretsu networks, centered around large commercial banks, provided manufacturers with reliable finance in pursuing technological transfers and investments in production equipment. At the same time, the Japanese state restrained the market competition in strategic industries through intensive government regulations. To nurture the competitiveness of Japanese companies in strategic industries, the state continued to restrain imports of foreign products to Japan. To promote exports, the state also controlled foreign exchange. Finally, cartels, which had been a critical instrument in Japanese industrial policy since the Great Depression, were again allowed to combat economic recession and to promote rationalization after being outlawed since 1947. In the managed economy, the function of these non-market mechanisms was to counter the Great Depression and to prevent the market forces from disturbing the nation's goal of ensuring the production of munitions industries. In the 1950s, their function was to prevent the market forces from scattering capital supply, to nurture the competitiveness of Japanese companies; and to keep an industrial order in rapid economic growth.

The industrial reorganization in the late 1960s in light of liberalization of foreign direct investment (FDI) served to restrain the market competition in order to increase the economy of scale. It was argued that foreign companies could cut the price down as their advantage in capital enhanced their economies of scale. In order to compete with them, Japanese companies must be organized into an industrial system which would not only coordinate capital investment and organize each industry's distribution system, but also encourage mergers among large Japanese companies in order to increase the economy of scale. All these measures became a big issue concerning the antimonopoly law. Supported by the state, however, they were carried out anyway. As a result, keiretsu witnessed a new wave of development and became major players in the international competition. The practice of relational contracting, as history would indicate later, constrained the market competition considerably. It especially restrained the access of foreign companies to the Japanese markets.

After the free trade regime pushed Japanese developmentalism to adapt to the new environment of an open economy, the private ordering became increasingly important and the power of state bureaucracy began to decline. The settlement of the "private ordering" in the governance of the Japanese economy reflected the continuities of not only the

26 Akira Hara, *Nihon no senji keizai-kokusai hikaku no shiten kara* (Japan's wartime economy-from a comparative perspective), in: Akira Hara, ed., *Nihon no senji keizai*. Tokyo 1995, 91.

anti-capitalist orientation of constraining the market competition, but also the anti-communist orientation which rejected the direct control by the state. This development directly resulted from the politics of building the new industrial system. At the time, MITI proposed the “state-private sector coordination,” which would give the state the power to supervise each loan made by commercial banks.²⁷ MITI’s proposal was perceived as “reviving the direct bureaucratic control” and was strongly resisted by big commercial banks. Resisting MITI’s bureaucratic control, the private sector came up with a proposal of “independent adjustment.” Eventually MITI’s efforts for enacting the “Law Concerning Special Measurement for Promoting Strategic Industries” were blocked, and the “independent adjustment” proposed by the private sector through non-market and non-state institutions turned out to be the major instrument to meet the challenge of the liberalization of trade and capital investment.

This development has a strong contemporary implication. With this settlement, the division of labor between the state and the private sector was redefined. Beginning at that time, the Japanese state began to depend more strongly on administrative guidance in its economic intervention. At the same time, the state relaxed its antimonopoly law; in the late 1960s it encouraged further industrial reorganization among big companies through mergers in order to strengthen the competitiveness of Japanese companies. Supported by the state, the industrial reorganization under the policy paradigm of liberalization resulted in a further development of non-market governance mechanisms, which privatized the protection of Japan’s domestic markets. As a result, not only keiretsu emerged as the major player in the international competition, various social regulations of the market such as trade associations also created a big problem for foreign companies to access the Japanese market. Although Japan’s domestic markets were opened, they were still tightly protected by both vertical and horizontal business alliances that practiced relational contracting.

In the postwar period, the profit principle was rejected again in the management of Japanese companies. This principle influenced the business strategy in the rationalization movement in the early 1950s in which Japanese companies made massive layoffs in an effort to reduce production cost. In the mid 1950s, progressive business leaders who gathered at the Japan Committee of Economic Development (Nihon Keizai Dōyūkai) initiated the productivity movement with the support by the state, aiming at taking labor unions into their program of promoting exports. In order to pursue comparative advantage in production technology, some large companies made a historical trade-off. They started giving up allocative efficiency as measured in short-term cost-benefit analyses; this had been their primary concern in the early 1950s. In exchange they wanted to gain labor’s cooperation in technological innovation and quality control; to do this, they were required by labor unions to provide job security and to increase salaries. During this process, the traditional value of harmony was strategically advocated by business leaders

to smooth the relationship between management and labor, which had been an arena of constant confrontation for a decade. Labor's response was divided. The majority of labor unions still remained skeptical, but one third of labor unions decided to cooperate with management. The so-called Takano Minoru line of the labor movement, which had advocated political confrontations with management, was replaced by the Ōta Kaoru-Iwai Akira line which emphasized gaining economic benefits through the spring strikes.²⁸ The solution to the labor conflicts was not widely accepted until the mid 1960s. As the Miike strike of 1960 indicates, a major labor dispute at the national level was to come soon. Nevertheless, the productivity movement had marked the beginning of the effort to stabilize labor relations.

The rejection of the profit principle was supported in part by a side-effect of democratic reforms. At the end of the war, there was a possibility for Japanese management to return to the prewar tradition. Nevertheless, the zaibatsu dissolution destroyed a core of the prewar corporate system. When the members of zaibatsu families were removed from managerial posts, management was finally separated from ownership. As a result, those who fought hard with the state to protect profits were replaced by a new generation of managers, and employee sovereignty was established. Supported by the main bank system, these managers obtained more autonomy. They aggressively engaged in the competition in long-term investment.²⁹ Besides, after the land reform and labor reform democratized Japanese society, equality became a widely-spread ideal. Under such circumstances, the wartime practice of ensuring job security and annual wage increase were regarded as desirable.³⁰ In the 1960s, the Japanese management system, characterized by permanent employment, the seniority-based wage scale, and company-based labor unions, was eventually institutionalized among large Japanese companies.

In the 1950s, despite the fact that some Japanese business leaders started their efforts to stabilize labor relations through the productivity movement, the impact of the confrontational strategy adopted by both management and labor still remained strong, there were still some considerable resistance and doubts to this initiative on both sides. A major confrontation eventually took place between the two sides at the national level during the Miike strike in 1960 when Mitsui Company intended to lay off more than six thousand workers in the Miike coal mine. The Miike dispute became a turning point in the postwar Japanese labor relations. Although this dispute ended with labor's failure, it forced the state, business leaders and labor unions to reexamine the confrontational strategies they had adopted. Labor unions realized that the national level and industry level confrontations could not effectively protect their interest; they decided to fully participate in the productivity movement. Management also keenly recognized the huge

28 Masanori Nakamura, 1950-60 nendai no hihon (Japan in the 1950s and the 1960s), in: Asano Naohiro / Amino Yoshihiko / Ishii Susumu / Kano Masanao / Hayakawa Shōichi, Iwanami Kōza: nihon tsūshi. Vol. 20. Gindai I. Tokyo 1995, 37-38.

29 Hideo Kobayashi / Okazaki Tetsuji / Yonekura Seiichirō, 'Nihon kabushiki kaisha' no showashi (The showa history of Japan Inc.). Tokyo 1995, 126.

30 Etsuke Sakakibara, Shihonshugi no oeta nihon (Japan that transcended capitalism). Tokyo 1990.

cost involved in the confrontational strategy. As the labor market became favorable to the supply side for the first time in 1963, management also lost its leverage over labor unions. In order to ensure the supply of labor, permanent employment became widely institutionalized. Previously the state had regarded labor disputes as an issue of public security. Now it realized that in order to sustain a rapid economic growth without major social disturbance, it had to treat labor relation as an issue of social policy.

Concluding Remarks

By the end of the 1960s, the transformation of Japanese developmentalism from the military version to a trade version was largely accomplished. Even though many original components of the wartime economic system changed in appearance, the general principles that had been established between 1931 and 1945 remained. Amaya Naoyasu, a young MITI bureaucrat, commented in the early 1960s that

The United States and Europe replaced their wartime practices in the postwar period with the social and economic continuities that originated in the nineteenth century. The operation of their postwar economies simply took the form of returning to the prewar tradition. Japan, in contrast, never returned to its prewar tradition. Something new, yet quite different, was born, which was strongly influenced by the wartime economy. Although the economy as a whole admitted the ideology of free economy, the market was vertically divided... Unlike the markets in the U.S. and Europe, which have high horizontal mobility, the Japanese market is vertically divided into several markets and each of them is topped by a commercial bank... Based on these social conditions, the government intervened in various ways.

In the postwar period, the principle of coordination changed from restoring economic order after the Great Depression and mobilizing resources for national survival during World War II to promoting economic growth. As a result, the means of coordination also changed significantly. Unlike the situation during the wartime, after 1952 the state no longer directly controlled the distribution of production materials and consumer products. Although the state still applied various policy tools to affect the behavior of private corporations, it could no longer use coercive power to achieve its goal. Sustained by the Bretton Woods system, the state was able to rely on an expansionary monetary policy to promote economic growth and meanwhile maintain a stable exchange rate with the dollar. Engaged in asymmetric cooperation with the United States, the state aimed at maximizing Japan's gains in international trade by promoting exports.

However, these institutions and mechanisms, designed to strengthen coordination, also weakened shareholders' control over management and banks' monitoring of corporate finance. They also encouraged moral hazard behavior: Banks lent money aggressively without close scrutiny of their corporate borrowers, and corporations borrowed and invested money aggressively at a level far beyond their capital worth. Excessive competition

for market share led both to the banks' over-lending and to the corporations' over-borrowing. Although MITI regarded the resulting excessive competition as a major threat to Japanese corporations' economies of scale and to Japan's international competitiveness, the vested political interest was too strong for any possible reform. The close relationship between coordination and excessive competition is the key to understanding not only how high growth was institutionally sustained but also the contingent dependence of the Japanese economic system on the international economic order and state policy mix. The implication is that when the contingent conditions that had tolerated excessive competition began to change after the collapse of the Bretton Woods system in the early 1970s, the Japanese economic system was destined to malfunction. In this sense, the ideologies and institutions of Japanese developmentalism which evolved between the 1930s and the early 1970s had already contained the built-in mechanisms that eventually led to the bubble economy in the 1980s and its burst in the early 1990s.³¹