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The Reform Debate in Japan: Patriotic Concern or Class Interest? Or Both?

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Abstract

The reform movement in recent Japan -- the drive to deregulate, to establish shareholder sovereignty, to make a nation of butt-busting competitors –has multiple origins: neo-liberal individualism, undiluted faith in the marketism of neo-classical economics, plus the belief that it is the recipe to get Japan back on the road to being Number One. It is also a reflection of the interests of the churyu-nisei, the first generation born into the urban middle class. The potential defenders of the employee-sovereignty firm are silent, but may prove stubborn. Only when the economy returns to growth will one begin to see more clearly how far the reformers will actually succeed.

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0. Introduction

Never have the times been more propitious for Japan's "reformers", the term which I shall use for those who would have Japan follow the sort of agenda set out by Professor Nakatani in a recent article: wholesale deregulation, intensified competition, active shareholders, an end to cross-shareholding among firms[1]. The depth of the economic crisis in this summer of 1998 has created a widespread and acute feeling that **something** must be done, so much so as to raise voting ratios in the July Upper House elections by a clear 14 percent over the previous round. And as to what that something should be, with few dissident voices the media seem to be at one in endorsing the slogans and waving the signal-flags of the reformers -- "deregulation" (albeit nuanced in *kisei kanwa* to "relaxation of regulations"), "competition", "consumer sovereignty", the "convoy system" (the enemy of competition), curing the problems of "the high-cost economy", "equality of opportunity not of outcomes", "transparency" and -- the word which in the spring of 1998 supplanted deregulation as the chief journalistic mantra-word -- "global standards". When the government collapses and a new start is made, whom does the *Nikkei Weekly*[2] ask to tell the outside world what Japan must do to be saved? Professor Nakatani and, someone who shares his view of the world, Professor Takenaka.

What their arguments and all these slogans add up to is (a) a general belief that the principles according to which the typical neo-classical economics textbook says the economy ought to work, are *a priori* correct principles, (b) that those principles are best exemplified in the American economy, and (c) the rightness of those principles is further confirmed by American success, and (d) Japan's present plight is not just a cyclical phonomenon and a debt-deflation hangover from the bubble; it is the natural and wholly just retribution visited on Japan for not following those principles.

Some of the reformers -- particularly the non-academic ones, writing often from experience of working in America or for American firms -- explicitly identify the US as the source of inspiration[3]. Others resort frequently to the term *obei senshinkoku* -- the advanced countries of Europe and America -- as the source of their model. They may act surprised when told that Germany, France, Holland, Italy, are in many ways very different from the stock-exchange-centred US and Britain -- or the other Anglo-Saxon countries, Canada, Australia and New Zealand for that matter. And that they are also a good deal more like Japan, while being equally, by Japanese valuations, "advanced". This may temporarily prompt them to talk of *eibei* (Britain and the US) instead of *obei*, but is unlikely to deter them from continuing to take America as model.

Indeed, it has for the reformers the advantage that they can count the much admired Mrs. Thatcher as, along with Milton Friedman, among the model's major prophets. (Ronald

[1] Nakatani Iwao, "A design for transforming the Japanese Economy", JJS, 23:2, 1997, 399-417.

[2] 20 July 1998.

[3] E.g., Yashiro Masamoto, *Yomigaere! Nihon kigyo (Wake up! You Japanese companies)*,Tokyo, Nihon Keizai, 1997.

Reagan not being a particularly plausible figure as pioneer of economic thought.) The reformist doctrine has no general name, perhaps because, being so all-pervasive, it needs none. "Neo-liberalism" as elsewhere, is a term more often used by the critics than by the adovcates of the doctrine[4]. The more substantively indicative "marketism" (*shijo-shugi*) has been used by the Doyukai (Japan Federation of Business Executives)[5], but can hardly be said to have caught on.)

1. The mainsprings of the reform movement

In a sense the whole reform movement is just reversion to normality. Only in very brief periods in the last 130 years has there been a widespread feeling of complacency, a slackening of the preoccupation with catching up with, learning from, "more advanced" countries -- arguably only twice: in 1942 between the fall of Singapore and the battle of Midway, and latterly in the late 1980s, at the time of the bubble-boom when the world seemed at Japan's feet, Japanese banks provided half the short-term lending for California, Mitsubishi owned the Rockefeller Centre and American scholars were writing articles on a possible future Pax Japonica. Now with the Japanese economy mired in deep gloom, and Americans claiming to have ended business cycles for ever, the Japanese have reverted to their normal state. And, as, over the decades, world cultural hegemony has decisively shifted from Europe to the United States, it is more exclusively the United States which has acquired the authority of the teacher. When Moody's downgrades a Japanese bank, that carries not just practical effects but also <u>moral</u> authority. Only a small minority circle of cool Japanese see it as (like the "Japan premium") one more example of concerted action by America Inc. getting its own back for the days when the uppity Japanese were sweeping all before them. When Robert Rubin lectures the Japanese on economic policy, few people any longer have the self-confidence to wonder whether this former Wall Street trader may be speaking for the interests of the American finance industry rather than benevolently giving the Japanese people advice for their own good. Every time some American official or some 29-year-old analyst of an American bank sniffs "too little and too late" about the latest desperate attempt by the Japanese government to "restore confidence" -- thereby helping to procure in "the markets" the confidence-destroying effects which they predict -- the major newspapers can always find some Chicago PhD from Keio, or some Harvard MBA making a fortune as a consultant, to endorse their contemptuous judgement.

For most Japanese readers of the serious bits of the serious newspapers, whatever the acknowledged defects of American society, whatever the excesses of American boardroom salaries, in all things to do with national competitiveness, America is the model. The exemplars of self-reliant entrepreneurship are to be found in Silicon Valley; the exemplars of bold and effective risk-taking in American venture capitalists; the exemplars of effective and

[4] See, e.g., Otake Hideo, *Jiyu-shugiteki kaikaku no jidai,(The age of liberal reform)* Tokyo Chuo-Koronsha, 1994 and *Gyokaku no hasso (The ideology of administrative reform),Tokyo, TBS Britannica, 1997.*

[5] In the title of its 1997 New Year manifesto: *Shijo-shugi no sengen,* (*A marketist Declaration*), though it chose, when publishing an English version to call it *A manfiesto for a Market Society.*

honest corporate governance, in American corporations, of "transparency" in financial transactions in the American stock-exchange, of consumer protection in American courts.

A second background swell of opinion which has furthered the reformers' cause is the cumulated populist resentment against the bureaucracy. The administrative reform slogans -- "small government", "from bureaucrat-led development to private-sector-led development" -- derive a good deal of extra impetus from the daily revelations in the media of evidence of official corruption. Has there indeed been a measurable decline in the public-service orientation of Japan's bureaucrats? Has the number of clearly bad apples in the barrel actually increased, or have standards risen and the possibility of cover-up diminished? Does the lavish hospitality which by long-standing convention career officials frequently but almost ritually receive (head of the Banking Bureau invited once a year by each of the major banks, for instance) cloud their judgement in matters of substance? (Should "relational regulation" perhaps be added to the vocabulary along with "relational trading" and "relational banking"?) And insofar as wining and dining does affect outcomes, does it do more than help to make bureaucrats champions for "the industry" -- does it, that is to say, have the more serious effect of inducing favours for particular firms? And if the agency capture is only by industries and not by particular firms, are its ill-effects mitigated by the superior social status the bureaucrats have enjoyed? And is it true, as the bureaucrats themselves claim, that thanks to the wining and dining, when they go to OECD meetings they can display a knowledge of the Japanese economy and of firms' strategies which makes them the envy of the officials of other countries? And if there are are such regulated-relational distortions of policy and administration how do they compare with the distortions which come from giving way to pressure from politicians in favour of particular consituents? And why did the prosecutors choose this moment to crack down on what everyone always knew was happening? Was it only because they came across the restaurant receipts when pursuing *sokaiya* cases, or is there some more deeply-laid plot (e.g., to wrest *amakudari* posts for the police and judicial officials from the Ministry of Finance as one newspaper commentator suggested[6])? Are the scandals beginning to have a real effect on the quality and motives of recruits to the public service?

All these are questions to which I do not know the answer (meat for a number of really interesting PhD theses). But what is abundantly clear is that the tendency --the universal populist tendency -- of the newspapers to give the worst possible answers to all those questions has reinforced all the marketist arguments for reducing the role of administrative discretion in economic affairs.

It has also, in the immediate 1998 crisis, made more difficult the necessary spending of public money to prop up the banks and, at a time when confidence/optimism is the chief missing ingredient, made it more difficult to find solace in the gloom induced by the colourless incompetence of political leaders from the thought that at least the officials know what they are doing.

[6] *Tokyo Shimbun*, 14 March 98.

2. The issues

At the moment of writing (July 1998) all the attention of the reformers seems to be concentrated on banking reform, with discussion dominated by a general desire to see a bit more blood on the floor in order to provide evidence that banks take non-performing loans seriously. "Reduction of capacity in the banking industry" was the euphemism used by Laurence Summers on one of the more recent occasions when he offered his generous advice to the Japanese. The perfectly sensible strategy of "trading through" -- as American banks did in the early 80s when Latin American debt made all the major banks technically insolvent -- seemed to work reasonably enough in the first half of the decade, and good profits were accelerating the absorption process when the economy was growing by 3.6 percent in 1966-7. (Though it has to be said that there was not much evidence of the belt-tightening which could also have accelerated the process: bank salaries -- for 40-44-year-old graduates -- went only from 128 percent of manufacturing salaries to 124 percent in five years.) Even the premature burst of fiscal prudence which led to the tax and health charge increases in April 1997 might have been taken in the economy's stride and allowed the process to reach its final stages but for the collapse of Asian markets that followed (hitting particularly badly the one supposedly gilt-edged bank, Tokyo-Mitsubishi). In spite of the fact that the bad debt problem is only tenuously connected (and primarily through confidence levels, the pessimism/optimism balance) with the much more serious problem of overall demand deficiency and the downward confidence spiral, "the markets" and their dominance over opinion, seem to have have made "tough" treatment of the bad debt problem -- another bankruptcy or two, perhaps -- the litmus test of administrative competence. In Japanese terms it has become the *fumie* that the Japanese government has to tread to satisfy the "authorities" (the markets and the US Treasury) that they are seriously in command. (The *fumie* was the picture of Christ the peasants of Nagasaki had to trample on to demonstrate the soundness of their religious orientation.)

The bad debts and the problems some banks have in meeting the new capital-adequacy ratios relate to the reformers' agenda fairly directly. The preferred solution of MOF and the LDP is to avoid panic-creating disruption as far as possible by getting the stronger banks to help the weak banks through the crisis with the "convoy system", dealing with inefficiency and over-capacity gradually through mergers (Sumitomo taking over the Long-Term Credit Bank, for instance) while employment is reduced by natural wastage -- much as the run-down of agriculture and the textile industry was managed in past decades. This convoy system -- the "over-regulated protective financial system" as Professor Nakatani calls it -- is anathema to the reformers. It seeks egalitarian outcomes by restraining competition, promoting inter-competitor cooperation and trying to keep as many people as possible earning and in business. Egalitarianism fine, says Professor Nakatani, but as welfare economics proved 40 years ago, a far preferable (because much more Pareto-optimal) mode of achieving egalitarian outcomes is free competition, the weeding out of the inefficient, combined with fiscal systems to redistribute income through welfare benefits for the losers[7]. (The reformers grouped around the Doyukai, however, are apt to make a distinction between the losers (*haisha*) inevitably and properly thrown up by competition -- they just need opportunity to

[7] Nakatani, *op.cit.*, pp.403, 406.

start again (anybody who is somebody in Silicon Valley has been bankrupt at least once) -- and *jakusha*, the old, disabled and feeble-minded who really need the handouts.[8])

There have been two quite spectacular uses of the convoy system in banking during the past year[9]. In 1997, Nissai, The Japan Credit Bank, was saved from bankruptcy by capital infusions from all the other major banks, organised energetically by the Ministry of Finance. In the spring of 1998, a large bank-rescue package in the form of the purchase of subordinated bonds was given to all of the 21 major banks. For the banks with strong balance sheets it was an embarrassment, particularly since they had to present belt-tightening reconstruction plans as a condition of benefitting from the plan, but they were persuaded to go along so as not to show the world which banks were weak enough actually to need the money.

It seems to be generally agreed, however, that the fast ships are getting increasingly reluctant to bother about the leakier tubs, and the Ministry officials have a far harder time persuading them to cooperate than they used to. It may still be possible for the Post Office Savings system to persuade all the Japanese banks to give Japanese consumers (the sovereign arbiters of the neo-classical economists who supposedly can benefit only from unfettered competition) an amenity which no other country has managed to achieve -- a single national cash-dispenser system -- but, slowly and imperceptibly, people say, the cohesion of *gyokai*, of the "industry as community", is breaking down.[10]. The reformers' ideology is gaining ground and the doctrines of rational self-interest maximization -- bottom-lineism, my-company-first-ism -- are gaining ground, (aided, also, by the decline in the authority of the coordinating officials). It is a measure of the control the reformers have achieved over the ideological airspace that even those who would like to retain *gyokai* cooperation are likely to object if anyone calls it the convoy system.

And, apart from any general tendency there might be for "industry community" solidarity to erode, in the case of the banking industry the problems of coordinating action to deal with the bad debts is complicated by the fact that they come at a time of the much-

8 See,e.g., Keizai Doyukai, *Sengo Nihon Shisutemu no Sokessan: Ima koso, waga kuni zaisei no arata na gurando dezain o egakiageyo* (Drawing a line under the postwar system: Now is the time for a grand design for Japan's public finances), April 1997.One of the more explicit statements that Japan has hitherto been too preoccupied with equality of outcomes, whereas the true goal should be euality of opportunity.

9 Since I wrote this, the world has seen an even more spectacular third -- the Fed's arm-twisting American financial institutions to the tune of $3.5 billion, in order to rescue Long-Term Capital Management.

10 This would seem to be confirmed by the results of a once-over-lightly survey of such industry associations carried out this year by Ianagami Takeshi and myself. We got 94 replies – about a quarter of the associations contacted. On the overall question: "Has the cohesion of your association –- the willingness to cooperate of member firms – increased or declined over the last ten years?" 21 said (admitted to: they were probably biased witnesses) decline, but 22 said that on the contrary they had grown stronger -–mostly because of new regulatory requirements or negotiations over deregulation, though in some industries (milk products was an example) stronger cohesion seemed to be attributed to big firm leadership. Among the factors affecting cohesion, 60 associations said that there had been an increase in competition among the firms in the industry, and 32 said that there was increasing pressure from the shareholders (bottom-line-ist, presumably).

heralded Big Bang -- the show-piece of the government's deregulation programme. The programme's major ostensible purpose is to strengthen the Japanee banking industry, by forcing Japanese banks to compete more directly, not only with each other, but with foreign banks too. The system, markets, competition, should be "free, fair and open". These are the magic words, and they have resonance in Japanese politics these days. When, in response to well-founded suspicions of a good deal of price manipulation by rumour, the Government strengthened controls on futures trade in the stock market in January, this brought forth a resounding denunciation from the Democratic Party[11] questioning the Government's true commitment to freedom and openness. "Against the world trend towards open market reform", "real problem is lack of transparency and blockage of information reduces foreigners' faith in our markets": the Party's resort to "what will the foreigners' think?" arguments is a clear indication of how far Japanese opinion is in the grip of the reigning ideology of the international financial community.

When programmed, of course, the Big Bang process was expected to take place at a time when Japanese banks had recovered full strength and could brave the new competition[12], not, as in the event it turned out, when they were psychologically, if not actually balance-sheet-wise, on their knees. It is an odd irony that one of its major architects is also one of the most explicit denouncers of those who think that "progress" consists in following America along the marathon track of history. (Sakakibara Eisuke, see his rumbustious polemic: *Farewell to Progressivism; The sins of the "Japan is different" theorists.*[13])

Many in Japan foresee the likelihood that, if the modes of financing -- and controlling -- economic activity in Japan come to be more completely market-dominated, more arm's-length contractual, less relational, then the likelihood that Japanese corporations will preserve their distinctive character also greatly diminishes. Some view this prospect with equanimity. (A former president of a major trading company told me that he had tried to unwind cross-share-holdings because when he met foreign shareholders in London and New York he was embarrassed by not being able to explain to them why he kept such low-yielding assets as the shares of other "partner" firms on his balance sheet. As for why a country with Japan's problems of excess savings needed foreign investors anyway, the only reply he could give was: "A global company ought to have global shareholders.") But why should even those who do not share such nonchalant reformist views and think the character of the Japanese

[11].Minshuto, Hatoyama Yukio danwa, *Okurasho no kabushiki karaurikiseikyoka ni tsuite (On MOF's tightening of controls over short selling on the stock exchange)*, 7 Jan 98.

[12] Hugh Patrick, "Japan's financial mess: causes and Consequences", Harvard lecture 5 May 98.

[13] Skakibara Eisuke, *Shimpo-shugi kara no ketsubetsu: Nihon-ishitsu-ronsha no tsumi*, Tokyo, Yomiuri Shimbunsha, 1996 Japan, he claims, has evolved a different but better form of capitalism, characterised by greater social solidarity and equality, which it should not throw out of the window. Something of his starting point can be gleaned from the way the book opens -- with a description of the day he stole from trade negotiations in Washington to visit the American family with whom he had spent a year as a high-school exchange student at the age of 17. They drove past the school where he had spent many happy and secure hours, with locked car doors; the district had become a no-go area full of drug pushers.

corporation worth preserving nevertheless be so much in favour of plunging Japan as fully as possible into the anarchy of world financial markets? The more internationalized Japanese finance, the more the Japanese economy as a whole is affected by the wild fluctuations of the exchange rate, and the more banking becomes dominated by trades in swaps and options, the arcane derivatives designed to hedge exchange rate risks. The arguments for Japan doing more of its trade in yen rather than dollars and making the yen a more important reserve currency, could well be strong, but it is not clear that the Big Bang measures will help to bring that about.

It does seem clear that, for all the -- doubtless genuine -- talk about strengthening Japanese banks and making them more efficient by exposing them to competition, another and probably the dominant motive for the Big Bang was to try to recover Tokyo's position as the major financial centre of Asia. See, for example, the shocked tones of some of its proponents, recording the way in which the Simex exchange in Singapore came to have a bigger turnover in Japanese stock futures than the Osaka exchange[14]. Japan might give up any ambitions to be Number One in aerospace, or even biotechnology, but ceding the number one slot to other Asians in a major industry like finance, was not to be contemplated. There may well be good economic arguments -- the creation of high-value-added employment in financial services, etc. -- and some of the recent measures, like allowing Japanese firms to use their export earnings directly abroad and not requiring them to repatriate them in yen first would seem (while depriving banks of some profitable business) to make obvious sense. The fear of American sanctions on "unlevel playing field" grounds may also play a reasonable part in the decisions. But the terms in which the discussion is carried on make it clear that prestige -- a burning nostalgia for the days when Tokyo's market capitalisation greatly exceeded London's -- was the major issue. And as for the attendant dangers to the Japanese way of life, we can handle them, Sakakibara says confidently.[15]

3. Deregulation

"Global standards" -- sometimes "*de facto* global standards" -- and the need to conform to them, became a major weapon of the Big Bang proponents. (The victory of VHS over Betamax is one of the prime examples appealed to -- without any demonstration that banking involves elements of the product compatibility problem which forced Sony to give in and conform.) Global standards has also become a central shibboleth, recently, of the corporate governance debate. More about that later. But first some thoughts on the deregulation debate which reached its peak in 1995-6, when one could hardly open a newspaper without finding the words *kisei kanwa* in it.

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[14] Suzuki Yoshio, *Biggu Ban no jiremma*, Tokyo ToyoKeizai Shimposha, 1997, p.30. See also, Yashiro, *op.cit.*, pp.14-15.

[15] Sakakibara Eisuke, "Reforming Japan: Thje once and future boom", *The Economist* 22 March 1997. See also the interview in Ronald Dore, *Nihon o tou: Nihon ni tou (Asking Japanese about Japan)*, Tokyo, Iwanami, 1997, pp.31ff.

After "small government" and tax cuts in the early 1980s, then *minkatsu,* privatization, in the mid to late 1980s, deregulation became the central focus slogan of Japan's "late-developer" neo-liberal reformers after the election of the Hosokawa government in 1993. Hosokawa, with his famous complaint that as a provincial governor he had to get the Ministry of Transport's approval to move a bus stop a hundred yards down the road, seemed to tap a widespread feeling that Japan was over-governed. And, of course, there were not a few businessmen whose ambitions were directly thwarted by regulatory restrictions -- the boxer-entrepreneur, author of *MITI tore me limb from limb*[16], for example, who tried to import gasoline from Singapore and forced MITI to shift from "administrative guidance" to "transparent" legislation in order to maintain its complex regime of protection in return for a "public interest" price structure in the refinery industry. (One of the few regulated industries not to become a major issue in trade talks, nor a major concern of the army of American scholars who write on the Japanese economy. Can it be because the American majors are full beneficiaries of the system?) Or the big and still expanding supermarket chains like Daiei, held back by the Large Retail Store law, even in its revised form; or the founder of the Black Cat transport business whose battle with Ministry of Transport restrictions had been long and bitter[17].

It was striking how frequently American commentators on the Hosokawa victory declared that at last Japan would have a government which promoted the interests of consumers rather than of producers, and how rarely Japanese commentators phrased their expectations in such terms. As Steven Vogel has convincingly demonstrated in a recent paper[18], Japanese consumer groups might gun quite vigorously for the big corporations, but by the same token have been more influenced by a "fellow-underdog" sympathy with protected groups like small retailers and farmers than by a "rational" concern with the lower prices which the abolition of protective controls and greater competition might bring. And individual Japanese consumers have been more influenced by considerations of quality and service than by price, and so have felt little outrage at all the arrangements -- fixed interest rates, regulated insurance premiums, "convoy system" recession cartels and so on -- which confine competition to non-price factors, (and, as Japanese consumers of financial services will soon discover, spares them the hours of fruitless pain and boredom they might otherwise be tempted to spend trying to work out which insurance company's fancy "product" offers the better deal.)

But, if not the Hosokawa government, the seemingly never-ending recession had an effect. Many middle-income families, with overtime cut and bonuses stagnant, began to feel the pressure. The price-cutting supermarkets and discount stores flourished while the "quality" department stores languished. There was enough of a constituency for government and the media to plug deregulation to the point at which the dwindling band of sceptics could

[16] Sato Taiji, *Ore wa tsusansho ni barasareta*, Tokyo, Tairyusha, 1986.

[17] See, Ronald Dore*, Nihon to no taiwa: Fufuko no shoso (Conversations with Japan: The various faces of disconntent)* Tokyo, Iwanami, 1994, pp.169-192.

[18] Steven K. Vogel, "When interests are not preferences: The cautionary tale of Japanese consumers", forthcoming in *Comparative Politics.*

refer sneeringly to the *daigassho* -- the great chorus. A 1995 survey found 45 percent of housewives agreeing, and only nine disagreeing, that deregulation would benefit consumers -- even though they also expressed worries about food safety, and the possible effects of open competition in destroying the little guys and favouring foriegn firms.[19]

By 1996, the chorus was at full volume. One of the more interesting texts, which summarises well the arguments the reformers deployed, was the report of the Deregulation Subcommittee of the Administrative Reform Committee, published in December 1996. The report bears the crusading title: *Creativity builds a new Japan*.[20] The committee was chaired by a former Economic Planning Agency bureaucrat, and contained some businessmen, but none from the traditional manufacturing sector; there is the head of a supermarket chain, of a research consultancy, the Japanese chairman of an American firm called Polyfibron Technologies Inc, and the French chairman of the Tokyo subsidary of Louis Vuitton Moet Hennessy. There is one trade union official, one journalist, one novelist and, crucially, a sprinkling of academic economists.

The report covered a highly diverse range of topics. It recommends, for instance, freer entry into the domestic airline industry, a simplification of the wheat-price system and the milk marketing system, clearer rules for the licensing of gas sub-contractors, the abolition of the plot-building ratios for urban factories which are designed to preserve open green spaces on the grounds that they are public goods the expense of which should not be thrust on individual business men. Many of the recommendations seem eminently sensible responses to changed circumstances; others, like the last, a good deal more controversial.

But more revealing than the individual recommendations is the committee's general crusading stance. Among the main arguments deployed are, first, the neo-classical base assumption, consumer sovereignty.

> The first fundamental principle is consumer sovereignty. What gets produced, and how. should not be decided by producers and producer associations and bureaucrats but by the choices that citizens make in the market-place, and the responses of creative entrepreneurs to those choices. Our existing system is based on the false premise that the interests of citizens are best served if bureaucrats regulate, that they should take the lead in balancing demand and supply in order to protect and monitor established producers and ensure stable and orderly markets. That is wrong. The aim should be to promote healthy competition through appropriate and transparent rules, such as product liability rules written from the consumer's point of view, thus avoiding the feather-bedding of inefficient existing producers and encouraging vigorous new entrants.... {The system} unfairly restricts citizens' choice. That is why the "feel good" factor is missing (*yutakasa no jikkan ga nai*.)

[19] Vogel, *op.cit.*

[20] Gyosei-kaikaku Iinkai, Kisei-kanwa shoiinkai, *Soi de tsukuru arata na Nihon*, 5 December 1996, included also in Somucho, ed. *Kisei Kanwa Hakusho 97-nen-ban* (*Deregulation White Paper 1997*).

To that individualistic argument, is added the patriotic argument from national interest.

> We live in a new age of intensifed world competition thanks to the rise of Asia and the arrival of the post-cold war world. Unless Japan can reform its high cost structure and create a new, transparent and open economic system, we shall be quite unable to compete. Our out-dated system and all its prohibitions ... inhibits the spirit of enterprise. Where, in Japan, are all the new firms which have given such economic dynamism to America and created so many employment opportunities? We need fundamental structural reforms. "Somehow we will muddle through" is not good enough: we must face up to the crisis, take the pain and overcome it, and move forward with new determination to creative nation-building,

There are two main strands to this patriotism/economic necessity argument. The first was elaborated also in a series of reports by other business organizations, especially the wage-bargaining organ, the Nikkeiren, which wanted to strengthen the case for low wage increases by claiming that deregulation could lower prices and therefore raise real wages even if nominal raises were miserly. (Little did they foresee how actual deflation would hurt when it came!) The argument is that regulation is concentrated in the non-tradeables sector. But the high prices which exporting industries have to pay for these goods and services enters into their costs and so makes it harder for Japan's champions, the exporting industries to compete in these fiercely competitive world markets.

The economists at the Nikkeiren must now, in the summer of 1998, with the yen at over 140 to the dollar, blush to recall those elaborate calculations which show that Japanese exporters have to pay, for example, 38 percent more than Americans for their electricity -- using to calculate the difference an exchange rate of $1=102 yen[21]. The whole argument is in any case flawed, as is shown by one of the few Japanese economists to take a professional and coolly sceptical look at the reformers' arguments. What makes non-tradeables seem pricey in Japan is the exchange rate, and what in the long run determines the exchange rate is the competitive strength of Japanese exporters. Get down those domestic costs by greater competition and you will reduce the costs of the exporters, thus adding to their competitive strength, thus raising the exchange value of the yen even further, thus putting the famous *naigai kakaku kakusa* -- the internal/external price differential -- back where it was before[22].

The second strand to this patriotism/economic necessity argument is what might be called the Schumpeterian one. Where is Japan's Silicon Valley? Where are our venture capitalists? The race to innovate is all-important in the modern competitive world. Japan is losing out, and while there may be problems with the educational system and its failure to promote creativity, the barriers to entry posed by regulations are also crucial. The Nikkeiren (the business federation chiefly concerned with wage and employment matters) was

[21] Nihon Keieisha Dantai Remmei, *BBPP kozoteki shomondai no torikumi* (*Bluebird Plan Project: Getting to grips with the various structural problems*) Material prepared for the summer seminar August 1996.

[22] Yambe Yukio, *Itsuwari no kiki: Honmon no kiki*, Tokyo, Toyokeizai, 1997, pp..90-119.

particularly insistent in its 1997 annual policy statement -- the Bluebird Plan (due acknowledgement to Maeterlinck) -- that dealing with the unemployment which deregulation would probably initially create required finding a "Third Way" -- the American economy's capacity for job creation, but without the inequalities: Europe's social cohesion but without its sclerosis. MITI's latest *Vision*[23] -- a poor shadow of the productions of earlier decades -- sees the possibility that by 2010 employment in 15 industries (from health-care and biotechnology to vocational training and new production technologies) could expand from 10.6 to 18 million, adding an extra 350 trillion to the national income. Provided the entrepreneurs can be found. In a Japan as deeply plunged in gloom as it is in the summer of 1998, it does seem, rather, like whistling in the dark.

4. Corporate Governance

The "great chorus" of the deregulators has died away to a background hum: only the most ardent of anti-Keynesians or pre-Keynesians would now argue that an extra dose of price-cutting competition, bankruptcies and extra unemployment would be helpful to a deflationary Japan in which confidence spirals down as fast as wholesale prices. All the attention of the reformers has now shifted to the issue of corporate governance. There is hardly a business organization in Tokyo that has not set up a committee and issued a report.[24]

Again, there is an element of late-developer mimcry in this present debate, as is shown by the frequent references to the British Cadbury and Greenbury reports, and the apparent close link between the Japanese Corporate Governance Forum and the stock-holder activists of CalPERS (The California Public Emplyees Retirement Scheme: CalPERS has circulated the English version of the report with great approval). But the arguments most frequently encountered are the following:

1. there is something rotten in the Japanese body corporate as is shown by all the *fushoji* -- a blanket term for all the revelations about the (somewhat paltry) sums paid to *sokaiya* as the price of a quiet life, the Yamaichi *tobashi* -- its shady (and expensive!) means of concealing bad debts -- the Sumitomo copper scandal, the Daiwa trading scandal, etc.

[23] MITI, Sangyo Seisaku Kyoku, *Keizai kozo kaikaku kodo-keikaku ni tsuite. (Action Plan for the reform of ecnomic structures)*, March 1998.

[24] See, for example, Keizai Doyukai, *Kigyo Hakusho 12-kai: Nihon kigyo no keiei-kozo kaikaku (Enterprise White Paper No.12: Reform of the Management Structures)*, May 1996, and *Kigyo Hakusho 13-kai:Shihon-koritsu-jushi keiei, (Ditto No.13: Management which prioritizes the efficient use of capital)*, April 1998: Nihon Kooporeeto Gabanansu Fuorum (Corporate Governance Forum of Japan, *Kooporeeto Gabanansu gensoku: Atarashii Nihon-gata kigyo-tochi o kangaeru* (in an oddly out-of-focus translation an English version available: *Corporate Governance Principles: A Japanese View*), 26 May 1998; 21-seiki Koporeeto shistemu Kenkyukai (Study Group on a corporate system for the 21st Century – a MITI-sponsored group) *Hokokusho (Report)*, June 1998: Keidanren, *Koporeeto gabanansu no arikata ni kansuru kinkyu teigen ("An emergency proposal for the reform of corporate governance")*, Jurisuto, 15 October 1997: Jiminto (Liberal Democratic Party) *"Kooporeeto Gabanansu ni kansuru Shohoto kaisei shian kosshi"* (*"Outline draft for revisions of the corporate governance provisions in the Commerical Code and other legislation"* -- a draft with only minor differences from the Keidanren proposals) SeimuChosakai, Saishin Joho, 8 Sept. 1997.

There is not just bad governance but an absence of governance which would never be allowed in America. (Nobody points out that -- in contrast to the shenanigans at RJRNabisco which prompted American shareholder activism in the 1980s, or the more recent Maxwell, Barings, Metallgesellschaft, BICC etc. scandals -- the *fushoji* were all cases of dubious activities conducted in the belief that they would benefit *the company*, not examples of self-enrichment at the company's expense.)

2. lack of control is also lack of transparency. It is because nobody trusts what firms say about themselves that foreigners impose premiums on loans to Japanese banks, and the stock exchange cannot perform its proper function of expressing, in the share price, a fair valuation of a company's worth.
3. main banks are no longer able or willing to exercise their monitoring function (as if, except when firms approached the brink of bankruptcy, they ever did!). Therefore there must be proper systems of monitoring the manager agents by the shareholder principals.
4. in any case, the contempt shown for shareholders -- perfunctory AGMs, all held on the same day in June, miserable dividends -- is quite contrary to the provsions of the Commercial Code. There are few explicit references in these reports to the "employee sovereignty"[25] character of the Japanese firm as being a perversion of the law: Keidanren, Doyukai and the Corporate Governance Forum all have occasional references to "other stakeholders" -- usually to claim that they too will benefit if managers concentrate single-mindedly on shareholder value -- but the LDP's draft law makes clear what is at stake. It proposes to start with a ringing declaration (absent from the Keidanren's similar draft) of which two versions are offered, either "Shareholder Sovereignty: The joint stock company belongs to its shareholders. Its shareholders are its sovereigns", or "The maximization of shareholder gain: The joint stock company must be governed in such a way as to maximize the profit of its shareholders").
5. insider control induces tunnel vision which outside directors might halp to correct, but it also induces slackness and corruption -- the subtle devices for maintaining hierarchy, sweeping nasty things under the carpet, covering up mistakes letting self-deluding incompetence play out its time, etc. -- all those devices by which harmony is maintained, sometimes at the expense of efficiency, sometimes at the expense of justice.
6. Japan has taught the whole world how to improve production methods and quality. TQM has become a global standard. Now it is our turn to meet global standards -- in best-practice corporate management, particularly in transparency which enables investors to make sound judgements about a company's worth. (In practice, of course, a close reading of a company's *yuka-shoken hokokusho* tells one far more than one can learn from company reports in other countries. Long-term *investors* are well served. It is the short-

[25] To use the phrase of Itami Hiroyuki, "The human-capital-ism of the Japanese firm as an integrated system" in K. Imai and R. Komiya, *Business enterprise in Japan*, Cambridge, MIT Press, 1994. Imai and Komiya, in the same volume, prefer the term "the labour-managed firm". Masahiko Aoki -- see his paper in the same volume -- prefers to speak of the J-model: managers as arbiters between the interests of employees and the interests of the providers of capital -- as distinct from the Anglo-Saxon agency model which treats them as the servants of the owners. "Sovereignty" is of course to be understood in the loose sense that "sovereignty lies with the people" in democracies. The crucial thing is the unitary concept of "employees" -- the absence of any clear dividing line between managerial employees who, on behalf of the owners buy labour, and the non-managerial employees who sell it, the one as cheaply, the other as expensively, as they respectively can.

term stock exchange speculators who need the quarterly profit forecasts provided by the probing "analysts" of Anglo-Saxon countries) .

There is one key word which recurs in these discussions, and which harks back to all those earnest post-war discussions about individualism, democracy and maodernity, reflecting, perhaps, now as then, a certain cultural envy of all those ten-foot tall Americians who find it so easy to speak their minds. It is "tension". Here, for example, is one question from the Doyukai's questionnaire to senior businessmen:[26]

> We set out below our basic approach to the problem of corporate governance. Please give us your reaction.
>
> The devising of a new pattern of Japanese corporate governance requires us to rethink relations with stakeholders. In doing so we have in mind the need to introduce an element of tension in the relation of various stakeholders with corporate management...
>
> Tension has hitherto been absent in the relations of managers, not only with shareholders, but also with labour unions and with customers. Problems were treated as if they were common problems. That -- the "insiderization" of tension relations (*insaida-ka*) -- was what counted as good leadership in a manager.
>
> But, in this new era of globalization, what is required is not merely just conduct towards insiders, but just conduct which can be explained to third parties. We need to shift our focus and appreciate that it is from the tensions of various relations with outsiders that good things can come.
>
> The word "tension" is frequently used in a context redolent of conflict, destruction, mistrust and evasion of responsibility, but we wish to understand it, rather, in the context of harmony, creativity, trust, and acceptance of personal responsibility. In that sense it is necessary to build relations with an element of tension not only between managers and stakeholders but mutually among stakeholders themselves.

Ironical, perhaps, that at a time when trust and its virtues are becoming a major theme of social scientists and the theme of Fukuyama best-sellers[27] -- with Japan frequently hailed as the very model of a high-trust society -- the Japanese themselves hanker after a bit more tension -- i.e., mistrust. Certainly, there were few of the nearly 300 respondents -- board members, presidents and chairmen -- who disagreed *in principle*. But in practice, "Japanese people aren't accustomed to having a fierce debate and then going back to work without any ill feelings." "But the Japanese habit of fostering warm relations between stakeholders with golf and parties isn't going to change very easily, however much, as we get more and more internationalized, this westernised, rational style has become more and more necessary for Japanese business."

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[26] Keizai Doyukai, *op.cit. (Daijunikai, Kigyo hakusho),* p.174.

[27] Francis Fukuyama, *Trust: The Social virtues and the creation of prosperity,* London, Hamish Hamilton, 1995.

5. Towards shareholder sovereignty?

It is clear that this is the heart of the issue. Most Japanese managers will now nod their heads gravely and say, "yes, indeed, we have not treated shareholders well hitherto: we must do better". ROE is on everybody's lips and enough managers make pronouncements about taking return on equity as the litmus test of company performance for the stock exchange quarterlies[28] now to offer "ROE ranking league tables" (regardless of the fact that the best way to get a high rating is to use more debt than equity as the source of your capital.) Nevertheless few face up to the prospect that they might really be forced to face not just a few nasty questions at AGM's but the threat of takeover if they let their share-price fall, or that they might have to meet American levels of profits and dividends to prevent that happening. "Employee sovereignty" -- the tendency of life-long-employee directors and presidents to consider themselves less as agents of shareholders than as the elders of an enterprise community whose first concern ought to be the welfare of that community's current and future members -- depends crucially on their not being faced with inflexible demands from shareholders. Change that, shift to shareholder sovereignty for real, and there would not be much substance left in claims that Japan could boast a distinctive form of capitalism.

So how far has practice actually changed? Restructuring has become a buzz-word, but no major firm has dismissed workers as a means of raising profit levels. Estimates of redundant "unnecessary workers" are in the two million range. There is a great deal of talk about flexible labour markets and merit pay, but the proportion of workers on non-standard contracts has grown only marginally, and if one looks at the effects of the elaborate new salary systems, they rarely produce much change in the actual spread in remuneration between the high-flyers and the laggards by the window. Presidents' and Board-room salaries have if anything declined relative to the average, thanks to demonstrative ten-percent cuts to impress on the company's workers how serious the recession is.

As for shareholders, dividends are still treated by most firms as a fixed charge. Even such a profitable firm as Orix, whose president is a prominent member of several of the committees which recommend changes in corporate governance, still pay their 15 yen dividends year in year out, even though that represents about half a percent of their current share price. Orix manages somehow to order (massage?) its accounts so that this represents, plus or minus half a percentage point, 20 percent of profits. Not so lucky, say, Mitsubishi Shoji which, to keep up its standard 8 yen per share, had to draw on reserves in 1993 when profits amounted to only 2 yen per share.

As for the cross-shareholding system which is crucial to the protcction of the "employee-sovereignty firm", news of its actual or imminent demise which so often brings a warm glow to readers of the *Wall Street Journal*, are greatly exaggerated. Stable share-holdings have lost about a half of their percentage increase from 1986 to 1991, but still

[28] See, e.g., Toyokeizai's *Kaisha Shikiho*, Spring 1998, p.1769.

account for about half of the shares of financial companies and a quarter of those of non-financial companies.[29]

There have been legislative changes. The procedures for bringing shareholder suits against incompetent or dishonest managers were greatly simplified and the costs greatly reduced (a direct result of the Structural Initiative talks). In 1997 the payment of directors and other employees in stock options (until then permitted only in venture capital start-ups) was made legal. (Toyota adopted the practice for its directors at its annual general meeting within weeks of the law's passing. Asked whether Toyota directors had been slacking and clearly needed the extra incentive, a senior manager was horrified. It transpired that, their chairman being the chairman of Keidanren, it was felt that the firm had a special responsibility to show the world -- or at least America -- that it took capitalism seriously.) At the same time share buy-backs were freed of what had been very narrow restrictions -- to the delight of neo-classical economists who believe that retained earnings are likely to be squandered, so that it is much better to return them to the market which can be relied upon to allocate them efficiently.[30]

The legislation currently contemplated as a result of all the recent discussion of corporate governance (see the LDP's draft cited earlier) is designed to strengthen the independent powers and functioning of the audit committees -- at present generally seen as more effective as a means of giving honorific positions to a few old men, than as guardians of probity and efficiency. A main motive for this appears, however, to be to provide a means of choking off frivolous civil suits brought against the management by shareholders.

6. Defence of the employee-sovereignty firm? How feasible?

There is clearly much that is tendentious in the arguments of the reformers, much that derives either from single-minded doctrinaire attachment to marketism, from *jidai-shugi* as the Japanese used to call "worship of the great and powerful" in the days when the young were preoccupied with personal autonomy, or from the sheer envy of the fantastic salaries and stock market gains which an American-type market society seems to offer. But how much truth is there in the reformers arguments that the costs of *not* changing, of *not* adopting the Anglo-Saxon model of the shareholder-sovereignty firm, would be intolerable?

How much loss of competitiveness would there be? One can imagine that there would be some support in Japan for the view that competitiveness is by no means the be-all and the end-all of policy. In the 1970s Antony Lewis, the New York Times correspondent in London wrote a book to tell the Americans that the British were pretty hopeless when it came

[29] NLI Research Institute (Nissei Kiso Kenkyujo), "Survey on Interlocking shareholdings 1996", in *Nissay Strategy*, vol 17. Nov. 1997, quoted in Mitsuhiro Fukao, *Japanese financial structure and weaknesses in the corporate governance structure*, paper for MITI Research Institute conference, "The role of markets and governments", March 1998.

[30] See, Fukao, *op.cit.*, pp.14-15 and Paul Sheard, "Japanese corporate governance in comparative perspective", *Journal of Japanese Trade and Industry*, 17, i, p.11.

to productivity and growth, but they had in fact made a sensible choice; preserving the quality of life, especially of public life, even at a lower average standard of living, was indeed more important. One can imagine a sizeable body of opinion espousing such a view in Japan (recall what was said earlier about the consumer movement not believing in consumer sovereignty), but it is hard indeed to imagine it ever dominating either among bureaucrats or among politicians.

So there is no avoiding the question: can Japan retain the employee-sovereign firm and still manage to grow at a rate -- should one say, not inferior to the OECD average? Or slightly better? Can Japanese firms go on nursing inflated work forces through recessions at the expense of profits? Can they go on ignoring the expectations of their shreholders? And still compete, and mobilise the financial resources to compete?

The most compelling argument supporting the answer "no" is the following.

High growth rates in the past were sustained by five factors, all of which are now of diminishing or zero force. They were:
(i) growth in the labour force,
(ii) a rapidly expanding share of world markets, fuelled initially by Japan's reaching world standards of technological capacity at a time when its standard of living was low and its labour cost advantage consequently great,
(iii) the momentum generated by that initial high growth -- high savings rates from rising incomes, high "habitual" rates of investment, a high level of "animal spirits" built on expectations of continued growth (continued capture of world markets as well as growth in domestic demand),
(iv) consequently young average capital vintages permitting rapid incorporation of new technology which helped to sustain productivity growth.
(v) the steady forty-year rise in asset prices, generated partly by population growth (especially in the case of land) and partly by the rising productivity of industrial assets and partly by the fact that physical assets were increasing in volume more slowly than the accumulated volume of savings competing to own them. The "wealth creation" of this asset price rise both created extra resources for investment, and meant that a large part of the value added by Japanese corporations could be absorbed by labour, giving (by the standards of other countries) small shares to capital, since the shareholder owners were rewarded by the steady increase in the price of shares and other assets. This meant that pension funds and life insurance companies could obtain viable returns within the Japanese economy itself by adding the profits of asset trading to their modest returns in dividends.

So, the argument goes, absent population and labour force growth, absent the momentum effect deriving from the period of labour cost advantage, absent, as a result, the prospect of a resumption of the slow but steady asset inflation and its benign effects in supplementing the rewards to capital, Japanese firms will simply have to raise their profit margins by more ruthless cost-cutting, and pay more of their profits to shareholders if they are to be able to raise capital in increasingly globalised capital markets, and if they are to enjoy, in their pensions and their insurance endowments, reasonable returns on their savings.

The argument is persuasive but not conclusive. With exchange rates fluctuating as wildly as they still do, a lot of Japan's enormous volume of savings will stay at home. (The Nagoya dentists whom Merril Lynch is persuading to invest in American mutual funds could well have their fingers burned in the next two years.) Japanese companies do not need new equity anyway; they can manage well enough with depreciation, retained earnings and debt. To be sure, stock market valuations will have to fall (the Nikkei index at half its present level?), once it becomes clear that the shareholder take is not going to improve in the long run. And that will be painful, but not as painful as the social disruption which would be caused by wholesale dismissal of redundant employees.

Only someone with a better grasp than I have of company finance can assess these arguments. I am equally uncertain of the answer to a second crucial question. Discovery and innovation are clearly essential ingredients of above average growth. There are two recipes for innovation. Which will, in the long run, prove the most effective: (i) the Silicon Valley model -- thriving graduate schools, individualistic entrepreneurial firms coming out of them (and out of big coporate labs) venture capital finance, high risks and sometimes high returns, or (2) the Hitachi or the Siemens model -- planned research by company teams which have learned to work with each other, backed by the deep pockets of a large corporation? Even in the United States, much more innovtion comes from the second, less romantic, model, but if it is the former which provides a crucial leading edge, then Japan's "community firms" will lose some of their comparative advantage.

7. The defence of the employee-sovereignty firm. By whom?

There is one striking thing about the latest round of proposals for revamping the coporate governance system through revitalising the audit committees. The audit committee originally came to Japan from Germany -- it was modelled on the *aufsichtsrat* supervisory board -- at the end of the nineteenth century, It lingered on, after the post-war Anglo-Saxon revamp of company law as a largely functionless appendix. On its home ground in Germany the *aufsichtsrat* has meanwhile been transformed into a major instrument of co-determination -- half employee and half shareholder representatives. If the Audit Committee of Japanese firms is to be revitalised, what could be more natural than that there should be moves to preserve the employee-sovereignty character of Japanese firms by adding employee representatives to i it ?

But such moves are there none. Rengo, the central labor union federation, shows a marked lack of interest in issues of corporate governance. At a major joint conference it organized with its opposite number, the Deutscher Gewerkshaft Bund, in September 1997, it appears from the 90-page report[31] that corporate governance was not even discussed. At a recent seminar, the president of the Japan Audit Committee Members' Association (which has produced its own suggestions for revising the LDP's proposed law[32]), was asked about the

[31] Rengo, *The future of work, the future of social welfare, the future of trade unions*, Tokyo, Rengo, 1998.

German model and employee representation. He replied that the Association had not given it any thought since noone had suggested it[33].

To explain this labor union indifference would require a whole essay in itself, tracing the transformations of "militancy" in post-war Japan, the institutionalization of consultative mechanisms, the drastic changes in unions' leadership recruitment, the changes in union power -- and the lack of change in union rhetoric. Suffice it to say that, whatever the practical achievements hitherto in establishing important consultation rights and even veto rights within the enterprise, this is not thought to be what unions should *really* be about. Ideology dictates that unions should not wallow in the warm bath of enterprise communities but, in the words of one of the essays in the compilation just quoted, overcome "enterprise egotism"; only thus can they "hope to become a real power capable of challenging the universal task of reforming the economic society".[34] As for the Communist Party which looks as if it is becoming the only opposition force at odds with the dominant consensus, it is even more imprisoned in vague class-based anti-capitalist rhetoric and its union strength lies almosts entirely in the public sector. It is an unlikely champion of the employee-sovereignty firm, for all that it commands the loyalty of economists who are capable of highly intelligent analysis of the macroeconomy[35].

So what about the managers? There is certainly -- particularly in the old traditional manufacturing industries -- a certain unease about all the brave talk of the need to modernize the Japanese firm and make it acceptable to the world's shareholders. But it rarely gets articulated. A trawl through the references in the *Nikkei Shimbun* to the introduction of stock options in 1997 found only one sceptical comment, by the chairman of a steel firm[36].

> It is not individuals so much as group cooperation that makes for success... at the time of yen appreciation it fell to me to be the main flag-waver for our efforts at restructuring the firm. We didn't do too badly and the firm got back into profit. But that was by group effort. Supposing that my role as flag-waver in the process had been seen as important and I'd been given stock options and exercised them and made a lot of money, I don't think I would have felt too happy about that. And I don't think my colleagues, in the bottom of their hearts, would have accepted the justice of it. In individualistic societies like America and Europe stock option systems may fit in very well, but I really wonder about their suitability for Japan.

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[32] Nihon Kansayaku Kyokai, *"Kooporeeto gabanansu ni kansuru shohoto kaisei-shian kosshi" ni taisuru iken (Comments on the [LDP draft for] revisions of the Commercial Law and other legislation concerning corporate governance),* Tokyo 1998.

[33] Inagami Takeshi, personal communication.

[34] Rengo, *op.cit.*p.84.

[35] See. e.g., Nihon Kyosanto, *Nihon Keizai e no teigen* (Proposals for the Japanese economy), Tokyo, 1994, (8th edition 1998).

[36] Suzuki Yoshio of Godo Seitetsu, writing in the Nihon Keizai Shimbun, 17 July 1997.

Then, secondly, there is the egalitarian approach to human relations of the Japanese firm. As it is commonly observed, the difference in pay between managers and other employees is far smaller in Japan than in America. And both managers and workers agree that this should be so. A factory director -- a member of the Board usually -- wears the same overalls and eats in the same canteen as the shopfloor workers and that is taken for granted.

When I read in the newspapers about CEOs in America who lay off large numbers of workers in a restructuring and earn themselves large sums of money from their stock options as a result, I ask myself how that can be psychologically possible. Japanese managers would have given up a part of their salary before they would get to involuntary lay-offs. My own salary at the moment is subject to a cut of ten percent plus. This is not hypocrisy. The saying that sums it up -- "Scarcity is tolerable; inequality is not." -- is a deeply rooted part of the Japanese ethic.

He excuses himself for setting himself against progress -- against a stock option system that, he understands, has "already been introduced in the advanced countries of America and Europe", on the grounds that he is only "an old steel man, drenched in the culture of an historic industry". And at the end he adds as a further extenuating circumstance, that he is an old man and "people of my generation of Japanese simply cannot free themselves of the feeling that "Fishing for people with the bait of money" is just an ignoble thing to do. That may be one reason why I would drag my feet on this issue.'

The voice of a dying generation? The egalitarianism and the appeal to unselfish cooperation within the group, come naturally to men like him who are old enough to have vivid memories of the days just after the war when they were struggling to get their factories going again, and their clothes were just as shabby, and their shoes just as leaky as those of their shopfloor workers. If it is instinctive fellow-feeling and shared hardship that makes for social solidarity and a sense of benevolent responsibility, then they have it. But the young turks on the government committees, and all the MBAs in middle management, have been brought up in affluence. Their smooth career paths have given them no such background of shared experience with those on the receiving end of their advice or their orders -- the likely losers from what they propose. For the last twenty years an increasing proportion of them have been siphoned off at the age of 11 into the elite private secondary schools and have no more contact with their less well-off countrymen than an Etonian has with his.

8. The *Churyu-nisei*

And, moreover, not only their formative experiences but also their economic background is different. Marxists and rational-choice political scientists will have no difficulty in recognising why it is that the reformers have a fair wind in Japan. The pressures to enlarge the capital share in the national economy are trends which suit very well the interests of that coalition of the high-income middle-class occupational groups which dominates agenda-setting in the main media, the Diet, the ministries, the boardrooms and even the central trade union councils. Journalists, academics (particularly the politically active academics who get on govenment shingikai), politicians, bankers, bureaucrats, businessmen, analysts in business associations and business research organs, accountants, the spokesmen for "the markets" (i.e., those confident and much-quoted young men who are the chief analysts, chief economists of Salomon Bros., Merril Lynch, WTBZ etc.). They all have, increasingly, one thing in common.

They are, more and more predominantly, what one might call *churyu-nisei*, second generation middle class. They are the children, (and soon increasingly the grandchildren) of first-generation immigrants into the metropolitan middle class. What distinguishes them from the first generation, men and women like the steel corporation chairman quoted earlier, is not just the quality of their historical experience. They also differ in average cumulated wealth.

There are still large numbers of professors at prestigious national universities, and members of corporate boardrooms, who are churyu-issei. They were educated entirely through the public system, often coming from rural schools. They inherited precious little from their parents -- with what legacy there was probably divided among five or six siblings. Most of what they own -- the mortgaged house in the suburbs at 90 minutes commuting distance, their libraries -- was saved out of their own earnings.

But the workings of meritocracy slow down the rates of social mobility. A steadily increasing proportion of the students at top universities are the children of parents who went to top universities themselves. Social class status is more likely to be inherited. (For economic, for cultural or for genetic reasons, who knows? And who is doing the research to find out? Who is bold enough, politically incorrect enough, even to sugggest that it is an important question?)

For all that inheritance taxes remain high in Japan, there are considerable avantages, not only in being brought up in the top ten per cent of the income distribution, but also in sharing -- probably as one of only two children -- in the property it has accumulated. The *churyu-nisei* and *sansei* are the ones with the threatened insurance policies, liable to despise the Japanese banks and securities companies which cannot offer half of what Merril Lynch is offering. And if the land and shares they inherit are not going on to appreciate in capital value as their parents' experience taught them they had a right to expect, then compensation in the form of higher current returns -- higher dividends and rents -- seems only fair. They are happy to be convinced that the state pension –the *kosei nenkin* –has to be cut back to half its value otherwise it will involve an “intolerable” payroll tax because they are the ones who have the incomes that permit savings and assure them a good private pension out of, not the labour income, but the capital income of Japan in 2030 and 2040. Hence, more consideration for shareholders, measuring performance by return on equity, become for them matters of elementary justice. Memories of their own "examination hell" hardly prompt frequent reflection on how, in Japan's meritocracy, opportunity is stacked in favour of the top ten percent. So "true equality is equality of opportunity, not equality of outcomes" strikes them as an eminently reasonable slogan. And as for "consumer sovereignty" is that not an integral part of the "democracy" which their parents worked so hard to establish and maintain in postwar Japan?

One of the more quirkishly reflective and reluctant reformers wrote interestingly about the sources of Japan's postwar egalitarianism, just before he left one of the centres of reformist orthodoxy, the Keidanren, to be Japan's ambassador in Budapest. Worth recalling, he says, (before the whole subject gets "relegated to the dustbins of history") that postwar egalitarianism had two sources. Socialism was popular: even outside the Socialist and Communist Parties, people in general "were prepared to believe that a planned fair and efficient distribution of resources was possible, provided only that the process was kept out of the reach of politicians inclined to stuff their own pockets." The second factor he identifies is survivors' guilt in the generation decimated by the war. He makes clear that he (a churyu-issei perhaps?) has outgrown that phase, but cannot refrain from adding, when he talks of the demise of socialism: "when eventually the last traces of Marxian economics had been wiped out, though, for some reason there was a weakening of the sense of fairness of those in the bureaucratic fold. Indeed, the ethical sensitivity of the whole leadership stratum eroded."[37]

And one can make out a good case for saying that it was only the continuing organizational strength of the Socialist Party which made that "aberrant" egalitarianism a force to be reckoned with for so long. At a recent symposium on Government and Market in Tokyo, industrial policy was discussed at great length as helping, or not helping, to promote dynamic efficiency. Eventually the point was raised: but surely Japan's industrial policy was as much about equitable distribution as it was about growth? The reply of the MITI Vice-Minister was clear, and coolly devoid of ethical judgement: yes, until quite recently, given the parliamentary conventions of compromise established between the LDP and the Socialists, the latter, as the permanent opposition party, had been able to get about 80 percent of what it wanted into policy. But no longer.

Will Kan and his colleagues want to, or need Communist Party support badly enough to have to, try to establish a similar braking control over policy?

Nukazawa, in the article just quoted, goes on to reflect on the role of nationalism in postwar Japanese economic policy, and nationalism is, indeed, crucial to understanding how it is that the reformers' doctrines have achieved consensus status. It may be that the reform agenda will substantially benefit only the top ten percent of sovereign consumers, but the power of that ten percent to set the agenda in their own self-interest is vastly increased by the fact that they can do so in the name of concerned patriotism. How could they be accused of being self-serving when it is not themselves, but "Japan" they are worried about. It is “Japan” which has to face the tough intensification of market competition in the post-cold world. It is “Japan” -- as the "Davos culture" elite within this elite constantly tell them when they come back from international conferences -- which suffers in prestige and runs the danger of "international isolation" from Japan's non-conformity to "global standards".

Otake points out that in the mid-1980s the neo-liberal reformers seeking, for example, to privatize the railways, were able to mobilize the support of the most conservative elements of the LDP by appealing on the one hand to their nationalism and on the other to their fear

[37] Nukazawa Kazuo, "The Japanese economy from World War II to the New Century", Japan Echo, April 1998, from Gaiko Forum, Jan 1998.

and hatred of the left, symbolized by the militants of the Doro railway union. Now, with the Socialist Party destroyed, the cold war over, the reformers have a harder job mobilizing the conservatives[38].

If the fear of the left has now practically gone, nationalism can still be appealed to. But nationalism has always been a two-edged force, ever since the *kaikokuha* battled it out with the *sonnoha* in the 1860s. It can spur radical pursuit of foreign models, but it can also take the more xenophobic form: "defend our national heritage against the infiltration of alien ways. The only manly response to those who tell us to conform to what they arrogantly claim to be global standards is a resounding no." Indeed, most of the articulate defenders of the employee-sovereignty firm are clearly motivated by such sentiments[39].

Which seems something of a pity, to one who over the years has come to feel some affection and respect for the egalitarian aspects, the communitarian aspects, the *omoiyari* consideration for others, the self-restraint in cooperation, and the concern for doing a good job which seem to be more evident in an employeee-sovereignty firm than in one whose managers are single-mindedly dedicated to the creation of shareholder value. But if xenophobic nationalism is the only easily available weapon for the defence of egalitarian values, then so be it. Every time I read of Robert Rubin, or "the analysts" rubbishing the latest Japanese government measure and self-righteously demanding more sweeping reforms, I am reminded of Nicholas Kristof's reflections on the 1950s. "It was precisely because the United States kept treating Japan as its puppet in the 1950s that leftists began to gain nationalist credentials... the main force that bolstered communism in Japan was not plotting in Moscow but arrogance in Washington."[40] For "communism" substitute "defence of the employee-sovereignty firm" and the same might be true today.

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[38] Otake Hideo, *Gyokaku no hasso* (*The thinking behind the Administrative Reform Program*), Tokyo, TBS Britannica, 1997, p.22.

[39] See, for example, Takahashi Yuji, *Anguro-Sakuson no kinyu-shihai senryaku (The Anglo-Saxon strategy for financial control)*, Tokyo OS Shuppan, 1998; Higashitani Satoshi, *Gurobaru Standaado no wana (The Trap of global standards)*, Tokyo, Nikkan Kogyo Shimbunsha, 1998; Uchihashi Katsundo et al, *Kisei kanwa to iu akumu (The deregulation nightmare)*, Tokyo Bungei-shunju, 1995; Iida Tsuneo,*Amerika no iinari wa mo yameyo. (Let's stop doing just what the Americans tell us to do)*, Tokyo, Kodansha, 1995, One exception, dwelling on the qualities of the Japanese model rather than its Japaneseness is Iwata Kikuo, *Nihongata byodo shakai wa horobu no ka (Must Japanes-style egalitarian society be destroyed?)*, Tokyo. Toyo-keizai Shimposha, 1995.

[40] Nicholas Kristof, "Japan's full story", *Foreign Affairs*, Nov-Dec. 1997, quoted in Kawachi Takashi, "A new backlash against American influence", *Japan Echo*, April 1998, p.46.