Change and Continuity in Japanese Regulation

Ulrike Schaede

I. INTRODUCTION

With the change in government in 1993, and ensuing modifications in Japan's political stance vis-a-vis its trading partners, many observers in the U.S. have come to conclude that Japan is now on its way to converge with the U.S. The Japanese economy, the argument goes, will soon be driven by free market forces only, and the economic system will become much like that of the U.S.[1].

This is seems to be a rather quick assumption by Anglo-American journalists and economists. Two questions need to be raised in this context. First, if Japan was indeed changing and "converging", why should it converge with the U.S., of all systems, rather than with, say, the German, Swedish, or Chinese systems? Second, and more importantly, how can we judge whether or not Japan is changing if we cannot even agree what constitutes the present underlying features of the Japanese economy?[2] This paper will develop an argument that there is no indication whatsoever of "convergence", as there are no basic changes in the ways the Japanese public thinks about the responsibility of the government to ensure economic growth and well-being. What we currently observe in Japan is not a fundamental change in the philosophy why things are done, but pragmatic adaptation to the ways in which the world is turning on Japan. To present just one example, the "opening" of the Japanese rice market in 1994 did not come about because the Japanese government acknowledged the necessity of free trade or accepted the principles of GATT, but because a bad summer destroyed the Japanese rice harvest and there was no alternative but to import rice[3].

Pragmatic adaptation to changes in the world is an underlying theme in Japanese history. Primary examples of such adaptation include: the *Taika*-reform of 645 and the introduction of a bureaucracy and tax system after the Chinese had brought confucianist thinking to Japan; the founding of the first new government that looked "Western" but was in fact a copy of that established in 645, after *Commodore Perry* arrived in Yokohama in 1853; or the creation of a new state system that looked American but largely represented a continuation of prewar practices after the defeat in 1945 (cf., e.g., *Hall* 1968, *Sansom* 1963). The "changes" in economic regulation in the 1980s, when Japan progressed from a "developmental" economy to a "developed" economy, constitute a further example in this time series of pragmatic adaptation.

During the developmental period (roughly 1950-1975), a certain set of policy tools and goals constituted the core of industrial policy, which aimed at fostering domestic economic growth across all designated growth industries (*Johnson* 1982). Beginning in the 1980s, the goals and tools, as well as the underlying strategic intent of economic policy, shifted towards an increase in international competitiveness and the prevention of a "hollowing out" of Japan. The underlying regulatory thinking, however, did not change. Therefore, what we observe is continuity under change, and certainly no "convergence" with the U.S. or any other system of capitalism.

This paper analyzes the features, tools, and enforcement mechanisms as well as the strategic intent and the core features of regulation in postwar Japan, in order to detect and interpret the ongoing changes and continuities. "Regulation" is understood in the broadest meaning of the word, i.e., simply as a single word description for the ways in which government and business interact in Japan. In contrast to the typical U.S. usage of the word, "regulation" here does not bear an *a priori* negative implication of government intrusion into market mechanisms. Rather, it is understood more in the continental European usage of the term, and refers without strong normative implications to the set of policies that a government employs for industry guidance[4].

II. PHASES OF REGULATION IN POSTWAR JAPAN

The postwar economic development of Japan can be divided into three major periods, of which the first and the third are of special interest for this paper. The first period, beginning in the mid-50s, and ending with the first oilshock in the early 1970s, is characterized by extensive regulation which aimed at economic recovery, development and growth. The second period, stretching over most of the 1970s until the second oilshock in 1979/80, is largely a period of flux. It is characterized by large-scale economic reorganization and industrial restructuring, towards increased exports and diminished dependence on other countries, in particular in terms of supply of raw materials. This period constitutes a mix of strict government guidance and regulation with increasing "emancipation" of large Japanese firms that turned global, at a time of "internationalization" in terms of flexible exchange rate and efforts towards enhanced world trade through GATT and other political forces. The third period, beginning in the mid-1980s and extending into the present, is also labelled in Japan the "period of low, stable growth". In this period, large firms turned increasingly "international", and government intent with regulation shifted towards supporting their international competitiveness, while at the same time deregulating domestic markets in order to avoid a "hollowing out" in the sense that Japanese firms could transfer their main activities to other countries where regulation is less stringent. Table 1 summarizes the major differences between the first and the third periods in terms of strategic intent, tools, enforcement mechanisms and focus of regulation.

Table 1: Regulation in the Periods of Rapid and Stable Growth

regulation	**1950-1975** **"period of rapid growth"**	**1980s/1990s** **"period of stable growth"**
strategic intent	• economic development / growth → industrial policy across all industries	• increased competitiveness • prevention of "hollowing out" → industrial policy in specific areas, depending on industry life cycle
tools	(a) support - low interest rate funds - direct subsidies through FILP - licensing of foreign technology - industrial parks - "promotion firms" - 5-year-plans (b) protectionism - tariffs - import restrictions - foreign currency controls	(a) support - tax incentives - public works and stimulus packages through FILP - research consortia - seed money / industrial parks - "regulatory firms" - more weight to deliberation councils - visions (b) deregulation - revision of foreign exchange and foreign trade law 1980 - free interest rates - abolition of some specific industry laws
enforcement mechanisms	- specific industry laws - licenses and permits - administrative guidance - *amakudari* Old Boys	- licenses and permits - more administrative guidance - *amakudari* Old Boys
focus	- direct - across-the-board regulation - little price mechanism • **active regulation** • **domination and control**	- indirect - situational regulation - more price mechanism • **reactive regulation** • **consultation and control**

The period of rapid growth can be described as one of "active regulation". This means dominance and control by the government of economic activities through extensive regulation. Regulation was "active" in that the government, through laws, rules, and guidance, prescribed what kind of activities could be performed; undesired activities were ruled out *a priori*. The strategic intent, economic development, was implemented through a large number of tools that influenced economic behavior directly. These tools, as analyzed in detail in *Johnson* (1982), can be divided into protective and supportive ones. On the protective side, we find measures such as trade barriers and foreign currency controls. On the supportive side, there was complete interest rate regulation with the aim of providing low-interest funds to strategic industries, subsidies in large amounts through the "second budget", FILP[5], as well as the purchase of foreign technology by the government, the creation of industrial parks, and the establishment of "promotion firms" (discussed below). These supportive measures were embedded in mid-term strategies as formulated in five-year-plans that were explicit endorsements by the government of investments by corporations in the proposed new areas, since it was assured that such strategic investments would be supported by further measures over the long term.

The primary enforcement mechanism for many industries in those days took the form of specific industry laws. Industries that were subject to such a law include: banking, investment banking, insurance, petroleum, pharmaceuticals, construction, tourism, warehousing, and, of course, food and electricity. On top of the direct legal ruling, and for firms in industries without such a law (such as electronics, automobiles etc.), the regulators employed indirect measures through the carrot-and-stick mechanism of administrative guidance (*gyôsei shidô*), which is partially based on the discretionary granting of licenses and permits. To increase their power, the ministries in charge (*kantoku-kanshô*) ensured that a permit or business approval was required for almost any activity by the firms under their supervision (*Johnson* 1982, *Schaede* 1994).

"Active regulation" was based on a focus of overall, across-the-board regulation, partially based on industry laws, and partially in the discretion of the regulators. To guarantee the proper functioning of this system, the price mechanism was all but extinguished in most areas, especially in finance. Since banks could not compete for clients through price-competition, and the artificially depressed interest rates resulted into excess demand for funds, the financial authorities (Ministry of Finance, Bank of Japan) controlled the banks' access to central bank money and, hence, market share within the banking industry. By also strictly controlling the bond and stock markets, which were kept small through over-regulation, the authorities indirectly controlled corporate access to funding: if banks did not have funds, neither would the corporations[6]. Overall, "active regulation" meant government dominance over corporate decision-making.

The oilshock and the sharp recession in the 1970s was, from a long-term perspective, a blessing in disguise. The Japanese industry emerged from the structural overhaul like Phoenix from the ashes, with competitive advantages in high technology, automobiles, and electronics, which were to develop into the major trade assets in the 1980s. While this restructuring was the result of major efforts in industrial policy, the recession changed the role of government in guiding the economy. Facing a sharp decrease in tax revenues, the government also felt a need to support the economy through stimulus measures. In order to finance public works, the government began to issue debt on a large-scale. This resulted into the development of a bond market, as well as the onset of interest rate deregulation. The development was further supported by the revision of the Foreign Exchange and Foreign Trade Control Law (*Gaikoku kawase oyobi gaikoku bôeki kanri-hô*) in 1980, which paved the way for cross-border transactions and international trade. In the 1980s, large Japanese firms began to turn "global" and emerged as leading multinationals. One of the major consequences of "internationalization" was that the tight structure of corporate dependence on domestic bank loans fell apart, since the large firms could not only build on retained earnings accumulated in the period of rapid growth, but also tap the Euromarket and other financial places outside Japan for external funding. The increase in relative power of large firm vis-a-vis the regulators resulted in a new catchphrase in the mid-1980s: the fear of a "hollowing out" (*kûdôka*), i.e., the fear that large Japanese firms would move their business outside Japan in order to avoid strict domestic regulation. The only response to this emerging trend was for the government to relax domestic rules.

Accordingly, regulation in the "period of stable growth", the starting point of which is in the late 1970s, is to be portrayed under a new heading of strategic intent (*cf. Table 1*). Rather than developing the economy, the government now sought to support the developed state in terms of increasing competitiveness and preventing the "hollowing out". Industrial policy now concentrates on specific areas. While in the developmental state almost all industries had to be nourished, industrial policy now takes into consideration certain phases in the industry life cycle: corporations and industries will be supported, guided, or restructured in both the infant and the maturing stages, but will largely be left alone while growing under domestic and worldwide competition (*Okimoto* 1989). One indicator of this shift is the more frequent abolition (and, occasionally, new formulation) of specific industry laws[7]. Rather than building regulation on specific industry laws, the government takes a more indirect approach, with an increase in administrative guidance and "situational regulation", i.e. ad hoc informal guidelines and measures in response to market shifts[8].

Reflecting the change in intent, regulatory tools employed in the period of stable growth differ from earlier mechanisms (*cf. Table 1*). On the support side, we now find tax incentives rather than subsidies, and FILP (Fiscal and Investment Loan Program - *Zaisei tôyûshi keikaku*) funds are primarily used for public works and general economic stimulus packages. Research incentives are now based on seed money and research consortia[9]. Large firms at the maturing stage, firms in maturing industries, or firms facing financial difficulties, are merged with firms that are at a different stage of their life cycle or in better shape. The government signals intents and strategy through medium-term "visions", and while the less flexible and longer-term five-year-plans are still being formulated on a regular basis, they are largely irrelevant[10]. The current period also knows only little protective measures in terms of an infant industry argument[11]. Rather, we see deregulation in cross-border transactions, interest rates, and even in the retailing system. Much of this deregulation was forced upon the regulators by market development and regulatory arbitrage[12]. As a result, the regulators turned into "reactive regulators": rather than prescribing *a priori* what can and what cannot be done, the government now has to react to new business practices of firms. For instance, when Japanese securities firms became active on Wall Street, they learned many new tricks from their American competitors, such as exotic triple currency swaps. These activities had not occurred to Ministry of Finance officials before, and so there was no rule for them. In reaction, officials then set out to formulate new rules and guidelines.

In such an environment, the regulators were threatened with losing their grip on the market and, accordingly, power. The reaction of the Japanese regulators was to increase their reliance on situational regulation and administrative guidance and the carrot-and-stick mechanism as enforced by discretionary power of business licenses and permits[13]. Also, the traditional mechanism of government-business relation, such as guidance through public corporations or promotion firms, or the *amakudari*, retired bureaucrats embedded in an "Old Boy" network are relied on more heavily to compensate for the decline in direct regulation[14].

In other words, the regulators increase the portion of indirect regulation over direct regulation. They open the formulation of regulation to more consultation by the industry through the deliberation councils. There are some 250 such councils (*shingikai*) which are involved in the process of formulating new policy strategies, visions, laws, and structural changes (*Johnson* 1982, *Schwartz* 1993). To be sure, MITI's Industrial Structure Council (*Sangyô kôzô Shingikai*) was established in 1964, and MOF's Financial System Reform Committee (*Kinyû Seido Chôsakai*) was founded in 1956. However, it is not clear whether in the early days of deliberation the final reports of these councils were actually written by the representatives of business and academia, or rather by the bureaucrat council members themselves. In many cases, the councils were merely mouthpieces of the ministry which they were supposed to advice, and their primary function was to coopt public opinion. While it largely depends on the personality of the head of the council, in recent years councils seem to have become more independent advisers that voice concerns even if that is against the interests of the regulating ministries[15].

As Table 1 shows, the two periods of rapid and stable growth differ across the board in terms of intent, tools, and enforcement of regulation. The reason for this change is that regulation in the rapid growth period had been successful, as firms developed into large multinationals. In response to their new relative power vis-a-vis the regulator, the government had to loosen its grip of the economy. However, all entries in Table 1 are based on the underlying features of regulation in Japan that have not changed. What we observe here is a change in *how* things are done, i.e. how the government regulates, but not in the underlying attitude that the government needs to do things, i.e. regulate.

III. THE FOUNDATIONS OF REGULATION IN JAPAN

The underlying rationale and philosophy of regulation in Japan is markedly different from other countries. In contrast to the U.S., there is no concern about the theory of free markets, and in contrast to Germany, there is no explicit government responsibility to ensure social security and market fairness. In fact, the major feature of Japanese regulation is that it is not based on any such principles. Regulation is a tool to achieve medium- and long-term goals, which in turn prescribe the adoption of medium- and long-term rules that can be reverted whenever goal achievement so requires. This "no-principle" approach is supported by two further features of Japanese regulation: institutionalized mechanism of control, consultation, and cooperation between government and business (working both ways, as government and business influence each other mutually), and credible commitments on both sides that ensure goal and strategy adherence.

1. Regulatory Pragmatism without Binding Principles

Ever since *Kant* and *Hegel*, "principles" (*Grundsätze*) have been basic components of Western thinking. By societal and constitutional norms, we adhere to the principles of equality, justice, and freedom; and *Adam Smith* added to these the principles of free market economics and competition. These overarching principles translate into static values and norms of behavior that have no ends in themselves. The principles, in turn, serve as the basis of rules that are meant to ensure law and order in the society and economy of a nation.

One of the reasons why we have difficulties in fully understanding East Asian societies is that we project our principles onto their histories, societies, and economies. But *Kant* and *Hegel* never travelled to Japan. There are no overarching, binding principles that rule the Japanese society or economy[16]. And while the economic institutions may look as if they were similar to Western institutions, they are based on a very different way of thinking about their functions and purposes.

The Japanese economy is not guided by any principle. Rather, what we find are rules that are driven by a goal. A specific goal is formulated, and rules are spelled out such that they serve to achieve the goal. Behavior is guided by the goal, not by an *a priori* norm[17]. Therefore, we need to differentiate between principles and maxims in the West, and goals and rules in Japan. Japan does not act "on principle", but pragmatically, based on the given situation in order to attain certain goals; the rules are created in an *ad hoc* manner[18] (*Pauer* 1994).

There is plenty of evidence in Japanese history for this acting on a situational basis without overarching guidelines, and in particular in its history of economic development. For instance, we all tend to think of war as being based on principles of right and wrong, and guided by some ideology. Japan in WWII was not driven by any ideology: the Japanese knew (or thought) they were weaker, since they had missed out on European imperialism before the turn of the century, and they saw a good opportunity to extract some resources from neighboring countries. The alliance with Hitler was not driven by ideology either: Japan joined forces with Germany because Germany seemed to be winning. In the same way, current Japanese foreign policy is not motivated by some ideology or principle (*Kerde/Pauer* 1994). The strategy with official development aid is to get the biggest bang out of each Yen[19].

In terms of economic development, *Pauer* (1994) observes that the goal orientation is obvious even in the years before *Meiji*: the goal was defense, and the *bakufu*[20] supported the *daimyô* by bringing Western researchers (*yôgakusha*) into the country that helped build the first guns and large ships in the years 1850-1870. During the *Meiji* period (1868-1911), the goal was to develop Japan as an independent state. The long-term catchphrases were *fukoku kyôhei* ("rich country, strong military") and *shokusan kôgyô* ("increase production and promote industry"), and the government supported this primarily through (a) building the infrastructure and (b) the foundation of military arsenals that became high-tech training centers for engineers in the early 20th century.

In the postwar period of rapid growth, we find the same basic approach to achieving the development goal. While fully aware of economic theory, the government discarded the price mechanism, not only for bank loans, but for most products (as evidenced in practices of construction bid-rigging, electronics and cosmetics retail price fixing, etc.). The effect was that Japanese firms came to excel in non-price competition, i.e., quality and service, which is the most important comparative and competitive advantage that can be developed by a country that cannot build its economic growth on natural factor endowments. When the price mechanism was slowly reintroduced into the Japanese economy beginning in the 1970s, the government designed various programs to absorb the shock: tax incentives, depreciation allowances, promotion firms and, on an international level, non-tariff trade barriers.

These examples show that Japan's economic policies are not based on principles, but on pragmatism[21]. Policies are based on long-term goals and strategies to achieve them. Goals are formulated in catchphrases and propagated as "aims of the nations". The goals are reformulated if the situation requires, and a pragmatic solution to external or internal shocks is sought for. The adherence to the goals and the implementation of their strategies is based on two mechanisms of monitoring and commitment.

2. *Institutionalized Mechanisms of Consultative Capitalism*

A large number of institutions serve to ensure proper understanding of government intentions, control over business behavior along the lines of goal achievement, and involvement of business in the formulation of government policies. These institutions include: "public corporations" that are run by retired bureaucrats and funded by government monies, but serve purposes of the private sector[22]; intermediary or "promotional" firms that are also run by former bureaucrats, but are funded by private monies and serve public purposes; the "old boy network" of retired bureaucrats that assume positions on the board of directors of private firms and banks; and the deliberation councils in the public policy process that assume functions of private/public think tanks and serve to co-opt public opinion on changes in government policies and laws.

The "intermediary firms" can be divided into three categories: those that are intended to support economic growth, those that serve public opinion purposes, and those that implement regulation. An example of the former is the JECC (Japan Electronic Computer Company) which was founded in 1961 by six computer companies (and heavily subsidized by the government). Its purpose was to promote sales for domestic computers by a leasing scheme that meant lower prices for the buyers and immediate cash flow for the makers (*Anchordoguy* 1989). The strategic intent behind the creation of JECC was to implement a "buy Japanese computers" policy in the face of overpowering IBM dominance.

An example of an opinion-making private firm is Nomura Research Institute (NRI), in the 1980s also labelled "Nakasone's private think-tank". NRI's presidency is customarily occupied by a former high-ranking Ministry of Finance bureaucrat, and the vice president is a former Bank of Japan director. Together with the deliberation council, the function of public opinion institutions is to circulate the government goals among business and the public, and give public policy objectives a private backing and acclaim. The co-optation of public opinion that subtly arises out of NRI statements is a major vehicle of goal achievement. Further, NRI forecasts on economic growth and studies on individual industries enforce MITI visions on future economic development and justify micro industrial policy[23].

The third group, the "regulatory intermediaries", consists of corporations that look just like private firms, but in fact regulate an industry or a certain activity within an industry by participating in the market. Often, these firms were founded originally to foster the business, and turned into regulators only in the course of economic growth. An outstanding example are the three "securities financing firms" (*shôken kinyû gaisha*) that are closely attached to the stock exchanges in Tokyo, Osaka, and Nagoya. The largest firm, Japan Securities Finance Co., is a stock-holding corporation located in Tokyo, owned by a group of competitors such as Nikko Securities, Nomura Securities, Industrial Bank of Japan and other banks. The CEO is a retired Bank of Japan official, the Vice CEO comes from the Ministry of Finance, and the other board members are representatives of banks and securities firms. In the early 1950s, the firm's function was to channel Bank of Japan money into the lackluster stock market by providing cheap loans with which stocks could be bought on margin (a partial amount of the price); today, the firm regulates and oversees interest rates on margin trading in bonds and stocks. This activity means fine-tuning of stock trading: when the market is depressed, the firm can lower the costs of trading on margin, and the market may pick up (this worked wonderfully after the October 1987 stock market crash, when investors resumed buying the day after the 12% price decline, largely driven by margin trading). The firm can also depress trading and, more importantly, punish individual firms by denying them access to loans or charging more for them[24].

Regulatory intermediaries increase the leverage of the bureaucracy in administrative guidance. While bureaucrats can issue written or oral "invitations" to certain behavior by certain industries or firms, and punish dissidents with withdrawal of denial of business approvals, these firms actually have control of market activities *after* the guidance has been issued. They monitor compliance and fine-tune the guidance.

The primary effect of the three types of intermediary firms ("private public" corporations or "coopted private corporations") is to ensure the smooth implementation of the strategic intent; i.e. to enforce the regulation that is exercised in order to achieve a certain goal over the medium or long term. This effect is complemented by the "old boy network" of retired bureaucrats that occupy board positions of private firms[25]. The *amakudari* system is based on three different motivations:

(1) The government aims to ensure implementation of regulation and, as a side effect, keep the former officials employed in the absence of a well-endowed pension system for civil servants.
(2) The government officials aim to increase lifetime employment by assuming a higher paying position after early retirement.
(3) Corporations pursue three objectives simultaneously: (i) to ensure access to information in an environment of non-transparent and situational regulation through administrative guidance; (ii) to ensure intermediation in times of clashes of interest with the government; and (iii) to lobby under the framework of encompassing regulation.

As a result, the Old Boys perform three functions. First, they smooth the information flow between government and business. Second, they impact the formulation of corporate strategies in that they represent the understanding of the regulator in the board discussion. Third, they impact the formulation of public policies in that they know how to effectively represent the firm's interest in the formulation of administrative guidance. This results in mutual consultation on how to achieve the overall national goal, in a system where market mechanisms are supplemented by cooperative efforts of government and business to ameliorate potential antagonism between their respective interests. In other words, the Old Boys constitute an institutionalized system for "lubricating" government-business relationships, which results in consultative policy formulation[26].

3. *Credible Commitments*

After a long-term goal of regulation has been formulated and government and business have agreed on strategies of how to implement it, a mechanism is needed that ensures all parties involved that everybody is committed to the strategy. This is indispensable in order to lower the uncertainty with goal-specific investments. Such a safeguarding mechanism is needed both among competing firms and between firms and regulators.

Firms have to trust their competitors that if they bow to a certain guidance they will not be ripped off by another firm that resists it. Most recent analyses on the industrial structure of Japan develop a "trust" argument: industrial relations in *keiretsu* and between large firms and their suppliers, for instance, are long-term because they build on trust and loyalty (e.g., *Smitka* 1991; or *Sheard* 1992 on the function of the main bank as a loyal monitor). However, it should be noted that "trust" is as much a Western, if not a purely Christian, concept as is the "principle". Even the quickest glance into Japanese history provides ample evidence of mistrust and "rip-offs" (consider the *Fujiwara*, the *Minamoto*, the *Hôjô*, the *shikken* system of pushing the sovereign out of power, or the rivalry among the *daimyô* in the *Tokugawa* period; as exemplified in the *Kurosawa* movie "*Ran*" which is a story of power battles and misguided trust). There is no tradition of trust in Japan.

An alternative interpretation of long-term alliance mechanism such as cross-shareholdings, the main bank system, the *shukkô* system of dispatching employees to other corporations on a temporary basis, or even the seniority pay system that comes with long-term employment, is that these are mechanisms intended to overcome the prevalent inherent *mistrust* of economic actors and firms in each other. If there was trust, there would be no need for such contractual alignments. But because there is no such "natural" trust, competitors would ruin each other in cut-throat competition without alignments. In order to ensure that they concentrate on producing good products rather than throwing each other out of the ring, the firms form alliances that make them stronger and less vulnerable, and tie them in with potential competitors[27]. These alliances are based on credible commitments, most importantly cross-shareholdings. These shareholdings can be very costly, since dividends are low and shares must not be sold under any circumstances. The foregone opportunity costs in cross-shareholdings make the commitments between firms credible.

Just as there is mistrust between economic agents, there is also mistrust in the regulators. To make sure that the regulators really have the firms' interests in mind when they formulate their visions and implement their regulatory tools, firms demand credible commitments. These come in the forms of "supportive" tools, as listed in Table 1. Consider the creation of research consortia. The government designs a vision of new strategic fields in technology. Firms will not be willing to invest in this new area unless the government first puts money where its mouth is. Thus, the government generates funds for a research consortium. All firms involved also have to put money in. When the research is successful, and a new technology is ready to be marketed, everyone withdraws and firms start to compete for market share in the new products.

All "support tools" listed in Table 1 can be understood as credible commitments by the government. Of course, these tools change with both the development of the economy and shifts in the strategic intent of regulation. But whatever the individual tools are at a given point in time, they perform the same underlying function: to make government visions credible and enforce the leverage of the major enforcement mechanism, administrative guidance.

IV. CONCLUSIONS

During 40 years of economic growth, Japan progressed from a "developmental" to a "developed" (industrialized) state. The development was guided and supported by a certain set of policy tools, based on the overall goal of economic growth. With the change in status, the goals as well as the tools have also changed. In order to interpret these changes correctly, the concept of "regulation" and the underlying philosophy have to be considered.

"Regulation", which bears a negative connotation in the mindset of the free market economist, is not assumed to be necessarily intrusive and disturbing in Japan. This is reflected in the fact that regulatory tools in Japan include "supportive" measures that alleviate the burden of restricting guidance. The reason for the more positive attitude towards the relation between regulators and regulated is not that they agree on all issues, or base their action on some miraculous or confucianist consensus. Much rather, the relation is not adversarial because there are a large number of mechanisms in place that allow corporations to influence the shaping of public policy (including the Old Boys, the deliberation councils, and bribery). The resulting system can be labelled one of "consultative capitalism" that builds on institutionalized efforts to mitigate the inherently adversarial relation between business and regulator. Because this system has functioned quite well over time, there is no pressure to change it. Most of the "changes" proposed by the *Hosokawa* and *Hata* administrations in 1993/1994 either refer to marginal issues or to left-overs from earlier days of "active regulation" that have bothered both industry and bureaucrats for a long time. The abolition of such rules does not touch the basis of regulation.

The three pillars of regulation, which have a long history and are not likely to change, are (1) regulatory thinking (policies are driven by goals, not by principles); (2) institutionalized mechanisms of "consultative capitalism"; and (3) credible commitments. Mechanisms such as *keiretsu* and cross-shareholdings are in place because the Japanese deeply mistrust each other. Similarly, the government has to commit itself to its messages. It has to support its "visions" by implementing supportive regulatory tools. The success of such government commitments is monitored by institutional features such as quasi-private firms run by retired government officials.

Since these three underlying features of regulation not only allow for, but demand, flexibility in the formulation of new regulation, changes in the environment translate into changes in the orientation (the goal), but not in the underlying character of regulation. Therefore, changes in regulatory tools and in regulatory intent do not indicate a basic change in regulation philosophy, and they certainly do not signal convergence with other systems of capitalism. When interpreting current events and seeming changes, one should base the analysis on the source, i.e. the underlying assumptions of regulation in Japan, rather than simply on the tools employed.

References

ANCHORDOGUY, MARIE, 1989, *Computers Inc. - Japan's Challenge to IBM*, Cambridge: Harvard United Press.

CALDER, KENT A., 1993, *Strategic Capitalism - Private Business and Public Purpose in Japanese Industrial Finance*, Princeton, Princeton United Press.

HALL, JOHN WHITNEY, 1968, *Das Japanische Kaiserreich*, Frankfurt: Fischer.

HANANO AKIO/TETSUNE HARUHITO/MORITA YOSHINORI, 1991, *Zaisei tôyôshi* (Fiscal and Investment Loan Program), Tokyo: Tôyô keizai shinpô-sha.

JOHNSON, CHALMERS, 1974, "The Reemployment of Retired Government Bureaucrats in Japanese Big Business", *Asian Survey,* Vol.14, November, pp. 953-965.

JOHNSON, CHALMERS, 1978, *Japan's Public Policy Companies*, Washington: AEI-Hoover policy studies.

JOHNSON, CHALMERS, 1982, *MITI and the Japanese Miracle - The Growth of Industrial Policy, 1925-1975*, Stanford: Stanford United Press.

KERDE, ORTRUD/ERICH PAUER, 1993, "Japanische Außenpolitik: Im Fernen Osten nichts Neues", in: WILFRIED VON BREDOW/THOMAS JÄGER (ed.), *Japan - Europa - USA, Weltpolitische Konstellationen der neunziger Jahre*, Berlin: Leske & Budrich, pp. 211-228.

LEVY, JONAH D./RICHARD J. SAMUELS, 1992, "Institutions and Innovation: Research Collaboration as Technology Strategy in Japan", The MIT Program in Science, Technology, Management Working Paper MITJSTP 89-02.

MATSUSHITA, MITSUO, 1993, *International Trade and Competition Law in Japan*, Oxford: Oxford United Press.

OKIMOTO, DANIEL, 1989, *Between MITI and the Market - Japanese Industrial Policy for High Technology*, Stanford: Stanford University Press.

PAUER, ERICH, 1994, "Die Rolle des Staates in Industrialisierung und Modernisierung", Working Paper, Japan-Zentrum, Philipps-Universität Marburg.

SANSOM, GEORGE, 1963, *A History of Japan*, Stanford: Stanford United Press.

SCHAEDE, ULRIKE, 1989, *Geldpolitik in Japan 1950-1985* (Monetary Policy in Japan 1950-1985), Marburg: Marburger Japan-Reihe Bd.1.

SCHAEDE, ULRIKE, 1993, "Securities Financing in Japan", in: Takagi Shinji (ed.), *Japanese Capital Markets*, Oxford: Basil Blackwell, pp. 517-556.

SCHAEDE, ULRIKE, 1994, "The Old Boy Network and Government-Business Relationships in Japan": A Case Study of "Consultative Capitalism", Working Paper, UC Berkeley.

SCHWARTZ, FRANK, 1993, "Of Fairy cloaks and Familiar Talks: The Politics of Consultation", in: Allison, Gary D. and Yasunori Sone (eds.), *Political Dynamics in Contemporary Japan*, Ithaca: Cornell United Press, pp. 217-241.

SHEARD, PAUL, 1992, "Interlocking Shareholding, Corporate Governance, and the Japanese Firm", Working Paper 4, Osaka University. Smitka, Michael J., 1991, *Competitive Ties - Subcontracting in the Japanese Automotive Industry,* New York: Columbia University Press.

UPHAM, FRANK K. 1987, *Law and Social Change in Postwar Japan*, Cambridge: Harvard United Press.

VOGEL, STEVEN K., 1994, *Freer Markets, More Rules - The Paradoxical Politics of Regulatory Reform in the Advanced Industrialized Countries*, manuscript draft, University of California, Irvine.

WILLIAMS, DAVID, 1994, *Japan - Beyond the End of History*, London: Routledge.

WOOD, CHRISTOPHER, 1992, *The Bubble Economy - Japan's Extraordinary Speculative Boom of the '80s and the Dramatic Bust of the '90s*, New York: The Atlantic Monthly Press.

Notes

1 See, among others, articles in *The Economist*, *Business Week*, and *The Wall Street Journal*. WOOD (1992) argues that Japan is doomed to fail if it does not introduce more U.S. practices into its system of financial trading and regulation.

2 As WILLIAMS (1994) points out, a new student to the field who reads both JOHNSON (1982) and CALDER (1993) must conclude that the two authors are talking about "two different planets".

3 Note that the government announced in July 1994 that it will not import any foreign rice in 1995, because Japan will experience a record rice harvest in the 1994/95 season.

4 JOHNSON (1982) subsumes all this under the term "industrial policy". However, recent discussions in the U.S. have narrowed the meaning of industrial policy to indicate policies concerning special industries, particularly in technology, and excludes broader issues such as financial market policies.
For the purposes of this paper, it is not relevant *who* within the government, i.e. the bureaucracy or the political parties, is the originator of regulation. An analysis of the effects of changes in the power structure between bureaucracy and politicians on the formulation and implementation of regulation is left for further research. The term "government" in this paper refers to the bureaucracy as the implementers, and possibly originators, of regulation.

5 The "Fiscal and Investment Loan Program"; see JOHNSON 1978, HANANO et al. 1991.

6 See SCHAEDE (1989) for a detailed analysis of these mechanisms in the period of rapid growth.

7 A further mechanism that serves the same end is the inclusion of an industry in the "Structurally Depressed Industry Law" (*Kôzô fukyô hô*) of 1983. This law excludes industries designated as "structurally depressed" from FTC (Free Trade Commission) intervention in production cartels and other protective measures initiated by MITI (see UPHAM 1987). For instance, the petroleum and steel industries were subject to this law between 1983 and 1988. This law is very convenient, because it allows the regulators to put certain industries under their control for a certain period of time without having to change existing laws or formulate a new industry law for them.

8 The term "situational regulation" refers to *ad hoc* measures by one ministry concerning one industry or one firm. A prominent example are the attempts by the Ministry of Finance to support the Japanese stock market in 1992/93 by stop-gap measures such as the lifting of the percentage limit of total funds that public pension funds may invest in equities, or the sudden shift of an accounting rule, that would depress the market, into the following fiscal year; see SCHAEDE 1994 for a detailed discussion.

9 For a discussion of the mechanisms and effects of research consortia see LEVY/SAMUELS 1992.

10 In interviews with 27 high-ranking incumbent bureaucrats at MOF and MITI in summer 1993, only three knew the title of the current five-year-plan, and no one had read it.

11 There are still many areas left in the Japanese economy that are highly protected from foreign competition. Some of the features are structural, as the Structural Impediment Initiative indicates; for instance, the distribution system that hurts Japanese consumers as much as foreign competitors. Others are by policy design, and they are much more subtle than tariffs or import quotas. As compared to the period of rapid growth, however, it seems fair to say that most protective measures, in an infant industry protection argument, have been abolished (cf. MATSUSHITA 1993).

12 The abolition of one rule creates new loopholes (business opportunities) which are exploited by the firms and lead to further pressure to deregulate, which again creates new loopholes. Once the structure of tight regulation has been loosened, the whole artifice is undermined.

13 VOGEL (1994) argues that the process of "deregulation" is really one of reformulation of regulation; accordingly, the power of the regulators is not reduced, but merely changes in character.

14 SCHAEDE (1994) shows that the number of retired government officials hired in industries that are known for their resistance of MITI guidance, such as automobiles and electronics, has increased since 1975. This is contrary to intuition, since one would assume that the more international and the larger these firms become, the less they are willing to hire government officials. The numbers suggests that the increase in "soft" regulation created new needs by the firms to hire former bureaucrats.

15 Interview with *Rôyama Shôichi*, long-term member of the Securities and Exchange Council (*Shôken Torihiki Shingikai*) and head of several of its subcouncils, in 1988.

16 This is not at all to say that Japan "suffers" from a "lack of principle". Quite to opposite, as will be shown below, not being constrained by certain fixed principles allows for more flexible regulation.

17 This point has been developed by PAUER (1994). PAUER explains the goal orientation through an analysis of the religious norms prevalent in Japan. None of the three major religions in Japan poses principles: Shintoism plans for the future, invites goal setting and promises continuation; buddhism postulates a practical, secular moral that includes the acceptance of worldly events, and confucianism stipulates norms (not principles) of behavior that are conveyed not in form of orders, but through situational descriptions and stories. All three entertain a strong orientation towards life (*Diesseitsorientierung*) and offer help in life in the form of rules; the actual body of thought and principle is diffuse in all three religions.
JOHNSON (1982) has made a similar point about the "pragmatic rationality" of the Japanese bureaucracy. In his view, however, there are still principles, only the principles are markedly different from the West.

18 This is also indicated in the Japanese term "*gensoku toshite*" (lit.: in principle"), which does not imply a message such as "in principle and without exception", but rather "normally it is done this way, but we can make an exception here"; the term does not convey a binding constraint.

19 This has been shown by KERDE/PAUER 1994. - The current "trade war" between Japan and the United States is discussed based on the principle of free trade, which is to be traced back to the *Ricardian/Smith* theories of absolute and comparative advantage, and its further development in terms of factor endowments. Japan does not have a comparative advantage in factor endowments, so that this theory does not have any value to the Japanese; hence it is discarded. The "principle" of free trade is meaningless for Japanese policymakers.

20 The government in *Edo* (Tokyo) during the *Tokugawa* period (1603-1868).

21 Note that the major portion of economic growth was paid for and borne by individuals and households (low interest rates on savings, no living environment infrastructure, long working hours, insufficient social insurance), which is a slap in the face of the principles of social equity and justice.

22 These are discussed in detail in JOHNSON 1978.

23 As defined by JOHNSON (1982), this means industrial rationalization policy, which implies state intrusion into the detailed operations of individual enterprises or industries.

24 See SCHAEDE (1993) for a detailed analysis of securities financing firms and the mechanisms of margin trading and stock market fine-tuning through these firms. - Another example of regulatory intermediaries are the money-market brokers (*tanshi*) that posted money-market rates as prescribed by the Bank of Japan in the 1970s and 1980s. The relevance of the *tanshi* is ensured by a law that requires all money market transactions to be conducted through one of these pseudo-private firms.

25 For the details of the *amakudari* ("descend from heaven") retirement mechanism see JOHNSON (1974) and SCHAEDE (1994).

26 See SCHAEDE 1994 for a detailed development of this argument.

27 It should be noted that these mechanisms are also the building blocks of the German industrial structure. In the case of Germany, however, they are usually not interpreted in a "trust" framework, but in a mistrust-collusion-competition framework.