

THE JAPANESE EMPLOYMENT SYSTEM AND THE EVOLUTION OF THE FIRM

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ABSTRACT

This thesis aims to briefly describe what has come to be known as the "Japanese employment system" (JES) and, more importantly, to *explain* its emergence and persistence. I argue that because the JES is an integral part of the Japanese firm it is necessary to understand the workings of this particular institutional form and how it evolved.

The Japanese firm is examined via a number of different theoretical lenses. Traditional arguments based on neoclassical economics are brought to bear, as are cultural formulations and Marxist-inspired models that focus on patterns of authority and control. The strengths and limitations of each of these research paradigms for our purposes is discussed.

Masahiko Aoki's model of the Japanese firm and labor relations is taken as a starting point for the analysis. It is argued that his explanation for the emergence of the JES relies too heavily on economic rationality and historical idiosyncracies of the immediate postwar period. I modify his formulation by attaching relatively more importance to (1) cultural traditions and practices dating back to the Tokugawa era, and (2) the political context--in particular, Japan's pro-active postwar industrial policy.

Next, drawing on the above arguments, a firm-as-community model of the Japanese company is presented. I argue first, that the practices of the JES seem much less mystical when they are taken as a self-supporting *system*, and second, that a number of external "facilitating" factors support its persistence.

Finally, two possible future trajectories for the JES are discussed. One sees essentially a continuation of the status quo, with little *substantive* change in the JES. The other takes into account the apparently deep-seated changes in the values of the young workforce, and predicts the gradual demise of the JES.

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CHAPTER 1

INTRODUCTION

This paper seeks to describe what has come to be known as the "Japanese employment system" (JES) and to explain its emergence and persistence. A thesis of this paper is that many of the seemingly inexplicable uniquenesses of the Japanese employment system are rendered understandable when it is acknowledged that the Japanese firm is a very different institution from the American (or British) firm, both in terms of its internal makeup and in terms its place in the broader political-economic context of these two countries. For this reason, particular attention will be paid to differences in *origin* and present characteristics between the Japanese and Anglo-American systems.

These issues have recently come to the fore with discussion of America's competitiveness, or lack thereof. Much of the popular literature on the subject seems to suggest--sometimes explicitly, but more often implicitly--that America could improve its productivity performance by adopting Japanese-style labor-management practices. What these prescriptions often ignore--how and why the Japanese system came to differ from the Anglo-American one--is a central theme of this thesis.

This thesis takes an explicitly *institutional* approach,

focusing on the Japanese firm as the unit of analysis and examining the forces that have shaped it. Accordingly, it is *multi-paradigmatic*. Because different theoretical lenses can illuminate different aspects of the JES (and introduce different biases), I have devoted Chapter 2 to the subject of theories and approaches.

Chapters 3 through 6 represent the core of the thesis. Chapter 6 is an explication of the JES as it exists today. I have attempted to avoid extensive statistical and descriptive detail, as the reader is likely familiar with the basic features of the JES--and this has, in any event, been described in great depth elsewhere. I instead discuss the firm-as-community model, because I wish to give a more holistic sense of how the Japanese firm as an institution is *qualitatively* different from those of other countries. Also, I present three external or "facilitating" factors that allow the Japanese firm and the JES to exist in their current form. Briefly stated, these are (a) a receptive and historically-rooted business culture, (b) a unique pattern of stock ownership and, (c) a history of pro-growth government policy and a set of highly engaged government institutions.

Chapters 3, 4, and 5 develop and support the ideas outlined above. First, because this is an institution-centered analysis of the JES, it is necessary to have a working model of the Japanese firm that incorporates the

integral role of the Japanese Employment System in it. One such model, Aoki's, is presented in Chapter 3.

Chapter 4 critiques and modifies this model's arguments. Specifically, it speaks to points a and b above (Japan's characteristic business culture and financial structure). It discusses historically how these came into being, and their past and continuing impact on the JES. It imputes relatively more importance (than Aoki's) to cultural traditions and practices dating from the Meiji Restoration. It also looks at these things in a particular institutional venue, the enterprise union.

Chapter 5 also criticizes and adds to Aoki's argument by discussing something that he gives short shrift to in his formulation: government policy. It is also in part historical; it picks up where Chapter 4 leaves off by discussing the role of industrial policy in postwar Japan and the debate surrounding it. Also, it looks at the specific *mechanisms* by which government policy affects the firm and has implications for the JES. In short, it describes the importance of point c above.

Chapter 7 is about the future of the JES, and presents two possible scenarios. It is meant to be more speculative than definitive: I have tried to make this thesis more about causes and explanations than effects and predictions. One path, the "status quo trajectory", sees the JES changing perhaps slightly in form, but not in substance. The other,

which sees potentially very deep societal changes afoot, sees the JES as a relic of Japan's past, and the convergence of Japan's industrial relations to greater alignment with those of other modern industrial societies.

CHAPTER 2

THEORY AND APPROACHES

Why have there been so many different and contradictory explanations for Japan's apparently unique system of industrial relations? This question frames and motivates this chapter. I will discuss two answers to it: First, the use of single industry case studies, and second--and more importantly--a desire for general, all-encompassing theory.

Case Studies

In an attempt to obtain greater historical specificity and depth, scholars have oftentimes selected one industry and examined the history of industrial relations in that particular sphere. This yields very rich historical detail, and oftentimes even decent "theory" for one industry or set of industries. Two examples are given below.

(1) *Heavy industry.* Andrew Gordon, in The Evolution of Labor Relations in Japan traces the development of the heavy industry sector of the economy--comprising shipyards, arsenals, and machine shops--from 1853 to 1955, paying particular attention to labor-management relations. He takes issue with Abegglen's claim, articulated in The Japanese Factory: Aspects of its Social Organization, that labor-management relationship conventions seen in present-

day Japanese factories are a manifestation of traditional, paternalistic *senpai-kohai* relationships that existed since the Tokugawa era¹. Gordon maintains that in fact in the formative years of the Japanese employment system, workers showed little respect for superiors (and vice versa) and changed jobs frequently. Even during World War II, managers had very serious problems with employee discipline and turnover.²

A counterpoint to this is offered by Sheldon Garon in The State and Labor in Modern Japan³. He maintains that the heavy industry sector accounted for a very small fraction of the work force: in 1902, only about 7% of Japan's industrial workers were in this area of business⁴ and the majority of industrial workers (approximately 54%) at this time were in the textile sector. By 1919 these percentages had become 16% and 57%⁵. As these statistics indicate, more than half of the industrial workers of the

¹ James Abegglen, The Japanese Factory: Aspects of its Social Organization (Glencoe: The Free Press, 1958).

² Andrew Gordon, The Evolution of Labor Relations in Japan: Heavy Industry, 1853-1955 (Cambridge, MA: Council on East Asian Studies, Harvard University/Harvard University Press, 1988).

³ Sheldon Garon, The State and Labor in Modern Japan (Berkeley: University of California Press, 1987), p. 13.

⁴ The number of workers listed in the category "machine and tool" was 34,000. If the number of workers in "miscellaneous" is included, the percent increases to 13%. The other categories of workers were "textile", "chemical," "food and drink," and "electrical, metal refining, mining". NRUS, 10: 104-7.

⁵ Ibid.

era were in the textile industry. And "the most distinctive feature of Japanese textile labor before World War II was the predominance of young, single female operatives, who typically came from rural areas and worked for less than two years."⁶ This is markedly different from the picture of Meiji industrial working class society that Gordon depicts in his work.

Thus, while it is true that the heavy industry sector may have been representative of the economy as a whole in some regards, and it is certainly true that it might have spawned some of the practices that eventually became enshrined in the JES as we know it, it is not necessarily safe to take it as a microcosm of the economy or system of industrial relations as a whole.

(2) *The merchant house.* Another business institution that has been examined in depth in an attempt to understand the genesis of the Japanese employment system is the merchant house. In The Japanese Company, Clark maintains that

"outsiders were taken in [to the merchant house] not as salaried employees, but as young apprentices for whom the househead was in some degree *in loco parentis*...outsiders were recruited into the business house in return not for contractual rewards, but for the benefits of a long, possibly even life-long association with the house in a

⁶ Garon, State and Labor, P. 7.

relationship which was always analogous to, and sometimes almost identical with, that of a family member."⁷

It is true that a few trading houses survived the transition to modernity to become present-day trading companies, and that other business institutions may have attempted to emulate these practices. Mitsui is often singled out as a company that provided such "institutional continuity". But Mitsui is notable, and often singled out, not because it is typical but because it is *unique* in its longevity. To his credit, Clark points out that "though the merchant house cannot be accounted the direct ancestor of the modern company, it has had an influence on the industrial organization of Japan. Perhaps its greatest contribution has been ideological"⁸. It set a pattern of how things should be, at least as system of norms for white collar workers. But it is difficult to convincingly generalize from these embryonic merchant house practices to industrial relations practices in the economy at large.

Overarching Theory

Many scholars have attempted to explain the emergence and persistence of the Japanese employment system under an all-embracing rubric such as "market forces", "culture", or

⁷ Rodney Clark, The Japanese Company (New Haven: Yale University Press, 1979), pp. 14-17.

⁸ Ibid.

"late development". The appeal of such overarching theory lies in the fact that it seems to impose some order on a seemingly idiosyncratic set of historic occurrences. Indeed, without such frameworks, our explanations would collapse to mere history and descriptive statistics. However, it seems that a good deal of the research has been based in or heavily influenced by a particular theoretical lens, often to the exclusion of other perspectives. A thesis of this paper is that all of these must be considered, not just one to the neglect of the others.

Market-based Explanations

This view seems to be based on the assumption--often so firmly entrenched that it is not recognized as such--that all societies can be descriptively and prescriptively characterized by the neoclassical political-economic axioms. Such ahistoric conceptualizations see social outcomes as the product of the atomistic interaction of individuals (or at a higher level, firms) subject to inalienable laws--much like in the physics paradigm atoms and molecules interact under unchanging physical laws. When asked to explain the manifold differences between the employment systems of Japan and America, a neoclassicist would likely explain them as the result of historical instances (e.g. postwar reforms) that changed the "rules of the game." Scholars with institutionalist leanings, such as Galenson, would likely

see these as stable organizational variants, within which people "optimize"⁹. Those of the more orthodox school would likely see such things as vestiges of the past that will eventually give way to properly rational, Western behavior.

Cultural Explanations

The use of "culture" as an explanatory variable in political science and management has a long and rich history. Those who use *cultural* explanations tend to focus on the values, beliefs, and emotional attitudes of a people as the independent, explanatory variable, while those who use *structure* focus on generalizations that "predict behavior from the situation in which actors find themselves, rather than from the values and ideas inside the actors' heads"¹⁰

The Vertical Frame Model. Chie Nakane presents a "vertical frame" model of Japanese culture that has been used to explain enterprise unionism as well as the system of lifetime employment¹¹. This, in various forms, is a very

⁹ Walter Galenson and Konosuke Odaka, "The Japanese Labor Market," in H. Patrick and H. Rosovsky, eds., Asia's New Giant (Washington: Brookings Institution, 1976), pp. 587-671.

¹⁰ Steven Reed, "Structure and Behavior: Extending Duverger's Law to the Japanese Case", British Journal of Political Science, v. 20, June 1982.

¹¹ Chie Nakane, Japanese Society (Berkeley: University of California Press, 1970).

popular framework for understanding Japanese society and political economy; it is a sophisticated articulation of the vague notions that the Japanese are "group oriented", their institutions are "familial", and their decision-making processes "consensual". Nakane is not the first or only scholar to posit this model, but she has probably the most compelling and elegant formulation of it.

Her "template" in its generic form has Japanese society organized around vertical hierarchically ordered institutions--such as schools, companies, or government ministries--rather than horizontal classes. A person does not view oneself first and foremost as, say, an electrical engineer or a "lathe operator III", but rather as a member of the Nissan Corporation. Nakane claims that for this reason, "management vs. labor" cannot become a serious societal problem in Japan--it is considered a "household" problem. A person feels a strong sense of solidarity with his/her organization; it is not a one-way Western loyalty, but rather a two-way structure of interdependence that is reinforced by deep-seated *oyabun-kobun* and *senpai-kohai* relationships. It is important to note that here, "hierarchy" should not be thought of in the pejorative Western sense: to the Japanese, it does not connote authoritarianism or domination. Rather, social structures characterized by equality are highly unstable--hierarchy, with its more determinate, predictable patterns of

authority, is much more stable.

Cultural models such as Nakane's often assume that certain behavior dispositions spontaneously arise from the Japanese psyche; the resultant patterns of behavior are then used as explanatory (independent) variables in social models. Nakane maintains that historic Japanese institutions--namely the *ie* and *mura*--are the source of these tendencies. The problem with her argument, however, is that there is no convincing organic link between the institutions of old and the practices of today. A very telling example is this: In her discussion of the Japanese company she says "The characteristics of Japanese enterprise as a social group are, first, that the group is itself familylike and, second, that it pervades even the private lives of its employees...These characteristics have been encouraged consistently by managers and administrators since the Meiji period."¹² Most scholars and historians of Japanese labor relations (most notably Andrew Gordon) have argued convincingly that this, in fact, was not the case.

The Use of Culture. Often it is assumed that culture does not change over time. Too often the generic explanation of "culture" is used in a monolithic sense, yielding arguments that collapse down to tautological statements of the form "the Japanese behave this way because they are predisposed to behave like this", without

¹² Nakane, *ibid.*

explaining how particular practices came into being. "Culture" is best used not in this undifferentiated sense, but rather to help explain the mechanism through which certain practices and institutions came into being. Roughly speaking, its impact can be felt in three ways¹³: 1. Via practices that have a traceable institutional continuity with pre-modern forms, 2. In newly created institutions that were constructed to conform to cultural predispositions, and 3. In institutions that were borrowed from other countries and/or fields of endeavor and were consistent with Japanese beliefs and values.

Samuels presents another way that "culture" can be used as a theoretical approach. He does not deny culture as an autonomous force, but suggests that it changes, and can--and in many cases, should--be thought of as *transitive* as well as *intransitive*. Barrington Moore states it nicely: "One has to explain why...tradition continue[s]. Human sentiments do not persist simply of their own momentum. They have to be drilled into each generation anew and kept alive through social structures that make them seem more or less sensible and appropriate."¹⁴ I do not propose "culture" in this sense as full-blown model, but rather as a

¹³ Ronald Dore, British Factory-Japanese Factory: The Origins of National Diversity in Industrial Relations (Berkeley: University of California Press, 1973), pp. 375-376.

¹⁴ Barrington Moore, Social Origins of Dictatorships and Democracy (Beacon Press, 1966).

particular take that can inform many approaches to Japanese political-economy. Gluck¹⁵ and Smith¹⁶ both note that "The Japanese... are not particularly unusual in the way they manipulate the record of the past, but...they are unusually adept at it".

History and Patterns of Authority

Marxism. Our previous discussion of the "transitive" use of culture leads us into our discussion of what can be loosely termed "top down" approaches to the Japanese society and polity. If the object of our transitive verb is "the populace" what is the subject? Many argue that it was/is an oligopolistic elite.

This school of thought assumes a cadre of businessmen, politicians, and bureaucrats whose commonality of interests and access to the levers of power allows them to systematically control the citizenry. Such models are reminiscent of Marxist models of the instrumentalist school, in that (in the extreme cases) they view the "state as an executive committee of the ruling class".¹⁷

This approach has been used to understand Japanese

¹⁵ Carol Gluck, "The Idea of Showa," Deadalus, Summer, 1990.

¹⁶ R. J. Smith, Japanese Society: Tradition, Self, and Social Order (Cambridge University Press, 1983).

¹⁷ Robert F. Tucker, The Marx-Engels Reader (New York: W. W. Norton and Co., 1978).

politics in many historical eras. Moore¹⁸ describes how the peasant class was systematically "squeezed" by a ruling modernizing *genro* elite, and was never given any meaningful political power. Labor was similarly exploited. Innumerable observers have attributed Japan's imperialism and ultimate involvement in World War II to a high degree of collusion between government and business elites, such as those of the zaibatsu; this, they maintain, was facilitated by a weak constitution. Indeed, such views held considerable sway in the post-war U.S. State Department and were an important impetus for SCAP's policy of economic decentralization and dismantling of the zaibatsu (more on this later).

In the post-war period, up to the present, Japanese consumers have been cast by some political thinkers as the new Meiji-era peasants: through industrial and trade policy formulated at the top, their standard of living has been held artificially low. Consumers financed business revitalization and allowed Japanese firms to gain global competitiveness, and in many cases dominance. A more detailed and comprehensive treatment of the issue of class in present-day Japan is provided by Robert Steven¹⁹.

Differentiated Elite. A common criticism of this

¹⁸ Moore, Social Origins.

¹⁹ Robert Steven, Classes in Contemporary Japan, (New York: Cambridge University Press, 1983).

approach is that it assumes a high degree of homogeneity of interests among the elements of the ruling elite (as well as a good deal of insight into what they should do to maintain their position). Other approaches--which might be termed "differentiated elite" models--similarly assume a top-down process, but make a greater effort to unbundle the motivations of and interactions between elites. This approach also has been used to explain Japanese politics in several historical periods.

Duus²⁰ maintains--in contrast to the (once-) conventional wisdom--that not only were the interests of big business not always consistent with the increasingly fascist government actors in the pre-World War II period, but that they were able to *resist* government control efforts. Garon²¹ conducts a detailed historical study of the interactions among bureaucrats and politicians vis-a-vis labor, and finds a plethora of motivations--from those with a genuine desire for liberal labor reform to those who, in the interwar period, wished to coopt labor in a fascist mode. A more recent articulation of this view is the notion of Japan, Inc.: just as in a firm, though there may be differences of opinion and agenda, all will work together,

²⁰ Peter Duus, "The Reaction of Japanese Big Business to a State-Controlled Economy in the 1930's", International Review of Economics and Business, Sept. 1984.

²¹ Sheldon Garon, The State and Labor in Modern Japan, (Berkeley: University of California Press, 1987).

more or less, to achieve a common goal.

Late development

A great deal has been written on "late development" and its power in explaining a number of different characteristics of Japanese society. For example, countries that industrialize relatively late have the advantage of observing other more developed countries' industrial practices. They can then adopt (and adapt) those that have proven most effective. Similarly, the late developer is given a menu of production technologies considerably more advanced than the pre-modern ones in then current use. These new organizational and materiel technologies (e.g. factories) offer the possibility of very rapid increases in productivity, but require large amounts of up-front capital and a good deal of training. This often requires substantial government involvement--or at least makes it seem more reasonable and justified.

I will not discuss here the many ways that "late development" has been used to explain the development of the JES, as this has been done elsewhere and the reader is referred to the many excellent pieces of research on it²².

²² See, for example, Dore, British Factory-Japanese Factory, pp. 375-403; Robert Cole, "The Late Developer Hypothesis: An Evaluation of its Relevance for Japanese Employment Patterns," Journal of Japanese Studies 4:2 (Summer 1978); Ronald Dore, "More About Late Development," Journal of Japanese Studies 5:1 (Winter 1979).

Suffice it to say that too often critics of the late-developer hypothesis have misrepresented it as a straightjacket approach to history. Properly understood, it is not a denial of culture or rationality or idiosyncracies of history. Rather, late development models attempt to impose some order on history by emphasizing the fact that the timing of a countries' industrialization effects the opportunities open to it and the imperatives it faces in a systematic way.

The New Institutionalism

What are we to make of these sometimes-conflicting approaches to the study of the JES? The stance to be taken in this paper was inspired by March and Olsen's, "The New Institutionalism"²³. They argue that a good deal of research in political science and other fields has been motivated by and undertaken in one particular theoretical perspective (much as those outlined above). They encourage greater attention to institutional forms, their inertia, and how they evolve. This involves understanding the institution's internal dynamic as well as the influences of its social and economic milieu; to do this, it is often necessary to invoke a number of research paradigms. The key institution for our purposes is the Japanese firm--and it is

²³ James March and Johan Olsen, "The New Institutionalism: Organizational Factors in Political Life," The American Political Science Review, September 1984, pp. 734-749.

to this that we now turn our attention.

CHAPTER 3

AOKI'S MODEL OF THE FIRM AND INDUSTRIAL RELATIONS

A number of recent works have characterized the Japanese firm not as the neoclassical profit-maximizing entity unilaterally controlled by an entrepreneur and based on contractual relationships, but rather a community of several "stakeholders" or an arena in which their diverse interests are brought into equilibrium. While it is certainly true that in Anglo-American companies also several (often conflicting) demands have to be reconciled and brought into equilibrium, much of the recent work suggests that it is true to a much greater extent in the Japanese firm. It is argued that there is *qualitative* difference between the Japanese and the Anglo-American firm.

A review of all of the recent work of this nature would be a prodigious task; this alone could be the topic of a paper (or book). I will instead focus on a conceptualization of the firm that is now particularly popular--that articulated by Masahiko Aoki. What follows is both a summary of his theoretical framework and a "straw man" of sorts: its shortcomings will serve as the bases for a more holistic and--I will argue--accurate model of the firm. This analysis will not only look at how the Japanese

firm is, but--more importantly--how it got to be that way.²⁴

Perhaps Aoki's most significant contribution to the field is his assertion that our notion of what the firm is and what role it plays in the overall economy is grounded in neoclassical economic theory, but that this body of thought lacks a coherent, cogent theory of the firm *per se*. The firm is seen as a technological black box that combines factors of production to produce marketable outputs; it is assumed to be describable merely by a production function. The firm is assumed to be controlled by "the entrepreneur" who assumes risk and is rewarded with the residual profits. Shareholders are seen to be extensions of the entrepreneur. This descriptive model has also been embraced for its supposed prescriptive veracity: to the extent that managers act in the shareholders' interests, and to the extent that labor and capital markets are liquid and unobstructed, the economy will operate efficiently and will grow.

Aoki argues that these notions do not accurately characterize the Japanese firm.²⁵ How, then, does he

²⁴ Aoki's theoretical framework is outlined in Masahiko Aoki, "The Japanese Firm in Transition," in Kozo Yamamura and Yasukicki Yasuba, eds., The Political Economy of Japan: Volume One, The Domestic Transformation (Stanford: Stanford University Press, 1987); and Aoki, "Aspects of the Japanese Firm," in M. Aoki, ed., The Economic Analysis of the Japanese Firm (Amsterdam: Elsevier Science Publishers B.V./North-Holland, 1984), pp. 3-43.

²⁵ Perhaps more importantly, the gulf between theory and practice has only recently been appreciated. As recently as 1977, the Japanese Economic Planning Agency utilized a predictive

characterize it? He says that "the body of employees is, together with the body of shareholders, explicitly or implicitly recognized as a constituent of the firm, and its interest are considered in the formulation of managerial policy."²⁶ But how is the Japanese firm different from the Anglo-American firm or, for that matter, the European one? In these countries also, employees are "constituents" of the firm in some sense also. It is the mechanism by which their interests are expressed and taken into account that differentiates these so-called national models from one another. In unionized Anglo-American firms, the managers represent the interests of the shareholders and bargain with union leaders, the representatives of workers; this is often referred to as the "collective bargaining" model. In West German companies, directors elected by the employees work with directors elected by the shareholders to set managerial policy (the "participatory management" model). In other cases employees own stock in the company, and express their interests via shareholders' meetings (the "employee part-ownership" model).

For the Japanese firm, Aoki posits the "corporative managerial model". Management, he claims, is not merely a

model based on the aforementioned neoclassical assumptions, and it performed very poorly. Masahiko Aoki, "Japanese Firm," pp. 263-264.

²⁶ Aoki, "Japanese Firm," p. 266.

reification of the shareholders' interests, but acts as a mediator between the wishes of the shareholders and the interests of the employees. Shareholders make their interests known via the stock market, shareholders' meetings, and informal personal contacts (in the case of large shareholders of the company's stock). Employees articulate their interests via the company's enterprise union and through informal pressures on supervisors. In Aoki's words, "management is a 'mediator' that weighs and equilibrates both the implicit and explicit bargaining powers of the firm's constituents."²⁷

In the Japanese firm, the technology employed is such that employees' skills are formed and transmitted on the job and in a team context. In order for management to retain employees, and thus recoup its large sunk training costs, they have instituted policies that reward seniority (e.g. promotion escalators, seniority related salary, retirement compensation). For their part, employees have essentially accepted job security and better prospects for intra-firm advancement in exchange for lower levels of current wages. In this context, it is not appropriate to think of managers unilaterally maximizing share price via employment and other managerial decisions posterior to wage negotiation but rather as an ongoing process of informal negotiation. In short, Aoki views the Japanese company as a two-person

²⁷ Ibid., p. 266.

repeated prisoners' dilemma game in which institutional structure has allowed a "cooperate-cooperate" equilibrium (yielding higher payoffs for both parties), rather than a "fight-fight" equilibrium (as has been seen in the US)²⁸.

Aoki's model gives us great deal of insight into the workings of the Japanese firm. However, he has for all intents and purposes stayed within the neoclassical economic paradigm and seems to assume the Japanese to be individualistic utility-maximizers, in the great Western tradition. The questions that he does not entirely address are these: How did the firm get to be the way it is, and why is it so dissimilar from the Western firm? And why have these practices continued as long as they have?

²⁸ Harvey Leibenstein, "The Japanese Management System: An X-Efficiency-Game Theory Analysis," in Masahiko Aoki, ed., The Economic Analysis of the Japanese Firm (Amsterdam: Elsevier Science Publishers B.V./North-Holland, 1984), pp. 331-351.

CHAPTER 4

FIRST CRITIQUE: HISTORY

Aoki argues that the answers to the above questions are almost entirely historical--namely, three dramatic changes that took place in Japan's political-economic environment in the immediate wake of World War II. I will present a history of the Japanese firm by presenting and critiquing these arguments. I will dispute him on his claim that they are sufficient conditions for the development of the Japanese employment system, arguing instead that they are perhaps among many necessary conditions.

Aoki argues that the Japanese employment system as we know it emerged as a result of three historic changes in the nature of the firm: ¹ the removal of "classical capitalist control", ² the formation of enterprise unions, and ³ the emergence of a pattern of corporate shareholdings that insulated companies from takeover.

Decline of Classical Capitalist Control

By "removal of classical capitalist control" Aoki is referring to both the wholesale purging of managers of zaibatsu as well as a purported revision in business ideology. Zaibatsu were broken up into their constituent companies, holding companies were dissolved, and SCAP's

Security Liquidation Coordination Council sold off their shares under rules designed to spread this wealth. It apparently was successful: at the end of fiscal year 1949, individuals held almost 70% of this stock. Also at this time, Occupation General Headquarters removed the officers of 200 important companies, the leaders of the zaibatsu families, and the executives of 240 zaibatsu-related companies. In all, more than 3600 wartime business leaders were purged.

Aoki maintains that the void was filled by lower-level managers from these firms (who were not necessarily loyal to the zaibatsu families) and entrepreneurial owner-managers, like Honda's Soichiro Honda and Sony's Tsuneo Morita. These new managers "showed more overt pride in being public minded, albeit socially influential, managers of ever-growing organizations than in being men of great wealth"²⁹. Thus they did not simply single-mindedly attempt to maximize profits, but took into account the interests of workers, and actively coordinated managerial decisions considering both labor and stockholders.

While it is undeniable that the events outlined by Aoki actually occurred, and there was definitely a change in the business environment, I will argue that this aspect of Aoki's argument is flawed in two ways: ¹There was not an appreciable change in *ideology* at that time, and ²in terms

²⁹ Aoki, "Japanese Firm", p. 269.

of patterns of shareholding, there has effectively been a drift back to "capitalist control", thus the power of this explanation is diminished for purposes of explaining the present-day institution.

Business ideology. Aoki is correct in pointing out the public spiritedness and selflessness of the Japanese manager as a reason for some of the unique characteristics of the Japanese firm. But attributing this solely to the occupation reforms casts it as an historical accident and de-emphasizes its cultural aspects. In fact, starting at the Meiji restoration in 1868, managers have seen the firm as an important social institution, not simply a legal fiction whose birth was the result of the release of unfettered market forces. I argue that this was so because of a Confucian ideological heritage of public service intermixed with patriotic sentiments.

The four-tiered class system that organized society in Tokugawa Japan was based on Confucian belief. The highest position was held by the samurai, followed by the peasants, followed by the artisans, followed by the merchants. The merchants occupied the lowest social strata because it was felt that unlike the peasant or artisan, merchants did not produce anything--they merely sold the output of others for personal gain. Throughout the peaceful and stable Tokugawa era the importance of the samurai warriors decreased, as did their standard of living, and the wealth

of the merchants grew--in some cases to the point that samurai were financially dependent on merchants. Still, the four-tiered class system persisted, and the merchants held an inferior position that was codified in law.³⁰

In 1853 Admiral Perry's "black ships" arrived in Japan demanding an end to its isolation. It became clear that Japan had to acquire advanced Western technology and build a solid industrial base. Initially the Meiji government attempted to do this via direct government ownership of industrial enterprises. When high bankruptcy rates made it clear that this approach was not effective, these businesses were sold at fire-sale prices to private investors (who frequently had government connections). Thus the keys to the survival of the Japanese state came to be held by private, previously ignoble businessmen. As a consequence, Tokugawa/Confucian ideology was not rejected, but altered.

"Changes did occur, and remarkable quickly. The ideology of industry and commerce was altered in three ways [:]by new ideas from the West, by the exhortations of the government and evangelical ex-government entrepreneurs like Shibusawa, and by the example of the businessmen who did achieve fame and who, whatever their real motives for enterprise, managed to represent their activities as morally and politically enlightened... Under these influences,

³⁰ Ruth Benedict, The Chrysanthemum and the Sword (Rutland, VT: Charles E. Tuttle Company, 1946), pp. 43-75.

public attitudes to commerce and its practitioners altered rapidly during the Meiji era. Businessmen were compared with samurai in the newly established business journals."³¹

It was this era, then, not in the immediate post-war period--that witnessed the emergence of the norm that the business leader should not strictly be a profit-maximizing, self-serving "economic man", but that he should serve the interests of the larger community, and that, at some level, he was a servant of the state and the broader national interest. What appears to be an historical event (the removal from power of "established money" and their replacement with a "new breed") is perhaps more appropriately thought of as a cultural trait, having its roots in the Japanese Confucian tradition and modified by the forces of industrialization and patriotism in a "late development" scenario.

Patterns of stock ownership. Another reason it is difficult to take seriously "the removal of classical capitalist control" as a significant prerequisite of the Japanese employment system is that the Occupation-reformed patterns of business ownership and control have largely disappeared (and did so some time ago). While it is clear that the extent of family control of zaibatsu firms and the concentration of financial power was greater in the pre-war era than it is now, and it is certainly true that the

³¹ Clark, Japanese Company, pp. 26-28.

distribution of wealth in Japan is much more equitable than in almost any Western democracy³², there remains a concentration of power in the form of stock ownership in the hands of lead banks, insurance companies, and ex-zaibatsu firms. This will be discussed at length in a later section.

The Emergence of Enterprise Unions

Aoki says that "because of the vacuum created by the war, there was no institutional inertia to hamper the formation of enterprise-based unions congruent to firm-specific employment structures"³³. He claims Japan's unique pattern of enterprise unionism is attributable to two historic events. First, in 1959 there was a three-month steel industry strike lead by leftist leaders. The strike proved unsuccessful, and afterwards a more moderate faction was elected that advocated bargaining on a more moderate, enterprise-by-enterprise basis, which served as a model for other firms. Second, in 1960, there was a violent strike at the Mitsui Mining Company's Miike Mine. This was significant in that it represented the culmination of a series of labor conflicts in which management attempted to

³² This is evidenced in many ways. For example, in 1927, the ratio of after-tax compensation of company presidents to entry level employees was 100.6. It had shrunk to 11.9 in 1963, and 7.5 in 1980--see J.C. Abegglen and G. Stalk, Kaisha: The Japanese Corporation (New York: Basic Books, Inc., 1985), p. 192. Gini coefficients tell a similar story--see A.B. Atkinson, The Economics of Inequality (Oxford: Clarendon Press, 1983).

³³ Aoki, "Japanese Firm," p. 270.

cut the labor work force by layoffs. Also, the Ikeda cabinet intervened to bring about conciliatory settlement. This incident is taken by many to be a central event--if not the pivotal incident--in the establishment of the Japanese employment system.

Clearly Japan did not have the tradition of industrial or craft unions and the baggage of labor-management conflict that England or America had. Similarly, the post-war reconstruction was an event that would allow for the emergence of "unique" patterns of industrial relations. But the workplace confrontations cited--in the steel industry and at Miike--do not provide an explanation of why enterprise unions came into being--as opposed to, say, corporatist systems like those of Western Europe. I will attempt to go beyond these "enabling prerequisites" and discuss how and why enterprise unions were formed. One of the most cogent explanations of the genesis and persistence of enterprise unions in Japan is offered by Shirai³⁴; I will follow the format of his arguments here, offering my own modifications.

Characteristics of labor markets. It is argued that vertical, rather than horizontal labor unions came into being and exist today in Japan because by and large there were and are firm-specific *internal* labor markets, rather

³⁴ Taishiro Shirai, "A Theory of Enterprise Unionism," in T. Shirai, ed., Contemporary Industrial Relations in Japan (Madison: University of Wisconsin Press, 1983), pp. 117-143.

than the Anglo-American style external market-based labor market. Workers who expect to be at one firm for their entire lives did not have a great deal of use in uniting with their brethren in other companies. Indeed, several scholars are now studying various aspects of Japan's internal labor market system--such as lifetime employment, in-house on the job training, *nenko* salary/promotion, and company welfare programs--as promoters of enterprise unions.

It is certainly true that all of the above practices are consistent with enterprise unionism. Indeed, one of the tenets of this essay is that the myriad aspects of the Japanese employment system--in particular, the "three pillars"--form a self-supporting system, and to determine which are causes or effects of others is a very sticky chicken-and-egg problem. In particular, Shirai's argument could be questioned on two grounds: ¹ Other countries have internal labor markets to varying degrees, but none has Japanese-style enterprise unions; and the degree of "enterprise-ness" of union does not seem to be proportional to the degree of "internalness" of the labor market. ² It is well known that among small and medium-sized firms in Japan there is a greater degree of labor mobility than there is among large, established "typical" Japanese firms. Yet even among these smaller firms, enterprise unionism is the norm. How are we to explain these things?

To get at this question, let's examine some things that

have been posited as causes of enterprise unionism: artisan guild structures and postwar Communist influence. Again, I will argue that it is inappropriate to take WWII as a discontinuity--it is instead necessary to look deeper into Japan's history and culture.

Artisan guild structures. Many of the workers in the late 1800's factories in the heavy industry sector were artisans who had been trained in indigenous crafts, and were retrained upon entering into employment. This is a very important consideration, because many of the social relations of the preindustrial era were in large part maintained in the factory environment. In Japan, the artisan tradition stipulated that one would work for a number of years as an apprentice under an established master. When one had reached a prescribed level of proficiency and was licensed by his city's guild, he would become a journeyman. As such, he would typically travel from master to master and eventually inherit the business of one of them, and establish his own shop.

A significant difference between the artisan societies of Japan and Europe was that Japanese craft guilds were generally confined to a particular urban area. The extensive horizontal regional and national guild networks that had been established in Europe, and served to control entry into the trade and establish standards for employment, were not present. Thus there was no tradition of horizontal

labor organizations, as there was in the West. The enterprise-specific union was thus a modern articulation of a pre-modern practice. Gordon puts a good deal of stock in this explanation: "The Japanese tendency to organize by factory or workshop and not craft must be linked to the nature of Tokugawa artisan society before it is viewed as a reflection of a unique vertical social structure, a manifestation of a group oriented value system, or the result of managerial manipulation of passive workers."³⁵

Communism. Another explanation offered for the emergence of enterprise unions is that the Communists played a leading role in the immediate post-war reconstruction of the labor organization, and they favored enterprise unionism.³⁶ This was because: ¹It was felt that workers would have greater control over the actual production process and the management of that process if unions were organized on a plant-specific basis. ²It was the only form of union organization that was consistent with the "one single union in one plant" stance taken by the World Federation of Trade Unions. ³The Communists wished to oppose the power of the right wing labor leaders, whose

³⁵ Gordon, Evolution, p. 302.

³⁶ H. Wawada, "Workers and Their Organizations," in K. Okochi, B. Karsh, and S.B. Levine, eds., Employers in Japan: The Japanese Employment Relations System (Tokyo: Tokyo University Press and Princeton: Princeton University Press, 1973).

basis of power lay in large extra-firm industrial unions.³⁷ This all may have had an impact on the *genesis* of the Japanese enterprise union, but it is difficult to believe this as a reason for the perpetuation or current form of Japanese unions, as the Communists in Japanese labor quickly diminished in power and popularity.

What are we to make of all of these not-entirely-consistent explanations for the emergence of enterprise unions? Perhaps the bland conclusion that "all had an impact". It is worth noting that there is an academic argument on this point: some maintain that the essential characteristics of the JES including enterprise unionism came into being (albeit in embryonic form) in the interwar period. This occurred, it is argued, due to the growing economic power of the workers and their demands for greater job security, regular pay increases, and greater "membership" in the enterprise, as well as legislation promoted by bureaucrats who were socially enlightened and/or who felt labor reform was in the national interest³⁸. Others, such as Taira, argue that lifetime employment, in its present form, was not established until after WWII; the prewar events outlined above simply set the stage for its

³⁷ Shirai, "Enterprise Unionism," pp. 121-124.

³⁸ Garon, State and Labor, passim.

future development³⁹.

Patterns of Shareholding

Aoki's third explanation for the emergence of the Japanese employment system is that a characteristic pattern of shareholding developed after WWII in which there was a high degree of mutual shareholding between firms and financial institutions such as city banks. This is perhaps Aoki's most convincing argument, and is one that has been underappreciated in the literature on the development of the Japanese employment system. It gets to the heart of the differences between the institution of the Japanese firm and that of the American firm. It is meant to explain how differences in who ultimately owns the firm, and whose interests are most at stake, affected the development of the Japanese employment system.

The Antimonopoly law of 1947¹ stipulated that city banks could hold no more than 5% of the shares of any single firm, and,² for all intents and purposes outlawed intercorporate shareholdings. However, in 1949 this second term of the Antimonopoly Law was repealed, and the 5% ceiling of the first proviso was raised to 10%. In 1956 bank holdings in listed companies stood at 20%+, and

³⁹ Koji Taira, Economic Development and the Labor Market in Japan (Columbia University Press, 1990), p. 156.

intercorporate shareholdings stood at 15.7%⁴⁰.

In the 60's Japan liberalized its foreign investment policies, and Japanese managers feared hostile takeovers from American and other foreign concerns. This further accelerated the practice of intercorporate shareholding, particularly among member firms of the ex-zaibatsu. By 1968, financial institution shareholding had reached 30.3%, and intercorporate shareholding stood at 21.4%⁴¹. This is a significant point, because more than half--a controlling portion--of all shares were in bank or corporate hands (which were thought to be "friendly" hands). This trend continued, though at a decreased rate, through the seventies. This pattern of shareholding has effectively insulated Japanese companies from takeover. The upshot of all of the above is that managers are freed for short-term share price maximization pressure, and can instead focus on the long-term profitability of the company. They do not have to lay off employees to maximize near-term profits. It is ironic that neoclassical economists would refer to this as a "market imperfection" or rigidity that would decrease efficiency. In fact they can serve to enhance long-term optimizing behavior⁴². This will be discussed in

⁴⁰ Aoki, "Japanese Firm," pp. 272-282.

⁴¹ Ibid.

⁴² Ronald Dore, Flexible Rigidities: Industrial Policy and Structural Adjustment in the Japanese Economy 1970-1980 (Stanford: Stanford University Press, 1986).

the following chapters.

CHAPTER 5

SECOND CRITIQUE: THE POLITICAL CONTEXT AND INDUSTRIAL POLICY

Aoki and some researchers of industrial relations have tended to ignore the political context of the firm. Probably this is due in part to the fact that in the US and Britain, it was historically not terribly important, and thus was not incorporated into theory. However, in present-day Japan, and in its entire postwar history, the government has played a central and integral role.

This chapter examines the political context, focusing on the industrial policy making process in Japan. It is in a sense a continuation of Chapter 4, as most of the events and practices described pertain to the period following the postwar reforms and continue to the present. I will first examine what has come to be known as "the Japanese industrial policy debate", which centers on disagreement over the role of industrial policy in the Japanese political economy and the extent to which it was responsible for creating the vaunted "economic miracle." I then will turn to an examination of the institutions of the Japanese government, the way they interact with one another, with industry, and with societal interest groups to formulate and implement industrial policy.

The Debate

The definition of industrial policy accepted here is as follows: "government [procedures] designed to affect the efficiency and organization of particular firms and industries, as opposed to fiscal, monetary, and other macroeconomic policies, or "horizontal" policies designed to affect the supply or quality of whole factors of production, such as labor or basic research"⁴³. I use the term *procedures* to connote interaction and interdependence between business and government and to de-emphasize the "top down-ness" of government decisions.

What, in a generic, macro sense, are the models used to understand and explain Japanese industrial policy which underlie our models of the policy making process? While there are of course a wide range of views on this subject, for the purposes of this chapter, I divided them into three approaches: the free market model, the "plan rational" model approach, and the "new Japan Inc." model. These will be discussed in turn.

Neoclassical. Analysts of the neoclassical free market school believe that industrial policy had a neutral or even negative impact on economic growth. They view the Japanese political economy as essentially competitive and pluralistic. Adherents of this view question the ability of

⁴³ G. Noble, "The Japanese Industrial Policy Debate," in S. Haggard and C. Moon, eds., Pacific Dynamics: The International Politics of Industrial Change, (Boulder: Westview Press, 1989).

bureaucrats to have greater insight than the market in picking winning industries⁴⁴. They cite MITI's many failures, such as their reluctance to allow Sony to license the transistor⁴⁵ and their attempts to dissuade Honda from entering what turned out to be exceedingly successful businesses as examples⁴⁶. Furthermore, they maintain that some of Japan's most successful export industries--cameras, watches, consumer electronics--received little help from industrial policy⁴⁷.

These liberals see policy as the outcome of a basically pluralistic political system. They doubt that firms would obey extra-legal "administrative guidance." These scholars often invert the oft-heard argument and claim that MITI had to revert to administrative guidance in the absence of stronger (e.g. legal) policy tools⁴⁸. The bureaucracy's powers, they maintain, were held in check by

⁴⁴ G. Saxonhouse, "Why Japan is Winning," Issues in Science and Technology, (Spring 1986).

⁴⁵ E. Lincoln, Japan's Industrial Policies (Washington, DC: Japan Economic Institute of America, 1984).

⁴⁶ H. Nakamura "Japan Incorporated and Postwar Economic Growth," in Japanese Economic Studies, 10:3 (Spring, 1982).

⁴⁷ H. Patrick and H. Rosovsky, eds., Asia's New Giant: How the Japanese Economy Works, Washington, DC: Brookings, 1976; J. Abbeglen and D. Stalk, Kaisha: The Japanese Corporation, (New York: Basic Books, Inc., 1985).

⁴⁸ J. Haley, "Administrative Guidance versus Formal Regulation: Resolving the Paradox of Industrial Policy," in G. Saxonhouse and L. Yamamura, eds., Law and Trade Issues of the Japanese Economy (Seattle: University of Washington Press, 1968).

industry and their supporters in the LDP⁴⁹. This is the "no miracle occurred" school of thought--any country with Japan's endowments (good education, stable macro policies, etc.) would have done it.

It is difficult to believe the free market conception of industrial policy in its pure form. It seems to be contravened--both in a descriptive and a prescriptive sense--by some pieces of historical data. For example, from a neoclassical perspective, immediately after World War II Japan should have entered light industry and other labor-intensive sectors. But instead, we saw the development of the steel, chemical, and automobile industries, and few would maintain that this was a mistake. How is this to be explained?

The Developmental State. This brings us to our second view of Japanese industrial policy: the "developmental state" approach. Japan, these analysts say, is not "market rational", as the free marketeers say, but "plan rational"⁵⁰. In such states, emphasis is placed on the achievement of economic goals and hence strategies for achieving the desired outcomes. Market rational states, in contrast, place emphasis on the "rules of the game"; such states are more likely to effect change through the

⁴⁹ G. Noble, "The Japanese Industrial Policy Debate".

⁵⁰ C. Johnson, MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975 (Stanford: Stanford University Press, 1982).

promulgation of non-particularistic laws rather than what is derogatorily referred to in the U.S. as "micro-management". Consequently, the most important criterion for evaluating policy in a plan-rational state is effectiveness, or outcomes, whereas in market rational states, it is efficiency (or "economic justice").

Part and parcel of a plan rational state is a pro-active industrial policy, and a high level of public acceptance of it. Indeed, in Japan, officials of the economic ministries--the Ministry of Finance, MITI, the Ministry of Agriculture, Forestry and Fisheries, and the Economic Planning Association have some of the most prestigious jobs in Japan. It is claimed that this, and the interrelated facts that the bureaucracy was politically isolated and that there was a broad based consensus in society on the need to "catch up with the West", allowed MITI to implement a highly pro-active--and effective-- industrial policy through extra-legal administrative guidance, subsidies, and trade restrictions.

Plan-rationalism is said to be caused in large part by late-development, which brings feelings that one should catch up with the industrialized world. Another reason for plan-rationality is that the Japanese never had the same level of ideological commitment to neoclassical political theory as the Americans or British. Indeed, many--if not all--of the bureaucrats who presided over Japan's rapid

postwar growth were schooled by Marxist economics professors⁵¹. Thus we do not see the "religion of antitrust" that is the norm in America and enshrined in such laws as the Glass-Steagle Act⁵². This acted at the public acceptance level also--indeed, traditional Confucianism viewed those involved in speculation and trade (noble pursuits for the liberal) with distaste⁵³.

The Network State. A third conceptualization of the industrial policy-making process is informed by approaches known variously as the "new Japan Inc." model⁵⁴, the "network state"⁵⁵ model, and "patterned pluralism". Here, industrial policy is not the outcome of an unfettered political interest marketplace, nor is it due to the actions of an omniscient and omnipotent economic bureaucracy acting on a basically quiescent business community. Instead, in this understanding of the industrial policy making process, what we must understand and examine are the intense and oftentimes informal ties between business and the economic

⁵¹ R. Samuels, 17.540 lecture, 4 March 1991.

⁵² L. Thurrow, "Producer Economics", IRRA 41st Annual Proceedings, 1989.

⁵³ R. Clark, The Japanese Company, (New Haven: Yale University Press, 1979).

⁵⁴ R. Samuels, The Business of the Japanese State: Energy Markets in Comparative and Historical Perspective, (Ithaca: Cornell University Press, 1987).

⁵⁵ D. Okimoto, Between MITI and the Market: Japanese Industrial Policy for High Technology, (Stanford, CA: Stanford University Press, 1990).

bureaucracies. The unit of analysis is not particular policies or policy tools, but the nexus of lines of communication, influence, and negotiation. Underlying this is the stability of the ruling LDP and their generally pro-growth policies, and the fact that there are no credible political threats to their dominance.

An important way that this differs from the "developmental state" view is that it posits a greater capacity on the part of business to influence the formation of industrial policy. They cite as an example the case of Japanese consumer electronics producers selling televisions below cost as exports, and subsidizing this with high prices at home. The impetus behind government policy that allowed for this, they argue, came not from MITI bureaucrats, but rather organizations of producers⁵⁶.

Before moving on I should note that I have overdrawn the differences and apparent irreconcilabilities for analytical purposes. Indeed, many reconcile them to some extent by saying while the immediate postwar era as one of state-lead, plan-rational capitalism, the sixties and seventies were a period that saw a decrease in the power of the economic bureaucracies and growing influence of a very vital business sector and the LDP. And all periods saw intense within-Japan firm level competition in the liberal vein.

⁵⁶ J. Haley, "Administrative Guidance..."

The Government Institutions

Having laid a theoretical foundation, I would now like to examine concretely the institutions, linkages, and processes of industrial policy making in Japan. I will pay particular attention to how each of the above frameworks informs (or distorts) our understanding of how policy is made, and to what extent these views are reconcilable.

MITI and *Shingikai*. The ministry that at the core of the industrial policy making process in Japan is the Ministry of International Trade and Industry. While some of MITI's bureaus are function-centered, many are based on broad categories of industries (e.g. the Basic Industries Bureau, the Machinery and Information Services Bureau, and the Consumer Goods Industries Bureau). Each bureau is subdivided into sections based on a finer subset of products, over which the officials of each section have "jurisdiction". The number and rank of officials involved in industrial policy discussions vary from case to case--important, broad-based issues will involve chiefs of the relevant bureaus and perhaps the vice minister. Less important problems will involve proportionately lower level officials (e.g. section chiefs).

An important organ for information gathering, interest representation (and perhaps interest modification) in the Japanese bureaucracy is the deliberation council, or *shingikai*. MITI makes extensive use of these councils--as

of the mid-seventies, there were 246 shingikai, 36 of which were attached to MITI; this was second only to the Prime Minister's office (which had 51)⁵⁷. Shingikai are composed of representatives from macro-level business organizations such as the *keidanren*, representatives from industry level and trade organizations, academics, journalists, and occasionally representatives of consumer groups and labor. Some are standing, and some are formed on an *ad hoc* basis.

Ministry of Finance. Another ministry that must be considered in the industrial policy making process is the Ministry of Finance. They have an interest because the overall health of the economy will effect tax revenues, and in their "guardian role" they must keenly watch these matters. They can attempt to affect policy via informal networks and inter-ministerial pressure (that have been well documented in the literature⁵⁸). MOF can also exert influence via MITI's budget.

The Diet. While some liberals would like to believe that "the diet is at the center of the policy making process in Japan"⁵⁹, this does not seem to be the case in the

⁵⁷ C. Johnson, MITI and the Japanese Miracle.

⁵⁸ See, for example, J. Campbell, "Policy Conflict and Its Resolution in the Governmental System", in S. Krauss, T. Rohlen, and P. Steinhoff, eds., Conflict in Japan, (Honolulu: University of Hawaii Press, 1984).

⁵⁹ E. Reischauer, The Japanese Today: Change and Continuity, (Cambridge, MA: the Belknap Press of Harvard University Press, 1988).

formation of industrial policy in Japan. In comparison to, say, regulatory policy in the US, industrial policy in Japan does not rely heavily on the use of formal law. Agendas seem to be set mainly by an elite ruling bureaucracy-big business (plus a complaisant LDP) triumvirate.

There have been some cases of politicians, via legislation, carrying out some kind of desired economic intervention. An example of this is the Law Concerning Adjustment of Large Enterprises' Business to Retain the Business Opportunity of Small/Medium Scale Enterprises, which in large part grew out of politicians' awareness of the discontent and electoral power of medium and small business owners⁶⁰. Such cases, however, are rare, and usually result in the granting of a broad mandate to MITI, rather than the promulgation of a well defined set of laws. Many analysts have commented on MITI's relatively weak legal power base.

Generally and historically speaking, the Diet serves as a kind of escape valve that indicates when the public at large is dissatisfied with the affects of industrial policy. The case of rapid, environmentally unsound industrialization followed by public outcry in the face of apparent ruling elite passivity, and the resultant policy shift exemplifies

⁶⁰ T. Wakiyama, "The Implementation and Effectiveness..."

this well⁶¹. This state of affairs is particularly troubling, given consumer and labor groups' limited access to other means of representation, such as *shingikai* and the informal *zoku*.

Policy Implementation

I have discussed a number of linkages within the government and lines of influence between government and industry. The following discussion of policy implementation will further exhibit how the above institutions interact, and, perhaps more importantly, will show how industrial policy formulation and implementation are subtly intertwined.

Business-Government Dialogue. Because an estimated 80 percent of bureaucratic activity is carried out through administrative guidance⁶², and because it arguably lies at the core of the Japanese industrial policy process, it will be discussed at length here. I will address the following questions: What is administrative guidance? At what level is it enacted, and the necessary corollary, Whose input is sought?

Administrative guidance is "advice" (which can vary in imperiousness) issued to the private sector in written or

⁶¹ F. Upham, Law and Social Change in Postwar Japan.

⁶² Narita, Gyosei Shido no Kino to Kozai (The Merits and Demerits of Administrative Guidance), 741 *Jurisuto* 36, p.39-40 (1981).

spoken form, the content of which is informed in large part by the intra-MITI, inter-ministerial discussion outlined above. It does not have a legally binding effect, and as such, it is "voluntary". Perhaps most importantly, MITI actively elicits the views of those who will be affected by the guidance in question and often leaves the specific formulation and implementation to the discretion of those being regulated. This generally makes for a higher level of acceptance of the guidance and a greater likelihood that it will actually be implemented. (In some cases, industry actually welcomes MITI's soft intervention.) This guidance is rarely a one-shot act, but instead usually involves a continuing process of information flow, persuasion, and negotiation.

Administrative guidance is most frequently enacted at the firm or trade organization level, but is also carried out vis-a-vis non-profit organizations concerned with industry activities and local governments. An example of firm-level guidance is MITI's (largely unsuccessful) attempt to set standards for video equipment beginning in the mid seventies⁶³. Here, they worked directly with Sony, Matsushita, Sanyo, and Toshiba (and, to a lesser extent, the Electronics Industry Association of Japan), attempting to get them to converge on a common video cassette format⁶⁴.

⁶³ G. Noble, "The Japanese Industrial Policy Debate".

⁶⁴ Ibid.

An example of industry association-level guidance are the well known oil cartel cases. Here MITI and industry officials agreed on the need for production limitations and price "stabilization", and MITI in fact gave the Petroleum Federation (a major industry trade association) the task of allocating production shares.

One problem with giving guidance to, and receiving input from, industry organizations is that those firms that are in the industry but not in the trade association are often excluded from the policy making dialogue. In a broader societal sense this process breakdown is also seen: consumer and labor organizations are frequently excluded due to MITI's heavy reliance on administrative guidance. Indeed, to observers accustomed to systems that have essentially pluralistic legislative processes and that regulate through law, this seems to create a potentially serious accountability problem.

Big Picture Implications

We now are in a position to again ask the question How can we best understand the postwar industrial policy making process, and business-government relations in general, in Japan? I will argue here that past attempts to understand it have been hampered by researchers' constraining their thought and inquiry to terms and ideas created for a different (generally Anglo-American) system and era.

First our attempts to separate the notion of "interests" from the process of the formation of industrial policy, in the neoclassical tradition, seems to be inappropriate in the case of Japan. Firstly, in the case of businesses, interests are taken into account through representation on *shingikai* committees, as well as membership in *zoku*--this is significant, because it allows for the moderation and alteration of interests on the part of both business and the bureaucracy. Interests are also promoted in what may be termed a "negative" way by large scale funding of LDP politicians, who assume a non-interventionist policy stance. Consumers, on the other hand first, have limited access to *shingikai* and *zoku*, and second, cannot seem to effect policy change through the Diet, since MITI, as we have seen, seems to have high degree of autonomy from the Diet.

The policy formation-implementation process shows a similar dialectic. In Japan, is perhaps more accurate to think of this as one process (called "administrative guidance") rather than two. We do not see industrial policy implemented in the form of law, which business can alter through legislative action. We have seen instead the degree to which firms and industry organizations can effectively alter industrial policy via the way they choose to implement it and by bargaining (in the present or in the future of the "repeated game" relationship).

In sum, we must consider what would be thought of as the interest representation process and the policy implementation process integral parts of the industrial policy formation process in Japan. The fact that these occur in overlapping organizational venues (*shingikai*, *zoku*, elite old boy networks), and the apparent imperviousness of these processes to outside forces--gives us reason to take models of the new "Japan, Inc." model seriously.

CHAPTER 6

THE JAPANESE EMPLOYMENT SYSTEM TODAY

If the previous chapters sought to explain how the JES came into being, this one seeks to explain the outcome of that process, and more importantly, how and why these practices of the JES are maintained. I will argue that the firm is not simply a legal fiction, an Aokian "arena" within which the "players" optimize, but rather a community, and one in which there is a considerable commonality of interest.

My primary objective is not to give a detailed description of current JES practices (which has been done elsewhere), but to explain the "whys" of its evolution. An attempt is made to tie together the analytical threads of the previous two chapters. That is, I will briefly summarize the way that the events described in Chapter 4 created a business culture and financial structure that helped to create, and serves to support, the JES. Also, I will outline the manner in which the Japanese government--largely via industrial policy--acts to facilitate practices of the JES.

The Firm as Community

The developments outlined in the previous sections have

led to a situation in which, in Robert Cole's words, "the specific institutional arrangements and historical configuration of events have led to the strong need to find fulfillment at work and the high level of identification with company goals⁶⁵." This should be contrasted with the situation in many U.S. firms, in which "the ideal of communal effort in which a group of individuals are united by common beliefs to achieve a common aim is foreign to large corporate enterprises...The firm's employees, especially the production workers, are concerned with improving their lives, a goal only incidentally connected with the corporation's success and in part opposed to it...By its nature, the corporation is not primarily concerned with worker's lives."⁶⁶

While reams have been written on separation of ownership and control in capitalist economies⁶⁷, for our purposes--i.e. to understand the most important differences between the American and Japanese firm--we can say that in America managers control the firm and run it with the interests of the shareholders firmly at heart. While

⁶⁵ Robert Cole, Work, Mobility, and Participation (Berkeley: University of California Press, 1979).

⁶⁶ Ibid.

⁶⁷ See, for example, Tandonori Nishiyama, "The Structure of Managerial Control: Who Owns and Controls Japanese Businesses?," in Kazuo Sato and Yasuo Hoshino, eds., The Anatomy of Japanese Business (Armonk, NY: M.E. Sharpe, Inc., 1982).

legally there is a contractual relationship between the stockholders and the managers, this relationship can be essentially characterized as one of trust: upper echelon managers are more or less given discretion to run the firm as they see fit, and are rarely dismissed, except in cases of gross negligence (or a hostile takeover). Managers hire workers on a contractual basis; they are bought and sold much like any other factor of production, such as electricity, fuel, and raw materials.

In Japan, as in America, holders of stock are one of the external groups that have a stake in the well-being of the firm and that must be kept happy. Other stakeholders include banks, distributors, and suppliers; often these stakeholders become so intimately involved with--or dependent on--the company that they become members of the "extended community". Examples of this are parts suppliers in, say, the automobile industry or the major creditor banks of a financially troubled firm.

However, in Japan the firm is a community in that the employees--rather than the shareholders--are the central stakeholder in the firm. The laborers and managers, who feel the kind of solidarity that members of the same community feel, are held together less by formal contract, and more by a sense of trust and shared destiny. The company is seen as an entity in and of itself which persists over time and to which its members feel loyal. The

historical incidents that best epitomize the feeling I am trying to convey are the accounts given by Tom Smith of the worker grievances of the late 1800's⁶⁸. First and foremost in laborers' minds were status distinctions between white and blue collar workers. Workers wanted membership in the firm on an equal footing, a sense and acceptance of their belonging to the enterprise community. Grievances did not take the form of appeals for workers' "rights," but rather a request for more respect.

It is in this context that the oft-quoted characterization "The three pillars of the Japanese employment system are lifetime employment, a seniority system, and enterprise unionism" must be understood. This quote conveys the sense that these three "pillars" support the other practices of the system, that they are perhaps *causes*, the other things *effects*. They are more appropriately conceptualized as integral (and entirely rational) components of the more holistic Japanese enterprise community, a very different institution than its American cousin. Too many explications of the Japanese employment system make point-by-point, rather than comprehensive, comparisons with the Anglo-American system.

Indeed, considerable light is shed on the situation by considering these practices as a set; this renders each

⁶⁸ Thomas C. Smith, Political Change and Industrial Development in Japan: Government Enterprise, 1868-1880 (Stanford: Stanford University Press, 1974), *passim*.

individual practice less inexplicably mystical. For example, an implication of near-permanent employment is that the hiring process is taken very seriously, both by the firm and by the employee. Freshmen employees are often subjected to wilderness survival training rituals, Zen Buddhist meditation marathons, and participation in apparently irrelevant company sales campaigns⁶⁹. While all of the above can--and have--been explained as another manifestation of Japan's unique, mystical, vaguely martial culture, it is more convincingly understood as part and parcel of the system of lifetime employment. Companies and employers look for a proper "fit"--which is entirely rational, since they are likely to be stuck with one another for a very long time--and work to ensure that fit through the aforementioned exercises. And it is rational for (most) American companies, which are interested in what skills employees bring to the job, and employees, who are interested in what marketable skills they can learn in the short term, to not engage in these practices. It is notable that U.S. firms like IBM and Proctor and Gamble--where *de facto*, lifetime employment is approximated--are known for their rigorous and drawn-out hiring practices as well as their extensive socialization practices for entry-level employees.

⁶⁹ Thomas Rohlen, "The Education of a Japanese Banker," Human Nature Magazine, vol. 1, no.1 (Jan. 1978), pp. 22-30.

External/Facilitating Factors

A central tenet of this thesis is that too many explanations of the JES--even those that recognize its communitarian aspects--fail to consider the external or "facilitating" political and societal factors. These provide a more cogent and convincing picture of the Japanese employment system, for they shed considerable light on the reasons for its emergence and help to answer the question "why does it continue?" While there are a host of such practices, I will classify them in three groups for analytical purposes as follows: ¹. A production-oriented rather than finance-oriented business culture. ². Financial structures and arrangements that allow companies considerable freedom from shareholder control. ³. The (often ignored) importance of proactive, pro-corporate government policy. These are discussed below--the continuity with the historical/political discussion of the previous chapters (hopefully) will be clear.

Business culture. While Japanese business culture is engineering- and production-oriented; American business culture tends to be finance- and accounting-oriented. This is manifested in many ways. Japanese engineers tend to be accorded higher status in Japanese firms, and in society at large, than finance or accounting types; in America, this is not the case. Indeed, on boards of directors in Japan, one is likely to see more with engineering backgrounds than with

backgrounds in economics or law. The reasons for this are largely historical. In America, capital was always the scarce resource, so its management was crucially important. In Japan--perhaps because of the timing of their industrialization--technology was the scarce resource. It was recognized as having strategic importance and its management was considered crucial⁷⁰.

Though things are purported to be changing in recent years, manufacturing companies like Toyota and Nissan are still considered more prestigious employers than securities firms like Nikko and Daiwa. Compare the situation to that in the US, where some of the brightest college graduates go to work on Wall Street for the likes of Morgan Stanley and Solomon Brothers. Indeed, the idea of the stock market as a fair arbiter of a firm's value never took root in Japan as firmly as in America. Beliefs that price "rigging" of some sort was *de rigueur* in such firms have only grown stronger with the recent scandals in the large Japanese securities firms.

The historical and cultural conditions described in Chapter 4 have lead to an ethos in Japan that it is almost one's *patriotic* duty to assist in her modernization by producing technically sophisticated products of high quality. This is a deeply-ingrained belief, and it is

⁷⁰ George Gilder, MIT Sloan School of Management Executive Seminar on Japanese Science and Technology, Endicott House, June 1990.

reflected in such things as the lyrics of Japanese company songs. It has led to a situation in which employees show great commitment to such companies, and show a level of self-sacrifice vis-a-vis the company that is highly supportive of the practices of the JES.

Financial context. Japanese companies tend to capitalize themselves to a greater extent via debt than equity, the bulk of which is often from a "lead bank". Furthermore, that equity tends to be held in "friendly" hands, such as the aforementioned bank(s); other companies of the corporate (perhaps ex-zaibatsu) group, if it is a member of such a group; suppliers; trading companies; the firm's insurance company; etc. In fact, on average the percentage of shares that is "floating" (i.e. in non-friendly hands) is only 23%⁷¹.

Due in large part to the structure of shareholdings, mergers and acquisitions among Japanese firms are very rare. Furthermore, by law a merger or acquisition cannot take place without the unanimous consent of all its directors, most of whom are not outsiders, but rather career employees of the firm⁷². This enhances the sense of the firm as community, rather than chattel that can be bought and sold.

⁷¹ Bill Emmott, The Sun Also Sets: The Limits to Japan's Economic Power (New York: Random House, 1979).

⁷² James Abegglen, and George Stalk, Kaisha: The Japanese Corporation (New York: Basic Books, Inc., 1985), pp. 198-203.

Indeed, communal attitudes could be the reason for the difficulty, *de facto* and *de jure*, of the buying, selling, divesting, etc. of companies. (Like many of the practices and tendencies listed here, it is difficult to identify it as a cause or an effect; it is instead an element of a mutually reinforcing system of practices.) All of this has served to reinforce the idea of the sanctity of the firm as an economic and social unit.

Government policy. An element of the economic environment that tends to be generally favorable to the Japanese employment system, and one that has been under-appreciated in discussions of the subject, is a generally pro-business government policy stance. Richard Samuels has characterized this as a consuming-for-production orientation as opposed to the Anglo-American producing-for-consumption orientation. "Excessive competition" is in the lexicon of the Japanese economic bureaucrat--too much competition may drive prices down to the point that one or more firms will be driven out of business; hence workers will be unemployed, at least temporarily. To American policy makers, on the other hand, "excessive competition" is an oxymoron--the more competition the better, because the resultant lower prices will benefit consumers. Short term worker unemployment is the price that must be paid for higher (allocative)

efficiency.⁷³

This stance can be thought of as an element of "plan rationality", as opposed to the Anglo-American "market rationality". In Japan, it has meant that government policy has regarded the private firm as an important economic and social unit. MITI has allowed--and in fact in some cases encouraged--cartels in threatened industries, thus allowing financially weak firms to survive⁷⁴. This is considered anticompetitive policy in America.

Occasionally MITI would help firms in troubled industries to restructure, easing the mergers of troubled firms, and assisting in the transformation of others into more profitable industries. All of the above policies have put a premium on not only preventing layoffs, but preventing displacement of workers. This has tended to reinforce the tenets of the Japanese employment system (and may represent and acceptance on the part of the government of the values implicit in it).

⁷³ Richard Samuels, 17.540 lecture, April 17, 1991. See also James Fallows, "Playing by Different Rules," The Atlantic, September 1987, pp. 22-32.

⁷⁴ Michael Young, "Judicial Review of Administrative Guidance: Governmentally Encouraged Consensual Dispute Resolution in Japan," Columbia Law Review, May 1984, pp. 923-983.

CHAPTER 7

WINDS OF CHANGE?

For several years, commentators have been predicting the demise of the Japanese Employment System. Some said it was a lingering vestige of feudalism that would eventually give way in the face of rational economic forces. Others have pointed to the aging of the Japanese population, maintaining the age-based promotion system cannot accommodate this large number of senior employees. They have pointed to the proliferation of meaningless posts as evidence of the weakening of the system. Another change is that large numbers of female workers are entering the work force--while in the past, it could safely be assumed that they would quit after five or six years, today this no longer seems to be the case. And the Equal Employee Opportunity Law of 1985 has made it increasingly difficult to dismiss female workers. Furthermore, rapid diversification into new fields of technology has led to an increase in "headhunting" activities; this, some claim, is weakening traditional lifetime/*nenko* practices.

It is very difficult to predict what the upshot of all of these changes will be. Instead of offering a definitive "answer", I will give two possible trajectories for the JES. The first one discussed is the "status quo" path. Here,

while there may be changes in the *form* of the JES, its *substance* remains the same. I argue that this is more likely, based on historical (and recent) data, the inertia of institutional forms, and facilitating political-economic factors. The second path, that of "deep societal change", posits the death of the JES. It sees broad-based shifts in the values of Japanese workers, and is in many ways consistent with theories of industrial convergence.

The Status Quo Trajectory

At this point, it is not at all clear what the ultimate effect of all of the aforementioned demographic changes will be on the JES. Japanese firms have responded to them in several ways. One solution has been to implement multi-track employment, in which separate or modified promotion schemes have been implemented for female workers, the aged, and those involved in high technology areas; this has addressed a number of the changes mentioned above. Another response has been an increase in what has been called the "core-periphery" phenomenon. When faced with pressure to lay off employees, companies have increasingly loaned workers--in a practice known as *shukko*--to other, often smaller companies in the same business group. Along these lines, in the wake of the oil shock, there was a tendency for firms to hive off divisions, making them independent companies. There was and is a growing tendency for firms to

keep only core, or essential, functions in house and to utilize on-site sub-contractors for other tasks, such as cleaning and set-up, that could be easily cut back in hard economic times.

What is notable about these solutions is not the degree to which the "three pillars" have been altered, but rather the fact that they have in large part been maintained, but in a different institutional form. Each of the tracks in a multi-track system would, in essence, have its own modified form of *nenko*. Similarly, when workers are "loaned" to subsidiaries or affiliates, *nenko* is maintained in large part, but in these smaller business units.

In fact, many maintain that the system has shown considerable persistence and resilience. D.H. Whittaker says "At present [the alterations to the J.E.S.] should be understood more as attempts to preserve the underlying principles of Japanese-style employment, rather than as attempts to abandon them...Evolution is taking place, but we are not yet witnessing the end of Japanese-style employment⁷⁵.

Deep Societal Change

Recently commentators have paid a great deal of

⁷⁵ D.H. Whittaker, The End of Japanese Style Employment? U.S. Japan Program Occasional Paper 89-19, Harvard University, Program on U.S.-Japan Relations, pp. 36-40.

attention to the *shinjinrui* (Japan's "new breed" of younger workers who place a higher premium on lifestyle, leisure activities, and separation of company and private time), saying they represent the beginning of the end of "lifetime employment".

The term "shinjinrui" translates literally as "new human race" or "new breed", and was coined to reflect the fact that to the older generation they are totally inscrutable; they seem to be operating under a totally different set of values and assumptions⁷⁶. While of course there is often a large gap between the values of the old and the values of the young, commentators feel the present generation gap is more like a chasm. The *shinjinrui* are not politically liberal, like their 60's predecessors. They place a great deal of emphasis on the quality of life, and are less likely to sacrifice their personal time "for the good of the company" or in accordance with corporate tradition⁷⁷. For example, in Japan it is a common practice for supervisors to take their employees out for drinks after work--but the *shinjinrui* reject such practices, and this illustrates their greater private, as opposed to company-

⁷⁶ Chikushi Tetsuya, "Young People as a New Human Race," Japan Quarterly, July-September, 1986.

⁷⁷ Emmott, Sun Also Sets.

orientation⁷⁸. They are said to be more rational and professional in manner. They view themselves as professionals who provide a service, and perform a function for the company, not as an obedient and respectful member of the company family⁷⁹.

The current debate in Japanese society over the *shinjinrui* is summarized well by Chikushi Tetsuya, editor in chief of the Asahi Journal: "A popular commentator with rightist leanings has recently urged that something be done to discipline the new breed before they bring about Japan's ruin. Left to their own devices, some people claim, the new breed will become lazy and unwilling to work, like Americans. I disagree. I think it is a healthy trend that a growing number of people, whether they are young or old, are insisting on leading their lives as they please and refusing to conform to outdated and hitherto-unquestioned traditional norms."⁸⁰

Some say these changes, changes in the fundamental values of the work force, cannot be addressed by mere *nenko* tinkering. What does all of this imply for the future of

⁷⁸ Tetsuya, "Young People"; and Keiji Wakimoto, The Mori Building Company, Research Division, interview by Peter Siekmeier, June, 1988.

⁷⁹ Kentaro Nobeoka, interview by Peter Siekmeier, February 1990; George Fields, Gucci on the Ginza: Japan's New Consumer Generation (New York: Kodansha International, 1989).

⁸⁰ Tetsuya, "Young People".

the Japanese firm and its system of labor relations? To answer this question, researchers might do what I have attempted to do in this thesis: examine the Japanese employment system via an examination of the institution in which it is set (i.e., the Japanese firm), its evolution, and its relationship with the broader social, political, and economic context. It is important to examine the historical record as well as the modern "facilitating" external factors and not limit our view to any one theoretical lens--neoclassical, cultural, or otherwise--but acknowledge that each of these is useful in seeking explanations for observed practices.