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INCAS

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Japanese Political Economy Revisited: Diverse Corporate Change, Institutional Transformation, and Abenomics

March 2019

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INCAS

Understanding institutional change in Asia: a comparative perspective with Europe
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ABOUT THE INCAS PROJECT

INCAS is a Marie Skłodowska-Curie Actions R.I.S.E funded project under the European Commission's H2020 Programme.

The project INCAS aims at creating a top-level research and advanced training network on institutional change in Asia, in comparative perspective with Europe.

The coordinator, Ecole des Hautes Etudes en Sciences Sociales (France), promotes this network together with Oxford University (UK), Freie Universität Berlin (Germany), and in collaboration with Waseda University (Japan). The aim of the proposed mobility scheme is to give birth to a European consortium and network of faculties and advanced graduate students specialized in the comparative analysis of institutional change in Asia and Europe. The partners have chosen Japan as a reference point because of its comparability with Europe as shown by previous studies, its historical influence on development and further institutional changes in Asia, and the expertise accumulated within our research team.

Analyzing current economic dynamics in Japan and later expanding this analysis to other Asian countries promises to generate insights that might be help to better understand challenges for Europe and to prepare relevant policy proposals. Our purpose is to compare the results obtained in the case of Japan and few other Asian countries (South Korea, Taiwan, China, and possibly Thailand, after having checked the data availability), not only to previous results on Europe but also to original results we will get on European countries (primarily France – which will be our reference country in Europe – and then the UK, Germany, and Italy) in mobilizing new historical data and applying our theoretical framework.

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Abstract

This introductory article to the special issue on “Japanese Political Economy Revisited: Diverse Corporate Change, Institutional Transformation, and Abenomics” starts with a short summary of the changing perceptions of Japan’s political economy from its meteoric rise as worldwide leading model in the 1970s and 1980s to its demotion to a problem and reform case since the later 1990s. Based on this overview, it identifies some striking issue and open questions in this conventional view of Japan’s political economy as problem and the high expectations on Abenomics as Japan’s current economic reform programme. Then we discuss the articles of the special issue and their new contributions to a better understanding of the developments at the corporate level as well as institutional change and economic reforms at the macro level in the last two decades. Finally, this introductory article ends with a short outline of a new research programme and four central research questions about the Japanese political economy.

Keywords

Japan, corporate governance, political economy, institutionalism, Abenomics

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This article has been published as the introduction of the special issue in *Japan Forum* (“Japanese Political Economy Revisited: Abenomics and Institutional Change”) and as an introduction to the book (*Japanese Political Economy Revisited: Abenomics and Institutional Change*, Routledge)

1. The Japanese political economy, beyond conventional wisdom

Over the last 30 years, the Japanese political economy system has experienced significant changes that are usually not well understood or analysed given their complexity and contradictions. After a decline of interest in the Japanese economy, it is possible to detect a revival, which utilises the tools of institutional analysis applied to Asian capitalism (Boyer *et al.* 2011, Storz *et al.* 2013). The strong mass media attention, but also academic interest in Abenomics, has further reinforced this new research interest on institutional change in Japan's economy. The purpose of the collection of papers included in this special issue is to provide new insights on the process of the evolving Japanese political economy.

As the Japanese economy has experienced two decades of economic stagnation, apparently similar to the one experienced by most European countries, one often forgets the epistemological shock that it produced in the 1970s and the 1980s (Altshuler *et al.* 1984, Dore 1973, Johnson 1982, Lazonick 1991, Ouchi 1981, Pascale and Athos 1981, Womack *et al.* 1989), when it overcame all the European economies before becoming the number one economy in the world. The origin of interest for the Japanese economy in the 1970s and the 1980s indeed comes from the differentiated performance of the Japanese economy on the one side and of the US and European economies on the other side, both in terms of growth and trade. This performance of the Japanese economy was all the more disturbing since a simple economic analysis shows that the way it was functioning at the micro and macro levels was far from the laws of market economy as taught in economics textbooks. For example, Japanese firms certainly maximised their profits, as American or European firms did, but some of their decisions – such as keeping non-profitable activities or avoiding lay-offs in case of negative shocks – show that profit was only one variable among others (such as growth, which is the condition of long-term employment) in the objectives' function. Stated differently, not only did Japanese capitalism not seem to follow the basic rules of a market economy, it seemed to be more efficient.

Moreover, Japan seemed to Western observers to represent an alternative modernity that might be worth emulating by the US and European societies (Kahn 1970, Sugimoto 2014, pp. 24-28, Vogel 1979). Comparative research showed that it achieved a high degree of socio-economic equality without extensive redistribution through a comprehensive welfare state and high taxes like the Scandinavian countries. Japan was a prime example for a productivist welfare regime, in which welfare programmes and benefits were small in international comparison. Instead state policies implemented functional equivalents that guaranteed social integration and cohesion. Although state expenditures for the education system were much lower than the OECD average, its students made it to the very top in comparative international surveys on education level. Its school system was described as highly meritocratic, which made Japan not only an equal, but also a fair society. Regarding industrial relations, Japan was known for its close cooperation between management and unions on the company level as a foundation for the highly efficient production system of Japanese companies.

This period is now over. Japan is no longer a role model from which to learn, but a problem case to be solved. Hence, academic research has concentrated on the long stagnation of the Japanese economy. More policy oriented or normative studies have proposed some solutions based on the structural reform discourses very similar to the one applied everywhere in the world since the mid-1980s (Ito *et al.* 2005, Lincoln 2001, Mulgan 2002, Pesek 2014). It is possible to summarise as follows the dominant vision about the Japanese economy from the early 1990s: the fact that the Japanese system has not adapted itself well to a new environment explains the poor performance of the Japanese economy since the early 1990s. More precisely, the simple discourse is that the “decay” of Japan (whose symbol would be demography) can be explained by the absence of reforms in a new environment characterised by new phases of globalisation and technical progress, rendering a radical reform of the former model necessary. This type of discourse is in fact very similar to the one in Europe that analyses the so-called “*eurosclerosis*”.

This vision of the Japanese economy is very popular and is very rarely criticised. It is not only dominant among foreign pundits and researchers, but also highly influential inside Japan in public discussions and among policy making circles. This vision also explains why some foreign observers and many in Japan received Abenomics so positively and had such high expectations for it. A contribution of this special issue is to show the limitations of this vision, in underlining the poor job it does in explaining a series of striking issues.

2. A series of striking issues and open questions

First of all, the conventional wisdom about the Japanese political economy underestimates the extent and intensity of changes it has experienced at both the micro and institutional level. Moreover, it does not explain why these changes, whose major aim was to promote a convergence towards the – partly fantasised – US type of liberal capitalist economy, did not lead to such a transformation and convergence of this ideal type. Moreover, at the firm level, we observe an increasing diversity in terms of organisation and performance, which is not explained (Lechevalier 2014). Second, although the aim of the series of structural reforms introduced since the mid-1980s was to improve the efficiency of the Japanese economy, rather the contrary has been observed (Boyer *et al.* 2011).

Third, conventional wisdom does not adequately take into consideration the social embeddedness of Japan's political economy. Its success up to the 1990s and its crisis since the 1990s are connected to what we might call the “Japanese way of life” as a social contract between Japan's elites and population (Chiavacci 2007). In this ideal life course, stability and security are priorities, and it is expected that high educational attainments will be translated into stable employment and internal careers in the cooperative and protective community of the employer. It was also connected to strongly differentiated gender roles with men ideally taking up the role as main breadwinner and life-time employed salaryman (*salarīman*) and women concentrating on being education mothers (*kyōiku mama*) in their role as centre of the family and especially the educational success of the children. Up to the mid-1990s, an increasing majority of the population was highly optimistic to accomplish (at least partially) this ideal life course model and, hence, to be fully integrated into Japan's success story, in which educational investment and hard work of men and women was compensated through secure employment, income and a continuation of this success story in the next generation of one's children. Since the proclamation of Ikeda's double income plan in 1960, the Liberal Democratic Party (LDP) was not only the guarantor of economic growth, but also the fruits of this growth would be fairly distributed through the Japanese way of life among the whole population. While foreign observers might have seen Japan primarily as a champion of economic growth, from a Japanese perspective the main point was that Japan was a prime example for shared growth. The Japanese way of life was attractive. From the 1970s onwards, it even evolved into a prescriptive model not only promising a better and brighter life, but also stipulating how to live one's life and how to educate one's children. Since the 1990s, structural change and diversification like the de-standardisation of employment and increasing differences among firms even of the same size and in the same sector has not totally disrupted this life course model, but significantly eroded it. It has led to a new insecurity and a feeling of crisis that has reached even those in Japan's core middle classes that have not yet been directly affected by these changes. While formerly a large majority firmly believed in the opportunity of fully participating in Japan's shared growth, now the society is marked by increasing inequalities and its division into winner and loser. And nobody seems to be immune from the risk of being sucked into the loser group. This has led to high levels of social anxiety and societal pessimism in current Japan (Allison 2013, Hommerich 2016, Kakei Keizai Kenkyūjo 2015, Tanabiki and Miyata 2015, van Houwelingen 2016, Yamada 2004). Conventional wisdom, hence, ignores the crumbling social foundation of Japan's political economy. Its recommendations might even be counterproductive as liberal reforms will most likely further increase feelings of insecurity among the population.

A concrete example of the limitations of conventional wisdom is the interpretation of the Japanese “crisis”. Although the purpose of this special issue is not an analysis of the crisis in Japan from the early 1990s but rather a study of institutional change, it proposes an original interpretation of the Japanese crisis, based on the analysis of the implications of the rise of corporate diversity. In doing so, we disagree with explanations that see in the stagnation the results of a series of short-term policy mistakes (e.g., Mikitani and Posen 2000). They certainly played a role but cannot account for the duration of this stagnation, which should be explained by some structural factors. Our analysis is an institutionalist one that criticises dominant institutionalist interpretations of the Japanese crisis, those, among others, which emphasise the lack of organisational diversity at the micro level (Aoki 2000) or which see in the over-coordination of Japanese capitalism the source of the lack of social change (Witt 2006). As for the first thesis, we provide a clear contradiction with stylised facts in this special issue, focusing on increasing corporate diversity.

In this context, the Japanese crisis – its intensity and its duration – cannot be explained by the absence of institutional change but rather by disruptions in the former system and the emergence of structural incom-

patibilities, which come from a lack of coherence and coordination. If this analysis of the Japanese crisis is correct, the revival of the Japanese economy lies in its re-coordination. We do not deny the importance of short term economic policies as the European case presently shows, through the inability of European commission and national governments to define an articulated growth strategy, which is not restricted to austerity measures or does not start with them. However, they are the alpha and the omega of growth, as the case of Abenomics shows.

From a perspective of economic sociology, one exemplary aspect to identify these disruptions in the former system and the emergence of structural incompatibilities is the relation between the growth model and questions of inequality. In the former system, shared growth was the foundation of an equal Japan and, hence, the high degree of social integration in a large part of the population. Although some research questions the dominant perspective of post-war Japan up to the mid-1990s having a highly equal income distribution per household and a highly meritocratic school system that led to a structural openness for social mobility (Ishida 1993, Ishizaki 1983), the high growth led to a very high level of absolute social upward mobility and generally increasing purchasing power. This general upgrading of the Japanese society overrode in everyday life the question of distribution and led to shared growth experienced by a large majority of the population. As shared growth is no longer taken for granted, questions of inequality have gained a completely new meaning (Chiavacci 2008, Chiavacci and Hommerich 2016). In recent decades, household incomes are decreasing or stagnating (even during periods of continuous growth of about 2% from 2003 to 2007), careers are focusing on restructuring and increasing atypical employment which is becoming more and more insecure, and even a university degree can no longer be taken as a guarantee for socio-economic stability. In view of this social crisis, much more than just some structural reforms and new money policy are needed in order to bring Japan back on track. The small welfare state had a long-time advantage for Japan, but in view of the end of shared growth and secure employment as its main functional equivalents, a fundamental rethinking of Japan's productivistic welfare regime seems unavoidable.

3. Major findings and implications of the special issue

This special issue includes five papers that we believe are all important contributions to the understanding of the contemporary Japanese political economy, especially from the viewpoint of the issues we have underlined previously. The major originality of this special issue lies in the coherence and quality of the set of papers it includes. Despite their diversity in terms of theory and methodology, each paper is a theoretically well-founded analysis and develops a new contribution to recent approaches on corporate and institutional changes as well as economic reforms in Japan (Amyx 2004, Aoki *et al.* 2007, Cargill and Sakamoto 2008, Hoshi and Kashyap 2001, Jacoby 2005, Lechevalier 2014, Olcott 2005, Park and Patrick 2013, Sako 2006, Tiberghien 2007, Vogel 2006, Whittaker and Deakin 2009).

The first group of three papers by Mitsuharu Miyamoto, Ryohei Nakagawa and Franz Waldenberger looks at evolutions at the corporate level, characterised in recent years by increasing firm heterogeneity in both organisations and performance that concerns various fields including corporate governance and employment practices. The perspective primarily comes from management studies and historical political economy. While corporate governance reform efforts as part of Abenomics have been lauded in leading Western mass media publications as a “revolution in the making” that will lead to new growth and wealth in Japan (de Swaan 2015, *The Economist* 2014, 2015), the three authors apply a much more subtle and theoretically driven analysis to the complex subject of corporate governance, human resource management and corporate reporting by discussing new developments in the context of their economic opportunities as well as of their institutional contradictions with continuities in Japanese business practices.

The first contribution by Miyamata analyses the relationship between reforms in corporate governance in Japanese companies and their human resource management. His main finding is an increasing diversity among Japanese companies concerning corporate governance as well as human resource management. While only few Japanese companies have shifted completely to a shareholder-oriented corporate governance à la US, many companies have *de facto* introduced incremental changes in their corporate governance. Miyamata shows in his analysis that this cumulative change in board structures also resulted in adaption in the human resource management in Japanese companies, which restricted life-time employment and

introduced performance-related pay. However, these developments are not homogeneously evolving in the same direction and by the same degree in Japanese companies, but show large variance, which allows for identifying different types of companies that have emerged in recent decades.

Waldenberger's paper addresses whether the envisaged corporate governance reform as a central element of Abenomics will really lead to higher productivity and growth in Japan. The reasoning for a positive answer to this question is that underperformance of Japan's economy cannot be attributed to missing efforts in research and development or a qualitatively poor workforce and missing financial capital, but is the result of risk avoidance of boards because they include no company outsiders. However, Waldenberger shows that the argument for a direct impact of a company's board composition on its performance is not persuasive. Both factors are, in fact, in his view influenced by a third factor, which leads to this spurious correlation. This third factor is the dominance of in-house careers among board members. Accordingly, Waldenberger argues that the current governance reforms will not by themselves solve the underperformance problem of the Japanese economy. Still, he regards them as a possible stimulus for new forms of human resource management that may lead in the long term to higher productivity and more growth.

Finally, Nakagawa's contribution in this first group of papers discusses the potential impact of the Japanese Stewardship Code, which was introduced in 2014, on the engagement of shareholders in corporate governance. He differentiates between institutional investors as outsiders *vs.* mutual cross shareholdings between companies or companies and banks as insiders. The share of outsiders among the shareholders has significantly increased since the late 1990s. In fact, since the early 2000s, they have overtaken insiders as shareholders. Overall, this transition has not only led to much shorter investment periods, but also corporate management has shortened its time horizon. While insiders still tend to hold stocks longer, they seldom actively engage in the corporate governance in their role as investors. According to Nakagawa's analysis, the new Stewardship Code will only have a limited impact and will not trigger stable market growth as intended. While the Code demands investors to actively engage in corporate governance, it is only directed at outsiders. By not covering insiders as a significant and potentially important investors group, the effect will be limited.

Overall, these three papers show not only the increasing heterogeneity among, but also new internal contradictions in Japanese companies in their investor relations, corporate governance and human resource management. Well-intended reforms and new developments on the corporate level have often happened on an *ad-hoc* basis with no comprehensive plan and in reaction to external pressures and new ideas. This has weakened and often even undermined the institutional complementarities between investor relations, corporate governance and human resource management. In the larger societal picture, this reduction in institutional complementarities is an important factor that has contributed to rising insecurity and constant questioning of the future of the Japanese way of life. Recent and envisaged reforms as part of Abenomics have been lauded as important measures to lead Japanese companies back to a path of growth and higher productivity, but the analysis in the group of papers shows that they have limitations and, at best, only a partial impact. Hence, it remains not only highly questionable if they can solve the internal fragmentation, but they might actually further enhance the internal fragmentation and its negative societal impact.

The second group of papers by Adrienne Sala and Saori Shibata deals with institutional change and evolving economic reforms on the macro level of Japan's political economy. The papers focus on the financial system regulation and economic growth policies as central elements of Japan's political economy and key drivers in the evolution of its economy. Rather than adopting the usual short term view, they adopt a political economy perspective that allows for connecting economic policies and reforms to overall institutional and social change. From this viewpoint, it is possible to better understand the interplay between reforms and change in consumption credit and to reinterpret Abenomics not as accidents but rather as a manifestation of ongoing contradictions within the Japanese political economy.

The paper by Shibata is a comprehensive and innovative analysis of Abenomics. Her analysis highlights the internal contradictions in Abenomics between its first two arrows, which are Keynesian-styled remedies, and the third arrow that encompasses a wide range of liberal-oriented structural reforms preached already for decades to Japan as part of the conventional wisdom identified above. Shibata regards these two strategies as mutual incompatibility, and, hence, assesses Abenomics not as a set of really new reform policies leading to an alternative growth model of Japan in the long-term, but as a re-packaging of older policies by former administrations that due to their internal contradictions pose a risk to the long-term stability of Japan's capitalism. As a main problem, she identifies the stagnating wages that lead to a weak demand. This is not only unsolved by Abenomics, but the envisaged deregulation of the labour market might even contribute to a further increase in wage insecurity and social instability.

Sala analyses, in the second contribution on the macro-level, the institutional change in the Japanese consumer finance market since the 1980s. During the economic downturn and stagnation from the 1990s onwards, the weakly regulated and unsecure personal loan market led to an increase in indebtedness and over-borrowing among the lower income households and resulted in a stark increase in bankruptcies in Japan. The market share of consumer finance companies, which use illicit and harsh practices, strongly increased in those years. The rising salience and increasing press coverage of these issues forced the Japanese government to enact reforms and a stronger regulation of the consumer finance market from 2006 to 2010. Sala points out that public debates and political reforms did not address the causes of rising social inequality that led to over-borrowing and rising bankruptcies, but that the reforms show the rising influence of civil society actors in policy making which resulted in better consumer protection.

Overall, the analyses on the macro-level show darker and brighter developments. Although Abenomics is already lauded by some as a success story (*The Economist* 2016), like Shibata points out, it does not address the central malaise of Japan's capitalism. Without reinforced security of one's social integration, overcoming decreasing purchasing power and stronger demand, the Japanese economy will not return to a path of shared growth and actually to any long-term growth at all. In fairness it has to be pointed out that Abe and his advisory team are not totally unaware of this main problem, which is also key for finally escaping deflation and provoking a significant inflation in Japan (Everaert and Gianelli 2016, Lechevalier and Monfort 2016, Porcellacchia 2016). Since 2012, Abe and his cabinet have repeatedly been campaigning for pay increases for all workers including those of small and medium-size companies (SME). For a conservative, business-friendly Prime Minister and administration, this an unexpected form of conduct, which has been nicknamed "governmental spring offensive" (*kansei shuntō*) by Japan's mass media (*Mainichi Shinbun* 2015a, Murata 2015). With the same aims, the current government has also decided to increase the minimum wage by an average of 18 Yen to a national average of 798 Yen, which is the highest hike since 2002 (*Mainichi Shinbun* 2015b). However, the results of this governmental pay offensive have been negligible. National statistics show still stagnating incomes in recent years (MIAC 2016: 138). According to a representative survey in February 2015, only 13% of the respondents personally experienced a positive economic effect of Abenomics (*Nihon Keizai Shinbun* 2015). The urgency felt by the government to reassure the population and re-establish shared growth is obvious in the revised version of Abenomics presented in September 2015 (Prime Minister of Japan and His Cabinet 2015). With this kind of Abenomics 2.0, three new arrows were announced: (1) 'robust economic growth that gives rise to hope', (2) 'dream-weaving childcare support', and (3) 'social security that provides reassurance'. While the first new arrow aims at an enhancement and combination of the prior three arrows of the first version of Abenomics, the second and third are directed solely at the domestic audience, moving beyond economic policies into social welfare. Still, to what degree this social policy reform agenda will be realised remains to be seen. In this context, Sala's analysis may also offer some hope. Her paper shows that through the involvement of civil society and increasing public pressure, more balanced reforms for consumers and producers as well as employers and employees are not impossible. However, it must also be noted that the crisis of Japan's capitalism and social contract has led to some new forms of political mobilisation and contestation, but 'the impact of such contestation on policymaking and actual policies has thus far been limited' (Shibata 2016, p. 496). In fact, the temporary deselection of the LDP from political power was primarily the result of established vested interests in rural Japan and not of new social movements or civil society actors (Chiavacci 2010). The voice of the people is, however, needed in order to find a lasting new foundation and social contract for Japan. It has to be remembered that the former social contract of shared growth and its Japanese way of life was the result of fierce and open socio-economic conflicts in the early post-war decades.

4. Towards a new research programme for the Japanese political economy

We hope that this special issue on Japan's political economy and corporate governance will not only be of interest for Japanese studies, but will also stimulate more interdisciplinary research on Japan's political economy and capitalism. In recent years, besides few exceptions like Pempel and Muramatsu (2014), economy and political economy as topics have been generally absent from Japanese studies journals such as *Japan Forum*. The major aim of this special issue is not only to contribute to the debates between economists but to open these debates to scholars from different disciplines. We are indeed convinced that the "closure" of economics and political economy to other disciplines is detrimental to the understanding of some key issues of contemporary Japan whose complexity requires multidisciplinary approaches. Japan's economic stagnation is on the one hand undermining the former social contract between Japan's elites and population. On the other hand, this unaddressed societal crisis has also led to the prolongation of the economic standstill. In other words, Japan's economy and capitalism are too important to leave to the standard economists.

Among the questions that have to be addressed by reference to the Japanese context and in international comparison, let us mention four of them:

- How can we conceptualise the revival of the intervention of the State in a context characterised by maturity (post-development) and liberalisation?
- Whereas social protection essentially relied on family and firms, how do we understand the rise of a social state in Asia, without any subordination to a productivist logic, as in the former model?
- How can the liberalisation of markets explain the increasing diversity of firms, in terms of organisation and performance?
- What would a new social contract look like as a new foundation for Japan's capitalism and society?

Despite their diversity, these questions converge towards the idea that a renewal of our approach on the Japanese political economy is necessary: it should be more comparative and more interdisciplinary. If this special issue can arouse, in this direction, a new wave of research on institutional change in Japan, then one of its goals will have been achieved.

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