Japan Remodeled

How Government and Industry Are Reforming Japanese Capitalism

By Steven Kent Vogel

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Reviewed by Stephen Kotkin

What's up with Japan? The ascent of China has diverted attention from the other formidable power in East Asia. With an economy still the world's second-largest ($4.7 trillion) after the United States, Japan is not to be taken lightly.

In the 1980s, the Japanese economic tsunami appeared set to engulf every country in its path. In the 1990s, just as deliriously, its economy receded. Ideologues of all stripes had a field day, because what looked like a state-guided model first produced stunning success (nearly a quarter-century of annual growth around 8 percent after 1950) and then stunning failure (more than a decade of stagnation after a late-1980s stock market and real estate crash).

Then came another surprise. Since early 2002, Japan has been on a steady rebound.

"Japan Remodeled" by Steven Kent Vogel, a political science professor at the University of California, Berkeley, gets beyond the punditry by presenting a social-science understanding tested against executive interviews, company case studies and foreign comparisons. It is not page-turning reportage. But the indulgent reader is rewarded with the best analysis in English of the distinctive Japanese market economy.

Vogel dispels two potent myths. First, he shows that all through its lost decade of the 1990s, as well as recently, Japan has experienced not paralysis but a frenzy of restructuring. Japanese enterprises expanded merit-based compensation, sold subsidiaries and moved production abroad. The government modified the pension system, revised corporate law, removed a pileup of bad loans and even reorganized itself.

Second, Vogel notes that a crisis-ridden Japan may have given the impression of adopting
American-style deregulation and shareholder value by privatizing public corporations, naming outside directors to boards and experimenting with stock options. But just as 1980s America did not turn Japanese, he writes, "a funny thing happened on Japan's way to the U.S. model: it never got there." Japan remodeled its own way.

The distinctiveness of Japan derives not from innate culture but from history and politics. In 19th-century Japan, as well as in Germany, industrializers sought to avert the socialist inclinations of working classes by resorting to extreme repression or paternalism. This contrasted with the British and U.S. market model that was developing under more limited governments. Germany and Japan had liberal capital markets, mirroring the Anglo-American model, but in the 1930s, they abandoned lower-cost capital for the security gained from corporate reliance on a main bank.

After World War II, the newly democratic West Germany and Japan moved to stakeholder partnerships for labor — encouraged by the U.S. occupation, which sought to promote social solidarity in cold-war allies to inoculate their societies against Communism. The upshot has been a German- Japanese "social market" alternative to the Anglo-American "free market."

In both pairings, governments intervene in the economy, but in different ways. In the United States, government policies formerly shifted vast wealth and opportunity to the middle; lately they have redistributed them upward. Germany and Japan integrate labor into corporate governance and afford considerable employment security. While American corporations benefit from nearly absolute freedom to hire and fire, Japanese companies benefit from low turnover.

Vogel reveals that American-style liberalization elicits ambivalence in Japan, even among the putative beneficiaries. Export-oriented manufacturers, for example, refrain from terminating workers to avoid damaging their domestic image or employee productivity. "We could not lay off workers in Japan," a vice president at NEC tells Vogel. "We have 150,000 workers, and most of them have families. If we laid them off, the local government would get after us, and the media, too."

Japanese companies also spurn mergers and acquisitions as disruptive and gimmicky. And they eschew supplier-hopping. "If you just procure what is cheapest," a Nissan vice chairman tells Vogel, "then what do you do about the cost of developing the next technology?"

Business elites in Japan tend to follow a collaborative and long-term approach, Vogel concludes, because it provides a valued sense of social harmony and equity, and because that is
how they make profits.

The Japan model discriminates against the women who predominate in the temporary work force, fosters industrial collusion and cheats consumers out of cheaper imports, Vogel notes. He also offers a chart indicating that from 1975 to 2004, annual equity returns in Japan have consistently been below those of the United States.

Liberalized pockets do exist in Japan, such as in telecommunications. And the Japanese post-1990s economic model has become more varied internally, partly from greater exposure to outside practices. The country has also become more openly differentiated by income.

Could world economic integration eventually eradicate broad system differences? Not likely. The global economy is a set of interrelated national market systems that must compete or suffer the consequences. But amid profound pressures today for convergence under American might, divergence persists. This is the often overlooked context for contemplating how China has boomed for three decades while flouting the supposed laws of market governance.

Communist-ruled China may be awaiting its economic comeuppance for being unfree. Or it may be on a winding path to a stable, prosperous market model of nationally specific institutions, drawing on others' and its own experience. Certainly China means business. Just ask the Japanese.