

**JAPAN'S DEVELOPMENT AND ECONOMIC THEORY**

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**HASAN CÖMERT**

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Approval of the Graduate School of Social Sciences

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Prof. Dr. Sencer Ayata  
Director

I certify that this thesis satisfies all the requirements as a thesis for the degree of Master of Science.

---

Prof. Dr. Haluk Erlat  
Head of Department

This is to certify that we have read this thesis and that in our opinion it is fully adequate, in scope and quality, as a thesis for the degree of Master of Science.

---

Prof. Dr. Eyüp Özveren  
Supervisor

**Examining Committee Members**

Prof. Dr. Eyüp Özveren (METU ,ECON)

---

Assoc. Prof. Dr. Ahmet Haşım Köse (A.Ü ,SBF,ECON)

---

Assoc. Prof. Dr. Cem Somel (METU , ECON)

---

Assoc. Prof. Dr. Onur Yıldırım (METU ,ECON)

---

Visiting Assist. Prof. Dr. Sheila Pelizzon (METU ECON)

---

I hereby declare that all information in this document has been obtained and presented in accordance with academic rules and ethical conduct. I also declare that, as required by these rules and conduct, I have fully cited and referenced all material and results that are not original to this work.

**Name, Last name :** Hasan Cömert

**Signature :**

## **ABSTRACT**

### **JAPAN'S DEVELOPMENT AND ECONOMIC THEORY**

Cömert, Hasan

M. Sc., Department of Economics

Supervisor: Prof. Dr. Eyüp Özveren

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This thesis investigates the relationship between economic ideas and practices in reference to Japanese development experience. To achieve this, it first examines the impact of economic ideas and economists on the Japanese development. Then it examines the characteristics of the Japanese development. Lastly, the study attempts to give an account of the direct impact of Japanese experience. It also tries to elucidate the indirect influence on the Japanese development economics which occurred through its impact on East Asian model. It has three main assertions. Firstly, it argues that Japanese economic thought and economists that were under the influence of heterodox economic schools such as the German Historical School, Marxism and the Schumpeterian and Keynesian schools, played a crucial role in shaping the Japanese development. Secondly, at least partly for this reason, Japanese development which can be considered as a piece-wise continuous accelerated growth phenomena, demonstrated heterodox characteristics. Thirdly, Japanese successful industrialization directly and indirectly, through influencing East Asian development model, deeply affected different economic approaches in development economics such as the developmental state, flying geese model and the Confucian ethic thesis. The broader implication of this thesis is that the economic ideas and economic practices have a circular relationship as Japanese experience has demonstrated.

**Keywords:** Development Economics, Japan, East Asia, Economic Thought

## ÖZ

### JAPON KALKINMASI VE İKTİSAT KURAMI

Cömer Hasan

Yüksek Lisans, İktisat Bölümü

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Bu tez iktisadi fikirler ve pratikler arasındaki ilişkiyi Japon kalkınma deneyimine referansla incelemektedir. Bu amacı gerçekleştirmek için, çalışma birincil olarak iktisadi düşünce ve iktisatçıların Japon kalkınmasındaki rolünü anlamaya çalışmaktadır. Daha sonra Japon kalkınmasını incelemektedir. Son olarak ise Japon kalkınmasının kalkınma teorisine doğrudan ve dolaylı, Doğu Asya modeli üzerinden, etkilerini açıklamaya girişmektedir. Bu tezin üç temel savı vardır. Birincisi, Alman Tarihçi Okulu, Marksizm, Keynezcilik ve Schumpeterci okullar gibi heterodoks okullardan etkilenen Japon iktisadi düşüncesi ve iktisatçıları Japon kalkınmasında çok etkin bir rol oynamışlardır. İkincil olarak ‘parçalı-süreklî’ ‘hızlandırılmış bir büyüme’ olan Japon kalkınması kısmen de olsa bu sebepten heterodoks özellikler göstermiştir. Üçüncü olarak, Japon kalkınması doğrudan ve Asya modelini şekillendirerek kalkınma teorilerini etkilemiştir. Bu bağlamda Uçan Kaz Modeli, Kalkınmacı Devlet Teorisi ve Konfüçyüsçü Ahlak Tezi Japon kalkınmasının izlerini taşımaktadır. Bu tezin daha genel bir sonucu iktisadi düşünceler ve iktisadi pratikler arasında, Japon örneğinin gösterdiği gibi döngüsel bir ilişki olduğudur.

Anahtar Kelimeler: Kalkınma İktisadı, Japonya, Doğu Asya, İktisadi Düşünce

*In memory of my friend Göksel Alkan*

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# CHAPTER 1

## INTRODUCTION

The relationship between the theories and practices of human beings has been subject to hot discussion. Many authors have tried to answer the question of what the role of ideas is in shaping practices of human beings or how material conditions exert an influence on theories and ideas. To tackle these questions, here we will confine ourselves only to a specific area in social sciences: economics.<sup>1</sup>

### **1. 1. General Comment on the Relationship between Social Theory and Practice**

Some argue that “[s]ocial science theories can influence reality in profound ways, by influencing how we think about ourselves and how we act” (Ferrero 2003:3). Although the full impact of social sciences can be materialized with a time lag (Boulding 1967) the ideas in social sciences can affect reality in different ways. As Campbell argues, “ideas facilitate policy-making actions not by just serving as road maps,” but they also provide “symbols” and other “discursive schemas”; thus, actors can make these maps appealing, convincing and legitimate (1998:381). For example, supply side economics legitimated and provided justifications for policies of the Reagan administration in US and the Thatcher administration in UK at the

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<sup>1</sup> It is generally accepted that any improvement or change in natural sciences directly or indirectly became very influential on molding the practices of human beings. So it seems that this discussion belongs to the realm of the social sciences. However, it can be a big mistake to consider the relationship between natural sciences and practices of human beings in a unidirectional form, from a change in the natural sciences to practices of human beings. In many cases social environment and special historical conditions can be very important in selection of subjects dealt with in the natural sciences. For example, the Cold War situation gave an enormous stimulus to space exploration in line with the rivalry between Russia and America.

beginning of the 1980s. According to Nelson (1987:1967) economists' initiatives in three areas helped to ease barriers in front of deregulation policies:

First, supply side economists helped to undermine the progressive-era ideology which provided the intellectual foundations for economic regulation. Second, economists showed that regulation resulted in an inefficient use of resources in specific cases. Third, the profession provided key policy entrepreneurs for the political struggle to achieve deregulation.

The institutionalized<sup>2</sup> characteristics of ideas strengthen the influence of these ideas. For example, one reason behind the widespread impact of neo-classical economics can be found in its highly institutionalized characteristics at least in terms of journals, conferences, traditions of famous schools such as Princeton, MIT, Chicago, and Yale and habits of thought of some influential groups. However, the institutionalization of ideas does not mean that they will not pass away. It is generally thought that the institutionalization of ideas is a dynamic process which happens and evolves in response to the needs of dominant actors or their rivals in a society.

Sometimes ideas in social sciences can even have self-fulfilling characteristics. The theory itself can create a benign atmosphere which helps to transform the theory from image into reality. In a similar vein, Ferraro, Pfeffer and Sutton (2003:2) argue that "theories can 'win' in the marketplace for ideas independently of their empirical validity to the extent that their assumptions and language become taken for granted normatively valued, and therefore create conditions that make the theories come 'true' ". According to them, ideas can become self-fulfilling through effecting institutional design, social norms and language within the context of culture and accountability. Therefore, created images can be perceived at a later time as entrenched facts. For example, the discourse of neo-liberalism around 1980s started to create a framework in terms of institutions,

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<sup>2</sup> Institution has two meanings in the dictionary: 1- a custom that for along time has been an important feature of some groups or society; 2- an organization founded and united for a specific purpose. Here, I use institutionalization as a term covering both of these meanings. An idea can only be institutionalized if it has been an important feature of the habits of thought in a society via being advocated from influential organizations, or being a part of society's long term entrenched customs.

norms and languages which later worked together in the direction of acceptance of its accounts as indisputable facts.

On the other hand, social theories cannot be separated from their social contexts because theories and any attempt in the direction of understanding realities about societies must reflect existing social realities. In this sense, in fact, the institutionalization of ideas is also a dynamic process which changes abruptly or evolves in response to the needs of specific influential classes and groups. For example, “Keynes [was] clearly a response to the Great Depression and to the apparently meaningless and bewildering experience of large-scale unemployment in a relatively developed society” (Boulding 1967:104). Material conditions not only play a part in shaping ideas but also they more or less determine which ideas will be chosen and remain influential. To become dominant, theories should be in harmony with the needs of major interest groups and classes, or their rival groups and classes in society. It may be argued that the perils of the Industrial Revolution played an important role in shaping socialist ideas. Furthermore, the emphasis on the interests of a rising working class helped socialist ideas to be very popular among the working-classes in many parts of the world.

As the above discussion pointed out, there is a dynamic relationship between theories and practices. “The total system [the relationship between ideas and practices of human beings] is circular and society itself [also] has an enormous impact on the social sciences” (Boulding 1967: 102). To elaborate the true nature of relationship between social reality and ideas for a vast area of social sciences is very difficult task. Hence, as we stated before, we will restrict ourselves to the field of economics. We will endeavor to throw some light on the nature of the relationship of economic ideas and economic practices. In fact, although, many authors have dwelt on this issue, they have generally attempted to demonstrate the role of economists and economic thought in a society (Allen 1979, Stigler 1982, Cayne and Boetke 1997). There are a few studies dealing with the role of material conditions on the formation and selection of economic ideas (Boulding 1967). Furthermore available studies such as Boulding (1967) are not based on a specific case study.

However, in this study, we will try to deduct our conclusions from a specific case study and also investigate the role of material conditions in the formation of ideas.

## **1. 2. The Relationship between Economic Theory and Practice**

There is no general consensus among economists who have explored the impact of economists on society. Some claim that the impact of economic thinking and economists on society are not very profound (Allen 1979, Stigler 1982, Hobsbawm 1994, Cayne and Boetke 1997, Blaug 1997). Hobsbawm (1994) claims that it is very difficult to find a correlation between the abundance of influential economists and the level of economic development within a given country. Similar argument can be found in Blaug (1997:2) who claims that modern economics is becoming an intellectual game distant from practical problems. Yet some others argue that economists are very important players in a society. They assume that economists occupy very important positions in society because they directly or indirectly effect the policy-making procedure. For example, Keynes (1936) points out that regardless of whether economists' ideas are right or wrong, their influence is very significant in a society. Similarly, Stiglitz (1998) points out that economics has a “[p]rofound effect on the lives of billions of people, making it absolutely essential”.<sup>3</sup>

## **1. 3. The Case of Japan**

Generally concerning the nature of the relationship of economic ideas and economic practices, tentative conclusions have been deduced from superficial observations. Hence to discuss the relationship between economic thought and economic practices we need concrete examples. The Japanese development experience can provide us with a suitable framework to discuss the dynamic relationship between material conditions and economic thought. I picked Japan for my case study because it has had a big impact on development economics that has

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<sup>3</sup> Hayek (1991) argues that economists have this great influence in the long run (Frey 2000).

nevertheless gone unnoticed. Furthermore, to discuss this issue within the context of Japanese experience can be very interesting because, although, the unusual Japanese growth performance has been explored in many ways, there are not many specific studies in the literature addressing the Japanese experience with reference to this dynamic relationship between theory and history. Generally, the available literature concerns itself with impact of economics and economic thought on Japanese high growth performance.

More specifically, here we will explore the unusual nature of Japanese development by considering the impact economic thought had on it and in turn the impact this experience had on economic thought. Although it will be elaborated in subsequent chapters, here we can sum up our main thesis in two steps as follows. First, the Japanese development experience had very deep intellectual heterodox roots which played a very important role in shaping it. In other words, Japanese economic thought and economists benefiting from heterodox approaches were very significant variables of the Japanese success. Secondly, Japanese high growth demonstrating heterodox characteristics affected the development literature directly and indirectly through affecting the East Asian economies. These themes will be dwelt on in five chapters including the introduction and the conclusion.

Chapter II is an attempt to figure out the theoretical underpinnings of Japanese economic success. It endeavors to find answers to the following questions: Did economic theory and economists have a role in formulation of Japanese economic policies of the high growth era? If they had a positive role, through which channels did they become influential on the policy-making procedures of Japan? In the light of these questions, we first explore schools which exerted an influence on Japanese economic thought. In this vein, we investigate sequentially, the diffusion and the extent of influence of the neoclassical school, German Historical School, Marxism, Keynesianism, and the Schumpeterian School in Japan. Lastly, though we discuss the role of the Japanese economists in historical sequence with the discussion of the diffusion of different economic schools in Japan, we try to identify direct mechanisms and indirect mechanisms which enabled Japanese economists to be important actors in the policy-making procedures.

Some claim that economic thinking and economists played a very minor role in Japan's unusual performance. In this sense, Hobsbawm's statement, which is quoted above, is very influential, although it is not based on a specific inquiry into the Japanese success. He seems to conclude that the Japanese success is a phenomenon independent from its economists' activities. Ryutora's and Yamamoto's (1981) argument has been mainly responsible for this kind of interpretation among Western as well as Japanese economists. Their main thesis in turn is based on the argument that there is lack of professional economists' position in government agencies. From this observation, they reach a conclusion that Japanese economists have been very passive in shaping economic policies. Ikeo (2003) and Hadley (1989:301) defend similar ideas. For example, Hadley (1989) claims that "neither academic nor government economists played a major role in Japan's high growth strategy. The strategy was the product of talented bureaucrats and business representatives working together largely on the basis of empirical evidence".

On the contrary, Gao (1994, 1997) and Suzuki (1989), and Okita (1985) can be seen among scholars who advocate the idea that Japanese economic thought and economists had very favorable impact on Japan's high growth performance. Here, one of our main claims in line with the argument of the camp advocating the significance of economists and economic thought in Japanese economic success is that Japanese development has very deep intellectual roots going back to the German Historical School and Marxism. From the 1890s to the 1980s, Japanese economists generally were influenced by heterodox economics, namely Keynesian and Schumpeterian Schools as well as by Marxism and the German Historical School. The late comer situation of Japan and specific historical conditions could facilitate to the acceptance of these approaches. It seems natural for a country which adheres firmly to the idea of catching-up with the Western countries to be attracted by heterodox policies instead of free-trade and neo-classical paradigm because heterodox schools give more credit to the role of government in industrialization.

Generally, a limited number of economists under the influence of heterodox schools directly or indirectly played a very important role in Japanese

industrialization. Economic agencies, study groups (such as planning boards) and special brain trust groups enabled these Japanese economists to be very influential on economic policy-making. Furthermore, Japanese bureaucrats generally remained under the impact of heterodox economic schools. Heterodox schools were very influential in the Tokyo Imperial University and in the other important universities from which most of the Japanese bureaucrats have been recruited (Gao 1994,1997). As a result, these economists did not only get directly involved in policy-making procedures but they also indirectly affected the direction of economic policies by shaping the intellectual milieu which surrounded other policy-makers.

Chapter III endeavors to clarify the reasons behind the Japanese high growth. To do this, we go back to earlier periods. The legacy of the Tokugawa period (1639-1853) and the Meiji Restoration of 1868 and 1930s are highlighted because of their role in the preparation of the self-sustaining high growth of 1960s. Then Japanese postwar situation is described. Here the impact of American occupation period and the American reforms on Japan are specifically investigated in order to clarify the role of the U.S in Japanese success. Then different approaches to the Japanese success are introduced. Given this background, high growth period is discussed in terms of the role of capital accumulation, labor, technology, the institutional structure and the government.

The significance of Japanese economists and economic thought under the influence of heterodox schools can also be deduced from the characteristics of Japanese industrialization which will be elaborated in Chapter III. I argue that Japanese high growth is a 'piece-wise accelerated' growth phenomena going back as far as the Tokugawa period. The heterodox characteristic is very apparent in all aspects of this accelerated growth. In this sense, Japanese institutional structure and special high growth policies was not based on principles of the neoclassical school. Most of high growth policies were in line with heterodox school's economic analysis. It is natural to reach the conclusion that Japanese economic thinking and economists are at least partly responsible for this, though special historical conditions and the late-comer situation are very important to explain this phenomenon.

Chapter IV is on the impact of Japanese experience on the East Asian economic success and development economics. To do this, first, it shortly summarizes East Asian high growth phenomena. Then, it seeks for an answer to the question of how Japan affected the East Asian economies. In this regard, pre-war colonial activities of Japan as well as Japanese scholarships and youth programs, aid and credit policies were very effective. Furthermore, whether or not Japanese demonstration effect is an important ingredient of East Asian development is explored. We then deal with the impact of Japanese economic performance on the development literature. The development literature which emerged after 1980s was generally based on the Japanese and East Asian experiences. However, East Asian development cannot be investigated separately from the Japanese experience. Hence in order to shed some light on the discussion of Japanese impact on the formation of economic ideas it is also necessary to explore the relationship between East Asian experience and Japan. In this sense, we focus on three important themes. First, we look at the flying-geese model; an original contribution by a Japanese economist to development economics. Secondly, we investigate Japan's exemplary influence on the elaboration of the idea of a developmental state. Finally, we look at Japan's role in the revival of cultural approaches to development economics by way of an emphasis on the Confucianist ethic. We prefer to focus on these three approaches instead of focusing on other approaches because we believe that these carry more trace of the Japanese experience than other approaches in development literature. From this discussion we reach another important conclusion of this study that Japanese high growth performance affected economic thought directly and through its influence on East Asian economies.

## CHAPTER 2

# ECONOMIC THOUGHT, ECONOMISTS, JAPANESE HIGH GROWTH

“...the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood.”(Keynes 1936: 383).

There are many assessments of the role of economists and economic thought in a society. Some claim that economists occupy a very important role in a society:

In a situation of crisis like the one the French government faced in December 1995, it seems more and more obvious that [economists] they are becoming the ultimate reference, the lender of last resort for most contemporary social actors-economic leaders, technocrats, politicians, unionists, intellectuals, etc (Lebaron 2001: 91).

Similarly, Stiglitz (1998:8) points out: “economic ideas and, knowledge about economics, have had [...] profound effect on the lives of billions of people, making it absolutely essential”. On the contrary, some claim that economic ideas and economists are not as significant as envisioned in practice. For example Hobsbawm (1994:564) argues some skeptical economists believe there is no correlation between the success or failure of a country and the “distinction of its economic theorists”.

If anything, it might even suggest an inverse correlation. Austria was not a by-word for economic success in the days (before 1938) when it possessed one of the most distinguished schools of economic theorists; it became one after the Second World War when it was hard to think of any economist resident in that country with a reputation outside it. Germany, which refused even to recognize the internationally recognized brand of economic theory in its universities, did not appear to suffer. How many Korean or Japanese economists are cited in the average issue of the *American Economic Review*? (Hobsbawm 1994: 564).<sup>4</sup>

However there are not many studies that define the role of economists and economic thought in public life. Concerning this, tentative conclusions are deduced from superficial observations. Hence it is necessary to make a detailed investigation into understanding the role of economists and economic thought. In this sense, the Japanese case provides rich material to deal with this issue. Here, I will focus on the Japanese high growth era, which is the so-called “Japanese Miracle”. Did economic thinking and economists play a major role in bringing about this high growth era? If yes, what sources of economic ideas were becoming influential in this period and through which channels did Japanese economists and economic thinking exert an influence on the high growth policies? These types of questions are the subject-matter of this chapter. In the first part, economic schools playing a part in the period from 1868 to 1945 will be introduced in order to define the pre-war intellectual sources of economic policies. In the second part, dominant schools and economic thinking in the postwar period will be discussed. We will then focus on channels that enabled economists to be effective in this period.

## **2.1 Penetration of Western Economic Thought into Japan**

Japanese meeting with the Western sciences can be traced back at least to the Tokugawa Period (1640-1853).<sup>5</sup> In this context, Dutch learning had played an important role. However the massive diffusion of Western sciences and especially

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<sup>4</sup> However, he does not fall into the trap of simplification. He also notes “However, Scandinavia, social-democratic, prosperous and full of the most internationally respected economic theorists since the late nineteenth century, could be cited on the other side of the argument” (Hobsbawm 1994: 564).

<sup>5</sup> For the importance of Tokugawa Period in Japanese economic thinking see Komuro (1998). According to him “in the Tokugawa period Japanese people already possessed the ability to form certain views on society and economy” (1998:1). Therefore it is wrong to think that they started everything with the introduction of western sciences and ideas.

economic ideas commenced with 1850s when Japan was faced with the challenge of Commodore Perry's 'Black Ships'. This process was accelerated and intensified by the Meiji Reform of 1868.

In fact, Meiji Reforms can be seen as a response to the challenge coming from the 'Black Ships' forcing Japan to open its ports to foreigners. When Japan was forced to do this, after a long seclusion policy followed by Tokugawa leaders, it was seen that the Tokugawa regime could no longer be continued. However, there was an intense debate among those who were against the Tokugawa regime. Some of them claimed that Japan should utterly reject all things coming from the West so as to resist the challenge. On the other side some were willing to absorb Western technology and ideas which could be useful to create a "strong army and a strong nation".<sup>6</sup> At the end, the second position comes on top among the Meiji reformists taking power around 1868 after a short civilian clash. They vigorously encouraged and sponsored importation of Western ideas in all sciences as well as in economics.

The diffusion of Western ideas took place in various ways. One most effective channel worked through students who were dispatched to Western universities by government. With the Meiji reforms many European sources became available especially to parts of the reading public who mastered a foreign language. Moreover, many Japanese had a chance to visit other countries especially in the West where they met with new ideas.

### **2.1.1 Classical Political Economy**

When Japan was challenged by the Western powers, one response of the Shogunate was to dispatch a restricted number of people to Western countries to learn more about the West. Those people's first observation was that one of the reasons behind the West's dominance was its laissez-faire capitalism. Therefore, Japan should adopt this doctrine. In this sense, Classical Political Economy was introduced into Japan mostly by these people. Among them, Yukichi Fukuzawa (1835-1901) was very effective in bringing liberal thinking into Japan despite the fact that he later revised his position vis-à-vis free trade with the changing context

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<sup>6</sup> It was the most important slogan of the Meiji period which was beneficial in the building of the modern Japanese state. One can easily recognize the militaristic emphasis of the slogan.

(Kumagai 1998). Fukuzawa can thus be considered as one prototype of Japanese intellectuals who are generally known as pragmatic and highly under the influence of nationalistic sentiments even when coming from Marxist, liberal or another background.

With the Meiji Restoration the works of classical authors became available especially to those with the knowledge of a Western language. Ukichi Toguchi (1855-1905) who can be considered among this group devoted himself to the study of Classical Political Economy after having studied a long list of subjects (Kumagai 1998). He was especially active in the publication of journals advocating free-trade in Japan (Sugiyama 1998). Ukichi firmly adhered to the idea that liberal economic thinking was universal and therefore also valid for Japan. In this vein, he is a rare type because Japanese thinkers generally stayed away from such extreme liberal dogmas even though they had benefited from the theory of the classical school. Whereas, Ukichi firmly defended his adherence to free trade, Fukuzawa displayed more flexibility on this issue. Furthermore, the two men had much in common:

Both were committed to enlightenment and interested not just in economic thought but in a wide range of subjects relating to the humanities, social sciences and history. Neither of them was content to be mere observer of events, and both of them were heavily involved in the actual evolution of politics, economic affairs, education and publication in Japan (Sugiyama 1998: XIV).

It is certain that at the beginning of the Meiji era, in the sphere of economic thinking, classical political economy played a predominant part (Sugiyama 1968: 326). However, what role classical political economy played in the practical policies of Meiji Japan has remained a debatable subject. Concerning this issue, Bell argued: “classical economics had little direct part in shaping Japanese economic policy or in directly providing doctrinal setting for the economic theory taught in the schools or practiced by the government” (Bell 1961: 285). And he added that “none of the classical doctrine were used in shaping banking or fiscal policies as was done in England and to a lesser degree in some other nations” (Bell 1961: 285). In contrast to Bell, Sugiyama (1968) claimed that Liberal School was effective as a theoretical background especially for land reform of 1870s and privatization of government

owned enterprises in 1881 which enabled, according to many writers, establishment of zaibatsu firms.

In retrospect, it is reasonable to believe that Classical Political Economy exerted a limited influence on the policies of Meiji government. One area where classical political economy had an impact was liquidation of the feudalistic ties. In this context, Meiji reformers invoked liberal ideas in order to struggle against feudalistic remnants of the old period (Sugiyama 1968). In addition, the influence of liberal economic principles on the privatization decision of 1881 can be observed, despite the fact that “this last policy was probably motivated more by financial necessity than by ideological considerations” (Suzuki 1989: 57).

The ascendancy of Classical Political Economy was short lived. Japanese government’s direct promotion of German studies in tandem with its decision to follow the German model was responsible for the decline of the Liberal School. Suzuki (1989:58) is right in arguing that

There was no extensive industrial capitalist class, whose members might desire to carry on their business unhindered by government interference. On the contrary, the small number of industrialists who were well aware of their fragile positioning against the world economy, generally welcomed the guidance and assistance of the state.

Influence of the Classical economic thinking continued right up to 1890. However, it is a striking fact that, although, the ‘Marginal Revolution’ was given limited attention by Japanese scholars up to 1880s, mainstream economic ideas of the West never gained currency afterwards. Moreover, even Japanese thinkers under the influence of Marginalists or another offspring of the classical school took the side of state intervention and welfare state as we observe in the case of Tokuzo Fukuda (1874-1934)<sup>7</sup> or used this kind of analysis as a non-dominant ingredient of their overall perspective.

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<sup>7</sup> He was one of the brilliant students of Tokyo Commercial School (after 1927 Hitotsubashi University). He was sent to Germany from 1898 till 1901 where he studied under K. Bucher in Leipzig and under L. Brentano who were very influential on Fukuda. (Inoune and Yagi 1998). He also worked on Marshall and the Cambridge School. However, although he benefited from Marshall and the Cambridge School, he did not hesitate to criticize them in many respects.

### **2.1.2 German Historical School**

Increasing industrialization led to the emergence of certain social problems and government involvement in line with the decision to follow the German model after 1881. This process enabled German Historical School to become dominant in Japan. German Historical School and its offsprings might be considered as the most influential force on the evolution of economic understanding of the Japanese intellectuals. Furthermore, it is not as well-known a school as the other schools as far as its impact is concerned, though nowadays the intellectual appeal of the German Historical School has been much more appreciated along with increasing appeal of institutions, ethics and historicism in economics. Therefore, it is necessary to present the case for the German Historical School in detail.

There exist many controversies over the nature and scope of the German Historical School. The number of the schools and their members has been subjected to the debates in the history of economic thought (Senn 2002). Some go as far as to argue that there was no such school (Pearson 1999). However it is more reasonable to accept that the term refers to a group of economists who lived in the middle to late 1800s (Senn 2002: 4). It is generally acknowledged that there were two generations of the German Historical School. One is called the older German Historical School. The other is called the younger Historical School. The historical School emerged in German universities along with the attempts of Wilhelm Roscher, Bruno Hildebrand, Karl Knies, Johannes Konrad and Adolf Held to apply the theories of Müller and List to academic economics (Pyle 1974: 133). Generally it is accepted that Roscher was the founder of the German Historical School. On the other side, Schmoller was the most prominent figure of the young generation including Adolf Wagner, Lujo Brentano. Although the members of the German Historical School did not share a full set of ideas, they had many common points in their understanding of economy and society. For example, history as a source of knowledge covered an important part in their research agenda. Almost all believed that state was an important actor in economic and social life. They also supported the idea that there cannot be universal economic laws as asserted by British classical economists. Moreover, institutions, law and ethics were important subjects in their research

agenda. Their ideas played an important role in crafting the German state and helped the legitimization of the policies of the new-born German State. In this sense, they should be understood in the dynamic context of the German unification and subsequent rise. For example, List was not only an economist but ardent supporter of the German unification.

German Historical School's criticism of the *laissez-faire* and universality of laws of economics echoed in many economists' writing in other countries. Especially, the 1870s can be conceived as a turning-point for the spread of the German Historical School's tenets. "In the broad flow of history, this movement was a contributory force to the renaissance in American intellectual life that accompanied America's great industrial revolution in the post-Civil War era." (Dorfman 1955: 17). One can find the traces of the German Historical School in other European countries in Europe<sup>8</sup>. However, outside Germany, the German Historical School may have exerted the greatest influence on Japan.

Throughout the late 19th century, the widespread appeal of the German Historical School can be accounted for by many interrelated factors. One of them is the success of the German industrialization by way of state-protectionist and state-interventionist policies. Another factor is the superiority of German universities; Free state universities, open to all with "systematic economic teaching" (Tribe 2002: 2). Last but not least, the perils of industrialization, which were seen by most people as a direct result of the *laissez-faire* system advocated by classical economists, intensified the hostility against British Liberal Economics and cultivated a sympathy for German Historical School which was critical of the *laissez-faire* system.

At the turn of the 19<sup>th</sup> century, many students from all around the world went or were dispatched to German universities that were under the influence of the Historical School. Japanese students were among them. After the Meiji Restoration of 1868 the Japanese government started to dispatch students to Western countries.

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<sup>8</sup> Although Coats (1954: 145) argues, "English Historicists did not directly owe their inspiration to Germany," he accepts that "they used the German writings in support of existing predilections." In this vein, comment of Ashley (1894), one of the prominent English Historicists, on Roscher's Program of 1843 shows that English Historicists was closely following and appreciating the German Historicists.

Thanks to these students the impact of German Historical School started to prevail in Japan. This was not the only way for the influx of the German Historical School. After 1880, government directly engaged in promoting German Studies in Japan. Sugihara (1990) points out that after decision of Japanese state on building its political institutions according to the German model, “German economics, as the cornerstone of German social sciences was forcibly imported. Meanwhile, the influence of British economics declined, along with all British conservative social sciences” (in Gao 1997: 61). In this vein, Society for German Studies was established with the support of powerful statesmen and bureaucrats to disseminate German ideas and policies (Kumagai 1998: 203). Moreover, apart from the activities of Society for German Studies Society for National Economy was established by economists who defended of protective trade policy and national economy. These societies were highly effective in the diffusion of the Historical School in Japan.

However, for the dissemination of German economic ideas in Japan, the most important stimulus came from the Faculty of Law at (Tokyo) Imperial University under the leading figure of Nobouru Kanai who had gone to German to study with Gustav Schmoller and Adolf Wagner.<sup>9</sup> Kawai (1998) argued Nabura Kanai “introduced and established the economics of the social policy school to Japan (in Fuji 1998: 44). Although this statement about Naburo Kanai seems to be exaggerated, it shows his importance. He and his student Kumaza Kuwata were the central figures in the establishment of Society for Social Policy, reminiscent of German *Verein für Sozialpolitik*<sup>10</sup> established by young German Historicists. The Society’s similarities with its German counterpart can be easily found in its program:

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<sup>9</sup> (Tokyo) Imperial University, first formal Japanese university, founded in 1877 “primarily to train administration and public servants, has been of enormous importance in the development of Japanese economics, and indeed of modern Japanese scholarship as a whole” (Suzuki 1989: 47). Imperial university, was later named as Tokyo Imperial University, because of the foundation of another university; Kyoto Imperial University. Furthermore, Tokyo Imperial University’s graduates in various areas have replenished Japanese bureaucracy.

<sup>10</sup> The leading figures in the establishment of the society were Schmoller, Wagner, and Brentano. The Purpose of *Verein für Sozialpolitik* was to advocate state intervention in the economy in order to ease class conflicts by way of social welfare legislation. (Pyle 1974: 134 )

We object to laissez –faire, because excessive self-interest and un-limited free competition cannot add to the aforementioned inequality. We also object to socialism, because an attempt to overthrow the existing economic system and to exterminate the capitalist class can only harm the development of the nation. Our aim is to maintain the present economic order based on private ownership and within that boundary to prevent class antagonism and to achieve social harmony through the activities of individuals and the power of the state (Sugiyama 1968: 336)

At the beginning the Society's members were limited to a few scholars and bureaucrats, however, later on, its supporters increased in line with the growing seriousness of labor problems and it eventually came to include almost all economic thinkers in academic and bureaucratic positions (Fuji 1998: 49). Therefore, it is true that the German Historical School was mainly represented by the Society. However, although, the German way of thinking was in a dominant position in the Society, it was nevertheless not a homogenous organization. There were socialists and variants of liberals. But all of them, more or less, shared the idea that state should engage in taking direct or indirect measures for the sake of preserving harmony in Japanese society.

After 1907 the Society held annual conferences on different subjects. The first conference was on the Factory Act which was passed as a law in many industrialized nations under the slogan of mitigating the social problems. Factory Act was enacted in 1911 as a consequence of long debates in Japan. Society can be seen as one of the promoters of this law. The Society continued to hold these influential conferences up to 1920s. Then, the influence of the Society and naturally that of German Historical School declined gradually. The most important legacy of the German Historical School may have been its impact on the bureaucracy. Many influential bureaucrats of the succeeding periods had come under the influence of German ideas during their education in the universities. In this sense, the influence of German Historical School continued on the policies of Japan up to the end of Second World War. Even afterwards, one of the important intellectual sources of the postwar economic policies was the German Historical School. Japanese protectionist, cooperative tendencies and over-bureaucratic orientation can be best understood when cast against background of the German Historical School. The

German Historical School was so appropriate as a source of inspiration for Japan because:

For many reasons- including traditions of bureaucratic rule and paternalism in the economy, the reaction to prevailing Westernism and the search for national institutions with their roots in Japanese cultural heritage-The Historical School had peculiar relevance for Japan. The bureaucracy, seeking ways to justify its rule, to mobilize national localities, and to deal with signs of emergent social unrest, found the German economic doctrines appropriate to their needs. Interpreted to fit Japanese unique circumstances, the Historical School became major influences in determining the bureaucracy's approach to the social problems of industrialization. (Pyle 1974: 134-138).

### **2.1.3 Marxian Economics**

The spreading of socialist ideas among Japanese intellectuals intensified after the Sino-Japanese War (1894-1895) when the effect of industrialization and urbanization began to appear on Japanese society (Beckmann and Genji 1969). In the early days of the dissemination of socialist ideas, Japanese intellectuals derived their socialist theories from anarcho-syndicalist authors and Marx. Furthermore, most of the socialists were close to the idea of social reform. In this line, many of them participated in the Society for Social Policy defending social reforms by the hand of state to narrow the increasing gap produced by industrialization (Fuji 1998). The First World War and mainly the Russian Revolution changed the situation. As a result of the Russian Revolution many socialists who previously advocated social reforms became more radical and converted to revolutionary Marxism. Not only had the leaders of social and democratic movements but also many liberals switched to Marxism (Ando 1998: 78). On the other hand, the appeal of Marxism in academia also increased as a result of the Russian Revolution<sup>11</sup>. In this sense as

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<sup>11</sup> For example Hajima Kawakami, one of the most prominent Marxists around 1920s, converted to Marxism in his 40s mainly because of the Russian Revolution. He entered the College of Law at Tokyo University. Then he began teaching at Kyoto Imperial University in 1908. Kawakami had been under the influence of German Historical School and also he was interested in the Marginal School. However, his concern about the social problems and the impact of Russian Revolution on his thinking led him to Socialism and Marxism (Inoune and Yagi 1998). Furthermore, he even became a member of the illegal Japan Communist Party established in 1922.

Bronfenbrenner (1956:39) argued “Marxism entered the Japanese labor movement about 1900s, but it entered the universities a generation later, almost by product of Russian Revolution”. The relatively free atmosphere of 1920s compared to the preceding period, also contributed to the diffusion of Marxism in the universities<sup>12</sup>.

Universities played a very important role in disseminating Marxist ideas around 1920s. In this sense, Tokyo Imperial University was major university where Marxists students and academicians were very active. Gao (1994:118) argues “Tokyo Imperial University became home of marukei” (Marxism)<sup>13</sup>. However, Marshall (1978) noted that conservative academicians and the government did not miss a single opportunity to assault Marxists in Tokyo University. Especially the Marxist students associated with Marxist academicians at Tokyo University were faced with strong opposition by a coalition of conservatives and liberals whenever they applied to take a post in academia. Hence, many of them took posts at the newer imperial universities and private colleges (Marshall 1978: 549).

Japanese Marxists, strong in economic circles and social movements, were mainly divided into two camps in 1927; the Koza Faction and the Rono Faction. The dispute was mainly about the nature of Japanese capitalism. The Koza Faction followed the theory produced by Comintern which claimed that feudalistic ties were the most important ties to defeat. On the contrary, the Rono Faction defended that Japanese capitalism was already in a mature stage (Ando 1998).<sup>14</sup>

Around 1930 the climate changed drastically. 1930s witnessed a ‘Great Transformation’ all around the world. Japan was not immune from this ‘Great Transformation’ although its own path was more or less different from that of its European counterparts. After the 1930s, militarism and nationalism dramatically

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<sup>12</sup> From 1912 to late 1920, Japan experienced a relatively liberal atmosphere compared to the preceding period. The Diet (Japanese Parliament) played a much more instrumental role in policy-making in Japan during this era.

<sup>13</sup> ‘Marukai’ has been used for Marxist economics by Japanese intellectuals. On the other side, ‘kinkei’ has been used for non-Marxist economics. (Gao 1994)

<sup>14</sup> This separation was rejuvenated after the Second World War, albeit in a different character.

increased as a response to the Great Depression and the changes in international order as well as the internal order in Japan. The Japanese state endeavored to supersede Marxism and other views in all areas as well as in economics because of the fear that they could have potential power to resist its imperialistic policies. Many of the socialist activists were either arrested or gave up their adherence to Marxism and socialism as a result of pressures and assaults. Marxist academics were gradually purged from the universities. The 'Tenko' (conversion) movement took place among Marxist academicians and members of the Japan Communist Party. They announced that they gave up their ideology in favor of national unity which was necessary because of the ongoing crisis. Indeed, Japanese Marxists were inclined to converge with nationalistic ideas. Many Marxist economists were affected by national ideas instead of universalism even though they did not form the majority of Marxists in Japan. For example,

In contrast to cosmopolitanism asserted by classical Marxism, [...] Arisawa Hiromi's version had a strong nationalist orientation; it emphasized ways to strengthen Japan in the competition among nation states, especially between Western and non-Western countries [...] Arisawa's version of Marxism moreover prescribed the avoidance of class conflict and advocated cooperation between management and labor especially when the nation was in a crisis (Gao 1997: 63).

On the other hand, some of Marxists even espoused Japanese expansionism in the name of Marxism. Takashi Kamekichi can be considered among those Marxists. He defended that Japan's war with Russia and China and its annexation of Korea were nationalistic wars waged in order to establish Japan as an independent state. Its proletarian revolutionary movement; therefore, should not despise nationalism, as the Comintern's program urged the JCP (Japan Communist Party) to do. Rather it must incorporate nationalistic elements into its movement in the manner prescribed by Lenin, for the colonial areas and from its relatively advantaged position vis-à-vis China and India, take the lead in liberating the oppressed people of Asia (Hoston 1984: 14).

## 2.2 Japanese Economics and Economists, 1931-1945

The period between 1931 and 1945 is conventionally characterized by the word 'fascism'. In contrast, Duus and Okimaoto (1979:76) argued "the field comes to a stage where the problems and costs of continuing this line of inquiry outweigh the benefit". Irrespectively of whether the period is labeled with fascism or not, it is true that from 1931 to 1945 Japan experienced a major 'Great Transformation'. This period can be interpreted as a bridge linking established theories and policies with the post war era. One important cornerstone of this bridge was economists. Most of them who were very active in molding policies in this period also played an essential role in giving a direction to Japanese capitalism after 1945. These economists' outlook was mainly based on German economics and Marxism. The Nazi and Soviet planning experiences had further shaped the influence of those two central pillars inherited from the interwar period.

Many German economists writing on cartels as well as other issues in capitalist economies were known among Japanese economists since the 1930s. In this sense, Werner Sombart was a particularly influential German economist during the 1930s. His famous book *Die Zukunft des Kapitalismus* (1932) was widely known by Japanese scholars (Yanagisawa 2001, 175). Oswal Lechnich was another German economist who wrote on cartels and had impact on Japanese bureaucrats and economists (Yanagisawa:2001:185). Another economic way of thinking behind the Japanese experience of 1930s and 1940s was Marxism, although many Marxists were persecuted. Marxists nevertheless contributed to the policies of 1930s in several ways. First, some of them directly endeavored to justify Japanese expansionism. Secondly, some of them saw this period as an opportunity to curtail capitalistic relations which could give way to socialization of production and distribution in parallel with socialist ideals. Third, some bureaucrats under the influence of Marxism were directly engaged in the planning process under way in the government bureaus. They proposed plan-oriented and anti-capitalist policies derived from their knowledge of Marxism and Soviet planning. Many bureaucrats and economists either graduated from the Japanese universities under the influence of German mode of thought and Marxism or had studied abroad at German

universities. Hence, they were most probably affected either by Marxism or German approach or both.

Throughout the period Showa Research Association (SRA) and Cabinet Planning Board (CPB) were two channels that enabled economists to be effective. Showa Research Group was organized in 1933 as an advisory committee for Prince Kanoe Fumimero; a leading figure in this era. Members of the group consisted of reformist bureaucrats, professors and leading intellectuals.

In the late 1930s, the SRA made systematic policy proposals for building an economic order. This proposal asserted that the state should control the profit of private companies, separate capital from management, and give managers official status. It also called for a transformation from a profit orientation to production orientation (Gao 1997: 107).

It is an interesting fact that many of these proposals were brought back into discussion after the Second World War and some variants of them became the backbone of the postwar policies in combination with new elements. The SRA mostly produced a theoretical justification for the emerging Japanese New Order around the 1930s. Because of this, it has been labeled as a fascist movement in several ways (Fletcher 1979). Although it is true that there were some persons inclined to Nazi ideas there were also Marxists and non-Nazi participants in it. Tobota Seichi, Nakayama Ichiro and Arisawa Hiromi can be counted as among this group. Therefore, it would be counterproductive to dismiss it as fascist. Intellectuals, economists and reform bureaucrats with very different intellectual background met in this group. Closer attention to their views may shed some light on the fact that what they had in common was an aversion to the dominance of capitalistic relations and the increasing misery and exploitation created by the zaibatsu firms. Furthermore they agreed on the primacy of Japanese national interests. Therefore, the perils of capitalism which became more and more evident after 1929 worldwide as well as in Japan forced these people to gather in the same group because of a common nationalistic sentiment.

The SRA's proposals generally found a receptive ground in the Cabinet Planning Board (CPB) established in 1937. This was the successor of Cabinet

Planning Agency formed in 1935. Establishment of CPB was one of the most important steps towards the ‘war economy’ of interwar period. According to Johnson (1982) “Cabinet Planning Board brought together military officers, detached reform bureaucrats, planners from Manchuria and (unwittingly) some of the leading Marxist economists of the time into what was hailed as the economic general staff”.

### **2.3 Japanese Economics and Economists after 1945**

World War II meant utter physical destruction for Japan. Subsequently, the army of USA formally occupied Japan between 1945 and 1952. Japanese production capacity fell drastically because of the destruction of machines and factories. The bulk of the available production capacity had been devoted to munitions production during the war. This brought a further constraint on the economy. Unemployment and inflation levels reached unprecedented levels. Japanese imports were reduced to only a few vital items. USA’s initial aim was to keep Japan as an underdeveloped economy without any military capacity.<sup>15</sup>

However, the above situation began to change as of the 1950s. Japanese production capacity incessantly increased so much so that Japanese production level exceeded pre-war level in 1955. Japan came to enjoy fabulous growth rate for about the next 20 years. From 1955 to 1973 Japanese average growth rate was above 10 per cent. This drew great attention and admiration from economists and politicians worldwide. Some even called it as ‘Japanese Miracle’. The reasons behind Japanese high growth have been discussed widely from a variety of viewpoints. However, intellectual sources of the high growth period, especially in terms of economic thinking, have not been discussed at length except by a few specialists. Moreover, there is no general agreement on this subject despite the fact that many authors accept indirect involvement of economists in the policy-making procedure. There are two camps in this debate. Some claim that, economic thinking and economists

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<sup>15</sup> The American attitude towards Japanese development changed sharply after the beginning of the Cold War in 1947. As of then USA gave more importance to Japanese economic recovery. Only after the Korean War, the importance of Japan in the eyes of USA increased further.

played a minor role in this situation. In this sense, Ryutaro and Yamamoto's (1981) interpretations have been very influential among Western as well as Japanese followers. They emphasize the lack of professional economist positions in Japan. Their explanations espouse the idea that Japanese academic economists have been very passive in the shaping economic policies: "Japanese prominent academic economists have never occupied important positions in government or the central bank; nor have high ranking officials become professors in leading universities after retiring from government service"<sup>16</sup>(Ryutaro and Yamamoto 1981: 601). Furthermore, Ikeo (2003), one Japanese eminent economist, asserts that Japanese economists did not play any direct role in designing Japanese industrial policy though he gives more credit for the general role of economists in policy-making in the period between 1945 and 1955 and after 1990s. Similarly, Hadley argues (1989:301) "neither academic nor government economists played major role in Japan's high growth strategy. That strategy was the product of talented bureaucrats and business representatives working together largely on the basis of empirical evidence."

On the other side of the debate, there are a few authorities asserting that economic thinking and Japanese economists exerted a significant influence on the policy-making procedure throughout the Japanese high growth era. Gao (1994, 1997) and Suzuki (1989) can be considered among those advocating the significance of economic thinking and economists in Japanese development. According to Suzuki (1989), especially the diffusion and adaptation of 'modern economics' provided many useful insights for Japanese industrial policy. Gao (1994) argues: "Contradicting the conventional belief, that Japanese policy had little intellectual foundation I contend that the Japanese state has had close tie with academia, incorporating various ideas into policy-making" (116). Gao (1997) in his impressive book, *Economic Ideology and Japanese Industrial Policy* defends similar ideas. In addition, Okita (1978) emphasizes the role of the government economists. He maintains that "[e]conomists are closely involved in all of [...] policymaking areas

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<sup>16</sup> It is striking that Komiya and Yamamoto themselves provide many examples demonstrating the role of economists in Japanese policy-making procedure.

and the economic measures finally decided upon inevitably reflect these economists's thinking".

On the whole, the second camp seems to be on the right track. Japanese development had deep intellectual roots going back to the German Historical School and Marxism. Undoubtedly, the late comer situation of Japan and historical conditions facilitated the acceptance of these approaches. Japanese scholars harmonized them with Japanese values. However, neither Suzuki and Okita nor Gao show enough effort to probe into the degree of realization of the ideas in policies, even though Gao provides strong evidence for discerning in which channels economists and economic thinking had a chance to become influential in policy-making. More work needs to be done in this field.

#### **2.4 Postwar Economic Thinking in Japan**

Seven years of American occupation caused deep structural and political changes in Japan. The land reform and the dissolution of zaibatsu firms can be considered among the most important shifts. Even so, as many authors put it correctly, 1945 did not abolish the whole heritage of the pre-war and interwar periods. In other words, although Japan underwent many structural changes, the legacy of the pre-war period prevailed in certain areas. In this vein, the institutional and bureaucratic heritage of the pre-war period was one such key factor. Hence, it is possible to claim that somehow post World War period can be considered as a continuation of the preceding periods. Even if 1945 can be considered as a breaking point, it was nevertheless along the same path. Hence, it is natural that we observe the continuity of many peculiarities of the pre-war period. Therefore, post-war period displayed many characteristics of the pre-war period.

In the sphere of economics this paradigmatic continuity is also valid. Although 1950s witnessed an increasing interest in variants of neo-classical economics, this school did not dominate Japanese economic thinking. Japanese economists continued to benefit from heterodox economic thinking as was the case in the period from 1890s to 1945s. In this tandem, Marxian, Keynesian and Schumpeterian ideas

continued to play an important part in Japanese economic thinking from the Second World War to the mid 70s. Moreover, the legacy of German Historical School was still significant among academicians and other bureaucrats. German influence was obvious in economic policy; especially in the period 1945-1949. Continuity of the paradigms was enabled especially by way of economists and bureaucrats who became influential in the post war period. They were brought up in the milieu of the preceding period. Many of them held important post in bureaucracy and various committees.

#### **2.4.1 Postwar Japanese Marxism**

Marxism and the socialist movement were invigorated immediately after the Second World War. Left-wing academics who were persecuted during the war returned to the universities (Suzuki 1989: 103). They got credit for being the group that had consistently criticized Japanese militarism (Ikeo 1996: 123). Furthermore, when the end of Japanese imperialism became evident, many old Marxists who had given up their Marxist ideas in the 1930s in order to espouse the Japanese war effort, rejumped on the bandwagon of Marxism (Gao 1997). Regardless of the USA occupation authorities' aims, the relatively liberal milieu of the occupation enabled Marxism to penetrate into Japanese society. One reason behind superiority of Marxists in Japanese economics was their pre-war background. They were not born from their ashes like a phoenix. The legacy of the pre-war period was an important source of the postwar Marxism in Japan. The successes of Soviet Union in the Second World War and the Chinese Revolution were two other factors that increased the sympathy for Marxism in Japan.

Nevertheless, the Cold War altered the attitude of the USA toward Japanese socialists and communists. The Korean War exacerbated this situation. "Communist leaders were purged from many industries, starting with the press and the broadcasting industry, on the advice of occupation forces" (Ikeo 1996: 437). Universities had their share from this campaign. Whereas Japanese communists were generally purged from many areas, Marxist academics protected their ascendancy in economics. Evidence for this can also be found in the words of an

economist writing during the late 1950s and early 1960s. Komatsu (1961) argued that, “the percentage of enthusiastic admirers of Marx was, and is noticeably higher in Japan than elsewhere, except of course, in Soviet Russia and her satellites, and Red China” (14). In line with this argument, Bronfenbrenner (1956) argued that more than half of the professional economists in Japan were Marxists<sup>17</sup> (390). For the next decade Akama (2000:128) maintained that Japanese Marxists lived their golden age between 1967 and 1983.

Compared to the preceding period, Japanese Marxists created more original and sometimes path breaking works throughout the postwar era. In spite of Bronfenbrenner’s (1956) claim that Japanese Marxists were illiterate in modern economics, many of them in fact had advanced knowledge of other schools including neoclassical economics and used this knowledge to create original studies. In the postwar period, the Koza and Rono schools continued to contribute to Marxist studies. They mainly discussed dependent characteristics of the Japanese state after 1945. Their discussion can be likened to dependency discussion of the 1970s (Suzuki 1989). Meanwhile, Uno School began to appear as a distinct approach within Marxism. Kozo Uno’s (1897-1977) ‘level analysis’ of capitalism attracted great attention not only from Japanese scholars but also from scholars abroad. Furthermore, perhaps the most important contribution to Marxism came from economists with a mathematical orientation. Their knowledge about Keynesian and classical economics advanced their studies. In this sense, Michio Morishima’s *Marx’s Economics* (1973) and a few other Marxists’ contributions were highly influential at home as well as abroad.<sup>18</sup> Although, Japanese Marxists created original studies, as Suzuki (1989) put it correctly, the inadequate communication channels with the west deprived them of becoming more influential on the world literature.

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<sup>17</sup> According to Ikee (1996:131), the number of members of Society for Political Economy founded for the Study of Marxist economics and the number of members of Japan Association of Economics and Econometrics representing generally neoclassical or Keynesian economists were respectively 600 and 519 in 1961. These figures were 859 and 869 in 1970.

<sup>18</sup> For further information about Marxist economists and their contributions in postwar period see Suzuki (1989), Ikee (1996).

Whereas Japanese Marxist economics was reinvigorated in the postwar era Japanese state policies towards Marxists restricted direct contribution of this approach to economic policies. However, this does not mean that they did not affect Japanese postwar policies at all. Above all, between 1945 and 1960 Marxist influence was very clear. In this context, especially Arisawa Hiromi's and other Marxists' engagement in postwar policies are significant. Furthermore, many of the old members of the Cabinet Planning Board of 1937 who were arrested in 1941 returned to positions in the Economic Stabilization Board and in the successor agency Economic Planning Board. In addition, the indirect impact of the Marxian School should also be taken seriously. Perhaps persistence of a very strong Marxist tradition might have served as an anchor for other economists who may have otherwise been attracted to neoclassical economics.

#### **2.4.2 Keynesian Economics in Japan**

The diffusion of Keynesian ideas among the Japanese academia commenced very early. The first translation of the multi-volume *Treatise on Money* appeared during 1932 to 1935. *The General Theory* was introduced to Japanese students only two months after its first publication (Hadley 1989: 291). Professor Ichiro Nakayama, one of the most prominent post war economists, used it as a textbook for his undergraduate seminar in Hitotsubashi University in the same year (Hamada 1986: 451). However, during the interwar period, the dissemination of Keynesian ideas among Japanese economists slowed down. Instead, many eminent economists devoted their energy and time to the study of the managed economy with nationalistic sentiments throughout this period. In addition, the lack of communication channels with the rest of the world restricted the further diffusion of new developments in Keynesian thinking.

After 1945, the diffusion of Keynesian ideas was accelerated. According to Hamada (1986), three factors can be counted to elucidate the increasing attention to Keynesian economics from Japanese economists. First, The American Cultural Center made available many new resources to Japanese readers. Secondly, traditionally most of the Japanese economists were not well acquainted with

neoclassical economics. Thirdly, Japanese bureaucrats, and economists may have been attracted to “the operational nature of Keynesian economics” which was useful to solve the daily economic problems of Japan (452). However, for the diffusion of variants of Keynesian economics, another important stimulus came from Fulbright and other fellowships enabling Japanese students to go to universities in USA where they met Keynesian and other ‘modern’ economics (Hadley 1989: 299). Last but not least, since all around the world, Keynesian ideas were very widespread; this inevitably stimulated their diffusion in Japan.

Whereas Nanto and Takagi (1985) argued that the Ministry of Finance under Takahashi Korekiyo benefited from Keynesian ideas to deal with the damaging effect of the Great Depression, genuine Keynesian policies were put into effect first by Ishibashi Tanzan who became Finance Minister in 1946 and remained as an important political figure in postwar Japan. He defended that easy monetary and credit policy should be implemented in order to facilitate Japanese recovery. After 1950s the government opted for a tight fiscal policy however, the general spirit of Keynesian economics was clearly seen in all aspects of Japanese policy.

After 1950s, many of the important government economists were influenced by Keynesian economics. In this sense, Sabura Okita and Osamu Shimamura were the best known economists who were under the influence of Keynesian economics although they also benefited from Schumpeterian and other approaches. Okita was a leading figure in the Economic Planning Agency. He was actively engaged in government policies from the very beginning of the new era. He and his colleagues prepared the first reconstruction proposals for postwar Japan. Then he became the chairman of Comprehensive Bureau unit which was responsible for working out the technical details of the ‘Income Doubling Plan of 1960. Osamu Shimamura was another prominent government economist who was very active after 1955. He supported the ideas of doubling income. In this sense, he may be seen as one of the most important theoreticians of the famous Income Doubling Plan, of which more will be said later.

### 2.4.3 Schumpeterian Economics

Schumpeter has been one of the most influential economists molding the minds of the Japanese “kinkei” economists since 1920s. He was invited even to teach at Tokyo University in 1924 (Gao 1997: 206). Nakayama Ichiro (1898-1980) and Tobata Seiichi who played a very active role in forming postwar Japanese economic policies were his students at Bonn University in 1927. Shigeto Tsuru (1912, - ) was also one of his students at Harvard. Nakayama first studied with Fukuda Tokuzo the famous pre-war Japanese welfare economist. Then he went to Bonn where he studied with Schumpeter. After returning to Japan, he was assigned to conduct surveys on unemployment in Fukuda’s research team (Nishizawa 2001a : 166).

Schumpeter visited Japan in 1931 to give a few lectures and to see his former students. His lectures drew great attention from Japanese scholars and newspapers (Suzuki 1989: 92). His visit increased his fame further among Japanese scholars. Moreover, Schumpeter’s impact upon Japanese economics increased after the translations of his works into Japanese (Gao1997; 207). Tobata Seiichi and Nakayama Ichiro translated *The Theory of Economic Development* in 1937. Later, *The History of Economics* in 1950, *Capitalism Socialism and Democracy* in 1951-52, *Imperialism and Social Class* in 1953 and *The History of Economic Analysis* in 1956-57 were translated. According to Gao (1997) the impact of Schumpeter’s theory of innovation on Japanese industrial policy was greatly enhanced by the publication of the 1956 government White Paper on the economy. Goto Yonosuke, the director of the Survey Division at the Economic Planning Agency, played a major role in promoting the policy agenda of technological innovation. In this sense, the

1956 white paper on the economy turned Schumpeter’s idea of innovation from an academic concept explaining long-term economic growth into a practical strategy to upgrade the industrial structure of the Japanese economy and improve the nation’s standing in international competition. (207-208)

## **2.5 The Japanese Miracle and the Role of Economists**

Economic thought became influential in the formation of economic policies in Japan through various channels. First, economists became very active in the period especially of 1945- 1965 when most of the high growth policies were put in practice. Some of them were academic economists. Others were non government economists. Government economists played an important role in economic planning agencies and related bureaus. They were also important actors in the publication of White Papers. Academic economists, similar to the preceding period, participated in special brain trust groups, planning commissions and committees. Special Survey Committee, Economic Stabilization Board, Coal Committee, Central Labor Commission, Productivity Council and a few other such places served as platforms for the raising of their proposals. Moreover, some of them served as personal advisors to leading politicians. Close personal relationships with high-ranking politicians and bureaucrats provided another channel that enabled a small number of economists to play a big role in Japanese economic policy (Gao 1994). In addition, journal and newspaper articles written by eminent economists drew great public attention.

Economic thought had great influence on bureaucrats considered by most economists as architects of the Japanese development. This has been generally underestimated by contemporary scholars. Strong bureaucracy does not mean that economic thinking was not significant in Japan. Quite the contrary, the milieu surrounding bureaucrats is also part of the game. Economic thought does not exert influence only in terms of economists' straightforward activities. One major motivator of postwar Japanese bureaucracy was the memory of economic policies implemented as of the 1930s. Moreover, we saw how these policies were highly influenced by German approach and Marxism. Many economists and bureaucrats who became influential in the postwar period were those who had served or grew up in the preceding period. Therefore, they were highly prone to work with the mindset consisting of ideas, first formulated during the interwar period.

### **2.5.1 Preparing the Groundwork for a High Growth Economy**

The day after the declaration of Japanese surrender, young bureaucrats, intellectuals and economists gathered to discuss the future of Japan. Later this committee was called Special Survey Committee at the Ministry of Foreign Affairs. Saburo Okita, one bureaucrat at that ministry, who later became an important figure in Economic Planning Agency, organized these meetings (Gao 1994). Many economists who played central roles after the post-war were members of this Committee:

These economists can be divided into three groups. The first group included some important spokesmen for Marxism, including Ouchi Hyoe, Arisawa Hiromi, Uno Kozo and Yamada Moritomo. The second group consisted of kinkei (modern economists) including Nakayama Ichiro, Tobato Seiichi and Tsuru Shigeto. The third group was the first generation of government economists including Inaba Hidezo, Okita Saburo and Goto Yonosuke. The men in the third group were very active in politics and later became important liaisons between academia and the state” (Gao 1994: 136).

This study group met regularly and provided two broad documents on the Japanese economies problems and possible solutions: Measure Towards Japanese Economic Reconstruction and Basic Problems of Japan’s Economic Reconstruction. These reports can be considered as the pioneers of Japan’s economy plans (Hein 1994: 758). Some authors even went as far as to compare the role of these economists in the group with the role of Meiji reformers (Suzuki 1989: 147).

Throughout 1946, Japan encountered many economic problems. As a result of this, there was a need for the centralization of the economic decision-making procedure. Under these conditions, the Economic Planning Board, one of the strongest institutions in the field of economic policy that Japan ever saw, was established in June 1946. The pressure coming from the American occupation authority played the most important part. Article 1 of the Ordinance of the Stabilization board states that

The Economic Stabilization Board is under the control of the Prime Minister and is to do office work in making emergent policies for economic stability relating to the production, distribution and consumption of goods, services, prices, finance, transportation and

others, and to do office work for coordination, inspection, and promotion of stability” (Ikeo 2000: 147).

As indicated by the above statement the Board had great power over ministries. Moreover, this power was strengthened in April 1947. Because of some ineffectiveness in the operation of the Board, the government transferred all planning functions pertaining to the economic administration from other ministries to the ESB. As a result of these developments, it is striking that the Japanese dream of a general economic staff was realized; a dream that had remained as such even during the interwar period (Gao 1997: 131)

In May 1946, Yoshida one of the leading politicians of the postwar era, became Prime Minister and the Minister of Foreign Affairs. He held unofficial lunch time meetings with Arisawa Hiromi, Nakayama Ichiro, Tobato Seichi, Wada Hiroo and some other influential figures (Ikeo 2000: 147). As in the case of Special Survey Committee the main theme of these discussions was the reconstruction of Japanese economy. Although this group did not produce any official report the meetings facilitated development of personal relationships between members. As a result, Yoshida offered the first chair of the Stabilization Board first to Arisawa Hiromi. Although he refused the offer, he became the personal adviser of Yoshida together with Nakayama Ichiro. Another result of this meeting was the Priority Production Thesis of Arisawa Hiromi. For the first time, he expressed his Priority Production Thesis there (Ikeo 2000 and Gao 1994: 136). Up to the 1950s, the Priority Production Thesis was the main framework of Japanese economic policy. It was mainly based on Arisawa Hiromi’s studies on the German Total War effort and Marxism. According to this thesis, selected sectors should be given priority. In fact, this was a very similar thesis to the unbalanced growth thesis of Albert Hirschman (1968) as opposed to Ragner Nurkse’s (1952) balance of growth thesis. According to this thesis, particularly coal production was vital for Japanese industries because of the inadequacy of energy resources. Hence coal production ought to be increased as fast as possible. In addition, the emphasis of the thesis was on the government’s direct initiation of planning and production of all economic activities (Gao 1994).

The Coal Committee established as a personal brain trust group of Prime Minister Yoshida on November 1946 played an important role in the development of

the Priority Production Thesis (Ikeo 2000). It did not have any official status; nevertheless it was effective in producing a detailed road map for the Economic Stabilization Board (Gao 1994). Arisawa Hiromi was the chair of the Committee. The other members were Inaba Hidezo, Okita Saburo, Shigeto Tsuru and several other economists and bureaucrats (Johnson 1982: 181). Although, later, the Committee was dissolved, the idea of priority production was put into practice with full force by Wada Hiroo who was appointed as a chairman to the Economic Stabilization Board in late 1947 under the socialist Katayama Cabinet. During his tenure (1947-1948), Economic Stabilization Board reached its peak power along with recruitment of the staff “among those who had been arrested as reds in the Cabinet .Planning Board incident of 1941” (Johnson 1982: 181). From 1945 to 1949 Priority Production Thesis was the leading paradigm and Japanese economy could be seen more or less as a closed economy. By the same token, the period was mainly under the heavy influence of war and pre-war experiences. Therefore, Marxian and German way of thinking and planning experiences determined the fundamental characteristics of the dominant paradigm. Although, the Priority Production Thesis was the main framework, there were nevertheless different approaches to it. For example, Ishibashi Tanzan, Finance Minister in 1946, had the idea that easy monetary and credit policy can be a cure to economic problems. He also supported mild government intervention in favor of a more pro-market mechanism (Hadley 1989, Hamada 1986). On the other side, Arisawa Hiromi, Wada Hiroo and bureaucrats of the Economic Stabilization Board who were generally Marxist oriented, took the side of planning and more government intervention.

### **2.5.2 The Role of Economists after 1950**

In 1949 Joseph Dodge, the famous banker, was sent to advise the Japanese government on how to tackle the sky-rocketing inflation. This was the beginning point of a new era for Japan. In line with Dodge’s advice, Japanese government took

measures for a balanced budget and tight monetary policy. Furthermore, relatively more liberal policies were gradually implemented. Nevertheless, this does not mean that Japan converged towards the western type of economy. What happened was that the characteristic of intervention changed. In this sense, direct or indirect government interventions were continued albeit in newer forms and through different channels. In this period, the influence of government economists was still very visible by way of the economic planning process. Secondly, the role of the academic economists in settling labor disputes commands attention. Finally, White Papers prepared by government economists were still another factor exerting influence on the direction of Japanese development:

The Economic Planning Agency probably provides the most economics-oriented input into the formulation of economic policies [...] Economists are closely involved in all of policy-making areas and the economic measures finally decided upon inevitably reflect these economist's thinking (Okita 1980:14).

Economic Planning Agency was the institution that succeeded Economic Stabilization Board. It was first organized under the name of Economic Deliberation Board in 1952, and finally established under its own name in 1954. Economic Planning Agency served as a secretariat of the Economic Council which was founded in 1952. Its members were chosen from among the leading industrialists, ex-bureaucrats academics and other influential figures. In the planning process, the Economic Council was first requested to draft the Economic Plan (Okita 1980: 19). The Bureau of Comprehensive Planning was dominant in this process. (Ryutaro 1975: 200). The plan was prepared in December 1955 and put much emphasis on self-support of the economy was the first to be officially adopted. Its target was to attain an average 5 per cent growth in GNP during the period of 1956-1960. However, this target was exceeded soon. Hence a new five year plan was prepared in 1958 for the period of 1959-1963.

According to Okita (1980:11) the first White Paper issued in 1947 was the most important factor in raising the influence of the post-war Japanese economists in the area of policy-making. Although this claim does not reveal the whole picture, at least it supports that White Papers were another channel enabling economists to be effective in postwar Japanese policies since 1947 when the first White Paper was

published by the Economic Stabilization Board. Shigeto Tsuru was the central figure in drafting the first paper. Saburo Okita and Hitoshi Matsuo were responsible for some parts of the paper (Ikeo 2000: 148). Saburo Okita took responsibility in writing White Papers during 1946-1948 (Suzuki 1989). The White Papers drew public attention especially when Yonosuke Goto contributed six papers from 1952 until 1958 (Ikeo 2000:149).<sup>19</sup> The most influential White Paper was that of 1956 which used Schumpeter's theory of innovation.

The quality of is a cut above the White Papers published in subsequent years. One contribution, for example, was its coining of the now commonly used term *gijutsu kokushin* to express technological innovation in Japanese (Tokimutsu 1984: 39).

It is impossible to conceive of a high growth process without clearing labor disputes. This can be achieved via different methods. Japanese response to this problem has been highly original. Participation of labor in the management process, life-time employment system and firm based trade unionism were the distinct features of the Japanese labor-management relations. These differences in labor-management relations were one key factor behind the Japanese high growth. However throughout 1950s, great problems were witnessed in the labor market. Central Labor Commission established in 1946 played an important role in dealing with labor disputes. Many economists became the members of the Commission. However, the role of Nakayama came to the foreground. He was an active participant of the Commission from 1946 until 1961 when he resigned (Nishizawa 2001b: 4). He also served as its chair from 1950 to 1960. In this sense he was very active in the stabilization of labor relations. As a book edited by the Central Labor Commission states:

Nakayama over a period of fifteen years following the war, provided a leadership unsurpassed in the area labor-management relations for our country, and was the man who brought together an area of epoch in industrial relations (cited in Nishizawa 2001b: 5).

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<sup>19</sup> Goto Yonosuke was the director of the Survey Division at the Economic Planning Agency (Gao 1997: 207). Goto was invited more than 50 times after publication of the paper to deliver lectures on innovation on which the 1956 white paper was formulated (209).

### 2.5.3 High Growth Period

At the beginning of 1960s there were two challenges in front of Japan. One was the students and unions' mobilization against the renewal attempts of the USA-Japanese Treaty of 1952 which in the minds of many remained as an indication of Japanese subordination. The response was to shift public attention from 'political session' to 'economic session'. In this context, the National Income Doubling Plan was partly envisaged to reach this target. The second challenge was the liberalization pressure coming from international organizations such as IMF, GATT, OECD along with the demands of major Western countries. This time, Japan tried to take counter-measures in order to balance the effects of forced liberalization.

The Income Doubling Plan began to be discussed in November 1959 by the Kishi Cabinet (Ikeo 2000: 158). However, the plan was molded and improved by the new Prime Minister Ikeda in 1960 under the influence of economists and bureaucrats. The plan's main aspiration was to double Japanese income in ten years; an objective that took shorter to realize. In this sense, the plan emphasized five points: strengthening social overhead capital, inducement to realize a highly industrialized structure for the economy, development of human ability and advancement of science and technology, mitigating the dual structure and securing social stability (Okita 1980). However whether or not the Income Doubling Plan played a role in Japanese high growth performance has been debated (Noguchi 2000: 254). Especially Ryuttora (1975) claims that economic planning process was not as influential as originally envisioned. Although the Income Doubling Plan or any other factor was not uniquely responsible for the Japanese high growth performance, one cannot deny the fact that "its chief importance was the psychological effect it had in creating optimism about the future to counter balance the pessimism about liberalization coming from the press and MITI" (Johnson1982: 253). In this sense "making a public promise to double income in ten years or less eliminated future uncertainty and stimulated investment and competition" (Minoguchi, Nishizawa and Ikeo 2000: 215). Moreover, as we will see many of the tenets of the plan were put into practice and later public policies and plans enabled Japan to join the industrialist nations club.

There were many academics and government economists involved in the preparation process of the Income Doubling Plan, even though Ikeo (2000: 159) claims that it is very hard task to measure the degree of the involvement of the Japanese economists in preparation of the Income Doubling Plan. Nakayama Ichiro and Shimomura Osamu and Saburo Okita were considered as theoreticians of the plan. Although the debate on the growth potential of Japan started as early as 1957 (Tsuru 1964: 91) the idea of increasing income twofold had been first offered by the economist Nakayama Ichiro who had also brought a suggestion in tandem with this in direction of doubling wages on January 3, 1959” (Takamitsu 1984: 40). However, as Tsuru (1964) and Suzuki (1989) state, the main theoretical underpinnings to the plan came from Shimomura Osamu. His main emphasis was on the stimulatory economic policies and technologic upgrading (Suzuki, 1989: 139). Moreover, as Tsuru (1982) demonstrated, Domarian characteristic of his model was very apparent (93). Therefore it is true that Shimomura’s thesis of high growth was formulated in the light of the ideas of Schumpeter, Keynes, and Harrod-Domar in reference to the empirical findings on the Japanese economy (Gao 1997: 238). Shimomura was also a close friend of Prime Minister Ikeda who was also known as Keynesian and influenced by Ishibashi Tanzan.<sup>20</sup> Sabura Okita head of the Comprehensive Bureau which was according to Ryutaro (1975) the most important division in the Economic Planning Agency, was responsible for the preparation of the elaborated version of the plan (Okita 1980: 20).

As the Japanese government put into practice this ambition at the beginning of the 1960s, liberalization began around the same time as a result of the pressure coming from the West. This was seen by many intellectuals as a second ‘Black Ship’ incident. The general consensus was that some necessary steps should be taken in order to protect infant industries. According to Johnson (1982), “the most important bureaucratic response to liberalization was MITI’s invention of the concept of ‘industrial structure and the creation on April 1 1961 of the Industrial Structure Investigation Council” (253). It was reminiscent of Rationalization Council of 1949. The council consisted of 12 subcommittees. Nakayama Ichiro was president of

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<sup>20</sup> Ishibashi Tanzan and Ikeda even wrote a book of which name is *100 Billion Public Expenditure and 100 Billion Yen in Tax Reduction* (Gao: 1997 243).

General Committee and Arisawa Hiromi was the chair of the Industrial Order Committee. Of all the most important and vigorous was Arisawa Hiromi's Industrial Order Committee (Noguchi 2000: 261, Johnson 1982: 255). MITI bureaucrats drafted the law aiming to strengthen the competitiveness of firms via encouraging mergers and other rationalization methods. In this process, main advice came from the Industrial Structure Investigation Council and particularly, the Industrial Order Committee. Although the law did not pass, it was implicitly implemented (Johnson 1982: 164).

## **2.6 Conclusion**

The Japanese case shows that economists and economic thought have been two of the most influential factors in determining the medium or long-run economic policy-making. For at least the Japanese case, economic thought and economists were neither unique factors nor ineffective variables. Both were significant.

This study also revealed some peculiar characteristics of the Japanese case. First, Japanese policies and economic thought generally remained under the influence of heterodox approaches. In this sense, the most influential ideas were adopted from the German Historical School, Marxism, Keynesianism and Schumpeterian economics. Secondly, nationalism has been more or less the ultimate reference point of economics and economic policies since 1868. This statement is valid also for the interwar period when Japan endeavored to develop as a non-Western powerful nation. Nationalism was then so powerful that some Marxists were inclined to support Japanese expansionism. In the wake of 1945, although Japanese nationalism seemed to retreat at first, the rejuvenation of the nationalistic outlook did not take much time. 'Strong army, strong nation' thesis was then replaced by the implicit 'strong economy strong nation' thesis. Third, although there is no mass participation of academic economists into the policy-making procedure, a limited number of economists exerted enormous effect on the decision making. Nakayama Ichiro, Arisawa Hiromi, Saburo Okita, Shimomura Osamu were the most well known such economists of the high growth period. Fourth, government economists and academics were directly involved in policy-making through various

channels. Brain trust groups, planning, and economic councils were among the most important activities that they undertook. Their personal relationships with high ranking politicians also gave them a chance to be influential. Interestingly, their publications attracted great attention. In this sense, White Papers command emphasis. Fifth, it can be asserted that, the dominant economic paradigm of the time more or less shaped the mindset of the bureaucrats towards economic problems. For example, Tokyo Imperial University served an important function because most of the high ranking bureaucrats were recruited from it. In this context, even Marxists who were generally purged from bureaucracy could be influential over the shaping of bureaucrats' mentality and outlook.

It is important to note that there is a mutual interdependence between ideas and economic practices. To put it differently, there is no uni-directional relation. Although, ideas are important in determining policies, ongoing developments also exert power over the selection of ideas. Japanese example displays that in response to external challenges, the dominant paradigms also shifted. For example, as a result of the challenge of 'Black Ship', Japan first embraced liberalism. In the second round, the Great Depression brought another challenge that placed Japan under the influence of Marxism and German approaches. After the Second World War, the paradigm shifted quickly in reaction to new dire needs. First the heritage of pre-war and the need for reconstruction, brought about the continuation of the old paradigm albeit in a new form. With the Cold War, Japan took the side of United States and this affected the selection of a new paradigm. Although Marxism was on the ascent in academia, Keynesianism and Schumpeterian ideas had a greater chance in policy proposals both for ideological and practical reasons. Furthermore, the last challenge we observe throughout high growth area has been liberalization. In addition; Japan naturally responded by further incorporating Keynesian ideas to its paradigmatic approach. Marxism began to lose its power at a time when the increasing hegemony of the Keynesian general framework was built.

## CHAPTER 3

### JAPAN'S 'UNUSAL' DEVELOPMENTAL PATH: A MIRACLE ?

Japan is the unique non-Western and non-White nation climbing the entire ladder of industrialization.<sup>21</sup> “No country in the history of the world has risen to international prominence as quickly as Japan” (Ohkawa and Rosovsky 1973: 2). Therefore there is a vast literature which aims at explaining the Japanese success in industrialization. Especially Japan’s unprecedented growth rate between 1950s and mid 1970s has remained a subject of general interest. This achievement also has been regarded as a ‘miracle’. However, an overemphasis on the high growth of Japanese economy during the post-war period can conceal the fact that Japanese pre-war economic performance was also spectacular. Although Japan experienced enormous destruction during the Second World War and poverty afterwards, one should not confuse Japanese situation with that of the Third World of that time. Japan at the end of 1930s was a player of the league of industrial nations with more than successful 50 years of modernization and industrialization experience. Japanese growth statistics show that the growth rate over each decade during the 1874-1967 period was 48.3 per cent. This means that Japanese growth rate was the highest among the developed countries (Kuznets 1971:11-14). This is not only because of the effects of high growth during the period 1950-1973 which is 9.3 percent. The preceding periods’ contributions were also significant. There are various reasons for this.

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<sup>21</sup> According to Maddison (1991) “The advanced capitalist group consists mainly of West European economies and their offshoots (Australia, Canada, and the USA). By world standards their levels of productivity and the real income are closely clustered, and their growth has traced a distinctive orbit. The only non-European country to have entered their orbit is Japan” (5).

First, the heritage of Tokugawa period and especially the long modernization period after the Meiji Restoration in terms of institutional structure, education level, skilled labor and accumulation of technology and capital should be highlighted to understand this development.

### **3.1 The Legacy of Tokugawa and Meiji Restoration**

Conventionally many authors begin to discuss Japanese economic development after the Meiji Restoration of 1868. There are valid reasons behind this. However, one should go back to the Tokugawa heritage to understand Japanese modern economic growth. The Shogunate, Tokugawa rulers, followed a seclusion policy after 1639. Up to the 1850s Japanese were not allowed to leave Japan without permission. Also foreigners were not allowed to visit or trade with Japan. Only, the Dutch and the Chinese were given some restricted rights to trade at the Nagasaki port. There is no accurate explanation for the Japanese policy prohibiting trade and mobility of people. However all available explanations are more or less related with the foreign threat against Japan.<sup>22</sup> Whatever the reason for the seclusion policy was, its results were not considered totally troublesome (Crawcour 1965, 1974, Yamamura 1973)

Although Japan remained in a state of relative backwardness under the Tokugawa rule, its condition, even prior to the Restoration should not be confused with that of those countries where economic and other types of backwardness were closely combined (Ohkawa and Rosowsky 1973: 4).

In this respect, Tokugawa period cannot be labeled as a period of total backward orientation. The heritage of Tokugawa in many respects provided necessary milieu for the Meiji take-off. First, Japan enjoyed peace and order for about 200 years even it was obtained by authoritarian methods. Secondly, the educational level during the Tokugawa period was very high. Literacy rate was around 30 percent in 1860s which was among the highest in the world (Crawcour 1965: 34). Thirdly, some

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<sup>22</sup> Tokugawa rulers were aware of the activities of the Spanish in the Philippines and the Pacific; therefore they endeavored to take preemptive measures against this threat. In addition, the spread of Christianity among the Japanese especially in the southern islands was considered as another threat against the unity of Japan. Moreover, Japanese rulers aimed to prevent masterless samurai (*ronin*) from taking foreign support.

claim that Tokugawa economy was not in a state of subsistence level, on the contrary, its commercial characteristic was clear (Crawcour 1965).<sup>23</sup> Whether this statement is totally true or not, it is safe to claim the Japanese agricultural productivity increased enormously only in response to introduction of small improvements in techniques after the Meiji Restoration. Fourthly, compared to that of the other Asian countries, Japan's roads and ports were well developed to support the hostage system (Bronfenbrenner 1961:13).<sup>24</sup> Fifthly, urbanization had developed before the Meiji restoration so that Japan had three of the most populated cities in the world. Last but not the least, although Tokugawa period can be characterized by semi-feudal structures, the ruling power of Tokugawa Shogunate cannot be compared with that of European feudal kings. In other words, the very success of the bureaucratic structure of the Meiji Restoration can be traced back to this period.

Even though the Tokugawa regime successfully maintained its seclusion policy for about 200 years, around the 1830s the weaknesses of the Tokugawa system became apparent. Financial instability and increasing dissatisfaction among *daimyos* started to undermine the Tokugawa system. In addition, the arrival of Commodore Perry's Black Ships in 1853 aggravated the situation. From 1853 onwards, the main debate was around the question of whether Japan should abandon its ongoing seclusion policy or not. The Shogunate policies undertaken to deal with the foreign threat did not satisfy the *daimyos* and low ranking samurais defending the idea of resistance against the Western Powers. This weak situation once more made the emperor one of the players of the game. Most of the *daimyo* considered reign of the emperor as a solution to protect Japanese honor *vis-à-vis* the western powers. Later developments led to the collapse of the Tokugawa regime and the establishment of the Meiji rule. As such, the Meiji Restoration of 1868 can be considered as a Japanese response to the Western challenge.

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<sup>23</sup> However, Ohkawa and Rosovsky claim that "the statement that Japanese agriculture by the 1860s had become basically commercial is not rare, but it is almost certainly wrong" (1965: 57).

<sup>24</sup> According to 'sankin-kotai' or hostage system feudal lords were forced to spend to divide their time between their own fiefs and the Tokugawa capital in Yedo (Bronfenbrenner 1961:13).

At the beginning of the Meiji Restoration the Meiji rulers were divided into cliques that held diverse views about the direction of reforms. However, in a few years the characteristic of the Meiji rule began to crystallize.<sup>25</sup> Although there existed different perspectives even within the dominant clique, which would precipitate the reshuffling of the clique in 1881, all sects in the dominant clique shared the view that opening of the doors and absorption of Western techniques and institutions were necessary to build ‘a strong army and a rich country’. Therefore they embarked on enormous modernization attempts in all segments of Japanese society and particularly with respect to its institutional structure.

In January 1871, the feudal clan system was abolished. Instead, a prefectural system of administration was established. From 1872 to 1875, several reforms in agricultural sector were archived such as the standard land tax which provided a stable revenue source for the government. On the other hand, this was partly beneficial for the agricultural sector too, because it did not include any ambiguous article imposing an unpredictable burden on the farmers which was the case in the old system (Ranis 1959). Compulsory primary education was introduced in 1872, earlier than most of the Western powers. This means that the educational level in Japan had continued to be superior as compared to that of many industrial nations. Banking system and financial system were reorganized to support economic growth. In this sense the origin of the Schumpeterian banking system can be found in the Meiji period. The government actively endeavored to promote industries by establishing public factories and encouraging private initiatives. Western techniques and equipment were imported for the new government plants and foreign managers were also invited. In addition to this, many Japanese students were dispatched to European countries to learn new techniques.

During 1870s and 1880s the institutional structure of Japan altered very rapidly. However, although it is true that many new institutions were set up throughout the beginning of the Meiji Restoration, this institutional change had

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<sup>25</sup> Elimination of the right wing mainly insisting on continuation of seclusion policy and of more conservative policies was one of the most important cornerstones of the Meiji reforms (Morishima 1982: 76).

actually begun even before the Meiji Restoration<sup>26</sup>. On the other hand, despite the fact that the new Meiji government put enormous reforms into practice, Japanese economic and social life was in a delicate situation before the mid 1880s.<sup>27</sup> As a result of this situation, high inflation became the most important problem in the late 1870s. To tackle with this, the government took anti-inflationary measures, which resulted in a long deflation known as the ‘Matsukato deflation’ that contributed to government revenue because of the fixed land tax (Ohkawa and Rosovsky 1965: 65).<sup>28</sup> Furthermore public-owned enterprises were sold at the beginning of 1880s.<sup>29</sup> Whatever the reason for the sale of the state-owned enterprises, many big merchants who had close relations with the new regime, became industrialists. They were the founders of large *zaibatsu* firms such as Mitsuie, Mitsubishi, Furukawa, Kuhara and Asano.

### 3.2 Modern Economic Growth in Japan

It is generally accepted that modern economic growth in Japan started in the mid 1880s after the Matsukato deflation (Ohkawa, and Rosovsky 1965: 53, Sheridan 1993: 35). This is a reasonable suggestion for at least two reasons. First, the fruits of the Meiji reforms began to mature only after the mid 1880s. Secondly, financial stability was a prerequisite for modern economic growth which was achieved only after the Matsukato deflation. Throughout the 1890s, Japanese entrepreneurs

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<sup>26</sup> Sheridan (1993:24) overemphasizes the institutional discontinuity between the Meiji Period and Tokugawa regime. He asserts “264 year-old Tokugawa regime disintegrated in the first 10-12 years after the Restoration, and the effective preparation for building modern Japan had begun, at least in the sense of constitutional and public administration”.

<sup>27</sup> “ Within a decade of its establishment the weak Meiji government had 1) issued large amounts of cash and government bonds to cope with the former samurai 2) carried out one foreign expedition (Taiwan expedition 1874) and (3) experienced one major civil war, several insurrections and numerous peasant uprisings” (Morishima 1982:93).

<sup>28</sup> The deflationary period lasted from 1882 to 1887. As a result of the deflation the general price level fell about by 75 per cent from 1881 to 1884 (Ohkawa and Rosovsky 1965: 66).

<sup>29</sup> As it was discussed before, the exact reason of this operation is not known. Some argue that it was a necessity. On the contrary, some argue that it was a result of the liberal dogmas which were influential up to early beginning of 1880, and corruption. Corruption has also been put forward as a explanation.

invested heavily on railways, electricity generation and shipbuilding. After big privatizations of 1881 “the government confined itself to more orthodox activities. It operated some factories (mainly arsenals) and trading monopolies, ran the railroads and communications, engaged in a variety of building and public works operated a central bank” (Rosovsky 1959: 350). However, its involvement in economy did not halt. Japanese government always guided market in line with militaristic and other ‘national’ interests. Whenever necessary, Japanese government did not hesitate to intervene to the market.

In the first phase of the Japanese modern growth, the government extracted surplus from agriculture to redistribute it to the industry. “Government policy called heavy taxes on both peasants and consumers and a lighter burden for the landlord and industrial merchant classes” (Ranis 1959: 449). This can be easily discerned from the following figures in Table 3.1. However thanks to increase in agricultural productivity and price of rice, the burden of land tax on agriculture as a whole did not rise. Indeed there was a declining trend in the burden on farmers. On the other hand, the well working banking system and regressive tax policy promoted higher marginal propensity to save which was necessary for financing industrial investment. Another source for capital accumulation was the reparation undertaken by Japan after the Sino-Japanese War of 1894-5. Allen (1981), points out that the indemnity taken by Japan after the war was about the quarter of Japan’s national income at that time (9).

**Table 3.1: Tax Burden on Farmers (Proportion of Land Tax in the Government Revenue)**

Year	1870	1880	1890	1900	1910	1920	1930
Land Tax	73.9	72.9	51.7	24.6	15.9	6.2	4.8

Source: Ranis (1959: 446).

After 1905, the increase in agricultural productivity reached its limits. Therefore, there was no possibility of further surplus transfer from the agriculture to industry. However, other sectors enjoyed stable and nearly incessant economic growth for another decade. This had various reasons. First, although Japan did not get any indemnity payment after the Russo-Japanese war of 1905, the war gave a big stimulus to investment via the widening channel of military expenditure. Secondly, favorable international conditions and opportunities created by World War I was one of the most important reasons behind Japanese economic growth of the next period. In this regard, Allen (1934) is right in claiming that,

[t]he development during the War period requires no explanation. Japan's chief competitors were absent from the world markets and there was an urgent demand for such products as Japan could supply both to neutral markets and to the markets engaged in the War (Allen 1934: 542).

Japan turned into a creditor nation from a debtor nation as a result of the war. Furthermore, Japan's national product increased by more than 9 per cent annually during the war. In other words, Japanese GNP increased about 40 percent during the war. As a result for the first time in Japan's industrial history, the shortage of industrial skilled labor appeared because of the boom caused by the war (Jansen 2002: 531).

It is also important that Japan, even before the World War I, had started to reach self-sufficiency in many key sectors, especially in military production. For example, "By 1914 Japan was one of only five countries (with France, Germany, England and America) to be self sufficient in the production of steam locomotives" (Jansen 2002: 531). Under these circumstances, Japan bought seven out of 77 ships for the navy from other countries during the period of 1905-1915.

In short, at the end of the 1910s, Japan emerged as one of the more important actors in world politics. After the Sino-Japanese war of 1894-1895 and Russo-Japanese war of 1905, Japan proved to be the most powerful nation in Asia. The annexation of Korea in 1910 and expansion of its rights over Manchuria in China strengthened Japan's position. By the same token, it captured some German colonies around the Pacific during World War I. After the war, Japan as an ally of the

winners of the war, England, America and France, took a seat in the newly established League of Nations. Therefore, Japan had established a very successful international political career before the 1920s.

However, with the end of the war, the boom also ceased. Japanese firms had to compete again with Western firms, which had withdrawn from the markets during the war. High inflation became a major problem; growth rate slowed down and became cyclical.<sup>30</sup> During the 1920s the conditions worsened. The Great Earthquake of 1923 caused tremendous damages; about 140,000 Japanese died and more than 250,000 people lost their jobs. Estimated wealth loss was about 1/8 of the national wealth of 1909 (Jansen 2002: 532-533). The situation was aggravated by the banking crisis of 1927 which led to many bankruptcies among banks and other firms. In 1929, Japan was faced with another external shock; the Great Depression. McClain (2002) argues “Between 1929 and 1931 Japan’s export fell in half, its GNP declined by 18 percent and investments in plant and equipment dropped by one-third” (405). However, he based his calculation on GNP with current prices. For the period of 1929-1931 if we consider the GNP with constant prices which reveals a more reliable picture, it can be seen that the effect of the Great Depression on the overall economy was not as severe as in Europe and USA. Japanese economy even grew slightly during the crisis according to Ohkava and Rosovsky’s (1973) GNP series. The big gap between the GNP figures with current prices and GNP figures with constant prices was stemmed from decrease in prices. It means that although Japanese real output did not decline during the period, deflation makes GNP lower.

It is interesting that, during 1920s, Japan at the same time upgraded its industrial infra-structure via imitation and direct technology transfer from Western companies through licensing or buying patent rights especially in electrical machinery and machine tool industries, even if Japanese economic performance was not so bright in terms of macroeconomic variables during the period at these years. Therefore this period according to Yamamura (1986) should be seen as an important

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<sup>30</sup> To tackle the high inflation problem the government decided to import rice from the colonies; Taiwan and Korea. However, the import decision triggered very violent farmer riots.

base for the heavier and aggressive industrialization attempt of the 1930s. These developments took place at the cost of the increasing gap between traditional sector and modern sector which is actually called a dual economy. So the power of *zaibatsu* and many big firms expanded in many sectors, and the income gap between rich and poor increased dramatically. As a result of the worsening income distribution, increasing monopolization as well as the impact of the Russian Revolution, Japan experienced much social unrest especially in the cities during the 1920s.

From the beginning of the seclusion policy of Tokugawa, foreign threat had been a major factor shaping Japanese policies economic or otherwise. After the arrival of Commodore Perry this foreign threat turned out to be a reality and led to the Meiji Restoration of 1868 along with other inner dynamics. To deal with foreign threat, Japan tried to expand its economic and military capability via westernization. However, Japanese society was essentially immune from the so-called 'demonstration effect'. Throughout long centuries as a result of distance barrier and seclusion policies, Japan developed highly different tastes and preferences which did not easily change. Because of insulation from the demonstration effect, Japanese market enjoyed a natural protection, although Japan did not have total control over its trade up to 1911. Therefore the Japanese economy remained largely Japanese as it developed very few enterprises controlled by the foreigners. (Bronfenbrenner 1961:11). The asymmetry between 'demonstration effect' and 'technological absorption capacity' is very crucial to understanding Japan's first industrial attempt. This asymmetry was caused by three interrelated factors. First, the late comer situation of Japan provided an opportunity to transfer the available technologies. Japan worked hard to imitate and copy foreign technologies. Moreover, her comparative advantage in educational and other institutional structures enabled Japan to exploit other opportunities. As it was mentioned earlier, the standards of the education system could be easily compared with that of the industrialized countries at that time. Moreover, the legacy of the Tokugawa period was not only important in terms of its high education level but also due to entrenched bureaucratic and institutional tradition that played an important role in shaping the Meiji institutional

framework. Institution-building by the Japanese government was facilitated by cultural peculiarities of Japanese society. For example, royalty to authority, emphasis on knowledge, and harmony in society were crucial elements in this respect. Therefore Japanese elites did not face with so many obstacles during the industrialization process, which was the case for, say, the Ottoman Empire in the 19<sup>th</sup> century.

### **3.3 Japan during the 1930s**

1930s can be considered as another turning point after the Meiji Restoration. In this respect, Japan experienced many economic and social transformations from 1930 to 1945. First “if the 1920s seemed to belong to the voices of the political left, the radical right made itself heard in the early 1930s” (McClain 2002: 414). Ultra-nationalists gained ground especially among young military officers and bureaucrats. In 1931 and 1932 many assassinations were carried out by members of these groups. Japan started to follow a high-posture policy in Manchuria after the Manchurian Incident of 1932 that was prepared by the section of Japanese Army responsible for the Manchurian area.<sup>31</sup> Then Japan withdrew from the League of Nations as a reaction to the acceptance of a report against the intervention of Japan to Chinese territory. Furthermore on February 26<sup>th</sup> of 1936 young army officers attempted to make a coup d’etat. They killed finance minister Takashi who was blamed for working against Japanese interests in favor of zaibatsu interests. At the end, Japan found itself in the middle of a total war with China. “China had become Japan’s Napoleonic nightmare, the war that would not end” (McClain 2002:449).<sup>32</sup> This trend reached its peak with the tragic Pacific War with America in 1941 and ended in defeat. As it was emphasized earlier, a strong army became an end itself rather than a means. That is why Japanese industrial attempt at least up to 1945, cannot be

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<sup>31</sup> Manchurian Incident of 1932 was a provocation prepared by Japanese officers in Manchuria. Japanese officers blamed Chinese forces for exploiting south Manchuria Railway. As a result of this event Japanese troops without taking any order from Tokyo attacked some cities and expanded the area under the control of Japan.

<sup>32</sup> In fact, many claim that the war between China and Japan was greater than the Pacific War in terms of scale and damages caused.

differentiated from Japanese expansionist and militaristic policies. As one can easily see from the figures below, share of military expenditures in total government expenditure increased gradually. These are two sides of the same coin. Throughout the whole period it is not easy to figure out whether industrialization is a by-product of militaristic aspirations or militaristic expansionism is a key factor for industrialization.

**Table 3.2: Government Total Investment Expenditure and its Military Component**

Year	Total Gov I/NNP (%)	Gov. Mil Exp/Total Gov. I (%)
1889-1904	5.4	35.5
1905-1919	7	32.6
1920-1931	9.1	22
1932-1938	11.5	46.9

Source: Calculated by the data from Rosovsky (1959)

Secondly, the influence of government on society rose in conjunction with the ultra-nationalism of military and young bureaucrats. From the beginning of the establishment of Ministry of Commerce and Industry (MICI 1925) the ancestor of the Ministry of International Trade and Industry (MITI), new institutions and new laws were formed in this direction. The Industrial Control Law of 1931 aimed at strengthening cartels and controlling industrial organizations to cope with the Great Depression. Furthermore, in 1937 Material Mobilization Law and in 1938 National General Mobilization Law was passed. These laws were implemented by the newly established Planning Agency, roots of which go back to the early 1930s.

In fact this shift cannot be characterized as a ‘revolutionary change’. In Japan, *laissez faire* policies had never become dominant. The German Historical

School and its offsprings, which advocated almost totally different policies from the neo-classical school, were very influential. From the beginning to the end, capitalists were always under the supervision of the government and military. Private sector and conglomerates always played an important role in the Japanese economy. But the private sector had firm connections with the government and military. In this sense, there was a mutual consensus among the military, zaibatsu, firms and government. So, although Japan experienced her 'great transformation' simultaneously with other countries in the 1930s, her motivations were essentially different from those of the Western countries. It can be said this was an unfinished 'great transformation' consisting of successive minute changes. In this way, Japanese politics and economy never went under the total control of a German type of homogenous ideology and absolute totalitarian governance even under the war conditions.

Thirdly, Japanese economy grew spectacularly. In this sense it can be said that this period was the beginning of Japan's second industrial revolution. If we deem growth rate from 1932 when Japan recovered from the impact of the Great Depression to 1937 when Japan embarked on total war in mainland China, Japanese GNP increased about 6,5 per cent which is a very impressive figure if we remember that most of the other countries were struggling with the worldwide economic depression at that time. Even if we consider the period from 1932 to 1940 the growth rate was 5,7. Throughout the 1930s, the earlier dominance of light industry over heavy industry had been completely reversed. Heavy industry, which constituted 38 % of the total industrial output in 1930, had reached 73 % of the total by 1942 (Cohen 1946: 361)<sup>33</sup>.

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<sup>33</sup> "The motor vehicle industry for example, which in 1930 produced only about 500 units (cars, trucks, busses, etc) reached a production level of 48.000 units annually during 1941. Only 400 planes of all types were produced in 1930. By 1941, the newly created Japanese aircraft industry was turning out over 5.000 planes a year. [...]. Naval shipbuilding rose from 15.050 gross tons in 1931 to 231.990 gross tons in 1941" (Cohen 1946: 362).

**Table 3.3: Gross National Product: Constant 1934-36 prices, million yen**

Year	Gross National Product	Change in GNP (%)	Average growth 1932-1937
1929	13835	0.4	6.6
1930	13976	1.0	
1931	14067	0.6	
1932	14610	3.8	
			Average growth 1932-1940
1933	16026	9.6	
1934	17510	9.2	5.7
1935	18437	5.2	
1936	18839	2.1	
1937	20709	9.9	
1938	21502	3.8	
1939	22272	3.5	
1940	22949	3.0	

Source: First column was taken from Ohkawa Kazushi and Henry Rosovsky (1973:280). Second and third column derived from the first column.

Fourthly, in the economic sphere new actors appeared. The army encouraged and directly helped the establishment of new zaibatsu firms, because old zaibatsu firms were considered as agents that only follow their interests as opposed to the

nation's interest. Nissan Nihon Chisso (Japan Nitrogen), Nihon Soda (Japan Soda) and Showa Denko (Showa Electrical) thrived through the protection of the military. "The capital for their enterprises was raised from the public on the open capital market. Through their close connections with the military they gained various concessions and were therefore loyal to the military" (Morishima 1982: 96). In this sense, the role of Nissan in Manchuria is a very well known example of the relation between new zaibatsu and the military<sup>34</sup>. In addition to this, many cartels, oligopolies and big firms emerged during this period. Of course, as it was discussed in Chapter 1, the cartel theory formulated in Germany was very influential in this movement.

### **3.4 Japanese Economy after 1945**

After the Second World War, Japan faced two major challenges; massive destruction and American political supervision. As it can be seen in Table 3.4, Japan's national wealth decreased nearly to its 1935 level. Especially the losses in shipping capacity were drastic. Japan lost nearly all her shipping capacity, which was very crucial to maintaining the imports of raw materials and energy sources. About 3 million Japanese soldiers and citizens died in the war. Japanese hyperinflation, which lasted from 1945 to 1949, introduced many uncertainties and disturbances. If 1945 is taken as a base year, the consumer price index rose to 515 in 1946, 1655 in 1947, 4585 in 1948 and 7889 in 1949 (Yoshihara 1994:17). Furthermore, the threat of famine stemming from the drastic decline in crops production together with high unemployment was another severe problem which endangered Japanese economy and society after the World War II.

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<sup>34</sup> Nissan took an enormous amount of financial and political support in return for investment in accordance with military demands.

**Table 3.4: Damage to the National Wealth Due to the Pacific War**

	National Wealth Prior to Damage	Proportion Damaged (%)	National Wealth Remaining at the end of War	National Wealth in 1935	Rate of change with respect to 1935 (%)
Structures	90,435	24.5	68,215	76,275	-10.6
Machinery and Tools for Industrial Use	23,436	34.2	15,352	8,501	80.6
Ships	9,125	80.6	1,796	3,111	-42.3
Electric and Gas Facilities	14,933	10.8	13,313	8,987	48.1
Railroads, All vehicles	15,415	9.8	13,892	13,364	4.0
Telegraph, Telephone and Water	4,156	15.8	3,497	3,229	8.2
Capital Goods	32,953	23.8	25,089	23,541	6.6
Furniture and Household Goods	46,427	20.5	36,869	39,354	-6.6
Other	16,340	33.5	10,857	10,389	4.5
Total	253,130	25.3	188,852	186,751	1.1

Source: Kosai, Y. (1991: 38)

However, despite the fact that World War II had disastrous effects, the level of wealth in terms of ‘Machinery and Tools for Industrial Use and Electric and Gas Facilities’ were significantly higher than their 1935 level. ‘Machinery and Tools for Industrial Use’ rose by 80 per cent and Electric and Gas facilities by 48.1 per cent as compared to their 1935-level. This is quite interesting because it implies that the

Japanese economy exhibited a significantly higher growth potential at the end of the war as compared to the 1935 level. Hence, “the large capital stock inherited from the pre-war and wartime years made very rapid economic growth during reconstruction possible without new investments, if only increased new imports of raw materials could be arranged.”<sup>35</sup> This can be also substantiated with the figures in Table 3.5. As it can be understood from the figures up to mid 1950s, whereas the share of private investment is not very high, its rapid growth was sustained. One can explain this by the high increase in labor supply and/or technology and/or human capital. One can go one step further and assert that non-economic factors such as organizational or institutional structure might have contributed to this high growth process. However, it is safer to claim that this was mainly due to the utilization of idle capacity, which resulted from the shortage of raw materials and coal plus other disturbances at the beginning of the War. We know that Japanese economy up to the beginning of the 1950s was almost a closed economy under very strict trade regulations imposed by Supreme Commander for the Allied Powers (SCAP) to keep the capacity of the economy at a certain level despite the fact that the signals towards facilitating Japanese economic growth via decreasing these restrictions started as early as 1947. Therefore transfer and improvement of technology was very limited up to the 1950s. On the other hand, increase in labor supply continued up to mid 1960s, therefore it did not belong only to this period.

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<sup>35</sup> “Factories that made machine guns turned to making sewing machines; optical weapon factories began turning out cameras and binoculars. In this way the facilities, technology and labor accumulated during the war exerted a tremendous influence on the subsequent direction of the economy” (Nakamura and Kaminski 1990: 15)

**Table 3.5: Growth and Investment Rates (% in GNP)<sup>36</sup>**

	1945-1950 (%)	1950-1955 (%)	1955-1960 (%)	1960-65 (%)
Economic Growth Rate	9.4	10.9	8.7	9.7
Pr. Investment (a)	8.3	10.8	16.5	18.5
Gross domestic Capital Fixed Formation (b)	21	19	25.1	33.5

a- private plant and equipment investment over GNP, For 1945 -1950 (Investment in private housing + Private plant & equipment)\* 2/3 in real prices (1970 prices). This part was taken form Kosai and Kaminski (1991: 5)

b- Gross Domestic Capital Fixed Formation over GNP. Calculated from Rosovsky and Ohkawa's 's GNP series (Ohkawa and Rosovsky 1973:289)

Even if a country has a very high potential growth, the shortage of raw materials and energy will set an upper boundary for growth. By the same token, one major problem of Japan was the shortage of energy supplies and raw materials. In 1947, the vicious circle of low level of raw material and shortage of energy supplies led to low levels of production in other sectors. Arisawa Hiromi's 'Priority Production System' was put into practice. According to this, all imported oil was channeled into the steel industry which was vital for other industries. Steel was used in coal production, which, in turn, was further used in steel industry and so forth (Nakamura 1990: 33). Although production in coal industry and in other sectors were sustained, high inflation remained intact. Therefore in line with American advice, the Dodge Plan commenced to be implemented. According to this plan of Joseph Dodge,<sup>37</sup> a tight fiscal policy was to be adopted. Therefore, the plan included increases in taxes

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<sup>36</sup> The investment figures cannot be used for a one- to- one comparison, because they were derived from different data sets which were estimated under different assumptions. However, they can be used to see the general trend in investment.

<sup>37</sup> A Detroit Banker, who was sent to Japan after drafting West Germany's currency reform in 1945-1946 as a representative of USA. As it was stated by Tsuru (1993) when Dodge arrived Japan, he found relatively benign conditions for his policies because conservatives had won a victory in the general election over Communist and Socialist, which ruled Japan from 1947 to 1948 (55).

and suspensions of government subsidies and loans. Furthermore, Japanese yen was pegged to US\$ with this plan. This fixed exchange rate regime continued up to the collapse of the Bretton Wood system. As Tsuru (1993:55) argued the Dodge plan envisaged a stable economy by way of price stability:

In fact, however, for fifteen month afterward, the economy showed little sign of recovery. Industrial activity rose only sluggishly, and durable goods production, the key indicator of the new capital investment awaited by concerned observers to replace the alleged consumer binge, actually fell. It was, in a sense, inevitable that this was the case due to partly to the peremptory decision by Dodge to terminate the use of Reconstruction Finance Bank (RFB) for industrial recovery.

The situation could have been worse, if the Bank of Japan did not pursue sterilization policies. In this respect, the Bank of Japan tried to reverse the impact of the Dodge Plan at least in two ways. First, it engaged in the purchase of securities to increase the money supply to provide loans for investment and tried to meet the borrowing requirement of the banking sector. Secondly, it encouraged and forced the banks to channel their resources to the industrial sector. Hence the overloan phenomena occurred. As such, although the deposits of the banking sector increased by about 100 percent, loans increased by 160 percent (Tsuru 1993: 56).<sup>38</sup>

Implementation of the Dodge Plan not only mitigated inflation but also stabilized the economy as a whole, even though the Bank of Japan adopted adverse policies. It can also be asserted that the Korean War saved Japan from a deflation spiral. The general increase in the volume of world trade especially in terms of armament in response to the Korean War positively affected the Japanese economy. Moreover, USA used Japan as a supply base for the needs of her troops in Korea. This was the so-called American procurement program. Therefore, Japan attracted a large flow of foreign exchange, which was vital to finance the balance of payment deficit.

After the Second World War, Japan lost its political independence, and American troops occupied Japanese territory between 1945 and 1952. American authorities had almost absolute power in deciding about Japanese economic and

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<sup>38</sup> These developments played an important role in shaping post-war keiretsu system and overloan phenomena (Tsuru 1993: 56 and Kosai 1991).

social policies. In this sense, the main American policy was to control the military and economic capacity of Japan in order to punish her. In fact, the Americans thought that Japan should have remained a relatively backward country as other underdeveloped countries with only agricultural and small industries sectors (Sheridan1993: 125). This point was made clearer by the Pauley Reparation Mission Report, which pointed out that the occupation authority “should take no action to assist Japan in maintaining a standard of living higher than that of neighboring Asiatic countries injured by Japanese aggression” (Tsuru 1993: 11). On the other hand, Americans allowed some social and economic reforms, which were believed to put an end to Japanese aggressiveness and militarism. Education, labor and land reforms as well as the dissolution of the *zaibatsu* firms were among the major institutional changes they sought.

### **3.4.1 Land Reform**

Before the Second World War, small land ownership, tenancy, and ‘absentee landlordism’ had been the main characteristics of Japanese agriculture. The typical ownership pattern consisted of holdings of very small land; about half of them were less than 1 ¼ acres and 94 per cent under 7 ½ acres. ‘Absentee landlords’ who did not cultivate their land but rented it numbered about a million (Allen 1981: 71). One third of the peasants did not have any land of their own. They had to pay big portions of their products (nearly half of their produce) to the landlords as rent (Kawagoe 1999: 11).<sup>39</sup> At this juncture, the land reform as one of the most important policies undertaken during the American occupation was enacted in 1946.<sup>40</sup> At the beginning of 1950, the tasks envisaged by the law were nearly completed. The ‘absentee landlords’ disappeared after the land reform. In this sense, after the land reform, most of the peasants possessed some land to cultivate.

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<sup>39</sup> However, it is also important to note that Japanese land lords had also relatively small portions of land compared to the landlords in other countries (Kawagoe 1999: 11)

<sup>40</sup> Since 1920s there had been some strains necessitating measures to deal with the mounting discontent within the majority of rural population. The increasing influence of military aggravated the strains in this direction. Furthermore, after the Chinese Incident of 1937 some serious course of action began to be realized.

According to Kawagoe (1999), Japanese experience was the most successful land reform in comparison with other experiences. However, the main motivation behind the Japanese land reform was political rather than economic. According to the American occupation authority, Japanese militarism had grown due to the feudalistic structures of rural Japan that ought to be destroyed.

Did the reform cause Japanese high growth? As Kawagoe (1999) put it, though its direct effect in terms of increasing agricultural productivity and output remained open to discussion (because of the decline in farming land area), its indirect impact was important. The land reform especially helped to stabilize the political arena through decreasing the disputes in the rural sector, which constituted an important source of problems in pre-war Japan. Moreover, the reform played an important role in decreasing overall income inequality, as was reckoned by most authors as a prerequisite for successful industrialization.

### **3.4.2 Dissolution of Zaibatsu**

Before 1945 the zaibatsu firms (big Japanese conglomerates) had played a very important role in shaping the Japanese economy. After the American occupation, zaibatsu firms were dissolved into smaller firms. The dissolution of zaibatsu firms divided the big conglomerates into different companies and deprived the owners of these conglomerates of their rights over the management of the firms. Americans ordered the dissolution of the holdings in December 1945, and in July 1946 details of the program were materialized. However, the implementation of this program created many obstacles. Japanese government tried to decrease the speed of the program. After the change of SCAP, the program lost its importance. “Though 235 firms were originally scheduled for decentralization, in the end 25 were broken up” (Rotwein 1964: 262). It is true that the program succeeded in removing the owners of the old zaibatsu from their positions; however after 1952, old zaibatsu firms started to form a new system of organization which was later called the keiretsu system or cross-shareholding (Rotwein 1964:263). Some authors claim that this new type of partnership cannot be compared with the old zaibatsu structure

(Yamamura 1964). However, it can be asserted that at least some characteristics of the old zaibatsu system continued after the post-war period.

### **3.4.3 Educational Reforms**

As we have already seen above, Japanese educational standards were comparatively high even under the Tokugawa regime. After the Meiji restoration, the education system started to be centralized. The slogan of the Meiji was that “there shall be no community with an illiterate family nor a family with an illiterate person” (Kobayashi 1976: 25). The Japanese government reaped the benefits of these efforts. As one can surmise from Table 3.6, Japanese education level was not inferior to that of other major countries in 1913. By 1920, there were 1604 secondary schools, 25582 elementary schools, 6 imperial universities and 20 non-imperial universities (Kobayashi 1975:28). After 1932, the centralization of the Japanese education system increased further.<sup>41</sup> This development can be explained by two factors: the increasing role of the military in Japanese political life and the rising the student movements in the universities during the 1920s.

From Tokugawa period to the Meiji, Japanese education system was mainly based on the Confucianist code of ethics almost without any consideration for occidental methods.

[T]he end of the 1870s, the policy of separation between Western techniques and Eastern morals was set up and carefully maintained by the government. [...] The westernization of education was allowed to proceed only within the limits of technology and related practice that is the curriculum structure, teaching methods, school organization, etc. The moral aims of education were cautiously prescribed and interpreted through the traditional national philosophy (Kobayashi 1976: 29).

After the Second World War, American policy tried to dismantle the nationalistic and Confucianistic character of the Japanese education system. Hence the US made the championship of decentralization and universalism in Japan. However, liberalization wave did not last very long. To defeat the strong labor and

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<sup>41</sup> Hofman (1999:90) asserts that this is a transformation from a nationalistic education system to an ultra nationalistic system.

student movements after 1945, the emphasis on national identity and moral codes re-emerged though this cannot be considered a return the pre-war educational system. In this sense, the changes in 1958 and 1970 were important. For example, moral education courses which were the backbone of the pre-war education system were reintroduced in 1958. Hofman (1999:92) argues “that Confucian ideals emphasizing unity in the community and conformity were again to be thought”. In this way, American reforms introduced some new structures, nevertheless did not create a permanent break with the pre-war education policies.

**Table 3.6. Average Years of Formal Educational Experience of the Population Aged 15-64 in 1913 and 1989**

		Total	Primary	Secondary	Higher
France	1913	6.18	4.34	1.77	0.10
	1989	11.61	5.00	5.29	1.32
Germany	1913	6.94	3.50	3.35	0.09
	1989	9.58	4.00	5.20	0.38
Japan	1913	5.10	4.50	0.56	0.04
	1989	11.66	6.00	4.95	0.71
Netherlands	1913	6.05	5.30	0.64	0.11
	1989	10.51	6.00	3.82	0.69
UK	1913	7.28	5.30	1.90	0.08
	1989	11.28	6.00	4.75	0.53
USA	1913	6.93	4.90	1.83	0.20
	1989	13.39	6.00	5.72	1.67

Source: Maddison (1991: 64)

### 3.4.4 Labor Reform

Before the postwar period, all progressive labor unions were banned and only some pro-national and pro-army labor organizations were allowed merely as tools of ultra-nationalist policies during the war. “It cannot be denied however, that a basically labor-movement potential was there, hidden and dormant under suppression

during the war years” (Tsuru 1993:23). Because of this and thanks to the relatively liberal milieu at the end of the Second World War, labor unions boomed at the beginning of 1945<sup>42</sup>. At the end of 1948 the number of labor unions reached 34000 and total membership rose to 6.7 million (Tsuru 1993: 24, McClain 2002: 546). However this burst did not last long. The first signal in the reverse direction came as early as 1946. In response to the militant and widespread left-wing labor movements, some legislative restrictions and obstacles were created to avoid strikes. By the same token, 1945 was a turning point for the post-war Japanese labor movement. General Mc Arthur, Commander of Allied Powers, banned the general strike of February 1946 just one day before the strike. In alliance with SCAP, Japanese conservative government enacted new laws with further restrictions. In 1950, the further step taken by the government was the so-called ‘red purge’, which resulted in the dismissal of many left-wing workers. To sum up, democratization in labor legislation did not last long and there remained no significant influence of the labor legislations even if the workers gained more rights as compared to the war years. However, war years cannot be a good reference point for comparison purposes. In a nutshell, Japanese labor rights started to be overshadowed by the ‘interests of nation’, despite the fact that this later term was given a new meaning different from that of the war period.

The overall objective of the American project was not to create an institutional structure which would be conducive to high economic growth. The main aim was to hinder Japan from maintaining any military capacity and developing militaristic tendencies. As such, the US tried to stimulate liberal reforms. However, the attitude of the American occupation authorities towards Japan altered radically over time, because of the outbreak of the Cold War in 1947. After 1947, the American approach was to rebuild the Japanese economy as a bulwark against Soviet Russia at the Pacific Rim. Hence, most of the reforms started to slow down. The US did not care for liberalism or democratic rights any more; her first priority was to

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<sup>42</sup> It is interesting that Tsuru (1993) argues “there were in February 1946, 675 unions with a total membership of 496 000” (24). On the other hand, McClain asserts “[...] by January 1946 nearly 1200 unions had come into existence with a total membership of nearly 900 000 workers more than double the pre-war peak” (546).

avoid communist expansion in East Asia. Therefore, The US allowed counter movements in many areas except the land reform. In the middle of the 1950s, old *zaibatsu* firms started to form new kinds of corporations. Education system again commenced with emphasizing moral code of ethics and put more emphasis on the harmony of society instead of universalism. Many improvements attained by the labor unions were taken back after the Cold War. Conservative characteristics of the political regime distorted labor market relationships. Whenever necessary, strikes were banned by the government. From the beginning of 1950, many elements pertaining to the pre-war or war period returned to the scene. In sum, except for the land reform, the American influence and ambitions did not change course.

It can be claimed that American policy might not have left any legacy had it not been for the outbreak of the Korean War. As a result of the Korean War, American Special Procurement Program was implemented as an important source of demand for Japanese goods. The total volume of the program reached about 3,5 billion dollars between 1950 and 1955. Although Japanese growth was mainly driven by domestic efforts (as in the whole period after the World War II) it cannot be denied that the US-aid and the Special Procurement Program contributed to Japanese performance by easing the foreign exchange bottleneck. During the mid 1950s, despite some obstacles, Japan experienced incessant high growth. This was mainly the result of a combination of inner dynamics (such as utilizing and reorganizing growth potentials) and favorable international conditions (such as the outbreak of the Cold War and the Korean War).

### **3.5. High Growth Period**

As we can easily figure out from Table 3.7 Japanese growth rate was significantly higher than all other countries during 1950-1973 period. The significance of Japanese growth can be seen well if we consider Table 3.7. In 1973 Japanese economy became the second largest economy among the capitalist

countries in terms of real GDP whereas in 1950, it had the lowest GDP among the same countries.<sup>43</sup> This was the result of 9.3 per cent annual growth rate, which is far above from the average growth rate (5.09) of the ten countries during this period. The high performance of Japan turned out to be a subject of interest to many economists. Although there is disagreement about the beginning year of the high growth period, many economists explain the high growth performance after the mid 1950s within a miracle context, because real GNP and GNP per-capita reached their pre-war level in 1951 and 1955, respectively. However it should not be forgotten that there were also earlier booms and waves of growth in Japanese history after the Meiji Restoration. For example the growth performance of the Japanese economy during the 1930s was also very spectacular, which was then halted by the war with China and the Second World War (Ohkawa and Rosovsky 1973). Apart from the question as to whether Japanese postwar economic achievements can be considered as a miracle or not, all statistics show that Japan experienced an extraordinary performance, which is worth exploring further.

**Table 3.7: Growth Rate of Real GDP (annual average compound rate)**

	1870-1913	1913-1950	1950-1973
Austria	2,1	0,2	5,3
Canada	4,1	3,1	5,1
France	1,5	1,1	5
Germany	2,8	1,3	5,9
Italy	1,9	1,5	5,6
Japan	2,3	2,2	9,3

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<sup>43</sup> Japanese per capita GNP in 1952 was \$188 which was below that of Chile, Malaysia, and Brazil (Patrick and Rosovsky 1976: 11). However, as it is now the case for China, it was due mostly to high population. Furthermore Japanese growth potential could not be compared with these countries since Japan had enormous amount of skilled labor resource, accumulated capital and high institutional capability.

**Table 3.7: (continuity)**

Norway	2,1	2,9	4,1
Sweden	2,2	2,7	4
UK	1,9	1,3	3
USA	3,9	2,8	3,6
Average	2,48	1,91	5,09

Source: Adapted from Maddison (1991: Appendix A)

**Table 3.8: Gross Domestic Product in Constant 1985 US Relative Prices (adjusted to exclude impact of boundary changes) (\$million)**

Year	France	Germany	Italy	Japan	UK	USA
1870	60397	31512	33663	2129	78936	89933
1890	77913	50481	42558	32581	118403	196433
1913	113741	113657	76873	57564	176986	473332
1929	152868	125529	100778	102924	198047	771532
1938	147523	175284	115914	141435	234507	723725
1950	173569	166888	132802	130728	284594	1311131
1960	271273	359172	23916	304629	377511	1805763
1973	537997	626607	469348	1003744	565655	2988621

Source: Modified from Maddison (1991:197)

### 3.5.1 Different Approaches to Japanese Economic Development

There has emerged a debate dealing with reasons of high growth of the Japanese economy especially since the 1960s. To categorize different positions separately would be implausible without making any simplification since many such approaches overlap with each other. Hence, there is no chance to escape from the trap of simplification. Here, we will try to investigate the explanations by dividing them into four broad categories.

According to the explanations in the first category, Japanese high growth or miracle was mainly due to the state's subtle industrial policies. As such, the miracle could not occur without these industrial policies. Some explanations emphasize the role of bureaucracy in the context of 'developmental state'. For example, Johnson (1982) devoted himself to prove that Japanese high growth was a genuine child of MITI and Japanese bureaucracy. According to him, "the particular speed, form, and consequences of Japanese economic growth are not intelligible without reference to the contributions of MITI" (1982: vii). Furthermore, Tyson and Zysman (1989) who were influenced by Johnson argued "that perspective motivating Japanese policy is explicitly dynamic and explicitly developmental. From this perspective the competitive advantage of a nation's producers' in world markets is created by policy rather than given by immutable resource and technological endowments" (xvi).

The second set of ideas can be labeled as a sociological approach to the miracle. Those who are following this line of thinking put more emphasis on religious, cultural and ethical values of the Japanese people as Max Weber (1958) did in his *The Protestant Ethic and the Spirit of Capitalism* to elucidate the birth of capitalism. They mainly emphasized the virtue of the 'Confucianist Ethic' instead of the virtue of the 'Protestant Ethic' despite some minor differences among various views. One of the most advanced explanations about Japanese economy based on Confucianist ethic can be found in the writings of the late Morishima (1982). He argues that the materialistic character of Japanese Confucianism is very different from its Chinese counterpart and education is vital to understanding Japanese capitalism. According to him:

It was fortune for Japan that Confucianism was intellectual and rationalistic. It rejects mysticism, incantation, magic and ghosts. The development of modern science in Europe, however, was slow.” [On the contrary] “in Japan it was entirely owing to the intellectualism of Confucianism that the Western sciences were able to plant their roots deeply and quickly without great suffering on the part of brave scientists.” [Moreover] “Confucianist education had trained the warriors to be efficient bureaucrats by the end of the Tokugawa era” (Morishima 1982: 60- 61).

In this regard, he put an emphasis on the Tokugawa period in shaping the Japanese people in terms of Confucianist values. According to him, “loyalty to the state or lord, filial piety to one’s parents, faith towards friends and respect towards one’s elder gave different characteristics of Japanese capitalism” (Morishima 1982: 86). In this line, Kahn (1979) was more orthodox in his belief that Confucianism was vital to understanding Japanese development.<sup>44</sup> On the other hand, Dore (1973, 1987) introduces advanced combinations of sociological and late-comer views although he points out that “many of the differences between Japan and Britain are in any case not primarily cultural in origin, but a product of Japan’s history as a latecomer to industrialization” (Dore: 1987: 8). Whatever the origin of these differences, he argues that Japanese capitalism had different set of ethical moral and other norms which cultivated success.

The third group’s main assertion is that generally the institutional structure of Japan was responsible for Japanese success. According to this group Japanese institutions were conducive to high growth and they were different from those of many Western countries. By the same token, Allen (1981: 22) asserts that

[t]he main causes of Japan’s post-war achievements can be examined under two headings purpose and institutions [...] The progress of the country in the last thirty years cannot be understood without reference to this whole-hearted pursuit of a single overriding purpose which commanded the assent of people. [...] Here however, it is necessary to emphasize that the realization of the purpose depended on the presence of congenial institutions. It is indeed conviction of the present author that partly by design, partly by accidental convergence of historical factors;

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<sup>44</sup> He claims that both aspects of the Confucian ethic- the creation of dedicated, motivated, responsible, and educated individuals and enhanced sense of commitment, organizational identity, and loyalty to various institutions were a chance for Confucianist societies. Therefore, these societies have potentially higher growth potential than other societies. (Kahn 1979: 1979 )

Japan's institutions were or became exceptionally well attuned to the conditions favorable to rapid growth.

The fourth type of the explanation stresses especially the importance of the role of entrepreneurs. This explanation relies on the priority of the market over state initiatives and industrial policies. For example, Patrick (1977:239) as a prominent specialist in Japanese economy argues that Japanese economic success mainly stemmed from "the actions and efforts of private individuals and enterprises responding to the opportunities in quite free markets for commodities and labor, while the government has been supportive and indeed has done much to create the environment for growth, its role has often exaggerated".<sup>45</sup> By the same token, Ryutaro (1995) claims that foreign Japanese specialists were generally prone to overestimating the efficiency of Japanese industrial policy.

### **3. 5. 2. The 'Relative Backwardness of Japan'**

Here we will start with Japan's initial potentials in order to elucidate the high growth period. Therefore, we will stress the importance of her relative backwardness or relative readiness of the country before the high growth period. These concepts are related to the notions of 'late-comer' and 'catching up'. However, as opposed to Gerschenkron type of late-comer analysis, the subject-matter can be clarified better by means of a new concept; i.e., "relative late-comer." Generally speaking, Gerschenkron claims that backward countries have more potential for high growth. In other words, followers catch up faster if they are initially more backward (Abromowitz 1986). According to us the potential for high growth caused by the late comer situation can only be valid, if the country is 'relatively backward' or 'relatively advanced' which means even though a country has technological or some other backwardness, it is at the same time developed in terms of institutional,

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<sup>45</sup> On the same issue, Sakoh (1984:537-541) defends a more radical view. He claims that "the secret of Japan's growth can be stated in the simplest terms of—a basically free-market economy, functioning effectively with minimal government intervention since the war". He also adds that "ironically, however, the government contribution is based not on how much it did for the economy but on how much it restrained itself from doing"

educational and organizational structure. More clearly, Gerschenkron (1962: 144) uses relative backwardness as follows: “Backwardness, of course, is a relative term; it presupposes the existence of more advanced countries” (144). However here we are using ‘relative backwardness’ or ‘relative advancedness’ to explain the possibility that a country, which can be considered as backward in terms of conventional understanding, may have other advanced particularities. This co-existence of the presence of ‘advancedness’ and backwardness may provide great potentials for accelerated growth.

Here we do not mean only technological backwardness implied by the term of ‘relative backwardness’, although we share the emphasis of Abramowitz (1986) that “a country’s potential for rapid growth is strong not when it is backward without qualifications but rather when it is technologically backward but socially advanced” (Abramowitz 1986). However it is also true that “growth is a process” and this cumulative process requires some preconditions and ‘piece-wise’ continuity (Galbraith: 1964: 45). To pass from one wagon to another, the necessary condition is being in the train. Relatively latecomer or backward countries are akin to passengers who are sitting in one of the back wagons. Therefore, such countries have a chance to change wagons. In this sense, Japan never became an ‘absolute’ late comer. She has been always in the train and passed gradually from back wagons to front wagons while carrying some of her belongings with herself.

At first glance, this seems very similar to Rostow’s (1971: 5) stage theory in the sense that “it is possible to identify all societies, in their economic dimensions, as lying within one of five categories; the traditional society, the precondition of take-off, the take-off, the drive to maturity, and age of high mass consumption.” However, it can be a mistake to see history within the framework of a linear continuity paradigm. Therefore, all countries cannot pass the same stages in a similar way. Furthermore, it is very difficult to claim that there is a tendency for convergence of all societies in terms of their wealth. Secondly, the different stages can carry many particularities of the preceding stages which can be called ‘hybrid stages’ in some countries (such as Japan) because of their historical, geographical and cultural factors. For example instead of a development in the direction of mass

consumption or “demonstration effect”, old habits of consumption can last long, which can, in turn, cause enormous amount of saving and investment. Furthermore, a dynamic industrial sector can live along with relatively unproductive sectors as legacies of the preceding periods. This situation is called a ‘dual structure’ within the economy, and as many authors observed for Japan it can contribute to the growth process. Hence, relative backwardness of Japan did not only enable her to exploit the available foreign technologies, but also enabled her to exploit internal opportunities. Therefore, Japan achieved an accelerated growth. Interestingly, a peculiar combination of the availability of opportunities and various backwardness particularities were an advantage in case of Japan.

However, availability of opportunities cannot automatically generate high growth. There are also well-known golden rules for the growth process. An increase in labor supply, capital or efficiency, which can stem from the increase in technological level or human capital, can expand production possibilities, which means higher growth. Any positive change in the combination of these factors would normally cause growth. Of course it is not an easy task to differentiate between technological upgrading and increases in human capital because, they are not mutually independent variables. In other words, they are strongly correlated.<sup>46</sup> Furthermore, although the prescription for growth is given in a very simple way in text-books, without benign institutional and historical conditions (and cultural conditions as well) which facilitate especially increase in technology and capital accumulation, it is not possible to attain higher growth performance. In this sense growth is a truly dynamic process which should be envisaged in the context of dynamic interaction of all factors.<sup>47</sup> Therefore, it is not difficult to explain Japanese high growth by recourse to high technological upgrading, high investment and abundance of skilled and unskilled labor. These factors worked together in the same direction within a favorable institutional and cultural framework along with

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<sup>46</sup> Labor supply increase may be also connected indirectly with increasing other variables, however, this connection is less than the relation that the other variables have with each other.

<sup>47</sup> This dynamic interaction of all factors is more necessary for especially countries within basic necessities of growth such as infrastructure, saving for investment, technological absorption capacity etc.

government's subtle industrial policies. Now our task is to explain the factors that increase the K-stock, L-supply and technological improvements. As such, we shall understand the dynamic characteristic of this process.

### **3.5.3. Investment**

One of the most striking features of the Japanese high growth period was its success in devoting her resources to investment, but especially fixed capital investment.<sup>48</sup> How can we interpret this phenomenon? There is a huge disagreement in the literature about the role of capital investment. Marx was one of the earliest economists who put an emphasis on investment. "He stressed the enormous growth of productive power represented by the transition from manufacture to machinofacture, and the importance of accelerated accumulation of fixed capital as the mainspring of economic progress" (Maddison 1991: 18). Later, in Harrod-Domar type of analysis, under the Keynesian influence, investment became the most important determinant of long run growth, which basically relied on saving ratios. In the 1950s, Lewis (1954: 4) argued that, with an unlimited supply of labor, "the real bottlenecks to expansion are capital and natural resources, and we can proceed on the assumption that so long as these are available the necessary skills will be provided as well, though perhaps with some time lag". However, Solow (1956) and his neoclassical colleagues downgraded the importance of capital accumulation in order stress the role of total factor productivity (TFP), which arises from exogenous technological change. After the 1990s, some economists restarted to emphasize the role of equipment investment. In this line, De Long and Summers (1991) and De Long, Summers and Abel (1992) made important contributions to the discussion.<sup>49</sup> According to them, "high rates of equipment investment can account for nearly all Japan's extraordinary growth performance" (1991: 446)<sup>50</sup>.

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<sup>48</sup> Conventionally, investment consists of fixed capital investment, inventory changes and residential housing expenditures.

<sup>49</sup> While, our results suggest that high rates of equipment may be necessary for rapid growth we certainly do not regard them as sufficient" (De Long and Summers 1991: 489).

In fact one of the most striking features of the Japanese high growth period was Japanese success in devoting enormous amount of resources to investment, but especially fixed capital investment. “It is no exaggeration to say that Japan’s high economic growth was brought to fruition mainly by the fixed investments of private companies in heavy industries” (Yaginuma 1998: 311). As one can easily figure out from Table 3.9, Japanese fixed nonresidential capital investment shows a gradually increasing trend in proportion to GDP. This trend accelerated especially after 1950 and peaked during 1961-73 periods.

**Table 3.9: Ratio of Gross Fixed Non-Residential Investment to GDP at Current Market Prices, 1871-1973, (in %)**

	France	Germany	Japan	UK	USA-b
1871-80	9.0	n.a.	n.a.	7.5	11.5
1881-90	10.4	n.a.	8.9-a	5.9	12.2
1891-1900	10.4	n.a.	11.2	6.8	15.8
1901-10	10.4	n.a.	11.0	7.4	15.7
1911-20	n.a.	n.a.	14.9	6.2	12.5
1921-30	12.1	11.9	13.9	6.4	12.7
1931-40	11.1	10.1	14.7	6.5	9.7
1941-50	9.1	8.4	14.3	6.3	9.9
1951-60	13.8	16.6	20.1	12.4	12.6
1961-73	17.0	17.6	26.6	14.7	13.5

Source: Maddison (1991: 41)

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<sup>50</sup> Because, marginal contribution of capital investment is very high without making any pressure on wage levels.

To evaluate the quality of investment one should also consider the sub-sectors towards which investment was channeled. First as we see above, non-residential investment is the biggest component of total investment. Secondly, Japanese investment generally went to the dynamic high-tech and other heavy industrial sectors instead of 'light industries' in which Japan had a comparative advantage (Allen 1981).

### **3.5. 3. 1. High Saving**

What were the sources of this high investment? We can divide these sources into two categories; domestic and foreign sources. For the Japanese case, as opposed to some other South East Asian countries, foreign sources did not constitute a big portion in financing investment (Yaginuma 1998). The sources of high investment were mainly domestic. "If the saving ratio had not increased rapidly after the WWII, Japan's remarkable postwar economic growth could not have been achieved" (Sato 1987: 140). The major component of domestic sources was household saving. Japanese saving ratios increased during the 1950s and 1960s. From the 1960s to the late 1970s, saving ratio remained above 20 per cent, which was very high relative to other industrial countries although some also argue that Japanese saving rate is not as high as generally it has been accepted (Horioka 1995).<sup>51</sup> Even so, we share the view that conceptual differences and their adjustments cannot be sufficient to explain fully the disparities among Japan and other countries (Kawasaki 1990:10)

There have been many attempts to account for Japanese high saving episode. According to Sato (1987:140) and many others, "the saving ratio is apparently a variable conditioned principally by macroeconomic forces rather than cultural factors". In other words, this line of thinking claims that Japanese high saving mainly stemmed from high growth itself.

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<sup>51</sup> For example Horioka (1995:388) claims "Although Japan's household saving rate is about two and a half times that of the United States if the unadjusted national income accounts data for the two countries are compared, the gap narrows considerably if conceptually similar figures are compared; for example, it narrows to only 1.4 times if Flows of Funds Accounts data are compared. Finally, my results show that household saving in Japan consists primarily of financial saving (net lending) and thus that, although Japan's household saving rate is not as high (either absolutely or relative to other countries) as is commonly thought, most of it is available to finance investment in other sectors of the economy and/or abroad." In other words, some measurement and misspecification problems lead to this conclusion.

Some others stress cultural variables (such as thriftiness) as promoting high saving in Japan. For example, according to Nathan (1976: 848), “Japanese have bent or dispositioned saving, that they value saving highly for itself –independently of their given circumstances and of any rational adoption of them”.

Although cultural and other factors might have contributed to Japanese high saving episode, institutional factors should also be taken into account. Postal saving system and bonus payment practices have played a central role in attaining high saving ratios in Japan. Japanese postal saving system was established in 1875 in line with the practice of British Post Office Savings Bank of 1861. The postal saving funds were directed to the industrial sectors such as steel, shipping and mining as well as to the construction of infrastructure especially under the Fiscal Investment Loan Program (FILP) during the 1950s. In fact, the cost of funds to the government was substantially low as compared to those funds raised from capital markets (Calder 1990:50) especially during the 1950s. The bonus system, the origin of which goes back to the 1890s, created additional revenue. Moreover, government policies in favor of tax exemptions for savings and deliberate creation of institutions (such as postal saving) were also important factors.

As the above discussion showed, there is no a single explanation for the Japanese high saving event. However, we think that relatively backward situation of Japan gave further spurt to the saving rates together with her advanced particularities. Japanese people did not totally develop a Western type of consumption pattern, and this promoted savings. As early as 1952, Ragnar Nurkse (1952:582) observed that:

It is well known that Japan, in the early course of her industrialization, imitated the Western World in everything except consumption patterns. She had kept herself in a state of isolation for centuries, and it was comparatively easy for her to maintain this isolation in regard to consumption patterns.<sup>52</sup>

We believe that isolation from western consumption patterns or, more literally, being immune from the so-called demonstration effect continued throughout the 1950s and

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<sup>52</sup> The person who might first use this kind of analysis to explain Japanese development was Veblen (1915) in his article entitled “The Opportunity of Japan”.

1960s.<sup>53</sup> This was partly the result of deliberate government policies such as restrictions on luxury consumption goods. It also stemmed from the special social and geographical background of Japan. In this context, Tokugawa seclusion policy was another major factor. Moreover, long years of war forced Japanese people to abstain from adopting Western consumption patterns in favor of the munition industry. This can be clarified further if we look at Japanese history from 1868 to 1945. This period can be labeled as an era of hundred-year wars. It is also well-known that Japanese consumer goods production drastically decreased during this era and many consumer goods plants were transformed to munitions factories. Secondly, up to end of 1970s, Japan exhibited also other types of backwardness which might have contributed to high savings. These were low security system, limited credit for housing and high expenditures on education. These might have made people very anxious about their future. If we associate these with the bad memories of the Second World War, which remained in the minds of Japanese people during the 1960s and 1970s, it can be possible to think that Japanese people could have reckoned income increases as transitional rather than permanent, as it was theorized through the permanent income hypothesis.

However, as Akyüz and Gore (1996) show for East Asia, high saving does not automatically generate high investment; there must be additional factors which decrease leakages of saving to unproductive sectors or speculative areas. In the Japanese case, government policies and institutional structures (such as Main Bank, direct financing, credit policies) helped to direct savings towards the productive sectors.

Generally, firms used an indirect financing method to obtain the necessary funds for their investments instead of direct financing via capital markets. There are some reasons explaining this fact. First, Japanese capital market remained undeveloped for a long time. Hence, finance via issuing shares or bonds was not a viable option for Japanese companies. Secondly, official interest rate policy was

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<sup>53</sup> According to Nurkse (1952: 580), [t]he demonstration effect leads directly to increased consumption, rather than investment. At least it makes an increase in saving peculiarly difficult as and when incomes and investment increase”.

regulated in such a way that borrowing from banks was very attractive. The monetary policy conducted by the Bank of Japan encouraged companies to borrow much from banks.

The main bank system decreased the problem of asymmetric information in terms of moral hazard and adverse selection and it also decreased the transaction costs associated with gathering information about the borrower firms. Because in this system a bank generally has a cross-shareholding relationship with a firm it is responsible for monitoring the firm and collecting necessary information. Hence this system also facilitated borrowing from the banks and decreased the problems which could arise from a capital market.

#### **3. 5. 4. Technology**

Technology has been emphasized more and more as a key factor for economic development in the literature. Schumpeter is one of the most prominent economists who saw the importance of technology as an endogenous variable in capitalist development. He pointed out that:

Innovational processes incessantly revolutionize the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism (1975: 83).

However, technology was neglected in economic literature for many years. Solow (1956) repopularized technology as an exogenous variable within the neo-classical framework in the 1950s. Economists who did not conform to the assumption that technology is an exogenous variable started to develop other models.<sup>54</sup> Moreover as Rutan (1998: 4) points out, the motive behind the re-introduction of endogenous growth theory was “lack of any evidence towards steady

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<sup>54</sup> In this context, Romer (1994:3) introduces his own work as follows: “This work distinguishes itself from neoclassical growth by emphasizing that economic growth is an endogenous outcome of an economic system not the result of forces that impinge from outside.”

state growth and instability to successfully account for differences in income growth rates or income level across countries”. In the light of the discussion above let us turn to the Japanese case:

The advantage of latecomers in modernization was never utilized in other countries so fully as in Japan. Japanese industries have tried very hard to borrow the best technology available in the world and then improve upon it (Ichimura 1998: 20).

Up to the 1970s, Japanese technological strategy mainly depended on the absorption of foreign technology instead of domestic innovation. In this sense, Japan pursued a technology policy, which relied on

[t]he absorptive functions of domestic research and development as a means of utilizing imported technology. This doesn't mean that the creative aspect was missing altogether since the two types can often not be separated. However, a major function of Japan's domestic R&D has been to facilitate adoption of borrowed technology rather than to discover innovations (Blumenthal 1976: 253).<sup>55</sup>

Technological absorption took very different forms in the Japanese case. The most widespread practices of technology upgrading were licensing and similar agreements with foreign firms on patents and other rights. On the other hand, Japanese engineers and scholars were dispatched to Western countries and especially to USA which was then the world leader in most technologies. Foreign engineers and scholars were also invited to Japan to improve the upgrading process. However, direct foreign investment had played a little part in upgrading Japan's technology (Odagiri and Goto 1996: 39).

The late-comer situation is not automatically conducive to borrowing and using available technologies. In this regard, to benefit from the late-comer situation, a country must possess other necessary conditions. High educational standards and a large supply of skilled labor and engineers are prerequisites for adopting available

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<sup>55</sup> Up to the 1970s, Japanese government's main policy was to import and modify technologies, improve complementarities and innovate over imported technologies. However, after the mid 1970s "the stress of the Japanese technology policy shifts more to creation of domestic via increasing funds spending on R & D research corporations synchronized by especially MITI (Ozawa 1974).

technologies. Japan had sufficient technological capabilities and accumulated a considerable amount of knowledge when she started the 'second big push' as we discussed before (Odagiri and Goto 1996: 43).

The diffusion of technology was determined by government policies in Japan. Although technology policies were liberalized gradually, the essence of the policy particularly MITI's manipulation capability in the process of firms' choosing foreign technology and making agreement with foreign firms remained intact.<sup>56</sup> Japanese government's basic tool to manipulate technological development in industries was the 'Foreign Exchange Law of 1949' and the 'Foreign Investment Act of 1950'. The Foreign Exchange Law of 1949 was enacted to ration limited foreign exchange reserve to avoid balance of payment problems. On the other hand, Foreign Investment Law's main target was to foster import competing and export competing industries (Ozawa 1974: 18-19). According to The Foreign Investment Act of 1950 governmental approval of all transactions involving remittances in a foreign currency was compulsory. Normally almost all technology import involved such a remittance. Therefore this legislation provided the basis for extensive control by MITI. The MITI used its approval power for many purposes. For example, in many cases competition among Japanese firms would increase royalty payments, unless MITI intervened so as to reduce the number of competitors. Secondly, MITI especially endeavored to prevent technological agreements including export and other types of restrictions (Peck and Tamura 1976).

Consequently, Japan benefited from the opportunities, which came into being thanks to her relatively backward situation. She modified creatively new technologies. Furthermore, the government actively prompted and monitored the technology transfer process. There is another result which can be deduced from our discussion above. For a late-comer economy like Japan, technology is not a totally endogenous variable as Schumpeter and Romer envisaged. Availability of foreign technology indicates that technology can actually be an external factor. However,

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<sup>56</sup> Even in the 1980s there were some mechanisms affecting the direction of the diffusion of technologies.

requirements of adoption or incremental modification of technology determine its ultimately 'endogenous' character for a late-comer country.

### **3. 5. 5 Labor Supply**

Increase in labor supply is another important determinant of growth for two reasons. First, an increase in labor supply can expand production possibilities. More labor would produce more output under certain conditions. Second, marginal contribution of investment can be very high without making any pressure on wage levels with an 'unlimited supply of labor'<sup>57</sup> (Lewis 1954: 4). In the classical approach, labor supply is abundant if the wages are assumed to be fixed in terms of agricultural goods. In this case, it can be said that labor supply curve is vertical with infinite slope. On the other hand, neoclassical approach claims that labor is never available to the industrial sector without decreasing agricultural output (Jorgenson 1961).

Japanese labor market after the war was characterized by a 'reserve army'. Therefore, marginal contribution of capital was very high without making any pressure on wage levels. Although some claim that Japan exhausted her unlimited 'labor supply' by the end of World War I, it is reasonable to accept the approaches of Minami (1968) and Ohkawa and Rosovsky (1973). They point out that Japan did not reach a turning point in terms of labor supply until the 1960s. In this sense,

[f]rom the viewpoint of modern enterprise, the post-war labor supply has been extremely favorable- certainly until 1965. Industry had little difficulty in securing the needed quantities of disciplined, loyal and skilful workers at reasonable wage" (Ohkawa and Rosovsky 1973: 118).

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<sup>57</sup>According to Lewis (1954:4), if there is unlimited supply of labor, shortage of skilled labor is "only very temporary bottleneck: if the capital is available for development, the capitalists or their government will soon provide the facilities for training more skilled people. The real bottlenecks to expansion are therefore capital and natural resource, and we can proceed on the assumption that so long as these are available the necessary skills will be provided as well, though with some time lag".

This was mainly caused by the dual characteristics of the Japanese economy: namely, co-existence of a modern advanced sector along with a traditional sector.<sup>58</sup> Agricultural sector had a very big surplus of labor working at very low productivity levels. At the beginning of the Second World War, this surplus reached enormous amounts because of the contributions of various factors. First, after the defeat, the Japanese army was dissolved. So, ex-soldiers became part of excess labor supply in rural or urban regions. Secondly, Japan faced huge immigration movements from ex-colonies. Japanese people settling in ex-colonies such as Korea, Manchuria and other Pacific countries had to return after the defeat. On the other hand, labor movement continued after the 1950s as a result of technological advances and structural change in agricultural sector. In this way, the land reform and technological advances made the agricultural sector more productive and provided extra supply of labor for industrial sectors. However, this relocation can contribute to the general productivity level if and only if the productivity level in the industrial sector is higher than that in the agricultural sector. For the Japanese case, high investment and technological developments made the modern sector more productive than the other.

However, interestingly, duality did not only prevail between the agricultural and industrial sectors. In the Japanese case, there existed another duality within the 'modern sector'. Very advanced

[l]arge firms co-exist with pre-modern (or pre-capitalist) medium and small firms, and in which there prevails enormous wage or income differentials not found in more advanced countries; there is also polarization of output and employment in the very large and the very small firms respectively (Shinohara 1962:15)

This kind of duality enabled big companies with price setting power to recruit very high skilled new graduates from universities at relatively low wages. Secondly, these big firms also exploited low wage advantage of small firms via the subcontracting system. Furthermore, in periods of crisis, this kind of duality served

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<sup>58</sup> Although Patrick and Rohlen (1987:354) argue that “ ‘[e]conomic dualism’ has become an outmoded phrase because the underlying economic conditions that determined the terms of the dual-structure analysis have changed substantially over the past two decades”, the concept is valid and proper to analyze Japanese high growth period.

as a pillar for big firms to secure their employment structure because big companies can roll over their problems to the sub-contractors which have more flexible labor market relations.

**Table 3.10: Rates of Change in the Labor Force by Industries (per cent)**

	Non-agricultural	Agricultural
1908-17	2.37(%)	-0.05(%)
1912-18	2.79	-0.84
1918-31	1.97	-0.26
1932-38	2.68	-0.25
1955-61	4.81	-2.34
1962-64	4.29	-3.72

Source: Ohkawa and Rosovsky (1973)

### **3. 5. 6 Government**

There is disagreement among Japanese specialists about the role of government in Japanese success. Some argue that without explicit reference to the role of Japanese government and bureaucracy, the Japanese high growth episode cannot be explained (Johnson 1982). On the other hand, some claim that it is an exaggeration to ascribe an important role to the government (Ryutaro 1990). As Allen (1981:31) points out, according to basic statistics the second view is irrefutable. Beginning with Russo-Japanese war the government expenditures rose significantly and, they exceeded 50 per cent of GDP at the end of 1930. However, after the war it showed a drastic decline (Ohkawa and Rosovsky 1973: 148). The ratio of government expenditure to GNP was relatively lower than that in other countries; in 1962 and 1967, % 18 and % 24 respectively. Number of public servants in total employment and share of public ownership were also considerably low as

compared to that in other countries (Allen 1981:32). However, statistical interpretations may lead us too quickly to wrong conclusions.

As we discussed before, Japanese government has played a very important role in the industrialization process in many ways from the beginning. In fact the role of government continued after 1945. In the first period (1945-1949), Japanese economy was regulated like a command economy. Although, from 1950 to 1970, the role and tools of the government gradually changed in many ways, the role of the government remained decisive.

### 3. 5. 6. 1 Government Expenditures

Although the ratio of government expenditure to GDP was relatively low during the high growth period, it is interesting that government expenditures on fixed capital formation were very high. These expenditures reached about half of the private plant and equipment investment in later years (Nakamura and Komiski: 115). Secondly, Japanese military expenditure did not exceed % 1 of GNP thanks to the post war constitutional restriction. However, in other developing and developed countries, this ratio was generally significantly higher as one can see from Table 3. 11. This fact has been put forward as a main reason for Japanese development. Arrighi (1994) claims that externalization of defense expenditures freed Japan from unnecessary expenditures so as to focus on more productive sectors.

**Table 3.11: Military Expenditure as Percentage of GDP, 1981**

France	Germany	Japan	Netherlands	UK(1978)	USA
3.8	2.9	0.9	3.3	5.0	4.7

Source: Maddison, (1991:79)

Thirdly, as Ryutaro (1990) points out, high municipality expenditures should also be considered before any judgment. Many public services in Japan had been carried out by local municipalities. If we consider their spending together with the government expenditure, the share of government expenditure in GNP will be much higher. However, whether the above factors which increased the importance of government expenditure were very strong or not, we should also look at other tools and strategies pursued by the government in order to assess the role of Japanese government in the industrialization process.

### **3. 5. 6. 2 National Planning**

In Japan, the outline for industrial strategy was prepared in general plans. In fact, the planning procedure goes back to the mid-1920s. Then, under the influence of Soviet Gosplan and German war-economy planning, 1930s witnessed an increase in planning efforts. During the pre-war years, Japanese economy came under total control of the government. This situation continued up to 1949 under the leadership of Economic Stabilization Board, which was established in 1946. Later, planning process turned into indicative planning for private sector. However,

[t]he government did not normally give direct orders to business, but, those businesses that listened to the signals coming from the government and then responded were favored with easy access to capital, tax breaks and approval of their plans to import foreign technology or establish joint ventures. The business literature of Japan is filled with description of very interesting cases of big firms that succeed without strong governmental ties (for example Sony and Honda), but there are not many to describe (Johnson 1982:24).

Furthermore, there is another aspect of the Japanese economy. In the preparation of most industrial policies, there were negotiation rounds with the representatives of the industries. Hence the Japanese government faced less problems in the implementation process.

Ryutaro (1990:268) argues that plans generally failed because they underestimated the growth potential of the economy. Therefore according to him as far as its quantitative aspect is concerned, planning experience should be taken as a long-term forecast with some goodwill. He argues that this failure was due to the

lack of self-confidence, intellectual criticisms generally coming from Marxists, and balance of payment constraints. On the other hand, Watanabe (1979:71) claims that plans have been prepared deliberately in the direction of underestimation for the sake of the fiscal objective. In this line, it is certain that there was a tendency towards underestimation of the growth rate although it might not be a well-defined systematic strategy (Suzuki 1989). Hence it can be misleading if one only focuses on the general planning procedure. Moreover, Japanese bureaucracy did not stubbornly follow what was written in the plans. Whenever it was necessary, MITI and other ministries did not hesitate to change, modify or prepare specific sectoral plans. In addition, the general plans were also altered in response to changing circumstances. From 1956 to 1975, Japanese government prepared seven general plans.

### **3. 5. 6. 3 Trade Policy**

Up to 1911 Japan did not have full control on its trade policy because of the treaties signed in the preceding period. After Japan regained control of her trade policies, she did not follow any neo-classical premises in implementing trade policy. Japanese government generally subsidized exports and endeavored to restrict imports. These trends also continued after 1945.<sup>59</sup> From the beginning, there were two main concerns about trade policy. The first concern was the balance of payments constraint. As a natural resource poor country, Japan had to import enormous amount of raw materials which led to big trade deficits. For example, fuels and materials covered 58 per cent of Japanese imports, while this ratio was 35.1, 26.8, 25.8 and 18.1 for Italy, UK, West Germany and United States, respectively, in 1968 (Rosovsky 1973:194). Therefore the government, up to 1965 when the balance of payments problem disappeared, always took its decisions under this constraint. The second concern of Japan was to protect newly developing strategic industries, or the so-called infant industries.

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<sup>59</sup> Minami (1986) argues that tariff protection was not confined to Japan and there is no evidence that it was stronger in Japan than in other developed countries.

**Table 3.12: Ratio of Balance of Payments to Gross National Expenditure in Japan 1885-1980**

	Trade balance	Current account	Current account balance
1885-90	-0.50	-0.72	-0.60
1891-1900	-1.77	-1.88	0.48
1901-10	-1.11	-2.05	-1.73
1911-20	3.27	2.82	2.99
1921-30	-1.91	-1.60	-1.47
1931-40	-0.70	-0.38	-0.10
1952-60	-0.10	0.14	0.11
1961-70	0.49	0.24	0.19
1971-80	0.67	0.63	0.50

Source: Minami (1986: 225)

To avoid balance of payments problems and to protect infant industries, Japan utilized all kinds of restrictive tools such as high tariff rates, import quotas etc. In this sense, imports of raw materials and machinery were given priority, while imports of consumption goods, which could be produced in the country, were strictly restricted. Hence, Japanese trade policies carried the characteristics of import-substituting industrialization model. However, Japanese government also

endeavored to take necessary steps to stimulate exports. In this sense, public funds and other kinds of subsidies were directed to export sectors. However, eventually international pressures started to challenge Japanese trade policies.<sup>60</sup>

The pressures in the direction of liberalization were an other big challenge for the Japanese authorities and people. As Ryutaro (1990) observes, liberalization policies were reminiscent of the visit of Commodore Perry's 'black ship' in 1853, which had caused the opening of the economy to foreign commerce and later gave birth to the Meiji Restoration. Japan developed delicate methods to deal with this challenge. It expanded the liberalization process and negotiated very hard to continue some protection measures for some targeted industries which were uncompetitive according to international standards. By the same token "Japan went one by one in such a way as to minimize competitive disadvantage to particular industries" (Tsuru 1993: 112). Even though Japan did not achieve to maintain tariffs and quotas, she nevertheless tried to mitigate the effects of liberalization via non-tariff barriers.

The Japanese governments used foreign exchange control and tax incentives very much beside the above tools. During 1950s and 1960s foreign exchange was controlled by MITI. So MITI gained enormous amount of power to manipulate decisions of the industry through allocation of short-term foreign exchange. This policy was used very effectively especially in the selection of imported technology and conditions of imports. Tax breaks was another tool used by the government. Japanese tax burden on industrialists was not very heavy due to the high growth that caused a rapid increase in government revenue. After the 'Dodge Plan', Balance of Budget Policies which continued into mid-1960s also helped the low tax policy. Furthermore, low social security expenditures and low defense expenditure were other factors that enabled Japan to pursue this policy. Japan did not only initiate low tax policy, but also, from time to time, new articles were amended for preferential treatment in taxation. For example, these kinds of laws were amended for machine-tool industry in 1956, the electronic industry in 1957 and the aircraft industry in 1958.

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<sup>60</sup> Japan became a member of GATT in 1963, of the IMF in 1964 and joined OECD in 1964.

### **3.5.7 Institutions**

In many ways Japanese institutional structure has been different from that of Western countries. Japanese employment system, financial system and industrial organization had many particularities, which have played a vital role in the Japanese success. Therefore, it would be a futile attempt to try to understand what happened during high growth era without examining the special institutional structure of Japan. Here, we will focus on Japanese employment, financial and industrial system with more emphasis on the organizational understanding of the term.

#### **3.5.7.1 Employment System**

Lifetime employment, seniority-wage, the promotion system, bonus payments, and company based unionism have been generally accepted as different characteristics of the Japanese employment practices. Japanese big firms generally recruited workers from among new university graduates after a highly competitive selection procedure. These workers became permanent employees of the company even under financial and economic distress, firing workers was not so common. Hence, the employees had more or less secure jobs. This was the so-called life-time employment.

The workers under the life-time employment system generally had seniority-based wages and received promotions and bonus-payments. Seniority-based promotion system means that the employees can reach a higher position after spending several years in the company. Furthermore, seniority-based system and bonus wages mean that the earnings are attached to the working year plus an extra reward payment depending on the profits of the company.

The other important peculiarity of the Japanese system is the company-based union. Instead of the industry-based western-type union system, Japanese trade unions were generally organized at company level. "It is not accidental that unions take an enterprise based form at Japanese firms rather than that of industrial or craft

unionism as in those economies where workers careers are more oriented to a broader market rather than a to the individual firm” (Aoki 1990:13).

However, as many authors pointed out, the systems of life-time employment, seniority wage and promotion, bonus payment and company based unions system did not cover the whole working class. Those who benefited from these privileges were generally laborers working in big firms. Approximately 1/3 of the total labor force was under the safety-net of the system before the 1980s (Ryutara 1980: 64). However, it can be misleading if one underestimates the significance of the system by looking at numbers of workers under this structure. Because, firms where these laborer work are the most vigorous and powerful engine of the Japanese economy which is highly innovative.

How and when this different employment structure start to emerge remains a question. It is generally argued that, although the origin of those employment practices goes back to the pre-war or earlier years, the system gradually became a central feature of the Japanese employment system only after the Second World War II (Allen 1981, Ryutaro 1990, Crawcour 1978).<sup>61</sup>

Which factors did play an important role in this process? According to Abegglen (1958), it was Japanese cultural peculiarities that gave shape to Japanese employment. Even if Japanese culture was a very important variable to explain the employment practices in Japan, it was not a unique and single determinant of the system. One should also consider other reasons. In the first place, shortage of skilled labor which occurred after the fabulous economic expansion following the First World War, forced Japanese employers to institutionalize these kinds of employment practices in order to stabilize the labor market (Cole: 1971). Secondly, after the 1930s and during the Second World War, many particularities of the present system were adapted because of corporate tendencies. Then, at the beginning of the post-war period, labor union activism and a relatively liberal milieu legitimized the

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<sup>61</sup>According Odako, company based system was part of Japanese employment system even before 1920s. In fact, company-based unions are usually said to have emerged around 1921. They had existed in large plant from before this time (Odako 1999: 155). On the other hand, Hoshimoto (1979) argue the practices of seniority wage and promotion life-time employment and bonus payments begun to take shape as early as in the 1890s.

demand for life-time employment. On the other hand, as Crowcour (1978) points out, deliberate efforts of government and employers to defeat the labor union movement contributed to the establishment of company-based unionism. Furthermore, unprecedented high growth did not only increase demand for skilled-labor but also enabled the system to spread through many firms. Therefore, Japanese employment practices can be understood within a 'piece-wise continuity' of institutions. In this respect, deliberate creation, institutional inertia and the cultural setting played very important roles. In other words,

[w]hile the system itself is a creative reaction to changing circumstances, and as such is innovative rather than traditional, what gives the system its characteristic flavor is the web of non-material sanctions by which employees and society as a whole have been conditioned to accept the system as both morally good and individually satisfying (Crowcour 1978:239).

Life-time employment, company based unionism and bonus payments contributed to the development of the 'notion of our company' and increased harmony within firms. Therefore, the survival of the company became a main concern of workers and employers. Hence survival of companies was not only a precondition for possessing of privileges but also essential for a system based on training and accumulation of knowledge within firms. Therefore, having long term perspective is much more important than running ahead of short-term interest. Of course, for the regular continuity of the bonus payments, profitability was also necessary. However, whenever short-term interests of the firms were in conflict with long-term interests, Japanese firms put priority on the latter.

Japanese employment system increased labor productivity more than increase in their real wages. In other words, as once can deduct from Table 3.13 increases in real wages did not follow the productivity rise because of company-based unionism and in relation to this the lack of militant labor movement.

**Table 3.13: Industrial Production, Productivity, Wages and Employment in Manufacturing (1975=100)**

Year	Production	Productivity	Real Wages	Employment
1955	13.2	18.3	32.8	41.2
1960	25.9	28.3	41.0	68.3
1965	44.9	40.9	49.3	92.0
1970	92.5	76.7	75.3	107.0
1973	117.0	104.6	98.9	106.0
1975	100.0	100.0	100.0	100.0

Sources: Ministry of Labor and Japan Productivity Centre cited in Allen (1981:155)

As a conclusion, Japanese employment system created a milieu which was much attuned to high investment and high growth especially for the period of 1960s as a result of combination of deliberate action and unconscious changes (trial and error) in response to alterations in Japanese society and economy shaped by Japanese culture. In this sense, Japanese employment system was the result of an evolutionary process ‘which is piece-wise’ and continuous.

### 3.5.7.2 Financial System

Many aspects of the Japanese financial system were also different from that of other industrial countries, although the system underwent enormous changes after the 1980s and 1990s. Indeed, from the beginning of the high growth era, Japanese banking system can be seen as a Schumpeterian banking system, the main duty of which was to supply necessary sources for high levels of investment in order to break the circular flow of economic life.<sup>62</sup> After the 1930s, this characteristic of the Japanese financial system became more visible. The peculiar characteristics of the Japanese financial system enabled the firms to have easy access to financial sources which were prerequisite for high levels of investment. In this sense, indirect financing and main bank system played important roles.

Throughout the World War II, Japanese corporate finances shifted from direct to indirect financing. After Japan's defeat, Japanese companies suffered from a shortage of capital, while relying heavily on loans from commercial banks. Given the tightness of and uncertainty in the financial market, Japanese corporations preferred to keep close ties with their banks. In fact, many of them were owned by the same *zaibatsu* group. Moreover, the low interest rate policy in favor of borrowing from the banks encouraged companies to do so (Gao 2001:86). As a result, main bank system and indirect financing were institutionalized.

The main bank system can be seen as a subset of the 'cross-shareholding system' (Hoshi : 1994: 290). In this sense, the main bank system is not only a major lender to the firm, but also the firm and the bank have corporate shares of each other. This particularity reduced the problems of information and incentives during the high growth era. Hence, asymmetric information and transaction costs associated with gathering information about the firm decreased. The system also decreased the moral hazard problem through the monitoring activities of the firm. By the same token, the main bank system could even take the control of the firm when the firm's

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<sup>62</sup> "With their [banks] help those [entrepreneurs] who carry out new combinations can gain access to the existing stocks of productive means, or, as the case may be, enable those from whom they buy productive services to gain immediate access to the market for consumption goods" (Schumpeter 1962/1934:73).

financial situation worsened (Aoki 1997:244). Therefore, the firms' investment was always under the control of the banks.

In the system of indirect financing, corporations rely on outside sources (mainly banking loans). During the 1960s and 1970s, corporate investments were financed by the indirect financing system as it can be seen in Table 3. 14. In contradistinction, in the United States, Britain, Germany, and Italy the weight of bank loans in total capital supply was very low in the 1960s. These weights were 5.8, 4.3, 18.8, and 12.4 per cent, respectively (Gao 2001: 86).

**Table 3. 14: Distribution of Sources of External Corporate Finance in Japan (1957-1988), (in %)**

Period	Equity	Bonds	Loans
1957-59	20,5	11,1	68,3
1960-64	21,2	13,6	65,2
1965-69	8,0	12,1	79,9
1970-74	6,4	10,3	83,3
1975-79	19,6	25,3	55
1980-84	30,0	25,1	45
1985—88	38,6	51,4	10

Source: Ueda (1994:105) as cited in Gao (2001)

As the corporations relied more on bank loans for capital, they relied less on share holders. This, in turn, increased the autonomy of managers to pursue policies

aiming at increasing the market share of the firms through investment without paying much attention to the interests of the share-holders.

### **3.5.7.3 Industrial System**

After the Meiji restoration (1868) many samurai families and old rich merchant houses embarked on investment in industries. In the course of time, these family firms turned into big conglomerates and they were called zaibatsu. In fact, in Japan these kind of big companies were not the natural result of competition as in Western countries. They were also deliberately stimulated and protected by the government<sup>63</sup>. As we have seen in the wake of Japanese defeat in the Second World War, USA occupation officers forced government to divide up these family firms into smaller parts in order to break the power of families. Later on, these firms which had been a part of 'zaibatsu' gathered and molded an informal grouping system called keiretsu. There are mainly six big keiretsu business groups; namely Mitsubishi, Mitsui, Sumitomo, Dai-ichi, Fuyo and Sanwa. These groups are quite distinct from the hierarchical structure groupings of affiliates. For example, the only thing which formally defines the identity of the group is the lunch on the last Friday of the month when the presidents of every company in the group get together (Dore 1973). In addition, they are not conglomerates because they have no central board or holding company. They are not cartels because they are all in diverse lines of business. Each group has a bank and a trading company, a steel firm, an automobile firm, a major chemical firm, a shipbuilding plant, an engineering firm and so on (Aoki and Patrick 1994).

This system not only strengthened coordination between groups of firms through supplying information network, but also sustained financial and other aids to the member firms in case of emergency. Furthermore, the system also provided stable supply of inputs to the firms because some members of the groups were the

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<sup>63</sup> Sometime they were created directly by the government (Gao 2001:85)

suppliers of inputs for the others. Thereby, firms focused on long-run investment projects rather than dealing with insecure supplies of inputs.

Cross share-holding which was based on the principle that firms had shares of each other was one of the features of the keiretsu system. However reciprocal shareholding was not confined only to the keiretsu system. It was widely used as a strategy to prevent hostile takeovers. Moreover “Japanese government strongly supported the private initiative of stabilizing share-holders as a counter measure to the liberalization of foreign investment” (Gao 2001: 96). As a result, institutional ownership of corporations increased gradually. In other words, the share of other firms, financial institutions etc increased in a firm’s equity structure.

Keiretsu system and cross-shareholding increased ties between firms and decreased uncertainties and asymmetric information and thereby enabled the firms to undertake long term decisions.

### **3.6 Conclusion**

Japanese economic and social development at least after the Tokugawa period, should be investigated within a ‘piece-wise’ continuity paradigm. Japanese development exhibited a ‘piece-wise’ continuity because despite the jumps (such as Meiji Restoration of 1868, increasing military influence in 1930 and the post-war period Japan started from a point which was a continuation of the old functional form in a higher plateau with a new set of particularities derived from the old functional form. For other development experiences, interruptions and big functional changes can be more important than ‘piece-wise’ continuity to understand their development, however, for the Japanese case new institutional structure and policies considerably carried traces of the preceding periods. Even though, at first glance, Meiji Restoration of 1868 seems to be a direct assault to the whole institutional structure of the Tokugawa Period, a careful investigation reveals that Westernization was not more than a rhetoric in which adaptation of Western techniques was seen as a precondition to catch up with and to become superior to the Western countries. In this sense, preservation of old values such as Confucianism and many particularities

of the past went hand in hand with the Westernization process. Post-war period and American occupation have been interpreted as they revolutionized transformations establishing totally different social and economic structures while they destroyed the old ones. However, although, post-war Japan had many departures from the pre-war Japan, similarities and continuities with the preceding period in terms of institutions, industrial policies and bureaucrats remain fascinating.

If we consider Japanese social and economic development within the context of the paradigm above it is not so difficult to reach the conclusion that Japanese high growth performance was not merely a post-war phenomenon. Japan was not a typical underdeveloped country in 1945. On the contrary, she had become a major military and industrial power just before the Second World War, although she had some signs of backwardness compared to other major industrial nations at that time. Furthermore, at the beginning of the post-war period, Japan had an enormous growth potential thanks to her accumulated capital, high-skilled workers and a very developed institutional structure even though she encountered enormous physical damage during the war. One should not confuse Japanese situation with the experiences of countries of that time, which exhibit an absolute backwardness in many areas. In this respect, Japanese high growth phenomenon cannot be seen as the development of an un(der)developed country. Therefore the concept of ‘miraculous growth’ is not suitable for the Japanese case. The similar argument can be found in Patrick and Rosovsky (1976: 6) although they endeavor to show that government policy or leadership, labor management practices, institutions and culture did not play a very important role in the Japanese economic growth. They argue that “Japanese growth was not miraculous: it can be reasonably well understood and explained by ordinary economic causes”. However, our aim is not to undermine the importance of the Japanese industrial policy and its institutions which had a very heterodox characteristic. We propose a Rosovsky type notion of ‘accelerated growth’ which indicates the existence of earlier periods of spurt in Japanese history, instead of the concept of ‘miracle’. There was no unique and singular reason behind Japanese high growth. Attributing Japanese high growth to a few factors is untenable. Indeed, the interaction of many factors within a dynamic framework

leads to the Japanese high growth performance. As such 'relative late-comer' situation of Japan provided her many opportunities. However, if Japan were an absolute late-comer without accumulated long development effort and achievements she could have not benefited from these opportunities as much as she did during the 1960s. Japan was backward especially in terms of her technology compared to USA. However, at the same time, she had many relatively advanced aspects such as a highly sophisticated institutional structure and a high educational level which enabled her to absorb rapidly the available technologies. Furthermore, Japan was not only technologically backward, but also possessed another interesting attribute of backwardness such as the presence of a dual economy and a comparative immunity from the so-called demonstration effect. These particularities provided Japan with opportunity to take advantage of inner asymmetries which prevailed between the developed industrial structure and this backwardness. For example as a result of her comparative immunity from the demonstration effect, Japanese consumption pattern did not follow Western habits. Therefore, resources for high capital accumulation could be directly deducted from house-hold savings. Furthermore, presence of a dual economy served two important functions; first, agricultural sector provided the necessary supply of labor for industrial development without causing any significant pressure on wage rates. Secondly, the industrial sector enjoyed an important flexibility *via* the sub-contracting system. Of course, these kinds of backwardness were the result of special historical and cultural conditions. Demonstration effect was not very influential in Japan because of the long seclusion policy that enabled Japan to develop different patterns of consumption. Furthermore, long war years after the Meiji Restoration along with the preparation periods for these wars prevented the Japanese people from developing a consumption habit in line with the imperative of industrialization. Of course, the government's neglect of welfare of the citizens in the name of catching-up with the West also contributed to this situation.

The availability of opportunities was not sufficient to achieve high growth. There is no automatic way to make an enormous amount of fixed-capital investment and to transfer technology from abroad as creatively as was the case with Japan.

Japanese financial sector, labor market and industrial institutions played very important roles in this process. These were mainly inherited from the preceding period, and they gradually evolved in response to the changing conditions. They are generally very different than neo-liberal economic institutions. Without the benign international conditions after the Second World War, Japan, could not exhibit such an impressive performance. The Breton Woods system, along with the balance of power between the USA and the USSR, provided Japan with highly favorable external conditions. Furthermore governments endeavored to manipulate them in the service of high growth. The government used all kinds of tools to attain a former slogan of 'strong economy, and a 'strong nation' instead of the 'strong army', and the strong nation'. In this sense, it deliberately followed industrial policies within the framework of 'governing the market'. Japanese economic policies have been very heterodox since the Meiji period. Later on, many East Asian countries tried to imitate these policies because of their fascination with Japanese continuous success. This will be subject of the next chapter.

## **CHAPTER 4**

### **THE IMPACT OF JAPANESE DEVELOPMENT ON EAST ASIA AND DEVELOPMENT THEORY**

The rise of Japan as an industrial nation significantly affected economic practices, policies and theories in other countries. After the success of Japan many developing countries tried to adopt similar policies that Japan pursued in the preceding period. East Asia is the region where the Japanese influence has been more apparent in their economical practices. Economists have attempted to draw general conclusions from the rich material provided by the Japanese and East Asian experiences, the latter was shaped under the influence of Japanese experience. So, Japan also affected economic theory via exerting influence on the East Asian economies. As a result, many new elements have been introduced into the theory of economic development to improve our understanding of the processes of economic development. Here we will first attempt to account for the general characteristics of East Asian growth. Then we will seek to find the Japanese influence in the emergence of the East Asian policies. Lastly, we will investigate the theories formulated directly by the Japanese experience or East Asian practices.

#### 4.1 East Asian High Growth

Many East Asian countries exhibited spectacular growth performance after Japanese success. Hong-Kong, Korea, Singapore and Taiwan, the four tigers, constituted the first successful group in industrialization in East Asia following Japan. Later on, Malaysia, Thailand, Indonesia and Philippines also commenced to climb up the ladder of industrialization. These countries not only exhibited high growth performance (see Table 4.1), but also benefited from growth in more egalitarian terms as compared to other developing countries, even though this was achieved by authoritarian and militaristic governments. These countries have had very low GINI coefficients which imply fair income distribution. Although initial conditions such as land reforms caused this, later policies did not create income inequality within society. By looking at this performance, Lucas (1993:251) points out that “I do not think it is in any way an exaggeration to refer to this continuing transformation of Korean society as a miracle or to apply this term to the very similar transformations that are occurring in Taiwan, Hong-Kong and Singapore”. What were the reasons behind these successful industrialization experiences of East Asian countries? There are many controversial views about this. However, ‘market-oriented’ and ‘state-led’ views have been the main rival theories in this area.

**Table 4.1: Average annual growth rates of real GDP in East Asia (1955-93),**

**(in %)**

	1955-70	1965-80	1980-93
Japan	9.7	6.4	4.1
Singapore		10.0	6.4
Hong Kong	9.6	8.6	7.1
South Korea	6.7	9.9	9.7
Malaysia	5.3	7.4	5.2

**Table 4.1 (continuity)**

Thailand	6.9	7.3	7.6
Indonesia	3.6	7.0	5.5
China		6.8	9.5

Source: Kosai and Takeuchi (1998:299)

Generally speaking, during the 1950s and the 1960s, development economics focused on Latin America and ignored the East Asian region. At that time, export pessimism was very widespread and import-substitution model was the dominant paradigm among development economists. Rosenstein-Rodan (1943), Nurkse (1952) and Hirschman (1968) were the leading development economists who built the theoretical foundation of development economics of the times. First neoclassical economists who paid attention to the East Asian performance were Little, Scitovsky and Scott (1970) and Balassa (1981). Neoclassical economists saw East Asia as an example from which many counter-arguments could be derived against the import-substituting industrialization model. These authors endeavored to demonstrate that East Asian success was based on outward-looking policies, which, according to them, gave support to liberal economic theory. However, after 1980, a counter attack against neoclassical liberalism emerged, and so East Asia became an arena for the new phase of an old battle between neoclassical and heterodox economists who put more emphasis on state's role and industrial policy in successful development processes. The influential studies of Amsden (1989), Wade (1990) and other development economists forced liberal economists to reconsider their position. The World Bank study entitled; *Asian Miracle* (1993) can be seen as an attempt in this direction, though it is inclined towards more-market oriented approaches. The study also has some references to the role of government in industrialization processes.

Mainly all countries in the region shared the characteristics of high saving and high investment. As one can see from Table 4.2 investment and saving ratios are above 30 per cent for almost all countries in the region from 1954 to the 1990s. These figures are highly impressive as compared to those of other developing

countries. However, high capital accumulation performance of these countries has also been a subject of heated debate; namely the so-called Total Factor Productivity (TFP) debate. Lau and Kim (1994) claim that there has been almost no TFP growth in these economies. In other words, high growth performances of East Asian countries are claimed to have stemmed from mainly the increases in the quantity of factors of production. Similarly, Young (1995:644) argues that “ [w]ith regard to productivity growth in the aggregate economy and in manufacturing in particular, the NICs cannot be considered to be strong outliers in the postwar world economy”. Even so, according to his calculations, productivity growth is one of the sources of the high growth in the region. Krugman argues that East Asian countries are “paper tigers” and their success is reminiscent of Soviet growth performance, which was also derived from a massive increase in the factors of production.<sup>64</sup> On the other hand Robertson (2000, 2002) tries to show that

**Table 4. 2: Saving and Investment ratios for East Asian countries, (in %)**

Country	Period	Savings	Investment
Republic of Korea	1951-1960	3.3	10.0
	1961-1970	13.7	20.0
	1971-1980	22.0	28.0
	1981-1990	30.4	30.7
	1991-1994	34.7	37.1
Taiwan Province of China	1951-1960	9.8	16.3
	1961-1970	19.7	21.9
	1971-1980	31.9	30.5
	1981-1990	32.9	21.9
	1991-1994	27.4	23.2

<sup>64</sup> He claims that “popular enthusiasm about Asia’s boom deserves to have cold water thrown on it. Rapid Asian growth is less of a model for the West than many writers claim, and future prospects for that growth are more limited than almost anyone imagines” (Krugman 1994: 64).

**Table 4.2(continuity)**

Hong Kong	1951-1960	9.2	9.1
	1961-1970	20.6	20.6
	1971-1980	28.3	26.7
	1981-1990	34.0	24.8
	1991-1994	34.0	27.6
Singapore	1951-1960	-	11.4
	1961-1970	14.9	22.3
	1971-1980	28.9	41.2
	1981-1990	42.1	42.1
	1991-1994	48.9	36.3
Indonesia	1951-1960	-	9.2
	1961-1970	4.9	10.4
	1971-1980	24.6	22.7
	1981-1990	25.1	28.3
	1991-1994	26.9	29.7
Malaysia	1951-1960	23.2	15.3
	1961-1970	21.5	19.9
	1971-1980	26.2	26.3
	1981-1990	27.4	30.7
	1991-1994	30.0	36.1
Thailand	1951-1960	15.3	13.5
	1961-1970	19.9	21.5
	1971-1980	22.4	26.2
	1981-1990	26.2	30.7
	1991-1994	33.7	40.5

Source: Akyüz , Chang and Kozul-Wright (1998:12)

TFP growth is a crucial factor behind the high performance of Asian countries.<sup>65</sup>

From a different perspective Lucas (1993:270) defends a similar idea. According to him,

[t]he main engine of growth is the accumulation of human capital – of knowledge – and the main source of differences in living standards among nations is differences in human capital. Physical capital accumulation plays an essential but decidedly subsidiary role. Human capital accumulation takes place in schools, in research organizations and in the course of producing goods and engaging in trade.

As Stiglitz (2001:512) pointed out, measurement of total factor productivity and interpretation of the residual approach are highly problematic issues.<sup>66</sup> Irrespective of the degree of factor productivity, it is certain that high capital accumulation contributed a great deal to the Asian high growth phenomenon. Moreover even if one accepts the assertion of neoclassical growth theory that a constant scale economy cannot continuously exceed a certain level of growth without technological change because of decreasing returns, this does not mean that East Asia followed the wrong way<sup>67</sup>. Because one, who is even analyzing within the neoclassical framework, can easily see that capital accumulation gave them a chance to exploit growth potential which stemmed from initial low capital output ratio.<sup>68</sup>

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<sup>65</sup> Although he does not give a detailed explanation he argues “it shows that much of the capital accumulation in South Korea, Taiwan and Hong-Kong was due to the productivity growth” (Robertson 2002:269). Moreover “the intuition for the result is that productivity growth induces capital accumulation. Hence part of growth of the capital stock can be attributed to productivity growth.” (Robertson 2002:344)

<sup>66</sup> Jesus Felipe and J.S.L. Mc Combie (2003:711) defend similar ideas more vigorously. According to them the methodological problems underlying the conventional neoclassical approach are serious enough to question the relevance of the whole discussion of whether TFP growth in East Asia is zero, positive or negative. This is irrespective of whether one uses growth accounting or estimates the aggregate production function.

<sup>67</sup> Blanchard (2003: 248) explains these phenomena as follows:

“Suppose the economy tried to achieve positive output growth. Because of decreasing returns to capital, capital would have to grow faster than output. The economy would have to devote a larger and larger proportion of output to capital accumulation. At some point there would be no more output to devote to capital accumulation. Growth would come to an end”.

Moreover, high capital accumulation, technological change and shift in export structure cannot be investigated as if they are mutually independent variables. Hence, it is normal to expect that this speculator investment performance also brought about at least a reasonable level of productivity growth. Given the high human capital investment and increasing absorption capacity of the region, this deduction turns out to be more reasonable. Regardless of the total productivity aspect, high capital accumulation is one of the preconditions of self-sustainable growth in developing countries. Therefore even East Asian “[g]rowth is less of a model for the West than many writers claim” (Krugman 1994:64) it can certainly be a model for developing countries to break the vicious circle of underdevelopment at least in terms of capital accumulation process.

High investment can be pursued by domestic agents or foreigners whose long-term investments are called Foreign Direct Investment (FDI). FDI did not play an important role especially in the first tiers of NIEs countries except Singapore. Interestingly, it did not also play a big part in South East Asian countries except Malaysia (see table 4.5). Then, how was this high investment sustained? There are two ways of financing investment; internal (domestic) and external (foreign) sources. Internal sources consist of household saving plus corporate saving plus government (public) sector saving. On the other hand, external savings can be in the form of a capital inflow or public and private borrowing and aids. Under strict capital controls one cannot speak of massive capital flows as in the case of East Asian countries. External borrowing was negligible in financing investment in East Asian countries although the saving-investment gap narrowed by the government borrowing from the international market up to the 1980s in Korea (Chang 1993). However American aids played a significant role especially in Taiwan and Korea up to the mid-1970s. In a nutshell, therefore it can be safely argued that generally East Asian investment was financed by high domestic saving because foreign sources were very negligible in these countries.

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<sup>68</sup> It is natural to think that a developing country has relatively low capital output ratio compared to developed countries.

According to Akyüz and Gore (1996), high investment was the result of high profits and rents created deliberately by governments. However, although rents and profits were important sources of domestic saving, household savings were much more important.<sup>69</sup> In this sense as Stiglitz (2001:515) argues, “given the almost inevitable limitations on equity markets as a source of finance, growth could have been sustained only by high debt policy”.

As in the case of Japan this indirect financing was supported by high household saving. However it is striking that the real interest rates were negative up to the 1980s as the result of high inflation in Korea. As it is explained by Chang (1993) with reference to Dornbusch and Park (1987:133), “Overall Korean experience suggests that there is no need for high positive real interest rates to mobilize saving through the financial system as long as large negative interests rates are avoided. The real interest rates are relatively insignificant”. How can one explain this increase in saving rates from 10% in the 1950s to 30% in the late 1980s given negative interest rates? The answer can be found in policies based on government intervention.

Forced saving as in the case of Singapore was also among the reasons of high saving episode in East Asian countries. In addition to this, repression of financial system and consumption pattern were also used in order to increase household saving. To put pressure on consumption, the Korean government implemented various policies. Public banks were not allowed to extend consumer loans. Foreign holidays were banned. Imports of luxury goods have been either forbidden or subjected to high tariffs. (Chang 1993:139)

Although high saving and investment are crucial to move up the ladder of industrialization they are not sufficient. The sector to which investment goes is also important. East Asian countries followed strategic industrial policies to shift their production structure from low value added industries to high value added industries.

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<sup>69</sup> Akyüz and Gore (1996) also claim that high household saving rates were due to the high profit and rents through instruments such as Japanese bonus payment system of which payments were determined by profitability of firms. However one cannot find many arguments which support the idea that high profits and rents were main reason of high saving rates.

In this sense without reference to government role one cannot shed light on the mystery of East Asian development. Balasa (1998:288) and other neoclassical economists claim:

[t]he neutrality and stability of the incentive system, together with the limited government interventions, well-functioning labor and capital markets, and reliance on private capital, thus appear to have been the main ingredients of successful performance in East Asia.

On the contrary this idea, instead of following the signals coming from the market, “governing the market” was also practiced by the East Asian governments (Wade 1990). Governments used various kinds of instruments to affect and stimulate investment in strategic areas: Credit subsidies, tax incentives, foreign exchange allocations, trade policies and public investment.

Korean government tried to affect investment decisions via controlling the banking system. The government provided very cheap and long term credits to the firms through publicly owned banks. Whereas in many Latin American countries these credits were distributed in a corrupt manner according to power-relations among politicians, bureaucrats and business elites, in Korea, credits were given to firms on the basis of certain criteria such as the implementability of their investment plans, technological capacities, domestic linkages and scale economies (Rodrik 1994:86). Moreover, Taiwan generally relied on tax credits. In other words, tax exemptions and other kinds of tax immunities for business activities were very important economic tools in Taiwan. The magnitude of tax credits (as a share of relevant tax base) exhibited a gradually increasing trend from 1955 to 1968 (Rodrik 1994). The other East Asian countries also used similar policies (Chowdury and Islam 1997, Akyüz, Chang and Kozul-Wright 1998).

Trade policies were used very effectively by the East Asian governments to manipulate export and import structure. Imports were vital for these economies. Firstly, many countries in the region such as Korea, Taiwan and Singapore are poor in natural resources and thus depend on raw material imports. Secondly, high investment requires very high capital good imports. Hence, governments tried to encourage imports of capital goods and raw materials, whereas they discouraged imports of luxury goods via tariffs and quotas. In some cases, foreign currency

allocation was also instrumental as in the case of Japan. Foreign currency controls did not only restrict the import of luxury goods, but also were a very important tool for direct investment and imported technologies towards the specific sectors since firms could not freely decide on the areas to invest under the foreign currency constraint. Export played two important roles. First, high export performance was a prerequisite to pay for imports and to avoid balance of payments problems. Secondly, given the small domestic markets, maintenance of high government performance in the external markets was necessary.<sup>70</sup>

Generally, subsidies and other kinds of incentives went to the sectors which were deemed as key sectors for industrial upgrading. Chemicals, ship building, steel, plastic industries were among them. Whenever it was necessary, government investment took place especially in these sectors. Public investment constituted a significant portion of GDP and of capital formation in many East Asian countries (Singh 1998). Governments did not hesitate to take necessary measures not only in terms of infrastructure and other conventional areas but also in public investment.

Governments generally endeavored to create scale economies through public investment and other kinds of state interventions. Therefore, particularly big firms were given priorities to reach the necessary sources for their investments. Except Taiwan, especially North East Asian countries strictly followed this path. For example “state in Korea was not just a referee or ringmaster in orchestrating investment races, it was also nursemaid or a fairy godmother to the chaebols” (Singh 1998:128). As a result of this special treatment to big firms concentration ratios and big firms’ share in GDP significantly increased. For example in Korea, the top 50 chaebols’ share in GDP was 15 per cent in 1990 and eleven of them were among the largest industrial companies at that same time (Singh 1998:125).<sup>71</sup> As a conclusion,

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<sup>70</sup> According to Rodrik (1995:74) “In fact, it is mainly the increase in capital goods that accounts for the rise in imports-GDP ratio. Hence, the increasing export orientation of the economy is quite consistent with investment-led growth, with causality running from investment to imports and from imports to exports”.

<sup>71</sup> In fact as Shahid (2001) rightly argues later increasing power of these chaebols undermined the governments’ ability to implement industrial policy. Therefore the delicate carrot and stick policy cannot be followed when power of private agents increased

without reference to the strategic intervention of governments, it would be futile to account for the myth of high economic performance in North East Asia. Furthermore, contrary to the conventional wisdom, this strategic government intervention was not only a characteristic of North East Asian countries but also characteristic of the many East Asian countries in general, though South East Asian countries did not use it as systematically as their northern counterparts (Akyüz, Chang and Kozul-Wright 1998:21).

How did East Asian countries achieve to pursue independent strategic industrial policies? The strong, capable bureaucracy insulated from vested interests has been considered as a main factor. In fact, Johnson (1982) was one of the first scholars who emphasized the role of strong bureaucracy in policymaking within a developmental state framework.<sup>72</sup> According to some authors, East Asian public bureaucracies are akin to Weberian type ideal bureaucracy in contrast to those of other developing countries which were not immune from business interests and were subject to rent seeking activities (Evans 1998). Regardless of the question of whether East Asian bureaucracies were Weberian type of ideal democracy or not, these bureaucracies were very efficient in designing and implementing various industrial policies. How could this kind of bureaucracy emerge? There are two main rival approaches attempting to answer this question. According to first approach, historical and social heritage are crucial. Japanese colonial heritage in Taiwan and Korea were main determinant of the post-war bureaucracy in these countries (Cummings 1987, Kohki 1994, 1997). Furthermore, according to Vogel (1991), Confucian tradition should be used as an explanatory variable to understand the bureaucracy in the region. On the contrary, some argue that “East Asian bureaucracies are neither gift from the past nor easy outgrowths of surrounding social organization. They are hard-won edifices constantly under reconstruction” (Evans 1998: 12). Chang (1999) also supports this view. He argues that up to the 1960s, Korea and Taiwan were sending their bureaucrats to Pakistan and Philippines

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enormously vis-à-vis government. This is an interesting dilemma of development in developing countries

<sup>72</sup> As Chowdhury and Islam (1997: 47-48) rightly point out, initial works in these area were mainly influenced by Japanese experience.

for training (Chang 1999:21). Hence, according to him, it is not plausible to accept that Japanese colonialism gave the shape of post-war Korean and Taiwanese bureaucracies. And Korean and Taiwanese bureaucracy was mainly result of post-war deliberate policies. We believe that these two lines of thinking contain some truth. As we will later elaborate, Japanese colonial period had left behind important bureaucratic structure. This structure was modified and strengthened. The post-war leaders took very vigorous measures to create a strong and capable bureaucracy. In this sense, Evans (1998:72) is right in arguing that nation-wide meritocratic selection system was a precondition to maintain this kind of bureaucracy. Furthermore, most of the East Asian countries were ruled by authoritarian or militaristic governments. These regimes did not encounter any difficulty to increase prestige, and power of the bureaucracy vis-à-vis private agents. Paradoxically, growth itself later undermined this bureaucratic structure. However, this system continued successfully at least up to the mid 1980s.

As it was discussed in detail in Chapter III for the case of Japanese experience, development was a painful and long process. Furthermore, if an economy has a relative 'advancedness' beside its relative backwardness, its growth potential is very high. In other words, if a country has a technological and industrial gap with developed countries, but if its institutional and social capacity is very high, the probability of quick take-off is also very high. In this sense, although, East Asian countries had many backward particularities in terms of technology and industrial structure during the 1950s and 1960s, most of them had significantly high social capital which facilitated capital accumulation and self-sustaining growth at least for a certain period. For example, As Adelman (1967) emphasizes, Korea and Taiwan were in the group of countries with highest score in terms of social and economic indicators (see Table 4.3). Although, it can be seen from Table 4.3 that their per capita incomes were very low. This means that Taiwan and Korea had a chance to grow fast. Similarly, the legacy of the English system in Singapore and Hong Kong positively affected social development in these countries.

**Table 4. 3: Grouping of Countries by Factor Scores on Factor Representing Level of Socioeconomic Development**

Country	Factor Score	Per Cap GNP 1961 (\$)
Ivory Coast	-0.98	184
Liberia	-1.01	159
Libya	-0.68	208
Senegal	-0.52	175
Indonesia	-0.40	83
Thailand	0.50	97
Chile	1.39	453
Colombia	0.66	283
Costa Rica	0.78	344
Mexico	0.75	313
Panama	0.84	416
South Korea	0.85	73
Taiwan	1.05	594

Sources: Adapted from Adelman and Morris (1967:170)

High social development indicators can be related to mainly two important factors. First, East Asian countries have had reasonably low income inequalities.<sup>73</sup>

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<sup>73</sup> Rodrik (1994:79) argues that especially distribution of income and wealth is very vital among initial conditions.

Gini coefficient (see Table 4.4) which measures income inequalities traditionally has been comparatively very low in these countries. The land reforms in Korea and Taiwan were generally responsible for this relative income equality. Furthermore in Singapore and Malaysia, government deliberately followed policies prone to income equalities to decrease social tension. In fact, the power of leftist movements forced the governments to make land reform or follow more equitable economic policies.<sup>74</sup> Secondly, the education level of the citizens of these countries were higher compared to the countries having same per capita (Rodrik 1995)

**Table 4.4: Gini Index, Period Averages, 1965-90**

Region	1965-70	1971-80	1981-90
Korea	0.34	0.38	0.33
Taiwan	0.32	0.36	0.30
Singapore	0.50	0.45	0.41
Indonesia	0.40	0.41	0.30
Thailand (b)	0.44	0.38	0.46
Malaysia	0.50	0.48	0.42
Hong Kong	0.49	0.42	0.39
Brazil	0.57	0.60	0.60
Colombia	0.56	0.58	0.51
Chile	0.50	0.53	0.53
Mexico	0.58	0.52	0.53
Average	0.50	0.50	0.48

Source: Campos and Root (1996: 9)

<sup>74</sup> Jose Edgardo Campos and Hilton L. Root (1996:39) point out that Malaysian New Economic Policy which aimed to reduce income inequality between different races was a response to social upheavals of 1967 in the country. Furthermore in Singapore “the immense power of labor and the students made the [ruling party] realize the importance of well paying reasonable housing opportunities for workers and universal education”.

## **4.2. The Impact of Japan on East Asian Countries**

In the preceding part we summarized general characteristics of the successful economies the East Asia. We saw that similar to Japanese experience, the East Asian high growth policies had mainly heterodox economic characteristics. Government role and industrial policy with many heterodox financial and industrial institutions are crucial to understanding of East Asian experience. Here we will attempt to answer the question concerning Japan's role in the formulation and implementation of these policies to understand the indirect links between Japan and development economics.

Cummings (1987) notes that “[a]n understanding of the Northeast Asian political economy emerges from an approach that posits the systematic interaction of each country with the other, and of the region with the world at large.” This statement is also valid for Southeast Asian countries. In this respect, Japanese role in the region has been a major factor to account for the trends which have been taking place in the region since the end of the 19<sup>th</sup> century. Japan deeply affected the East Asian economic policies and institutions from which, after the 1980s, development economics benefited much to formulate a new line of thinking.

Japanese influence in the region became very apparent after 1905 when it surprisingly defeated the Russian army. From then on, Japan started to be a model to many countries in the region as well as in the world. As Mahathir bin Mohamad (2002), the former leader of Malaysia, put it:

Looking East Asia is therefore not a new thing. The people of East Asia had been looking East at Japan even when they looked up to the West. Japan's success in modernizing gave them hope. They believed that they could become as good as Japan.

Japanese activities in the region before the Second World War started to have very imperialistic character. Japan colonized or dominated many countries in the region. Japanese colonization activities were very brutal. The occupation years meant deprivation from basic rights, forced working, and prohibition of learning their own language history and many other suffrages for the people of occupied countries (Edward 1992:102). This evaluation is especially valid for Korea.<sup>75</sup> However, regardless of brutal aspect of Japanese colonization period, it is generally accepted that foundations of the later economic policies and economic success can be found in this period (Cummings 1987, Kohli 1994, 1997 and Edward 2002)

Japanese influence has been especially visible in Korea and Taiwan because of Japan's colonization in these countries. Japan annexed Taiwan in 1895 after the Sino-Japanese War and Korea in 1910. So these countries underwent Japanese occupation up to the end of the Second World War. Hence, it is natural to expect that this period of Japanese occupation left a considerable legacy in these countries.

Firstly occupation period was important in creation of an infrastructural base in these countries. In this context,

Japan's imperial experience differed from the West in several fundamental respects. It involved the colonization of contiguous territory; it involved the location of industry and infrastructure of communications and transportation in the colonies bringing industry to the labor and raw materials rather than vice versa (Cummings 1987:51).

Japanese attempt to shift some of her industrial base to Korea, Manchuria and Taiwan accelerated during the 1930s in line with her preparation for total war. As a result, interestingly, both Korean and Taiwanese annual growth rate between 1911 and 1938 were higher than that of Japan (Japan 3.36 per cent, Korea 3.5 per cent, and Taiwan 3.8 per cent) (Cummings 1987:45). Some argue that the Second World War wiped out accumulated industrial bases in Taiwan and Korea the state structure was there and so was the know-how to engineer industrial policy (Cummings 1987:327).

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<sup>75</sup> As Amsden (1979: 348-349) notes, Taiwanese people developed less reaction to Japanese colonization. In this sense "An interesting feature of the Japanese interlude was its ramontication after the war and at least through the 1960s, by those of the middle class in Taiwan with a taste for Formosan (i.e Taiwanese) nationalism." And "the Japanese interlude and Japanese culture in general were romanticized by Formosan nationalist if only to demystify the degree of economic development achieved under the Mainlander rule".

Secondly, in Korea and Taiwan, Japanese administration initiated land reforms which were reminiscent of the land reform undertaken in Japan just after the Meiji Restoration of 1868. This process took place from 1898 to 1906 in Taiwan and from 1910 to 1918 in Korea (Cummings 1987:54). According to Amsden (1979), Taiwanese government could not have undertaken effective land reforms around the 1950s, if this earlier experience did not take place. Thirdly, Japanese colonial practices significantly differed from those of the European countries in empowering bureaucratic and institutional capability of the occupied countries. For example, Basil Davidson “once reckoned that when the Belgians abandoned Congo, which is today Zaire, they left behind fewer than twenty Africans with postsecondary education, none of whom had serious administrative experience” (cited in Rapley 1996:143). The capacity of the bureaucracy, which is among the major explanatory variables of the post-war economic success of Korea and Taiwan increased during the Japanese occupation period. (Cummings 1987 and Kohli 1994, 1997). “The bureaucratic structure, imposed on colonial Korea and Taiwan was a modern, meritocratic and authoritative one, with much of it [all the offices and substantial personals] was carried forward to independence” (Cuming 1987: 327). One can find much continuity between pre-war and post-war bureaucracy in Korea and Taiwan. However, this continuity was not an inevitable episode (Kohli 1994: 1286). New leaderships in these countries could have put into practice very fundamental changes which could have caused different state structure and bureaucratic understanding. Although they made some important changes, they nevertheless did not significantly break the continuity with the old structure.

Japanese influence on East Asia ceased after the Second World War for a time. Japan endeavored to recover from the ravage of the Second World War by turning inwards. Furthermore, many East Asian nations which experienced Japanese invasion were very reactive to Japanese economic and other policies in East Asia. They generally saw Japanese actions as a revival of the pre-war Japanese expansionist policies.<sup>76</sup> After the 1960s, some normalization steps were taken. The Kennedy administration’s attempts were very crucial in this respect. The main aim

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<sup>76</sup> In fact, even today the memories of Japanese invasion are very lively especially in China and Korea. From time to time big protests are being held against Japan in these countries.

of the US was to increase integration among Asian nations in order to form an anti-communist East Asian bloc against the Soviet Russia. In this regard, Taiwan, Japan and Korea were strategically the most important countries in East Asia for American foreign policy. Therefore the first attempt was in the direction of increasing economic and other relations among these countries. In fact, starting the normalization process could have taken much longer had it not been for the American initiative. Along with this normalization process, Japanese direct investment, joint ventures and technological transfer to East Asian countries commenced.<sup>77</sup> Although Japanese direct investment played a very important role in East Asian development, this issue is beyond the scope of our study. Therefore we will not go further in this direction. For this study, the links between Japan and East Asian countries that affected high growth policies in these countries were much more crucial.

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<sup>77</sup> The first wave of Japanese investment went to especially North East Asian countries with relatively labor intensive production sectors (Cutler, Berri and Ozawa 2003:37). Japanese giant electronic firms such as Sonya, Hitachi and Sharp were very active in this first wave (Edgington and Hayter 2004:12). Japanese companies generally preferred more joint activities with domestic firms as compared to American firms which sought 100 per cent ownership of their subsidiaries in Taiwan and South Korea (Edgington and Hayter 2004:14). However, the international operation of the Japanese firms was highly restricted during the 1950s and half of the 1960s because of balance of payments problems. Japanese government started to relax the restrictions on the overseas investments along with improving the balance of payment situation after 1965. This facilitated overseas investments of the Japanese firms. In addition to this, after the first oil crisis, Japanese firms' activities gradually increased in East Asia because of the decreasing growth potential of the Japanese economy and collapse of the Bretton Woods system which opened the door for yen to appreciate.<sup>77</sup> Although it exhibited an increasing trend, Japanese firms' direct investment in the region cannot be considered very huge even during this period. However, Japanese investment started to enter very strategic sectors in East Asian countries (such as the electronic sector) which later became the export engine of these countries. Therefore, the impact of these investments cannot be measured only in terms of quantity. Furthermore, technology transfers in the form of patent and licensing agreements also constituted a very important channel. Furthermore, Japan was a major supplier of machinery and capital goods, which were vital for the developmental efforts of the East Asian countries. In this sense, 80% of their import from Japan in 1980 included capital and technology-intensive products (Ozawa 2003). Japanese giant companies increased their high posture in the region along with the changing circumstances in Japan and in the world economy after 1980s. In fact, some authors called this process as the "hollowing out" of the Japanese industry (Ozawa 2001). The appreciation of yen, liberalization policies of the 1980s, Japanese trade conflicts with USA, cheap and abundant labor supply mainly determined their decisions in the direction of shifting their operational basis to the neighboring countries.

The true nature of these links is hard to capture. However in order to understand them one should also consider the ‘demonstration effect’ of Japan on East Asia.<sup>78</sup> East Asian countries tried to imitate many Japanese practices even before the post-war era, because of her spectacular economic performance. This influence continued with an accelerated trend after the post-war era. Many countries in East Asia as well as in other regions endeavored to learn from Japanese post-war and pre-war economic policies especially after 1960s when the success of Japanese post-war policies which were similar to the policies implemented during the pre-war period, became very apparent.

Some countries publicly announced their campaigns in the direction of learning from Japanese practices. One important example for this is ‘Malaysian Look East Policy’ which was launched in 1982 to learn from Japanese practices to improve Malaysian economic policies (Ping 2005: 1). Malaysia’s Former President Mahathir bin Mohamad (2002: 1) explains this as follows: “Malaysia is perhaps less bashful and announced loudly that it intended to look East, look at Japan mainly for inspiration and guidance.” Malaysia identified certain factors which they believed Japanese success was grounded upon. These factors “[a]re patriotism, discipline, good work ethics, competent management system and above all the close cooperation between the government and private sector” (Mohamad 2002: 2). Mahathir Mohamed is proud of this campaign. He argues (2002: 2) “[w]e tried to adopt these practices and instill these cultures in our people. And everyone now acknowledges Malaysia has made better progress than most other developing countries. The fastest pace of Malaysia’s progress and development took place in the last two decades coinciding with Malaysia’s Look East Policy”.

Singapore also embarked a ‘Learn from Japan Campaign’ in 1978 to improve her policies in the light of Japanese experience (Ping 2005: 1). It is interesting that,

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<sup>78</sup> Here we take demonstration effect in a broader sense than Korhonen (1994: 104). According to him “Japan [...] may have provided a demonstration effect to the other Asians - at least in the sense that if the Japanese can do it Chinese or Koreans certainly could do it, too”. On this subject it is better to follow Cutler, Berri and Ozawa (2003: 39) who argue that Japan pervasively demonstrated how industrial catch-up could be accomplished.

the characteristics of Japanese high economic performance that Singapore identified to emulate were similar to those that Malaysia identified. They are high productivity, social cohesion, teamwork, politeness, preserving cultural tradition against westernization, and above all industrial policy (Hong 2003:1).

Korea and Taiwan were other countries which looked at Japanese pre-war and post war policies to formulate their post-war policies although Korean leaders in particular generally avoided declaring their ambitions to learn from Japan because of bad memories of the Japanese colonization in their country. In this respect, Wade (1990: 326,334) notes that:

Japan was the textbook for Taiwan and Korea; it is no surprise that it shows the same array of governed market elements [...] Japan looked to the United States and Europe, Taiwan and Korea looked more to Japan with the perception that they are descending the same stretch of river (in the Japanese metaphor) as Japanese did fifteen to twenty five years ago.

It is generally accepted that Park Chung Hee who indisputably was the man behind the Korean development between 1960s and 1970s was heavily influenced by the pre-war and the post-war Japanese development experience. Kohli (1994) argues that he was the product of Japanese colonial army. In fact this statement has some truth because Park, after a short teaching career, entered Japanese Military Academy of Manchuria in 1940. And then, he went to Regular Course of the Japanese Imperial Military Academy in Tokyo from which he graduated in 1944 (Hee 1970a: 239). Therefore he was very much familiar with Japanese policies. Maybe for this reason, he did not hesitate to declare the influence of Japan on him, although, he gave reference to the pre-colonialist Japan. Following sentences can easily reveal Japanese influence on him:

[T]he empire [Japanese Empire] was able to accomplish political reform, economic improvement and social reformation on a firm basis. It was enabled to overcome an excessive inclination to the European system and progress steadily [...]. At any rate, though the age and people are different from then, the case of the Meji imperial restoration will be of great help to the performance of our own revolution. My interest in this direction remains strong and constant (Hee 1970b:120)

Although, demonstration effect is very important to elucidate the impact of Japanese influence on East Asian countries, Japan also deliberately attempted to

popularize its industrial policies via providing scholarship, aid and credits holding big youth exchange programs and encouraging research on her and East Asian high-growth policies. Especially East Asian students and institutions have had easy access to these research and education opportunities although these channels also enabled Japan to expand its influence over other developing countries. Japanese main aim was to increase her cultural and economic influence in the region. Sabura Okito, who was a very important figure in the preparation of post-war economic policies, eagerly got involved in the campaign increasing integration among East Asian countries. He increased his activities in this direction after he became the Minister of Foreign Affairs. (Korhonen 1994). According to Korhonen (1994), Okita tried to make the flying geese model a corner stone of the Japanese foreign policy.

Japan can be considered as the country which has the most comprehensive youth exchange programs. The participants of these programs are chosen from countries which had political and economical importance in the eyes of Japanese government. The programs generally consist of many discussion and seminar sessions on Japan and Japanese economy as well as entertainment activities. Japan meticulously prepares these programs and spends enormous amount of money on them. The participants of the programs generally return to their countries with good memories of the Japanese government and people. Their relationship with Japanese government continues via alumni associations in many countries. Japanese government seriously endeavors to make these associations take part in preparation of later programs. The Ship for World Youth Program and The Ship for South East Asian Youth Program were most famous Japanese youth programs.<sup>79</sup> The latter is organized annually only for the South East Asian youth. And the main aim is to expand Japanese political and economical influence throughout East Asia. As a participant of The Ship for World Youth Program, the writer of these lines witnessed

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<sup>79</sup> The Ship for South East Asian Youth Program is an annual program sponsored by Japanese government. It started in 1974 with the participation of the youth coming from five ASAN countries. About 300 youth from ASEAN countries and Japan participated in the program each year. They spend about 50 days together on a ship called Nippon Maru. The Ship for World Youth Program is very similar to the former except that it is open to participants from all over the world.

how Japan successfully used these programs as a tool to increase attractiveness of Japan and Japanese practices among youth coming from all over the world.

Japan also provided many scholarships to foreign students especially to the East Asian students after 1960s. Monbukagakusho: MEXT scholarship is the most famous among Japanese scholarships. Students or researchers can use this scholarship for their undergraduate studies or researches in Japanese universities. Japanese government has spent more than 200 million \$ for this purpose.<sup>80</sup> Each year more than 5000 students and researchers benefit from this opportunity (Ohnaka 2004: 12). About half of the scholarship quota is allocated to the students or researchers studying Japanese language or Japanese culture. The students or researchers, who have strong interest in Japanese culture and desire to learn form Japanese economic, technological and political practices are also strong candidates for the quota allocated to applicants coming from the other fields.

Japan also effectively uses her aid and credit policies to increase her influence on other countries especially on the East Asian countries. Japanese aid and credits to the region significantly increased after 1965 along with the normalization of Japan relations with other East Asian countries which underwent Japanese invasion before or during the Second World War. For example, during 1966 and 1967, South Korea received 108.5 million dollar private loans from Japan (Johnson 1987). Later on, aid policy became the backbone of Japanese foreign policy to expand her influence in the region (Korhonen 1994).

Japanese aids' and credits' aim and scope were very different from neoclassical conception of the role of aids. Ohno (1998:2) who worked for Japanese aid institutions points out "we feel that its methodological scope is too narrow to handle a total social change such as economic development or transition".

The interest rates of Japanese credits were significantly below the market interest rates. Access to these credits has some requirements such as distribution of these credits to certain sectors line with long term industrial policies of the recipient government. Japanese aids also have characteristic encourage strategic intervention

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<sup>80</sup> Japanese government also allocates 100 million \$ to support foreign students at personal expense and 30 million \$ to cover the student exchange programs (Ohnako 2004: 12).

and ‘governing the market’ (Ohno 1998). “In doing so, Japan endorsed a market-guiding role of for the state in recipient countries, and justified this role by pointing to its success in the development of Japan, Taiwan and South Korea” (Wade 1996: 4).

Japan followed this line of thinking in her policy suggestions to the ex-communist countries in East Asia and in other regions in their attempt to transform their economies from a command economy into a market economy. For example, the Japanese officials’ suggestions to Russia, Kyrgyzstan, Vietnam were very different from the conventional prescriptions of the IMF. They proposed more output oriented, long term, active government approach to these economies instead of short term sudden structural adjustment programs of the IMF (Kaneda 1998, Ohno 1998, Nishumura 1998, Japan International Cooperation Agency 1998). Ohno (1998:4) summarizes clearly the differences between Japanese view and the IMF’s neoclassical approach in the following table.

**Table: 4. 5 Comparison of Development and transition strategies**

	Neoclassic approach	Japanese approach
Highest priority	Financial aid and macroeconomic (fiscal and BOP deficits, money, inflation debt)	Real (output, employment, industrial structure)
Time scope	Short-term (solving problems as they arise)	Long-term (long-term targets and annual plans)
Basic attitude toward market	Laissez-faire; minimal government intervention	Active support by government
Speed of systemic transition	As quickly as possible	Will take long time even with maximum effort

Source: Ohno (1998: 4)

The World Bank and the IMF found Japanese policy suggestions to developing countries as well as East Asian countries inconsistent with their own views of development which consist of less government, deregulation and no industrial policy (Wade 1996). However, Japan became the second important shareholder of the World Bank in the 1980s and she emerged as largest provider of official development assistance programs. During this period Japan was very self-confident about the superiority of her model over the Western model because of her incessant high growth performance. Japan wanted to show that she followed a different model from the Western one in terms of the institutional structure and many other variables. Japan felt that she had enough power to try to force the Bank to consider its position vis-à-vis the Japanese aid, credit and other policies toward East Asian countries as well as other developing countries in the late 1980s (Wade 1996). However, Japan was faced with a very interesting dilemma. Officially she was trying to prove that her model was not based on high tariffs and discrimination against foreign firms in order to avoid trade frictions with the USA. Therefore, Japan did not have full flexibility to force the World Bank to reconsider its attitudes towards Japanese approach to development.

However, these limitations did not hinder Japan officially from beginning to negotiate with the World Bank for the preparation of a report on the story of the Japanese and East Asian industrialization. Finally, World Bank accepted to prepare such a report just after Japan undertook to cover most of the expenses. Then the report was published under the title of *East Asian Miracle* in 1993. It is generally accepted that although the miracle report had some reference to the role of state and some other heterodox policies in industrialization of developing countries, it mainly tried to substantiate 'market friendly' neoclassical approaches. However, the report also created a very lively discussion about the role of government and industrial policy in reference to Japanese and other East Asian countries' experiences. In this sense, although, the report itself did not give much support to the Japanese arguments many of later studies defended the variants of Japanese ideas (Wade 1996, Akyüz and Gore 1996, Sing 1998)

It is obvious that policies and institutional structures in East Asian economies were formulated at least partially in the light of Japanese successful development experience. Here we will touch on some similarities between Japanese and other East Asian countries' policies. First, the role of the banking system or more broadly the financial system was of Gershenkron (1962) or Schumpeter (1962/1934) type in Japan and in other East Asian countries. Financial system was designed to give top priority to providing cheap credit for investment. In this sense, financial system was 'immature' in terms of western standards. However, this immaturity of the system enabled the countries to direct saving to necessary areas instead financial speculation. Secondly, bureaucracy was immune from rent-seeking and patronage relationships. Bureaucracy was relatively autonomous in Japan and East Asian countries though this could not be sustained for a very long time. This characteristic of bureaucracy has evolved gradually in Japan at least since the Meiji Restoration of 1868. Japanese occupation legacy was important to understand the post-war bureaucratic structures in Korea and Taiwan. However this does not mean that the post-war deliberate policies of the East Asian governments had no role in the emergence of this bureaucracy. Thirdly, another similarity is the role of the big firms in these countries. The chaebols were the result of the authoritarian Korean government policies in the direction of creating scale economies in the light of Japanese experience (Woo-Cumings 1998:327). The proto-type of this system was the keiretsu system of the post-war period or the zaibatsu system of the pre-1945 period. In Taiwan public enterprises, rather than big private firms, played a very important role, whereas South East Asian countries generally tried to attract big international firms especially after the 1980s, although they endeavored to manipulate these firms in the direction of their national economic development policies. Fourthly, one can see major similarities in trade and industrial policies of the countries under consideration. Protection of infant industries for certain periods via tariffs, quotas, subsidies, tax exemptions for strategic sectors and the export promotion system were the cornerstones of trade and industrial policies. A combination of outward (export-led model) and inward looking (import substituting industrialization model) was followed by Japan and many other East Asian countries. Government role was very crucial in understanding of the success of these countries.

In this sense, Japan first proved the necessity of state intervention and ‘guiding the market’. In relation to these, Japanese experience demonstrated to other East Asian countries that generally, heterodox economic analysis and prescriptions are superior to neo-classical paradigm to achieve the aim of industrialization. Fifthly, many others countries in the region envisaged economic growth as their fundamental aim as Japan did before. In this respect, they ignored social policies in the name of ‘GNP’ism’. In this way the other East Asian countries also adopted a kind of authoritarian state. Japanese authoritarianism can be considered very soft in relation to other East Asian countries’ very ‘hard’ authoritarianism. However, initial factors such as the land reforms and prevention of speculative activities protected these countries from an unequal income distribution at least up to the 1990s. Lastly, the consumption pattern of these countries did not match with that of the Western countries. Many of these countries were immune from the ‘demonstration effect’ in terms of consumption.

Some authors (Kahn 1979, Vogel 1991) claim that cultural factors were responsible for this distinct characteristic of Japanese and East Asian model. However, cultural factors cannot explain this phenomenon. Deliberate government policies in the direction of repression of consumption pattern and historical factors such as long war periods were important in accounting for this phenomenon.

Up to now, we investigated East Asian model and the role of Japanese experience in its emergence. We tried to demonstrate that Japanese model played a very important role in the emergence of East Asian model. Hence, it can be argued that the influence of East Asian economies on development economics can be seen as an indirect effect of the Japanese influence on development economics. In the following sections, we will deal with theories formulated in reference to Japanese successful performance and East Asian model.

### 4.3. The Flying-geese Model

The impact of the Japanese development experience on East Asian countries has been interpreted within the context of the ‘flying-geese model’ of industrialization by many authors. The flying geese model was first formulated by Akame Akamatsu during the 1930s. This model is derived from time-series curves of Japan’s imports, domestic production and exports in the textile industry from about 1870 to World War II (Akamatsu 1962:11). It was in fact an original late-comer theory which tries to explain the catching-up process in developing countries (Kojima 2000). In Akamatsu’s words “The wild-geese flying pattern of industrial development denotes the development after the less-advanced country’s economy enters into an international economic relationship with advanced countries” (Akamatsu 1962:11).

Before 1990s, the theory itself was hardly known outside Japan and the image of theory was generally negative because during the Second World War it was officially used to legitimize Japanese expansionist policies in the Asia-Pacific region (Korhonen 1994:93). After the 1990s the situation started to change and many writers tried to verify the validity of this theory (Dowling and Cheang 2000, Cutler, et al 2003, Edgington and Hayter 2004, Ginzburg and Simonazzi 2005). On the other side some writers opposed the idea of flying geese pattern of development (Hart-Landsberg and Burkett 1998, Bernard and Ravenhill 1995).<sup>81</sup> However there is scarcely any reference to the original formulation of this model in most studies. Therefore it is necessary to summarize Akamatsu’s original theory.

According to Akamatsu (1962), there are four stages of flying geese type of industrialization. In the first stage, consumer goods are imported from industrial or advanced countries, and “in exchange for them, special products of less-advanced countries are exported” (12). In the second stage, import substitution starts for the consumer goods. It was “due to the fact that concentration of purchasing power on such articles makes their domestic production profitable” (Kojima 2000: 377). This

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<sup>81</sup> Tung (2003:49) endeavors to follow an intermediary path between these two camps. According to him “The results are mixed. The country ladder is found to exist on the aggregate level, but not necessarily so at the disaggregate level”.

process is also conducive to the domestic market. In this way protectionist measures and economic nationalism appear. However, in order to start consumer goods' production, imports of capital goods constitute a necessity. Akamatsu claims that in such countries as Japan where supply of raw materials is not sufficient, imports of raw materials also constitute a necessary condition.<sup>82</sup> Thus this stage also includes investment on energy resources and energy industry that are vital for the production of consumer goods. In short, the second stage can be characterized by "(t)he development of the domestic production of hitherto imported consumer goods and increased imports of capital goods as well as gradually decreasing importation of consumer goods" (Akamatsu 1962:14). In the third stage, domestic consumer goods industry starts to export. At the same time, import substitution of previously imported capital goods begins to take place. Furthermore:

[t]he consumer goods industry was already homogenized with that of advanced countries, attaining the same standard as that of the advanced countries; therefore, those countries are no longer less-advanced countries as far as this industry is concerned but have joined the ranks of advanced countries as an exporter of these goods (Akamatsu 1962:15).

In the final stage, consumer goods industry displays a decreasing trend. This means that exports of goods decrease. Export of capital goods replaces that of consumer goods. This was caused by the establishing of this industry in other less-developed countries. Indeed, this pattern is an indication of the flying-geese pattern of development. The pattern of industrialization in a less developed country follows that of the more advanced country.

Akamatsu notes that throughout these four stages, the country displays an export pattern that export market expands from the less developed area to the

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<sup>82</sup> According to Akamatsu (1962) "The primary condition for this consumer goods industry to be established is the existence of a domestic market for these goods. Such a market has already been developed by the imported goods, which fact has been overlooked in Nurkse's theory. Nurkse holds that in less-advanced countries no demand for industrial goods exists because of their poverty, and in consequence, there is no incentive to investment. However, the reverse being the case manufactured consumer goods are being imported in exchange for special products and form a big export market for the advanced industrial countries" (13).

advanced area. Throughout these stages, products become more sophisticated. Therefore he believes that international trade enables the country to climb up the ladder of industrialization in the flying geese pattern, from less sophisticated goods towards more elaborated goods. In other words, “The countries of the world form a wild-geese-flying order from the advanced countries which have reached the stage of high-degree heavy and chemical industries to the less-advanced countries which are still in the stage of primary industries” (Akamatsu 1962: 17). According to him, geese which are relatively backward will be eventually industrialized, though at a different speed. If so, why do all countries not display a homogenized pattern of industrialization? According to Akamatsu, the answer is technology. “The advanced ‘wild geese’ which are in the lead are flying onward, incessantly achieving technological innovations and trying to maintain a certain distance of heterogeneous difference from the less-advanced ‘wild goose’” (Akamatsu 1962:18). In this sense technology serves two opposite functions. First, it creates opportunities for homogenization. Secondly, it destroys these opportunities via the actions of the leader flying geese. So, this process consists of incessant homogenization and heterogeneization of the countries. However, throughout this process, the rank of the leader flying goose can change. It means that the speed of the goose is not the same in all stages. “Some of the less-advanced countries always remain in a stagnant state falling more and more behind in the wild-geese-flying order, while others, like Japan, joined the ranks of advanced countries by making rapid advances and are strengthening a high degree of homogenization” (Akamatsu 1962: 18). Furthermore there are regional differences in these large series. In these groups, there exist regional leaders such as USA, Germany and England and Japan. According to Akamatsu, Japan is the ‘leader goose’ of the East Asian countries.<sup>83</sup>

In Akamatsu’s original theory, there was no explicit reference to the role of foreign direct investment in the industrialization of a country. In fact, this is natural because when he wrote, foreign direct investment was unimportant. Furthermore, he

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<sup>83</sup> “However, the wild geese order of industrial development from the advanced countries is not a one-series row, but is divided into several wild-geese-flying rows, one following another. There is a wild-geese-group with America taking the lead, and a Western European group with England and Germany taking the lead, as well as comparatively small group with Japan taking the lead” (Akamatsu 1962: 18).

based his theory on the Japanese experience for which foreign direct investment has never been an important source for growth because Japan has always considered foreign direct investment as a threat rather than an opportunity. However, flying-geese model later became a corner stone of the explanations on the role of foreign direct investment (Kojima 2000, Edgington and Hayter 2001, 2004, Ginzberg and Jimonazzi 2005). This was mainly due to the belief that the role of foreign direct investment increased enormously after the Plaza agreement of 1985. Hence some authors even commenced to interpret the flying-geese model almost fully in terms of foreign direct investment. For example, Dowling and Chenag (2000:441, 458) claim

[t]he linkage between economic development trade and FDI has been described by the so called flying-geese pattern of development [ ...] An important implication of the flying-geese theory highlighted in this paper is that trade and FDI are both engines of economic growth.

The theory has been criticized by several economists. They assert that the theory implies homogenization of all economies in a linear manner. However, as it was noted before, Akamatsu mentions the counter-forces at work against linear homogenization. Furthermore, it can be asserted that there may be convergence (homogenization) in countries' performance especially in different clusters of the flying geese groups because of various reasons such as the demonstration effect, complementarity of manufacturing structure, availability of proximate markets and easy excess to knowledge. However, we think that a problem arises if one tries to explain East Asian development within the framework of the flying-geese theory via emphasizing the role of foreign direct investment. Although Japan (and USA) was very important in the industrialization of East Asian countries in terms of its role in the provisioning of knowledge, joint ventures, and foreign direct investment to the region, as one can easily see in Table 4.6 foreign direct investment has never become the important source of capital investment in the region except for Malaysia and Singapore. In this sense, it can be argued that, generally speaking, the East Asian growth is a domestic-source driven growth. Hence, the flying-geese theory with an emphasis on foreign direct investment cannot fully account for the East Asian development.

**Table 4.6: Ratio of FDI Inflows to Gross Fixed Capital Formation in Selected East Asian Countries, 1971-93 (percentage)**

Country	1971-1980	1981-1990	1991-1993
Japan	0.1	0.1	0.1
Hong Kong	5.1	9.9	5.7
Republic of Korea	1.2	0.9	0.5
Singapore	15.8	26.2	37.4
Taiwan Province of China	1.3	2.6	2.6
Indonesia	3.5	1.5	4.5
Malaysia	13.6	11.3	4.5
Philippines	1.0	3.8	4.6
Thailand	2.3	4.8	5.0
China	0.0	1.5	10.4

Source: Akyüz , Chang and Kozul-Wright, 1998:12

The second problematic area for the theory is the non-existence of reverse imports into Japan (Tung 2003:38-39). According to the prediction of the theory, after the third stage, capital goods export starts from the follower(s) to the leader. However, as it was pointed out before, Japan never became an important export market for the East-Asian countries. In this sense, an important division of labor emerged between Japan, East Asian countries and USA. Japan mainly provided necessary capital goods for investment to the region while USA became a main export market for the East Asian goods.

The last flaw of the theory in explaining of the East Asian growth can be found in it's sequencing of import, production and export of a good. Akamatsu claims that demand for domestically produced goods grows out of importation of a good. However, as many economists point out, backward or forward linkages can

create demand for new goods without earlier importation of a particular good (Hirschman 1968). Therefore an investment spurt in many areas can easily create the demand for new goods which are complementary with this investment. Moreover, the export of a good can precede production for domestic market. Therefore, sometimes export markets can play a greater role in stimulating the production of a good. In this sense, many East Asian countries started to export without going through any import substitution period for a good, even though they used import substitution in many other areas.<sup>84</sup>

However, the theory is a very important tool to capture the impact of Japan on East Asia especially in terms of its ‘spillover effect’ and ‘demonstration effect’. Firstly, Japan showed these countries how to industrialize. In this sense, they followed the ‘leader goose’. They successfully tried to imitate Japan and learn from her. They even launched national campaigns to do this as in cases of Malaysia and Singapore. Secondly, Japanese high economic performance also increased the demand for the goods of these countries. Therefore, as Akamatsu (1962) envisaged, Japanese industrialization stimulated production in other East Asian countries. Furthermore, the significance of Japan for these countries has originated from its place as the source of the import of capital goods by these countries. In other words, Japan has been the main supplier of capital goods without which East Asian countries could not have increased their capital stock as rapidly.

#### **4.4 The Developmental State Theory**

The tenets of the developmental state theory were put forward by many authors before the 1980s. One can even go back to List (1966) to find a theory of the developmental state. Later on, Gerschenkron (1962) formulated a late-comer industrialization hypothesis which was based on the industrialization of the Eastern European countries. He implicitly claimed that the need for a developmental state in

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<sup>84</sup> Tung (2003:39) also touches this point. However he puts emphasis on the role of foreign direct investment. “[I]mport substitution does not always precede export as prescribed in the basic pattern. For example, Taiwan’s export capacity of electronics parts and components in the 1960s established by the multinational corporation, was not build on any substantial import substitution”.

a country increases if the country is more backward. Then, many structuralist writers such as Hirschman (1968) emphasized the role of state in industrialization. However, the most explicit theory of the 'developmental state' commenced with Chalmers Johnson's magnum opus; *MITI and the Japanese Miracle* (Evans 1989, Öniş 1991, Leftwich 1995). Leftwich (1995:403) notes that "it was only with the publication of Chalmers Johnson's seminal work on East Asian developmental states and Japan in particular that the phrase 'developmental state' made its formal debut and that a serious attempt was made to conceptualize it." Johnson (1982) mainly embarks on to develop a general framework of the developmental state by investigating the factors behind the so-called 'Japanese Miracle' in his *MITI and the Japanese Miracle*. Here, we will first attempt to summarize the main findings of Johnson (1982).

Johnson defines Japanese state as 'plan-rational' or developmental state as opposed to 'command-rational' state (ex-communist states), or market rational states (USA and several other Western countries). In this sense, he notes that Japan had been a developmental state from the beginning of the Meiji Restoration of 1868. Although Japan passed through different epochs, the main ingredients of the Japanese developmental state were gradually transformed in a dynamic framework in response to changing circumstances. By looking at the Japanese experience he defines four facets of a developmental state. "The first element of the model is the existence of a small, inexpensive, but elite bureaucracy staffed by the best managerial talents available in the system" (Johnson 1982:315). There are three important duties of this bureaucracy; identifying and choosing industries to be supported, finding best ways to feed these industries and supervising them to sustain their "health and effectiveness" (Johnson 1982: 315). The second tenant of the developmental state is a political system which provides bureaucracy with enough space to take free initiatives. Therefore, other branches of the government should be restricted to the so-called 'safety valve function' In other words, "[t]he political system of the developmental state covertly separates reigning and ruling: the politicians reign and bureaucrats rule" (Johnson 1982: 316). Third element of this model is the "perfection of market-conforming methods of state intervention in the

economy” (Johnson 1982: 317). In this way, he notes that the state should pursue such industrial policies that will work-against the private agencies as little as possible. He claims that Japanese experience exhibited the best way for ‘market-conforming’ method of state intervention to the economic realm, that is, ‘administrative guidance.’ According to Johnson, in the Japanese type of administrative guidance system, there is no need to give direct orders to the business sector. They generally tend to observe the signals coming from the government for easy access to government subsidies, tax breaks, and approval of their plans to import foreign technology and establish joint ventures. (Johnson 1982:24).<sup>85</sup> So, without following detailed statutes and laws, bureaucracy flexibly can give response to all changes in economic realm after discussing with the private agents.

The intent of the public system is to manipulate the inputs into the decision making process of privately-owned and managed enterprises in order to achieve developmental goals, but the content of its inputs is continuously affected by feed back on profit-and-loss conditions, export prospects, raw materials cost and tax receipts (Johnson 1987:142).

However the long-term political stability and long-term predictability of the system requires a degree of authoritarianism (Johnson 1987:143). How will abusements be eliminated in this system? He claims that the answer “seems to lie in finding better bureaucrats and not eliminating their discretionary power” (Johnson 1982:19). Final ingredient of the model is key pilot agencies such as the MITI in Japan. The pilot agencies should have very strong presence in a specified area which should be neither too large nor too small.

According to Johnson, the workability of this model depends on the prevalence of widely agreed goals such as the growth of GNP. Otherwise problems and conflicts can easily arise in society. He notes that “[i]n the developmental state economic interests are explicitly subordinated to political objectives” generally derived from “comparisons with external reference economics” (Johnson 1982:24). Generally existence of a foreign threat is used to formulate national goals and for the

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<sup>85</sup> He claims that firm did not have to respond to the government. “The business literature of Japan is filled with descriptions of the very interesting case of big firms that succeed without strong governmental ties (for example Sony and Honda) but there are not many to describe” (Johnson 1982:24)

legitimization of means which are used to reach these goals (Öniş 1991, Johnson 1987, Wade and White 1988). In the Japanese case, the urgency of the reconstruction economy after the Second World War provided necessary goals and legitimacy to the government.

Which system is better to reach developmental goals? Johnson makes a distinction between hard authoritarianism and soft authoritarianism. He points out that the degree of government's reliance on more authoritarian ways increases during the period of crisis or anticipated crisis. However, for him, Japanese type of soft authoritarianism based on the dominance of one party system after 1955 is presumably one that can be preferred over the Taiwanese or Korean hard state.

Later studies which focused on East Asian countries come to face an interesting dilemma although they found rich material to elaborate this model. The countries which were generally successful in implementing developmental state type of policies in the region were being ruled by the governments coming to power by using anti-democratic ways. At best, these countries could be a kind of guided democracy under the shadow of the military. For example, from 1949 to the end of 1980s Taiwan was governed by Guamindong, a nationalist party which was defeated by Chinese Communist Party in the mainland. Korea remained under the control of the military or parties coming to power with strong military support. In a similar vain, Indonesia, Malaysia, Thailand, Singapore had governments with very hard hand, though the degree of authoritarianism varied from one country to another in the region. Therefore, the emphasis on the authoritarian characteristic of developmental state increased. For, example this tendency is very apparent in Leftwich (1995).<sup>86</sup> In line with increasing emphasis on authoritarian characteristic of the developmental state, the discussion about the autonomous characteristic intensified. How can we define the term autonomy? It means:

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<sup>86</sup> After Johnson the most elaborate theory of the developmental state can be found in Leftwich's writings. According to him there are six important elements which define developmental state: "1- a determined developmental elite; 2-relative autonomy; 3- a powerful competent and insulated economic bureaucracy; 4- a weak and subordinated civil society; 5-the effective management of non-state economic interests; 6-repression, legitimacy and performance" (Leftwich 1995: 405).

[T]he state has been able to achieve relative independence (or insulation) from the demanding clamor of special interests (whether class, regional or sectoral) and that it both can and does override these interests in the putative national interest” (Nordingler 1987:361 cited in Leftwich 1995: 408)

In this sense, it is generally accepted that one of the most important characteristics of the developmental state is its autonomy from different interest groups. So bureaucrats can be true to focus on developmental goals as in the East Asian case.

This theory can only be useful if one realizes its limits. In this regard, there are at least four missing points which have not been taken into account in the developmental state discussions. First of all, as Bagchi (2000:398) claims “there were developmental states long before economists, political scientists or historians recognized them”. If we define developmental state as “a state that puts economic development as the top priority of governmental policy and is able to design effective instruments to promote such goals” (Bagchi 2000: 398), then one can find many examples of developmental states in history (Bagchi 2000.). Secondly, there will be developmental states as long as nation states exist. In this sense, it is a category that pertains to the age of nation-state. However, 20<sup>th</sup> century’s developmental states were very different from the preceding examples. For example, the developmental states in the 20<sup>th</sup> century evolved along with the independence and industrialization attempts of the developing countries. Korean developmental state was dated at about 1961 when general Park Jung Hee came to power. It can be claimed that at that time South Korea was still being transformed into an independent nation after the Second World War (when Japanese occupation ended) and the Korean War. Similar arguments can be set forth about Taiwan and other countries. In this sense, developmental state creation overlaps with a kind of new process of nation state building. Therefore, nationalistic sentiments played a very important role in these countries. This also provided legitimacy for repression and other kinds of authoritarian methods. Furthermore, in a country where state capacity is very limited, bureaucracy gains more importance to improve state capacity. In this context, relative autonomy of bureaucracy to implement industrial policies also appeared as a key factor.

There was an important advantage of these new developmental states. It was their relatively advanced situations. In other words, although state and society were not very developed in these countries, they never became absolutely backward countries as in Africa. For example, it is generally agreed that the legacy of Japanese occupation was very important in explaining the development process of Korea and Taiwan. Furthermore, the heritage of English colonial period was important for Singapore. The social development index in Malaysia and Indonesia was not commensurate with many other countries. However, why did developmental states not emerge in Latin American countries? Although this is beyond the scope of our discussion, it is enough to say that Latin American countries which gained independence at the beginning of the 20<sup>th</sup> century passed the period of independence and nation-state building much earlier. Hence, they lacked the ability to mobilize masses in the direction of national growth. Furthermore, they did not create any other means which could legitimize the process of the developmental state. Their authoritarian regimes could not succeed in finding any creative ways to mobilize masses. In this context, Japan is very interesting and may be the exceptional case. Japan always found a way to legitimize its soft authoritarian tools in the eyes of masses thanks to her specific history. Of course, the virtuous circle of growth helped to maintain developmental state policies until a certain period. The success in economic realm created also conditions for the maintaining of one party-system which was the key factor behind Japanese developmentalism. Thirdly, in relation to second reason, the developmental states are mostly product of the specific historical context; such as the Cold War and the rising impact of the socialist movements. Without reference to the Cold War, the category of the developmental state cannot be fully explained. A short inquiry into the history of countries which are labeled as developmental states such as Japan, Korea, Taiwan, Malaysia, Indonesia and Thailand can easily reveal this fact. The governments of these countries either came to power to suppress communist movements as in Indonesia and Thailand or in response to the communist threat coming 'external' sources as in Taiwan and Korea. Again, Japan was an exception where one party-dominance started after the 1955 democratic election. Furthermore, especially Japan, South Korea and Taiwan are

countries which benefited from huge amounts of American aid or procurement programs because of their strategic importance in the Cold-War.

The developmental state itself is a self-defeating system. In this respect, there is no time period, during which developmental state type of relations between different governments and classes lasted long. In other words, governments could not keep business under control or discipline it for a long time. The developmental state was bound to reach an end because of its very success. East Asian and Japanese experiences substantiate this fact even though Japan postponed her destiny as much as possible by using all available means. Once government helped capitalism to emancipate from its fetters, capitalism in the developmental states will see its safe-guard as a rival, although it will call its old safe-guard whenever it falls in trouble. Some theoreticians of the developmental state are aware of this fact:

In contrast to the incoherent absolutist domination of the predatory state which seems self-reinforcing, embedded autonomy has been, to a surprising extent, its own gravedigger. Its very success as a framework for structuring the accumulation of industrial capital has changed the nature of relations between capital and the state. Private capital has become less dependent on the resources provided by the state and the relative dominance of the state diminished (Evans 1989: 575).

#### **4.5 Confucianist Ethic**

Japanese success in catching-up with the West has influenced many studies. Some of them asserted that Japanese culture in general and Confucianism in particular were the main driving forces behind this achievement. In this way, culture and religion were reintroduced into economic and sociological studies as explanatory variables of economic success. In other words, it was Japan's economic development in the 20<sup>th</sup> century which stimulated the re-examination of Max Weber's theory of capitalism (Sang-In 1999:192). According to Weber (1958), Protestant ethic was in the very foundation of capitalism. He claimed that this ethic which gave rise to capitalism existed only in Western Europe. Hence, capitalism

developed in this region rather than elsewhere. However, new studies on Japan endeavored to substantiate that Confucianist ethic is also conducive to capitalist development.

Many studies which saw Confucianism and Japanese culture as a vital factor to elucidate Japanese success were inspired from Ruth Benedict's seminal work, *The Chrysanthemum and the Swords*:

Benedict wanted to know why the Japanese were willing to keep fighting even when they were losing, why they would be ready to die rather than be taken prisoner. She was puzzled about the paradoxes she observed, by people who could be so polite and yet insolent, so rigid and yet so adaptable to innovations, so submissive and yet difficult to control from above, so loyal and yet capable of treachery, so disciplined and yet occasionally insubordinate, so ready to die by the sword and yet so concerned with the beauty of the chrysanthemum (Vogel 1989).

She saw the solution of this paradox in the following terms: duty, discipline and willingness to sacrifice (Benedict 1989/1946).

During the 1960s and 1970s, the number of cultural and Confucianist studies on Japanese economic development increased (Bellah 1968, Vogel 1979). However, maybe the most influential book in this category was written by Morishima (1982); an old Marxist. According to him, elements such as high literacy, quick absorption of modern sciences and capable bureaucracy are crucial factors to elucidate Japanese success. He claims that they were mainly the legacy of the Confucian past of Japan. In his own words:

It was fortune for Japan that Confucianism was intellectual and rationalistic. It rejects mysticism, incantation, magic and ghosts. [...]. In Japan it was entirely owing to the intellectualism of Confucianism that the Western sciences were able to plant their roots deeply and quickly without great suffering on the part of brave scientists. [...] Confucianist education had trained the warriors to be efficient bureaucrats by the end of the Tokugawa era (60-61).

He notes that Japanese capitalism was very different from Western capitalism. Therefore, different institutional and political structures emerged in Japan: "loyalty to the state or lord, filial piety to one's parents, faith towards friends and respect towards one's elder gave different characteristics of Japanese capitalism" (86). Morishima (1982) attempted to explain the stagnation of Japan in reference to the

waning of above values. According to him, the reforms undertaken especially in the education system during the American occupation period intruded with the foundations of Japanese capitalism.<sup>87</sup>

Many researchers attempted to apply the framework of the Confucianist ethic theory to East Asian countries after observing the high growth performance of the several countries in the region. According them these countries share very similar culture and religions which are attuned to high economic growth (Kahn 1979, Vogel 1979). Kahn argues (1979:122):

As opposed to the earlier Protestant ethic, the modern Confucian ethic is superbly designed to create and foster loyalty, dedication, responsibility, and commitment and to intensify identification with the organization and one's role in the organization. All this makes the economy and society operate much more smoothly than one whose principles of identification and association tend to lead to egalitarianism, to disunity, to confrontation, and excessive compensation or repression.

From this observation he concludes that East Asian neo-Confucian nations have potential higher growth rate than their counterparts (Kahn 1979)

Without any hesitation, culture and religion matter. There is no doubt that culture and religion of a country are important ingredients in determining institutional, political and economic structure. In this sense, one cannot easily claim that there is no relationship between Japanese culture and labor market relationships and bureaucracy. However, this does not necessarily mean that cultural variables can explain Japanese success by themselves. Hence, these variables can be used in explaining Japanese or East Asian success only to a certain extent. Furthermore, cultural explanations have certain flaws.

First, it is very difficult to define a general homogenous set of cultural and religious values for East Asian countries (Sang-In 1999). Japanese Confucianism is different than that of Korea; Korean Confucianism is different than that of Taiwan. Gong and Jang (1998:88) rightly argue "The key values of the Confucianism respected in each country are quite different. There is no agreement on what exactly constitutes Confucian values and on which values are the most influential factors for

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<sup>87</sup> He also mentions some factors such as aging society in explaining the Japanese stagnation.

development”<sup>88</sup> Hence, Japan and different East Asian countries should be investigated separately. In this way, it can be asserted that the impact of cultural values is much more important in determining institutional structure in Japan because of her relatively continuous history. However, culture can have less explanatory power in countries such as Taiwan, Korea, Singapore and Hong- Kong which have less continuous history.

Secondly, same culture or religion can be come either a hindrance on a stimulus to high economic performance in different historical and international contexts. For example, a society in which kinship is very important can face the trap of uncreativity because of lack of individual initiatives. However, the same particularity can be a stimulus via conducting to coherence in the same society. In the beginning they can be retarding factors for an economic success. For example, Morishima (1982) asserts that Chinese Confucianism is different than that of Japanese. Hence, according to him, capitalistic relationships did not develop in China before the Communist regime. However, “it is of no wonder that the same Confucianism which was once responsible for the stagnation of the Asian economy is now seen as enhancing its capitalist transformation” (Sang-In 1999: 195).

Last but not least, generally speaking, one can argue that cultural and religious explanations generally envisage that the causality between economy and culture runs from the later to the former. However, in a context, where dynamic capitalist relationships exist, cultures can hardly determine economic processes even if initial cultural and religious endowments can be very important in determining direction and performance of capitalism as was the case in Japan. In many cases, it can be claimed that generally cultural values are subordinate to political and economic relations. In this sense, their effectiveness in institution-building decreases. For example, labor market relations in Korea are highly different from those in Japan even if many consider that loyalty and hard-working are their common characteristics. However, authoritarian regimes of Korea occasionally resorting to violence were mostly responsible for the specific nature of labor market relations.

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<sup>88</sup> Similarly, Kyong Dong (1994: 96) claims that “[C]onfucianism has many faces; therefore it is necessary to clearly delimit which version of Confucianism one deals with”.

Furthermore, the very success of capitalistic development undermines social and cultural values. Therefore, Confucianistic values cannot remain intact.

#### **4.6 Conclusion**

The spectacular growth of Japanese economy has influenced Asian economies and the theory of economic development profoundly. Japanese impact on East Asian economies materialized through different channels. Some East Asian countries were colonized by Japan; Taiwan and Korea were formal colonies of Japan from 1895 to 1945 and from 1910 to 1945 respectively. Therefore the legacy of this period played a very important role in terms of industrial base, bureaucratic structure and measurements in the direction of land reform in both countries though the colonization period meant degradation and coercion for the masses. The Second World War interrupted the influence of Japan on East Asia. However, from the 1960s onward, Japanese commenced to become apparent again in the region. The 'demonstration effect' of Japan on these countries should be taken into consideration very seriously. Japan enlightened the industrialization path of the East Asian countries. In this sense, Japanese experience always provided necessary material from which East Asian countries could learn much. Japan also deliberately attempted to export her model to East Asian countries as well as other countries via using different means. Japanese scholarship and youth programs, aid and credit policies were among these tools. Especially, Japanese aid and credit policy became backbone of her foreign policy after 1960s. Her advice to developing countries and the recipient countries have been fundamentally different than the advice of IMF and the World Bank. Japan suggested much more heterodox policies to East Asian countries. Many authors have endeavored to elucidate the role of Japan in the region by the flying-geese paradigm. Hence, the flying-geese model, formulated in 1930s, commenced to be influential after mid 1980s in the literature on the development economics. Japanese successful development intensified the discussion of the role of the state in industrialization. In this sense, the main framework of the developmental state theory was inspired by the Japanese experience. Accordingly,

Japan can be considered as a developmental state which takes all measures in a relatively autonomous manner to reach the goal of industrialization via the support of her capable bureaucracy. The framework of the theory was expanded along with the increasing influence of the East Asian experience.

Other authors, tried explain Japanese success in reference to her cultural and religious particularities. According to this approach, Japan succeeded in industrialization thanks to her special cultural and religious peculiarities. This led to the revival of cultural explanations in the development theory after 1960s. Confucianism has also been very influential in several countries in the East Asian region such as Taiwan, Korea, Singapore and Hong-Kong. Therefore, the high growth performance of East Asian countries further intensified this discussion. As a conclusion, Japanese high growth experience directly or indirectly became very influential in either the determination of economic practices or revitalizing old theories and generating new ones.

## **CHAPTER 5**

### **CONCLUSION**

Our main findings can be categorized into three in reference to the three major chapters in this study. First, Japanese heterodox economic thought and economists should be seen as one factor behind the Japanese successful catch up until the 1980s.

Neoclassical school was effective only in short interlude from the Meiji Restoration of 1868 to the mid 1880s. Adherents of the German Historical School then started to be dominant. Japanese government sent many students to German schools in different fields. Japanese students of economics became acquainted with the ideas of the German Historical School while in Germany. When these students returned to their country, they started to spread the ideas of the German Historical School. Especially, the Tokyo University became the center of scholars who were under the influence of German Historical School. In this way, many bureaucrats who graduated from Tokyo University became acquainted with the ideas of the German Historical School. This school's ideas became part of the policy-making paradigm of Japan by way of these bureaucrats.

The Japanese industrialization process also brought about many social problems in Japan. This led to development of socialist ideas. At about the same time, Japanese students started to bring home Marxism from Europe. The Russian Revolution was a turning point in the expansion of the influence of Marxism. These ideas overshadowed German Historical School in Japan after the 1920s. The relatively liberal milieu in Japanese politics contributed to this process. However, the atmosphere commenced to alter at the beginning of 1930s. Japanese government

used all ways to suppress Japanese Marxists and socialist movements. During the 1930s, the theories formulated in Germany became once again very influential in Japan along with the rising militarism and fascist ideology. The role of government in the economy increased significantly. This was the first time planning committees were established with the influence of the Soviet Gosplan, the total war experience of Germany in the First World War and the economic spurt in Nazi Germany in 1930s. Some Marxist scholars and bureaucrats directly or indirectly played a part in this process.

After the Second World War which ended disastrously for Japan, the Marxist movement and scholars returned to the scene as a most prestigious group because of their opposition to Japanese expansionist policies. They enjoyed relatively free atmosphere until the beginning of the Cold War thanks to the American occupation policies of which the main target was to destroy Japanese militarism via the pursuit of comparatively liberal policies. After the 1950s, socialists were marginalized yet remained a significant academic force until the 1980s. The other economic schools which were influential in Japanese thinking after the war were the Keynesian School and the Schumpeterian School amidst a neo-classical revival as of the beginning of 1960s.

Japanese economists affected Japanese policy-making directly or indirectly after 1945. In this regard, economic agencies' study groups (such as planning board) enabled Japanese economists to be very influential on economic policy-making. During the period of 1945-1950 Japanese economy could be considered as a closed economy which was almost totally under government control. In this period, economic institutions were main actors in shaping economic policy. The ideas of Sabura Okito, Arisawa Hiromi, Shigeto Tsuru and Ishibashi Tanzan who were eminent economists at that time were put into practice by way of these institutions. Interestingly, most of them had had an experience in the planning of 1930s and a kind of heterodox background. Arisawa Hiromi was the most influential among them.

After 1950s, Japanese economic policies commenced to be liberalized. However this did not have to do with what we understand today from liberalization

today. The government remained very influential in many areas up to the 1990s even if new liberalization policies took place during the period because of mainly American pressure. In this period, although, Hiromi, Okita and Tsuru continued to be influential, especially the ideas of Ichiro, who supported the idea of greater integration with the world economy (especially with Western economies) gained ground.

After 1950s many economic councils such as the Industrial Rationalization Council and Labor Council were established. These were highly influential in setting regulatory rules for the economy. Furthermore, planning institutions continued to play an active role. The most important project of the period was the Income Doubling Plan of 1960. This plan was mainly prepared under the impact of the ideas of Shimomura Osamu, and it targeted at doubling the Japanese income in ten years. This goal was achieved in about five years.

Japanese economic thought and economists also affected Japanese policy-making via implicit mechanisms. In this regard, Japanese bureaucrats who graduated from Tokyo Imperial University always remained under the impact of heterodox economic schools such as the German Historical School and Marxism. They played a very important role. It has been accepted that they were key actors in the decision-making procedure in Japan. It is natural to expect that these heterodox schools should have affected the Japanese powerful bureaucracy. Given the continuity of bureaucracy, this assumption becomes more reliable.

Our second major conclusion is that, Japanese high growth is a piece-wise continuous accelerated growth achieved via very heterodox policies. The role of government, industrial policy and institutions as well as initial advantages of 'relative backwardness' were very important in explaining. Japanese high growth performance is a phenomenon which started before 1868 and continued in a piece-wise manner at least up to the 1970s. In this sense, Japanese post-war growth cannot be considered as the development of an underdeveloped country. It is a case of accelerated growth.

The Tokugawa heritage was very important in terms of relatively high standards in education, bureaucratic structure, and developed infrastructure. This

period also helped the homogenization of Japanese nation. After the Meiji Restoration of 1868, Japanese government started to create on a more developed institutional, bureaucratic and educational structure. Therefore, it embarked on various reforms in policy and economy. Given this background, Japanese modern industrialization started after 1890s. The First World War enabled Japan to reach a higher growth level. The speed of Japanese industrialization was also unusual during the 1930s compared with many European countries which were in the throes of the Great Depression.

From 1868 to 1939, Japan maintained its relatively high growth performance. During the period, the diffusion of technology was high because of high absorption capacity. Government directly and indirectly determined the structure of economy. Although Japanese industrial pattern followed those of the Western countries, its consumption pattern differed from theirs because of deliberate policies and cultural factors. This enabled Japan to maintain high investment without any foreign source of finance.

Japan was faced with huge amount of destruction in the Second World War. However Japanese potential growth after 1945 was high because of her educated labor, absorption capacity and developed institutional structure. The main goal of USA was initially to keep Japan as a relatively underdeveloped country. Beginning of the Cold War and later the Korean War reversed this decision. In this sense, American aid and procurement program helped the revival of the Japanese economy. Although, the role of American policies cannot be neglected in the economic sphere, its influence on Japanese institutional structure did not create as great break with the past as usually assumed.

The 'second modern growth' or the second industrial revolution of Japan started in the 1950s. As many authors have already pointed out, the virtuous circle of high saving and high investment, increasing participation of labor and high technological absorption were general characteristics of this Japanese high-growth period. Although it is accepted that the size of the Japanese government is not very big, it played a crucial role in this high-growth era as in the pre-war period. It guided Japanese economy by various channels. Control on allocation of foreign exchange,

protective trade policies, various export incentives, directing credits to the strategic targeted sectors were major tools of the Japanese government to affect the economy. Government did not use only direct policies but also indirect methods such as 'administrative guidance'.

Japanese institutional structure was also attuned to high growth. This was mainly the result of evolutionary processes. Some of such institutions were deliberately created by trial and error while others were shaped under the influence of Japanese cultural particularities. Japanese financial structure can be considered as a Schumpeterian or Gerschenkron type of development-oriented main bank system. Yet the labor market in Japan was highly different from the Western type of labor market. Life time employment, bonus payment system, company based unionism were its main characteristics. As a result of this system, relative harmony in labor market was sustained. Furthermore, labor productivity increased, because workers were under the illusion that they were among the owners of the company for which they worked. The industrial system was also quite different. Cross-shareholding and separation of ownership from management were widespread in the Japanese industrial system. This institutional structure provided enough stimuli for corporations to focus on long-term projects and growth target instead of following short-term profit maximization policies since they were immune from the pressure of shareholders. Furthermore, there is almost no possibility of hostile take-over in this system. When one firm fell into trouble, other firms who had cross-share holding relationship with the firm generally came to its help.

Our third major conclusion concerns the theoretical effect of Japanese success. Japanese development experience became very influential on East Asian countries and development economics. After the 1980s, many theories emerged or old ones were revisited in the light of Japanese and East Asian model. However, East Asian model was more or less based on Japanese development experience. Therefore, the impact of East Asian countries on development economics can be seen as an indirect effect of the Japanese model.

The legacy of the Japanese colonial period in Taiwan and Korea was important in explaining the self-sustaining growth of the post-war period in these

countries. Although Japanese colonialism was very brutal in these countries, the colonial bureaucratic structure and some of the industrial bases remaining from the Japanese colonial period eased development effort of these countries. Japan also demonstrated these countries how successful economic policies can be formulated and implemented. In this sense, many East Asian countries were willing to learn from the Japanese experience. They launched special campaigns such as Malaysian 'Look East Policy' or 'Learn from Japan Campaign' of Singapore in order to learn from Japan. Some of strong leaders in the region such as Park Chung were personally influenced though they did not hold public campaigns. As a result, institutional structures and economic policies of the East Asian countries became resembling to those of Japan.

Japanese experience did not only affect the East Asian economies but also development economics as an academic discipline. The flying-geese paradigm, developmental state model and the theory of Confucianist ethic were developed in reference to the lessons of the Japanese experience and partially East Asian model. However, the influence of East Asian economies on development economics can partially be seen as the indirect effect of Japan on development economics.

Many authors tried to explain the East Asian pattern of development within the framework of the flying-geese model. According to them, Japan was the engine of the East Asian development as a leader goose. In this regard, the industrialization pattern of East Asian countries follows that of Japan because of intense trade links. Another economic theory which was formulated in the light of Japanese practices is the developmental state theory. It is generally accepted that the developmental state theory was first formulated by Charles Johnson in its modern version. According to Johnson, Japan is a developmental state which focuses on the development target by using all available means. Capable, relatively autonomous bureaucracy with a pilot agency, MITI, is crucial in explaining the Japanese case. The Confucianist ethic approach or many cultural explanations in economic theory were also rejuvenated along with Japanese success. According to proponents of this theory the heritage of Japanese Confucianist past is a major factor to grasp the essence of the Japanese

success. In this regard, Confucianist particularities such as loyalty, sacrifice, willingness to work and giving importance to education are emphasized.

In the light of the above findings we can conclude that, there is a strong relationship among economists, economic development and the theory of development economics. Economists impact upon economic policy through direct or indirect mechanisms in the light of their training and theoretical formulations in the Japanese case. In turn, economic development itself provides lessons for followers to emulate. In this sense, East Asian countries can be considered the hard-working students eager to learn creatively from Japan without falling into the trap of mere copying. In this process, economic theory itself is reshaped in reference to the economic development of the leader as well as the followers. The evolution of the theory of development economics in reference to Japanese and East Asian development experience is a very good example of this multi-faceted process. Therefore one final broader implication of this study is that there cannot be a pure economic theory independently of historical record.

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