The Japan Story

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A history of winners and losers.

Over the past two decades, the Japanese economy has been proceeding through a major transformation as it moves away from the economic system constructed during the 1930s, organized to mobilize the economy for war. Under this system, which survived seven years of post-World War II American occupation, most Japanese tended to rise and fall together, mostly rise. As the old system winds down, Japan is becoming a nation of winners and losers—across regions, industries, firms, and individuals.

END OF THE 1935–45 MOBILIZATION ECONOMY

Drawing lessons from the large-scale fighting during World War I, Japan's military strategists saw the need for mobilization planning, led by the military itself and by like-minded government bureaucrats. Mobilization staff promoted the idea of government authority over economic affairs in wartime. These ideas were put into practice with Manchurian industrial development in the 1930s, coordinated by these mobilization bureaucrats.

As Japan's war in China expanded in the 1930s, the government chose to impose economic controls to allocate resources rather than to rely on markets to do the job. After Japan enlarged the war by attacking American and other territories in December 1941, counterattacks on Japanese transportation networks and industrial facilities intensified supply shortages and increased the premium for effective planning. Military planners and government administrators turned to an increasingly controlled and planned economy, taking advantage of the experience gained just a few years earlier in Manchuria's government-led industrialization.

Two institutions, in particular, were critical for the course of later economic developments: bank-centered finance and a new legal structure of corporate governance, which combined to dethrone both shareholders and profitability from their premier positions influencing firm behavior.

The financial institutions were expected to provide long-term as well as the customary short-term funds in a timely and straightforward manner. Until the 1930s, large Japanese companies raised most of their funds by retaining earnings, by selling shares in the company, and by issuing bonds. For large corporations, bank loans accounted for no more than 15 percent of total funding. This picture changed in the mid-1930s, particularly among firms supplying the military. Within ten years, the ratios were reversed with banks providing the bulk of companies' financing needs.

Dividend payments, which had averaged 60–80 percent of profits until 1937, fell to 30 percent in 1944. The downward trend continued in the postwar years

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when the average payout fell below 10 percent. Some scholars refer to the ideas, methods, and institutions that came out of the war as the 1935–45 system, which continued to influence public policy for several more decades.

Japanese often look to the United States and other countries for hints about new directions. The consequence of this approach is that Japan tends to lag behind the world leaders.

THE POSTWAR SYSTEM

What may be called the canonical Japanese postwar economic system included: bank-centered finance; corporate governance with weak shareholders, managerial control, and oversight by main banks; networks of businesses centered on a key group company, often owning stakes in one another as a means of finance and mutual security; reduced price competition, including cartels, both legal and informal; internal labor markets with a commitment to so-called lifetime employment; and tight regulation of key sectors along with industrial policy that promoted specific industries. These elements formed an interlocking system with mutually reinforcing parts, given additional strength by their consistency with cultural norms.

Despite government's key role, any sense of an overall vision quickly lost coherence. As elsewhere, government planners and regulators often became the pawns of politicians and of the industries and companies they were supervising. Internal battles for dominance within the government further weakened any sense of coordinated strategy. Nevertheless, bureaucrats' inclinations to distrust markets continued to influence written and unwritten regulation and guidance.

Several forces are contributing to ending the influence of the wartime system. Gradual deregulation of finance, retailing, transportation, and other industries introduced more vigorous competition. Foreigners now own 28 percent of Tokyo Stock Exchange shares and accounted for half of all transactions in 2007. Foreign direct investment, including mergers and acquisitions, has climbed from near-zero levels to a hundred or so annually, although it is still below the standards of other rich economies. Deregulation and foreign influence have reduced the willingness of companies to accept government guidance. Changes in corporate governance laws, including the ability of shareholders to bring suits against managers who act contrary to shareholder interests, further constrain firm behavior. Now, as the ratio of bank financing to total assets for large companies falls to 10 percent, the role of financial markets has regained much of the influence that it lost in the 1930s.

Table 1: Sales Rank, General Merchandise Stores, Japan and United States

Japan			United States		
	1983	1998		1983	1993
Daiei	1	1	Wal-Mart Stores	17	1
Ito-Yokado	2	2	Sears Roebuck	1	2
Jusco	4	3	K-Mart	2	3
Mycal	5	4	Dayton Hudson	12	4
Takashimaya	7	5	J. C. Penney	5	5
Seiyu	3	6	Home Depot	-	6
Uny	10	7	Kroger	4	7
Mitsukoshi	6	8	Safeway	3	8
Seibu	9	9	Costco	-	9
Marui	13	10	American Stores	9	10

McKinsey Global Institute, "Why the Japanese Economy Is Not Growing: Micro Barriers to Productivity Growth," Washington, D.C.: McKinsey Global Institute, July 2000.

EMERGENCE OF WINNERS AND LOSERS

McKinsey Global Institute, the research arm of the business management consultants, illustrated the absence of dynamic change in Japanese business by comparing sales rank changes of the ten largest general merchandise stores in Japan and the United States (see Table 1). The remarkable feature of the Japanese rankings was their constancy over fifteen years. Among the top five companies, only mild reshuffling occurred. The American companies, over a shorter span, saw two companies in the top ten that had not existed a decade earlier, and number one Wal-Mart in 1993 had jumped from the seventeenth position.

This kind of stability was common across Japanese industries. Therefore, it is informative to revisit the McKinsey list. Daiei went into bankruptcy and was acquired by trading company Marubeni and a private capital partner. Mycal also entered bankruptcy proceedings and was restructured by Aeon, a retail holding company formed in 2003 on a core based on Jusco. Seiyu and Seibu also flirted with bankruptcy; Seiyu came under the control and management of Wal-Mart and Ito-Yokado took over Seibu. Mitsukoshi is to merge with lower-ranked retailer Isetan. Ito-Yokado restructured itself as a holding company (Seven and I Holdings), which included the former general retailer, its wholly owned convenience store chain 7-Eleven, and other acquisitions. These consolidations were accompanied by large-scale store closures. As Table 2 shows, the 2006 rankings based on a survey by Nikkei bear little resemblance to the 1998 standings. The electronics and appliance seller Yamada Denki was the first time that a retailer other than a supermarket or department store has ranked among the top three in the forty-year history of the survey. What is occurring in Japanese retailing is beginning to look more like the American model.

The divergence of fortunes among Japanese firms is occurring also at the industry level. For example, from 1970 to 1980, eleven industries out of a total of forty-two accounted for two-thirds of aggregate growth; from 2000 through 2005, only two industries—electronics and business services—made up the same proportion, while many others were in long-term decline.

Across Japan's regions, over the past ten years, almost two million people have moved into Tokyo and its three neighboring prefectures, including 800,000 into the capital itself. Outlying regions have seen equal declines. These shifts have affected land prices, which had declined for fourteen years after 1991 in every prefecture and for every type of property, but not uniformly. In the past two years, commercial land prices have dropped 14 percent on the northern island of Hokkaido while rising 33 percent in central Tokyo. It is not necessary to look across the breadth of Japan to spot such differences. Land prices in Chiba, to the east of Tokyo Bay, declined 41 percent from 2000 to 2007, whereas central Tokyo rose 11 percent.

The urge of government policymakers and politicians is to preserve old arrangements, to subsidize declining industries, and to underwrite regions with few prospects.

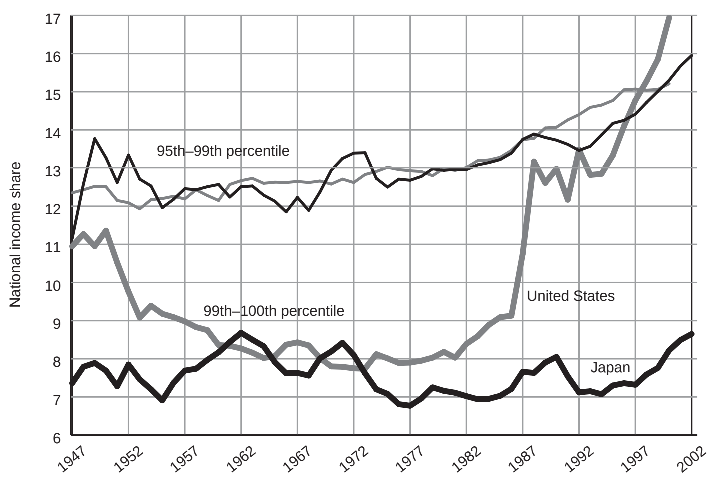
Japan's reputation in the 1970s was that of possessing the most equal income distribution of all OECD members. Considering the increased differentiations across firms, industries, and regions, it should not be surprising to find similarly rising diversity across individual incomes. Surveys that assess income distributions in Japan agree that inequality has been increasing since the 1980s. Several forces drove change in Japan. Chief among them was the aging of the population. However, even within the working age population, inequality rose from the 1980s. Another major influence on inequality was the rise of non-regular workers in

Table 2: Sales Rank of Japanese Retailers, FY2006

1	Seven & I Holdings
2	Aeon
3	Yamada Denki
4	Daiei
5	Uny
6	Takashimaya
7	Seiyu
8	Daimaru
9	Mitsukoshi
10	Isetan

Source: Nikkei, July 2, 2007

Figure 1 National Income Share of Top Individual Taxpayers, Japan and United States



Moriguchi, C. and Saez, E., "The Evolution of Income Concentration in Japan, 1865–2002: Evidence from Income Tax Statistics," Cambridge, MA: National Bureau of Economic Research, Working Paper 12558, October 2006.

Piketty, T. and Saez, E., "Income Inequality in the United States, 1913–1998," Cambridge, MA: National Bureau of Economic Research, Working Paper 8467, September 2001.

the labor force. They receive lower wages and fringe benefits, and work fewer hours than so-called regular workers. From 19 percent of employed persons in the early 1990s, they have grown to account for one-third of all workers.

All the inequality measures, including Gini coefficients and share of national income reported by the top 5 percent of taxpayers, show declining inequality from 1945 to the end of the 1970s, after which Japanese incomes became more unequal. For example, the income accounted for by the top 5 percent of taxpayers rose sharply after 1980, swelling by 5 percentage points to almost a quarter of all income. This ascent paralleled the rise in the Gini coefficient.

The story in Japan, though, is not of the super rich at the very top of the income pyramid, but rather of those just below the top; the gains in income shares appear only in the 95–99 percentiles. The very top tiers of Japanese taxpayers did not increase their piece of the economic pie (Figure 1). This result stands in contrast to incomes of top earners in the United States. The American growth in inequality includes the ranks above the top 1 percent whose share of personal income rose from 8 percent to 17 percent from 1970 to 2000; the same group in Japan hovered around 8 percent for fifty-five years.

IMPLICATIONS OF GROWTH WITH DIFFERENCES

It is not yet clear if greater variability of economic fortunes is a temporary adjustment to more liberalized constraints, or a permanent feature of a less-fettered economy. Since it has been ongoing since the late 1970s, it is probably not temporary, but reflective of a different kind of economy. Importantly, these changes predate the policies of Prime Minister Koizumi, although many observers link increased differentiation to his tenure.

A future with greater variability will require policies that encourage mobility of people and capital so that new opportunities can be exploited and unprofitable ventures be abandoned. However, the urge of government policymakers and politicians is to preserve old arrangements, to subsidize declining industries, and to underwrite regions with few prospects. That approach to dealing with differentiation will become more costly in the future than it has been in the past because there will be fewer resources to distribute as well as more cases of decline, even as new possibilities arise.

The tension will be between assisting individuals versus preserving larger collectives such as industries and regions. Policies that enhance productivity growth will make life riskier for individuals. Programs that attempt to preserve predictability will retard productivity and growth, and reduce the resources that can be delivered to unlucky individuals. Not only is the economy of Japan changing, but the pressures on politicians to adapt to this more differentiated world also will be keenly felt.

Japanese often look to the United States and other countries for hints about new directions. The consequence of this approach is that Japan tends to lag behind the world leaders. A Japanese novelist captured this predicament almost one hundred years ago. Natsume Soseki wrote that attempts to pursue progress must be accompanied by frustration because standards of progress came from the West, not from within. Each time Japan achieved an objective, a new one is imposed and the Japanese, who do not even fully comprehend the old one, are left behind. According to this reading, the world—seen as something "out there"—is a continuing source of change and anxiety. "Out there" is now closer to home. Much as it required twenty years to recognize the end of high-speed growth, the internalization of the forces driving change may also take time to be recognized. ◆