

# Relationship between government and business in japan



Ever since the 1800s, Japan had experienced, throughout the years, many peaks and troughs in the economy. Peaks are created when there were industrialization and large growth, and troughs were the results of recession, high unemployment and serious deflation. It all begun from the Meiji restoration, where Western influences first came in and expanded the industrial sector. After 1920 (end of WW I), there was an influx of more advanced Western technology and large amounts of private investments. In addition, after WW II, the government concentrated more on economic modernization by improving “ model firms” and thereafter using them as a guide to the others in the industry. The improvements made after the two world wars contributed to a huge economic growth and industrialization with huge accumulation of raw materials and capital investment.

During mid-1950s to the 1970s, Japan’s economy experienced an “ economic miracle” due to strong and stable government intervention through the Ministry of International Trade and Industry (MITI) and a bank-based financial system. The miracle was driven by rapid accumulation of inputs as well as improvements in productivity. During this period, Japan became an economic superpower, the second largest economy for a long period of time. However, after the asset bubble burst and problems started to surface in the financial institution during 1990 (Shiratsuka, 2003), Japan slumped into recession. The economy faced serious deflation, high unemployment and accumulation of huge government deficits due to poor policy implementations. In this essay, we would like to analyze the various aspects of Japan’s policy implementation and economic structure in different periods that makes it such a unique model.

## **How is the economic role of the government different in Japan?**

The economic role of a government can be analyzed through microeconomic and macroeconomic factors. Microeconomic would include provision of public goods, efficient resource allocation and income inequality. Macroeconomic goals include inflation, unemployment and GDP growth. Generally, the economic role of the government in Japan is similar to many Western countries, like United States of America (US). Governments aim to fulfill the aims to the best that they can in order to maximize social benefits but the methods adopted by the Japan government to achieve the goals might not be the same as other countries. We would focus on Japan's past industrial policy, expansionary fiscal and monetary policies during the bursting of the asset bubble and the recent quantitative easing policy to analyze the similarities and differences between the Japan's government, US's government and the United Kingdom's (UK) government.

### Government Role in Industrial policy

Even though other countries have used industrial policies, none was as methodical and coordinated as Japan's industrial policy that was implemented in the 1950s and 1960s. In Japan, the industrial policy was most pronounced in the manufacturing industry. By definition, industrial policy refers to all government policies that affect the allocation of resources, with the main economic aim of promoting economic growth. This common aim motivates the Japanese to work together for the greater good of the country.

The “Iron Triangle” is a stable coalition of politicians, bureaucrats and businessmen. The strong cooperation between the members helped to coordinate the implementation of the industrial policy. A strong bureaucracy, like MITI, and a strong state are the pre-conditions for an active industrial policy. The Ministry of International Trade and Industry (MITI) – an important component of the Iron Triangle – enforced international trade policy with other groups, such as the Bank of Japan. MITI was guided by economic nationalism, which can be defined as pursuing policies that promote national economic interest. There were two distinct periods in MITI’s industrial policy – pre-1973 and post-1973. Before 1973, the government was active in implementing the industrial policy through MITI. MITI selected “winning industries” such as iron and steel manufacturing, to focus on developing and producing high-quality goods in vast quantities at competitive prices to compete in the international market. In order to ensure the success of these “winning industries”, optimal operation conditions were artificially induced by MITI through preferential treatments such as protection from imports, subsidies and easy credit. Under the industrial policy, the government also increased investment in infrastructure, such as transportation and communication, to encourage economic growth.

Another integral component of the Japanese industrial policy was the main bank system that was influenced by Ministry of Finance (MOF). The main bank system refers to the close-knitted relationship between the main bank and its associated firms. The main bank acts as a guarantor for its associated firms and assists the firms in financial matters. Financial credit to the “winning industries” increased as the MOF used the Bank of Japan (BoJ) to

relax supervision over banks. The banks had given loose loans to firms to encourage investment and expand Japan's industry. In addition to helping the "winners", the government also "protected the losers" – firms that were losing out to international competition (Schultze, 1983). This was to prevent the collapse of flailing companies which would cause mass unemployment. During the pre-1973 period of the industrial policy, GNP grew at a phenomenal rate of 13.9 per cent despite a largely protected domestic economy.

After 1973, the government's involvement was passive and indirect. As the business sector grew due to economic growth, the reliance on government for direction and aid declined. Hence, the government turned its focus towards assisting firms in research and development (R&D), as such undertakings require large amount of funds. The government also increased attention and aid to firms that were performing poorly.

In comparison to the US, though direct government intervention is frowned upon as it prides itself as a "free-trade" nation, government intervention can be seen in areas such as lumber and steel industries (COMPAS Inc., 2002). As foreign imports of lumber and steel are increasingly cheaper due to increased efficiency and productivity, the US government has helped to protect its domestic industries with trade barriers such as high import tariffs. These measures prevent dumping and ensure that firms are able to sustain so that unemployment does not occur (Lee and Mensbrugghe, 2002).

Though both countries practice protectionism to ensure the survival of domestic industries, they had different reasons to enforce it, hence there

were different outcomes. Japan wanted to protect domestic industries to nurture and prepare them to be efficient in order to compete in the world market. In the long run, Japan's export increased and eventually Japan's economy grew to become the world's second largest. However, US's protectionism did not help to encourage domestic firms to increase efficiency; instead there is increased reliance on the trade barriers to ensure their survival. Higher tariffs only serve to increase the price of the goods of a specific industry. At the same time US industries become more reliant on their government for protection and hence are less competitive.

Similar to Japan's industrial policy, the currently defunct Advanced Technology Program in the US which begun in 1990 and the Technology Innovation Program in 2008, seeks to encourage research and development (R&D) of promising, high-risk technologies (Advanced Technology Program, 2005). Through these measures, both governments intended to help the industries improve productivity and technological advancement.

#### Government Role in Asset bubbles

Japan's asset prices inflated in 1987-1990 could be attributed to the appreciation of the Japanese Yen against the US dollar. When the Yen appreciated, property and stock prices increased relative to the world price. This attracted the inflow of hot money by speculators, pushing the prices higher. When Japan's asset bubble burst in 1990, it led to a widespread devastation of the financial system. The commercial banks were left with large amounts of non-performing loans by borrowers, whose assets used as collateral collapsed in value. Consumers' and businesses' loss of confidence

due to the declining economy led to a plunge in consumption and investment. The government attempted to salvage the crash of the economy with expansionary monetary and fiscal policies, but these failed to solve or cushion the crisis. The main problem for the attempt at monetary policy was the time lag in recognizing the problem and implementing suitable policies to salvage the problem. The government had initially intended to let free-market mechanism to adjust the situation. Therefore, by the time the government implemented expansionary monetary policy, it was a futile effort.

The late injection of liquidity and reduction in interest rates failed to stimulate consumption and investment as public confidence in the economy was still low. Increasing liquidity was also ineffective as Japan was caught in a liquidity trap, where people hold on to excess funds instead of spending it on consumption and investment. The government also tried to implement expansionary fiscal policy in a bid to revive the economy. However, much of the additional spending went to wasteful “ pork barrel projects” which did not benefit the society much (Ujikane, 2009). Multiplier effects of government spending and reduction in taxes is also limited by the reluctance of consumer spending and commercial investment. The government’s efforts only led to an ever-increasing budget deficits and government debts.

In the recent sub-prime mortgage crisis in the US, most firms were trapped in the recession “ quicksand”. The firms that are most adversely affected are banks and investment companies, as the number of default loans increased.

They will most likely sink further until they have no choice but to declare bankruptcy like the Lehman Brothers. To avoid a mass collapse of firms and  
<https://assignbuster.com/relationship-between-government-and-business-in-japan/>

eventually the economy, the US government reacted swiftly to bail out firms, such as Fannie Mae and Freddie Mac, which were drowning in default loans.

Though both Japan and US governments solved the economic problems by expansionary monetary policy, US's decisive reaction to inject liquidity of billions of dollar into the economy increased the public's confidence in the US government. US's timely massive injection of liquidity might have helped to stabilize the economy. The impact of the policies was different due to the governments' different rate of response to the crisis.

### Government Role in Quantitative Easing Policy

Countries generally push for slight inflation per annum in order for the economy to grow and expand. Inflation cannot be eliminated completely as it would affect other macroeconomic goals such as unemployment levels.

However, Japan's unique situation of deflation from 2000 to 2006 worsened the problems from the lost decade (from 1991 to 2000), which would cause the economy to shrink in the long run if no action was taken. Expansionary policies will not work due to liquidity trap and consumers' expectation of further decrease in price level; hence the government had to use other methods to stimulate the economy. Japan attempted to use quantitative easing policy to stimulate the economy when the interest rates are either at, or close to zero per cent but it had not shown significant results. The aim of quantitative easing was to bring down interest rates of assets by creating more money in the central bank's credit. This allows central bank to buy assets of companies, such as bonds and equity. The government was hoping that cheaper cost of borrowing would encourage the firms to spend more,



putting additional demand on the economy and pulling it out from recession (Giles C., O'Murchu C., Bernard S. and Lemer J., 2009). Since consumers would expect future prices to increase due to the increase in money supply, they would increase current consumption hence stimulating the economy. When the money ended up in bank deposits, banks would have more funds available to lend to companies. However in Japan's situation, banks did not increase the loan rates and companies were not enticed by the low cost of borrowing for investment. Banks chose to park excess yen into government bonds, or lent trillions of yen to overseas borrowers. This led to "yen carry" trade, where investors borrowed at low interest rates in yen and used the loan to buy higher yielding assets elsewhere, like the US, to exploit the gap between US and Japanese rate of returns (Dorsch, 2008).

While the policy was in effect from 2001 to 2006, there was no significant improvement in the economy. Though Japan's economy improved thereafter, it was uncertain whether the results were due to quantitative easing policy or a general improvement in the public's expectation of the economy. With the current global recession, Japan's interest rate continues to remain low at 0.1 per cent, with no further intention to increase the interest rate in the near future.

Interest rates in US have been consistently at 0.25% since December 2008, when the effects of the sub-prime mortgage overwhelmed US's economy. The projected injection of an extra US\$1 trillion (£700 billion) to resuscitate the recession-hit US economy by the Federal Reserve would increase money supply, hence interest rates might be expected to fall even lower (Stewart, 2009). The decrease in interest rate might stimulate consumers and  
<https://assignbuster.com/relationship-between-government-and-business-in-japan/>

investors to increase consumption and investment respectively, helping the economy to improve and grow.

As the world starts to fall into a global recession, other countries such as UK, is also applying the quantitative easing policy to stimulate the ailing economy. The Bank of England cut interest rates in March 2009 from one per cent to 0.5 per cent and bought £2 billion (US\$2.8 billion) of government bonds in bid to inject liquidity into the economy (CNN, 2009).

Though the results of the recent application of quantitative easing policy in other countries are not visible yet, they might be more successful than Japan's attempt due to the difference public's expectation. The application of the policy over a period of about five years in Japan failed to show any significant results and this might be due to Japanese being more frugal and people's loss of confidence as deflation had been persistent. The reduction of interest rates failed to stimulate domestic demand and investment.

However, consumer culture is relatively stronger in Western countries. Hence the policy might be more effective in US and UK.

## **What had been the relationships between government and business in Japan?**

Although the developments in economics depend on products of private businesses, they are correlated to the government support and intervention as well. Japan government had taken initiative to push their country to industrialization ever since the Tokugawa Era. Government influences in the economy were so pervasive that people popularized the term 'Japan Inc.' to describe the alliance of government and business.

## The Iron Triangle – underpinning the Japan Inc.

The government is deemed to have more economic information and the business sector looked to government for guidance. These attitudes, coupled with the view of the nation as a family, allowed government to influence businesses, and encouraged them to work hard not only for their own profits but also for the country. There was a national consensus that Japan must become an economic power and that the duty of all Japanese was to sacrifice them for this national goal (Library of Congress, 1994). Thus, government and businesses were collaborators, as reflected by the Iron Triangle. In the Iron Triangle, it is a union of three important players: the politicians, bureaucrats and the businesses. The politicians are stationary bandits with long term horizon, and needs to be elected into cabinet. In return for the support given by businesses, they will return the favor by influencing the policies to be advantageous to businesses. In the past, businesses play a weak role in the economy, and need the guidance and help from politicians and bureaucrats. Bureaucrats on the other hand, require the help of politicians and businesses for jobs after they retire. These bureaucrats who make the decisions in the government are strong and efficient in the past; they are able to help the politicians and businesses through the implementation of the Japan industrial policy. The relationships as we can see are interrelated with the bureaucrats in domination.

MITI, the best of a strong bureaucracy, served as the heart of the industrial policy where it controlled the regulation of production and the distribution of goods and services. Moreover, MITI was in charge of controlling Japan's foreign trade and international commerce; to ensure the smooth national

<https://assignbuster.com/relationship-between-government-and-business-in-japan/>

economy. It focused on promoting the development of manufacturing, mining, and distribution industries, and supervising the procurement of a reliable supply of raw materials and energy resources. With responsibility in the areas of exports and imports and all the domestic industries and businesses, MITI was one of the usual advisors in regulatory and pollution control policies to the corporation in Japan. Besides that, MITI also worked closely with the keiretsu (which evolved from zaibatsu) and sought for their advice in making economic policies (Library of Congress, 1994).

Keiretsu (formerly known as zaibatsu)

Keiretsu generally refers to the large Japanese enterprises which controlled diverse business sectors in the Japanese economy. Before the WW II, it was known as zaibatsu which had been dissolved later due to nationalism issue. After the war, they re-established as keiretsu with some progress in their structure. The most significant groups are the Mitsubishi, Mitsui and Sumitomo, which still continues to exist today. The major keiretsu surrounds a bank, which lends money to the keiretsu's member companies and hold equity positions in the companies. Each bank has great control over the companies in the keiretsu and acts as a monitoring entity and as an emergency bail-out entity. They were typically controlled by a singular holding company structure and owned by families or wealthy Japanese who drove the finance, heavy industry and shipping sectors that forged the heart of Japan's economy. They worked closely with the bureaucracy and Bank of Japan. Hand in hand, the government and keiretsu guided Japan in borrowing Western technology and Japan gradually took control majority of Asia's market for manufactured goods.

<https://assignbuster.com/relationship-between-government-and-business-in-japan/>

Besides MITI, there is another ministry that closely relates to the business fields – the MOF. MOF initiates fiscal policies and monetary policies through its indirect control over the Bank of Japan (central bank) to assist businesses. To promote industrial expansion, MOF establishes low interest rates to reduce the cost of investment funds for corporations. In addition, MOF allocates public investment, formulates tax policies, collects taxes and regulates foreign exchange.

A close relation with the ministries will make the company in a better position than others as they can get preferential treatment. This has brought about the issue of amakudaris and corrupted bureaucrats. Amakudari refers to the reemployment of the retired bureaucrats to the private and public corporations which are under the jurisdiction of their ministries or agencies. This normally leads to corrupted practices as it is unhealthy for the state and businesses to maintain such close relationship. The retired officials collude with their ex-colleagues to help their new employers secure government contracts, avoid regulatory inspections and generally secure preferential treatment from the bureaucracy. The practice is most prevalent in industries which have very strong government and business relations, and exists almost throughout the Japanese economy (Library of Congress, 1994). However, this dampens economic progress by increasing unnecessary expenditure.

### Government as an Administrative Guidance

Administrative guidance (gyosei shido) is a principal instrument of enforcement used extensively throughout the Japanese government to

support a wide range of policies. Influence, prestige, advice, and persuasion are used to encourage both corporations and individuals to work in directions judged desirable. The persuasion is exerted and the advice is given by public officials, who often have the power to provide or to withhold loans, grants, subsidies, licenses, tax concessions, government contracts, import permits, foreign exchange, and approval of cartel arrangements. The government uses administrative guidance to buffer market swings, anticipate market developments, and enhance market competition.

### Government-Owned Corporations (Public)

At the national level, public companies are normally affiliated with one of the economic ministries however the extent of direct management and supervision are varied. The public corporations are divided into several categories. The first includes the main public service and monopoly corporations: Nippon Telegraph and Telephone Corporation, Japanese National Railways, and Japan Tobacco and Salt Corporation. The second category includes the major development corporations: housing, agriculture, highways, water resources, ports, energy resources, and urban development projects. Other categories of corporations include those charged with special government projects, loans and finance, and special types of banking (Library of Congress, 1994).

Public corporations help the economy in several ways. For example, Nippon Telegraph and Telephone Corporation are important sources of technology development funds, or centers around which private industry could cluster. The development banks, particularly the Japan Development Bank, were

sources of long-term investment funds and are instrumental in shaping the pattern of industry, especially during the early postwar period. They also provided employment for retired bureaucrats. Public corporations also have a negative side. Their operations are apt to be less efficient than those of the private sector, (because they are not motivated by profits and they are funded by the government) and in some corporations, close government supervision impedes corporate responsibility.

### Corporate organizations

Links between the corporate world and government in Japan were further maintained through three national organizations: the Federation of Economic Organizations (Keizai Dantai Rengokai-Keidanren), the Japan Committee for Economic Development (Keizai Doyu Kai), and the Japan Federation of Employers' Association (Nihon Keieishadantai Renmei-Nikkeiren). They work closely with MITI and servicing the country's most important enterprises. Nikkeiren was concerned largely with labor-management relations and organizing a united business front to negotiate with labor unions on wage demands during the annual " Spring Struggle". The Keizai Doyu Kai, composed of younger and more liberal business leaders, assigned itself the role of promoting business's social responsibilities. Whereas Keidanren and Nikkeiren were " peak organizations", whose members themselves were associations, members of the Keizai Doyu Kai were individual business leaders.

Because of financial support from corporations, business interest groups were generally more independent of political parties than other groups. Both

Keidanren and the Keizai Doyu Kai, for example, indicated a willingness to talk with the Japan Socialist Party in the wake of the political scandals of 1988-89 and also suggested that the LDP might form a coalition government with an opposition party. Yet through an organization called the People's Politics Association (Kokumin Seiji Kyokai), they and other top business groups provided the Liberal Democratic Party (LDP) with its largest source of party funding.

## **How have the relationships evolved and affected the Japanese economy in recent years?**

### Modern Iron Triangle

In recent years, the roles of the businesses and the bureaucracy changed- bureaucracy weakened while businesses became stronger. The politicians in the “Iron Triangle” became roving bandits who only had short term planning horizon. Personal incentives come before the needs of the nation's economy leading to buy over of officials who have the power to influence policies. As a result, the bureaucracy is no longer making effective and suitable policies for the improvement of the nation. On the other hand, as businesses have become stronger with economic growth, they are now capable to shift their weight and influence policy outcome. Despite the shift in roles, the business still relied on the government in their business prospects through influencing the policy-making process.

Despite the role of bureaucracy has weakened, businesses still buy them over to influence policies. Under Koizumi's rule in 2001, efforts had been made to solve the bureaucracy problem which had led to corruption



practices. Koizumi acted in against the bad debts with commercial banks, and reorganize the factional structure of the LDP. In addition, his policies also included transforming public companies into private companies and announced the “ seven no’s”- pledging to never permit the misuse of tax money, irresponsible management, changes in corporation names, unfair competition with private business, delays in abolishment or privatization, transfers of profits to subsidiaries to hide them and the practice of hiring retired bureaucrats (Nabeshima, Japan Times, 2001). Despite resistance from the LDP in implementing the policy, he managed to privatize 3 postal service corporations and 4 public corporations that construct and manage roads and bridges (Harvard International Review, 2002). When companies are privatized, the bureaucrats and government will play a lesser role in how the corporation will run. Instead, decisions will be based more on market forces, mainly supply and demand of the consumers.

However, for corporations that have yet to privatize, or firms that still belong to the keiretsu, relationships with the government have yet to change much. Corruption still takes place in government office, while amakudaris still exist. Despite Japan being ranked 19 in economic freedom, with a score of 75 for “ Freedom from Corruption” – 0 being less free and 100 being most free. (The Heritage Foundation, 2009) Reason being, foreign investors found it hard to penetrate into strong relationships among businesses and government and also are often subject to opaque regulatory barriers (The Heritage Foundation, 2009). That could possibility be due to the “ Iron Triangle” and keiretsu established since the Meiji era and have yet to be broken down through Koizumi’s policies. The situation now, however, had improved from

the 1990s. Corruption perceptions index (CPI) had improved from 5.8 in 1998 to 7.3 in 2008. Recent cases of corruption included scandals of ministers accepting bribes from defense equipment suppliers for special favors, and amakudari and bribery cases with Green Resource Agency (J-Green) in 2007. (Transparency International Japan, 2007)

In the banking industry, the Japanese government still plays an important role in the functions of the system. Even though Japan Post had been privatized from 2007, the rest of the banking system is still under government influences. The banks still have close relationships with the government and the companies under the “Iron Triangle” system, the banks do hold shares of the companies they work with to minimize the red tapes and offer them better rates. On financial freedom, which is a measure of banking security as well as a measure of independence from government control, Japan’s score is only 50 in comparison to 80 in the United States (The Heritage Foundation, 2009). This means that there is more government influence over the financial system in Japan. This was attributable to the close relationships established in the past which is still present now.

### DPJ and the Recent Elections

After Koizumi’s rule, Aso Taro had failed to carry on his avocation to solve the bureaucracy problem and corruption within the government. Japanese citizens’ loss of confidence in the LDP, had lead to the landslide victory of the DPJ in the recent elections in September 2009. Throughout the campaign for support, DPJ promised to address the main problems that remained or worsened since the recession started in 1990. These were problems that LDP

had failed to smooth out, despite some changes made under Koizumi's administration. In 2008, unemployment at 2008 was at 4% (Figure 1), which had since increased to 5.7% in July 2009 (The Associated Press, 2009).

Some of the promises that the DPJ made seemed plausible, while others appear unattainable. For instance, to encourage women to give birth and solve the ageing population problem, DPJ is giving families 26,000 yen (\$275) a month per child through junior high. This is on top of the lump sum of 350,000 yen (\$3,700) that the government is already giving. (New York Times, 2009) DPJ had proposed to use funds, from melting down the strong bureaucracy, to sustain the social policies promised.

In comparison to the world's bureaucracy, Japan is heavily regulated, with corruption damping all kinds of activity throughout the red tape procedures. The infamous "Iron Triangle" which comprises of the dependent relationships between the bureaucrats, politicians and businesses had stifled innovation and reforms (Wakabayashi, 2009). The DPJ also seeks to ban the amakudari and watari practices in the ministries and government agencies by the end of 2009 (Kyodo News, 2009). Amakudari and watari had always been the source of government corruption – the mis-transfer and misuse of funds, poor approval and implementation of projects and policies. Both had required the ministers to set up a close relationship with the business, giving them a smoother implementation of projects for the company with special favors given. Once DPJ actualizes the ban, they will carry on Koizumi's advocacy to solve corruption and minimize bureaucracy. The relationship between the government and businesses will be strictly supervised to ensure that funds are used at the right areas.

<https://assignbuster.com/relationship-between-government-and-business-in-japan/>

Breaking down of bureaucracy for Koizumi was hard, and it will remain so for the DPJ who also wish to minimize unnecessary expenditure of the government. The relationships that have been established among the politicians and the businesses over the years are strong, and politicians will not support the melting down of bureaucracy which is in their favor. The current practices of bureaucrats are advantageous to the corporations that had developed a strong bond with the government, giving them easier access for more funds in their projects for example. However to new firms entering the industry, it might be much harder as the government will assist firms who have better relationships with them. This impedes foreign investment. Therefore, DPJ should introduce strict rules and practices to increase transparency of the government and corporations to minimize the problem. Furthermore, they should also be prepared to face opposition, as they have to see through the policy for improvement in the economy and increase overall confidence level in the country when people know where their tax payments are not going to corruption acts.

### Analysis of DPJ Initiatives

In analysis of DPJ's current policies and promises to the Japanese, DPJ's solution is to move Japan away from a corporate-centric economic model to one that focuses on helping people. As such, they had proposed an expensive array of initiatives: Ca