Factors Contributed to Corporate Growth in Japan : National Attitude,Economic Policies and Institions

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FACTORS CONTRIBUTED TO CORPORATE GROWTH IN JAPAN

——National Attitude, Economic Policies and Institutions——

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Japan's economy has seen remarkable growth since the end of world war Ⅱ. The question is how the dynamism in this economic boom developed and how it has been maintained even after the oil crises. For populous countries like Japan, nothing is more important and no strategy more fundamental than securing stable employment and raising the national standard of living. Japan was able to successfully achieve these goals through industrialization centering on manufacturing. This paper focuses on the historical and institutional conditions that contributed to this success.

1. National Attitude and Innovation

The most important factor behind a country's economic growth may well be its national attitude. Thus, one key determinant is whether the people have confidence in the future of their country's economy and actively participate in economic activities. It was perhaps in the early 1960s that the Japanese people first felt convinced that high economic growth was possible.

Actually, Japan started to achieve high economic growth from the latter half of the 1950s. But the nation as a whole did not clearly perceive the reality of this growth until the Ikeda Cabinet announced the Income-Doubling Plan in 1960. It is well known that this Plan was greatly influenced by a series of papers of Dr Osamu Shimomura. He theorized that strong growth-promoting trends were emerging in Japan's economy in the latter half of 1950s. He predicted with confidence that Japan could realize economic growth of more than 10% a year in the 1960s[1].

With the end of the post-war inflation and the completion of the economic rehabilitation, people gradually became more confident in the future of Japanese economy. At the same time, the theory of Dr Shimomura was actively embodied in economic policy. These aggressive policies further strengthened confidence of people in Japan's economic growth.

Technical innovation is also essential for economic growth. Increasing productivity through innovation raises per-capita GNP. And innovation is given concrete form through investments in plant and equipment by private companies. These investments are nothing other than current actions of entrepreneurs directed towards an inherently uncertain future. Thus, these investments are an important indicator of the extent to which people have confidence in the economic future.

Economic growth is brought about through a combination of innovation and free ingenuity of the people. In this sense, these two factors can be considered fundamental conditions for economic growth. Economic policies and industrial policies in Japan let

Japanese people participate actively at their own risk. These policies stimulated investments by private companies and accelerated economic growth.

2. Macro Conditions That Brought Corporate Growth in Japan

Favorable International Environment

Needless to say, the prewar economic system, such as the gold standard and block economies, significantly hindered world economic growth. Therefore, liberalization of the world economy from the restrictions of these old systems was of great benefit to the Japanese economy. The immediate post-war world economy was characterized by the setting up of the IMF and GATT systems. The IMF was established with a view to realizing full employment and higher living standards on an international scale, while the free trade principles of GATT contributed to the further upgrading of Japan's industrial structure. Such international reforms in the world economy gave rise to conditions for expanded equilibrium in the Japanese economy. Under these conditions, private sector ingenuity began to be emancipated in the post-war Japanese economy. And innovation primarily through private sector investment in plant and equipment advanced rapidly.

An additional important aspect of the international environment was that the American economy was healthy and expanded rapidly until the mid 1960s. The stable and expanded equilibrium in the American economy enabled Japanese corporations to export freely and thus realized economic growth. Moreover the sound American economy had become the critically important foundation for the stable maintenance of the IMF and GATT structure.

Economic Democratization

Soon after the World War Ⅱ, three major reforms to democratize Japan's prewar economic system were put into practice by the Allied-Powers, in reality, the American forces[2].

First reform was the dissolution of the Zaibatsu. It was to break up the traditional holding companies which were regarded as the core of economic control. As a result, competition among companies became so vigorous that they invested in plant and equipment aggressively to produce economic growth. Second was a thorough-going land reform which stipulated that all the land of absentee land-lords would be bought up by the government for redistribution to the tenant farmers. This reform encouraged farmers to increase rice productivity. An increase in income in agricultural sector caused an expansion of domestic demand. Third, the labor union was legalized. The ratio of unionized workers in total employees rose rapidly from zero in 1945 to about 60% in 1948-49. The labor movement based on the corporate union played an important role in improving working conditions. And in due course, Japanese-style labor-mamagement relations became firmly rooted, with its two main characteristics of the lifetime employment system and seniority wage system. These three major changes in institutions stimulated social mobility and formed the foundation of the post-war Japanese economy.

Constructive Macro-economic Policies

Macro-economic policies have a major effect on corporate growth and industrial development. Generally speaking, economic management of the government causes a breakdown in the domestic economy if the fiscal balance and the international balance are greatly destroyed. This problem afflicted the American economy in the 1980s. A similar trend can be seen in the developing countries that are suffering from accumulated foreign debt.

Managing fiscal and monetary policies so that the domestic and international balance can be achieved simultaneously is fundamental to stable economic growth. Under this kind of disciplined economic management, a nation and its people can realize their maximum potential properly. The Japanese economy in the 1960s was in a condition of expanded equilibrium under a healthy American economy and the IMF system. And high economic growth in excess of 10% a year was achieved while maintaining both fiscal and current account balance. Needless to say, this high growth was brought about by private sector plant and equipment investment which embodied technical progress.

During high growth period of the 1960's, plant and equipment investment by the private sector showed an annual increase of 18%. Positive tax reduction policies and expanded public investment stimulated private sector plant and equipment investment, giving rise to private-sector-led high economic growth. This high growth yielded a substantial increase in tax revenue, and despite active fiscal policies, resulted in the achievement of an equilibrium between fiscal revenues and expenditures. Meanwhile, balance was also maintained in the current accounts. High economic growth led to sharp increase in imports. But these were offset as active plant and equipment investment brought about the modernization of capital stock, and greatly increased exports.

Another characteristics of Japanese economy has been the stable relationship between productivity and wages. Wholesale prices have therefore been stable over a long period. Stability of wholesale prices is a prerequisite for stability of economic growth and exchange rates. The animal spirit mentioned by Keynes is the most important factor in the corporation's decision to proceed with plant and equipment investment. Investment made now is influenced by what corporations expect with regards to future prospects. Government policies were active to increase effective demand and prices including exchange rates were stable. Under these favorable conditions, the more boldly companies will act, and the greater the ingenuity will be displayed by entrepreneurs.

The active economic policies used in Japan during this period successfully enabled the private sector to display its initiative. Both government and private enterprise were able to pursue high growth, and this high growth, in turn, brought about economic stability. Therefore, overall high growth in the 1960's was realized under domestic equilibrium (including stable manufactured goods prices and a fiscal balance) and an international equilibrium (balanced current account).

In contrast, from the 1970s the world economy entered a period of less dynamic and slower economic growth. As was shown by the two oil shocks, petroleum resources began to place restrictive conditions on growth. Moreover, in recent years, global warming, which is caused by an accumulation of carbon dioxide, seems to place new restrictions on the world economy. If economic management pursues a course of high growth during such a period, economic stability will collapse.

The Reaganomics of the 1980s promoted active policies which could be justified only during a period of high growth. Under the actual conditions of the 1980s, however, these policies increased instabilities and greatly magnified the imbalance in not only the American economy, but also the world economy[3].

The world economy seems to be more unstable since the 1970s. But in any period, disciplined economic management that aims at domestic equilibrium and international equilibrium is important for drawing out a country's long-term economic capacity. For Japanese corporations, disciplined management is requested not to depend too much on export growth.

3. Industrial Policies Emphasing Efficiency

The heavy and chemical industry policy of the 1950s and early 1960s probably most accurately typifies Japan's industrial policy. The Ministry of International Trade and Industry (MITI) chose key industries and formulated concrete strategy to protect and foster these industries during their infancy. Industrial development, particularly development of the manufacturing industry, was extremely important for Japan's economic growth. Japan is a populous country and it needed a variety of industries which could compete in the world market.

Given these interests, the protectionist industry-fostering policies, or import substitution policies, were successful. But at the end of 1950s, these policies were gradually changed. Trade liberalization was promoted as a means to effectively raise industrial efficiency and value-added productivity. If people seize future potential as a challenge and look ahead with an attitude full of youthful vitality, as was the case in Japan during the high growth era, growth policies based on gradual liberalization will prove successful.

Japan's industrial policies emphasized efficiency and market results. Because of this, corporations in Japan were able to grow their main line of business, without forgetting their product and industrial ideals. Thus, competition for expanded market share, which is a characteristic of Japanese companies, brought about the realization of economies of scale through active investments in plant and equipment[4].

Industrial policies in the United States, however, emphasized equity or reduced concentration under the antitrust laws. For this reason, American companies began to veer away from their main lines of business, choosing conglomerate-type growth so as to avoid market concentration. Companies were managed by business school graduates, and the dominant influence within company management was held by finance managers who emphasized company revenue and profit based on the portfolio theory.

4. Efficient Long-term Business Practices

Together with industrial policies, an institutional factor which has worked in favor of

Japanese company growth is the long-term and continuous business relationship[5].

Long-term business relationships within a company include the long-term employment system, the internal promotion system and the internal job transfer system. It has therefore been possible to manage most Japanese companies from a long-term view that stresses product-making and technology. These three systems also are believed to have played a major role in the pursuit of 'scale merit' and learning effects. This long-term employment system was effective in facilitating investment in rationalization and labor-saving after the oil shocks in the 1970s.

Another aspect of long-term business practice is the relationship between companies. Examples of this are the relationships among members of Keiretsu groups (interlocking corporate groupings), and business practice between assembling companies and their parts suppliers.

The Japanese-style long-term business practice emphasizes efficiency based on mutual trust. Its special characteristics are that this business practice makes possible exchange of information between related companies and facilitates flexible response to changes in economic conditions.

Behind the emergence of the long-term business practice was the increasingly fixed quality of "stocks", such as plant and equipment capital and human capital (expertise), which are fundamental factors of production. An increase in the fixed nature of these stocks required a continuos business practice.

Recently, however, some aspects of this type of business practice have been criticized from foreign companies and Japanese consumers. The Keiretsu in distribution market seems to have become inefficient. The Japanese employment system is too fixed for a worker to change his occupation, when economic conditions are rapidly changing. Therefore, now the Japanese system is facing the need to be more open to outsiders and more transparent to consumers and shareholders. Japanese business practice was rational and efficient. But we have to consider that it has become somewhat inefficient and is not necessarily equitable. In this sense, we should introduce some aspects of American and European models to make Japanese system more open, transparent and equitable.

5. Policy Based Finance[6]

The postwar Japanese economy developed rapidly while undergoing profound structural change. This process of development prompted various changes in the aims of government policy and, at the same time, formed the history of changes in the Policy Based Finance. This section is to outline the salient features of this history by tracing the development of Policy Based Finance when the emphasis was placed upon the nurturing (fostering) of the domestic industry (from the latter half of the 1940s to the mid-60s) and focus on the activities of the Japan Development Bank.

The Background to and Necessity of the Introduction of Policy Based Finance

The primary aim of government policy in the latter half of the 40s was to return to prewar levels of economic activity. Immediately after the war, inflation was running at an abnormally high rate. In order to improve the disastrous state of the economy, it was necessary to take firm steps towards restoring industrial production which had fallen to roughly 30% of prewar level. A great deal of capital was required to restore production capacity, yet the amount of funds which were available from the nation's financial institutions had significantly declined. Consequently, the formation of a financial system which could provide this urgently needed capital became a serious issue for the government. After much consideration, the government responded to the problem by establishing the Reconstruction Finance Bank in 1947.

The bulk of the capital provided by the Reconstruction Finance Bank consisted of funds for capital investment. Since these funds were concentrated on the industries which were being emphasized at the time, it could be said that they formed the basis for the full scale rehabilitation of the country's production. However the underwriting of Reconstruction Finance Bond by the Bank of Japan seemed to stimulate the growth of inflation. So financing by the Reconstruction Finance Bank was halted in 1949 in tandem with the implementation of the Dodge Line.

In the first half of the 50s, the aims of the government were to achieve an autonomous economy and full employment. These aims helped to form the framework for the policy for nurturing and developing industry. In the field of Policy Based Finance, the Export-Import Bank of Japan was established in 1950 and the Japan Development Bank in 1951-the first of many such government-related financial institutions established in this period. The Japan Development Bank was founded with the aim of "supplementing and encouraging such functions as the credit operation of ordinary financial institutions, through the supply of long term funds, in order to promote the reconstruction of the economy and industrial development. "

The background lying behind the foundation of the Japan Development Bank can be summarized in the following three points. First, as inflation became subdued, hopes had risen for the establishment of a financial institution to take the place of the Reconstruction Finance Bank while carrying on the role which the latter had played in boosting the nation's production capacity. Second, excess lending by private sector financial institutions had become chronic at that time. This problem had grown to become a heavy burden for both the private sector financial institutions and for those industries which had such a strong demand for capital. Thus, the establishment of a stable structure for the provision of long-term capital had become a very desirable goal. Third, it was feared that "Mikaeri-Shikin" (counterpart funds) which had played an important role in the provision of long-term finance to key industries would gradually decrease in line with the termination of aid to Japan. Consequently, there was a need for the financial institutions to be reordered so that they could achieve more efficient reinvestment of the recoverable capital and interest revenue from these funds.

Furthermore, the unique Japanese postal savings system, which operated through a nation-wide network of post offices, was taking in small deposits. With the amount of deposits in the postal savings system rapidly increasing, voices were being raised for the establishment of a public financial institution to ensure the efficient management of these funds.

Until the middle of the 50s, the Japanese economy was confronted by a significant lack of supply capacity and an excess demand for investment. Consequently, an emphasis of government policy was placed on guaranteeing the quantitative flow of long-term capital.

Industries and Sectors Targeted by Policy Based Finance, Criteria Used for Selecting Industries and the Purpose of the Policy

The two most pressing issues for industrial policy in the period leading up to the mid-50s were the rehabilitation of the postwar economy and economic autonomy. Consequently, the emphasis of government policy was on the modernization of plant and equipment, the promotion of overseas trade (the expansion of exports) and the improvement of domestic self-sufficiency. Emphasis was thus laid upon the provision of funds to four key industries: electric power generation, ocean shipping, iron and steel production and coal mining. Policy Based Finance provided the above mentioned funds in line with a policy of priority production.

The task of postwar reconstruction had been accomplished by the mid-50s. Then, with the coming liberalization of foreign trade, the emphasis of industrial policy shifted to the issues regarding how the industrial base should be built up and how the heavy chemicals industry should be promoted. This period marked the early stage of the high growth era, and Policy Based Finance concentrated on maintaining a constant flow of funds to four major industries mentioned above. A great deal of time and energy was expended in trying to clear away some of the bottlenecks in the nation's energy supply and transportation capacity. At the same time, however, the increasing degree of complication in the industrial structure meant that there were new areas to be funded and nurtured, such as the fledging petrochemical industry and synthetic textiles which were struggling with revolutionary new technologies, and the machinery industry (including electronic machinery) which was confronting the problems associated with modernization and rationalization.

As the areas subject to Policy Based Finance became more diversified in this way, the government's industrial policy tended to avoid direct intervention in industry. It moved more towards a method based upon guiding industry in such a way that allowed it to set its own goals, while, at the same time, it aimed at nurturing crucial industries. This period marked the transition point of a shift in the content of Policy Based Finance away from a policy of quantitative support to that of qualitative support (reductions in lending rates, longer maturing) for the private sector.

Throughout the period of fast growth in the 60s, the Japanese economy underwent a shift towards a greater emphasis on a wide spread process of heavy chemicals industrialization. This was due to the necessity of boosting the productivity of all types of industry so as to raise the living standards and maintain full employment in a nation with a population as large as Japan's. The fast rate of growth, which continued from the latter half of the 50s until the end of 60s, thus represented the process by which the level of technology in Japan caught up with that of the industrialized nations of the United States and Europe.

With respect to this point, the machinery industry is considered to have been one of the sectors benefiting from Policy Based Finance. Modernization of the parts industry, which is dominated by small to medium-scale enterprises, was indispensable in enabling the machinery sector, particularly the automobile and electrical machinery industries, to establish mass production systems. At that time, the Japanese parts industry was beset with problems of low productivity, low wages, and small, multiple lot production. Here, Policy Based Finance in the machinery and electronics industries encouraged the promotion of components standardization and of a higher level of quality in manufacturing. This was also a major factor in promoting the accumulation of capital stock and technological know-how in the parts industry.

Evaluation of Policy Based Finance

Many historical and institutional factors can be cited to explain the growth of Japan's economy and the development of its industry. One fortunate factor at the start of the postwar economy was that management know-how and technological expertise had been preserved within the nation's companies. This factor boosted the efficacy of both industrial policy and Policy Based Finance.

Another important factor was that by means of a positive economic policy, a deep rooted sense of confidence in the nation's economic growth was fostered among the Japanese people. Economic growth depends largely on whether or not the creativity of the people can be harnessed to maximum effect. In this respect, the government's rapid growth policy played an important role.

Postwar industrial policy up to the mid-60s can be said to have been centered on the policies of protection and nurturing. Industries with economies of scale and with the capacity to provide large amounts of jobs were selected, and a wide array of policies (so-called import substitution policies) were implemented. The aim of these policies lay in achieving a dynamic comparative advantage[7]. In the course of achieving this aim, boosting the efficiency of the market mechanism over the long-term was stressed. It may be said that the overall emphasis of Japanese industrial policy lay in improving market performance, and that it made a considerable contribution to the development of Japan's industry.

Policy Based Finance is intimately related to industrial policy. For Policy Based Finance to be successful, industrial policy has to be rational. In addition, the operations of the financial institutions must be carried out in a rational manner.

Take for example, the Japan Development Bank. Several points of particular interest may be raised. First, in relation to the selection of companies, a strict credit analysis of the firms is undertaken placing heavy emphasis on the market mechanism. Consequently, the financing decisions taken by the Japan Development Bank fulfill a role which may be described as a kind of "cowbell effect" for the private sector financial institutions. Furthermore, it may be noted in this regard that this financing is carried out in a fair and neutral manner without reference to any financial or corporate groupings that the companies may belong to.

Second, as the private sector financial markets have matured, the role of Policy Based Finance has changed from providing quantitative to qualitative support for private sector finance. Moreover, the areas covered by this financing have changed in response to changes in policy issues. Thus, Policy Based Finance is supposed to respond flexibly to a changing situation. Finally, at the time of its establishment in 1951, the management of the Japan Development Bank stressed most heavily that it should be independently responsible for its own financing activities. Especially individual lending decisions were made independently of politics. This is called the sound banking principle. In addition, the fact that the industrial policy had long-term rationality also contributed to sound banking principle.

Notes

1 Shimomura (1971)

2 Nakamura (1981)

3 Horiuchi (1989)

4 Nambu (1991)

5 Okuno (1991)

6 This section is based on the paper presented at the 30th Anniversary Symposium of the Overseas Economic Cooperation Fund (OECF) in 1992.

7 Tsuruta (1982)

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