Introduction

“The rise of the Phoenix” may well be an apt phrase for the dramatic renascence of the Japanese economy from the hopelessly prostrated nadir of the immediate postwar period to the top-rank position in per capital GNP within less than a generation. One statistic alone is sufficient in testifying to this soaring performance: with the 1950 level at 100, the index for 1973 of the growth rate of labor productivity in manufacturing was 1412 for Japan, contrasted to 210 for the US and 411 for West Germany. An analysis of how this was possible is part of the task attempted in this volume. But it is, from my point of view, the less important task.

Challenge for affluence was accepted and the accomplishment in terms of GNP growth is beyond doubt. But the pitfalls of affluence are now no less evident, especially as the consequences of “the price revolution” in urban land and of financial euphoria have steeped into the fabric of a society with a prevalent money-oriented psychology. One of the pitfalls came to be exposed in the month of August 1991 as I write this Introduction, i.e., a number of financial scandals involving security houses, banks, credit unions, and some bureaucrats. As The Economist wrote: “[these scandals] make the eyes spin like a fruit machine. Add more noughts to the figures, find scams in every financial firm in the land, and no Japanese would any longer be surprised. It is dawning on many in the West, too. Japan is up to its neck in dirt . . . Scandals are sewn into the fabric of Japan’s financial system, its corrupt politics and even of its business ways. They are systemic not only in nature but also in the risk that they pose: the world’s largest single source of capital and one of its three top financial centres is riddled with crookery, has been supervised by the blind or the complacent, and could be – not is, but could be – facing collapse. Japan’s dirt is dangerous stuff.”

It is clear enough that the sequel to the “The rise of the Phoenix” story has to deal with the logical and historical connections of such “systemic” scandals to the antecedent events in the Japanese economy as well as to
broad background in the international financial world. As readers will see, I have not done this task fully, partly because the revelation of the infamous events came only after I completed the text of this volume. However, I may point out that Chapters 6 and 7 do discuss somewhat longer-range development of the basic aspects of Japanese capitalism which might illuminate the systemic roots of the recent volcanic eruption of financial scandals. For the elucidation of this connection, I propose to add a few paragraphs here, in a hope of providing readers with a perspective of my own longer-range approach to the subject in question.

Schumpeter used to say: “You can ride on a horse, but not on a claim to a horse, whereas a claim to money or to objects of money is as good as money itself.” Credit received is a claim to money, involving intertemporal exchange at a price which is called the rate of interest; and in Schumpeter’s theoretical structure credit creation was regarded as pivotal in economic development under capitalism. But it is likely that Schumpeter never dreamed of the extent of multiplication of credit instruments in the decades after his death and the emergence of what Peter Drucker calls “symbol economy” – capital movements, exchange rates and credit flows – uncoupled from the “real economy” – the flow of goods and services. It cannot be doubted that “what is essentially new in the present economic situation is that the center and focus of the capitalist economy has shifted from the production of goods and services to the buying, selling, and multiplication of financial assets.”

Statistical confirmation of this trend is patent enough. For the international scene, relevant comparison would be between the volume of international trade in goods and services with the turnover of foreign-exchange transactions in the world’s main money centers. As of April 1989 it was reported that the average daily net foreign-exchange transactions in the four world markets (London, New York, Tokyo, and Toronto) amounted to $445.9 billion dollars, or 111 trillion dollars on the annual base. This figure, be it noted, is about 22 times the total annual world trade of approximately 5 trillion dollars in 1989. The trend was also significantly shown by the fact that the foreign-exchange transactions in the four markets increased by 116 percent from March 1986 to April 1989, while external trade in goods and services of the four countries (UK, the USA, Japan and Canada) expanded by 56 percent between the first quarter of 1986 and the first quarter of 1989. The gap in question was definitely widening in recent years.

Turning our attention to Japan’s domestic scene, we observe, as described in Chapter 6, that due to the urban land-price revolution capital gains in landed property in one single year, in 1987 for example, amounted to 416 trillion yen – an amount exceeding Japan’s GNP of that year (343
trillion yen) by more than 20 percent. A clear enough evidence of excessive overgrowth of claims to money as against productive activities!

Thus in both respects, that is, in the international financial activities and in the domestic monetary transactions, Japanese capitalism has come to develop a structure top-heavy with multi-layered financial claims on the basis of “the real economy”, naturally enlarging the scope of mercenary and speculative activities among the men in “the symbol economy” echelon structure. One after another of revelations in the nature of financial scandals in Japan as the decade of the 1990s opened, involving security houses, banks, a “nod and wink”-prone Ministry of Finance, and even gangster groups, are of one piece with the pitfalls of affluence which set great store by money-making among the general public in the era of corporate capitalism. Galbraith has warned recently that “there is the possibility, even the likelihood, of self-approving and extravagantly error-prone behavior on the part of those closely associated with money.” This in itself is true enough. But more than the personal behavior pattern of individuals is at issue. The systemic roots of the type of excesses in “the symbol economy”, so admirably analyzed by Anglietta and Orléan in their La Violence de la Monnaie, are the problems challenging political economists of today to wrestle with.

Social consequences of the land-price revolution are discussed in Chapter 6 of the text; but broader ramifications of the financial euphoria in the various aspects of the present-day Japan are not dealt with here. Therefore, I may relate one piece of evidence in this regard, which has far-reaching significance for the future of Japan.

A recent opinion survey of high-school students showed that more than 50 percent of them responded affirmatively to the statement that “the present-day Japan sets too much store by money and material objects and makes little of warmth of heart.” Further, on the question: “Which color do you choose to characterize the future of Japan?”, their response was “grey” 38.8 percent, “black” 15.7 percent, and “rose-color” 3.1 per cent. The survey suggests clearly that the younger generation in Japan is groping for concrete guiding principles for themselves, living as they do in the money-contaminated materialistic society of today. It is ironic that when small boys are asked if they know what a beetle is like the most commonly received answer is: “Yes, I know. That’s what I can buy with a hundred yen coin.”

It is certainly high time, I believe, that a generation like mine, which has gone through Japan’s vicissitudes of war and peace, hardship and affluence, fulfills its responsibility of transmitting the lessons learned and of bringing out in bold concrete visions for the future of the country, so that hopefully at least 30 percent of the high-school students and not a mere 3.1
percent will be able to see “rose-color” prospect for themselves. This is what I have tried to do in the concluding chapter.

There is one other matter which I should like to explain by way of offering an excuse for my not applying a commonly used growth accounting approach in the discussion of Japan’s growth performance in the postwar period.

The so-called “fundamental equation of growth accounting” is given, e.g. by Samuelson and Nordhaus, as:

$$ \frac{\Delta Q}{Q} = \frac{\Delta L}{L} + \frac{\Delta K}{K} + T.C. $$

where $Q$ stands for output, $L$ for labor, $K$ for capital and $T.C.$ for technical change (or total factor productivity) that raises productivity, and where $\frac{\Delta L}{L}$ and $\frac{\Delta K}{K}$ are the relative contributions of each input to economic growth, given by their relative shares of national income. Since, however, technical change cannot be measured directly, it is calculated as a residual, thus:

$$ T.C. = \frac{\Delta Q}{Q} - \frac{\Delta L}{L} - \frac{\Delta K}{K} $$

On the basis of this equation, Samuelson and Nordhaus calculated, substituting numbers for the period 1900–86 in the US, the contributions of technical change to be 1.85 percent per year against the 2.1 percent per year increase in output per worker, capital deepening accounting for the remaining 0.25 percent. More recent statistical studies for the US do not attribute such a big share to technical change in the growth accounting.

A natural question arises: What were the respective contributions of labor, capital and technical change to the 10 percent annual growth rate period of postwar Japan? It should be most interesting if we could compare the results with other countries and other periods. And we do have studies carried out by Japanese economists applying the above growth accounting approach. Readers will be able to find the answers in the Annual Economic Report of the Economic Planning Agency, giving the figures, for example, for the period 1970–89, of 4.8 percent for output, 2.9 percent for capital, 0.3 percent for labor, and 1.5 percent for technical change.

One wonders how useful these figures are. As for myself, I have been skeptical of this growth accounting approach ever since the idea was first formulated by Robert Solow in 1957; and I wrote a critical essay on the subject in 1965. I take up this problem here because it is concerned with a basic methodological stand which lies behind my thinking as a political economist.

Readers will note that I make a peripheral reference to the distinction between “the real-wealth aspect” (or the real aspect) and “the socio-institutional aspect” (or the value aspect) as I discuss the role played by technological progress. There, my thesis is that technological progress,
which belongs to the realm of the real-wealth aspect, does impinge upon the
mode of production, or the socio-institutional aspect, in such a way that
this latter undergoes qualitative changes often of major dimensions.
Methodological significance of this distinction between the real aspect and
the value aspect, as well as the need for integrating the two, is quite far-
reaching in the historical analysis of institutional development; and I
dwelled on this problem quite extensively in my Mattioli Lectures of
1985.  

More specifically, the basic difficulty with the growth accounting
approach is: whereas technical change belongs in the realm of the real
aspect, factors of production, capital in particular, are essentially value
concepts. In order that the Cobb-Douglas function, on which the
accounting is based, be applicable, both capital and labor have to be
identifiable in homogeneous physical units. But, for a dynamic economy,
the choice of units for both labor and capital presents a formidable
problem. For example, one cannot escape from the value implication of
capital as affected by the rate of interest, the time pattern of wage rate
changes, the interaction effects, etc., unless we assume a radically simplified
economy with one-type of machine and no technological change. A great
many refinements have been made on the technique of growth accounting
by E. Denison and others over the last three decades; but the doubt still
remains as to the practical significance of this approach, which does not go
beyond a common-sense statement for Japan like: “the very high 1953–71
Japanese growth rate was not ascribable to any single determinant.”  

The problem of units, I believe, remains unsolved. Economists like
Keynes and Harrod, who performed a pioneering role in the development
of modern macroeconomic theory, were, in their own way, aware of the
peculiar difficulty which presented itself in the matter of the choice of units –
the difficulty which stemmed from the double character (the value and the
physical) of the production process, especially of the economic system as a
whole. Keynes’ solution was, as is well known, to adopt the labor-unit and/or
the wage-unit. Harrod, too, wrestled with a similar problem when he
posed the question of whether neutral technical progress required new
investment and answered that it was a question of definition – that the
answer depended on whether a labor standard of value is chosen or a goods
standard of value. The distinction between a labor standard or a goods
standard corresponds to that of the value aspect and the real or physical
aspect. Whereas microeconomics for a capitalist society can navigate
almost entirely in the world of values, macroeconomics, especially of the
dynamic type, finds it difficult to dissociate itself from the real or physical
aspect of the subject matter. In this sense, the fact that Keynes, who was
interested more in the short-run problem with no technological change,
chose a labor standard and Harrod, who was concerned with a dynamic economics, chose a goods standard is easily understandable.

I hope that the foregoing is sufficient to convey my methodological inclination, while at the same time giving an explanation for my not using the growth accounting approach in the text.
1 The defeat and the Occupation reforms

This opening chapter is intended to serve as factual background for my analysis, in later chapters, of the vicissitudes of Japanese capitalism in the postwar period. Thus, I tried to be as objective as possible in following the relevant events, refraining from interweaving the accounts with my personal involvement in the affairs of the state. The chapter begins with the summary of the consequences of the defeat in the war, followed by a somewhat textbook style account of what the occupying authorities, essentially led by the US government, attempted to achieve by way of reforming Japan. Probably the most important among the reform programs were the land reform and the revision of the Constitution, both of which have had long-lasting impact on Japanese society, most likely because they found solid backing in the minds of Japanese people themselves. Since the subject matter dealt with in this chapter is a well-trodden ground, I felt that I could fulfill the task in a condensed manner, relying on the fact that interested readers could consult the fuller accounts given in the bibliographical references cited at the end of the book.

1. Consequences of the defeat in the war

The postwar history of Japan has to begin with the account of losses and damages as consequences of the defeat in their manifold aspects – territorial, material, human and organizational. Territorially, the partition of the erstwhile Japanese empire involved, first by the terms of the Cairo Declaration of December 1943, the “stripping of all the islands in the Pacific which Japan has seized or occupied since the beginning of the first World War in 1914, and restoring to the Republic of China all the territories Japan had stolen from the Chinese, such as Manchuria, Formosa, and the Pescadores,” and also the promise that “in due course Korea shall become free and independent”; and, second, by the terms of the Yalta Agreement of February 1945, the cession to the Soviet
Union of the southern half of Sakhalien (Karafuto) and the Kurile Islands. In addition, by the terms of Japan’s surrender, a large part of peripheral islands, such as Ryūkyū (including Okinawa), Bonin, Izu, Iwó, and Marcus, were relegated to the trusteeship of the United States. In other words, Japan at the end of the war was shrunk essentially to four main islands of Hokkaido, Honshū, Shikoku, and Kyūshū.

Related to the loss of territories was the severe restriction of fishing grounds imposed by the Allied Powers. Before the war, Japan was the world’s foremost fishing country, with an annual catch of almost one million tons. But the catch declined to 360 thousand tons by 1950.

Material losses and damages might have been far greater were it not for the fact that the fighting was terminated without a last ditch stand on the main islands. Thus a statement by Ambassador Edwin W. Pauley, head of the US Reparations Mission to Japan, in December 1945, as follows:

Despite all the destruction, Japan still retains, in workable condition, more plant and equipment than its rulers ever allowed to be used for civilian supply and consumption even in peaceful years. That surplus must be taken out. To complete the demilitarization of Japan by taking it out will not mean the complete deindustrialization of Japan. I want to be very emphatic on that point. Figures concerning one key industry will show what I mean. In steel, and in machine tools and other machinery made from steel, Japan’s own figures show that she still has, in workable condition, more than twice the facilities that she had when she invaded Manchuria in 1931.

Still, the extent of losses and damages was severe enough through the bombings from air, bombardment from warships and submarine attacks; and it is generally agreed that of the total national man-made material wealth which would have been in existence in 1945 in the absence of wartime damage roughly one-quarter was gone. This meant that the amount of damage was approximately equal to the net addition to such national wealth over the decade of 1935 to 1945, leaving the remaining total equivalent to the amount existing in 1935.

Naturally, damage was quite uneven among different categories of material wealth. Most severely hit were commercial ships. There were six million tons of such ships before the war, and four million tons were built during the war. But 8.6 million tons of them were sunk in the war, leaving approximately 1.5 million tons of which two-thirds required major repairs.

The major damage, other than plant and equipment closely related to war activities, was in residential houses, most of which in Japan, being of wooden construction, were highly vulnerable to incendiary bombs during air attack. It is estimated that 2.1 million units were destroyed through bombing, and in addition 550,000 units were lost through removal and demolition, creating a shortage to the amount of 4.5 million units at the end.
The defeat and the Occupation reforms

of the war, taking into consideration the net increase of demand by
repatriates and also the needed catch-up construction to fill the gap of
absolute shortage during the war.

In a number of industries what is called “indirect damage” has to be
taken into account, that is to say, loss of capacity performance due to
insufficient repairs and up-keep caused by lack of component materials and
speeded-up production – an inevitable consequence of the war-time effort.
The extent of loss in this regard is not easy to estimate in terms of stocks, but
can be guessed at in terms of flows of subsequent production. The
government report earlier cited gives the figure of stock-equivalent loss of a
little less than one-third of the “direct damage” loss; but the accuracy of this
estimate is somewhat questionable.

The overall effect of the war on man-power supply is rather complex. On
the one hand, the number of those who died in battle or from diseases
contracted at the front was fairly accurately counted inasmuch as their
relatives had to be officially notified of their death. Official figures of such
death, estimated as of 1948, were:

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<tr>
<td>Army</td>
<td>1,404,429</td>
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<tr>
<td>Navy</td>
<td>414,879</td>
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<tr>
<td>Total</td>
<td>1,555,308</td>
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This total, however, was the minimum figure since it did not include (a)
those who were “missing,” numbering 240,000 as of 1948, (b) the heavily
wounded persons who subsequently died, and (c) those who died in non-
oficial duties on the battle ground. On the other hand, the number of
civilian deaths through bombing (including atomic bombs) is far more
uncertain, although official figures (as of May 1948) showed:

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<tr>
<td>Deaths</td>
<td>299,485</td>
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<tr>
<td>“missing”</td>
<td>24,010</td>
</tr>
<tr>
<td>Seriously wounded</td>
<td>146,204</td>
</tr>
<tr>
<td>Total</td>
<td>469,699</td>
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This total, however, does not include the civilian deaths in Okinawa, which
are variously estimated as being within the range of 100,000 to 200,000.
Thus, the total fatal war casualties may be roughly estimated to be
anywhere around two and a half million.

Against this negative population effect we have to take into consider-
ation the positive addition to domestic population in the form of returnees
from mainland China and other Asiatic regions after the end of the war,
numbering some six million, a large part of whom was technically qualified
personnel. For example, in the category of railroad workers alone the
forced returnees from China numbered close to 200,000. Most of such
returnees entered the employment market, willing to work at lower wage-rates than their qualifications warranted.

Thus, the net effect of the defeat in the war upon the manpower situation could be considered positive from the standpoint of needed economic reconstruction within the shrunken territory of postwar Japan.

Organisationally, consequences of the defeat in war subsequent to the extreme strains for the war effort were, to say the least, considerable. The normal distribution system was naturally slow to recover after commandering for military purposes was terminated and the dire shortage of basic consumers’ goods continued in the atmosphere of popular resistance against war-time rationing. A natural consequence was the hoarding of any stocks which promised price rises on the one hand and the mushroom growth of black-market dealers on the other. As the defeat in the war became obvious to everyone through the Emperor’s broadcast on August 15, 1945, or even before this day of unconditional surrender, since through the years of 1944 and the spring of 1945 defeat appeared inevitable, the national sense of manifest destiny, instigated by the war-time leaders, started to wane very rapidly; and this had the necessary effect on the established mores of social discipline as regards respecting of boundaries of propriety. The lid was lifted by natural force, so to speak, from sundry restraints that had been imposed by the war-time government. The obvious, overall consequence was that the general price rise was further stimulated by the wanton disbursement of the budgetary war fund, immediately subsequent to the unconditional surrender, for the liquidation of war-time contracts and for lump-sum retirement grants to the military personnel.3

The best indication of the general price rise was the trend of the official producers’ price of rice, which was set on September 18, 1941 at 49.00 yen per koku (180 liters), raised on April 30, 1945 to 92.50 yen per koku, and then again raised in March 1946 to 300.00 yen per koku – the price which was applied retroactively to the rice harvested in 1945. It can be seen from this trend that whereas the percentage rise during the Pacific War was 89 percent, the end of the war precipitated the rise to 224 percent.

The organizational disruption brought about in the realm of corporate management was serious enough, although the disruptive effect was destined to become more intense as the mandatory reparation removals, the dissolution of the zaibatsu, and the purge orders against war-time business leaders loomed on the horizon. Inevitably, the recovery of production in the manufacturing sector took longer time than otherwise would have been the case.