Introduction: globalization, institutional reform, and government structure

GLOBALIZATION AND GOVERNMENT STRUCTURE

Trade, investment, information, and communication intrinsically link the Japanese and international economies. As rules and norms in the international economy change, the Japanese economy is pressured to make the appropriate institutional adjustments to remain globally competitive. The public policy reforms, which have dominated Japanese national politics from the mid-1990s to the present, are attempts to make large-scale institutional adjustments to an economic system that was becoming inefficient and less competitive under the globalizing liberal economic order.

Adjustments have meant institutional reforms in Japan’s post–World War II politico-economic system, including the beliefs held by politicians, bureaucrats, and private economic agents about the role of government in the market and the resultant behavioral changes. From the reformers’ perspectives, an adjustment should improve Japan's overall economic efficiency and outweigh the coordination costs, which some segments, especially inefficient sectors, would incur. With these expectations, the reformist political leaders, most notably Prime Ministers Hashimoto, Koizumi, and Abe of the Liberal Democratic Party (LDP), initiated profound public policy reforms in the financial system, labor markets, and postal services in the late 1990s and the early 2000s. However, these reform movements faced some stumbling blocks.

Several analysts have attributed limits in Japan’s reforms to its fragmented political structure, which is entrenched with special interests and numerous veto points that have hindered political leadership’s policy initiatives (Calder, 1988b; Katz, 1998; Vogel, 2006). To coordinate bureaucratic tasks without the influence of bureaucratic politics and special interests, these analysts claim that an adjustment requires not just public policy reforms, but also political and administrative reforms to remove government structural impediments and to strengthen leadership’s policy authority. Thus, centralization is a reaction against a decentralized government structure. That is, in a globalized world, the governing patterns need to be more coherent.
Globalization has made conventional governance virtually impossible (Ohmae, 1999). Conflicts frequently emerge between the tasks of different bureaucratic agencies as well as the interests of the governing coalition members whose solutions require coordination by central political leadership. Multiple agencies within the government and a decentralized autonomy reduce the capacity of the government to exert control over those agencies’ tasks and interests (Mosley, 2003). Although political leaders are in a position to assume political responsibility for the public interest, they must have a real capacity to influence the behavior of those agencies. Globalization increases the importance of a coherent centralized government for governability and policy effectiveness (Weiss, 1998; Hirst and Thompson, [1996] 2009). This view is consistent with the international relations theory of intergovernmentalism (Keohane and Nye, 1977; Moravcsik, 1997).

In contrast, other analysts (Peters, 2001; Slaughter, 2004; Shiroyama, 2013) have claimed that the real problem of government ineffectiveness in a globalizing economy lies in an adaptation failure due to the weakening of states’ bureaucratic agencies and transgovernmental networks composed of agencies and international organizations. Increasingly bereft of policy authority in a centralized government, bureaucrats are discouraged from updating information and maintaining the expertise necessary for policy adaptation to rapidly changing international rules and norms. This claim is based on the assumption that the centralized, top-down, and monopolistic nature of government is at the core of governance problems. A more decentralized government structure may be both more efficient and more democratic, and has the potential to respond more flexibly to the many challenges faced by a contemporary government.

Policy delegation to specialized bureaucratic agencies within a decentralized government, which are well connected with their foreign counterparts and international organizations via transgovernmental networks, may improve adaptation capabilities. This type of state is characterized as ‘disaggregated’ (Slaughter, 2004) or ‘perforated’ (Jessop, 2002). These institutional arrangements provide bureaucratic officials with incentives and opportunities to adapt their policy domains to changing international rules and norms by updating their information and expertise. From this viewpoint, delegation and decentralization, not command and centralization, facilitate policy adjustments. This approach to governing devalues coordinated and central responses to policy problems in favor of flexible and entrepreneurial responses that are sensitive to sectoral demands (Peters, 2001, pp. 3–4). The logic of control in the public sector has switched from hierarchy toward competition and mutuality. This position accords with the theory of transgovernmentalism (Kingsbury et al., 2005; Slaughter, 2004).
These two competing arguments imply that the question of how to set forth an appropriate government structure in the age of globalization has become a major concern in academic and policy circles. Both viewpoints hold that a state ought to adjust its policy domains to changing international policy environments by reinventing the government structure. In general, such adjustments are composed of adaptation to new international norms and rules through learning and behavioral changes as well as coordination between conflicting interests and public policy tasks. In this vein, the government structure constitutes a major instrumental variable to facilitate adjustment tasks – adaptation and coordination.

This structural controversy is intrinsically related to another controversy between globalists and comparative institutionalists. They both argue that a globalizing economy enables business firms to reinforce their bargaining power with regard to states through exit options. Firms can relocate their production or marketing facilities to foreign countries with fewer regulations and lower taxes. This generates a race to the bottom, promoting deregulation and privatization, or an adjustment to the neoliberal international order.

On the one hand, globalists (Ohmae, 1999; Takenaka, 2008) predict that globalization will benefit not only multilateral corporations, but also the nation as a whole due to the expanded employment opportunities, trickle-down effects with respect to economic growth, tax revenue increases, and so on. Notable pioneers of globalism in international political circles are Conservative Prime Minister Margaret Thatcher of Great Britain and Republican President Ronald Reagan of the United States, who were succeeded by New Labour Prime Minister Tony Blair and Democratic President Bill Clinton, respectively. Leaders in non-liberal states, including Chancellor Gerhard Schröder of Germany, President Sarkozy of France, and Prime Minister Koizumi of Japan, among others, have followed Anglo-American initiatives. Thus, the globalist hypothesis expects that governments undertake comprehensive adjustments to the neoliberal international order through not just competition, but also learning and emulation, irrespective of cultural, historical, and partisan differences (Simmons and Elkins, 2004).

In contradistinction to the globalist sweeping institutional reform, there are rival accounts for incremental change. Comparative institutionalism argues that institutional reform is necessary but depends on the path of the existing institution (Hall and Soskice, 2001). Stakeholders seek to adjust their institution to changing international order in pursuit of efficiency and competitiveness while preserving the core of the institution in pursuit of internal complementarity and social stability. Thus, the adjustment process is an incremental adaptation characterized by layering, conversion,
displacement, and drift (Streeck and Thelen, 2005), which is carefully planned and executed by specialists, administrators, and regulators in a decentralized government.

**PROBLEMS WITH EXISTING JAPANESE POLITICAL-ECONOMIC STUDIES**

These general arguments concerning globalism and comparative institutionalism have influenced Japanese political and policy studies in significant ways. Below, the findings of the studies are summarized for the globalist and institutionalist schools, which have slightly different interpretations from analytical perspectives.

**Comparative Institutionalism and Bureaucratic–Industrial Collusion**

In the edited volume by Streeck and Yamamura (2003), Vogel (2003) concludes from observations of various adjustment attempts in contemporary Japan that the government has implemented selective and incremental adjustments to correct significant institutional defects without altering its foundation. This practice constitutes the Japanese way of structural adjustment but is still consistent with the general pattern of incremental change in pursuit of institutional complementarity and social stability. The comparative institutionalist hypothesis acknowledges the virtue of the existent Japanese-style coordinated market economy (CME) as well as the need for adaptation, and is sympathetic with the slightly different interpretation below.

Another analytical perspective views incremental adaptation as a consequence of political–bureaucratic–industrial collusion and a deliberate attempt to secure the vested interests under a fragmentary decentralized government (Calder, 1988b; Katz, 1998; Amyx, 2006). Even reformist leaders are barred from initiating meaningful reform by the collusion within which bureaucrats deliver policy rents to the regulated industrial sectors in exchange for post-agency employment, while rank-and-file parliamentarians pressure for lenient regulations in exchange for votes and political contributions. Accordingly, even when the leadership claims that it seeks a ‘bold’ adjustment via its initiative, in an attempt to persuade the opponents about the need for the adjustment, it sooner or later has to curtail the extent of the announced reform so as not to jeopardize vested interests (Vogel, 2006).
Globalist Majoritarian State and Monopolistic Leadership

The globalist perspective contends that domestic electoral and administrative reforms in the 1990s transformed the once fragmentary governing system into a coherent majoritarian system with improved political command (Berger, 2007; Rosenbluth and Thies, 2010). The new system is capable of adjusting its economic institution to the neoliberal international order through comprehensive reforms regarding banking, corporate governance, labor relations, and so on. These reforms were timed with the worsening of the deflationary economy in the aftermath of an asset bubble burst in 1991 that eroded business confidence in the CME system, which is associated with public discontent with the political–bureaucratic–industrial collusion. This perspective also overlaps with the idea of internationalization. ‘Second image reversed’ theory or global convergence that predicts a major transformation of a non-liberal market economy to a neoliberal order occur through a distinct path (Gourevitch, 1978).

While it suggests correctly that a coherent majoritarian system with political command, if obtainable, might solve the problems of strategic interactions between leadership and rank-and-file parliamentarians and between politicians and bureaucrats, the majoritarian hypothesis fails to notice that the post-reform political system is hardly a two-party system and that the reforms have been derived from the elitist political–bureaucratic partnership at the cabinet level, not from the voter-majority–party-cabinet link. Furthermore, because of its faith in democratic majoritarianism, the thesis fails to notice that elitist politics could engender another problem of monopolistic leadership – the central command at the top of the government hierarchy is susceptible to communication and information cutoffs. This structure discourages bureaucratic officials from acquiring the information and expertise necessary for policy adaptation. As a result, some reformist leaders and their associates may be ill informed of efficient and effective ways for adaptation, leading them to believe that the properties of CME can no longer benefit Japanese firms and to them calling for neoliberal market economy practices.

As shown above, the empirics are mixed and open to variable interpretations by the contending schools of thought, including institutionalist, globalist, political–bureaucratic–industrial collusion, and monopolistic leadership. In this book, I try to sort out these hypotheses via normative and empirical analyses. I then argue that the government structural architecture and ancillary authorities are crucial for mediating global pressure and adjustments, generating varying outcomes across public policy domains.
ANALYTICAL FRAMEWORK

Within the last century, the Japanese political economy transformed from the prewar mercantilist economy through the interwar command economy into the postwar coordinated market economy in attempts to keep pace with changing international orders. These political economic systems were essentially non-liberal, entailed close public–private relations, and employed government interference with economic transactions to high and variable extents. Thus, the non-liberal state’s public policies, or national rules and standards, are qualitatively different from those of a liberal state that embraces arm’s-length public–private relations based on the principle of non-interference.

The systemic transformations in Japanese political economy were associated with major political changes that were driven by war and peace. Each political change generated change in the government structure or the reallocation of policy authorities between politicians and bureaucrats through which both struggled to adjust public policies to an emergent international order. However, each systemic transformation was not a complete abandonment of the past. A new system maintained several institutional arrangements of an old one, keeping the legacy of non-liberalism, primarily because political, bureaucratic, and private actors had incentives to maintain existing arrangements. In recent times, the Japanese political economy is faced with yet another major turning point, at which it is urged to effect a systemic transformation one more time in order to keep pace with a new order – that is, the global neoliberal order. This has evoked the quintessential problems of authority reallocation and policy change.

To analyze the contemporary and historic systemic transformations, I use a framework that links policy authority allocation (either bureaucratic delegation or political command) to adjustment mechanisms (either adaptation or coordination) for international orders. My analysis regards authority allocation as an important intervening variable due to the fact that significant public policy changes emerged despite the rare occurrence of partisan shifts in national politics. Likewise, existing scholarly analysis of policy change in postwar Japan has focused predominantly on the location of policy authority and the relationship between politicians and bureaucrats (Muramatsu and Krauss, 1984; Inoguchi, 1993; Pempel, 1998). This authority-centric analysis is in sharp contrast with comparative public policy studies in North America and Europe (Alt, 1985; Garrett, 1998), which often use partisanship as a primary explanatory variable to account for changes in policy regimes and institutions. In these states, governing parties almost always have robust central commands within their respective democratic governments to initiate policy changes. However, in
the Japanese case, political command with substantive policy authority is not readily available, and must be created via appropriate authority reallocation and skillful political strategies, which therefore have to be my major analytical concern.

Thus, the analytical framework of this book is as follows:

- To construct and maintain efficient economic institutions, the government needs to adjust its public policy domains. Without appropriate policy changes, economic institutions will lose competitiveness, reducing the public well-being and even undermining the governing party’s electoral prospect.
- Economic institutions consist of private arrangements underpinned by public policy domains and are characterized by ‘institutional bundling’.
- An institutional reform means ‘institutional rebundling’, which is a change in private arrangements induced by policy reforms in public domains. Institutional rebundling is often difficult because agents are bound rationally and are unable to reach an efficient solution under informational uncertainty or high transaction costs. Alternatively, agents have the malicious intent of preserving existing institutions in pursuit of their self-interest.
- The nature of discrepancy between the prevailing international economic order and a state’s economic institutions should determine the mechanism of adjustment. That is, in simple binary terms, the government is tasked with adaptation (policy reform in one or more domains to keep pace with changing international order with complementary cross-domain effects) and coordination (policy reform in multiple domains to keep pace with changing international order with substitutive cross-domain effects).\(^1\)
- Adaptation and coordination can be performed efficiently via distinct ‘policy authority allocation’ schemes over policy domains using ‘bureaucratic delegation’ and a ‘central political command’, respectively.
- Even if a desired change in one policy domain is complementary to that in another domain, the change may be hindered by informational uncertainty. That is, agents (private actors and bureaucratic officials) in one policy domain are uninformed of agents’ behavioral choices in a different domain, inhibiting an efficient solution. This scenario mimics a stag hunt or assurance game in which hunters fail to capture a stag jointly because they individually pursue hares.
- Change can be facilitated by efficient ‘information transmission’ between bureaucratic officials who manage the two different policy
domains. Using their technical information and expertise, they can discern a relatively efficient equilibrium via learning and an inter-ministerial communication channel.

- Political leadership can promote policy adaptation via bureaucratic delegation that encourages bureaucratic officials to further their specialization, learning, and inter-ministerial communication.

- If a suggested change (say, foreign exchange liberalization) in one policy domain is *substitutive* for a corresponding change in another domain (say, interest rate control for private banks), the change may be hindered by a distributive conflict. That is, agents in the latter domain (banks) will suffer a loss from the change in the former policy domain, and thus veto the change. This mimics a battle of the sexes or coordination game in which a couple of friends fail to choose the same dating spot due to divergent preferences.

- The solution to the coordination problem may be achieved by *compensating* the sufferers for the losses, by *persuading* them to accept the change, or by *coercing* them to acquiesce to the change. However, success is constrained by the high transaction costs associated with compensation, persuasion or coercion, under decentralized arrangements. In this case, the solution should be facilitated by powerful central command capable of performing either one or more of the three.

- In theory, the nature of the discrepancy between the state’s economic institutions and the international order should determine the appropriate adjustment mechanism and policy authority allocation. Accordingly, the extent and process of policy change (dependent variables) are determined by change in the international order (independent variable) and policy authority allocation and related political strategies (intervening variables). Different authority allocation schemes siphon the leadership’s policy goals, the governing coalition’s sectoral interests, and bureaucracies’ organizational interests into policy domains with different extents. Change in authority allocation reconfigures the distribution of goals and interests, inducing public policy domain changes and affecting institutional reforms.

**OUTLINE**

The above analytical framework has both normative and positive elements that will be discussed in greater detail in Part I, Chapter 1. However, the normative and positive hypotheses are often met with empirical defiance. In practice though, the authority allocation schemes are influenced by the
politics of bureaucracy and the governing party’s coalition as well as by leadership’s strategies to untangle them. In the real world, authority allocation may fail to produce desirable policy outcomes for two reasons. First, it suffers from a structural dilemma as an authority allocation scheme to achieve both efficient adaptation and coordination concurrently is hard to come by. The central command may be strong in coordination, but weak in adaptation, while the opposite is true for a bureaucratic delegation. Second, agents may deliberately engage in structural manipulation or choose an authority allocation scheme that differs from what the normative theory recommends due to an electoral or a political reason.

In the absence of a robust central command, deconcentrated bureaucracies fail to execute coordination and stifle policy adjustment. For example, suppose that coordination is concerned with comprehensive trade liberalization that encompasses industrial and agricultural products. Due to fears of relative inefficiency and loss, the farming community wishes to prevent comprehensive liberalization altogether and receive protectionist rents from the closed trade regime. Bureaucratic delegation may provide the agricultural ministry with veto power to defend the vested interests at the expense of national consumerists’ interests. This type of government is referred to as a degenerate decentralized government and is the critical focus of many empirical studies of contemporary Japanese political economy.

Another case of inappropriate authority allocation is that, even if adaptation is needed, leadership may choose a central command in order to fulfill its policy goals without proper parliamentary and bureaucratic consultation, proclaiming that the goals are in the ‘public interest’ regardless if this is true. Via the central command, the leadership may be able to make a bold policy change, but the change may be inappropriate because the top leadership in the government hierarchy is ill informed and not helped properly by disillusioned bureaucrats with poor information and expertise. The result is a policy domain divergent from public interest or international order. This type of government is referred to as a ‘monopolistic’ government and is largely ignored by contemporary scholarship.

In Chapter 2 of this book, I will extrapolate four empirical models on the Japanese government and its performance from the existing scholarly literature. Two of the four models are consistent with the aforementioned theory, while the other two are degenerate versions. All four models are useful for conducting historical and contemporary analyses in the following chapters. Each empirical analysis will intend to test the models, rather than provide comprehensive descriptions or explanation of institutional reform at hand.

In Chapter 3, a historical analysis will focus on the pre–World War II
Japanese political economy. It will show how the Meiji oligarchs presided over institutional reform from feudalism to modern industrialism under the forced free trade regime without tariff autonomy imposed upon Meiji Japan as part of the treaty port system by Western powers until the early twentieth century.

On the other hand, during the post-oligarchic party politics in the Taisho era (1912–26), the Japanese political system became a quasi-parliamentary democracy with two rival political parties vying for power under the Meiji Imperial Constitution. However, despite embryonic liberalism at home, the party governments had difficulties conforming to the interwar liberal international order. The collapse of party government was followed by bureaucratic, constitutional-dictatorial, and grand coalition government. The major question here is why the Taisho democracy collapsed and centralization took place, with the disastrous consequence of total national mobilization and warfare.

The empirical analysis in Chapter 4 will focus on the four decades after World War II when the Japanese-style market economy, known as a coordinated market economy (CME), thrived and produced phenomenal growth under the international order of embedded liberalism. It is widely known that the Japanese-style CME emerged as a stable equilibrium institution underpinned by the relevant public policy domains. I will show how the Japanese-style CME evolved from the interwar planned economy via occupation reforms, creating a bundle of private arrangements, including the main bank system, manager-centric contingent corporate governance, long-term employment, and integrated industrial networks. From the mid-1950s through the early 1990s, the Liberal Democratic Party (LDP), a product of the merger of two conservative parties, maintained the bureaucratic-cabinet system, delegating policy authority to bureaucracies and protecting the CME via public policies. In the meantime, the cross-sectoral governing coalition, composed of bankers, business managers, skilled regular employees, and farmers, remained remarkably unchanged. How could this be possible, given phenomenal economic growth, shifting comparative advantages, and the associated social change?

In Part II of this book, I will conduct contemporary analyses with an emphasis on the process of altering the authority allocation scheme through political and administrative reforms in the 1990s. The reforms were made in part to adjust the ailing CME to the change in the global order toward neoliberalism. To overview the crucial reforms, in Chapter 5 I will examine the electoral and administrative reforms that are said to produce a majoritarian-consumerist tendency, centralize the government structure, and strengthen political leadership appropriate for neoliberal policy change. My analysis will show how the mixed electoral system with
the resurrection rule has generated an imperfect two-party system with a weak majoritarian-consumerist tendency and resilient sectoral representation. Likewise, the administrative reforms still have allowed bureaucratic decentralization particularly in the policy domains with strong demands for expertise and balancing social interests. Given the possibility of structural dilemma and manipulation, policy change must emanate from political leadership’s initiative, central command, as well as its creative political strategy. From this perspective, I will analyze several policy domains that have recently undergone variable adjustments to a neoliberal international order, including corporate governance and labor relations (Chapter 6), international trade (Chapter 7), and banking (Chapter 8).

In Chapter 6, the ongoing reforms on corporate governance and labor relations will be analyzed. Both reforms are highly technical and are often referred to deliberative councils sponsored by bureaucratic ministries for detailed scrutiny. I will show that the LDP-led government has used not only conventional referral to deliberative councils, but also strategic referral to an advisory council in the Cabinet Office for radical change. The leadership employed the different referral strategies for policy change and maintenance, depending on who would be affected. The distinct referral patterns constitute the politics of counseling that is swayed by the governing coalition with some corrective influences from opposition parties.

In Chapter 7, I will turn to international trade. Trade is the linchpin of Japanese economic growth because it provides resources and markets for a resource-poor island state, also bringing international competition to the shore as a stimulus for efficiency improvement. Globally, because of the multilateral negotiation deadlock, the World Trade Organization (WTO) regime has permitted contracting states to conclude bilateral or regional free trade agreements (FTAs). In response, the Japanese government initially took to bureaucratic delegation – the four-ministry co-chair system – to adapt to the FTA movement under the devolved global trade order. By taking advantage of bureaucratic expertise, the system has concluded a number of technically sophisticated and mutually beneficial agreements with small economies, while satisfying the interests of efficient and inefficient industrial sectors at home. However, the bureaucratic system has been confronted with limits and the resulting unfavorable trade position. The Abe LDP Cabinet has shifted to central command to reach ‘welfare-improving’ FTAs with large economies, which are believed to stimulate economic growth but will generate a major distributive problem. I will show how the conservative cabinet used issue-dimensional politics with an emphasis on the national security imperative in relation to the US rebalancing strategy under changing security orders in East Asia, while
struggling to keep political support from the governing coalition via policy ideas borrowed from opposition parties.

Chapter 8 will shift analysis to banking and the politics of crisis. Banking, the key financing component of the Japanese-style CME, was faced with a new global financial order, defined by the Basel minimum capital requirements for commercial banks. Again, the LDP government initially used bureaucratic delegation to enforce the Basel requirements, based on the expectation that regulatory compliance with the requirements would help modernize the Japanese banking system and adapt it to the global order with a minimal influence on lending. However, an acute non-performing loan crisis shattered expectations, making coordination between compliance and lending intractable to the bureaucracy-led policy domain. I will show how crisis politics drew transnational financial networks and a major opposition party into the policy domain and led to eventual compliance by establishing a central command mechanism capable of implementing strict supervision and public fund injection to bail out banks.

Throughout Parts I and II, I will explain that the historical and contemporary Japanese political economies are both affected by the quintessential problem of adjusting public policy domains and economic institutions to shifting international orders through authority allocation schemes and political strategies. The mechanism and process of policy and institutional reform are not policy rational, but politically contentious and variable across time and policy domains. In the concluding chapter of this volume, Chapter 9, I will discuss the nature of political leadership for a non-liberal state faced with the neoliberal global order. I will discuss the political implications of a structural tendency toward central command and the impacts of transnational networks and opposition parties on policy and institutional reform.

NOTE

1. Adaptation and coordination approximate what Pempel (1998) calls the first-order change and second-order change, respectively, to characterize a regime change.