

Economic ideology and Japanese industrial policy

Developmentalism from 1931 to 1965

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1. Introduction

It has been a half-century since the end of World War II, the war that changed the course of modern history. How did this war affect our present life? This question was repeatedly raised and answered in Japan during the war's 50th anniversary. "With regard to the Japanese economy," writes economist Noguchi Yukio (1995), "the war never ended." Even today, after 50 years, the Japanese economy still operates, both institutionally and ideologically, by the "1940 system," a wartime establishment that was alien (*ishitsu*) to prewar Japan. This system, which overemphasizes production while rejecting competition, has resulted in "institutional exhaustion" – a major symptom of the "Japanese disease" that has made the nation's economy crumble. Senior bureaucrat Sakakibara Eisuke (1995) disagrees, however. He argues that present-day Japanese capitalism should be regarded not as alien but as parallel to developments in Europe and the United States – one of the three distinctive patterns of modern capitalism that evolved from a great transformation in the period between the late 1920s and the early 1950s. After World War I, the Communist Revolution, as exemplified in the Soviet Union, was not the only alternative to traditional capitalism. Capitalism in all major industrialized countries transcended the stage of *laissez-faire* and entered a new era of state intervention. From this process emerged democratic socialism, practiced in France and Britain; state socialism, practiced in Germany, Italy, and Japan; and the New Deal, practiced in the United States. Today's economic institutions in these countries still reflect the transformation that occurred decades ago. For this reason, says Sakakibara, one cannot judge whether Japanese capitalism is alien according to neoclassical assertions such as "consumer rights" or "perfect competition." Instead one should analyze this historical transformation from a comparative perspective.

Both Noguchi and Sakakibara have a point. It is true that the institutions and ideologies that originated in 1931–45 and helped to create

one of the world's strongest economies are now stifling rather than supporting the Japanese economy. It is also true that the wartime legacies have put Japanese capitalism on a totally different track in the postwar era and have made it a competing model to Anglo-Saxon capitalism, though the difference between Japan and its Western counterparts was deliberately denied during the Cold War. Many questions, however, remain: What kinds of institutional and ideological changes occurred in the Japanese economy in 1931–45? Why have the wartime legacies continued in postwar Japan? When we talk about these continuities, how should we count the impact of democratic reforms introduced by the occupation authority in the late 1940s and the changes in social and economic structures brought by high growth? In other words, is present-day Japanese capitalism simply a heritage of wartime or has it absorbed new elements in the postwar era? If the latter, what are these new elements?

This book addresses these issues directly and portrays the emergence of Japanese developmentalism – a distinctive set of economic ideas and ideologies on how to create wealth for a late-developed nation – in the period between the Great Depression and the end of World War II and discusses its postwar evolution. From a broad historical perspective, this book shows how the policy innovations of the state and the institutional reforms of the economy in 1931–45, governed by these ideas and ideologies, caused Japanese capitalism to depart considerably from pre-1930 practice (I will discuss why the changes in 1931–1945 can be regarded as a departure in Chapter 3). Moreover, many wartime ideologies and institutions survived the postwar democratic reforms and were reinforced to combat the economic crisis in the late 1940s; they adapted well to the Cold War situation and the global technological revolution in the 1950s; and they were further upgraded in the liberalization of trade and capital investment in the 1960s.

The continuities of the wartime institutions and ideologies in the postwar era have been sustained by three important factors. First, as a country heavily dependent on trade, Japan encountered great pressure to respond as a nation-state to the changes in the world system. The perceived external threats, such as the Cold War and the liberalization of trade and capital investment, often revived the wartime practice of national mobilization, though for different purpose. Second, the various versions of nationalism that rose and fell from 1931 to 1965 often promoted the legitimacy of policy goals in terms of collective survival

and downplayed the value of individuals. Popular ideology not only influenced public judgment on economic ideas; it also changed the way economists perceived the situation. As a result, many problems in today's Japanese economy were created and enforced in the name of the "national interest." Third, the vested interests in the state and in state-business relations often constrained the selection of means for industrial policy. Although certain new economic ideas changed the ways political actors perceived interests and formulated strategies, they alone could not influence policy outcome. They had to gain policy-making power by generating support from political and business elites.

Although the questions of how Japanese capitalism differs from Anglo-Saxon capitalism and what the origin of the difference is are as old as the field of Japanese studies, they have never been addressed as seriously in the past as today. Before communism collapsed in the former Soviet Union and the Eastern European countries, the ideological pressure to keep the Western bloc united remained strong. "During the Cold War," states Chalmers Johnson (1993:54), "there was only one capitalist god and He lived in the United States, even though there was growing awareness of very promising national churches in Germany and Japan." For this reason, Japanese studies in the United States had long been perceived as irrelevant to the mainstream of American economic, political, and intellectual life. Even when the sudden "loss of irrelevance" (Steinhoff 1993) of Japanese studies, due to the rapid expansion of Japan's economic power in the international market, posed a great intellectual challenge to Western social sciences in the 1980s, studies that focused on political and economic differences between Japan and the United States were still labeled either *revisionist* or *Japan bashing*. By the end of the 1980s, according to Johnson (1988), none of the major schools of Western economic theory, including neo-classical, Keynesian, and Marxist, had succeeded in explaining the Japanese achievement in economic development; the field of Japanese political economy was suffering "a crisis in theory." Speaking of the seriousness of this failure, Alan Blinder (1990:21) wrote that "all in all, economists weaned on Western economic thought must conclude that Japan does almost everything wrong. Such a litany of errors should cost them dearly. Yet Japan's economy is a dynamo. How do they do it? American capitalism rests on a grand theory began by Adam Smith. There is no comparable theory of Japanese capitalism, but we need one

if we are to formulate an intelligent economic policy toward Japan. The Japanese themselves seem less concerned with conceptualizations than with results. So, we may have to produce that theory ourselves.”

Since that time, however, the serious academic efforts to build theory on Japanese capitalism have been shaken and divided by a succession of striking changes in the world, which make some people believe that this task has become less significant. First of all, communism collapsed in the former Soviet Union and the Eastern European countries, one of the most important historical events of the twentieth century. Predicting the impact of this great transformation on our future, Francis Fukuyama (1989:3–4) states that

the ultimate triumph of Western liberal democracy seems at its close to be returning full circle to where it started. . . . What we may be witnessing is not just the end of the Cold War, or the passing of a particular period of postwar history, but the end of history as such: that is, the end point of mankind’s ideological evolution and the universalization of Western liberal democracy as the final form of human development.

Fukuyama’s argument suggests that there no longer exists any ideology to compete with the orthodox view of economic liberalism and democratic politics now that both fascism and communism, not to mention the Japanese variant of capitalism, have disappeared from the historical arena.

Second, in the past few years, Japan’s seemingly irresistible competitiveness has declined suddenly as a result of the breakdown of Japan’s bubble economy in the worst economic stagnation since World War II. Many Japanese firms have lost their edge in international competition in several strategic industries, notably automobiles, computers, and software, where American firms are demonstrating a comeback. In addition, the widely praised practices of lifetime employment and the seniority-based wage system have become problematic; many prominent Japanese companies have begun to lay off their employees under the pressure of recession. The reaction in the West verges on sensationalism. The prominent British business magazine *The Economist* (1994) issued a special edition titled “Oriental Renaissance,” in which it argued that “Japan’s working practices and institutions were successful only at times of very high growth. Many had built-in obsolescence.” Success has made this system outmoded, declared *The*

Economist, even among those who once preached it, and Japan is converging with the West.

The reality, however, is much harsher than assumed by Fukuyama and *The Economist*. More than at any time in history, the conflicts among countries' institutionalized beliefs about how the economy works may challenge the order of the international economy. Capitalism, both its institutions and its ideologies, never has been homogeneous and probably never will be. "With their common enemy consigned to history, capitalist countries are starting to skirmish over the relative merits of their systems" (Neff 1993). Comparative capitalism is replacing comparative communism, emerging as a leading research agenda in this post-Cold War era. In the 1980s, Japanese government officials tended to avoid involvement in direct intellectual confrontation with Western countries, especially the United States, for various political reasons. In the 1990s, however, they have become very outspoken, strongly defending the legitimacy of Japan's economic institutions. Eisuke Sakakibara (1993:v) argues that "a neo-classical, or neo-American, view of capitalism, which dominated the world in the decade of the 1980s, seems to have passed its peak. . . . The post-socialist age may also become a post laissez-faire age." What does this change of attitude mean? According to Japan's former prime minister Nakasone Yasuhiro and his three advisors, Anglo-Saxon capitalism can no longer claim universality because developmentalism, which is based on the market economy but admits active intervention by the state, is spreading out in East Asia. Whether these two types of market economies can compromise with each other will determine the international order in the future (Nakasone, Murakami, Satō, and Nishibe 1992:168). It is argued that because capitalism differs across national borders as a result of various historical and cultural backgrounds, and will continue to do so, the countries "will have to accommodate each other in certain ways. In some instances, these accommodations may take the form of modification of the principle of laissez-faire" (Sakakibara 1993:vi). In this sense, asserts David Williams (1994:xiv), "history will not end until Japan, and much of East Asia with her, is made to conform to this new consensus. Until this happens, the world will stand beyond the end of history regardless of what has happened in Eastern Europe." Samuel Huntington (1993) warned that the fundamental source of international conflict in the post-Cold War era will be

primarily cultural because the conflicts between deeply institutionalized beliefs and value systems in different civilizations through hundreds or even thousands of years of history will not disappear easily. As the interactions between peoples of different cultures increase, cultural consciousness will be intensified; eventually the result may be the “clash of civilizations.”

The challenge to international economic order created by the differences in economic ideologies is heightened by the fact that many former socialist economies and developing countries are attracted by the Japanese model of economic development. At the beginning of the transition from a planned economy to a market economy, the former Soviet Union and the Eastern European countries embraced the doctrine of neoclassical economics and attempted to turn a planned economy into a market economy through *shock therapy*. As this program has failed to deliver what it promised, many government officials and intellectuals in the former socialist countries perceive the Japanese experience of managing the economy as a valuable lesson. In addition, the Japanese developmental strategy has been regarded as the secret of economic success in many newly industrialized countries in East Asia and developing countries in Latin America. Moreover, as *Business Week* (1994 Special Issue:32) reports in a special issue entitled “21st Century Capitalism: How Nations and Industries Will Compete in the Emerging Global Economy,” dozens of Japanese

from ministries, think tanks, and universities have spread out through Eastern Europe and Southeast Asia to proselytize Japanese-style economics to governments eager for advice. This missionary work goes largely unnoticed by the Western press, but in the next decade it could have a profound effect on global capitalism. . . . A likely outcome of this quiet counsel: Many nations will absorb at least some of the lessons of Japanese industrial policy, which include protection of infant industries and emphasis on exports. As a result, the world probably won't embrace wholesale neoclassical, American-style capitalism, which largely trusts markets over state intervention.

Because the Japanese type of capitalism has been, is, and will be practiced by many countries in an increasingly interdependent international economy, the intellectual foundation of Japanese industrial policy and business strategy deserves serious study. It is not only an academic research agenda, but also has important implications for the international political economy. Deliberately neglecting the differences because we do not like them will simply keep us from making serious

yet realistic efforts to build a better framework for the international economy in the future. To replace the objective examination of what exists with ideological assertions of what should be is the major barrier to such an effort.

This book aims to contribute to the existing literature on Japanese political economy in the following ways.

First, it shifts the focus of analysis on Japanese industrial policy from the conventional, actor-centered approach, which focuses on who won the battle in policy making, to an institutional perspective that emphasizes the impact of industrial policy on the transformation of the governance of the Japanese economy.

Since Chalmers Johnson presented the theory of the *developmental state* in his classic study on the Ministry of International Trade and Industry (MITI) in 1982, many studies on Japanese industrial policy have emphasized whether the state policy has been influenced or resisted by the private sector. Among the state, nonmarket governance structures, and the market, the focus of dichotomy in the debate has been located between the state and the other two, but whether the private sector was regarded as the personalized nonmarket structures or the personalized market is often unclear. These studies have certainly enriched our understanding of the important role played by the private sector in both the policy-making process and economic growth. Nevertheless, as David Williams (1994:194) points out, developmental state is a *macro theory* in which the nation-state is the unit of analysis. This theory is based in part on a comparison with Anglo-Saxon capitalism. Thus, micro-level analyses, which focus on the conflicts within Japan's policy community, cannot replace discussions of the institutional differences between Japanese capitalism and its Western counterparts at the national level.

In this book, I shift the focus of dichotomy from the state to the market. I argue that the most important distinction between developmentalism and liberal capitalism is not how the state is constrained by the private sector, but how the market is organized by both the state and nonmarket governance structures. As economic growth strengthened the power of the private sector in domestic politics and foreign countries, especially the United States, often pressured Japan to eliminate the barriers between foreign companies and Japanese markets, nonmarket governance structures in many cases have replaced direct

bureaucratic control. In history, however, the development of these structures had been driven primarily by the industrial policy practiced by the Japanese state. *Governance structure* refers to the mechanisms that interdependent economic actors adopt to organize their business transactions and to solve their problems in order for economic activity to continue. In this matrix of social relationships, the market is simply one type of governance structure, and its weight varies considerably among different capitalist economies. The obligational network, hierarchy, monitoring, the promotional network, and trade associations also play a very important role in organizing economic life (Lindberg, Campbell, and Hollingsworth 1991:5–6). These mechanisms, as alternatives to the market, constitute “the vast area of social regulation – the social arrangements that condition and shape microeconomic choices . . . [and] encompasses all of the divers ways in which individual economic behavior is embedded in a broader social framework” (Block 1990:42). The state, moreover, plays a very important role in developing nonmarket governance structures of the economy. According to Leon N. Lindberg and John L. Campbell (1991), the state affects the governance of the economy not only through direct control of resource allocation, but also through defining the range of organizational forms by establishing the rules within which economic activity takes place and by facilitating the development of more multilaterally and formally organized governance mechanisms to achieve its goal in economic development. As Alfred Stepan (1978:xii) points out, the state attempts “not only to structure relationships between civil society and public authority in a polity but also to structure many crucial relationships within civil society as well.”

In the Japanese case, I further argue, the development of nonmarket governance structures resulted directly from the politics of industrial policy, whereby the state often attempted to constrain the market forces through bureaucratic control, while the private sector fought hard to protect its own interest. As a political compromise, nonmarket governance structures prevailed. They served as a tool not only for the private sector to resist direct bureaucratic control, but also for the state to constrain the market forces in order to achieve its policy objective. Rather than focusing on who beat whom in policy making, I emphasize the mutual impact both sides had on each other on the institutional evolution of the governance of the Japanese economy. The private sector indeed often conflicted with the state, but it did not always reject

the idea of organizing the market. What it cared about was whether it could organize the market by itself and what kind of mechanism could protect its interest best. Thus, the real point at issue regarding the conflicts between the state and the private sector in developmental politics is often *how* to organize the market in economic development rather than *whether* the market should be organized.

Second, this book stresses the role played by ideas and ideologies in formulating state industrial policy and shaping the direction of the institutional evolution of the Japanese economic system.

Ideas and ideologies are important to modern politics. According to Peter Hall (1989:383), policy making occurs in the context of a prevailing set of ideas:

These include shared conceptions about the nature of society and the economy, various ideas about the appropriate role of government, a number of common political ideals, and collective memories of past policy experiences. Together, such ideas constitute the political discourse of a nation. They provide a language in which policy can be described within the political arena and the terms in which policies are judged there.

Although ideas and ideologies are not the only forces driving modern politics, they are indispensable to understanding the political process of state policy making because “beliefs about causal connections between interests and policies are at least as important as the nature of the interests themselves” (Goldstein 1993:237). Atul Kohli (1994) remarks that studies of developmental states so far have focused more on a state’s capacity to implement its policy goals than on the origins of those goals, and believes that future research on developmental states should focus explicitly on “the politics of how developmental goals emerge as a priority.” Taking this perspective seriously, I give economic ideas the central place in the analysis of Japanese industrial policy. By doing so, I change the developmental state from an independent variable to the dependent variable, examining how the developmental programs adopted by the Japanese state were shaped by modern politics and what role ideas and ideologies played in the policy making.

Ideas and ideologies not only shape policy outcomes, they also express the meaning contained in the institutions that evolved in the politics of industrial policy. On the one hand, these ideas and ideologies are subjective. They are neither a collection of analytic abstractions and transcriptions of an already given reality nor a set of principles for

purely utilitarian calculations. Rather, they are a symbolic instrument, a “cultural tool,” and a “construction of the world” by which economic actors discover, elaborate, and express the meaning of their life in an effort to create an order for this temporal world (Block 1990; Gudeman 1986; Swidler 1986). On the other hand, the rational meaning (an institutionalized rule in its infant state) is real and concrete. It reflects the realistic reasoning of actors concerning how to handle their relationship in economic activities effectively rather than an outcome of ceremonial conformity to any existing rules of culture. Only after they are accepted by all parties concerned through a political process do rational meanings become institutionalized rules. As the meaning contained in these ideas and ideologies does not have much ritual power in comparison with its later state as “highly rationalized myth” (Meyer and Rowan 1977), it is an important indicator of the power structure that shapes institutional creations and reproductions, as well as the rationale that economic actors decided to accept certain practice as their agreed pattern of “industrial culture” (Dobbin 1994; Dyson 1983).

For these reasons, I do not analyze the Japanese experience by applying Western economic theories; instead, I emphasize *how the Japanese themselves thought about economic development*. John Hicks (1969:6) once pointed out that “the way in which the economist develops his hypotheses is by asking himself the question: ‘What should I do if I were in that position?’ It is a question that must always be qualified by adding: ‘if I were that kind of person.’ . . . It is only by getting a feel of what people were like that one can begin to guess.” Joseph A. Schumpeter addressed the same issue. He argued that the application of an analyst’s own model in studies of the economic behavior of others

does not in itself say anything about reality or about anybody’s actual behavior or rationality. It is of particular importance to note that even if the model should fit anyone’s behavior this does not mean that the individual in question consciously aims at the result and still less that he arrives at it by processes at all similar to the analytic procedure. . . . Beyond very simple cases which we may hope hail from an almost universal pattern of human behavior, understanding an end and judging rationality of means often requires that the analyst ‘put himself’ into places very far distant from his time and social location. Sometimes he has to transplant himself into another cultural world. (Swedberg 1991b:321, 325)

I argue that the ways in which the Japanese perceived the situation, formulated their strategies, fought for legitimacy, and confronted each other and structural change at each turning point of economic development have strongly influenced the kinds of goals that were set for industrial policy and the kinds of economic institutions that were derived from the implementation of industrial policy. Therefore, they can best reveal the economic rationale underlying Japanese industrial policy and the nature of Japan's economic institutions.

Third, this book intends to highlight the importance of history in understanding the dynamics in the evolution of modern economic institutions.

Peter Berger and Thomas Luckmann (1966:54–5) point out that “institutions always have a history, of which they are products. It is impossible to understand an institution adequately without an understanding of the historical process in which it was produced.” For this reason, both Paul DiMaggio (1988) and Stephan Krasner (1984) argue that the causal arguments appropriate for periods after the institution is established may not be appropriate for periods of crisis when institutions are first created or are undergoing dramatic changes. Thus, “only a dynamic analysis can handle the problem of institution formation in the economy” (Swedberg and Granovetter 1992b:19). Institutions, moreover, do not evolve in an incremental pattern, but rather in the form of *punctuated equilibrium* (Krasner 1984). A new practice is often institutionalized as a response to rapid structural changes as actors urgently seek new solutions when the established practice is discredited by crisis (Dobbin 1994; Krasner 1984; Weir and Skocpol 1985). As Okazaki Tetsuji (1993:97–8) argues, the economic system, as an equilibrium of multiple institutions that complement each other, lives on path dependence. When a crisis in history creates changes in these institutions simultaneously, it will shift to a new equilibrium that is different in nature from the previous one. Even after the great shock that stimulated the institutional recomposition disappears in history, the repatterned economic system will continue irreversibly on its own inertia.

Embracing the neo-Weberian position that “one can only hope to find and explain historically specific patterns and sequences of transformation” (Lindberg, Campbell, and Hollingsworth 1991:4), I re-elaborate Karl Polanyi's ([1944] 1957) perspective, which regards fascism, socialism, and the New Deal as three distinctive patterns with

which industrialized countries responded to the failure of the self-regulated market indicated by the Great Depression and the disorder of the international economy and military confrontations among nation-states. According to Polanyi, the power and dynamism of fascist movements were not a function of their capacity to recruit supporters but rather a result of their ability to provide an alternative solution to the impasse of liberal capitalism. Despite the fact that Germany, Italy, and Japan were confronted by conjunctural problems common to all industrialized countries in the between-wars period, they inherited structural problems peculiar to their own countries. As a result, "the economic policies of Italy, Germany and Japan differed notably from those of the capitalist countries in the 1930s" (Woolf 1968:142). Fascism was not only a political system, it also had enormous economic implications. Economically, fascism was not only a system of war mobilization, but also a major revision of many basic principles of liberal capitalism. It was this latter facet of the wartime system that distinguished Japanese capitalism from liberal capitalism in 1931–45 and transformed the Japanese economy into an alternative model of development in the postwar environment. This is not to say that the Japanese economic system is still fascist, but that without taking the impact of fascism into account, we cannot explain fully the irreversible departure of the Japanese economy in 1931–45 from its pre-1930 practice, both institutionally and ideologically.

Fascism has been regarded as an inadequate concept with which to interpret Japanese politics in 1931–45 (Duus and Okimoto 1979). Our present concern with comparative capitalism, however, has bestowed on this concept new significance. The 1930s can be viewed as an intersection of history at which the patterns of policy innovations and institutional reforms shared by Germany, Italy, and Japan not only reflected the tensions and contradictions generated in their singular paths to industrialization, but also represented a major revision of liberal capitalism that considerably shaped the track of these economies in the years that followed. As an analytical category, fascism demonstrates one distinctive pattern of the institutional recomposition of capitalist economies in the 1930s that led to further development of the diverse forms of capitalism in the postwar era. Rather than using fascism as a holistic concept to label the entire Japanese economy in 1931–45, I treat fascism as one of the important variables that led to a renaissance of the Japanese economic system with a strong develop-

mental orientation. Instead of using the conventional definition of fascism, which emphasizes primarily politics, I confine the discussion of this concept to its basic economic principles.

Although the rise of Japanese developmentalism in 1931–45 was influenced by fascism, its postwar evolution was shaped by liberal capitalism in the form of the Pax Americana in three different ways. First, the land reform, new labor legislation, the *zaibatsu* dissolution, and the new constitution that prevented Japan from declaring war democratized the Japanese economy and eliminated its military components. Second, the implementation in 1949 of the Dodge plan, which reconnected the Japanese economy with the international market, and the liberalization of trade and capital investment in the 1960s, which forced Japan to open its domestic markets, changed Japanese developmentalism from an inward-oriented economic system characterized by strong bureaucratic control to an externally oriented economic system characterized by both strong leadership of the state and entrepreneurship of the private sector in international competition. Third, the U.S. policy of using Japan to contain communism during the Cold War also helped preserve many wartime institutions, such as the state bureaucracy and the main bank system. As a whole, the Pax Americana has not turned the Japanese economy toward the Anglo-Saxon type of liberal capitalism. Instead, it made various developmental elements of the wartime economic system, which were first derived from fascism, compatible with a new, democratic political institution and a free trade regime. In other words, the Japanese economic system was forced to make great adaptations, but it has been able to retain its developmental nature. Barrington Moore (1966) argues that fascism as a political system could coexist with capitalism as an economic system before the end of World War II. I argue the opposite way: that the policy innovations and institutional developments influenced by fascism during 1931–45 as an economic system, after certain adaptations, could coexist with democracy as a political system in the postwar era. As an alternative model of industrialization, moreover, this economic system has demonstrated great strength in international competition in peace.

Fourth, this book advances the research agenda of comparative capitalism by exploring the institutionalized beliefs of developmentalism reflected in Japanese industrial policy and economic institutions. The book shows that despite changes, sometimes substantial, in its leading propositions, Japanese developmentalism possesses certain