

# Structural Reform in Japan: An Intellectual History\*

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## I. Introduction

During the long stagnation of the Japanese economy, commonly known as Japan's Great Stagnation, "structural reform (Kozo Kaikaku : 構造改革)" has become a buzzword. The concept is elusive, yet powerful enough to influence the policy discussions during the period.<sup>1</sup> The paper traces intellectual origins and lineages of this concept, exploring the interactions between academic and popular economic discourse and those between Japanese and international contexts. I shall argue that there are several strands of economic thought which have merged into forming the concept and become appealed to the Japanese economists as well as the public. Historically, structural reform has been used as an alternative, and even an antithesis to Keynesian-style demand-management macroeconomic policy, therefore it has a strong affinity with austerity policy (Blyth 2012). Also this has similarities with the structural adjustment program advocated by the international organizations against the background of the transformation of macroeconomics and macroeconomic policy during the 1970s after the Great Inflation. Therefore, one is tempted to argue that structural reform is a part of the so-called neo-liberal economic thought (Mirowski and Plehwe 2009, 7-9). Certainly there are some elements of truth in it, but structural reform in Japan is not necessarily a part of neo-liberal economic thought, rather a part of Japanese economic thought. First, there has been a tradition which has strong preoccupation with structural factors in the Japanese economy in the history of Japanese economic thought, Marxism and developmentalism in particular (Gao 1997, Wakatabe 2013). Secondly, the Japanese economists have absorbed the developments in economics in the 1970s, and turned it to economics with a particular emphasis. Moreover, structural reform has been also a political, policy, and popular slogan for a movement, and as such rhetoric and tactics in the media discourse matter greatly (Mata and Medema 2013). In this context, the role of policy entrepreneurs and media pundits cannot be overlooked. The prime example was Heizo Takenaka (1951-) who was the closest advisor to Prime Minister Junichiro Koizumi, becoming a Minister for Economic and Fiscal Affairs in April 2001: together with Prime Minister Koizumi, he led "Seiiki naki Kozo Kaikaku (Structural Reform with no sacred cows)".

The paper is organized as follows. The next section explores the emergence of the concept, tracing possible sources. Section III deals with the heyday of structural reform in Japan as the movement. The last section concludes the paper.

## II. The Ideas

The exact origin of structural reform is hard to trace. One source in economics was "structural adjustment" advocated mainly by economists related to development economics and international organizations.<sup>2</sup> Its emphasis on macroeconomic stabilization, usually austerity measures, and structural policy package including deregulation, liberalization, and privatization has strong affinity with structural reform, but Japan was been among the developing countries which needed cure and remedy. Rather, Japan was considered as a success until the 1990s. Another important source was the market-oriented reforms of Reagan and Thatcher administrations from the late 1970s to the 1980s. Clearly this experience later became a focal point and model for advocates of structural reform, but I shall argue that the origins are more rooted in Japanese economists' perception of the Japanese economy. As for the timing, some economists advocated the wholesale change of the system before the Reagan-Thatcher reforms.

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<sup>1</sup> Atsumi 2006 lists 15 different definitions of structural reform during the Koizumi administration era.

<sup>2</sup> "The etymology of structural adjustment appears to await scientific study" (Fisher 1995, 21).

There was a series of innovations to economic theory during the 1970s. Game theory in the non-cooperative setting and the economics of information revolutionized applied microeconomic theory including industrial organization and international trade. Along with the insights of new institutional economics of Douglass North and the economics of the firm of Ronald Coase and Oliver Williamson, economists became more equipped with analytical tools to understand a wide variety of customs, habits and institutions which had been once considered as “unique” or “peculiar”. This has enabled Japanese economists to analyse, explain, and even justify the “unique” or “peculiar” Japanese economic institutions or system in terms of mainstream economics. One example is the reconsideration of industrial policy in Japan. Although the general tone of the conference volume which was devoted to the topic was highly critical toward the efficacy of industrial policy (Komiya et al. 1984), the theorists presented their papers viewed industrial policy in a more positive manner than the previous literature (Ito et al. 1988).

Masahiko Aoki (1938-) represents this trend in Japan. He used to be a radical student activist,<sup>3</sup> turning to mathematical economics, having received Ph.D. at Minnesota. His interests have moved from resource allocation mechanism design à la Leonid Hurwicz, to a game-theoretic new approach to firms and organizations, and eventually to comparative institutional analysis. Although Aoki specifically denied that his was an uncritical justification of the Japanese economic system, saying that he “did not side with Japan as No.1 thinking à la Ezra Vogel’s bestseller” (Aoki 2008, 169-170), his analysis was welcome since it was the day that the Japanese economic system received a considerable amount of attention and Aoki offered an explanation based on analytical tools of mainstream economics. According to him, the Japanese economic system is a coherent one with rank-hierarchical personnel and decision-making structure; it can perform well under certain conditions, yet may not be easy to change since components of institutions have strong complementarity. However, he did not really specify what went wrong with the Japanese economic system after burst of the bubble in late 1980s except to say that global competition intensified. Also it lacked any discussion of macroeconomic factors despite his casual remarks about the bubble and its burst: conspicuously absent was any discussion about deflation which has been hotly debated subject.

The most influential argument for structural reform directed toward the general public came from Noguchi and Sakakibara 1977. The authors, Yukio Noguchi (1942-), and Eisuke Sakakibara (1941-) who both came from the Ministry of Finance, having received Ph.D. in economics from American graduate schools, later to become influential economists and media pundits. They argued that the post-War economic system was forged during the War time, and it remained intact despite post-War reforms by the American occupation forces. Against this background, the post-War economic system was highly controlled one with the Ministry of Finance and the Bank of Japan as the arbiter. But this system, so they argued, could not survive in a new changing environment: Japan needed a wholesale systemic reform. It is true that as economists they introduced the concept of rational expectations into Japan, and were highly critical about the Keynesian economics, but their arguments were framed toward the Japanese context. Later, Noguchi were to write in a similar vein, popularizing the word “1940-nen Taisei [the 1940 system]” (Noguchi 1995, 1998).

Aoki’s comparative institutional analysis and Noguchi and Sakakibara’s perspective inspired other economists. Group of economists led by University of Tokyo professors conducted an economic and historical analysis of the origins of the Japanese economic system (Okuno-Fujiwara and Okazaki 1993). For the financial sector reform, Kazuhito Ikeo (1953-) played an important role. He is an expert on banking known for his contributions to banking applying the economics of information (Ikeo 1985), advocating the “Big-Ban” approach to financial sector reform. He attacked the inefficiency of Japan’s financial sector as a remnant of developmentalism: once it was successful, yet it became outdated (Ikeo 2006). However, his diagnosis and remedy are also heavily influenced by “institutional” or “system” approach. The outmoded Japanese economic system should be replaced by newer economic system altogether, thus he endorsed the wholesale reform of the financial sector. But unlike Takenaka, in the course of Japan’s Great Stagnation, he became more pessimistic toward the possibility of reform and curability of the Japanese system (Ikeo 2003). When he was asked by Takenaka to join the expert team for non-performing loan issue, the so-called

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<sup>3</sup> As a radical student activist, he wrote several articles and a book on State monopoly capitalism, and translated Leon Trotsky’s works into Japanese. While he was at Harvard, he befriended with radical economists including Samuel Bowles, and Herbert Gintis.

Takenaka Project Team, in October 2002, he declined the offer referring to the impossibility of reform.<sup>4</sup>

There was a powerful dissenting voice. Yasusuke Murakami (1931-1991) wrote his magnum opus in 1992 (Murakami 1992), extending the concept of “developmental state” of Chalmers Johnson (Johnson 1982), he defend developmentalism as much a coherent and justifiable economic system and thought as a Western one: it was the system relied on dynamic increasing returns whose implication led to some form of industrial policy, protectionism and regulation. But he was keenly aware of the important role of efficient bureaucracy. In this sense, his analytical framework was similar to Aoki’s and those analysts of industrial policy. Surely his favourable evaluation of developmentalism is different from others, yet it is noteworthy that both sides shared the same concept and framework.

These academic discussions were to feed into a popular account of what went wrong with Japan by a foreign observer. The prime example is Katz 1998 which argued that the nature of Japan’s economic malaise lied in Japan’s failed transformation from “developmental state”: “The root of the problem is that Japan is still mired in the structures, policies and mental habits that prevailed in the 1950s-60s. What we have come to think of as the ‘Japanese economic system’ was a marvellous system to help a backward Japan catch up to the West. But it turned into a terrible system once Japan had in fact caught up” (Katz 1998, 4).<sup>5</sup>

Those authors who argued for the once efficient and effective developmental economic system did not provide systematic evidence: for instance, the success of Japan’s industrial policy was taken for granted rather than tested.<sup>6</sup> Other possible contributing factors to Japan’s high economic growth including macroeconomic policy, trade liberalization, highly educated working population, or were not taken into account.

### III. The Movement

The elusive nature of structural reform is best illustrated by in its policy context. It is true that the Nakasone administration (1982-) implemented the privatization of Japan National Railway and Nippon Telephone and Telecom (NTT), and tried to consolidate fiscal balance. But austerity measures did not really persist. In 1985, the Japanese government agreed with the U.S., and West European governments to appreciate Yen against the background of Japan-U.S. trade disputes. The government further pushed for expansionary fiscal policy based on “Naijyu Kakudai Ron (Increased Domestic Demand Argument)”. It argued that Japan, along with the U.S., and then West Germany, was responsible for expanding their domestic demand to correct international imbalance. The landmark policy paper was what was popularly known the Maekawa report<sup>7</sup>: the government report of a committee headed by former BOJ Governor Haruo Maekawa advocated the expansion of domestic demand for Japan as the solution to trade surplus problem. Here structural reform was linked with expansionary fiscal policy, therefore it defied the usual association between structural reform. Also the booming economy from 1987 to 1990 generated enough revenue to close the fiscal deficit, so the call for fiscal consolidation faded out for a while.

Everything changed after the bubble burst. During Japan’s Great Stagnation, the governments struggle to revive the economy, but failed to sustain it. Economists have been still arguing about the true cause(s) of stagnation, but two things are certain. First, the governments and the Bank of Japan did not pursue expansionary macroeconomic policy consistently: the Hashimoto administration (1996-1998) raised the consumption tax rate from 3 to 5 % in April 1997; the Bank of Japan raised its policy rate in August 2000: in both cases, the economy plunged back into recession. Secondly, structural reform emerged as the main pillar of economic revitalization plan of successive governments. First came the Hashimoto administration which had an ambitious six-point Economic Structural Reform Plan, then Junichiro Koizumi and Heizo Takenaka.

Heizo Takenaka is an outsider to Japanese academic circle. He did not graduate from a graduate

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<sup>4</sup> Takenaka 2006,59. He did not name the person in question, but it was believed to be Ikeo (Ono 2005, 45).

<sup>5</sup> He specifically referred to Ito et al. 1988.

<sup>6</sup> The effectiveness of Japan’s industrial policy has been questioned in the literature. See Beason and Weinstein 1996.

<sup>7</sup> See the full text in Okimoto and Rohlen 1988, pp.252-256.

school, but he managed to learn and teach economics.<sup>8</sup> Indeed economics is his main weapon, although his economics has been formed during his stay at the U.S. in the 1980s. American experience showed him three “models” for his later career. One is literally mainstream economic models. The 1980s was the heyday of rational expectation revolution and supply-side economics: this would later become the backbone of his policy.<sup>9</sup> The second one is the American economy and society itself: he were to use the U.S. as reference point for reform in Japan. The third one is that of economic policy-making: he was mesmerized by the “revolving door” style engagements of policy-oriented professionals in the U.S., and later consciously tried to import its economic policy-making style by promoting think-tank activities and becoming a policy entrepreneur himself. Also he consciously appeared on media, TV in particular, to propagate his ideas. He is a public intellectual in the age of markets for ideas (Mata and Medema 2014).

As for his economics, he showed some sympathy toward the “Shock therapy”. Referring to Jeffrey Sachs’s program for the former communist countries, he said that “in general, the shock therapy has not been popular in Japan. . . Even though Japan is a country of gradualism, it is greatly doubtful that gradualism has been successful. . . On the other hand, it could be argued that Japan has adopted a shock therapy at critical junctures” (Takenaka 1993, 80-81). As the stagnation of the Japanese economy became apparent, he became more and more convinced that the root cause of the problem was structural, in the sense that Japan lost its ability to adjust to the changing more global environment: “More important is the basic point that the Japanese economy has lost an enough adaptability, while the market economy around the world has significantly transformed” (Takenaka 1999, 16).

As for his policy, he confounded the concept of structural reform since he was so flexible that he could . During his term, he tackled the non-performing loan problem and the privatization of the Japan Post. It would be debatable whether the former could count as structural reform, and the problem was solved not because his tougher approach to the bank supervision succeeded but because the economy recovered from early 2002. However, it was his evolution and flexibility which eventually saved Takenaka’s reputation: unlike other proponents of structural reform, he was to worry about deflation: he mounted an increased pressure on the Bank of Japan to engage in more expansionary monetary policy. Without full-fledged cooperation by the Bank of Japan, he could not overcome deflation, but deflation pressures subsided in 2004-6, thanks in part to booming world economies: macroeconomic recovery helped to advance structural reform.

Structural reform was hugely popular among the general public during the Koizumi structural reform period. According to the public opinion survey conducted by Asahi Shimbun (Asahi Newspaper, the second largest circulating newspaper in Japan), the support for the Koizumi administration fluctuated during his term, while the support for his structural reform was mostly more than 50 % and constant (Kume 2010).<sup>10</sup> As a movement, structural reform had the flare of revolution. It is ironic since reform is usually an alternative for revolution.

#### IV. Conclusion: Will Structural Reform Be Dead?

The reputation of the Japanese economy has fluctuated measurably during the post-War period. Accordingly, the main arguments on the Japanese economy have fluctuated: it changed from the story of strengths to that of weaknesses. But the main tenet remains the same: they have always concentrated on structural factors. The evidence about the efficacy of structural reform has been mixed (Teranishi 2010, Hoshi and Kashyap 2011, 2012),<sup>11</sup> but the call for structural reform dies hard. As of now, economic policy package

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<sup>8</sup> He eventually received his Ph.D. in economics from Osaka University. He wrote a book on his term as government ministers. For his life and work, Sasaki 2013 offers a highly critical—perhaps too critical—account.

<sup>9</sup> His first work Takenaka 1984 based on his thesis was about the economics of R&D and other investment decision making using rational expectation approach to investment.

<sup>10</sup> This does not mean there was no contemporary critic; on the contrary there were many. See for example Noguchi and Tanaka 2001.

<sup>11</sup> As Quiggin 2010 reports, the evidence on market-oriented reforms has been also mixed. Also the “big ban” approach is misperceived. OECD economist concluded their study to the effect that “Arguably, none of the examined countries

of Prime Minister Shizo Abe, the so-called Abenomics, is at the centre of economic debate, but many commentators tend to dismiss the significance of macroeconomic policy embodied in the first and second arrows, instead emphasizing the growth strategy, the third arrow. In this sense, it resembles “Zombie economics,” a term coined by Quiggin 2010. However, it is misleading to say that structural reform in Japan is a fashion motivated by neo-liberal thought or mainstream economics: some of its origins have preceded the Thatcher-Reagan reforms, and been inspired by multiple strands of thought.<sup>12</sup> Also, it has been historically rooted more deeply into preoccupations of economists in Japan. Nevertheless, structural reform is an idea for times of crises: it has self-perpetuated in times of crises, and it has not gone yet. In all probability, it will remain with us.

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(which do not include the transition countries) has ever tried a “big bang” approach to structural reform. Even the United Kingdom during the Thatcher administration and New Zealand in the 1980s and Australia over the past two decades can in reality better be described as sustained reform efforts over relatively long periods of time” (Høj et al. 2006).

<sup>12</sup> Eisuke Sakakibara traced genealogy of debates on the Japanese Economy back to debates within the Marxians, Koza-ha vs. Rono-ha, in the 1930s, and “two-tier economies” debates in the 1940-50s (Sakakibara, 1993, Appendix A).

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