

# TOWARD A BETTER UNDERSTANDING OF THE INDUSTRIAL AND TRADE POLICY OF MITI

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## Introduction

Just as physics is built on theories dealing with the motion and force of the atom, so economics has been built, since the times of Adam Smith, on theories of the nature and behavior of homo economicus (or economic man). In the industrial West, one has the feeling that there is not much difference between the man in flesh and blood and homo economicus the abstraction, while in Japan there is a considerable difference between the two. This may explain the widespread myth harbored by the peoples of the West of the inscrutability of Japanese economic behavior.

Therefore, the key to understanding the economic behavior of the Japanese and their economic policy lies in identifying the causes of this difference. To gain a proper perspective, one has to dig down into the social history of the Japanese people and grasp the characteristics which distinguish the "homo economicus japonicus" from homo economicus of Adam Smith. In my personal view, the *genus* of the contemporary Japanese may be traced to the three prototypes of (1) the *samurai* (or the warrior caste), (2) the merchants, and (3) the farmers. At this point, I would like to review the ethics or the rules of conduct peculiar to these three social classes which existed in the period preceding the Meiji Restoration of 1968.

## Ethics of Samurai

During the reign of the Tokugawa shogunate which lasted from 1603 to 1867, Japan was divided into 300 "HAN" s of feudal fiefs (HAN was a local government in the Tokugawa period extending over a territory allocated by the Shogunate and *presided* over the *samurai* class). The *samurai* were the ruling

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class of the HAN, and their status and rights within the HAN were made hereditary. Each HAN contained a tightly-knit community of *samurai*. Since the HANs were often at loggerheads with one another, HAN demanded unquestioning loyalty of their *samurai*, who themselves considered such loyalty as the supreme virtue, and an appropriate answer to the grace given to them by the HAN.

Following the establishment of the Tokugawa shogunate, peace and order reigned over the entire country. The shogunate enforced strict national seclusion and maintained an effective check of ambitious domain lords, and for the ensuing 250 years, Japan was spared the disturbance and destruction attendant upon a war with a foreign country or upon a battle between feudal clans. Being blessed with peace, the major concern of each HAN was directed to improving the economy within their domain, and this put an extra demand of entrepreneurship on the *samurai*.

With a view, therefore, to systematizing the rules of conduct demanded of the *samurai* and to fostering their leadership quality and managerial *acumen*, the Tokugawa shogunate sought to establish the system of values and social code elaborated by Confucius of China in the 6th-5th century before Christ, known as Confucianism.

Confucianism emphasizes self-fulfillment through stoical cultivation of mind and service to the community. It rejects mysticism and irrationalism and attaches great value to learning rather than to believing; it lays stress on a pragmatic and rational approach to life. It teaches its followers that a pragmatic and rational life of individuals leads to the development of an orderly and prosperous society. The *samurai* subscribed to such teachings of Confucianism, which formed the basis of their ethics.

### **Ethics of the Merchants**

In the hierarchical structure of the Japanese society of the Tokugawa period, the merchant class occupied the lowest rank. In terms of influence, however, the merchants as a group were second in power only to the *samurai*. The reason why they were powerful was because they were in a strategic position to control the national economy. Why were they in this position? In the Tokugawa period, the traffic facilities developed and the public peace was well maintained, and the trade inside Japan made great progress. As the merchants were well informed of the demand and supply situations in various areas through their information network spread all over the country, they could make great profits by playing the role of entrepreneurs who could supply just what was demanded. I think they might be the distant ancestors of the present day trading companies. The ethics of the

merchants which prevailed in the period emphasized were, among other things, honesty, hard work and precise execution of contracts. What was important for them was to render such services as organizing the production, purchasing the products and then selling these goods with honesty and diligence, based on the correct information on what was to be sold and produced where and for what price. It seems to me that these ethics of the merchants as well as of the *samurai* are akin to "the Ethics of Protestantism and the Spirit of Capitalism" propounded by Max Weber explaining the rise and shine of the British economic development in the 19th century.

#### **Ethics of the farmers**

For more than 2,000 years, agriculture has been the main stay of Japan. Although the family constitutes the basic unit of farming operations, it's almost impossible for a family to run its farm independently of others. Therefore, 10 to 50 farm households would form themselves into a village to jointly undertake common village projects, while individual households ran their family farms assuming responsibility for the harvest.

As in Thailand, the main agricultural product in Japan is rice which is grown in the paddy field. Japan being a mountainous country, most part of the country, even arable land, is more or less sloped, which means that water flows down swiftly. We have pretty heavy rainfall in Japan but it is a very difficult work to make effective use of this water in the sense that it is fairly distributed to each piece of paddy field just corresponding to the need. Individualism and predetermined harmony don't work well here. Villagers should cooperate with each other as far as controlling effectively and distributing fairly the water is concerned. They also cooperated for investment in infrastructures such as road and forest, and for coping with such disasters as typhoons, earthquakes and unbearable taxation by government.

Under the circumstances, they cooperated closely with each other as members of a community, while they competed severely with each other as responsible producers. Cooperation and competition in balance was the basic ethics of the traditional Japanese agricultural community.

Changes in four seasons in Japan is delicate and quick. Agricultural work should be in perfect harmony with this quick change in climate in order to achieve high productivity. Therefore, farmers work very hard to accomplish their work precisely in a limited period of time. This also contributed to foster their ethics respecting diligence and preciseness.

In politics, important decisions affecting the villagers, as a rule, were made through democratic process, often with unanimous consent. I am not too well

informed on the workings of the communes in Switzerland, but I have the feeling that the principles on which Japanese villagers dealt with their community affairs are similar to those of the Swiss communes.

To casual foreign observers, it may appear that there is no significant difference between the systems of the present-day industrial society of Japan and those of the Western countries. It is true that in the wake of the two watershed events that had occurred in Japan, namely, the Meiji Restoration of 1868 and the defeat in the war in 1945, Japan imported on a large scale the legal, political and social systems, business practices and technology from Europe and the United States. Just as we had shed our traditional kimonos in favor of Western clothes, so we founded joint stock corporation which were modelled after those of the European countries; we are now producing goods and services in Western style; we conduct business transactions in accordance with Civil and Commercial Codes which are substantially similar to those of the Western countries.

However, a closer examination of these phenomena and practices will make it evident that the hearts and ethics of the Japanese people which underlie the operation of these systems inherit those of the erstwhile *samurai*, merchants, and farmeres. When you compare the values, ethics, and behavior of the *samurai* of the Tokugawa period with those of present-day government officials, notably the technocrats; when you compare those of the Tokugawa merchants with those of the present-day business elite; or those of the Tokugawa farmers with those of the modern factory workers; you will be impressed by the striking similarities in their values, ethics, and behavior.

I might venture to say that today's business enterprises of Japan are offsprings fathered by the Western culture and mothered by the Japanese tradition. They inherited the physique of their Western father and mind of their Japanese mother. The traditional wisdom has it that East is East and West is West, but a marriage between East and West has been consummated in Japan. What is it that has helped consummate the marriage?

To my mind, a certain amount of credit should be given to the late General Douglas MacArthur. In pre-war Japan, corporations served the capitalists as a tool for exploiting the laborers, as the HAN in the Tokugawa period served as a tool for exploitig farmers. The life-time employment system did exist in pre-war Japan, but it applied only to key members of the management. Ordinary workers were highly expendable, subject to layoff at the whim of the management. Therefore, there existed a deep rift between capital and labor similar to the one which existed between the *samurai* and laymen.

When MacArthur assumed the control of government after the war, he broke up the *zaibatsu*, financial combines and purged all important corporations of their pre-war managers. As a result, the elite class which had been controlling the nation's business received a crushing blow. Those who took over the management of these corporations were their former employees. Therefore, the dislocation which used to separate management and labor disappeared, in the new corporation system after the War, there exists only functional division among basically equals. When equals formed a functional group, the ethics which had held together the village communities of the Tokugawa period revived, and thus the corporations of Japan have been transformed into highly cohesive communities of interests just as the feudal villages were before them. When you compare the Russian Czars with Joseph Stalin--and for that matter, the Emperors of ancient China with Mao Zedong--you will be surprised to find the similarity of their behavior. This illustrates the fact that whatever ideology they may espouse, or whatever political system they may erect, the basic of a people cannot escape from inertia of history. Industrialization of a country cannot but be influenced by the foregoing agricultural society.

As the corporations under the new system drew their funds mostly from banks, which were also reorganized, the influence of stockholders, already weakened by the MacArthur shock, waned rapidly, and the corporations increasingly took on the characteristics of a community of employees. In addition, MacArthur liberalized the union movement and sought to inspire the workers with the idea of freedom and democracy, and this helped the workers gain a much stronger voice in the affairs of their companies. All these factors combined to develop the corporations into a community of interests more akin to the traditional villages than to the hierarchical feudal HANs. Incidentally, I feel that the corporations in Japan before the War had more in common with the HANs or feudal clans than the villages.

The second factor which oiled the gears of the East-West marriage in Japan was the fact that after the war, Japanese society developed a crystalline structure supported by a foundation of coherent values. After the war, the Japanese people rallied around a national purpose of catching up with the Western industrial nations by achieving rapid economic growth. At the corporate level, this translated into a drive aimed at increasing their market share through rapid expansion of their business. At the level of individual workers, this inspired them with an urge to achieve faster promotion in the company they belong to through hard work. Thus, the workers, the corporations and the nation as a whole developed a clear and shared sense of purpose to which they single mindedly directed their energy. And as means for achieving such a rapid economic growth, they sought to import the Western systems and technology as much and as quickly as possible, while they maintained substance of traditional ethics.

As might be expected, however, the over-zealous pursuit of marriage between the Western systems and the Japanese tradition has given rise to a host of contradictions, strains, and frictions. In consequence, the government introduced a series of industrial policy measures to deal with these difficulties. The industrial policy of Japan has taken on, as it were, the characteristics of a genetic engineering project which is designed to overcome the various difficulties arising when the disharmonious elements of the East and the West are coupled.

### **The Necessity and Role of an Industrial Policy**

Verdinand Toenies, a German sociologist, divided social groups into "Gemeinschaft" and "Gesellschaft". "Gemeinschaft" means a community which comes into existence naturally, while "Gesellschaft" refers to a functional group formed for the purpose of pursuing certain objective under a contract. A typical Gemeinschaft is a village and a typical Gesellschaft is a company.

In the model of market mechanism as perceived by Adam Smith, the market is an aggregate of business firms or "gesellschaft", and homo economicus. But the corporations founded after the war in Japan are not pure "Gesellschaft", nor are they pure "Gemeinschaft". They are a hybrid of "Gemeinschaft" and "Gesellschaft", or what you might call a "Gemassellschaft".

When Japanese corporations which have such characteristics are left to their own devices in competing with one another, the market forces arising from the activities are materially different from those visualized by Adam Smith. The ethical values of company as Gemeinschaft, and the loyalty held by individual workers combine with the motivation of the corporation for larger profit, market share, and prestige, resulting in excessive competition among corporations. This calls for a disinterested coordination of competing interests by a third party to alleviate the wasteful competition. Generally speaking, a private third party is not powerful enough to exercise any influence over the concerned parties, and such a form of coordination, when successful, is likely to conflict with the Fair Trade Law. Herein lies the necessity and justification for an intervention by the Ministry of International Trade and Industry, or MITI, for short.

There is another factor contributing to the necessity of an industrial policy. When Japan opened its windows after the war and looked out to the Western world, it was struck by the multitude of temptingly attractive technologies as a garden bloom with beautiful flowers. Every firm scrambled to buy the technologies, but Japan had only a limited amount of hard currency to satisfy the hunger of all Japanese firms. Even if Japan had enough cash, and had allowed dozens of companies to try to import the same technology, a cut-throat competition would have been created among them and millions of dollars would thus have been

wasted for self-defeating purposes. Here also lay a role which MITI could play, in the selection of qualified importers for such technology through coordination as a disinterested third party.

In short, the role played by industrial policy was to alleviate or to possibly remove the causes of contradiction between the ethics and behavior of Gemasellschaft and the market mechanism.

#### **Relationship between MITI and Private Firms**

The relationship between MITI and private firms is not one of dictatorship toward the latter by the former. In Japan, we have a time-honored tradition of consensus through exchanges of information and views. Except in cases of isolated exceptions, the formulation and implementation of policies by MITI has been carried out on the basis of such consensus with the business community.

In this manner, a system has been built under which the secondary industries of Japan operate in a free market with some amount of coordination by MITI.

However, the substance of a consensus worked out between MITI and private firms, and that of the industrial policy which MITI implements on the basis of such consensus, vary from one industry to another and according to the time factor. The steel industry is a case in point. Steel mill operators frequently exchange views among themselves and with MITI. They are quite amenable to consensus-forming. For instance, the trigger-price system guiding the export of their products to the United States is being observed on the basis of a general consensus. This is not to say that all of them are receptive to forming a consensus all the time. When in the mid-1960s MITI extended administrative guidance to them and asked for self-restraint on equipment investment to head off building excessive capacity, Sumitomo Metals Co. openly resisted MITI recommendations. Generally speaking, the majority of cases of administrative guidance prescribing self-restraint on capital investment were directed to such capital-intensive materials-processing industries as steel, energy, petrochemicals, synthetic fiber, non-ferrous metals, paper and pulp, and cement. On the other hand, there are only a limited number of cases of administrative guidance extended to machinery and electronics manufacturers which employ a large variety of technologies, produce numerous kinds of goods, and cater to diverse consumer needs and preferences. In these areas, MITI has played the role of a sort of traffic regulator with respect to standards, specifications, product categories, and technologies. In other words, as the slogan "development of knowledge-intensive industries" suggests, the administrative guidance extended by MITI is of a mild nature designed to encourage corporate efforts for certain visionary goals.

Where computers and semiconductors are concerned, however, MITI has played a more active role by subsidizing R & D activities or by arranging joint research and development for private firms, since too many corporations duplicated subsidies research, wasting large amounts of funds and human resources. Actually, government amounted, to about 30% of the total costs required, and they worked well as a piece of carrot to lure the horse. Here I would hastily like to add that the government subsidies I have just mentioned are quite modest when compared to the corresponding government expenditures in the United States and European countries.

### **Trade Policy of MITI**

We believe that quality control should cover not merely the quality of hardware but should be extended to the competence of workers, because the quality of products is only as good as the competence and sense of responsibility of the workers who produce them. Fortunately, this is not a difficult task to accomplish in Japan because of the work ethic with which the Japanese workers are imbued. They are particularly good at mass producing products built of numerous parts and components. There are a large number of manufacturers which produce such categories of products as automobiles and VTRS. And as noted earlier, there is a fierce competition among them. If and when improvement in quality and cost-reduction of, say, automobiles, occurs quickly and simultaneously among all the concerned companies and passes a certain threshold, the result would be a snowballing of exports unbearable to the importing countries. However, because of the Fair Trade Act of the United States, private firms in Japan are prohibited from working out a self-imposed restraint on their exports. Therefore, MITI has often had to intervene in order to hold down auto exports to the United States and other countries. We have had similar experiences with the export of textiles, sewing machines, binoculars, radios, television sets, steel, and machine tools.

Ideally, restraints on international trade, if imposed at all, should be instituted only according to the rules of GATT; self-imposed regulation of exports is not desirable. In actuality, however, self-regulation of exports has been implemented as a necessary evil. For instance, the Danforth-Bentzen Act is, in our view, the worst evil, but to the extent that a self-regulation of auto exports to the United States will help shelve the Danforth-Bentzen Act, such self-regulation is a necessary evil. To make such necessary evils unnecessary, Japanese exporters must of their own accord moderate their exports of goods which are likely to aggravate the friction already sustained on account of such imports from Japan. However, in a competitive free market, this is easier said than done.



### **The Closed Nature of the Japanese Market**

The question as to how extensively the Japanese market is closed to foreign competition is open to debate. The barriers standing in the way of foreign penetration in the Japanese market may be divided into two categories, official and private. Included in the official barriers are import quotas, high tariffs on some items, the complexity of customs clearing procedures, and over-regulation of business in some sectors by the government. Since these are erected by the government, it is not impossible, although it may prove politically difficult, to improve them.

By contrast, the government is helpless in its efforts to remove private barriers which have come into existence due to the character and behavior of business and consumers in Japan. By and large, they are born, not intentionally made. A case in point is the coalition between the dealers and the manufacturers. A dealer who sells automobiles or home appliances of a certain manufacturer tends to be reluctant to carry the goods of competing manufacturers. He would feel that this is the safest and most profitable way of doing business in Japan. This way of thinking is closely connected with the character of Japanese society, which is more "Gemeinschaft" than in Europe or America. What can be done about this attitude? This is a problem for private companies in Japan and the foreign companies trying to penetrate the Japanese market to solve in real earnest.

### **Dismantling of Institutional Barriers**

I must admit that I am not too well informed on the situation of the primary and the tertiary industries of Japan. But I do have the impression that they are over-protected. Such over-protection is prejudicial not only to foreign producers but also to the Japanese consumers. Personally, I believe that the Japanese government should actively continue to promote the liberalization and deregulation of these markets on its own, but the government is encountering a strong political opposition. Under such circumstances, its efforts at liberalization of these markets under the pressure from the outside is perhaps better than do-nothing. A disinterested review of the relations between Japan and the outside world since 1853 points to the positive benefits, not losses, such pressure brings to Japan, as far as long-term results are observed. Japan must continue its efforts to grow out of the closed nature of its market and join the ranks of open societies of the free world.

In conclusion, I would like to emphasize that there are a variety of industrial policies pursued by a variety of countries. There is so far no uniform or universal theory for the industrial policy. In such advanced countries as UK and USA, up to quite recently there was neither concept nor word for the industrial

policy. There existed strong values that government intervention into the economy was, in principle, undesirable.

In the economics of the countries which started comparatively late for industrialization, more or less government intervention is actually unavoidable. Inherent problem of the industrial policy is that it is quite likely that the industrial policy may be so polluted and corrupted by arbitrariness, foolishness and selfishness may the bureaucrats and politicians. Because of this, there are successful as well as unsuccessful industrial policies between which there exist big differences.

I am not an advocate of the industrial policy as a universally feasible policy. But roughly speaking, for economically late-comer countries, an industrial policy is a sort of necessary evil, and if one wishes to have a good and successful industrial policy, what is important is, inter alia.

- (a) to build well organized and disciplined bureaucracy in the public as well as private sector.
- (b) to try to curtail function of industrial policy to give more freedom to the private sector, as economy develops and gets competitive.
- (c) to pay careful attention in order to keep mutual trust and respect between the government and private sector.
- (d) to try to foster and enhance ethics of the people for diligence, honesty and loyalty to the community on one hand and freedom, equality and fairness on the other. I think those values and ethics are more or less inherent in and intrinsic to human nature but is likely to be eroded by a variety of reasons.

Generally speaking, orthodox economists don't pay much attention to ethics, but I think business ethics is the key element for economic development. Therefore, industrial policy should take ethics seriously into consideration, which I think is the necessary condition for successful industrial development and growth.