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JAPAN IN THE NEW WORLD CONFRONTATION:  
A HISTORICAL PERSPECTIVE

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**JAPAN IN THE NEW WORLD CONFRONTATION:  
A HISTORICAL PERSPECTIVE\***

Yujiro Hayami

**ABSTRACT**

In terms of the history of modern economic growth the major axis of world confrontation has always been between early and late comers to industrialization. Severe confrontation arises typically when a late-comer country is believed to have developed a model of economic development capable to catch up or even surpass the economic power of the early-comer countries. Rises and falls of the various catch-up models in the modern history are examined. In this historical perspective the nature of confrontation is identified between the system of developmental market economies in Japan and Asian NIES and the system of liberal market economies in Western countries.

**JAPAN IN THE NEW WORLD CONFRONTATION:  
A HISTORICAL PERSPECTIVE**

Along what axis of major confrontation will the world economic and political system be structured after the demise of the cold war? In terms of the history of "modern economic growth" a la Simon Kuznets (1966), I would predict that, as was always the case in the past, the new axis of confrontation will be between early and late comers to industrialization. To be precise, a late-comer country (or countries) is bound to face confrontation with the countries that accomplished industrialization earlier, when such a country is believed to have developed a model of economic growth capable to catching up or even surpassing the economic power of the early-comer countries. The communist bloc was able to establish the status of being one major camp in world confrontation when the "model of central planned economies" was hoped for and feared of being able to "bury capitalism." However, it lost this status when this model proved incapable of accomplishing the task.

An indispensable element of any effective catch-up model is a mechanism of forced saving to enable accumulation of both physical and human capital in the late-comer country at a much faster speed than in the early-comer country.<sup>1</sup> The centrally planned economies have tried to achieve this goal by government's direct command on resource allocations. In this respect, the centrally planned economies that existed in this century represent a development model. Not all the centrally planned economies are the development model, however, since resource allocations with higher priority on

"bread and butter" than on "iron and steel" are theoretically possible under central planning.

In this perspective, the demise of the cold war is nothing but the obvious failure of the centrally planned economies to be an effective model of economic development for the late-comer to catch up the early-comer country in industrialization. For the future prediction, it is critically important to understand that such a failure is not new, but rather has been repeated throughout the history of modern economic growth over two centuries.

### **Defeat of "Old" Developmental Market Economies**

The first major confrontation between the early and the late comers in the history of modern economic growth occurred when Germany tried to catch up to England. England, which had established itself as the "workshop of the world" by the early nineteenth century, followed the model of "liberal market economies" in the tradition of Adam Smith (1776). In this model, ordinary economic activities should be left to decentralized private decisions under competition of market, while government is supposed to maintain law and order as a basic framework within which market operates.<sup>2</sup> Investments in human capital, such as education and research, were also left largely to the private sector.

When Germany accomplished national unification under the leadership of Prince Bismarck and set forth to industrialization, government invested heavily in industrial infrastructure including technical education and applied research/development, while it installed tariff walls against imports of manufactured commodities according to Friedrich List's (1841) thesis of infant industry protection. This strategy was geared for accelerating capital accumulation and economic growth by suppressing consumption by

means of government finance and border protection, within the basic framework of market economies. As such, it was a development model for catching up, which may be called the model of "developmental market economies." By this model, Germany was able to surpass England already in the 1870s in the areas of heavy and chemical industries.

Germany's success attracted other late-comer countries, Tsarist Russia and Imperial Japan among others, to imitate the model of developmental market economies. It is important to note, however, that the United States preceded Germany in the use of this model. Following the advocacy of Alexander Hamilton, "the American System" had been established by the first half of the nineteenth century to protect domestic industries by tariff and to invest the tariff revenue in public infrastructure, such as canals and highways, for integrating frontiers into a single domestic market. In fact, List developed his idea of infant industry protection from his personal observation on this "American System" in the Hamilton tradition during his exile to the United States (List, 1827). Thus, the model of developmental market economies was universal in its appeal and applicability to the late comers in the nineteenth century.

The problem with this model for Kaiser's Germany as well as for Imperial Japan was that it was tied to narrow nationalism or racism to promote imperialistic expansion for supporting industrial exports abroad. Since such ideology had no universal appeal, expansionist policies inevitably resulted in isolation of these nations in the world community. In the end, the Second and Third German Reichs, as well as Imperial Japan, had to experience disastrous defeats in the world wars. The United States was able to escape this route, partly because of its stronger liberalist tradition but, also, because of open frontiers available for

continued expansion in domestic market until the Spanish-American War.<sup>3</sup>

In retrospect, while this "old" model of developmental market economies was able to achieve success in fast economic growth and catch-up, it failed because its supporting ideology was incompatible with the world system.

### **Failure of Centrally Planned Economies**

Upon the defeat of old developmental market economies, centrally planned economies became the forefront of development models for catching up. This model was not only adopted in the communist bloc, but also incorporated into many national development programs in the Third World.

Attractiveness of this model to developing countries was, in part, based on relatively good growth performance of the Soviet economy in its early stage. Resource allocation by central planning and command can be relatively efficient where income levels are low and people's wants are homogeneous so that it is not so difficult to estimate demand and supply of commodities. Another condition for effective working of centrally planned economies is strong ideological belief to prevent people, especially leaders, from free-riding and rent-seeking. Communist ideal, coupled with nationalism, should have served this purpose, for the periods during and immediately following the revolution as well as during the war against Nazi Germany.

This model's attractiveness to the Third World was, also, based on ideological appeal of socialism for the period immediately after World War II. For newly independent nations, capitalism and market were perceived as a mechanism of colonial exploitation. Socialism and central planning, which were said to serve for people's common well-being, were a much more attractive system. Unlike narrow

nationalism and racism which led pre-war Germany and Japan to isolation, socialist ideology was able to secure wide sympathy and alliance from the world for the communist bloc.

However, centrally planned economies have a critical defect as a catch-up model. While resource allocations can be decently efficient under central planning in the low-income stage, errors in planning increase progressively as the level of income rises and people's wants diversify. Also, altruism based on communist ideology, which may be an effective enforcer of leaders' morals as well as workers' morale under the crisis situation of revolution or war, can not sustain for long in peace. As the income level rises under peace, both planning errors and rent-seeking behaviors accumulate to such an extent as to collapse the economy. Thus, centrally planned economies are bound to fail before attaining the catch-up goal.

In my perspective, the communist bloc failed not because of its ideology but because of the critical defect on its development model.<sup>4</sup>

### **Prospect for "New" Developmental Marketing Economies**

The receding tide of centrally planned economies has coincided with the rise of a new model which may be called "new developmental market economies." This is the developmental strategy that has been adopted by post-war Japan, followed by Asian NIES such as Korea and Taiwan, and later followed by ASEAN nations.

This model is similar to the old developmental market economies of pre-war Germany and Japan with respect to the fact that government promotes high capital accumulation by suppressing consumption through strong regulations and administrative guidance within the basic framework of market economies.<sup>5</sup> It is different from the old model in the aspect that it is not tied up with narrow



nationalism or racism. Instead, the new model is implicitly based on "developmentalism" or "production fetishism" by which people judge whether or not certain policies are good and just in terms of their contributions to the growth of material output. This hidden ideology in the new model seems to have stemmed in Japan from deep disillusionment on the use of military power and sheer need for escape from hunger and poverty immediately after World War II, in addition to a century-long desire to catch up with the West.

Effectiveness of this model in terms of its catch-up goal has been proved by the post-war history of East Asia. As the failure of centrally planned economies has become evident, attractiveness of new developmental market economies has increased for developing nations. Economic reforms in China and India in the past ten years appear to represent an effort to reorient their development model from centrally planned to developmental market economies. Also, recent reform in Vietnam seems to go along this line. This course might be followed by some East European countries, too.

### **Structure of New Confrontation**

My historical perspective on the rise and fall of catch-up models predicts the major axis of the new world system to be confrontation between liberal market economies in North America and Western Europe and new developmental market economies in East Asia and its followers. Compared with this major axis, other confrontations even including the recent Gulf War are not really global but rather local by nature, however severe and violent they may be, since countries like Iraq have accidentally become rich enough to build military power sufficient for seeking regional hegemony, but have not developed an effective system of sustaining economic development with which they can challenge for world-wide hegemony.

Unlike the confrontation between liberal market and centrally planned economies, the new confrontation is not ideological but is limited to conflicts in economic interests. Yet, there is a danger that this confrontation will escalate beyond the economic sphere. As developmental market economies become successful in industrial development, they begin to compete in the world trade of manufactured commodities. If this speed is too fast and exceeds the capacity of industrial adjustment on the side of advanced economies, it tends to create strong political demand for protectionism within advanced countries. The real danger arises when the protectionist bloc tries to achieve its political goal by escalating economic conflicts to ideological confrontation. Their common strategy is to condemn advancement of developmental market economies to the world market as based on "unfair" production and trade practices, and to conclude these "unfair" practices as based on different culture and ideology from Western democracy and liberalism. On this ground, they argue that, since there is no common ground for settlement through rational dialogue, these economies must be "contained" by force. This is typical of the arguments against "the Japanese System" of so-called "revisionists" represented by James Fallows (1989), Chalmers Johnson (1982), Clyde V. Prestowitz, Jr. (1988) and Karel van Wolfaren (1989).<sup>6</sup>

If such a political maneuver to escalate the economic problem to the ideological confrontation is successful, it will result in popular criticism from the side of advanced economies on the social/cultural systems of developmental market economies. Resulting external pressures for reforms in these systems will evoke reactional nationalism on the other side. If developmental market economies may thus be pushed too hard, they may revert their route to that followed by pre-war Germany and Japan. On the other hand, if developmental market economies shall be allowed to grow

smoothly, their political systems which are now somewhat despotic and totalitarian are likely to move toward democracy and liberalism; this tendency is evident from the recent moves in Korea and Taiwan.

### **Beyond Developmental Market Economies**

It will add another major example to the stupidity of the human race if advanced countries will chase out newly emerging nations from the new to the old model of developmental market economies. We must remember how Weimar democracy in Germany and Taisho democracy in Japan were massacred by economic blockism following the World Depression. Unless such stupidity shall be prevented from recurring, the new world system will suffer the same fear and waste as experienced under the cold war.

How can the new confrontation between liberal and developmental market economies be structured so as to be constructive rather than destructive? In order to prevent the confrontation from turning into a negative-sum game, both sides must be freed from mutual fear and distrust. For that purpose, clear understanding must be established that liberal and developmental market economies are not really discontinuous. It must be recognized that, while the present system of Japan and Asian NIES might be unique, it may not be quite so unique relative to "the American System" or "the German System" in the nineteenth century.

Since the system of developmental market economies is a catch-up model, its positive role should end when the zeal of late-comer countries for catching up to advanced will be satisfied. If a country would wish to further promote the economic welfare of its people in a stage beyond the successful catch-up, the country must transform itself from developmental to liberal market economies, because the system which can best serve for consumers' (citizens')

welfare at a high income stage characterized by increased variations in people's wants is nothing but the free market mechanism based on competition under transparent rules.

The best proof for continuity to exist between liberal and developmental market economies will be Japan's transformation. Japan was a forerunner of new developmental market economies and was successful in achieving the catch-up goal almost two decades ago. Yet, its transformation into liberal market economies has long been overdue. As the result, the nation is now suffering from serious international economic frictions as well as a large gap between GNP and the quality of life. Japan must be quick to abandon the government regulations and administrative guidance that are against the principle of consumer sovereignty, and thereby to establish the free market system that is transparent to all citizens and open to the world.

This shift does not mean abandonment of Japan's cultural identity. The prevailing government controls and regulations were not necessarily rooted in the unique culture of Japan but were mostly created in the relatively recent past as a device of catching up. Somewhat unique business organizations and trade practices do exist that may appear to be strongly group-oriented and non-individualistic to the eyes of westerners. However, real monopoly and inefficiency tend to arise where these group-oriented organizations are reinforced by government controls. Once those controls shall be removed, some of the apparently unique organizations and practices in Japan will disappear as they will lose to competition in the free market if they are inconsistent with the interests of consumers. Those institutions that may survive through market competition, even if they might be originated in Japan's unique culture, will have universal applicability and contribute to revitalization of the world

economy.<sup>7</sup> It must be recognized that the vitality of liberal market economies, too, can not be maintained unless they continue efforts for institutional and organizational innovations, sometimes by learning from other cultures' innovations, in response to changes in technology and people's preference.

Already it is late but it may not be too late for Japan to prove by itself that, upon successful catch-up, developmental market economies shift to liberal market economies. If Japan accomplishes this task, fear and suspicion of advanced industrial countries against late-comer countries based on the system of developmental market economies may be reduced. Also, bold opening of the Japanese market would increase confidence and reliance of developmental market economies on Japan. On the basis of increased confidence and trust from the world, Japan should act as a *bona fide* moderator between liberal and developmental market economies so that their relation will turn out to be a positive-sum game.

If the world system instead falls into a negative-sum game, the basis of Japan's prosperity will inevitably be lost. Public awareness of this danger has not yet been sufficiently strong so as to overcome the resistance of vested interest groups to the swift shift to liberal market economies. Indeed, the system of developmental market economies, which proved to be extremely successful for Japan in the past, has now been turning into its fatal stumbling block.

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## NOTES

1. Of course, another requirement is the society's ability to allocate the saving efficiently among alternative investment opportunities so as to maximize the long-term growth rates of national product.
2. In the course of history this model has undergone major modifications in North America and Western Europe including England itself under the tides of social democracy and Keynesianism. Yet, the model of liberal market economies based on the principles of equal opportunities, free competition and consumer sovereignty has survived as an ideal to bind economic policies in the western countries.
3. Moreover, it would not be an unfair statement that the model of liberal market economies in early-comer countries such as England and France was supported by the vast market in their overseas colonies.
4. Several other catch-up models also failed before they became major contenders to world economic hegemony. For example, the "Latin American model" as represented by Peronism, which is considered a marriage of populism with the model of development market economies, failed because producers' excess profits due to such policies as import-substitution industrialization were dissipated for consumption.
5. The structure and the working mechanism of this system have been described from various angles, including Johnson (1982), Yamamura and Yasuba (1987), Prestowitz (1988), Okimoto (1989), and Yamamura (1990). An interesting general characterization of postwar economic policies in Japan is advanced in Yasusuke Murakami's article (Yamamura and Yasuba, 1987, pp. 33-90).



6. For a succinct restatement of their position, see Fallows, Johnson, Prestowitz and van Wolfaren (1990). For a critical review of revisionists' arguments and counter arguments, see Yamamura (1990, pp. 13-64).
7. For the nature and significance of intra- and inter-firm organizations in Japan, see Abegglen and Stalk (1985), Aoki (1984a, 1984b, 1988), Imai, Itami and Koike (1982), and Imai and Komiya (1989). Thomas C. Smith (1988) provides a useful perspective on how the unique industrial organization of Japan had stemmed from the organization of premodern agrarian society.