HOW THE FUNDAMENTALS OF AMERICAN AND JAPANESE CAPITALISM DIVERGE

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Japan was once thought of as a considerable challenger to the United States' economic dominance. While it never lived up to those lofty expectations, its form of capitalism still proves fascinating. Graeme O'Meara gives an absorbing account of how Japan's economy works, comparing it directly to the free market capitalism of the United States.

Introduction

How can we define a 'capitalist' economy? Milton Friedman describes it as the 'organisation of the bulk of economic activity through private enterprise operating in a free market' (Friedman, 1962, p.56). J.M. Keynes offers a humorous thought on capitalism: 'Capitalism is the astounding belief that the most wicked of men will do the most wickedest of things for the greatest good of everyone' (cited in Albert, 2000, p.152). Specific histories and cultures lead to many varieties of capitalism; it can be thought of as a stage in social revolution (Groenewegen, 1997). Let us distinguish three prominent styles of capitalism which dominate the global economy: enterprise, social and collective capitalism. Enterprise or 'pure capitalism' is strongly associated with the United States. It is based on the ideas of Adam Smith (1723-90), David Ricardo (1772-1823) and updated by modern economists such as Friedman. 'Its central feature is faith in the untrammelled workings of market competition, born out of the belief that the market is a self-regulating mechanism [Smith's 'Invisible Hand']' (Heywood: 2002: 180). The open market is the epitome of freedom in a capitalist society. Friedman contends that:

> The great advantage of the market is that it permits wide diversity. It is in political terms, a system of proportional representation. Each man can vote, as it were, for the colour of tie he

wants and get it; he does not have to see what colour the majority wants and then, if he is in the minority, submit (Friedman, 1962, p.15).

Enterprise capitalism is edged by desire for profit, high productivity, flexibility of labour and emphasis on expansion/growth. Trade unions are seen as an obstacle to productivity and are therefore minimised.

Social capitalism involves a significant role for governments in regulating markets and providing social support for the poor, and is mostly associated with continental Europe and is therefore not relevant to this particular argument. However, it isw collective capitalism with which we associate Japan. Its entity is co-operative long-term relationships, originating from the post World War II boom. 'Relational markets' consist of groups such as the *keiretsu*, the *kigyo shudan* and the *kankei-gaisha*, with whom major industries are members and aim to ensure each other's competition by providing finance and expertise. Trademarks of Japanese employment include seniority-based promotion, lifetime employment, pensions/social protection and a high emphasis on teamwork. This collective identity in the workplace is underpinned by narrow wage differentials between manager and worker (Heywood, 2002). Workers are seen as 'members' of the firm rather than employees; 'the firm is a surrogate family' (Eccleston, 1989, p.69).

In this essay, I intend to provide an in-depth analysis into the elements of these two capitalist models that I feel possess fundamental differences. I will use the American style as a base for contrasting the Japanese equivalent.

Liberal Market Economies: the US

In the US, capitalism is pursued by means of an unregulated 'free market'. Organisations act independently, yet interdependently in the sense that firms can pursue any strategy they desire, but such strategies are generally formulated based on what rival firms do. Financial systems or markets for corporate governance encourage firms to be attentive to earnings and shares on the stock market. Companies secure finance based on a valuation in equity markets, where investors depend on publicly available information (yearly financial reports/value of assets) to assess the firm. This also applies to bonds, the issuing of shares and bank lending. Compensation systems for top management who increase net earnings of the company are a trademark of liberal market economies. Trade Unions (seen as a barrier to productivity) have little power to sway management who are under no obligation to establish any representative bodies for employees. Typically, the free market economy relies on macroeconomic policy and market competition to control wages and inflation. A fluid labour market means that workers are in plentiful supply and at any firm's disposal. This makes it less attractive to pursue production strategies that promise long term employment and since people drift between jobs, transferable skills rather than company specific knowledge are encouraged. The fluid labour market often facilitates transfer of technical information via the movement of scientists from company to company. In this respect, companies are loath to invest in apprenticeship schemes with industry specific skills for fear that competitors will snatch their apprentices (Hall and Soskice, 2001). Companies often provide 'in house' training in marketable skills that employees have incentives to learn. This produces a well equipped labour force suited to job growth in the service sector, but often leaves firms short of employees with highly specialised or company specific skills (Hall and Soskice, 2001).

The liberal market economy is also based on standard market relationships and formal contracts. In America, these relations are mediated by markets, doctrines of contract laws and rigorous anti-trust regulations that prevent collusion to control prices. In this respect, companies wishing to engage or co-operate with other firms are discouraged by the US legal system. The liberal market economy also depends heavily upon the licensing or sale of innovations to assist technology transfer, which is feasible in sectors where patenting is possible, such as biotechnology, micro-electronics and semiconductors. Creators of new inventions profit by licensing it to multiple users, which explains the presence of venture capital firms in the liberal market economy: one success at standard setting can pay for many failed investments. (Hall and Soskice, 2001) In conclusion, inter firm collaboration plays a far less important role in the process of technology transfer than in Japanese capitalism.

Characteristics of Japanese capitalism

Traditional economic theory advocates that free competition is a source of sound economic development, maximum social welfare, innovation and equitable prices. Industrialised nations are always in the position of trying to balance free competition and prevent monopolies. US industry is highly concentrated with numerous monopoly firms such as IBM, Xerox and Boeing. For example, when the airline industry in the US was deregulated in the early 1980's, concentration in the market was higher than ever by the end of the decade. (Adams, 1990) Monopolies tend not to form in Japan; in the US, Eastman Kodak is the only player in the photographic industry, while Japan (with a market half the size) has two only competitors. When a new market emerges in Japan, firms rush to get a foothold - Sega and Sony challenging Nintendo being a case in point.

This 'supermarket' strategy, in which each company has a hand in every area, worked well during Japan's economic boom between 1960 and 1990. 'Made in Japan' gadgets, once considered poorly manufactured, ended up as world leaders in quality, humiliating America's electronics along the way (The Economist, 2009).

And despite acquisitions, bankruptcy or voluntary exit, firms rarely leave an industry. This intense competition in Japan has resulted in lower profitability, but greater innovation and quality in production. 'This pattern of fierce competition without losers has underpinned Japanese economic and competitive success in the post war period' (Tezuka: 1997, p.84). Japanese capitalists suppress competition, augment innovation and boost growth in three fundamental ways: through favourable industrial policy, membership of the 'keiretsu' and a regime of guaranteed lifetime employment.

Japanese Industrial Policy

'Both academic analysts and policy makers in other countries too often overlook the role of Japan's industrial policy in sustaining strong domestic competition' (Tezuka, 1997, p.85). After World War II, the Japanese state acted as a 'capitalist developmental state' which undertook development functions to make up lost ground on the other capitalist powers. Industrial policy decided where and how much investment was made, what kinds of technology development and training took place, as well as the pace and direction of innovation and diffusion (Coates, 2000). The Ministry of International Trade and Industry (MITI) used its influence over the Japanese Development Bank to guide post war companies into industries and technology it thought desirable. It also steered private capital out of low wage textile production into heavy industry – steel, chemicals, shipbuilding and autos. David Coates (2000) describes the Japanese state as a 'gatekeeper' after the war; it controlled entry of capital, technology and manufactured goods into the economy, preventing the domestic market from being colonised by foreign companies bent on export penetration. These policies continued for decades afterwards; in the late 1970s the MITI sponsored a project to develop VLSI semiconductor technology. The government contributed ¥30 billion and industrialists provided ¥42 billion. This strengthened the semiconductor industry in Japan, generating over 1,000 patents on the VLSI process, which the government then licensed out to firms who couldn't afford the investment in the project. As a result, ten semiconductor companies emerged, which led to Japan becoming a world leader in semiconductor manufacturing.

Keiretsu

'Keiretsu' translates as 'order' or 'system,' and is seen as a continuation of the 'zaibatsu,' after the latter was closed down by the Allied forces in the late 1940's. It operates through cross shareholdings, acting as an efficient competitive mechanism. Two distinct types are evident: the horizontal keiretsu (six large groups across a wide range of industries) and the vertical keiretsu (supplier-assembler networks and relationships in major manufacturing industries). Each (horizontal) keiretsu has a member company in one of Japan's major sectors (steel, chemicals, shipbuilding). Groups are loosely co-ordinated by minority cross shareholdings, regular communication by top executives and co-operation for mutual benefit

(Tezuka, 1997). Members do not expect high dividends or returns on investment, they commit to prevent hostile takeovers of a fellow member, external pressures or high levels of autonomy in company management. The banking member acts as a financier and if one member is seen to be struggling, the other members will offer aid to ensure the group's prosperity and continued competition. In this respect, risks are eliminated when making investments, and because risk is shared, lower interest rates can be obtained. For example, when Mazda ran into trouble during the first oil crisis, the Sumitomo group bank provided financial assistance, installed a new CEO and encouraged other members of the keiretsu to purchase Mazda vehicles (Tezuka, 1997).

The vertical keiretsu is held together by a complex mix of suppliers (*kankei-gaisha*) and manufacturing firms – typically in auto and electronics industries. Firms tend to avoid reliance on one supplier; the rate of single source parts in the auto industry in Japan is 12.1%, well below the US rate of 69% (Womack, 1990). The lead firm in the keiretsu is 50% dependent on one supplier, 30% on a second, and 20% on a third. At least one supplier is not a member of the group, and the lead firm will encourage its second and third supplier to match the cost/quality of its first supplier – this way it pushes for improvement and keeps competitive pressure on its first supplier. If a supplier falls behind, the lead firm provides aid, and if there is no improvement over time they will be replaced by another supplier. Suppliers are also encouraged to sell outside the keiretsu to gain experience and inflate economies of scale. However, the lead firm is its main customer, as one keiretsu supplier noted: 'As soon as I succeeded in becoming such a supplier, I was considered part of its 'family'. I was expected to be loyal to that company whatever the sacrifice' (Sakai: 1990, p.32). The Experience Curve shows that as cumulative experience in an industry rises, quality of service rises and costs fall, and that each time cumulative experience doubles, costs per unit fall by 10-30% (Dyer and Ouchi, 1993). Japanese firms consolidate their business with a few high quality suppliers and create the appropriate conditions to permit suppliers to make the necessary investments to accelerate down the experience curve (Dyer and Ouchi, 1993). When a supplier wins a contract with a leading firm in the auto industry, for example Nissan or Toyota, they are guaranteed four years of business (the lifetime of the curve) and know that if they perform well, they can win a contract for the next model. In this way, firms encourage long term planning and investment. Conversely, American firms continually split business among many suppliers, destroying the experience curves, to the extent that no supplier can accelerate down its experience curve to accumulate cost advantages. Suppliers in the US stated that they stand a 69% chance of winning business again with a firm, while a survey estimated the average contract lasts 2.5 years. (Dyer and Ouchi, 1993) As a result, each model changes as the experience curve of the previous supplier is destroyed and the new supplier incurs start up costs.

Lifetime Employment

The Japanese Ministry of Labour (JMOL) defines lifetime employment as the practice of companies hiring their core employees primarily from among new graduates and other young persons, to plan their continual training and development, to continue their employment within the company group over a long period of time (usually until age 55 or 60) and not to discharge or lay off such employees except in very unusual circumstances (JMOL, 1995, p.2).

This applies to core employees (not seasonal or part time workers), and generally occurs in larger companies. A JMOL survey of manufacturing companies with a workforce of over 1,000, showed percentages of male white collar employees who remained with their first employer at various ages: 30 – 78.9%, 40 – 70%, 50 – 66.2%, 60 – 33.6% (JMOL, 1995, p.5). This survey has shown that, on average, two thirds remain until age fifty and by sixty most retire or move to subsidiaries. The general trend is to maintain this system of lifetime employment, as only 2% of firms in the above survey had laid off workers in the last year, while 56% intended to continue offering lifetime placements.

Newly employed graduates face seniority based promotion and salary increases: 'There is no fast track in the Japanese company, but there is a very long track', (Tezuka: 1997, p.88) and jobs tend to be vaguely defined, allowing for versatility. As previously mentioned, duties at the workplace are organised in groups, as opposed to individual tasks. Contrary to the fear of losing their job, employees face the panic of lagging behind. This internal competition could have created a hostile environment, were it not for group work, which means the best performers cannot succeed without the co-operation of their team: '[C]ollective action supersedes individual action' (Konzelmann, 2005, p.49). Similarly, imprecise description of tasks pushes workers to set goals for themselves, resulting in elevated productivity. Just like the keiretsu and industrial policy, lifetime employment obtains full commitment and co-operation from all players, while allowing weaker contenders to remain in the system. Whereas in the market orientated economy there are winners and losers (the unemployed), Japanese society faces lower social costs as lifetime employment becomes a substitute for government welfare programs. 'Because families or companies traditionally looked after people, the state did not have to. Moreover, there is a stigma in Japan if an unemployed person asks for help: 'If you don't work, you don't eat' as the saying goes' (The Economist, 2009). It is in light of these characteristics that I believe American and Japanese capitalism possess fundamental differences.

American and Japanese Models Compared

The Japanese and American systems of corporate governance and employment relations diverge mainly due to the differences assigned to market and production processes. The shareholder system of corporate governance in the US prioritises the providers of capital, and views labour as a factor of production/cost to be minimised. Conversely, the stakeholder orientated form of corporate governance in Japan observes labour as a productive resource. Thurow (1992) claims that in Japan, employees are the number one stakeholders, customers follow second and shareholders third. In contrast, the USA places shareholders first, customers second and employees a 'distant' third. For Japan, markets serve as an arena in which efficiency is recognised (Konzelman, 2005). Japanese management is controlled by a variety of disciplinary mechanisms that ensure the interest of stakeholders is served. 'In Japan, producing goods and services that enhance the lives of others is good. Spending one's life in the speculative purchase and sale of financial claims is bad' (Dore, 1993, p.77).

An emphasis on the requirements of production is evident in the archetypal Japanese firm: rates of turnover are low, lifetime employment exists, substantial expenditure is made on firm specific training and even when staff is laid off, companies often provide retraining to boost their employability (Konzelmann, 2005). In this respect, employee welfare is seen as the responsibility of the firm and Human Resource management is stakeholder orientated. The Japanese system delivers high quality productivity in tandem with highly co-operative employment relations because the logic of production is not subordinated to the market, i.e. because the desire for profit is not overwhelming, efficiency tends to be higher. Contrastingly, Americans see markets as outlets for productive activity, where competitiveness depends on setting the pace in effective co-ordination of production and innovative activity and in creating as well as responding to consumer demand. Each model is not without its strengths and weaknesses: the free market permits dynamism, job rotation, radical innovation and perfect knowledge, while in the long run it tends to perform weakly when dynamic efficiency requires specific investment (Groenewegen, 2005). For Japan, its forte is investment in human capital, the availability of finance and the execution of team work both inside and outside the workplace. However, profits tend to be lower, and there are innumerable rigidities within the system that make managerial decisions time consuming.

Conclusion

If we juxtapose both capitalist models, fundamental differences can be observed from the outset. Lifetime employment is not a policy of US employers because the fluid labour market means that labour is at their disposal, collaboration of major industries is not encouraged by the US legal system, and the state plays a more subtle role in dictating where industry is to prosper. While America maintains a conscious welfare state and social security system that looks after the unemployed, the Japanese state has placed this responsibility in the hands of private enterprise. The drive to dominate financial markets causes American capitalists to use dynamism to cope with competition, while the Japanese employ and sustain competition as a way of boosting innovation. The overbearing profit motive in US capitalism often means that specific investment in human capital or intermediate goods is not made, and so performance suffers. When the Japanese do make this essential investment, profit margins are diminished. Which model works best? The answer depends on the objective of the business: to make profit by whatever means possible, or to do so collectively.

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