RE-VISITING THE ROOTS OF JAPAN'S STRUCTURAL DECLINE: THE ROLE OF THE JAPANESE CORPORATION

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The Role of the Japanese Corporation

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Abstract

For a long period in the twentieth century, the development of the Japanese corporation appeared congruent with the development of the Japanese economy. The growth maximising behaviour of the Japanese corporation and the preference for internal growth over acquisitions (see Odagiri, 1992) appeared to suit the long-term ambitions of Japan. Now, that formerly clear connexion between the ambitions of corporate Japan and the Japanese public interest is no longer so clear. Increasingly, the global ambitions of the corporation appear as an impediment to Japan's development. By favouring the development of large-scale transnational corporations, Japanese industrial policy-making appears to have contained a fundamental flaw. Japan is now dominated by large-scale organisations that are controlled by a corporate elite. It is unlikely that their strategic decisions will correspond with the wider public interest, which raises the possibility that Japan is now afflicted with "strategic failure". Other examples from around the world suggest that Japan is not unique in this respect. Alternative ways forward are suggested.

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1. Introduction

Japan's ongoing stagnation continues to raise concern and provokes much debate amongst both academics and policy-makers[1]. These concerns are very real, given the prominent position that Japan holds in the world economy. With genuine fears of a continuing slowdown in the US economy, Japan's failure to move towards recovery, now raises the possibility of a serious world economic downturn.

In analysing Japan's economic stagnation, most observers have sought to identify structural factors as the source of the economy's decline. Western authors have, in particular, argued that Japan is a highly regulated and bureaucratic society, where there is little flexibility for market forces to operate efficiently to facilitate an economic revival. Within this context, the nature and role of Japan's institutions, such as the financial and industrial keiretsu, labour market arrangements and the over-protectionist nature of the Ministry of International Trade and Industry's (MITI) industrial policy, have all faced serious question marks. For instance, Japanese employment practices and job security policies are now regarded as a barrier to generating new business, whilst the nature of Japan's industrial groupings is blamed for excessive investment and poor returns for capital. Many commentators now advocate that Japan undertake major structural reforms and move towards an Anglo-American style of capitalism (see, for instance, Katz, 1998).

We would agree with most Western commentators that Japan's current economic problems are structural. However, our main concern is that most (Western) economic analyses of Japan ignore the dominant role played by the economy's transnational corporations. In a recent paper, we have argued that strategic decision-making affecting the level of investment, employment and output in the Japanese economy are concentrated within the corporate hierarchies of Japan's large transnationals. The dominance of transnational corporations and the concentration of strategic decision-making within Japan now raise the serious possibility that Japan is afflicted with "strategic failure" (see Cowling and Tomlinson (2000)). This is a situation that occurs when strategic decisions, taken by corporate elites, conflict with the wider public interest. There is then no available market mechanism for society to redress the

[1] See, for instance, recent articles in the Oxford Review of Economic Policy, Vol.16, No.2 (2000).

balance and achieve what it regards as a socially desirable and efficient outcome (see Cowling and Sugden, 1994).

At this point, we should note that, for a long period in the twentieth century, the development of the Japanese corporation appeared congruent with the development of the Japanese economy. The growth maximising behaviour of the Japanese corporations and their preference for internal growth over acquisitions (see Odagiri, 1992) appeared to suit the long-term ambitions of Japan[2]. Indeed, Japanese industrial policy was geared towards promoting these large-scale corporations to compete on an international level - a policy akin to the promotion of national champions (see Piore and Sabel, 1984). By the early 1980's, the Japanese economy, the Japanese corporation and aspects of Japanese industrial organisation were often acclaimed as alternative models to Western style capitalism, for sustainable economic development and corporate success (see Johnson, 1982, Kenny and Florida, 1988). However, now the formerly clear connexion between the ambitions of corporate Japan and the Japanese public interest is no longer so clear; the global ambitions of the corporation appear as a possible impediment to Japan's future economic development. By favouring the development of large-scale transnational corporations, Japanese industrial policy-making appears to have contained a fundamental flaw.

It is our view that a focus upon the concentration of strategic decision-making, within corporate Japan, allows us to detect the roots of the economy's structural change and identify the barriers to future economic prosperity. The starting point for such an analysis is an understanding of the Japanese corporation and in this respect our line of reasoning follows Aoki (1990, p2) who remarked, *"one of the important sources of the industrial strength (and weakness in certain respects) of the Japanese economy can be found in the micro-micro (internal) structure of firms"*. Interestingly, through a strategic decision-making approach, we find that there are similarities in the command structures and centres of control in the industrial organisation of both Western and Japanese corporations. This is important, since proponents of Anglo-American style (industrial) restructuring often ignore these parallels. As a consequence, Western

[2] Internal growth provides a widening span of opportunities for both managers and other employees and is suggested to reflect a wider concern with the human resources of the firm (see Odagiri, 1992).

policy proposals for Japan maybe misguided and could prove to be counter-productive.

The remainder of this paper is as follows. In Section (2), we analyse aspects of the both the Western and Japanese corporation, and review their role in industrial development and note the major differences. These differences are reconciled through a strategic decision-making approach in Section (3). Section (4), draws upon our earlier work in Cowling and Tomlinson (2000), where we argue that the concentration of strategic decision-making within corporate Japan has been detrimental to the long-term prosperity of the Japanese economy. We also note that the Japanese experience is not unique, since there are similarities in the roots of Japan's current malaise with economic problems, in the recent past, that have afflicted other countries, in particular, Sweden's model of social democracy and the former Soviet Union. In the light of our analysis, Section (5) concludes with some suggestions for the direction of policy that may enable Japan (and other countries) to move towards a more stable and sustainable long-term development path.

2. The Role and Nature of the Large-Scale Corporation

Across the industrialised world, countries have primarily followed a development path that is closely aligned with the growth of the large-scale corporation (see Cowling and Sugden, 1999). In the Western economies, the role of the large-scale corporation is best acknowledged in Alfred Chandler's (1962, 1990) seminal work on the nature of the multi-divisional enterprise. According to Teece (1993, p.211), Chandler regarded "the business enterprise, through the development of organizational capabilities, as playing the central role in industrial development in the USA, Britain and Germany". With regards to Japan, industrial development occurred much later and the State played a significantly more interventionist role (see Johnson, 1982). However Japanese industrial policy, and production, was also centred upon the activities of large-scale firms (see, for instance, Piore and Sabel, 1984).

There is, of course, a considerable economic and business literature on the contrasting characteristics of Western and Japanese business and industrial organisation. We are unable to do justice to that literature here, although an interested reader may wish to consult Putterman and Kroszner (1996). The focal point of our analysis is the

Japanese corporation, although we will begin with a (brief) historical overview of the Western hierarchical firm, which Aoki (1990) has labelled as the H-mode. This is important because of the prominent role that the Western corporation has played in the industrialised world, in terms of both its role in economic development and, as we shall highlight, its influence on the organisational form that has been adopted in different economic regimes. We will then consider the characteristics of the Japanese firm, which Aoki (1990) labels the J-mode.

2.1. The Western (Hierarchical) Firm

It is now widely accepted that, in the twentieth century, the most dominant form of Western industrial organisation has been the large-scale, multi-divisional and, in many cases, vertically integrated firm (see also Radner, 1992, Teece, 1993). The Western organisational form evolved from the early commercial success of the large US corporations, such as General Motors. The general principle behind the Western corporation was the realisation that large-scale production of a standardised product could achieve greater (internal) economies of scale, higher productivity and lower prices than traditional small-scale craft production (see Piore and Sabel, 1984).

In order to achieve these objectives, large Western firms relied upon raising the rate of mechanisation in production and also increasing the division of labour, which was achieved through a greater standardisation of workers' jobs. Firms also introduced a system of scientific management, or Taylorist organisation, where workers' tasks were periodically monitored and subjected to work measurement audits. These processes were implemented through a hierarchical structure of management and seniority, which acted both as an incentive device for workers to achieve "promotion"(see Aoki, 1990) and as a means to exert authority and maintain discipline (see, Ruigrok and Van Tulder, 1995).

For Chandler (1962, 1990), the corporate success of the large-scale organisations lay in their superior organisational efficiency. The multi-divisional enterprise enabled both planning and production decisions to be co-ordinated, whilst investments in large-scale production facilities, product-specific marketing, distribution, and purchasing networks allowed firms to exploit both economies of scale and scope (see also Teece, 1993). In addition, a vertically integrated structure of production also provided the firm with a formal command structure, through which it could directly control its whole production process. This allowed direct control over both the supply and quality of inputs, the use of production technologies and the activities of downstream distribution channels (see, for example, Ruigrok and Van Tulder, 1995)[3].

Across the USA and then throughout Europe, firms replicated the organisational structure of the multi-divisional enterprise and introduced the technologies to facilitate a system of mass production (Piore and Sabel, 1984). However, this organisational structure was not only confined to the Western industrialised world. Indeed, the hierarchical command structures of Western corporations were also adopted by the Soviet Union, whose bureaucratic leaders sought to plan and supervise economic activity from a centre of control (Davies, 1990). As Ellman (1989) has pointed out, the Soviet planners readily accepted and implemented the principles of mass production, the division of labour and Taylorism[4].

At an aggregate level, the system of mass production became associated with higher output and lower prices. By the 1920's, the USA had become the world's first mass consumption society. Later, in the immediate post-war period, the hegemony of the large corporation and mass production appeared complete, with Western economies enjoying both higher real wages and increases in productivity, during the "golden age" of economic growth. However, throughout the turbulent economic conditions of the 1970's and 1980's, the concept of the large vertically integrated Western corporation began to lose its theoretical appeal. It became regarded as being an inflexible form of organisation, with limited adaptability to meet the challenges posed by the oil crises, the increasing diversity in patterns of demand and rising labour militancy (see Piore and Sabel, 1984). **Keith - Maybe include a quote here from Chandler (1990) about the failure of the Western firm?**

[3] Williamson (1975, 1985) provides an alternative interpretation of the vertically integrated firm. Williamson (1975,1985) defends vertically integrated governance structures on efficiency grounds, in that they can minimise the "transactions costs" of using the market mechanism. Such transactions costs are said to relate to bounded rationality, uncertainty and complexity, opportunism and small numbers. For a critique of Williamson's work, see Cowling and Sugden (1998).

[4] Indeed the large Western corporations developed a long business association with the former Soviet Union and state socialist economies, dating back to the 1920's. For instance, Western corporations provided the Stalinist regime with both new technologies and technical advice on Taylor's scientific management of labour (see Ellman, 1989).

It was during this period that a number of authors began to consider the claims of Japan as an alternative model for sustainable economic development (see, for example, Johnson, 1982). Since the Second World War, Japan had consistently out-performed her major international rivals on all the key economic indicators and her leading corporations had risen to international prominence. Furthermore, Japanese firms were also seen as being "flexible" in production, enabling them to be more resilient and successful than their Western rivals, in the face of international crises (see Kenny and Florida, 1988, 1993).

2.2. The Japanese Firm

The (economic) theory of the Japanese firm is most closely associated with Aoki (1984, 1988, 1989, 1990, 1994). In Aoki's model (1990, 1994), there are clear differences between the Japanese firm, which he labels the J-mode, and the Anglo-American hierarchical firm, which he refers to as the H-mode. It is generally accepted that the main differences relate to industrial organisation, the workplace and labour relations, and the financial structure (see Aoki, 1990, Boltho and Corbett, 2000). By focusing upon these aspects within the Japanese firm, we now briefly highlight the major differences, before attempting to reconcile them within our own approach in Section (3).

A unique feature of Japan's industrial structure is that the large Japanese firms belong to a corporate group or "kigyo shudan", which represents a horizontal conglomerate of financial and industrial interests (Scher, 1997). However, unlike traditional Western corporations, the typical Japanese firm is a vertically de-integrated entity. Production is organised through keiretsu networks where intermediate goods and services are supplied through an extensive set of (vertical) sub-contracting arrangements. Within these keiretsu networks, relationships between firms are usually close and long-standing, with firms often encouraged to co-operate and innovate through the sharing of technology and personnel exchanges. Throughout the supply chain, there will generally be a particular emphasis upon quality control or *kaizen*, and firms are also expected to achieve ongoing cost and price reductions (Aoki, 1988). In addition, firms may be required to deliver inventories on the *kanban* or *just-in-time* principle, which involves frequent deliveries, in small batches, at specific times to suit their main contractor (see, for instance, Abegglen and Stalk, 1985). Competition between firms is generated through a transactional hierarchy, where main contractors maintain rankings of their suppliers, with poor performance leading to a loss of position and future business (see, for instance, Asanuma 1989).

Within the Japanese firm, it is accepted that there is a wide degree of job rotation, allowing workers variety in their daily tasks and providing the firm with flexibility in the production process. Workers are said to be regarded as an integral part of the firm and develop firm-specific skills. They are rewarded through incentive devices based upon a rank hierarchy that primarily provides financial rewards (e.g. salary and bonuses) for length of service and good performance. The nature of the Japanese incentive system is said to allow for a greater delegation of decision-making, which encourages wider on-site information and problem solving and horizontal co-ordination across departments. This all facilitates positive learning externalities throughout the firm (Aoki 1988, 1990). Furthermore, relating incentives to long service also enables firms to retain employees with firm specific skills, which helps to explain the long-standing tenure of Japanese employment (Aoki, 1990). In contrast, Western firms are said to rely upon a hierarchical promotion system where incentives are primarily based upon job classification and seniority. Aoki (1990) infers that the Western incentive structure is one of status and therefore relies upon creating layers of specific tasks. This lessens the opportunities for workers to gain wide-ranging work experience and also reduces the flow of information flow throughout the firm. Furthermore, Western managers may be less likely to delegate decision-making, since it may undermine their own autonomy.

The Japanese firm's main financial relationship is through the main bank system, which provides cheap access to long-term funds, advice on investment projects and assistance in financial and foreign markets. The main bank usually has an equity stake in the Japanese firm, although it is unlikely to intervene in the business affairs of the company unless the firm is in financial distress. In effect, Japanese firms are given a corporate ranking, which is related to their profitability (Aoki, 1990). Dividends are usually paid at a set rate and are not related to profitability (see Abegglen and Stalk, 1985). An additional feature of Japan's capital markets is the prevalence of cross-shareholdings between companies, the reciprocity of which encourage a remarkable stability in equity holdings (Sheard, 1994). The financial system thus shields the

Japanese firm from the (short-term) threat of take-over, which is a particular feature of Anglo-American capital markets. It is argued that these arrangements allow the Japanese firm to make long-term investment decisions, particularly with respect to Research and Development[5].

The Japanese firm thus appears to embody long-term co-operation, trust and flexibility between the various parties involved. For Aoki (1990), the Japanese firm is a nexus of treaties with keiretsu relationships, employee relations and the financial structure all inter-related. The economic rationale behind their sustainability can be explained in terms of each party recognising the mutual benefit of co-operation. Furthermore, Aoki (1990) believes that because of these mutual interdependencies, the Japanese firm represents a wider set of interests than the typical profit-maximising Western corporation. Other writers have gone further and suggested that the arrangements within the Japanese firm favour employees, who can be considered as the firm's most important stakeholders (see Abegglen and Stalk, 1985, Miwa, 1996). We will return to all these issues in the next section.

3. Analysing the Corporation Through a Strategic Decision-Making Approach

As discussed in Section (2.2), Aoki (1990) emphasises the non-hierarchical coordination of production within the Japanese firm as compared to the hierarchical nature of the Western organisation. The question now arises as to whether these two organisational modes can be reconciled. In this Section, we adopt a strategic decision-making approach, which allows us to recognise a fundamental symmetry in both types of organisation - that control is exercised from one centre of strategic decision-making.

A strategic decision is one that determines the broad direction of a firm, such as its "geographical orientation, its relationship with rivals (and sub-contractors), with governments, and its labour force" (Cowling and Sugden, 1998, p.64). Those who have the power to make strategic decisions, thus effectively control the firm (Zeitlin, 1974). Furthermore, a concentration of strategic decisions can have wide implications for all those involved along the value chain. This would infer that the boundaries of

[5] Japan's financial structure has also been criticised as encouraging over-borrowing and unproductive investment (see, for instance, Hanazaki and Horiuchi, 2000).

the firm could extend beyond their legal frontier, to include not only in-house activities, but also all subcontracting arrangements. In this context, we would regard a firm as "the means of coordinating production from one centre of strategic decision-making" (Cowling and Sugden, 1998, p67).

The strategic decision-making approach has a number of implications. In our view, Japanese keiretsu relationships fall under the ambit of the core firm within the corporate group. Similarly, the boundaries of the Western firm also include activities conducted both in-house and through the market. If activities in each type of organisation are co-ordinated and controlled from the centre, then there are clear parallels between the command structures in both Western and Japanese firms. This may mean that the hierarchical differences highlighted by Aoki (1990) are somewhat superficial.

In our view, both the hierarchical nature of control and the concentration of strategic decision-making in Western firms reviewed in Section (2.1), and aptly described by Aoki (1990) as the H-mode, are valid (see also Cowling and Sugden, 1998)[6]. We would also maintain that similar command structures exist within Japan and that strategic decisions are concentrated within the controlling groups of corporate Japan. However, the Japanese case requires some further exploration, particularly in the light of Aoki's (1990) description of Japanese firms as being non-hierarchical in production and the various aspects of Japanese organisation that have led some authors to consider employees as the most important stakeholders (see Section (2.2)).

From our perspective, we first note that Japanese industrial organisation has historically been centred upon large-scale firms, or the core firms within the corporate group(s). Indeed, as we have already noted, within MITI's post-war industrial policy of targeting strategic industries for industrial development, there was a clear prejudice in favour of promoting the interests of the larger corporations (see Piore and Sabel,

[6] We should note that, in response to the Japanese challenge of the 1970's and 1980's, the modern Western corporation has been in the process of restructuring its organisation and altering its production processes to so-called "best practice". Some have argued that this re-organisation is along the lines of flexible specialisation and that the H-mode model may no longer be applicable (see Sabel, 1988). However, whilst changes in organisation may affect the operations of the firm, we would maintain that they are made to suit the interests of the firm's strategic decision-makers and, since the changes were generated from the top, they can easily be reversed in a similar fashion. The strategic decision-making approach thus retains its validity (see Cowling and Sugden, 1998).

1984). These were effectively regarded as Japan's national champions, who were encouraged to compete - internationally - with their Western rivals. With some modifications, Japan's production system was also one of mass production, and the activities of the smaller keiretsu firms, were geared towards the requirements of the large corporations (see Piore and Sabel, 1984).

In this respect, Japan's large firms effectively have control in production decisions, which this enables them to dictate contract conditions and impose technologies and processes upon their keiretsu partners. Ruigrok and Van Tulder (1995) have examined the various control mechanisms that the large Japanese corporations can exercise. They particularly regard the vertical keiretsu relationships as creating a "one-way dependency of suppliers on the end producers" (Ruigrok and Van Tulder, 1995, p.53). For instance, the core firm's insistence upon a *Just-in-Time* delivery system and kaizen quality control effectively forces the supplier to subordinate their production activities to suit the main contractor. In some cases *Just-in-time* allows the main contractor to shift the burden of inventories onto their upstream supplier, whilst tightening quality control measures, subjects the supplier's production processes to increased monitoring and effectively raises their dependency upon their main contractor. Furthermore the nature of open-book accounting and the expectation that suppliers should achieve ongoing cost reductions, position the main contractor in a strong bargaining position (Ruigrok and Van Tulder, 1995).

A related issue is the nature of Japanese equity holdings. Whilst the corporate group's equity ownership is relatively dispersed throughout the group, major shareholdings are typically concentrated amongst a few large corporate shareholders, who can exercise joint control (Sheard, 1994). These shareholders - which include the main bank - are likely to use their position to protect their own long-term interests. In the value chain, core firms usually control a significant proportion of equity in their lower tier suppliers. It is quite usual for core firms to use this influence to appoint their former executives into key positions within their supply chains (Ruigrok and Van Tulder, 1995). This has the effect of establishing direct lines of communication and allows for the dissemination of corporate strategy from the hierarchies of the core firms throughout the supply chain. Finally our view that Japan's keiretsu firms, are under the direct control of the larger corporations is reflected in recent comments accredited to Adio Kodani, a former Nissan appointed President of the automobile manufacturer's (then) Group supplier, Ikeda Bussan. According to Kodani, his experiences were that the "keiretsu served to create a comfortable vertical supply structure for Nissan, rather than as a structure to make affiliates stronger" (Nikkei Weekly, 21/8/2000). Clearly then, the ambit of the Japanese corporation extends beyond its legal boundaries to include the activities of their keiretsu sub-contractors.

In the workplace, we would also take issue with those authors that suggest that the Japanese firm is "run in the interests of the workforce" and that employees participate in corporate decision-making. Whilst we accept that, in the Japanese firm, there is a greater delegation of decision-making, we would argue that these refer to operational decisions; decisions that concern the daily operations of the firm. These are not strategic decisions, which, as we have described, affect the broad direction of the firm (Cowling and Sugden, 1998). Furthermore, the incentive schemes discussed by Aoki (1990, p.11-13), would also suggest that employees are subordinated to comply with management authority. The management themselves are also monitored through the main bank system, and poor corporate performance can lead to their removal (Aoki, 1990, p.15-16).

4. Strategic Failure

We have shown that, through a strategic decision-making approach, there is a fundamental symmetry between the command structures of both Western and Japanese style corporations. In each case, strategic decision-making and control is concentrated within elite, corporate hierarchies. This raises the possibility of strategic failure. We have argued, elsewhere, that Japan's current economic malaise can be seen in such terms (see Cowling and Tomlinson, 2000). As in the rest of the world, the Japanese economy is now dominated by large transnational corporations and we believe that their strategic decisions and global activities have precipitated a structural change within Japan that is possibly at the root of Japan's current economic stagnation.

Since the late 1970's, Japan's large transnationals have increasingly been moving their production activities offshore to take advantage of lower labour costs, to overcome rising Western trade barriers and to compete, strategically, on a global scale with their world rivals. The growing internationalisation of Japanese production is reflected in Figure (1), which plots the continued rise in Japan's overseas production ratio. The ratio measures the proportion of total manufacturing output produced offshore and, between 1985 and 1999, it had risen almost five-fold. In 1997, outsourcing also accounted for 31.1% of the total corporate output of Japan's transnationals', which represents more than a 350% increase on its 1985 level (see Figure (1)). In contrast, over the same period, overseas production has risen less significantly, in other major industrialised countries, such as Germany and the USA (see MITI, 1999a).

The trends in Figure (1) indicate the growing extent to which Japan's large firms have become involved in transnational production networks. These networks primarily involve production linkages across the Triad economies of Asia, North America and Europe, through the operations of Japanese affiliated and group companies. In this respect, MITI (2001) estimate that 48.7% of all Japanese transnational's trade-flows are now intra-firm. Such trade-flows include the exports of intermediate goods to offshore affiliates, which may aid domestic production and national income. However, the export induction effect of offshore production is increasingly being offset by reverse imports of manufactured products - from such affiliates - back into Japan. This is reflected in Figure (2), where the value of reverse imports, in relation to the value of exports of intermediate goods (to offshore affiliates), has risen significantly since the mid-1980's. This trend is a consequence of falling procurement rates from Japan, whilst over the same period, Japan's transnationals have increasingly begun to serve Japan's domestic markets from their offshore bases, primarily from those in East Asia[7]. From Figure (2), it is clear that a significantly greater proportion of Japanese value added is contributed by Japan's offshore affiliates.

We are concerned that the emergence of Japanese transnational networks and the associated growth in the outsourcing of production has exacerbated a significant decline in Japan's domestic industrial capacity, raising fears of a "hollowing out" of Japanese industry. In particular, successive MITI surveys have shown that the large

[7] Procurement from Japan is on a downward trend. In 1986, Japanese offshore affiliates procured 55% of all inputs from Japan. In 1996, this had fallen to 37% (MITI, 1998). MITI (2000) have noted that procurement rates from Japan continue to fall. In 1998, reverse imports accounted for 14% of all Japanese imports, compared with 4.5% in 1986. Japan's East Asian affiliates account for over 80% of all reverse imports and have increased four-fold during the 1990's (MITI, 2000).

transnational's global sourcing strategies have created severe demand problems for smaller firms within Japan's domestic keiretsu networks (see, for instance, JSBRI 1996, MITI, 1999b). Many small firms are effectively "locked in" to specific keiretsu relationships with their main contractors; indeed, such is the nature of these (vertical) relationships, that MITI (1999b, p.71) report that 81.6% of small firms have never changed their main contractor. This creates a major problem for small firms, since the growth of global sourcing places them in a weaker bargaining position in their contractual relationship with the large Japanese transnationals. As such, smaller keiretsu firms are finding it increasingly difficult to maintain order books, price levels and earn sufficient revenue to repay long-term borrowing commitments (JSBRI, 1996). The performance of the small business sector, as measured in by profitability, appears to be in long-term decline (see Figure (3)).

A related issue is that larger keiretsu firms have been encouraged to "follow" their main contractor overseas and the effect has led to a substantial decline in activity within Japan's industrial districts, such as the once prosperous Ota-ku Ward, in Tokyo (JSBRI, 1996). These trends not only divert investment away from Japan, but also reduce the potential for economic recovery and future industrial development. Finally, in the aggregate, MITI (1998) have estimated that the activities of Japan's transnationals have, since the early 1990's, adversely affected both domestic output and employment. Consequently, Japan's traditional institutional arrangements, such as full employment policies are no longer regarded as being viable in the global economy (see Katz, 1998). Japanese unemployment is now, for the first time in the post-war era, higher than that recorded in the USA (see also Cowling and Tomlinson, 2000).

At this point, we should note that there appears to be considerable similarities in the roots of Japan's current economic problems with those in countries that have also experienced periods of serious economic stagnation. As mentioned in Section (2.1), the large Western corporation was regarded as being inflexible in the face of lower economic growth and changing patterns in world demand during the 1970's and 1980's. Some authors have attributed the domination of the traditional Western corporation, in both the USA and Western Europe, as being a significant factor in the relatively poor economic performance of these economies during this period (see, for instance, Piore and Sabel, 1984). A similar story may also be told in the case of the former Soviet Union where, as we have already noted, Western command structures and industrial organisation practices were also adopted. In the Soviet model, bureaucratic elites emerged. Through rigid administrative control and central planning, the elites effectively stifled any opportunities for innovation or dynamism throughout the economy (see Davies, 1990, Ellman, 1989, Chavance, 1994).

The interesting feature in the Japanese case is that Japan - unlike the free-market approaches of the UK and the USA, or the bureaucratic approach of the Soviet Union - tried to combine a market economy with a strong interventionist industrial policy (see Johnson, 1982). In this sense, MITI may be seen to have tried to reduce the risks of strategic failure, since industrial policy attempted to control the direction of industry, maintain employment levels, and through MITI's close relationships with industry, monitor the activities of the large-scale firms. Industrial policy was implemented within the discipline of a market economy and, for most of the post-war period; the role and development of the Japanese corporation appeared to be congruent to Japan's economic prosperity. However, over the years, MITI's powers, in relation to Japan's large corporate sector, have since diminished and thus its ability to pursue the wider public interest has been undermined.

In this context, there is, perhaps, an even closer parallel between the Japanese experience and the recent demise of the Swedish model of social democracy. Since the Second World War, Sweden has actively pursued social and industrial policies described by Glyn and Rowthorn (1988) as "social corporatism". This involved the long-term co-operation of the State, large corporations and trade unions, which allowed Sweden to pursue an active labour market policy that minimised the risk of severe unemployment. This was particularly effective during the international economic crises of the 1970's and 1980's. However, in comparison to other industrialised economies, Sweden's productivity record was quite poor, which limited the possibility for further economic development. Interestingly, in this respect, Blomström and Kokko (1997) have noted that Sweden's "social corporatism" was engineered in favour of the larger transnational corporations - at the expense of the small business sector. The lack of economic dynamism in Sweden may be expected, given our earlier observations regarding the structure of these large corporations.

However, the neglect of the small-firm sector has meant that Swedish small-firms are less dynamic and innovative than in other countries, which also has had long-term implications for Sweden's economic performance (Blomström and Kokko, 1997). Today, Sweden suffers from much higher unemployment than in the recent past, and the model of social democracy has disintegrated.

5 Concluding Comments - A More Hopeful Way Forward

In this paper, we have explored the roots of the present stagnation of the Japanese economy. The main focus of our analysis has been the Japanese corporation and its (changing) role in Japan's economic development. We have argued that the command structures of the Japanese corporation are similar to those in their Western counterparts, and that control is exercised from one centre of strategic decision-making. This is important since there is now a concentration of strategic decision-making within the controlling groups of corporate Japan. The Japanese corporation now sees it's future as being increasingly involved in transnational production networks to such an extent that this is no longer congruent with the wider Japanese public interest. This strategic failure represents an almost inevitable long-term consequence of tying Japan's economic development to the development of its dominant transnational corporations. We have identified a variety of situations around the world where similar strategic failures have occurred.

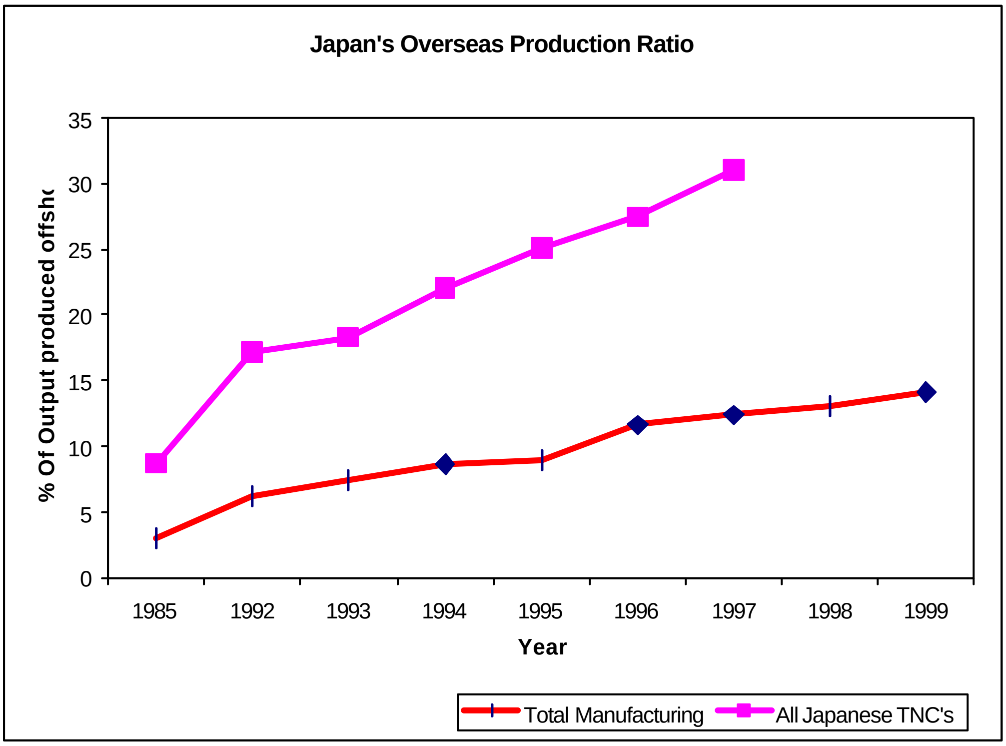
We would not, however, like to end on a pessimistic note. We believe that if appropriate policies are designed and pursued, then there can be grounds for optimism. We believe that, in order to rebuild a viable, long term and stable industrial base, Japan, and other countries, should begin to develop the foundations of a new diffuse economy, based upon non-hierarchical modes of production where strategic decision-making becomes more devolved at a local level. This leads us to favour policies which aim to promote and aid essentially horizontal networks of small firm production which may provide the basis, for what Best (1992) describes as a "collective entrepreneurialism", where clusters of small firms are able to challenge the current dominance of the large transnationals. This can only be achieved through an industrial policy, which is rooted in locality and community, where individuals and small firms can form and pursue their own ideas and interests but can also reach out towards a national and perhaps multinational level. We believe that it is only by taking such bold and radical initiatives that Japan and others can transform their economies and lay the foundations for recovery from the phase of strategic failure to which their current development path are inexorably led.

In this respect, it is interesting to note that MITI have recently been studying the experiences of small firm agglomerations in the industrial districts of Emilia-Romagna, in the Third Italy (JSBRI, 1996). Here, small firm networks, co-operating in a geographically confined region, have emerged to compete successfully, through flexibility and diversity, with the dominant large-scale, often vertically integrated corporations. In some respects, they mirror the traditional Japanese keiretsu firms, although they are not restrained by the high dependency nature of vertical de-integration.

The global economy also offers Japan new possibilities. Rather than promoting the interests of the large transnational corporations, Japan could encourage the formation of multinational webs made up of small firms (see Cowling and Sugden, 1999). This would see numerous Japanese small and medium sized firms being able to compete globally, as part of a group of similar sized international firms. In this situation, each firm operates on a small scale, but the activities of the group, in the aggregate, constitute a large-scale production process. The arrangements could be supported by supra-national institutional arrangements, including educational links and mutual research bodies. These suggestions may allow for economic decision-making to become more devolved, whilst also offering a viable, flexible alternative to the instabilities of large-scale transnational production.

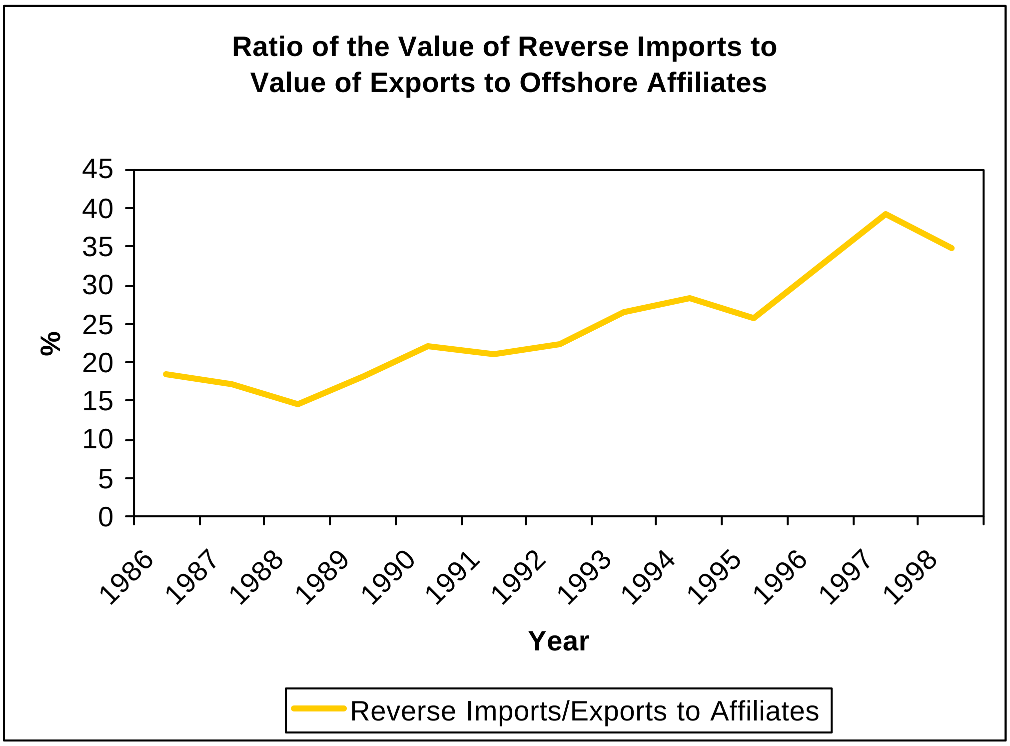
Appendix

Figure 1



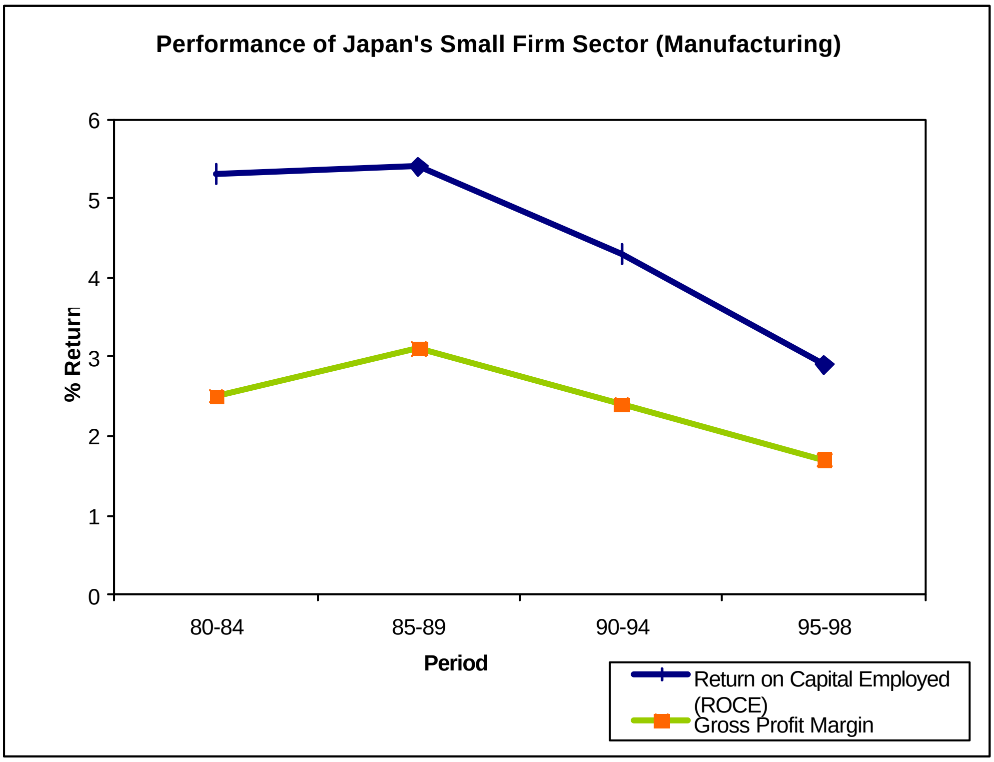
Source: MITI (June 2000): Summary of the 1999 Survey of Overseas Business Activities
MITI (September 1999): White Paper on Small and Medium Sized Enterprises in Japan

Figure 2



Source: MITI (June 2000): Summary of the 1999 Survey of Overseas Business Activities

Figure 3



Source - Japanese Statistical Yearbook - Various Issues.

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