

**JAPAN'S
ECONOMIC
POLICY**

—G. C. ALLEN—

JAPAN'S ECONOMIC POLICY

By the same author

BRITISH INDUSTRY AND ECONOMIC POLICY
THE INDUSTRIAL DEVELOPMENT OF BIRMINGHAM AND
THE BLACK COUNTRY
BRITISH INDUSTRIES AND THEIR ORGANISATION
THE STRUCTURE OF INDUSTRY IN BRITAIN
MONOPOLY AND RESTRICTIVE PRACTICES
A SHORT ECONOMIC HISTORY OF MODERN JAPAN
JAPAN'S ECONOMIC EXPANSION

Japan's Economic Policy

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In memoriam
Eleanorae
conjugis amantissimae

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Preface

My acquaintance with Japan began in 1922 when I took up a teaching appointment at the Nagoya *Koto Shogyo Gakko*, the precursor of the present Department of Economics at Nagoya University. At the outset my curiosity was aroused by certain distinctive features in the country's financial organisation and policy. This explains why the earliest of the papers in this collection are studies of Japan's foreign exchange, banking and monetary system in relation to her economic development. In the 1930s the centre of my interest shifted to her industrial organisation and to her progress as a producer and exporter of a widening range of manufactured goods. I retained this interest and later extended it to include the complex of factors responsible for her exceptionally rapid growth throughout the modern period, and especially for her industrial expansion after the Second World War. Aspects of this subject are reviewed in several chapters. One cannot proceed far in the study of this economy without becoming aware of the important role of the state in economic development. The role is not easy to understand. In Japan the public sector is small by international standards, and private enterprise and the market economy have flourished since the war. Yet the government, in recent times as in the past, has exerted a strong and pervasive influence on private decision-making and on the whole course of development. This theme is pursued in several of the papers and is central to some. Hence the title that I have given to this collection.

With two exceptions, the chapters reproduce the papers and articles in the form in which they were originally published, although I have not hesitated to make minor changes in the text in the interests of clarity, or when excisions were called for in order to avoid the tedious repetition of facts or arguments.

Such repetitions as remain are, I hope, justified by the differences in the context in which they occur. The first exception is Chapter 2 which is the result of conflating two papers, one published in the *Economic Journal* in 1925 and the other in *Economic History* in 1933. The second exception is Chapter 6. This consists, in both substance and form, of a long paper published in the *Annals of Public and Cooperative Economy* in 1968, but it also includes some paragraphs from an essay that appeared in the *Economic Review* of Hitotsubashi University in 1970. In the introductory chapter I have distinguished the main themes of the several papers and have called attention to the links between them. I have also ventured to carry a few of the arguments beyond the limits to which they were originally confined.

I express my thanks to the following for permission to republish the articles and papers of which the book is composed: the editors of *International Affairs*, the *Oxford Review of Education*, *Lloyds Bank Review*, the *Economic Review* of Hitotsubashi University, and the *Economic History Review* (for an article in *Economic History*); the editorial committee of the *Three Banks Review*; the Cambridge University Press (for two articles in the *Economic Journal*); the Director of the International Centre of Research and Information on Public and Cooperative Economy (for an article in the *Annals of Public and Cooperative Economy*); the Manchester Statistical Society (for the report of an address published in its *Proceedings*), and the British Association for Japanese Studies (for an address delivered at one of its conferences and afterwards published in its *Proceedings*). Acknowledgements in detail are given in the references to the individual papers.

I wish to record my indebtedness to my wife (to whose memory the two volumes of my collected papers are dedicated) for all the help, linguistic, literary and secretarial, that she gave me over many years.

1 Introduction

For almost a century the Japanese economy has grown at an exceptionally fast rate by international standards: in the interwar period the annual average rate was about 4.5 per cent, well over twice the rate in Western Europe.¹ At that time the outside world paid little heed to this achievement, largely because Japan, having started from a low level of income and technical accomplishment, still lagged behind the leading countries. Even when certain Western industries, for example, the manufacture of textiles, pottery and some miscellaneous consumption goods, felt the impact of her competition in international markets, her success was commonly ascribed to her low wages. Her advances in productive efficiency were generally ignored. Up to the eve of the Second World War it seemed inconceivable that Japan could hope to match Europeans and Americans in the higher reaches of industrial enterprise. To quote Sir George Sansom's comment on this attitude: there long remained in the minds of Westerners the presumption that 'only they themselves had the secret of manipulating levers and valves'.² An enquiry undertaken by the Royal Institute of International Affairs in 1935 came to conclusions that expressed the general view at the time: 'Japan remains primarily a peasant and agrarian State', so it was declared.³ Her industrial strength was confined to a few labour intensive industries, notably textiles, which drew their ill paid labour force from the overpopulated countryside. While she might well be able to enlarge her production of light manufactured articles, her prospects in the metallurgical industries or as a manufacturer of heavy and complex engineering goods were inauspicious.

Whether this prediction would have been generally accepted by European technicians with experience in Japanese firms during the middle 1930s is open to question. It is true that their

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counterparts a decade earlier were dubious about the ability of Japanese producers to rise above mediocrity in the industries characteristic of the advanced countries, metals, engineering and chemicals. By the 1930s, however, their technical capacity shown in a wide range of industries had won the respect of their European colleagues. Still, these were a small minority. In general, the Western world, on the eve of the war, was content to accept the comfortable verdict that Japan, for all her apparent progress, had 'feet of clay'⁴. And, even in the years just after the war, what were regarded as reasonably well-informed business and official circles, in Britain at any rate, were pessimistic about Japan's economic prospects, as Chapter 11 shows.

Until well into the 1950s the outlook was unpromising. Industrial production did not approach its prewar level until the economy felt the impact of the American demand for supplies on the outbreak of the Korean War. Although output rose quite fast after 1952, Japan's competitive position in international trade remained weak in most classes of manufactures for much of the decade. There were exceptions. The cotton and rayon industries were quickly re-equipped and soon became formidable rivals once more to their Western counterparts. Japan also showed distinctive excellence in the manufacture of a number of new light manufactures (cameras, binoculars and sewing machines). Yet the latter class of goods could never hope to rank as staple exports, while her trade in textiles was threatened by the growth of domestic textile industries in some of the Asian and South American countries she had formerly supplied. Her heavy industries, metals, machinery and chemicals, were much larger than in 1937, but in the early 1950s they were handicapped by the presence of obsolete or inferior plant installed during the years of war. Her costs in these industries were high because of her technical backwardness, the lack of cheap coal and the loss of her former sources of raw materials in East Asia. In international trade in their products she was considered a 'marginal' supplier, finding markets only when Western competitors were short of capacity. Her export trade as a whole did not regain its prewar volume until 1959.

In the early and middle 1950s her forlorn present concealed from outside view the pace of her reconstruction. Her investment, chiefly in industrial plant, reached 25 per cent of GNP in 1952 and rose steeply (proportionately as well as absolutely) in

subsequent years. The new equipment closed the technical gap between her and her Western rivals in one industry after another. Nor were her exertions limited to technical improvements. They extended also to the reconstruction of her financial and mercantile organisation (see, Chapter 7 below). So the pace of her recovery accelerated throughout the decade. The short cyclical recessions of 1954 and 1958, far from halting her secular advance, had a therapeutic effect by eliminating inefficiencies and compressing costs, thus preparing the way for future expansion. Yet it was not until the early 1960s that the small group of highly developed countries realised that a newcomer had joined their ranks. Even then there was widespread doubt whether Japan could stay the pace. Every recession gave rise to confident assertions that her days of rapid expansion were over, and that the influences responsible for her postwar achievements had spent their force.

Chapters 2, 3 and 4 consist of papers written during the interwar period and relate to the time when Japan, despite her progress, was still regarded as an 'underdeveloped' country. The financial difficulties analysed in Chapter 2 were closely linked with the expansionist financial policy that she had pursued from the early days of the modern era. Her leaders were preoccupied with the task of reconciling that policy with the maintenance of financial stability—the avoidance of inflation and of recurrent deficits in the balance of payments. In the days of the international gold standard, the problem presented itself in the form of constant threats to the gold parity of the yen. The chapter describes the expedients employed to meet these threats and traces the changing nature of the problem from the early years of the present century to the 1930s. Contemporary advocates of expansionist monetary policies may appeal to Japan's early experience in support of their views, but the identity between her policy at the time she adhered to the gold standard and the expansionist policies of the postwar years is more apparent than real. Japan's monetary expansionism was then kept in check by the discipline of a fixed exchange rate, a discipline which governments now repudiate.

At the time the first part of this chapter was written, economists, interested as many were in problems of the undervaluation or overvaluation of the exchange value of currencies, were much given to calculating purchasing power parities in trying to