

# Jissen-ha Economics and Japanese Industrial Policy

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Until very recently, the economic ideology that inspired Japanese industrial policy was neglected in social science discussions in English-speaking countries. It was widely believed that the Japanese experience of economic development had little intellectual foundation. Not only does every educated person in North America know that Western mainstream economics is largely irrelevant to the study of Japanese-type economies; even specialists in Japanese studies believe that “neither academic nor government economists played a major role in Japan’s high growth strategy”<sup>1</sup>. Academia in general has long indulged in what Saitō Seiichirō calls “a fallacious contrast between the prosperity of the Japanese economy and the desolation of Japanese economics”<sup>2</sup>. These perceptions may be correct in the sense that neoclassical economics has not exerted any notable influence on Japanese development. Academicians, however, have neglected the fact that a group of Japanese economists represented by Arisawa Hitomi (1896-1988), Nakayama Ichirō (1898-1980), and Tōbata Seiichi (1899-1983), who belonged to the generation educated before the war, played a very important role in the state’s policy making. These economists helped the nation to establish an urgent agenda, to identify the future direction of economic development, and to build theoretical framework for Japan’s industrial policy in the context of international pressures and domestic turmoil from the 1930s to the 1960s. According to leading Japanese economist Komiya Ryōtarō, “until about 1965, Japan’s industrial policy, implemented primarily by the Ministry of International Trade and Industry, was based on the ideological groundwork laid by this generation”<sup>3</sup>.

The major propositions of these economists constituted the core of what Kanamori Hisao calls “Jissen-ha economics” (the economics of actual fighting)<sup>4</sup>. Jissen-ha economics reflects the logic of economic reasoning behind three successive paradigms of Japanese industrial policy: the managed economy, technological innovation and high growth. These three policy paradigms together represent the intellectual foundation of Japanese developmentalism — a distinctive set of economic ideologies on how to proceed industrialization in a late-developed country.

## The Managed Economy

The managed economy was practiced in the 1930s and the 1940s. It was a watershed in

the institutional development of Japanese capitalism, and marked a major departure from the laissez faire doctrine. The most important development in the managed economy was the increasing intervention of the state in the economy. Because the goal of the managed economy was national survival in "total war," how to mobilize the limited resources for military purposes when the nation was isolated from the international market became the chief consideration in Japanese industrial policy. Theoretically the ideology of the managed economy rejected the importance of private ownership and private control of the economy, as well as the assumption that private ownership translates into economic and political power. Instead of the market, the state fulfilled the function of "economic general staff," exercising tight control over resource allocation at the macro level.

Many institutions that have strongly influenced Japan's postwar development originated in policy innovations under the managed economy. First, the state began to control the behavior of private firms through excessive regulations (which have become the major target of reform in the 1990s), and the function of the market in organizing economic life was significantly constrained. In the managed economy, almost every business practice was subject to state regulation. Second, the state replaced the old, voluntary cartels with a new, involuntary system — "the associations of control" (*Tōsei-kai*), which became an important instrument for achieving the state's policy objectives. Third, the state began to categorize firms and industries into a hierarchical order according to their importance to the national defense and then adopt a discriminatory policy in resource allocation. This practice was shared by many industrialized countries during World War II. It was a Japanese invention, however, to continue this discriminatory policy in resource allocation for the purpose of developing strategic industries in the postwar period. This has made a great difference between Anglo-Saxon capitalism in the United States and developmentalism in Japan.

The managed economy demonstrated a strong nationalist orientation through its racial and ethnic identity. Since the Meiji Restoration, Japan had had a tradition of "leaving Asia and joining Europe." It had also experienced a long period of domestic conflict between the working class and capitalists. In Japanese economic ideology between World War I and the end of the 1920s, the Taishō democracy increased the influence of Marxism as well as cosmopolitanism. The leading Japanese economic ideology, however, rapidly turned inward after the Manchurian Incident in 1931. Under strong pressure from the international community following Japan's misconduct, the ideology of managed economy began to advocate harmony and cooperation between capital and labor and to support the national interest in business operations. It rejected both Marxism, which proclaimed class struggle, and the laissez-faire doctrine, which regarded the profits of capitalist shareholders as the company's first priority. This change laid an ideological foundation for the postwar evolution of Japanese management because the wartime practices of assured job security and consistent annual wage increases were often interpreted as Japanese tradition.

## Technological Innovation

In the 1950s, as Japan shifted its focus from the military to wealth as the foundation of national power, it adopted a grand strategy of emphasizing the export of value-added heavy-chemical products in order to achieve a strategic position in the international competition. The ideology of technological innovation revised the neoclassical definition of comparative advantage, replacing the focus on an advantage in cheap labor with emphasis on an advantage in production technology. Although technology had always had strategic implications for Japan's national security, it was of central importance in Japanese economic ideology in the 1950s, and was perceived as Japan's only alternative to military force in international competition in peacetime. After they received an opportunity in the postwar period to learn the achievement of technological development in the United States, many Japanese concluded that their defeat in World War II was a result of losing the competition in technology.

In this new paradigm, the focus of Japanese industrial policy was shifted away from the effectiveness of resource allocation at the macro level, which had predominated in the managed economy, to efficiency of production by firms at the micro level. In the ideology of the managed economy, industries were perceived as supporting the military forces in wars among nation-states, and the state was said to act as the economic general staff in charge of the general mobilization of the nation. In contrast, in the new paradigm of technological innovation, firms rather than military forces, were perceived as the major fighters in international competition. Under such circumstances, according to the leading Japanese ideology, the state should no longer take over the function of the market. Since the winners and the losers in the business race had to be determined by their products, firms must promote their strength in market competition. The rigid control by the state on resource allocation would simply weaken the competitiveness of individual firms.

This new perception of comparative advantage in production technology led to some profound institutional reforms in the governance structure of the Japanese economy. The legacy of state intervention was modified into new forms. The bureaucratic control on material distribution was abolished, but the state continued to identify strategic industries and to allocate financial resources through its control of credit and foreign exchange to nurture the development of those industries. The state also played a very important role in keeping the market competition in strategic industries at a certain level through its antitrust policy and other state regulations, aiming at strengthening the competitiveness of Japanese firms through market competition while avoiding the waste of resources in "excessive competition."

The most important development in Japanese capitalism during the 1950s, however, occurred at the micro level. To strengthen the competitiveness of Japanese firms in the international market, the prewar *zaibatsu* business groups were reorganized into *keiretsu* after temporary dissolution during the occupation period. Centered around large commercial banks, these *keiretsu* networks provided manufacturing firms with reliable finance to promote production technologies through aggressive technological transfer and investment in

production equipment. At the same time, the state supported business leaders' initiative in stabilizing Japan's labor relations through the productivity movement. The eventual result was the institutionalization of Japanese management, which was characterized by lifetime employment, the seniority-based wage system, and the firm-based labor union. Under the paradigm of technological innovation, the general principles that governed Japanese business operations changed profoundly. Japanese firms made a historical trade-off, giving up the short-term profits that had often created layoff, in exchange for labor's participation in promoting production technology.

## High Growth

In response to the strong pressure for liberalizing trade and capital investment, the paradigm of high growth in the 1960s redefined the role of the state in economic development. In the 1960s, government planning and public spending were perceived as important means to sustain economic development, and macro financial policy was tied directly to industrial policy. The aggressive public spending in the 1960s was aimed at not simply adjusting for market fluctuations and sustaining economic growth, but upgrading the industrial structure of the Japanese economy and moving quickly toward more value-added heavy-chemical industries. After World War II, Keynesian economics became influential in state policy in most industrialized countries. In the Japanese case, however, macro-economic policy was applied to promote the industrial structure of the economy. The Japanese state increased public spending on a large scale in order to induce private investment and to sustain the high rate of economic growth; the goal was to strengthen the Japanese competitiveness not only in several strategic industries, but also in the entire economy. Economic growth had been a national goal for many countries, but the Japanese state in the 1960s made it into a means of strengthening Japan's position in the international competition.

Another profound change in Japanese capitalism in the 1960s was the settlement of the "private ordering" in the governance structure of the Japanese economy. Although the prevailing ideology of high growth stressed the leading role of the state in economic development, it focused on cooperation between the state and business, relying heavily on the dynamics of the private sector rather than assuming direct bureaucratic control. This was the outcome of a political struggle between MITI and big commercial banks. Under the pressure of liberalizing trade and capital investment, many Japanese were unsure whether Japanese firms could survive the imminent competition with foreign firms in their backyard. The reorganization of industry became a major concern in the policy debates in the 1960s. MITI bureaucrats proposed the bill titled "Special Measurement for Promoting Strategic Industries," in which the state would be given the power to supervise each loan made by commercial banks according to its policy objective. This was perceived as the "revival of the managed economy," and was strongly resisted by the private sector. Eventually MITI's initiative was blocked, and the "automatic adjustment" by the private sector prevailed.



as the governance pattern for the economy. With this settlement, the influence of giant companies and *keiretsu* on the economy increased rapidly.

## Marx, Schumpeter, and Keynes

These three successive paradigms in Japanese industrial policy between the 1930s and the 1960s were intellectually inspired by three great thinkers in Western economics; Karl Marx, Joseph A. Schumpeter, and John M. Keynes. The impact of Marx, Schumpeter, and Keynes on Japanese economic ideology were reflected in a series of interviews conducted by the *Toyo keizai shinposha* in 1967 with eight prominent Japanese economists on their general views of the Japanese economy: Arisawa Hiromi, Nakayama Ichiro, Tobata Seiichi, Tsuru Shigeto, Shimomura Osamu, Ouchi Hyoe, Takahashi Kamekichi, and Horie Shigeo. (Most of these men are discussed in this study.) After these interviews, one of the interviews, Koizumi Akira, tried to classify their positions into three categories: the market economy, represented by Friedrich A. Hayek; the mixed economy, represented by John M. Keynes; and the planned economy, represented by Karl Marx. He found that these eight economists' theoretical orientations were similar to those of either Keynes or Marx, and that none favored of Hayek, though he had become popular with the younger generation at that time. Instead of the static Hayek, this generation of Japanese economists preferred the dynamic Schumpeter. Another interviewer, Miyazaki Yoshikazu, pointed out that the perspectives of these Japanese economists were either short-term Keynesian plus long-term Schumpeterian, or short-term Keynesian plus long-term Marxian<sup>5</sup>. What particular elements of Marx's, Schumpeter's, and Keynes's theories inspired the policy agendas of Japanese developmentalism in different periods? How did these elements together prescribe a grand strategy for Japan's industrialization? Most *Jissen-ha* economists shared the Marxian belief in economic planning. At the same time, however, they differed from orthodox Marxism in certain important ways. In contrast to the cosmopolitanism asserted by classical Marxism, for example, Arisawa Hiromi's version had a strong nationalist orientation; it emphasized ways to strengthen Japan in the competition among nation-states, especially between Western countries and non-Western countries. Accordingly this version focused on production force based on technology and often acknowledged the role of big firms in innovation, rather than emphasizing the relations of production and treating big firms as agents of monopoly capital. Arisawa's version of Marxism, moreover, prescribed the avoidance of class conflict and advocated cooperation between management and labor, especially when the nation was in crisis.

Schumpeter's idea of innovation, in the Japanese context, was no longer an academic concept for making sense of the dynamics of economic growth, but was perceived as a practical strategy to upgrade the industrial structure of the Japanese economy so as to enable the nation to gain a strategic position in international competition. Gotō Yōnosuke once explained in what sense he introduced Schumpeter's idea of "innovation" in the 1956 White Paper on the Economy. He said that "according to Schumpeter's definition, innovation refers

to new technology, new products, new business organizations, and the creation of new markets. In this white paper on the economy, the meaning of innovation is further broadened. It suggests the modernization of Japan's economic structure"<sup>6</sup>.

Keynesian economics is applied in Japan as part of industrial policy to induce private firms to participate in innovation in order to meet the challenge of liberalizing trade and capital investment. Shimomura Osamu once made a clear distinction between the welfare state and Japanese industrial policy regarding the implications of Keynesian economics. He argued that the application of Keynesian economics "does not have to be limited to the economic situation when effective demand is needed. In that way, the issue of development is confused with the issue of full employment. The nature of development lies in innovation. Development is nurtured by promoting productivity, upgrading industrial structure, and enlightening human creativity. In short, it aims at paving a way for new and still higher productivity"<sup>7</sup>.

### **The Unit of Analysis: The Nation-State**

Rejecting methodological individualism asserted by neoclassical economics, Japanese industrial policy takes the nation-state as its unit of analysis. Unlike Anglo-Saxon capitalism, which was nurtured in the cultural environment of individualism that emerged in the Enlightenment, Japanese industrialization was a radical response to the Western challenge in the mid-nineteenth century. It was a "transplant" or an "imitation," which did not include the *laissez-faire* mindset. From the very beginning, Japanese industrialization was driven to achieve three collective goals: to "increase production and develop industry" (*shokusan kōgyō*), to build up "a rich country and a strong army" (*fukoku kyōhei*), and to pursue "enlightenment and civilization" (*bunmei kaika*). In short, Japanese industrialization was motivated not by the wish to improve individual economic well-being, but by the desire to strengthen the national power in international competition.

The nation-state as the unit of analysis in Japanese economic ideology encountered a great challenge during the period of "Taishō democracy." Japan underwent rapid industrialization after the Sino-Japanese War of 1894-1895 and the Russo-Japanese War of 1904-1905. By the end of World War I, Japan had become one of the major powers in the Far East. As the power of capitalist class and political parties reached a peak, Western individualism and *laissez faire* economics also spread widely. Although they did not completely prevail over other perspectives in the 1920s because of the strong influence of Marxism, declarations favoring individual shareholders' profits were more influential in political discourse than before and after that time.

The Great Depression and the international conflicts that followed the Manchuria Incident of 1931 changed the Japanese economic ideology profoundly. From then on, the nation-state had remained the unit of analysis in Japanese economic ideology until the end of the 1960s. This transformation reflected the changing historical environment. Assuming the inevitable military confrontation between Japan and Western powers, the managed economy

was driven by the concern for national survival in total war. The large-scale investment in equipment and the stabilization of labor relations in the 1950s were aimed at achieving economic independence for Japan by building comparative advantage in production technology and promoting exports in heavy-chemical industries. A fundamental concern in the high growth policy in the 1960s was to ensure Japan's position in international competition by improving infrastructure, promoting human capital, and upgrading industrial structure in the face of liberalization of trade and capital investment. The nation-state is the starting point in understanding Japanese economic ideology. Without this reference, many policy outcomes and institutional developments may be misinterpreted. This is why Daniel Okimoto argues that "the secret to Japan's apparent success lies in the overall system within which industrial policy functions. It is the dynamic combination of factors, interacting within the structure of an integrated system, that gives shape to the apparent effectiveness of Japanese industrial policy"<sup>8</sup>.

### **The Preference of End: The National Power of Production**

The preference of end in Japanese industrial policy is to build the national power of production. It emphasizes the long-term effectiveness of reaching goals, rather than the short-term efficiency of utility maximization. Lester Thurow once called the Japanese logic the "producer economics"<sup>9</sup>.

The implications of this producer economics varied. The ideology of the managed economy, according to Arisawa Hiromi "regards the public interest as more important than individual interest, and does not allow the practice of treating profit and individual interest as the first priority in economic activity"<sup>10</sup>. It was believed that "a laissez-faire economy based on the profit principle cannot integrate economic laws with ethics. Therefore the profit principle of the laissez-faire economy must be suppressed in order to make internal integration possible"<sup>11</sup>.

In the 1950s, it was thought that Japan is an island country with few national resources, and the operation of the Japanese economy inevitably depends upon trade. Without trade, both domestic production and employment will decrease, the economic cycle will be very small, and the Japanese people's standard of living cannot be sustained at a reasonable level. For these reasons, Japanese firms must aggressively pursue the advantage in production technology, disregarding the significance of short-term profit to business operations<sup>12</sup>.

Under the external pressure to liberalize trade and capital investment, the high growth policy in the 1960s extended the focus on the national power of production from the level of industry to the level of the entire economy. The National Income Doubling Plan declared that Japan must improve the infrastructure, promote trade, and develop human capital, science, and technology. As Shimomura Osamu remarked, high growth in Japan did not simply mean economic growth at a high rate. Rather, it implied the real promotion of productivity by rationalizing the production process and investing in production equipment<sup>13</sup>.

The emphasis on building the national power of production had a profound effect on the Japanese economy, and this "producer economics" had a dark side. During the process of Japanese industrialization, the ambition to build a "rich country" required many sacrifices by individuals. For a long time, as many critics pointed out, issues of individual rights, social welfare, consumer protection, and environmental protection received little attention in the ideology of Japanese developmentalism. As a result, improvement in the standard of living during the high growth period lagged far behind the pace of economic growth itself. Even in the 1990s, the quality of living in Japan is still not compatible with the country's GNP.

### **Instrumental Means: The State, Business Networks, and Japanese Management**

To facilitate the goal of building the national power of production through industrialization, Japanese economic ideology emphasized three instrumental means: the state, business groups, and Japanese management.

The state has been perceived by Jissen-ha economists as a "precondition" for sustaining industrialization in a late-developed country: capital expected the state to support the development of heavy-chemical industries, while labor demanded social legislation. The state, they contended, not only should act as an "entrepreneur," but also should take "political responsibility" for both economic growth and social stability<sup>14</sup>. This "developmental state," Chalmers Johnson argues, gave the greatest precedence to industrial policy. It provided businesses with the support and guidance they needed in an effort to upgrade the industrial structure of the Japanese economy and to enhance the nation's competitiveness in the global market<sup>15</sup>. The frequent state intervention in Japan, however, by no means indicates that the state intends to replace the function of the market. The leadership of the Japanese state in economic development does not preclude the role of the private sector. The real goal of Japanese industrial policy, Murakami Yasusuke argued, is to provide private firms with strong incentives to compete in strategic industries, while keeping the competition in these industries at a certain level by discouraging excessive incentives in order to avoid wasting limited resources. In other words, the state relied upon the market to strengthen the competitiveness of Japanese firms. At the same time, however, the state does not allow the market forces to run their own course, but guides these forces to serve its own policy agenda. The goal of Japanese industrial policy agenda. The goal of Japanese industrial policy is to sustain and guide market competition in the long run, rather than to replace market competition with bureaucratic control<sup>16</sup>. Keiretsu has been recognized as a distinctive pattern of business organization in Japan. The interfirm relations, according to Ronald Dore, comprise two types of "relational contracting," one between unequal forces and the other between equals<sup>17</sup>. The rational nature of this arrangement, according to the Weberian approach, lies in its "effective regulation of conduct depending . . . upon the strong common purpose of the group," excluding "outsiders" in an effort to reduce uncertainty in economic exchange<sup>18</sup>. From the viewpoint of Japanese industrial policy, the cost resulting from

competition sometimes may be greater than the profit. When numerous small firms compete with each other in the market, their profits will decline, and the capital return may become negative throughout the industry. More important, excessive competition will cause capital and labor to be concentrated in one industry more than is necessary; in the end, competition may not create the most efficient production system for the Japanese economy<sup>19</sup>. Since production technology and economy of scale are the most important factors in making Japanese firms competitive in the international market, Japan must enlarge the heavy-chemical firms and strengthen the integration between firms in R & D, investment, and cooperation in order to create companies that can compete internationally in strategic industries.

Japanese management has been perceived as another major instrumental means of promoting the national power of production. In Anglo-Saxon capitalism, the financial market functions as the major means by which individual shareholders generate profits, while the labor market enables individual workers to improve their incomes and other economic welfare. In Japanese capitalism, in contrast, both markets play a marginal role: the financial markets provides less opportunity to maximize profits, while the labor markets does little to promote social mobility<sup>20</sup>. Japanese management, characterized by lifetime employment, the seniority-based salary, and firm-based unions, represents principles fundamentally different from Anglo-Saxon principles regarding who owns the firm and how rights, responsibilities, benefits, risks, and information are distributed among parties affiliated with the firm<sup>21</sup>. The true nature of Japanese management is as an organizational arrangement to sustain the efforts of building the national power of production by linking technological innovation and promotion of productivity directly to the gains generated from these activities according to an agreed-upon arrangement between the firm and labor. The practices of lifetime employment and the seniority-based wage reflected the Japanese managers' intention to "get rid of the arbitrariness of the old capitalism, which follows the urge to pursue short-term profits"<sup>22</sup>. The Japanese state had long ago adopted a labor policy favoring firms. In light of liberalization of trade and capital investment, it shifted its policy toward labor in the early 1960s and began to "take a neutral position on the issues concerning labor relations and represent the interest of the nation by mediating competing interests"<sup>23</sup>.

## Another Way of Economic Thinking

Jissen-ha economics not only stands as an alternative theory of industrialization to neoclassical economics; it also resembles the tradition of the German historical school in the history of economic thought regarding research methodology.

Murakami Yasusuke pointed out that the fundamental difference between neoclassical economics and Japanese developmentalism is that capitalism as a subject for research in the former is an ahistorical concept, while industrialization in the latter is historical<sup>24</sup>. Neoclassical economics focuses on a particular aspect of virtually all of human behavior and

investigates facts and discovers truths about them. In contrast, Japanese developmentalism emphasizes the concrete processes of production, distribution, exchange, and consumption of goods and services. For this reason, Japanese developmentalism rejects neoclassical economists' claim that economic laws are universal, and insists on the relativity of economic theories. This view is consistent with Veblen's proposition that economics is an evolutionary science because the conditions of economic life are subject to variation. Most *Jissen-ha* economists belonged to either *Marukei* or *kinkei* by academic definition, but in regard to policy issues they could overcome the ideological restrictions of a single economic doctrine, and borrowed selectively whatever proved useful.

Moreover, neoclassical economics derives economic laws methodologically through logical and mathematical deduction, disregarding the ethnographic facts about human behavior in any given society and the cross-cultural data about any economic system<sup>25</sup>. Once these logical principles are derived by introspection, they become the axioms from which the "data" and the "facts" about others societies are to be "generated" or deduced. Produced in this way, models in neoclassical economics are inevitably derivative and universal<sup>26</sup>. In contrast, the major theoretical propositions of *Jissen-ha* economics were derived through induction. They were based on empirical studies of economic reality and were concerned with the timely issues confronted by the Japanese economy.

Neoclassical economics is based on methodological individualism and explains macro economic phenomena as an aggregation of individual behaviors. In this sense, neoclassical economics is influenced by the "physics imperialism" that emerged in the nineteenth century; methodological individualism simply resembles the method of atomization in physics<sup>27</sup>. Japanese developmentalism, in contrast, inherited the tradition of the German historical school. It treats economic phenomena institutionally, emphasizing how the nation-state increases its wealth through promoting the power of production by employing a state industrial policy, business networks, and Japanese management.

Finally, unlike neoclassical economics, which claims to be value-free, Japanese developmentalism regards the economy as a social system that has ethics. For this reason, the description by John Neville Keynes (the father of John M. Keynes) of the characteristics of the German historical school is also a precise summary of the standing propositions of developmentalism in Japan: "The school explicitly calls itself ethical; it regards political economy as having a high ethical task, and as concerned with the most important problems of human life. The science is not merely to classify the motives that prompt economic activity; it must also weigh and compare their moral merit. It must determine a standard of the right production and distribution of welfare, such that the demands of justice and morality may be satisfied. It must set forth an ideal of economic development, having in view the intellectual and moral, as well as the merely material, life; and it must discuss the ways and means — such as the strengthening of right motives, and the spread of sound customs and habits in industrial life, as well as the direct intervention of the state — by which that ideal is to be sought after"<sup>28</sup>.



## A Research Subject for Comparative Capitalism

As communism collapsed in the former Soviet Union and Eastern European countries in 1989, Francis Fukuyama cheered the “end of history”, predicting that there no longer exists any ideology to compete with the liberal capitalism<sup>29</sup>. What has emerged on the intellectual horizon since then, however, is not the “ultimate triumph” of laissez-faire doctrine, but an emerging research agenda of comparative capitalism. This agenda is oriented strongly toward a theory of capitalism alternative to neoclassical economics. It reflects a serious effort to search for a new order for the international economy in this post coldwar era. As the Japanese type of capitalism has been, is and will be practiced by many countries in an increasingly interdependent global economy, the theoretical foundation of Japanese industrial policy deserves serious study. Although the triumph of the Japanese economy prescribed by these economic ideas has become history with the passage of time, the logic and the reasoning contained in Japanese developmentalism have been incorporated into modern economic institutions, and stand before us as clues for exploring the nature of Japanese capitalism. As David Williams asserts, “history will not end until Japan, and much of East Asia with her, is made to conform to this new consensus. Until this happens, the world will stand beyond the end of history regardless of what has happened in Eastern Europe”<sup>30</sup>.

### Notes

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