In the 1970s and 1980s, Japan earned the moniker "reactive state" for the way in which its foreign economic policy tended to move mostly in response to strong foreign pressure from the United States, known internationally by the Japanese term *gaiatsu* (Calder 1988). Japanese officials showed few signs that they recognized that capital and trade liberalization, deregulation, and other economic reforms urged by the United States might actually benefit the country. They were seemingly blind to the fact that the postwar process of trade liberalization had played such a critical role in fostering Japan's own economic success. Japan did remove trade and investment barriers during these decades, reducing tariffs on many goods and eliminating quotas on beef and oranges. It seemed to adopt these policies, however, only when faced with strong pressure from the United States, often giving in at the last minute after facing strong threats.

Since the mid-1990s, however, Japan has been much more proactive in its foreign economic policy. Starting in 1994, when Prime Minister Hosokawa Morihiro refused to budge in the face of strong pressure from President Clinton at their summit meeting in Washington, Japan began saying "no" to American
trade pressure in sectors ranging from autos to film to semiconductors. At about the same time, it began removing regulatory and trade barriers, supporting multilateral trade liberalization, and negotiating free trade agreements—all on its own initiative. Although the fact that Japan began taking these initiatives at the same time it was saying “no” to the United States suggests that its emerging economic liberalism had little to do with American gaiatsu, this chapter develops the opposite argument. The growing tendency of Japanese elites to see economic liberalization as being in Japan’s own interest is the product of a long term learning process set in motion by earlier market-opening trade pressure, reinforced by the “school of hard knocks” Japan endured over its decade and a half of economic stagnation.

Before proceeding, let me clarify what I mean by Japan’s emerging economic liberalism. I am not saying that Japan has completely liberalized its economy and is on an uncontested path toward free trade. I am saying that Japan’s elite—its economic bureaucrats, leading opinion-makers, and some of its politicians—have shifted their beliefs about which economic policies are likely to produce the best performance for Japan. Fifteen years ago, even in the first several years after the collapse of the bubble, the broad consensus was that Japan’s system of “convoy capitalism” (lifetime employment, the main bank system; keiretsu business groups; and regulation and management by the government designed to keep this entire convoy moving steadily ahead) was a superior form of capitalism that promised faster growth with more economic stability than the alternative models found in Europe and North America. Japanese officials such as the Ministry of Finance’s (MOF) Sakakibara Eisuke loudly touted this model in meetings with foreign officials and within international organizations.

Today, in contrast, the conventional wisdom in Japan has turned against the old Japanese model, as is suggested by the following passage from the 1996 report of the Deregulation Subcommittee of the government’s Administrative Reform Committee:

The fundamental principle is consumer sovereignty. What gets produced, and how, should be decided not by producers and producer associations and bureaucrats but by the choices that citizens make in the marketplace and the responses of creative entrepreneurs to those choices. Our existing system is based on the false premise that the interests of citizens are best served if bureaucrats regulate; that they should take the lead in balancing demand and supply in order to protect and monitor established producers and ensure stable and orderly markets. That is wrong. The aim should be to promote healthy competition through appropriate and transparent rules, such as product liability rules written from the consumer’s point of view, thus avoiding the feather-bedding of inefficient existing producers and encouraging vigorous new entrants.

(quoted in Dore 2000, 160–61)

This passage, similar in tone and content to ones that can be found in dozens of advisory council and business group reports published since the mid-1990s (Dore 1999), clearly rejects the idea that the best way for Japan to maximize its economic welfare is through government regulation and protection of existing domestic producers. Instead, what Japanese government and other economic elites in recent years have been repeating over and over is that Japan needs to embrace domestic and international rules-based market competition as a means of restoring economic growth and competitiveness.

Japan’s emerging economic liberalism, however, involves more than rhetoric or ideas. Just as the Great Depression turned Americans against protectionism in ways that were institutionalized at the domestic and international levels (Goldstein 1993), the rejection of the idea that convoy capitalism represents a superior model for Japan is starting to produce domestic and
policies suggested by the isolationist orthodoxy in the lead-up to World War II, and got sucked into that terrible conflagration anyway. The presence of a coherent alternative vision for the nation thus combined with this "learning experience" to lay the basis for a new orthodoxy in the years after the war.

Although Legro correctly points us to an important part of the learning process—Japan would not likely be shifting to a new liberal orthodoxy if it had not experienced its longest and deepest recession of the postwar period—he unnecessarily restricts our focus to the process going on within domestic society. Extensive research in social psychology informs us that individual learning does not happen merely through individuals' experiences of "hard knocks," but inevitably involves social processes in which those who are learning interact with peers and teachers (Checkel 2001). We should not be surprised, therefore, that learning relevant to foreign policy similarly involves patterns of social interaction across borders (Haas 1990; Finnemore 1996; Keck and Sikkink 1998). In this article I explore how Japan's emerging economic liberalism has been influenced by Japanese elites' interactions with American economic officials and non-Japanese staff of international organizations. Japan's moves toward liberalization in the 1990s, I argue, have not been a product of coercion, lower transaction costs, or other material factors emphasized by realists and liberal institutionalists, but have instead resulted from elites' social, cross-border learning.

Let me emphasize: I do not consider this learning to have been a passive process in which meek Japanese officials learned at the feet of American teachers. Far from it! Japanese officials in the 1980s were self-confident about the superiority of their model. They had been hearing lectures about the magic of free markets from Americans for decades, going back to the Occupation years, but they had stuck stubbornly to the Japanese model. Nevertheless, even as years of lecturing by the United States trade negotiators provoked trade officials and politicians
to offer heated defenses of Japanese policies, they exposed them to the ideas of neoclassical economics—to arguments about how consumers, as well as producers and national income, all suffer when inefficient domestic producers are sheltered from foreign and domestic competition. When the Japanese economy turned sour in the 1990s, Japanese officials had plenty of old "class notes" to consult as they sought to diagnose the problem. This learning process was helped along by how Japanese officials themselves used liberal language and ideas, at first for purely defensive reasons aimed at countering American trade pressure, and by their defensive embrace of WTO and the Organization for Economic Cooperation and Development (OECD) multilateralism.

The Reactive State Pattern

When Japan gained admission to the General Agreement on Tariffs and Trade (GATT) in 1955 and the OECD in 1964, it assumed a variety of obligations requiring it to remove, reduce, or recon gure barriers to trade and foreign investment. Its admission to the OECD obliged Japan to eliminate restrictions on foreign direct investment, where under GATT rules, Japan was, in principle, expected to replace quantitative restrictions on trade, which were particularly numerous in the agricultural sector, with tariffs. These rules were based on neoclassical economic ideas about how competition, including international competition fostered by foreign investment and trade, improves economic ef ciency, enhances productivity, and propels economic growth. There is no evidence, however, that the Japanese who led the nation into these organizations did so because they shared these ideas. On the contrary, the extended period of mostly bilateral negotiations required to force Japan, through the use of threats and deadlines, to comply with these basic obligations of its membership in GATT, and the OECD helped earn the nation its "reactive state" reputation (Kusano 1983; Calder 1988; Mason 1992).

The initial negotiations wherein Japan resisted United States pressure to live up to its GATT and OECD commitments set the pattern for a long series of market-opening negotiations, stretching from the 1970s into the 1980s. Japan also resisted United States pressure to improve access to markets for American semiconductors, auto parts, satellites, supercomputers, construction, glass, paper, wood products, retail stores, financial services, telecommunications equipment, medical products, tobacco, and lawyers. In each of these cases, negotiations followed a set pattern (Campbell 1993). The United States would raise objections, usually beginning in late March of a given year when the Office of the US Trade Representative was required to list outstanding foreign trade barriers. It would initiate an investigation under US trade law that set speci c deadlines a year or so in the future and invite Japan to participate in bilateral talks aimed at "resolving" the dispute. The Japanese side would initially deny that there was any problem and grumble about American unilateralism, but always agreed to talk (at least until the mid-1990s).

In the early months of these talks, Japanese officials would insist that the difficulties US producers had expanding their Japanese market share was not due to Japanese barriers but to a lack of effort on their part. They would also explain why change was impossible. United States officials, meanwhile, would muster statistical evidence showing how US firms had much larger market shares in neutral markets than in Japan and warn the Japanese about how Congress was likely to "go protectionist" unless barriers were removed. They would also add some lectures about how liberalization would benefit to Japanese consumers and the economy as a whole. Japanese negotiators continued to defend existing policy. Then, as pressure built in the final days before a deadline, Japan offered enough last-minute
concessions to allow US officials to declare that they were satisfied.

Japanese liberalization in these cases was always grudging, offering no more than the minimum policy change to satisfy American negotiators, often at the very last minute. When announcing trade deals, Japanese officials rarely even pretended that Japan might actually benefit from the agreed policy changes. They listened to the lectures from the Americans about the benefits of free trade and market competition, but they stuck stubbornly to their beliefs that Japan’s model—with an extensive role for the government in managing competition so that Japan could move up the product cycle to dominate the most technologically sophisticated industries—was superior to American-style capitalism (Johnson 1982; Heginbotham and Samuels 1998; Tilton 1996). When Japanese officials conceded, under duress, to open markets, they made it clear that they had agreed to this only because the nation’s most important trading partner and ally was demanding that it do so. Trade liberalization was simply a price Japan had to pay to maintain access to the US market and to retain the American security guarantee (Calder 1988; Mikanagi 1996).

The Legitimation of Liberal Economic Views

Analysts studying Japanese economic policy have often asserted that national elites were more influenced by the economic ideas of Friedrich List than those of Adam Smith and David Ricardo (Fallows 1994; Samuel 1994). List emphasized how late developing countries needed to develop economies of scale behind protective trade barriers before facing competition with more advanced industrialized nations. The state also needed to help industries coordinate investment, through cartels and regulations, to speed the pace at which they developed scale economies and technological capabilities. Japanese industrial policy was long based on these List-inspired ideas. Given Japan’s backwardness, the state needed to step in to limit “excessive competition,” regulate market entry, and coordinate investment so that industry could develop the economies of scale and technology needed to compete with larger and more technologically advanced foreign firms (Johnson 1982). Not surprisingly, given the predominance of these views, few Japanese elites in the 1970s and 1980s subscribed to neoclassical views about the benefits of free trade and competition.

Of course, ideas similar to List’s were also once dominant in the United States. Alexander Hamilton, in the nation’s founding years, had emphasized the need for the state to assist industry by providing trade protection. As recently as the 1920s, the idea that trade protection was the best way to safeguard the nation’s economic interests was predominant in the United States. As noted above, however, the United States rejected this set of ideas after the disaster of the Great Depression and World War II, embracing in its place (embedded) liberal ideas closer to those of Smith and Ricardo (Ruggie 1982; Goldstein 1993).

In Japan, too, the learning process owed a great deal to the nation’s experience of its “Great Recession” in the 1990s, but learning began in 1980s when the nation’s economy was still outperforming that of the United States. Japanese officials at that time still believed in the superiority of the Japanese model, but, faced with a growing number of bilateral market-opening disputes and an impatient United States Congress, they put into practice a technique all good school children learn: the best way to avoid a teacher’s ire is to tell her what she wants to hear. Reagan administration officials, many of whom were neoliberal ideologues, were particularly prone to lecture Japanese about the virtues of free markets. Prime Minister Nakasone Yasuhiro was toying with this philosophy himself with his emphasis on budget-cutting “administrative reform” (Ohatake 1994). He decided that one way to get the Americans off his back would be to organize a blue ribbon commission that would produce a
document loaded with liberal policy proposals. With this aim in mind, he appointed a commission chaired by the former head of the Bank of Japan, Maekawa Haruo. Nakasone had deliberately staffed the group with reformist, market-oriented economists and intellectuals, knowing they would propose a reform vision that would please American critics of Japanese trade policy. That his audience was primarily foreign is also suggested by his decision to request that the commission complete its reports just in time to deliver them during “Ron-Yasu” summit meetings.

The reports were indeed a marked departure from earlier economic policy reports. Calling for “policies based upon market mechanisms,” the Maekawa Commission urged the government to promote deregulation based on the idea that there should be “freedom in principle, restrictions only as exceptions.” Rather than relying on increased exports to propel the economy forward, it urged, the government should “strive for economic growth based on domestic demand” in areas like housing and social infrastructure. Such changes were necessary, it argued, not because Americans demanded them, but because “the time has come for Japan to make a historical transformation in its traditional policies on economic management. ... There can be no further development for Japan without this transformation” (Maekawa Commission 1987, 22–30).

At the time, the Maekawa reports were widely dismissed as “window dressing,” both inside Japan and in the United States. The private advisory organ had no legal standing obliging the government to follow its recommendations, so its pretty words about how Japan would benefit from market-oriented reform were seen as little more than an attempt to distract American critics so they would not notice how slowly Japan was actually changing. Over time, however, the reports did have an impact. Japanese reformers involved in their preparation referred to them to back up their arguments, and US officials brought them up during subsequent bilateral talks, especially during the Structural Impediments Initiative between 1989 and 1993 (Armack 1996; Schoepf 1997).

Although the Maekawa Commission and the stubborn recession of the early 1990s had made liberal ideas about trade and competition more legitimate within Japan by the time the Clinton administration took office in 1993, the Japanese elite could not yet be called converts. Faced with post-bubble problems in the financial system, the cabinet led by Miyazawa Kiichi had propped up the stock market and banking system instead of allowing market forces to accelerate the structural adjustment of the economy, and once again the Japanese were relying on growing trade surpluses to plug the demand gap. When it took office the Clinton team thus stepped up the pressure, vowing to force Japan to accept voluntary import expansion (VIE) targets as the primary means of opening the nation’s markets.

Unwilling to accept VIES, Japanese economic officials once again planned to use American liberal economic ideas to deflect bilateral pressure. When the Clinton team pressed Miyazawa to accept targets during his spring 1993 visit to Washington, the prime minister and officials traveling with him spoke from a well-coordinated script. VIES would require the Japanese government to increase its intervention in the nation’s economy at a time when it was trying to move to a more free market approach, they said. Japan was finally trying to live up to the liberal ideals America had been selling for so long. It was now on the side of “free trade,” whereas the Americans were pushing “managed trade.” The Japanese continued this line of rhetoric through the conclusion of the auto dispute in the summer of 1995, to good effect (Lincoln 1999). They ultimately won the Europeans and other third parties over to their side as they isolated the Clinton team internationally, a strategy that helped Japan fend off VIE demands.

Although this Japanese attempt to hide behind the “free trade” banner was again mostly a public relations exercise, the
rhetoric and ideas in reports such as these. Within months of the Hiraiwa Commission’s adjournment, one of its leading members, Nakatani, was loudly bemoaning the failure of the commission to live up to its rhetoric (Nakatani and Ohta 1998). A few years later, Takenaka Heizō, another reformist economist who played a leading role on the Economic Strategy Council under Prime Minister Obuchi Keizo, similarly lambasted the government for failing to match its rhetoric with deeds. These advocates of market-oriented reform did not just write books, they appeared over and over again on television, gaining a wide audience for their views and virtual celebrity status—especially as Japan relapsed into recession after 1997 and again after 2000. In each case, they had a larger audience than they would have because they appeared as “I-told-you-so” prophets, arguing that the economy’s difficulties grew out of the nation’s failure to fully enact their pro-market policy packages.

By the end of the decade, liberal ideas were the new orthodoxy in Japan. Policy was not yet aligned with these ideas, but everywhere one looked one saw government reports, best-selling books, and television commentators criticizing regulations and trade protection for stifling economic growth and toutng rule-based market competition as the tonic for what ailed the nation. Not just Nakatani and Takenaka, but other reform economists and intellectuals, such as Sakaiya Taichi (1999), Katō Kan (1997), and Noguchi Yukio (1995), all wrote hot-selling books featured in cascading displays in Tokyo’s bookstore windows.

Meanwhile the government continued to churn out economic policy reports, by this time independent of the US-Japan negotiating calendar, urging Japan to embrace competition, individualism, and risk-taking. Particularly notable was the language chosen by two advisory councils organized by Prime Minister Obuchi Keizō after the economy hit a new low amid fears of a financial crisis in the summer of 1998. Neither of these
reports was motivated by a desire to give the Americans some pretty prose to distract them from bilateral trade demands. As the panels deliberated in 1998 and 1999, US-Japan economic relations were as relaxed as they had been in many years. Obuchi convened the panels simply to provide the government with blue prints for the future that would guide Japan's own efforts to restore the economy to health as it entered the new century.

The first panel, organized immediately after Obuchi took office, was headed by businessman Higuchi Hirotarō. It was the Economic Strategy Council, charged with the urgent and immediate task of recommending how Japan could right-end an economy that was on the brink of a financial crisis and suffering from deflationary tendencies. The panel's recommendations again emphasized competition. It blamed Japan's economic problems on the prevalence of "moral hazard" situations "where consequences do not change regardless of whether people try to do their best." It called for reforms that would introduce a "competitive society with soundness and creativity" in place of the old "convey system" (Economic Strategy Council 1999, 18).

Also interesting was the report issued by a follow-up panel, the Prime Minister's Commission on Japan's Goals in the 21st Century (2000), that was tasked by Obuchi with the job of fleshing out a longer term vision. In a section titled "Realizing Japan's Potential," the commission wrote:

The other essential change is to redefine and rebuild the relationship between private and public space in civil society. This means first and foremost promoting individuality and individual initiatives: unleashing sturdy individuals who are free, self-reliant, and responsible .... These tough yet flexible individuals will participate in and expand public forums on their own initiative, creating a dynamic public space. The public space thus cultivated will provide individuals with more diverse choices and opportunities. This will lead to the emergence of individuals and a society that take risks more boldly, address pioneering challenges, and are more creative and imaginative.

(p. 2)

Elsewhere, the report speaks about the need for Japan to replace a governance system where exalted officials look down on citizens with a new contractual relationship where "the people" delegate authority to their government (pp. 6–7). If the Maekawa and Hiraia reports sometimes read like the work of a student trying to use words and phrases that would please the teacher, these more recent documents, prepared mostly for consumption by the Japanese public, suggested that Japanese elites had internalized liberal ideals.

Defensive Multilateralism

Before turning to the consequences of this idiosyncratic shift, we need to consider another channel through which American aggressive bilateral trade pressure led Japanese economic elites to imbibe liberal economic ideas. By the mid-1990s, Japan was among the most enthusiastic cheerleaders of the WTO (Pekkanen 2001a and 2001b; see also Davis and Shirato 2007). During their tense standoff with the United States over the auto dispute, Japanese negotiators presented themselves as the defenders of the multilateral trade order against American aggressive unilaterals. When the United States attempted to press Japan into negotiating bilaterally to resolve their subsequent dispute over photographic film, Japan again insisted that all such disputes needed to be referred to the WTO. More recently, Japan stepped forward during the lead-up to the new Doha Round as a leading advocate of WTO reforms designed to end abuses of anti-dumping remedies.

Japan's embrace of multilateralism in the 1990s certainly contrasted with its slow compliance with GATT and OECD rules in the 1960s and 1970s and suggested that the nation "had seen
the light" and changed its views on its own. In fact, the conversion had been very much assisted by the United States, which, through insistent bilateral demands, drove Japan to seek refuge in multilateralism. Japanese government officials are quite frank to admit that they turned to the GATT and WTO in self-defense.1 In the late 1980s, after Congress added a "Super 301" provision targeting Japan under US trade law, Japanese officials began considering how best to counter the intolerable trend toward escalating demands. At about the same time, GATT signatories were considering ways to improve the organization's dispute settlement mechanism. Japanese officials quickly realized that proposed reforms, which after adoption eliminated the ability of losing parties to veto dispute panel rulings and reduced opportunities for delay, provided another means for them to deflect bilateral demands. Because the United States too was backing the reforms, they could insist that American officials live up to their commitment by referring all subsequent disputes to this body. They could also counter any American threat to impose sanctions unilaterally with a threat to challenge such a move before a WTO panel (Schoppa 1999).

Japanese officials also worked to channel bilateral disputes involving competition policy and regulatory harmonization into the OECD, another venue for discussing issues in a multilateral setting. Competition policy was not something the WTO had traditionally handled. Faced with American demands that therefore these issues needed to be handled bilaterally, Ministry of International Trade and Industry (MITI) officials proposed the OECD as an alternative forum for dealing with these issues. MITI officials also sought to improve their ability to resist bilateral pressure to harmonize regulations on American standards by turning to the OECD as a forum in which the Japanese could point to a number of competing regulatory standards closer to those employed in Japan.

Though motivated primarily by defensive concerns, Japan's embrace of multilateralism again had consequences. One of the most interesting consequences was the effect of this strategy shift on Japanese officials sent to staff these international organizations and negotiate under their jurisdiction. Whereas the most promising young officials in the Ministry of Foreign Affairs (MOFA) and the Ministry of Economy, Trade, and Industry (METI) had, in the past, been routed through key positions dealing with the bilateral relations since the late 1980s, these ministries have promoted to the most senior positions officials with extensive experience in multilateral economic organizations. Officials admit that this personnel shift reflected their conscious decision to put more emphasis on multilateralism in order to counter American trade pressure.2

Like the decision to incorporate liberal rhetoric into government reports, this strategy had ideational consequences. It is well known that international organizations like the International Monetary Fund (IMF), WTO, and OECD share an organizational culture that emphasizes neoclassical economics. Though John Williamson (1990) was referring mostly to the Washington-based international organizations (the IMF and World Bank) when he coined the term "Washington Consensus," the phrase captures just as well the economic ideology of the OECD (based in Paris) and WTO (Geneva). Each of these institutions employs large number of economists, most of them trained in the United States even if they are not American themselves. The policies they recommend include privatization of state-owned enterprises, deregulation, and labor market reforms. By sending fast-track young officials to serve in these institutions for periods of two or more years, the government assumed the risk that they might absorb some of these ideas that were so contradictory to the pre-1990 conventional wisdom in Tokyo.
Some of them clearly did. One example is Kawamoto Akira, a young METI official who was sent in 1995 to serve on the staff of the OECD in Paris. In that capacity, one of his duties was to assist in the preparation of the OECD Review of Regulatory Reform in Japan, published in 1999. Over an extended period, he was required to respond to criticism of Japanese policy based largely on neoclassical ideas about the benefits of competition. Although his job was to make sure Japan did not come off looking too bad in the report, he had to phrase his defenses in terms that appealed to the permanent OECD staff. The daily experience, he reports, convinced him that Japan needed far-reaching reform. While in Paris, he wrote a mass-market book titled Regulatory Reform: Competition and Cooperation (1998), emphasizing Japan’s need to harness competitive market forces in order to deal with its economic problems. After he returned from Paris, he was tasked first with helping to draft the ministry’s White Paper, sketching out its overall policy vision. In 2001, he was given a job where he had an opportunity to put his ideas into practice. As head of the Electricity Market Division, he helped draft new regulations for the electricity sector that have introduced (a limited degree of) market competition into a sector that had previously been dominated completely by regional monopolies (Schoppa 2006).

Such experiences, shared by many other young economic officials, have helped further consolidate the ideational shift toward the acceptance of neoclassical views on economic causes and effects within the Japanese government. My experience talking with economic bureaucrats over the past ten years suggests that most of the under-45 generation, as well as many of those above this level, now accept the view that market competition, facilitated by ample international trade and investment, is required to make mature economies such as Japan’s more productive and wealthy. Older and retired bureaucrats such as Sakakibara (1999) may still tout the advantages of Japan’s state-led approach, but his views are now in the minority among government officials—not just in METI and MOFA but also in MOF.

The Consequences of Ideational Change

Changes in economic ideas, of course, do not in themselves constitute changes in policy. Though Japanese bureaucrats and other elites now accept the idea that coddling incumbent firms through regulation and trade protection imposes costs on society, they are frequently unable to move reforms based on these ideas through the policy process in the face of inertia built up over many years of running the economy based on the Japanese model. Indeed, actual change in economic policy happens slowly, with the government hesitant to unleash market forces that might lead to cascading bankruptcies and rising unemployment and promise to hurt most those constituencies tied most closely to the ruling Liberal Democratic Party (LDP).

Nevertheless, the shift in ideas I have described has already had two consequences that have started to move actual policy outcomes in a liberal direction and make continued movement in this direction likely in the future. First, liberal economic reforms have reached the top of the policy agenda. Scholars of public policy have long emphasized how policy change depends critically on which alternatives are on the table (Kingdon 1984). The predominance of liberal economic ideas in Japan today guarantees that whenever there is enough energy to generate policy change, reforms almost always involve further relaxation of regulations and opening of markets. Second, liberal ideas are being institutionalized through changes in domestic and international law in ways that promise to shape policy for years to come.

Both of these causal mechanisms through which ideas shape policy can be seen at work in the example of Prime Minister Hashimoto Ryutaro’s Big Bang reforms. Announced in the fall
of 1996, this initiative was designed to make Japanese financial markets "free, fair, and global." Interestingly, neither Hashimoto nor the chief architect within the Ministry of Finance, Sakakibara, was regarded as a liberal. Yet, faced with the need to do something about the hollowing out of Japanese financial markets, they turned to the set of proposals that happened to be on the agenda—all of which involved introducing more competitive market forces into financial markets. Just a decade earlier, when the mcr had been pressured to liberalize financial markets, it had done so in ways that actually increased officials' discretionary power by creating "more rules" (Vogel 1996). This time, with the dominant ideology having shifted to a point where most economic elites saw a need for Japan to constrain bureaucratic discretion and rely on market forces, the policy package Hashimoto announced took a genuinely liberal form.

Though phased in more slowly than the British Big Bang of the Thatcher years, with the final measures not implemented until 2003, the package lived up to this promise. Firms previously operating in segmented markets for various banking services (city, trust, and long-term credit), various types of insurance (casualty, life, and third sector), and securities are now free to compete across all of these boundaries. Previously strictly regulated fees for these services were liberalized so that firms can compete based on price. All foreign exchange restrictions were eliminated, allowing capital to flow across borders with no restrictions. The government guarantee that had previously promised no bank would be allowed to fail was removed (Laurence 2001). These reforms have already had a major impact on this area of business, with foreign firms playing a much larger role in a wider range of financial services and Japanese firms having to worry much more than in the past about the possibility of bankruptcy if they fail to compete.

The Big Bang also illustrates how ideas, once institutionalized, can have broad and long-lasting effects. Once dismantled, the government cannot easily recreate the convoy. Once the reforms began to be implemented in the late 1990s, the government was no longer able to keep the weakest firms in banking, securities, and insurance afloat. And once firms in the financial sector saw that their survival was at risk, they stopped supporting the weakest, most over-leveraged firms in retail, construction, and manufacturing. That both financial and nonfinancial firms now face the possibility of bankruptcy means they cannot afford to overlook opportunities to buy good foreign products at a cheaper price or enter into partnerships with competitive foreign firms. This shift in incentives affecting the procurement and business strategies of Japanese firms has already played a major role in opening up what were once closed markets in Japan.

The role of ideas could also be seen at work in the term of Koizumi Jun'ichiro as prime minister. Faced with stubborn debt and deflation problems, Koizumi embraced a reformist vision that was even more closely attuned to the new liberal orthodoxy than Hashimoto's Big Bang. He could have emphasized increased spending on unemployment insurance and other measures of this type, designed to reassure voters nervous about the economy's continued poor performance, but instead he, too, focused on a set of reforms that were largely based on liberal economic principles. His slogan, "structural reform without sanctuaries," told voters he wanted to help accelerate the pace at which the economy adjusted to market forces. Though it promised pain in the short term, the idea was popular enough to help him win approval ratings that topped 80 percent early in his term and were high enough even in 2005 to allow him to challenge opponents of liberal reforms inside the LDP.

The specific reforms he stressed, too, were liberal ideas, including a freeze on government debt issuance and the privatization of public corporations—including Japan Highway, the Japan Housing Finance Agency, and the mail, banking, and
insurance services provided by the postal service. Koizumi had a decidedly mixed record in his efforts to push forward this liberal reform agenda (Schoppe 2006). His attempt to restructure Japan Highway in a way that would constrain its ability to finance extensive new road construction failed. On the other hand, the Japan Housing Finance Agency was restructured in a way that took it completely out of the business of providing new housing loans. It now operates primarily through its role in the secondary markets, like Fannie Mae. Koizumi’s most famous achievement—the privatization of Japan Post, secured by expelling rebel LDP Diet members from the party and calling an early election in 2005—is not as clear a victory for liberal reform as was advertised at the time. To secure the passage of this legislation, Koizumi was forced to accept a number of compromises that have limited the entry of new competitors in mail services and have dragged out the process of privatizing postal financial services to such a degree that it remains unclear whether the restructured Japan Post will begin rechanneling its massive financial assets away from the traditionally favored, government-affiliated clients (Macalatchan, 2006). My point here is not that liberal economic ideas have triumphed over all opposition, but that they set the agenda in such a way that policy change since 2000 has moved mostly in a liberal direction whenever political energy has created an opening.

The final set of economic policies that can be linked to Japan’s emerging economic liberalism are those that deal directly with trade: the proposals for Japan to participate in an expanding array of bilateral and, now region-wide, free trade areas (Manger 2005; Pekkanen 2005; and Noble in this volume). Bilateral Free Trade Agreements (FTA) have now been completed with Singapore, Mexico, Malaysia, and the Philippines, and additional bilateral deals are in the works. And these bilateral deals are now being supplemented by regional deals, starting with a recently-signed FTA linking Japan and Association of Southeast Asian Nations (ASEAN), that may lead eventually to wider regional agreements including China, Korea, India, Australia, New Zealand, and maybe even the United States. These agreements are clearly driven in part by forces outside Japan, and cannot be attributed solely to a shift in ideas among Japanese elites. Japan’s interest in FTAs began when other nations (Mexico and Singapore) came to METI with proposals, and its willingness to consider one with ASEAN as a whole had much to do with the organization’s earlier decision to sign one with China. But the rapid pace with which they have accumulated is also a reflection of METI’s view, heavily influenced by liberal economic ideas, that Japan cannot afford to be left behind as the United States and Europe gain advantages by widening and deepening their own regional free trade networks (Krauss 2000). METI officials see these free trade areas not only as opportunities to expand export markets for Japanese goods and assist transnational Japanese firms with operations spread across the region but also as opportunities to bring import competition to bear on inefficient Japanese industries in ways that force them to become more competitive. Free trade is now seen within METI as a vital part of its effort to accelerate structural adjustment of the economy.

Of course, Japan’s regional trade policy continues to be constrained by politicians and ministries that do not share METI’s enthusiasm for structural adjustment. Singapore became Japan’s first FTA partner in large part because it does not have an agricultural sector that threatens to challenge Japan’s inefficient producers. While the power of farmers’ material interests trumps Japan’s emerging economic liberalism in many cases (as it has in the United States and Europe), this should not distract us from the fact that outside of agriculture these agreements promise to markedly increase trade volumes, investment flows, and international competition—exactly what liberal economic doctrine prescribes.
Conclusion

This chapter has argued that Japan's shift toward a more proactive foreign economic policy is a product of a complex learning process that has convinced Japanese economic elites that the nation's economic interests now lie in dismantling convoy capitalism and introducing market forces. Rather than waiting for pressure from the United States to force it to adopt these policies, these ideas are generating home-grown initiatives like the Big Bang, structural reform without sanctuaries, and regional free trade agreements that are opening Japan up to foreign and domestic competition for its own sake. Whereas recent initiatives have been "home-grown," however, the process of ideational change that has helped produce them was in part the product of Japan's earlier interactions with the United States. Its efforts to deflect gaiatsu by setting up liberal advisory councils and using liberal rhetoric ended up legitimizing these views, especially after Japan’s economy entered its decade-long slump. At the same time, when it sought to channel negotiations into multilateral institutions, it ended up exposing the new generation of fast-tracked economic officials to the liberal ideas that dominate these institutions. We cannot make sense of Japan's shift toward a proactive foreign economic policy without appreciating the role gaiatsu played in speeding and directing Japan's learning process.

This last claim is perhaps the most likely to be challenged by skeptical readers. Isn't it possible that the shift in ideas I have described here is best explained by the economic difficulties that confronted Japan during the 1990s? American trade pressure and related interactions among American and Japanese economic elites were not necessary to bring about the shift because it was bound to happen in view of the economic difficulties Japan was confronting. Readers who are themselves believers in orthodox neoclassical economic ideas are likely to conclude that it was only "natural" that Japanese elites turned to market competition as the alternative to the Japanese model when that system was so obviously failing.

I agree that the nation's economic difficulties, like American difficulties during the Great Depression, were a major cause of the ideational shift. To assume that therefore Japan was destined to learn that the American model was superior, however, is to ignore the inherent difficulties nations face when an old orthodoxy is overthrown. Rejection of the old approach does not lead automatically to the acceptance of a new one because there are usually several contending approaches. The extensive attention paid to the United States because it was Japan's primary interlocutor in trade and economic diplomacy, and the way in which this led the Japanese government to parrot liberal ideas, played a critical role in making American-style liberal capitalism the "focal point" as Japanese elites searched for alternatives to the floundering Japanese model.

We cannot rerun the 1990s without American influence to see if Japan would have settled so quickly on liberalism as the alternative to the Japanese model, purely due to its economic difficulties. The best we can do is to consider a counterfactual. What if Japan's primary interlocutor during these years had been Europe? The problems Japan has faced in the 1990s have not been merely those of efficiency but also of economic insecurity and associated tendency of consumers to hold back on consumption. If Japan had been heavily engaged in economic negotiations with Europe during these years, isn't it possible that the European welfare state might have emerged as the orthodox answer to Japan's economic worries?

Of course this is not how history unfolded. Instead, the loudest gaiatsu came from the United States, and Japan tailored its response to the American audience. The government peppered its publications with nods to the economic efficiency of markets; economic negotiators sought to counter the Americans by portraying themselves as champions of free trade; and the
nation sent its brightest young officials to participate in multilateral economic institutions. It should not surprise us that these strategic reactions to American pressure led Japan to hone in on American-style capitalism as the primary alternative to the Japanese model.

Notes


References


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In the 1970s and 1980s, Japan earned the moniker "reactive state" for the way in which its foreign economic policy tended to move mostly in response to strong foreign pressure from the United States, known internationally by the Japanese term gaiatsu (Caldar 1988). Japanese officials showed few signs that they recognized that capital and trade liberalization, deregulation, and other economic reforms urged by the United States might actually benefit the country. They were seemingly blind to the fact that the postwar process of trade liberalization had played such a critical role in fostering Japan's own economic success. Japan did remove trade and investment barriers during these decades, reducing tariffs on many goods and eliminating quotas on beef and oranges. It seemed to adopt these policies, however, only when faced with strong pressure from the United States, often giving in at the last minute after facing strong threats.

Since the mid-1990s, however, Japan has been much more proactive in its foreign economic policy. Starting in 1994, when Prime Minister Hosokawa Morihiro refused to budge in the face of strong pressure from President Clinton at their summit meeting in Washington, Japan began saying "no" to American
trade pressure in sectors ranging from autos to semiconductors. At about the same time, it began removing regulatory and trade barriers, supporting multilateral trade liberalization, and negotiating free trade agreements—all on its own initiative. Although the fact that Japan began taking these initiatives at the same time it was saying "no" to the United States suggests that its emerging economic liberalism had little to do with American gaiatsu, this chapter develops the opposite argument. The growing tendency of Japanese elites to see economic liberalization as being in Japan's own interest is the product of a long term learning process set in motion by earlier market-opening trade pressure, reinforced by the "school of hard knocks" Japan endured over its decade and a half of economic stagnation.

Before proceeding, let me clarify what I mean by Japan's emerging economic liberalism. I am not saying that Japan has completely liberalized its economy and is on an uncontested path toward free trade. I am saying that Japan's elite—its economic bureaucrats, leading opinion-makers, and some of its politicians—have shifted their beliefs about which economic policies are likely to produce the best performance for Japan. Fifteen years ago, even in the first several years after the collapse of the bubble, the broad consensus was that Japan's system of "convoy capitalism" (lifetime employment; the main bank system; keiretsu business groups; and regulation and management by the government designed to keep this entire convoy moving steadily ahead) was a superior form of capitalism that promised faster growth with more economic stability than the alternative models found in Europe and North America. Japanese officials such as the Ministry of Finance's (MOF) Sakakibara Eiuke loudly touted this model in meetings with foreign officials and within international organizations.

Today, in contrast, the conventional wisdom in Japan has turned against the old Japanese model, as is suggested by the following passage from the 1996 report of the Deregulation Subcommittee of the government's Administrative Reform Committee:

"The fundamental principle is consumer sovereignty. What gets produced, and how, should be decided not by producers and producer associations and bureaucrats but by the choices that citizens make in the marketplace and the responses of creative entrepreneurs to those choices. Our existing system is based on the false premise that the interests of citizens are best served if bureaucrats regulate; that they should take the lead in balancing demand and supply in order to protect and monitor established producers and ensure stable and orderly markets. That is wrong. The aim should be to promote healthy competition through appropriate and transparent rules, such as product liability rules written from the consumer's point of view, thus avoiding the feather-bedding of inefficient existing producers and encouraging vigorous new entrants."

(quoted in Dore 1999, 160–61)

This passage, similar in tone and content to ones that can be found in dozens of advisory council and business group reports published since the mid-1990s (Dore 1999), clearly rejects the idea that the best way for Japan to maximize its economic welfare is through government regulation and protection of existing domestic producers. Instead, what Japanese government and other economic elites in recent years have been repeating over and over is that Japan needs to embrace domestic and international rules-based market competition as a means of restoring economic growth and competitiveness.

Japan's emerging economic liberalism, however, involves more than rhetoric or ideas. Just as the Great Depression turned Americans against protectionism in ways that were institutionalized at the domestic and international levels (Goldstein 1993), the rejection of the idea that convoy capitalism represents a superior model for Japan is starting to produce domestic and
international laws such as the big bang financial reforms and the new World Trade Organization (WTO) dispute settlement system that will have long-lasting effects on the nation’s foreign economic policy.

In addition to advancing this characterization of what has changed in Japan, this study also advances a specific argument, built on constructivist international relations theory, about why economic liberalism is emerging in Japan. Economic liberalism has become the new orthodoxy in Japan, I argue, through a process of elite learning that can be traced back to the earlier era of gaïatsu, when American trade officials lectured self-confident and skeptical Japanese about the virtues of free trade and market competition.

Much of the constructivist literature on social learning, or ideational change, has described this process as something that goes on within domestic society. Legro (2000a), for example, describes how the process of social learning requires that a society go through a two-step process that is fraught with “collective ideation” problems. First, society has to come to an agreement that the old orthodoxy is inadequate, and second, it has to embrace en masse a new orthodoxy. It is because both of these steps are difficult: for groups to negotiate, he argues, that orthodoxies tend to be durable once formed. Nevertheless change is likely, he argues, when a society experiences a disaster despite having followed a policy line suggested by the old orthodoxy and when a new set of ideas is ready made to explain the past mistakes and recommend an alternative course.

Legro describes these processes as “endogenous to the ideational structure” and suggests that they take place primarily within a given society, illustrating this argument by contrasting how the United States failed to make the leap from isolationism to internationalism after World War I, but did make this shift after World War II (Legro 2000b). A key difference between the two cases, he argues, was that the United States tried to follow policies suggested by the isolationist orthodoxy in the lead-up to World War II, and got sucked into that terrible conflagration anyway. The presence of a coherent alternative vision for the nation thus combined with this “learning experience” to lay the basis for a new orthodoxy in the years after the war.

Although Legro correctly points us to an important part of the learning process—Japan would not likely be shifting to a new liberal orthodoxy if it had not experienced its longest and deepest recession of the postwar period—he unnecessarily restricts our focus to the process going on within domestic society. Extensive research in social psychology informs us that individual learning does not happen merely through individuals’ experiences of “hard knocks,” but inevitably involves social processes in which those who are learning interact with peers and teachers (Checkel 2001). We should not be surprised, therefore, that learning relevant to foreign policy similarly involves patterns of social interaction across borders (Haas 1990; Finnemore 1996; Keck and Sikkink 1998). In this article I explore how Japan’s emerging economic liberalism has been influenced by Japanese elites’ interactions with American economic officials and non-Japanese staff of international organizations. Japan’s moves toward liberalization in the 1990s, I argue, have not been a product of coercion, lower transaction costs, or other material factors emphasized by realists and liberal institutionalists, but have instead resulted from elites’ social, cross-border learning.

Let me emphasize: I do not consider this learning to have been a passive process in which meek Japanese officials learned at the feet of American teachers. Far from it! Japanese officials in the 1980s were self-confident about the superiority of their model. They had been hearing lectures about the magic of free markets from Americans for decades, going back to the Occupation years, but they had stuck stubbornly to the Japanese model. Nevertheless, even as years of hectoring by the United States trade negotiators provoked trade officials and politicians
to offer heated defenses of Japanese policies, they exposed them to the ideas of neoclassical economics—to arguments about how consumers, as well as producers and national income, all suffer when inefficient domestic producers are sheltered from foreign and domestic competition. When the Japanese economy turned sour in the 1990s, Japanese officials had plenty of old “class notes” to consult as they sought to diagnose the problem. This learning process was helped along by how Japanese officials themselves used liberal language and ideas, at first for purely defensive reasons aimed at countering American trade pressure, and by their defensive embrace of WTO and the Organization for Economic Cooperation and Development (OECD) multilateralism.

The Reactive State Pattern

When Japan gained admission to the General Agreement on Tariffs and Trade (GATT) in 1955 and the OECD in 1964, it assumed a variety of obligations requiring it to remove, reduce, or reconfigure barriers to trade and foreign investment. Its admission to the OECD obliged Japan to eliminate restrictions on foreign direct investment, where under GATT rules, Japan was, in principle, expected to replace quantitative restrictions on trade, which were particularly numerous in the agricultural sector, with tariffs. These rules were based on neoclassical economic ideas about how competition, including international competition fostered by foreign investment and trade, improves economic efficiency, enhances productivity, and propel economic growth. There is no evidence, however, that the Japanese who led the nation into these organizations did so because they shared these ideas. On the contrary, the extended period of mostly bilateral negotiations required to force Japan, through the use of threats and deadlines, to comply with these basic obligations of its membership in GATT, and the OECD helped earn the nation its “reactive state” reputation (Kusano 1983; Calder 1988; Mason 1992).

The initial negotiations wherein Japan resisted United States pressure to live up to its GATT and OECD commitments set the pattern for a long series of market-opening negotiations, stretching from the 1970s into the 1980s. Japan also resisted United States pressure to improve access to markets for American semiconductors, auto parts, satellites, supercomputers, construction, flat glass, paper, wood products, retail stores, financial services, telecommunications equipment, medical products, tobacco, and lawyers. In each of these cases, negotiations followed a set pattern (Campbell 1993). The United States would raise objections, usually beginning in late March of a given year when the Office of the US Trade Representative was required to list outstanding foreign trade barriers. It would initiate an investigation under US trade law that set specific deadlines a year or so in the future and invite Japan to participate in bilateral talks aimed at “resolving” the dispute. The Japanese side would initially deny that there was any problem and grumble about American unilateralism, but always agreed to talk (at least until the mid-1990s).

In the early months of these talks, Japanese officials would insist that the difficulties US producers had expanding their Japanese market share was not due to Japanese barriers but to a lack of effort on their part. They would also explain why change was impossible. United States officials, meanwhile, would muster statistical evidence showing how US firms had much larger market shares in neutral markets than in Japan and warn the Japanese about how Congress was likely to “go protectionist” unless barriers were removed. They would also add some lectures about how liberalization would benefit to Japanese consumers and the economy as a whole. Japanese negotiators continued to defend existing policy. Then, as pressure built in the final days before a deadline, Japan offered enough last-minute
concessions to allow US officials to declare that they were satisfied.

Japanese liberalization in these cases was always grudging, offering no more than the minimum policy change to satisfy American negotiators, often at the very last minute. When announcing trade deals, Japanese officials rarely even pretended that Japan might actually benefit from the agreed policy changes. They listened to the lectures from the Americans about the benefits of free trade and market competition, but they stuck stubbornly to their beliefs that Japan's model—with an extensive role for the government in managing competition so that Japan could move up the product cycle to dominate the most technologically sophisticated industries—was superior to American-style capitalism (Johnson 1982; Heginbotham and Samuels 1998; Tilton 1996). When Japanese officials conceded, under duress, to open markets, they made it clear that they had agreed to this only because the nation's most important trading partner and ally was demanding that it do so. Trade liberalization was simply a price Japan had to pay to maintain access to the US market and to retain the American security guarantee (Calder 1988; Mikanagi 1996).

The Legitimation of Liberal Economic Views

Analysts studying Japanese economic policy have often asserted that national elites were more influenced by the economic ideas of Friedrich List than those of Adam Smith and David Ricardo (Fallows 1994; Samuels 1994). List emphasized how late developing countries needed to develop economies of scale behind protective trade barriers before facing competition with more advanced industrialized nations. The state also needed to help industries coordinate investment, through cartels and regulations, to speed the pace at which they developed scale economies and technological capabilities. Japanese industrial policy was long based on these List-inspired ideas. Given Japan's backwardness, the state needed to step in to limit "excessive competition," regulate market entry, and coordinate investment so that industry could develop the economies of scale and technology needed to compete with larger and more technologically advanced foreign firms (Johnson 1982). Not surprisingly, given the predominance of these views, few Japanese elites in the 1970s and 1980s subscribed to neoclassical views about the benefits of free trade and competition.

Of course, ideas similar to List's were also once dominant in the United States. Alexander Hamilton, in the nation's founding years, had emphasized the need for the state to assist industry by providing trade protection. As recently as the 1920s, the idea that trade protection was the best way to safeguard the nation's economic interests was predominant in the United States. As noted above, however, the United States rejected this set of ideas after the disaster of the Great Depression and World War II, embracing in its place (embedded) liberal ideas closer to those of Smith and Ricardo (Ruggie 1982; Goldstein 1993).

In Japan, too, the learning process owed a great deal to the nation's experience of its "Great Recession" in the 1990s, but learning began in the 1980s when the nation's economy was still outperforming that of the United States. Japanese officials at that time still believed in the superiority of the Japanese model, but, faced with a growing number of bilateral market-opening disputes and an impatient United States Congress, they put into practice a technique all good school children learn: the best way to avoid a teacher's ire is to tell her what she wants to hear. Reagan administration officials, many of whom were neoliberal ideologues, were particularly prone to lecture Japanese about the virtues of free markets. Prime Minister Nakasone Yasuhiro was toying with this philosophy himself with his emphasis on budget-cutting "administrative reform" (Ohtake 1994). He decided that one way to get the Americans off his back would be to organize a blue ribbon commission that would produce a
document loaded with liberal policy proposals. With this aim in mind, he appointed a commission chaired by the former head of the Bank of Japan, Msekawa Haruo. Nakasone had deliberately staffed the group with reformist, market-oriented economists and intellectuals, knowing they would propose a reform vision that would please American critics of Japanese trade policy. That his audience was primarily foreign is also suggested by his decision to request that the commission complete its reports just in time to deliver them during "Ron-Yasu" summit meetings.

The reports were indeed a marked departure from earlier economic policy reports. Calling for "policies based upon market mechanisms," the Msekawa Commission urged the government to promote deregulation based on the idea that there should be "freedom in principle, restrictions only as exceptions." Rather than relying on increased exports to propel the economy forward, it urged, the government should "strive for economic growth based on domestic demand" in areas like housing and social infrastructure. Such changes were necessary, it argued, not because Americans demanded them, but because "the time has come for Japan to make a historical transformation in its traditional policies on economic management. ... There can be no further development for Japan without this transformation" (Msekawa Commission 1987, 22–30).

At the time, the Msekawa reports were widely dismissed as "window dressing," both inside Japan and in the United States. The private advisory group had no legal standing obliging the government to follow its recommendations, so its pretty words about how Japan would benefit from market-oriented reform were seen as little more than an attempt to distract American critics so they would not notice how slowly Japan was actually changing. Over time, however, the reports did have an impact. Japanese reformers involved in their preparation referred to them to back up their arguments, and US officials brought them up during subsequent bilateral talks, especially during the Structural Impediments Initiative between 1989 and 1993 (Armacost 1996; Schoppa 1997).

Although the Msekawa Commission and the stubborn recession of the early 1990s had made liberal ideas about trade and competition more legitimate within Japan by the time the Clinton administration took office in 1993, the Japanese elite could not yet be called converts. Faced with post-bubble problems in the financial system, the cabinet led by Miyazawa Kiichi had propped up the stock market and banking system instead of allowing market forces to accelerate the structural adjustment of the economy, and once again the Japanese were relying on growing trade surpluses to plug the demand gap. When it took office the Clinton team thus stepped up the pressure, vowing to force Japan to accept voluntary import expansion (VIE) targets as the primary means of opening the nation's markets.

Unwilling to accept VIES, Japanese economic officials once again planned to use American liberal economic ideas to deflect bilateral pressure. When the Clinton team pressed Miyazawa to accept targets during his spring 1993 visit to Washington, the prime minister and officials traveling with him spoke from a well-coordinated script. VIES would require the Japanese government to increase its intervention in the nation's economy at a time when it was trying to move to a more free market approach, they said. Japan was finally trying to live up to the liberal ideals America had been selling for so long. It was now on the side of "free trade," whereas the Americans were pushing "managed trade." The Japanese continued this line of rhetoric through the conclusion of the auto dispute in the summer of 1995, to good effect (Lincoln 1999). They ultimately won the Europeans and other third parties over: to their side as they isolated the Clinton team internationally, a strategy that helped Japan fend off VIE demands.

Although this Japanese attempt to hide behind the "free trade" banner was again mostly a public relations exercise, the
THEORETICAL CONSEQUENCES. Having claimed that the Japanese government was moving away from market intervention, Japanese officials involved in the framework talks with the Clinton administration risked being ridiculed unless they could show that the government was indeed liberalizing the economy. Partly to fend off accusations of this kind, the prime minister who had replaced Miyazawa after elections in July 1993, Hosokawa Morihiro, quickly charged another blue ribbon commission with mapping out a reform plan. He instructed it to report back by December so that he would have something in hand before he had to travel to the United States. Hosokawa modeled the new commission on the earlier Maekawa Commission, inviting Hiraiwa Gaishi, head of Keidanren, to head the panel and bring on board reformist economists such as Nakatani Iwao.

The Hiraiwa Commission report again featured liberal ideas about how Japan needed deregulation, market-opening, and competition to propel its recovery from the post-bubble recession (Nakatani and Ohta 1994). This time, however, the commission took more care to assure that the momentum that had built up during its high profile deliberations would not be lost as soon as its meetings ended. It urged the creation of a deregulation promotion headquarters, the government's commitment to a five-year deregulation action program, and the publication of annual deregulation white papers—recommendations that were all adopted by the Hosokawa cabinet in the early months of 1994 (Carlile 1998). By institutionalizing its ideas in this way, it thus helped guarantee that the public would be seeing a steady stream of pro-market advisory council reports from the government over the succeeding years.

Critics of Japanese economic policy have belittled the initial deregulation plans of the mid-1990s as little more than re-packaged, bureaucratic initiatives (Carlile and Titon 1998). A narrow focus on the immediate results misses, however, the longer-term consequences of Japan's decision to trumpet liberal rhetoric and ideas in reports such as these. Within months of the Hiraiwa Commission's adjournment, one of its leading members, Nakatani, was loudly bemoaning the failure of the commission to live up to its rhetoric (Nakatani and Ohta 1998). A few years later, Takenaka Heizô, another reformist economist who played a leading role on the Economic Strategy Council under Prime Minister Obuchi Keizo, similarly lambasted the government for failing to match its rhetoric with deeds. These advocates of market-oriented reform did not just write books, they appeared over and over again on television, gaining a wide audience for their views and virtual celebrity status—especially as Japan relapsed into recession after 1997 and again after 2000. In each case, they had a larger audience than they would have because they appeared as "I-told-you-so" prophets, arguing that the economy's difficulties grew out of the nation's failure to fully enact their pro-market policy packages.

By the end of the decade, liberal ideas were the new orthodoxy in Japan. Policy was not yet aligned with these ideas, but everywhere one looked one saw government reports, best-selling books, and television commentators criticizing regulations and trade protection for stifling economic growth and touting rule-based market competition as the tonic for what ailed the nation. Not just Nakatani and Takenaka, but other reform economists and intellectuals, such as Sakaiya Taichi (1999), Katô Kan (1997), and Noguchi Yukio (1995), all wrote hot-selling books featured in cascading displays in Tokyo's bookstore windows.

Meanwhile the government continued to churn out economic policy reports, by this time independent of the US-Japan negotiating calendar, urging Japan to embrace competition, individualism, and risk-taking. Particularly notable was the language chosen by two advisory councils organized by Prime Minister Obuchi Keizô after the economy hit a new low amid fears of a financial crisis in the summer of 1998. Neither of these
reports was motivated by a desire to give the Americans some pretty prose to distract them from bilateral trade demands. As the panels deliberated in 1998 and 1999, US-Japan economic relations were as relaxed as they had been in many years. Obuchi convened the panels simply to provide the government with blueprints for the future that would guide Japan's own efforts to restore the economy to health as it entered the new century.

The first panel, organized immediately after Obuchi took office, was headed by businessman Higuchi Hirotarō. It was the Economic Strategy Council, charged with the urgent and immediate task of recommending how Japan could right-end an economy that was on the brink of a financial crisis and suffering from deflationary tendencies. The panel's recommendations again emphasized competition. It blamed Japan's economic problems on the prevalence of "moral hazard" situations "where consequences do not change regardless of whether people try to do their best." It called for reforms that would introduce a "competitive society with soundness and creativity" in place of the old "convey system" (Economic Strategy Council 1999, 19).

Also interesting was the report issued by a follow-up panel, the Prime Minister's Commission on Japan's Goals in the 21st Century (2000), that was tasked by Obuchi with the job of fleshing out a longer term vision. In a section titled "Realizing Japan's Potential," the commission wrote:

The other essential change is to redefine and rebuild the relationship between private and public space in civil society. This means first and foremost promoting individuality and individual initiatives: unleashing sturdy individuals who are free, self-reliant, and responsible ... These tough yet flexible individuals will participate in and expand public forums on their own initiative, creating a dynamic public space. The public space thus cultivated will provide individuals with more diverse choices and opportunities. This will lead to the emergence of individuals and a society that take risks more boldly, address pioneering challenges, and are more creative and imaginative.

Elsewhere, the report speaks about the need for Japan to replace a governance system where exalted officials look down on citizens with a new contractual relationship where "the people delegate authority to their government (pp. 6–7). If the Maekawa and Hiraiwa reports sometimes read like the work of a student trying to use words and phrases that would please the teacher, these more recent documents, prepared mostly for consumption by the Japanese public, suggested that Japanese elites had internalized liberal ideals.

Defensive Multilateralism

Before turning to the consequences of this ideological shift, we need to consider another channel through which American aggressive bilateral trade pressure led Japanese economic elites to imbibe liberal economic ideas. By the mid-1990s, Japan was among the most enthusiastic cheerleaders of the WTO (Pekkanen 2001 and 2001b; see also Davis and Shirato 2007). During their tense standoff with the United States over the auto dispute, Japanese negotiators presented themselves as the defenders of the multilateral trade order against American aggressive unilateralism. When the United States attempted to pressure Japan into negotiating bilaterally to resolve their subsequent dispute over photographic film, Japan again insisted that all such disputes needed to be referred to the WTO. More recently, Japan stepped forward during the lead-up to the new Doha Round as a leading advocate of WTO reforms designed to end abuses of anti-dumping remedies.

Japan's embrace of multilateralism in the 1990s certainly contrasted with its slow compliance with GATT and OECD rules in the 1960s and 1970s and suggested that the nation "had seen
the light" and changed its views on its own. In fact, the conversion had been very much assisted by the United States, which, through insistent bilateral demands, drove Japan to seek refuge in multilateralism. Japanese government officials are quite frank to admit that they turned to the GATT and WTO in self-defense.  

In the late 1980s, after Congress added a "Super 301" provision targeting Japan under US trade law, Japanese officials began considering how best to counter the intolerable trend toward escalating demands. At about the same time, GATT signatories were considering ways to improve the organization's dispute settlement mechanism. Japanese officials quickly realized that proposed reforms, which after adoption eliminated the ability of losing parties to veto dispute panel rulings and reduced opportunities for delay, provided another means for them to deflect bilateral demands. Because the United States too was backing the reforms, they could insist that American officials live up to their commitment by referring all subsequent disputes to this body. They could also counter any American threat to impose sanctions unilaterally with a threat to challenge such a move before a WTO panel (Schoppa 1999).

Japanese officials also worked to channel bilateral disputes involving competition policy and regulatory harmonization into the OECD, another venue for discussing issues in a multilateral setting. Competition policy was not something the WTO had traditionally handled. Faced with American demands that therefore these issues needed to be handled bilaterally, Ministry of International Trade and Industry (MITI) officials proposed the OECD as an alternative forum for dealing with these issues. MITI officials also sought to improve their ability to resist bilateral pressure to harmonize regulations on American standards by turning to the OECD as a forum in which the Japanese could point to a number of competing regulatory standards closer to those employed in Japan.

Though motivated primarily by defensive concerns, Japan's embrace of multilateralism again had consequences. One of the most interesting consequences was the effect of this strategy shift on Japanese officials sent to staff these international organizations and negotiate under their jurisdiction. Whereas the most promising young officials in the Ministry of Foreign Affairs (MOFA) and the Ministry of Economy, Trade, and Industry (METI) had, in the past, been routed through key positions dealing with the bilateral relations since the late 1980s, these ministries have promoted to the most senior positions officials with extensive experience in multilateral economic organizations. Officials admit that this personnel shift reflected their conscious decision to put more emphasis on multilateralism in order to counter American trade pressure.

Like the decision to incorporate liberal rhetoric into government reports, this strategy had ideational consequences. It is well known that international organizations like the International Monetary Fund (IMF), WTO, and OECD share an organizational culture that emphasizes neoclassical economics. Though John Williamson (1990) was referring mostly to the Washington-based international organizations (the IMF and World Bank) when he coined the term "Washington Consensus," the phrase captures just as well the economic ideology of the OECD (based in Paris) and WTO (Geneva). Each of these institutions employs large number of economists, most of them trained in the United States even if they are not American themselves. The policies they recommend include privatization of state-owned enterprises, deregulation, and labor market reforms. By sending fast-track young officials to serve in these institutions for periods of two or more years, the government assumed the risk that they might absorb some of these ideas that were so contradictory to the pre-1990 conventional wisdom in Tokyo.
Some of them clearly did. One example is Kawamoto Akira, a young METI official who was sent in 1995 to serve on the staff of the OECD in Paris. In that capacity, one of his duties was to assist in the preparation of the OECD Review of Regulatory Reform in Japan, published in 1999. Over an extended period, he was required to respond to criticism of Japanese policy based largely on neoclassical ideas about the benefits of competition. Although his job was to make sure Japan did not come off looking too bad in the report, he had to phrase his defenses in terms that appealed to the permanent OECD staff. The daily experience, he reports, convinced him that Japan needed far-reaching reform. While in Paris, he wrote a mass-market book titled Regulatory Reform: Competition and Cooperation (1998), emphasizing Japan's need to harness competitive market forces in order to deal with its economic problems. After he returned from Paris, he was tasked first with helping to draft the ministry's White Paper, sketching out its overall policy vision. In 2001, he was given a job where he had an opportunity to put his ideas into practice. As head of the Electricity Market Division, he helped draft new regulations for the electricity sector that have introduced (a limited degree of) market competition into a sector that had previously been dominated completely by regional monopolies (Schoppa 2006).

Such experiences, shared by many other young economic officials, have helped further consolidate the ideational shift toward the acceptance of neoclassical views on economic causes and effects within the Japanese government. My experience talking with economic bureaucrats over the past ten years suggests that most of the under-45 generation, as well as many of those above this level, now accept the view that market competition, facilitated by ample international trade and investment, is required to make mature economies such as Japan's more productive and wealthy. Older and retired bureaucrats such as Sakakibara (1999) may still tout the advantages of Japan's state-led approach, but his views are now in the minority among government officials—not just in METI and MOFA but also in MOF.

The Consequences of Ideational Change
Changes in economic ideas, of course, do not in themselves constitute changes in policy. Though Japanese bureaucrats and other elites now accept the idea that coddling incumbent firms through regulation and trade protection imposes costs on society, they are frequently unable to move reforms based on these ideas through the policy process in the face of inertia built up over many years of running the economy based on the Japanese model. Indeed, actual change in economic policy happens slowly, with the government hesitant to unleash market forces that might lead to cascading bankruptcies and rising unemployment and promise to hurt most those constituencies tied most closely to the ruling Liberal Democratic Party (LDP).

Nevertheless, the shift in ideas I have described has already had two consequences that have started to move actual policy outcomes in a liberal direction and make continued movement in this direction likely in the future. First, liberal economic reforms have reached the top of the policy agenda. Scholars of public policy have long emphasized how policy change depends critically on which alternatives are on the table (Kingdon 1984). The predominance of liberal economic ideas in Japan today guarantees that whenever there is enough energy to generate policy change, reforms almost always involve further relaxation of regulations and opening of markets. Second, liberal ideas are being institutionalized through changes in domestic and international law in ways that promise to shape policy for years to come.

Both of these causal mechanisms through which ideas shape policy can be seen at work in the example of Prime Minister Hashimoto Ryutaro's Big Bang reforms. Announced in the fall
of 1996, this initiative was designed to make Japanese financial markets "free, fair, and global." Interestingly, neither Hashimoto nor the chief architect within the Ministry of Finance, Sakakibara, was regarded as a liberal. Yet, faced with the need to do something about the hollowing out of Japanese financial markets, they turned to the set of proposals that happened to be on the agenda—all of which involved introducing more competitive market forces into financial markets. Just a decade earlier, when the MOR had been pressured to liberalize financial markets, it had done so in ways that actually increased officials' discretionary power by creating "more rules" (Vogel 1996). This time, with the dominant ideology having shifted to a point where most economic elites saw a need for Japan to constrain bureaucratic discretion and rely on market forces, the policy package Hashimoto announced took a genuinely liberal form.

Though phased in more slowly than the British Big Bang of the Thatcher years, with the final measures not implemented until 2003, the package lived up to this promise. Firms previously operating in segmented markets for various banking services (city, trust, and long-term credit), various types of insurance (casualty, life, and third sector), and securities are now free to compete across all of these boundaries. Previously strictly regulated fees for these services were liberalized so that firms can compete based on price. All foreign exchange restrictions were eliminated, allowing capital to flow across borders with no restrictions. The government guarantee that had previously promised no bank would be allowed to fail was removed (Laurence 2001). These reforms have already had a major impact on this area of business, with foreign firms playing a much larger role in a wider range of financial services and Japanese firms having to worry much more than in the past about the possibility of bankruptcy if they fail to compete.

The Big Bang also illustrates how ideas, once institutionalized, can have broad and long-lasting effects. Once dismantled, the government cannot easily recreate the convoy. Once the reforms began to be implemented in the late 1990s, the government was no longer able to keep the weakest firms in banking, securities, and insurance afloat. As once firms in the financial sector saw that their survival was at risk, they stopped supporting the weakest, most over-leveraged firms in retail, construction, and manufacturing. That both financial and nonfinancial firms now face the possibility of bankruptcy means they cannot afford to overlook opportunities to buy good foreign products at a cheaper price or enter into partnerships with competitive foreign firms. This shift in incentives affecting the procurement and business strategies of Japanese firms has already played a major role in opening up what were once closed markets in Japan.

The role of ideas could also be seen at work in the term of Koizumi Jun'ichiro as prime minister. Faced with stubborn debt and deflation problems, Koizumi embraced a reformist vision that was even more closely attuned to the new liberal orthodoxy than Hashimoto's Big Bang. He could have emphasized increased spending on unemployment insurance and other measures of this type, designed to reassure voters nervous about the economy's continued poor performance, but instead he, too, focused on a set of reforms that were largely based on liberal economic principles. His slogan, "structural reform without sanctuaries," told voters he wanted to help accelerate the pace at which the economy adjusted to market forces. Though it promised pain in the short term, the idea was popular enough to help him win approval ratings that topped 80 percent early in his term and were high enough even in 2005 to allow him to challenge opponents of liberal reforms inside the LDP.

The specific reforms he stressed, too, were liberal ideas, including a freeze on government debt issuance and the privatization of public corporations—including Japan Highway, the Japan Housing Finance Agency, and the mail, banking, and
insurance services provided by the postal service. Koizumi had a decidedly mixed record in his efforts to push forward this liberal reform agenda (Schoppa 2006). His attempt to restructure Japan Highway in a way that would constrain its ability to finance extensive new road construction failed. On the other hand, the Japan Housing Finance Agency was restructured in a way that took it completely out of the business of providing new housing loans. It now operates primarily through its role in the secondary markets, like Fannie Mae. Koizumi's most famous achievement—the privatization of Japan Post, secured by expelling rebel LDP Diet members from the party and calling an early election in 2005—is not as clear a victory for liberal reform as was advertised at the time. To secure the passage of this legislation, Koizumi was forced to accept a number of compromises that have limited the entry of new competitors in mail services and have dragged out the process of privatizing postal financial services to such a degree that it remains unclear whether the restructured Japan Post will begin rechanneling its massive financial assets away from the traditionally favored, government-affiliated clients (Maclachlan, 2006). My point here is not that liberal economic ideas have triumphed overall opposition, but that they set the agenda in such a way that policy change since 2000 has moved mostly in a liberal direction whenever political energy has created an opening.

The final set of economic policies that can be linked to Japan's emerging economic liberalism are those that deal directly with trade: the proposals for Japan to participate in an expanding array of bilateral, and now region-wide, free trade areas (Manger 2005; Pekkanen 2005; and Noble in this volume). Bilateral Free Trade Agreements (FTA) have now been completed with Singapore, Mexico, Malaysia, and the Philippines, and additional bilateral deals are in the works. And these bilateral deals are now being supplemented by regional deals, starting with a recently-signed FTA linking Japan and Association of Southeast Asian Nations (ASEAN), that may lead eventually to wider regional agreements including China, Korea, India, Australia, New Zealand, and maybe even the United States. These agreements are clearly driven in part by forces outside Japan, and cannot be attributed solely to a shift in ideas among Japanese elites. Japan's interest in FTAs began when other nations (Mexico and Singapore) came to METI with proposals, and its willingness to consider one with ASEAN as a whole had much to do with that organization's earlier decision to sign one with China. But the rapid pace with which they have accumulated is also a reflection of METI's view, heavily influenced by liberal economic ideas, that Japan cannot afford to be left behind as the United States and Europe gain advantages by widening and deepening their own regional free trade networks (Krauss 2000). METI officials see these free trade areas not only as opportunities to expand export markets for Japanese goods and assist transnational Japanese firms with operations spread across the region but also as opportunities to bring import competition to bear on inefficient Japanese industries in ways that force them to become more competitive. Free trade is now seen within METI as a vital part of its effort to accelerate structural adjustment of the economy.

Of course, Japan's regional trade policy continues to be constrained by politicians and ministries that do not share METI's enthusiasm for structural adjustment. Singapore became Japan's first FTA partner in large part because it does not have an agricultural sector that threatens to challenge Japan's inefficient producers. While the power of farmers' material interests trumps Japan's emerging economic liberalism in many cases (as it has in the United States and Europe), this should not distract us from the fact that outside of agriculture these agreements promise to markedly increase trade volumes, investment flows, and international competition—exactly what liberal economic doctrine prescribes.
Conclusion

This chapter has argued that Japan's shift toward a more proactive foreign economic policy is a product of a complex learning process that has convinced Japanese economic elites that the nation's economic interests now lie in dismantling convoy capitalism and introducing market forces. Rather than waiting for pressure from the United States to force it to adopt these policies, these ideas are generating home-grown initiatives like the Big Bang, structural reform without sanctuaries, and regional free trade agreements that are opening Japan up to foreign and domestic competition for its own sake. Whereas recent initiatives have been "home-grown," however, the process of ideational change that has helped produce them was in part the product of Japan's earlier interactions with the United States. Its efforts to deflect gaiatsu by setting up liberal advisory councils and using liberal rhetoric ended up legitimizing these views, especially after Japan's economy entered its decade-long slump. At the same time, when it sought to channel negotiations into multilateral institutions, it ended up exposing the new generation of fast-tracked economic officials to the liberal ideas that dominate these institutions. We cannot make sense of Japan's shift toward a proactive foreign economic policy without appreciating the role gaiatsu played in speeding and directing Japan's learning process.

This last claim is perhaps the most likely to be challenged by skeptical readers. Isn't it possible that the shift in ideas I have described here is best explained by the economic difficulties that confronted Japan during the 1990s? American trade pressure and related interactions among American and Japanese economic elites were not necessary to bring about the shift because it was bound to happen in view of the economic difficulties Japan was confronting. Readers who are themselves believers in orthodox neoclassical economic ideas are likely to conclude that it was only "natural" that Japanese elites turned to market competition as the alternative to the Japanese model when that system was so obviously failing.

I agree that the nation's economic difficulties, like American difficulties during the Great Depression, were a major cause of the ideational shift. To assume that therefore Japan was destined to learn that the American model was superior, however, is to ignore the inherent difficulties nations face when an old orthodoxy is overthrown. Rejection of the old approach does not lead automatically to the acceptance of a new one because there are usually several contending approaches. The extensive attention paid to the United States because it was Japan's primary interlocutor in trade and economic diplomacy, and the way in which this led the Japanese government to parrot liberal ideas, played a critical role in making American-style liberal capitalism the "focal point" as Japanese elites searched for alternatives to the floundering Japanese model.

We cannot rerun the 1990s without American influence to see if Japan would have settled so quickly on liberalism as the alternative to the Japanese model, purely due to its economic difficulties. The best we can do is to consider a counterfactual. What if Japan's primary interlocutor during these years had been Europe? The problems Japan has faced in the 1990s have not been merely those of efficiency but also of economic insecurity and associated tendency of consumers to hold back on consumption. If Japan had been heavily engaged in economic negotiations with Europe during these years, isn't it possible that the European welfare state might have emerged as the orthodoxy answer to Japan's economic worries?

Of course this is not how history unfolded. Instead, the loudest gaiatsu came from the United States, and Japan tailored its response to the American audience. The government peppered its publications with nods to the economic efficiency of markets; economic negotiators sought to counter the Americans by portraying themselves as champions of free trade; and the
nation sent its brightest young officials to participate in multilateral economic institutions. It should not surprise us that these strategic reactions to American pressure led Japan to hone in on American-style capitalism as the primary alternative to the Japanese model.

Notes
1 Interviews with two retired senior Ministry of Economy, Trade, and Industry (METI) officials, 1996 and 1998.
2 Interview with MITI and Ministry of Foreign Affairs (MOFA) officials, 1996 and 1998.
3 Interview with Kawamoto Akira, 1999.

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