

# **RACE FOR THE EXITS**

**The Unraveling of Japan's System  
of Social Protection**

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## Chapter 1

# Exit, Voice, and Japan's Economic Problems

The setting and the topic of conversation could hardly have been more discordant. The restaurant in which we were dining, on the top floor of a ritzy hotel in central Tokyo, featured white linen tablecloths and black-tie waiters. The presentation of the gourmet Chinese food suggested that the chef had trained in France. Yet my host, Kōno Tarō, the son and grandson of Liberal Democratic Party (LDP) cabinet ministers and now an ambitious politician in his own right, was riffing on Japan's economic decline. "Japan is the last socialist country on the planet," he said, "and like the rest of the socialist countries is headed toward collapse." The fault, he continued, lay with his own political party, the LDP, which should actually be called "the Communist Party of Japan."<sup>1</sup>

Kōno is known for hyperbole, so it was tempting to dismiss his analogy as mere theatrics. Yet the more I thought about it, the more valid it seemed. Japan's poor economic performance in the period since 1990 is now well known. After growing economically by an average of 8.4 percent from 1950 through 1973 and 3.5 percent from 1975 through 1990—rates that placed Japan at the top of the growth charts for the industrialized world over both of these periods—Japan has grown by an average of just 1.01 percent from 1991 through 2003.<sup>2</sup> After recording just one year of negative growth over the first four decades of the postwar period (in 1974, following the oil shock), Japanese endured four years of negative real growth in rapid succession, in 1993, 1998, 1999, and 2002. Because of deflation, the nominal economy has grown even more slowly. In 1995, the nation's gross domestic product stood at ¥497 trillion. In 2003, it was exactly the same size: ¥497 trillion. These statistics were not nearly as dire as those experienced in the Soviet Union, but given Japan's record up until 1990, its performance over the past decade and a half ranks with the Soviet collapse as one of the great reversals of fortune of our age.

Less well known outside of Japan is another parallel between Japan's economic system and that of the old Soviet Union: the "socialist" way in which Japan's eco-

economic system made sure most Japanese shared in the nation's economic gains. Between 1963 and 1993, the income gap between those in the top and bottom quintiles of the nation's households shrank sharply, from a factor of 5.6 to 3.4.<sup>3</sup> Midway through this period, a famous study by the Organisation for Economic Co-operation and Development (OECD) declared that Japanese levels of income distribution were among the most equal in the industrialized world, just below those of Sweden and Norway.<sup>4</sup> By the 1980s, 90 percent of Japanese routinely told pollsters that they were members of the "middle class."

What was amazing about the Japanese version of socialism was that it was able to build such an effective safety net for society without massive government expenditures—unlike Sweden and Norway, and completely unlike the Soviet Union. Rather than redistributing income through government spending and providing care through public services, Japan built a system of social protection that relied largely on firms and families (especially women) to provide a safety net of income, benefits, and care.<sup>5</sup> Japan's secret was a system of regulations, taxes, and benefit rules that encouraged and enabled firms to offer "lifetime employment" to their core male workforce while encouraging women to care for children and other needy family members. These private actors were expected to help make sure all Japanese advanced economically together, like a convoy of ships moving ahead at a slow but steady pace, with the government providing a naval escort through its regulatory interventions.

Japan's system of "convoy capitalism," with its bank-centered financial system, cartels, and extensive regulations, all carefully managed by the state, has been known mostly for the role it played in facilitating the success of Japanese export industries and the rapid economic growth of the nation as a whole.<sup>6</sup> But this system was also designed to protect vulnerable members of Japanese society, including workers and their families, by keeping firms in business so they could keep their commitments to employees and business partners. Convoy capitalism, like the welfare state regimes of Europe, had productive *and* protective elements that were mutually reinforcing.<sup>7</sup>

This system worked quite well during Japan's high-growth years, producing a "miracle" combination of growth and equity. Yet by the 1990s, like the Soviet version of socialism, the system was in trouble. Not only did national growth slow abruptly but levels of equity declined as well. The income gap between the bottom and top quintiles of the nation's households widened from a factor of 3.4 in 1993 to 4.6 in 1998, reversing much of the progress made over the previous three decades.<sup>8</sup> Many Japanese still had the money to enjoy expensive meals at rooftop restaurants, but many others were struggling to get by. The number of homeless living in Tokyo's parks and other public spaces grew sharply, and high school graduates around the country struggled to find work in a terrible job market.<sup>9</sup> Describing the new inequality trend in Japan as the most rapidly emerging one in the industrialized world, economist Tachibanaki Toshiaki argued that Japan had become one of the most *unequal* nations in the OECD, right up there with the United States and Britain.<sup>10</sup>

Along with the troubling decline in growth and the rise in inequality came signs that it was taking growing sums of taxpayer money to keep the leaky convoy system

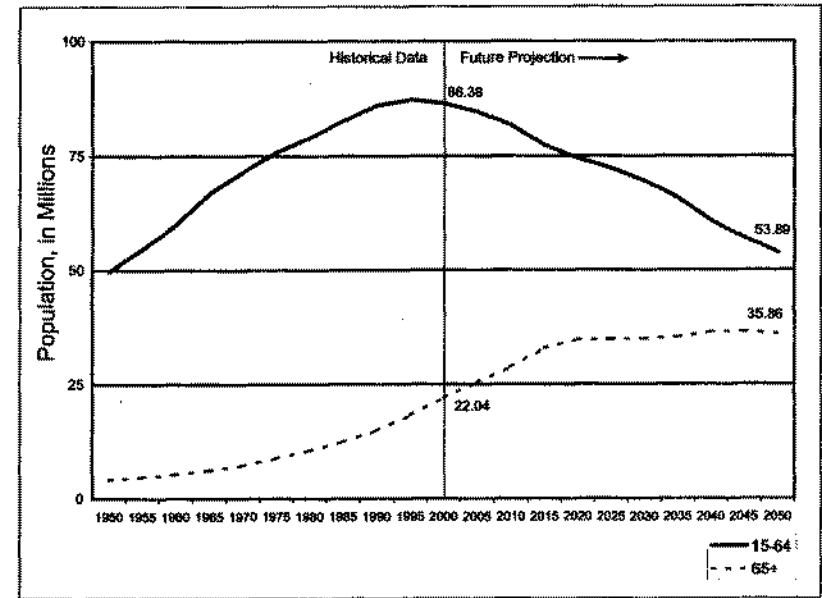


Fig. 1.1. Japanese population trends and projections

Source: Historical census data is from National Institute of Population and Social Security Research, *Population Statistics of Japan* (Tokyo, 2003), 13; projections beyond 2000 are based on the medium-case scenario reported in NIPSSR, *Population Projections for Japan: 2001–2050* (Tokyo, 2002), 12.

afloat. By 1998 it became clear that the banks could no longer carry out their assigned role in the system without taxpayer help. The government attempted to bail out financial institutions in ways that would allow them to continue protecting firms from pressure to restructure, but these bailouts only seemed to buy troubled banks and firms a few extra years. As insolvent firms desperately attempted to maintain cash flow without regard to profits, their excess production contributed to the phenomenon of deflation, which forced the government to ramp up public spending in a desperate attempt to keep the economy from sinking into a deflationary spiral.

By 2000, Japan's public expenditures had risen to almost 37 percent of GDP, up sharply from the level of 30 percent in 1990.<sup>11</sup> Because taxes are kept low to stimulate the economy, the nation is now adding about 7 percent of GDP to its public debt every year—a mountain of debt that had risen to 166 percent of GDP in 2003.<sup>12</sup> All of this is taking place as Japan's aging baby-boomer generation is just years away from retirement, a demographic jolt that is being made worse by the continuing drop in Japan's fertility rate. With the population of working-age adults expected to shrink by 16 percent in the next twenty-five years and another 22 percent by 2050 (see figure 1.1), Japan is entering a period of even slower growth and

unstable government finances. Given this precarious situation, it is hard to imagine that just a decade ago Japan was seen as an economic juggernaut threatening the prosperity of the rest of the industrialized world.

What happened? With their system no longer producing growth and equity, why haven't the Japanese made needed reforms and created a new productive and protective system better suited to the new socioeconomic environment?

Kōno's answer is to blame it on the LDP, "the Communist Party of Japan." Blaming Japan's poor economic performance—its lackluster growth and growing inequality—on its politicians is certainly a popular pastime.<sup>13</sup> It has been almost as popular as blaming the failures on Japanese bureaucrats.<sup>14</sup> These simple explanations neglect to take the next step, however, and ask why Japan's politicians and bureaucrats have been so ineffectual. In the Soviet Union, it hardly seems surprising that Communist Party apparatchiks and bureaucratic *nomenklatura*, insulated from society by their firm grip on power, could steer the nation into such trouble. But Japan has a democratic system of government, with opportunities for those frustrated by the status quo to seek change through elections, social movements, campaign contributions, and free expression. Why haven't the Japanese people forced their politicians and bureaucrats to change course?

### Firms and Women

This book seeks answers to this question by looking closely at the behavior of two groups that have had the greatest cause to be frustrated with the failing system of convoy capitalism: firms, especially those in export sectors; and women, especially young women eager to live a life in which they have the opportunity to enjoy both meaningful careers *and* the experience of raising children. It is axiomatic in much of the literature on globalization that firms in the traded goods sector—Toyota and Sony, for example, in the Japanese case—should be at the forefront of economic reform movements in their home countries. Because these firms must compete against rivals in other nations, their profits and survival depend on their ability to minimize costs associated with social programs and the protection of sheltered sectors of the economy.<sup>15</sup> While the Japanese system of convoy capitalism was long known for its ability to generate superior growth rates, it also imposed costs on firms. Employers faced restrictions on their ability to lay off workers during recessions, and they had to pay high prices (relative to what their overseas rivals paid) for electricity, financial services, construction, transportation, and retailing because these sectors were sheltered from market forces by extensive government rules and regulations.

For the first several decades after Japan's postwar recovery, the nation's export-oriented firms were able to thrive, despite these costs, because the same system of convoy capitalism protected *them*. International capital flows were strictly regulated, limiting the degree to which Japanese firms had to compete against foreign multinationals in the domestic market, and the government faced few restrictions on its ability to use regulations and trade barriers to protect these firms from in-

ternational competition. By the early 1980s, however, capital was flowing freely in and out of Japan, most formal trade barriers had been negotiated away, and the government faced threats of trade sanctions whenever it attempted to use its regulatory authority to protect Japanese firms. As a result, firms that had been content to pay high prices in order to play their part in the convoy system, confident that the government would be able to manage competition so that they would not suffer, found that they were exposed. They were still expected to pay the high prices, but the government could no longer protect them from international competition, at least not to the degree it had previously. In this book I look at how these firms responded to their situation and how their responses fed into the policy process.

Women have received much less attention in the literature on economic and welfare state reform.<sup>16</sup> I have chosen to focus on this group, along with firms, because women were the other segment of Japanese society that was heavily constrained by the role they were expected to play in providing social protection under Japan's system of convoy capitalism. Women were expected to devote their primary energies to the care of children and other needy family members, such as frail mothers-in-law. To ensure they were available for this caregiving, and to give firms the flexibility they needed to keep core male workers on the payroll, female participation in the paid labor force was largely confined to part-time and temporary work. Tax policy encouraged women to quit work once they married and had children. Work rules and the limited availability of leave to take care of their children and childcare services made it hard for them to continue in full-time careers after they had children, even if they wanted to do so. Once they quit such jobs, the lifetime employment system, which provided few opportunities for mid-career job mobility, kept them from ever gaining access to the best jobs. Many Japanese women were content with this system, but a growing number began to grow frustrated with the strict assignment of gender roles and restricted job opportunities. In this book I look at how these women responded and how their response fed into the policy-making process.

The key to understanding why Japan has not acted more proactively to deal with the crisis of convoy capitalism is to recognize that these two affected groups, women and firms, were not restricted to a *political* response when they became frustrated with the system. Most studies of economic reform in Japan, reflecting the bias in the broader political science literature, have assumed that all of the action that matters takes place in the political arena. Thus T. J. Pempel argues, for example, that a "regime shift" is imminent in Japan because leading manufacturing firms are much more exposed to trade and tied to international business networks than they used to be. He rightly points out that this change in the business environment has made these firms frustrated with LDP policies that force them to pay high prices and fork over tax money to support sheltered sectors of the economy such as construction and agriculture.<sup>17</sup> He misses something, however, when he takes the next step of assuming that firms would necessarily express this frustration by splitting the social coalition that has backed the LDP for so many years and mobilizing for economic reforms. Faced with policies that have raised their production costs, these firms have frequently taken the option of *escaping* from the problem by

relocating operations overseas. If they can “exit” from their problems in this way, why bother taking on powerful opponents of reform in the LDP?

Young Japanese career women, too, have had exit options that have reduced their propensity to mobilize in the political arena to challenge a system of social protection that relies on them, rather than public social services, to care for children. Few have exercised the most extreme exit option (leaving the country, marrying a foreigner, and working for a foreign firm), but a great many have exercised the “partial exit option” of giving up on one part of their work-family goals. Many women who began their working careers expressing a desire to work and have a family have opted out of the struggle to hold onto their careers after having a child, choosing to throw all of their energies into raising their children. A smaller but significant number have given up on marrying and having children. Whichever choice they make, they lose much of the motivation to mobilize for expanded childcare services and changes in benefits and work rules designed to make it easier for mothers to stay in the full-time labor force.

It is my argument that we cannot understand the pattern of Japan’s response to the crisis of convoy capitalism without appreciating the complex ways in which these exit dynamics affect the policy process. The overall inadequacy of the response to this crisis, as well as the uneven and reactive character of the reforms that have been implemented, reflects the mix of reform-sapping and reform-inducing effects of exit on policy outcomes. On the one hand, the ability to exit from problems reduces the incentives affected groups have to campaign for improvements in the system. This can result in a perpetuation of failing status quo policies as the political process is left under the control of opponents of reform. On the other hand, when large numbers exit all at once, this uncoordinated individual behavior can create problems that force the government to respond. Thus the decision of many firms to move production operations overseas has created a “hollowing-out problem” (*kūdōka mondai*) that is receiving the attention of government elites. Likewise, the decision of increasing numbers of women to opt out of motherhood has led to a sharp fall in the fertility rate, to a record low of 1.29 in 2003, contributing to a debate over how Japan should respond to its “declining fertility problem” (*shōshika mondai*). The future of Japan’s system of convoy capitalism is being determined by varying exit dynamics that have deprived reform movements of energy in most cases but propelled it forward in a few areas.

### Exit and Voice

To understand where Japan is going, we need an analytical framework that can help us understand how exit dynamics interact with the political process to produce policy outcomes. The obvious place to start is with the work of Albert Hirschman, whose book *Exit, Voice, and Loyalty* remains one of the few works that genuinely bridges the fields of economics and political science.<sup>18</sup> Hirschman deserves this ac-

colade because he realized that, for all of our attempts to divide the world into economic markets where organizations respond to uncoordinated individual decisions (exit) and political structures where organizations respond to mobilized demands from inside the group (voice), organizations in the real world are confronted by both response mechanisms. Corporations that manufacture automobiles, for example, are organized to respond to the uncoordinated individual decisions of millions of customers to buy or not to buy their products, but they may also be confronted periodically by a consumer movement, led by someone like Ralph Nader, that demands that they make better or safer products. Similarly, labor unions tend to be organized to respond to the mobilized demands of their members, changing course when they are confronted with noisy speeches, letters, petition drives, or campaigns to recall the union leadership. Yet, they are also frequently confronted by the problem of mass defections, or exit. Because all social organizations deal with both exit and voice, social scientists need to think carefully about how these response mechanisms differ and how they interact.

Hirschman provides us with two insights that are critical to understanding the impact of exit on the policy process in Japan. First, exit and voice represent two very distinct mechanisms that organizations respond to when there is dissatisfaction with their performance, each with the potential to spark a turnaround. Exit works quietly, as many individuals react to their dissatisfactions by changing their purchasing behavior, leaving their organization, or trying to escape from negative effects in some other way that involves uncoordinated individual action. The turnaround begins when managers, watching the bottom line, diagnose the problem, propose solutions, and put them into effect. Voice, naturally, involves a great deal more noise as those who are dissatisfied mobilize within the group—attend meetings, write letters, and build coalitions with like-minded individuals—to bring about changes in the group’s way of doing things.

This insight suggests that complex social organizations such as states have the capacity to turn around their performance in response to exit, and not just in response to voice. Social scientists have long held that states have their own interests, such as security and national wealth, which shape foreign and economic policies.<sup>19</sup> The managers of the state, the bureaucrats and the top leaders, are in effect responsible for watching this bottom line in the same way that corporate executives watch profit trends. When large numbers of citizens exit from the negative effects of policy in ways that threaten the nation’s wealth and security, these managers can be expected to intervene in the policy process in a top-down manner to put into effect reforms designed to return the nation to a richer and more secure path. This dynamic constitutes the upside of exit, its capacity to prompt a turnaround in the performance of states, such as reforms in a malfunctioning system of convoy capitalism.

Hirschman’s second insight, in contrast, points to the downside of exit. He argues that in spite of the capacity of both exit and voice to spark improvements in performance, most social organizations are unable to respond with equal effectiveness to both mechanisms. The difficulty arises because the two response mecha-

nisms are so different that social organizations inevitably have to structure themselves to respond primarily to one or the other. Corporations organize themselves to respond to exit by making sure executives receive timely information about what is happening to the bottom line and by empowering them to respond quickly. Democratic states, despite their interest in making sure managers are able to look after the bottom line of wealth and security, inevitably structure themselves primarily to respond to voice, the mobilized demands of social constituencies. This structure suits states fine as long as constituencies frustrated with the performance of their leaders respond by organizing social movements, voting for parties that favor reform, and campaigning for change. It doesn't work very well, however, when frustrated individuals start to exit.

This difficulty is aggravated, Hirschman argues, by the way exit opportunities affect the propensity of frustrated citizens to use voice. When disgruntled individuals have opportunities to escape from the problems created by a given policy, they are less likely to use voice to complain about it. Hirschman called this his hydraulic model: "Deterioration generates the pressure of discontent, which will be channeled into voice or exit; the more pressure escapes through exit, the less is available to foment voice."<sup>20</sup> Democratic states structured to respond to voice will be more likely to turn around in the face of a decline in performance when frustrated citizens with no way out begin communicating their concerns and working together to move the state in a new direction. When frustrated individuals begin opting for exit, states are not likely to respond effectively because exit will reduce the volume of complaining voices that states are listening for. Even if those choosing exit options do so in such numbers that their behavior begins to affect the wealth and prosperity of society, states will tend not to respond as effectively because their structures make them less responsive to this mechanism.

One of Hirschman's examples nicely illustrates how governments confronted by exit are unlikely to respond effectively. Public school systems, he pointed out, give parents dissatisfied with the performance of their schools two options: they can stay and use voice to try to improve their schools or they can exit by sending their children to private schools or by moving to another school district. Since public school systems are democratic structures organized to respond to parents' concerns expressed through the PTA, in school board elections, and in other forms of political mobilization, they tend not to respond very well when parents react to a decline in educational quality by *leaving*. The immediate effect of the departure of disgruntled parents is a decline in the volume of complaints that school leaders hear. Principals and school boards may actually find their lives more restful when the noisy complainers are gone. In time the decline in school enrollment may prompt a response, but because school systems have not traditionally been organized to respond to the exit mechanism, school officials are not likely to respond quickly or very effectively. What public schools are left with, Hirschman suggests, is the worst possible combination of exit and voice: enough exit to draw concerned

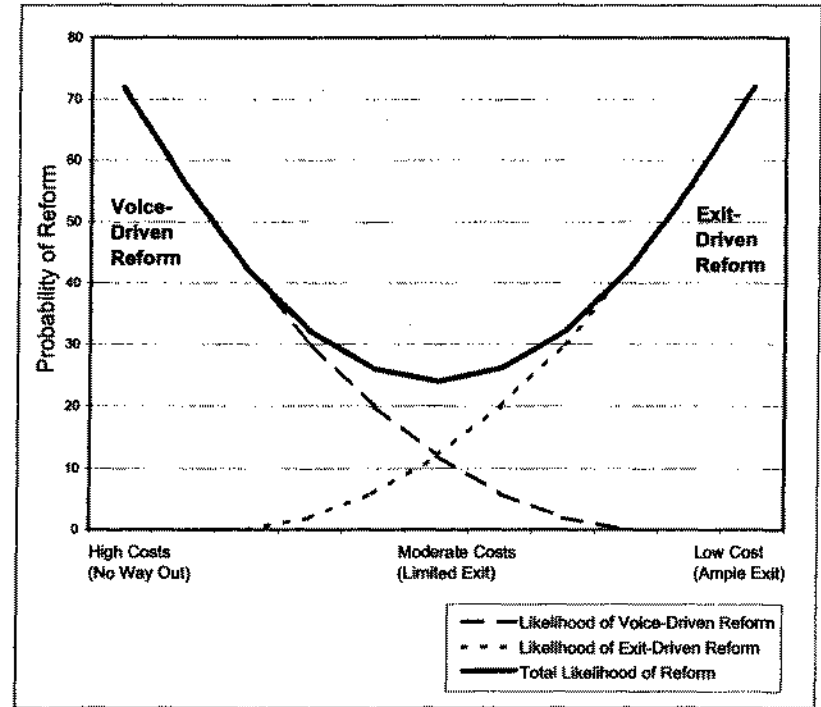


Fig. 1.2. Hirschman's framework: probability of reform as a function of exit costs. This figure assumes that dissatisfaction with the status quo and the costs of mobilizing in the political arena are constant.

parents out of the political debate over how to improve public schools but not enough to motivate needed changes through market forces.

The reason democratic structures such as public school systems are prone to this worst-of-both-worlds situation is because they make available exit options that are *moderately costly*, in the middle of the range of exit costs (see figure 1.2).<sup>21</sup> To take their children out of a public school, parents must either spend thousands of dollars a year on private tuition or uproot their families and move to another school district, in many cases one with much higher housing costs. Because these options may cost a lot, only some parents can afford to leave, and those who do leave tend to do so over a long period of time. Confronted with only a trickle of exit, school administrators accustomed to paying more attention to parent complaints than to enrollment trends are unlikely to respond by making improvements in the school's educational services. Since the immediate result of the departure of the school's most frustrated parents is a diminution of complaints, school officials in this situa-

tion are also unlikely to respond to the voice mechanism. With neither mechanism signaling the need for the school administration to change course, the school is likely to continue to spiral downward in its performance.

Hirschman's framework suggests that the performance of the organization would have been much better if the cost of exit was much higher (at the left end of the cost range shown in figure 1.2) or much lower (at the right end). If exit were close to costless, parents would respond to a decline in quality by moving their children quickly and in large numbers or by using the *threat* to pull their kids out of school to demand improvements. Faced with the prospect of seeing their schools rapidly depopulated, school system leaders would have no choice but to improve educational quality in order to win back their customers.<sup>22</sup> Alternatively, if exit were extremely costly, if parents had no choice but to put their children into a given public school, they would respond to a decline in performance by getting more involved in the PTA, calling the principal, and behaving in a determined way until the quality of education improved.

Hirschman's insights and this example show why it is critical to take into account what I call "exit dynamics" in order to understand the pattern of Japan's response to the decline in the performance of its system of convoy capitalism. Barriers to reform in the political system certainly matter, and so does the degree of discontent among those affected by public policies, but what Hirschman tells us is that, holding these factors constant, one can nevertheless get a wide variation in the responsiveness of the system depending on how costly it is to exit. If frustrated individuals have *no way out*, they will mobilize despite the barriers to political action, helping to push through reforms. If they can *escape at moderate cost*, they will be less likely to use voice to call for reform, depriving the voice mechanism of energy—and yet they won't exit quickly enough or in large enough numbers to prompt leaders to institute top-down reforms out of concern for the national interest. Exit will only propel reforms when frustrated individuals can *escape at little or no cost*, generating exit trends that are so pronounced that even distracted leaders will realize the need for action, diagnose the problem, and push through reforms.

### Convoy Capitalism Confronts Shifting Exit Dynamics in Japan

The system of convoy capitalism that is the focus of this book is composed of a large number of policies and practices that for several decades fit together neatly in a way that generated economic growth and a remarkable degree of social protection. One of the best known is the practice of lifetime employment, encouraged by labor regulations that make it very difficult for firms to lay off regular employees. Another is the regulatory system that managed competition in a wide range of sheltered sectors, such as electricity and telecommunications, so that firms were able to operate in a business environment where they did not need to worry about sudden price swings that would push them into bankruptcy. A similar regulatory system for

financial firms played a particularly critical role in protecting the convoy of banks from financial instability, giving the convoy system its name. The government restricted financial firms to a narrow range of services, set prices, and managed competition so that banks were guaranteed against the risk of bankruptcy themselves and so could afford to enter into long-term main bank arrangements with their borrowers. These policies worked together to provide Japanese firms with a secure and predictable business environment in which they could make long-term relational commitments to workers, suppliers, and distributors.<sup>23</sup>

Another set of policies encouraged women to serve as primary caregivers for their families. Tax and benefit rules subsidized "dependent" housewives by providing them with pensions to which they did not contribute themselves, tax credits, and other benefits that were so substantial they had a strong financial incentive not to boost their annual earnings above ¥1.5 million (\$12,500) a year. The limited supply of childcare and eldercare services, and the complete absence of family leave, pushed many women to quit their jobs when they had children or when a family member needed care. Finally, work rules offered little protection to full-time working mothers who needed flexibility to care for their children or frail elderly relatives. In combination, these policies pushed and pulled women into fulfilling a vital role in the system of convoy capitalism: wives were to be available at all times to provide care to family members so that husbands and the state did not have to; and they were to serve as a flexible labor force so that firms could keep core male workers on the payroll when times were tough.

This entire system has come under pressure as a result of socioeconomic changes, in particular globalization and the changing aspirations of women. Firms have been increasingly frustrated by the high prices they have to pay for a variety of inputs, such as labor and electricity, at a time when many of them are less insulated from market pressures than they used to be. They have also begun to worry about the long-term implications of public debt, which has been mounting as the government has struggled to patch holes in the convoy system. Similarly, more and more women have become frustrated with being expected to focus most of their energies on caregiving.

These frustrations should be prompting Japanese citizens to engage in a national debate about how to update their system of production and social protection. How can the burden of caregiving be reallocated between husbands, wives, employers, and the state so that children and the elderly receive high-quality care while both women and men balance work and family life? How can social protection for individuals be maintained without requiring that Japanese firms and the taxpayers pay high prices and subsidies to declining sectors of the economy? If the Japanese were able to debate these questions and arrive at answers, the nation might well be on its way to solving its problems of public debt, lagging growth, rising inequality, and declining population.

Unfortunately, this is a debate the Japanese continue to avoid. The reason women and firms have not forced the country to engage in this debate is because

both have found opportunities to escape from some of the most frustrating features of the system. Just as America's urban school systems have suffered as large numbers of parents have taken their children out of them rather than pressing them to improve, Japan is suffering because women and firms have found their own private exit strategies. The problem is that these exit strategies have by and large fallen in the moderate cost range that Hirschman's framework identifies as most problematic. They have consequently failed to spark either an exit- or voice-driven response, while adding to Japan's economic difficulties.

Escaping from high production costs by relocating to China and elsewhere overseas allows firms a way out, but this strategy takes many years and many yen to implement. Because it has taken so long for the extent of the trend to become visible and because the opportunity to exit has made firms less likely to speak up to identify the problems that are driving them overseas, it is only recently that some observers have begun to describe the foreign direct investment (FDI) trend as a "hollowing-out problem." The managers of the state have been trying to figure out what's wrong, but without the support of firms they are having difficulty diagnosing the problem and pushing through controversial reforms.

Similarly, women have found that their partial escapes from the system are not costless. The single and double-income, no-kids (DINK) lifestyles are second choices for most women, who continue to tell pollsters that they would ideally like to marry and have children. Only some of these women have been willing to give up forming families in order to continue in their careers, and they generally only come to this decision after many years of self-questioning. The declining fertility trend that has recently become a national obsession has therefore taken many years to emerge—with demographers predicting as recently as 1997 that the dip in fertility rates was only temporary. Because women opting not to marry and not to have children have made these decisions individually and silently, there has been no young women's movement to define the problem and advocate solutions. Instead, it has been left to bureaucrats to identify the "declining fertility problem," determine the reasons it has emerged, and advocate gender-role changes that some have now concluded are necessary before the trend can be reversed. Without more active support from young women, government officials have found it difficult to grasp the extent of social and policy change that is required, and they have found it even more difficult to accelerate social change.

While the main focus of this book is on these reasons for the slow pace of reform of the system of convoy capitalism, I do not argue that the system is intact—far from it. Key elements of the system have been subject to far-reaching reforms. The extensive liberalization of the financial services sector has weakened a vital pillar of the entire system. The Gold Plans of the 1990s, which sharply increased government spending on eldercare services, and the introduction of the ambitious Long-term Care Insurance (LTCI) program for frail elderly in 2000, combined to guarantee a hitherto unimaginable level of social service provision for senior citizens. Notably, these programs were specifically designed to relieve female family

members of much of the burden that used to fall almost exclusively on their shoulders.

These exceptions to the pattern of stasis, I argue, can also be explained by the distinct exit dynamics that have produced very different responses by women and firms affected by these policies. In the case of financial services, firms frustrated by the limited availability and high cost of specific services frequently found that they could exit at little or no cost. All they had to do was book the transaction in London or Singapore or Chicago. The low cost of exit allowed firms to exit quickly and in large numbers, producing the hollowing out of specific financial service markets. The magnitude of the exit behavior and its causes were so obvious that it propelled reform, culminating in the "big bang" reforms adopted in 1996. With the Gold Plans and LTCI, it was women with no way out that helped propel reform. While young women could get around the problem of balancing careers with childcare by opting not to have children, older women who were expected to drop everything to care for frail family members could not easily opt out of having parents or in-laws, or of aging themselves. The inability to exit motivated women to form groups, lobby bureaucrats, and run for office, even winning the support of conservative men in the LDP.

These exceptions, unfortunately, do not signal that Japan's system of convoy capitalism is smoothly evolving toward something new and functional. On the contrary, the uneven patterns of reform driven by varying exit dynamics have helped make the system more dysfunctional than ever. The system is unraveling, and only when the problems of hollowing out, declining fertility, and perhaps the most threatening exit trend of all, capital flight, reach crisis levels will the Japanese be motivated to respond.

### What's Ahead

Hirschman subtitled his book "Responses to Decline in Firms, Organizations, and States." Most of the examples in his book are drawn, however, from the first two categories, and his frequent references to "customers," "managers," and "members" seem to have discouraged other scholars from applying his insights to organizations as large and complex as states. Instead, most scholars who study economic and social policy have built their models on foundations laid by two other economists with aspirations to apply their discipline's tools to the study of politics: Anthony Downs and Mancur Olson. From Downs we have models that treat the policy-making process as a "political marketplace," with voters choosing parties and parties choosing policy in ways not dissimilar from the way customers buy goods and firms sell them; whereas from Olson, we have models that assume that concentrated costs and benefits cause political actors to organize and mobilize in the political arena.<sup>24</sup> In neither of these approaches, however, is there much room for voters and other political actors faced with a policy they don't like to *avoid its ef-*

fects rather than acting in the political marketplace. Ironically, these economists and the political scientists who have followed their lead seem to have forgotten that there is a market out there where individuals frequently have opportunities to exit instead of using voice.

Although this book is organized around the puzzle of Japan's poor economic performance, it also challenges the preeminence of Downs and Olson in political science by insisting that we take seriously Hirschman's insights about the "hydraulic" relationship between exit and voice. As I discuss in more detail in chapter 2, political economists studying the effects of globalization and scholars studying women's movements, reflecting the influence of Downs and Olson, tend to focus most of their attention on what is going on in the political arena. As globalization makes the costs of welfare states more salient and social change leads (some) women to grow frustrated with welfare policies organized around male breadwinners, they assume that women and firms will mobilize in the political arena in an effort to change policy. Even if they don't succeed at first because political institutions get in their way, when they get frustrated enough they will mobilize to change these institutions so that they can realize their goals. The assumption that frustrations lead to mobilization makes most of these scholars "optimistic"—if that is the right word given that many analysts of welfare states bemoan the pressures these policies face—that state structures will not remain out of conformance with socioeconomic conditions for long.

Hirschman's observation that individuals frequently have exit options and that their exercise of these options will tend to draw them *out* of the political arena should lead us to rethink those theories and arguments about globalization and women's movements that do not adequately take into account the hydraulic implications of exit. Although the empirical discussion in this book is focused primarily on Japan, chapter 2 makes it clear that if my application of Hirschman's logic to the areas of economic and social policy in Japan helps make sense of the slow and uneven pace of reform there, we should be asking similar questions about other nations. Maybe one reason the U.S., German, and Italian governments have been slow to expand public childcare systems is because career women in those nations too have exit options that take them out of the political process. Likewise, instead of focusing primarily on labor union power to explain why Germany has been slow to introduce more flexibility into its labor market, we should be asking whether the ability of German firms to relocate production to eastern Europe has reduced the vehemence with which they seek reform through the political process.

After drawing out the broader comparative implications of this study, I return the focus to Japan in chapter 3, detailing how the nation's system of convoy capitalism operated before it came under pressure, focusing on its productive and protective features. While much of the literature on Japanese political economy has emphasized the productive advantages of elements such as the main bank system, cross-shareholding, vertically integrated production networks, and government in-

dustrial policy, the emphasis in this chapter is on how all of these structures, together with the fragmented system of social insurance and the reliance on women as primary caregivers, also contributed to social protection under the socioeconomic conditions of the high growth years.

Yet these conditions inevitably changed. Chapter 4 looks at how socioeconomic changes since 1980, in particular the economic changes captured by the term "globalization" and changes in young women's role aspirations, have caused women and firms to become increasingly frustrated with the system of convoy capitalism. Although some have responded by mobilizing in the political arena, I argue that the predominant response has been slow, quiet exit through foreign direct investment by firms and declining fertility and departure from the full-time workforce by women.

The next three chapters make up the heart of the book, the exploration of how the uncoordinated exit decisions of Japanese firms and women have affected the policy process. In chapter 5, I describe how long it took for the decisions of firms to exit via FDI to be seen as a hollowing-out problem. When the trend first began, it was actually applauded by bureaucrats, who developed policies to encourage Japanese firms to relocate production overseas in hopes this would appease critics of Japanese-style capitalism in the United States, Europe, and Southeast Asia. Even after Japan entered its "long decade" of stagnation, now stretching to fifteen years, Japanese officials hesitated to call FDI a problem. Not surprisingly, this hesitation has blunted exit-driven policy change in Japan. In chapter 6, I examine a series of case studies of labor market reforms, electricity-market reforms, and public-sector reforms. In none of these areas, I argue, did the state respond vigorously out of concern for hollowing out—in large part because the trend emerged slowly and was hard to interpret. Yet the slow departure of Japanese corporations provided enough of a relief valve that it sapped the energy that firms might have devoted to demanding economic reforms in the political arena. Without more support from this constituency, Japanese officials found it difficult to convince the Liberal Democratic Party to tackle these structural reforms.

Chapter 7 spotlights the features of the system of convoy capitalism that affect women, in particular those affecting their ability to combine work with child rearing. I examine how the declining fertility trend has affected the policy process, focusing on the complications that have made it difficult for government officials to grasp the significance of the problem, diagnose causes, and formulate a response. I also examine how the ability to exit affected the women's movement and its role in this policy debate. Finally, I focus on the limited reforms that have and have not been implemented in this area, including childcare leave (as leave to care for one's own children is called in Japan), expanded childcare services, tax and benefit reforms, and reforms in employment regulations.

In the penultimate chapter I examine the two exceptional cases of far-reaching reform, those in the financial services sector and those expanding services for the frail elderly. I examine the effects of exit dynamics on the reform processes in these

sectors and then summarize the lessons from the comparison across cases in this book. Chapter 9 returns to the big question with which we began: Why haven't the Japanese people forced their politicians and bureaucrats to change course? Can we expect them to get the message anytime soon? And is there a way for Japan to reform its system before it faces a true "race for the exits" crisis?

## Chapter 2

# Taking Exit and Voice Seriously

As befits a topic of such importance to the contemporary world, scholars and policymakers have been engaged in a lively debate about the degree to which globalization, declining fertility, and aging threaten the mechanisms through which advanced industrialized nations provide social protection for their citizens. Some tell us we are doomed to see laboriously constructed social programs cut back and dismantled, with the whole world converging on the U.S. model of unfettered capitalism, while others tell us we can expect a diversity of systems—including systems with generous social protection—to survive. Who's right? What are the implications of these debates for Japan? And what are the implications of this study for these debates?

What I find when I review this literature is that most works focus on "the political marketplace" to the neglect of the economic marketplace that operates alongside it. Global economic changes, demographic shifts, and value changes are seen as drivers of new patterns of political mobilization, typically a realignment of political forces for and against policies that provide social protection. This pattern of realignment is then seen as the driver of systematic policy change.

This literature has not completely neglected the role of exit in the economic marketplace. Scholars who study globalization place a great deal of stress on the role of greater capital mobility (or capital exit) as a factor reshaping social and economic policy. Similarly, some scholars who study family policy have stressed the role of falling fertility rates (another type of exit) as a motivator of policy change. What is notable about this work, however, is that all of it expects the economic and political processes to operate separately, but in tandem, to reshape policy. Capital mobility is expected to *work with* the mobilization of traded goods firms in the political system to push governments to scale back social protection. Falling fertility rates are expected to *work with* the mobilization of women in the political arena to push governments toward adopting more gender-neutral social policies.