JAPAN SEEN FROM THE FOCUS OF HER ECONOMIC POLICY

By VLADIMIR PERTOT*

In searching for the real economic background of the extraordinary development and high growth rate of Japan during the two decades preceding the last world recession of the early seventies, one may be discouraged by the many and widely differing, not to say evasive and rather inconclusive answers offered by analytical papers dealing with the Japanese economy.

Assuming that the explanation of the Japanese economic of recipe is to be sought in an analysis of the system of her economic policy as a whole this paper[1] will suggest that it is not a lack of insight into the Japanese economy which obstructs the appearance of more uniform interpretations of the meaning of the Japanese economic record. There might rather be initial political commitments preventing economic analysts from looking at the Japanese achievements from similar focuses and from coming to more coherent conclusions about the dynamic forces behind the gigantic achievements of this nation.

I

There seem to be two main types of methodological approaches in the rather extensive literature on Japanese economics.

One is sectional, more or less liberalist, capitalist, western: one or more sectors of the Japan economy are analysed and compared mostly with the working of corresponding sectors in one or more western-type economies. Even when the whole of the Japanese economy is under scrutiny the method remains, in principle, the same: Japan is divided from her totality into sectors and the general analysis is then a pondered comparison by sectors between Japan and other countries.

The political background of this method is that it is taken for granted that Japan is a free enterprise, free market, capitalist country where cyclical dynamism can differ from dynamics in Western industrialized countries only where some kind of economic intervention in Japan has diverted the free movement of value from a free market equilibrium to some altered and deformed condition. There is therefore the assumption that it is sufficient to study sectors of the Japanese economy where the relationship of values seems to have been deformed by intervention to identify the essential differences between Japanese and western economie policy.

The second type analytical approach may be called centralist, dirigist, socialist, eastern.

* Professor (*Kyōju*) of Department of Economics, University of Zagreb.

[1] This is a summary of a book the author is preparing for publication under the same title in Jugoslavia (University Press "Liber", Zagreb, 1978).

Here there is no particular interest in splitting the Japanese economy into sectors. Any interventionist deformations that may characterize individual sectors of the Japaneze economy are already politically explained to be deformations immanent in modern capitalist markets and just a proof of the economic chaos the free market system may cause. This prejudice, however, prevents further comparison of Japanese economic planning with eastern central economic planning. Dogmatically the mere existence of free markets in Japan precludes any comparison between the two systems.

The two methods of analyses seem to share a look of finality in their approach to Japan. There always remains an extra factor (or a missing one) which usually has to be explained away by specific conditions or characteristics of Japan or the Japanese. Both approaches also share a tendency to compare the effects of the reflexive sectional intervention which characterizes their respective home territories only with the corresponding parts of the Japanese system of intervention, neglecting the latter's closed and synchronized quality.

There could, of course, also be a third method of approach, an uncommitted, unaligned one. It could have the advantage of being free from any dogmatic or political initial commitment. There is no immanent need for comparison with other countries or with similar measures taken under different conditions. This method would have the advantage of taking the Japanese economic policy under scrutiny as a whole, as a closed system of general and synchronized intervention having the sole aim of reaching certain national economic goals.

II

One suspects that there must be something essentially wrong with the criteria usually applied in evaluation of the effects of economic intervention in the modern world. Unless the political or dogmatic criteria of such an evaluation are completely omitted from the start, there will be a persistent difficulty in reaching a thorough understanding of the Japanese economic policy.

When at the beginning of the thirties the world succumbed to a general wave of economic intervention nobody took it then as the beginning of a new adaptation of economics to the latest requirements of advanced technology. There was no inclination to interpret the changes as the first symptoms of the developing interventionism, a fundamental change in techniques of economic policies such as only big crises or calamities can introduce. Still, more than half a century of protectionism that preceded this moment had already indicated this most probable world trend in policies. Probably the intensity of the world economic crisis did not allow much of this kind of fundamental thinking during the thirties. Liberal economists were not prepared to accept this new phenomenon of a spreading intervention otherwise than as a temporary and provisional necessary evil to be relinquished with the first possible re-establishment of free markets. The development of interventionism was initially treated only in terms of the arguments usually deployed against protectionism, and thus the fundamental problems it posed were brushed under the carpet. Discussion between freetraders and protectionists usually remained on the economic platform. However the interventionist controversy soon acquired strong political overtones. These went far beyond the purely economic question of to what extent shifts in internal and external value relationships should be controlled by the extensive use of the whole range of possible intervention by the state in all kinds of value formation internal and external, trade and finance. Politicians seem to have failed to note that in interventionism many more economic consequences were involved than in simple import tariff rates.

These political or dogmatic attitudes to economic intervention had been implicitly challenged by the October Revolution 1917 in the USSR. The mere fact that a decade or more before the world economic crisis intensive economic intervention had already been used in the USSR to destroy the capitalist system seems to have been enough to persuade western economists that using intervention was simply anticapitalist. It should therefore be avoided by all means if the existing social system should be preserved. Claiming that absolute intervention (meaning avoiding any free formation of internal values) is the only socialist method of economic policy, eastern economists merely underlined this belief. Since then any liberalization of the existing interventionist system in eastern terms is held to become synonymous with opening the economy to capitalist influences. Any intensification of intervention is considered in the West to be nearly identical with the application of dirigist, socialist methods of economic policy.

These onesided attitudes could not change the reality that modern technology cannot develop any more in a classical free market environment. This is not so much because free markets in the classical sense do not exist any more. It is because of the nature of modern technology that intervention is indispensable, whatever the social system may be.

Whether it started for purely technological or for other / cyclical / reasons, the use of intervention is so widespread over the whole world that new rules of value distribution have been introduced in economies whatever their social systems.

These new rules can be usefully utilised if properly studied. They can be recognised by economists in all the direct and indirect economic effects of each kind of intervention. However by labelling in advance types of intervention in terms of dogmas, policy or social systems, attention from the real economic meaning of any intervention can easily be diverted in such a way that entire economic systems may be misinterpreted.

The direct or primary economic effect of an intervention corresponds to the degree of shifts of value such a measure was meant to cause or has already accomplished in relation to standards in which a free market mechanism would otherwise result. It is in view of obtaining such immediate shifts or disparities of values that politicians (western or eastern) make their choices between different alternative types of intervention. Given such dogmatic backgrounds the priority of choice falls to political criteria. Only secondarily can the real economic effectiveness then be considered, be it import tariff, a capital allocation, a special exchange rate, or shifts in prices, wages, profit rates or consumption.

The indirect effects of intervention represent the secondary changes in value that usually follow the primary shifts or disparities. These effects are mainly a consequence of the existing interrelationships between production and trade. Any directly caused change in value of a product with the passing of time will snowball in further smaller changes of values of items that process the primary material, semifinished or finished good or service initially directly hit by intervention. These secondary changes in values will of course be very different and will correspond to the change in the share of material costs caused by the change of value of the item directly influenced by intervention.

To whatever social system economies may belong today there are probably practically none left without fundamental disparities in costs of production as consequences of accumulations of direct and indirect effects of intervention of the previous years or decades. These accumulations and disparities would have no similarity even between two countries that in the past might have applied the same kinds of intervention of the same intensity. The different structures of trade and the differing corresponding interrelationships of values would preclude any similarity. One and the same type of intervention applied in the same country in different times or at the same time in two different countries, will again result in differing secondary effects on values in proportion to the differences in previously accumulated disparities in the economies. Under such sircumstances, comparisons between economic policies of countries become more and more difficult, requiring a thorough knowledge of present and past policies and of indications about cost disparities and the cumulative effect of sectional interventions. Hence the general preference for sectional approaches not only in analysis but also in new intervention.

The difficulties become evident if such sectionally oriented analysts meet constellations of values within the Japanese economy and its component sectors which differ fundamentally from what might be expected to result from the various types of intervention in such sections considered separately. These anomalies require specific explanations, often quite mystical even though there is no type of intervention found in Japan that has not already been used previously in other countries.

III

There may be three reasons which might have led the Japanese at the end of the forties to constructing their peculiar system of economic policy. They had practically no resources to allocate to the producers; they needed a system to cope with adverse transport disparities; and they had an administration able to handle even such a desolate situation.

After the moral shock the lost war and the following occupation caused to this proud nation they underwent in the second half of the forties an even worse shock by becoming aware that in the changed situation the volcanic islands offer no natural possibilities of development whatsoever. To this by then numerous nation only substantial imports could help but they had to be paid for. While the population was still a third of its present number, a century ago, Japan could still start with colonies, occupations and migrations and a very low standard of living to settle the difficulties of the balance of payments. But to feed and employ a nation of a hundred million on a reduced number of islands seemed practically impossible.

Although there are many other poor nations in the world and some have also succeeded in solving the problem of adverse provision of natural resources Japan has, to make things worse, a disadvantageous geographical position too, shared by no other nation. This causes permanently higher costs of transports in external trade whatever its direction. If half the length of the Equator is taken as the highest cost of transportation a nation has to support on this planet, this is the position of Europe in relation to Japan. Both North and South America and Australia are still more than half this length from Japan. In 1955 60.7% of the value of import and 47.3% of exports was still with these four distant continents. Only 6.9% of imports and 7.5% of exports Japan developed within the range of

2.000 seamiles (S. Korea, China, Taiwan and the USSR). This is the range in which most nations of the world place the majority of the value of their international economic exchanges. The difference in transportation costs Japan has to cover in comparison with the most important industrialized countries of the West in 1955 could be estimated to be about 1.92% of her GNP. So once Japan succeeded in finding trade combinations to pay with exports the imported raw materials there remained the need to compensate within the economy a large part of the GNP before being competitive on world markets, all other conditions being the same as for the competing industrial producers.

An economic policy had to be shaped so that it would really be able to counteract effectively the comparative disadvantages Japan had to overcome to be able to utilize her poor soil in the worst location. Any waste of values through uncontrolled and counteracting accumulated disparities of sectional or automatic reflex intervention had to be avoided. So a completely synchronized system of economic intervention arose whereby not only all secondary effects of intervention were considered from the beginning, but in addition a permanent survey of the flow of values in all channels of the economy was so effective that the direct and indirect effects of specific interventions melted together with similar effects of other types of intervention. The synchronized flows of values resulting within the economy had only to be surveyed and corrected from time to time by regulation that worked on these general flows.

It is somehow surprising that the Japanese alone succeeded in shaping such a synchronized policy while practically all the rest of the world was limited to the use of sectional intervention as a kind of reflex. Dogmatic commitment has already been mentioned as an explanation: as long as intervention is considered in the West as a transitional measure limiting the freedom of markets and as a dangerous approach to socialism, there can by definition be no initiative to bring order into the effects of intervention. So long as the central planning theoreticians believe that they have succeeded in eliminating the laws of supply and demand, but at the same time keep money as a unit of value, will they consider all value disparities that do not fit into the planned relationships only as irregularities that have to be suppressed by immediate new direct intervention against each sector that shows signes of such indiscipline. By contrast the Japanese system without any prejudice uses the mechanism of the free market everywhere to the extent that it can be helpful. It ties however to interventionism all other formation of value where it appears to be necessary to obtain growth. In extremely poor circumstances of natural resources and extremely disadvantageous transportation costs this was more often necessary than not.

Japan had the great advantage of continuity of administration and a good administration at that. The Meiji restoration of 1868 was in reality not a complete revolution of civil rights, so the efficient feudal administration embracing many *samurais*, was simply taken over and expanded by the addition of intellectuals who were sent to study in America and Europe and even of foreign experts and scientists. During the thirties this administration submitted to the military dictatorship and avoided distruction. After the war, once it was decided to let Japan try to find its own feet MacArthurs occupation forces were soon relieved to see how many of the former civil servants were still available. They could be re-instated into the reformed administration. Since then the cream of Japan's new intellectuals have streamed into the civil service. It is now considered the most socially prominent profession in Japan.

IV

In shaping the new policy the administration had the advantage of having a clear-cut purely economic target—to restore the economy—and of having no need to cater for parliamentary sensitivities about the dogmatic meaning of individual types of intervention.

The problem for Japan was initially not whether to use intervention or not; Japan wanted to exist. The problem was how to avoid the addition of accumulation of secondary effects of intervention to the two other fundamental difficulties economic policy had to solve. Fighting with inadequate natural resources and transportation cost disparities was already quite an excessive assignment for intervention.

The advantages of a synchronized general economic policy thus became evident. The only way to solve the Japanese structural problem was to build directly into national economic aggregates the structural disparities of the costs of production. Japan can produce only if one group of structurally elevated costs can be compensated by equally low costs of some other kind if Japanese export prices are to remain on the world market level. Instead of calculating corresponding disparities of costs in each case, for aggregate disparities that are anyway the consequence of structural disadvantages, Japan chose a simpler, general solution namely a monetary one. The principle seems to be to accept a general, linear depreciation of the yen in terms of the kind of costs that in Japan for structural reasons are unavoidably higher than in competitive world markets. The aggregate depreciation of the yen in terms of such high costs is then to be matched by corresponding aggregate appreciation of the yen in terms of other costs of production.

Once this general compensation of structural cost disparities is realized, there could still be a question of additional sectional intervention in individual sectors. But the Japanese experience shows that once the individual disparities are fundamentally solved in national aggregates there is almost no need of additional sectional intervention (and consequently no accumulation of adverse indirect effects).

In order to reconstruct a system of disparities that reproduces clearly the aims of Japanese official economic policy, it might be useful to rearrange the conventional economic definitions of different costs in an economy. The value of material costs for this purpose might be reduced by the component of taxation which producers usually have to pay. Taxation will be treated here as a separate cost of production. This separate item of costs will include also all other forms of taxation which production has to pay even if it is not necessarily connected with the value of material used.

It seems also advisable to subtract from the classical definition of material costs all types of depreciation of capital, and all the costs of capital such as interest rates. These can then be added to profits or capital income in an extension of the category of capital cost. This may be called recapitalization or gross capital income in the largest sense. All these items are equally subject to changes in financial policy.

To the thus reduced category of material cost, the suggested new category of taxation and the extended category of recapitalization, the fourth cost item, labour cost may be added unchanged with its usual meaning.

Of the four groups of costs of production, material cost and taxation can be considered as fixed costs. From the point of view of producers their value cannot be altered. Producers can accept these costs at the level at which the market offers them, or at which the state imposes them,—or they can leave production. Labour costs and recapitalization on the other hand are items where the influence of the producer can be crucial for their determination. They may be called variable costs from the point of view of producers. From the point of view of economic policy however all costs are variable. The only limitation of policy to influence these costs appears exceptionally in material costs if they are imported from abroad and are high.

The Japanese economic policy is one where material costs are practically fixed by the level of world market prices. Moreover these fixed material costs in Japan are world market import prices inflated additionally by the transport cost disparity.

However to enable producers to export from Japan economic policy must compensate additionally for all the transport cost disparities in exports even though all the other differences in productivity between the national and foreign producers have been provided for.

To compensate for these adverse relationships in transportation there was not much left for Japanese economic policy to do within fixed costs. Intervention could ensure that the demand for the most expensive materials does not increase through inappropriate new investments too disproportionately, and that the imported materials are most rationally utilized. As for taxation costs, from the postwar beginning taxes were extremely low. This was to give an incentive to production. Any later increase of functions of the state had thus to be accomplished in ways that did not increase the current rate of taxation.

So the only potential source for active compensation within costs remained variable costs. Both labour cost policy and financial policy were thus extensively used in the Japanese system of intervention. However the focus of intervention shifted in time from labour costs to recapitalization but in a rather smooth way.

In the first postwar years there was practically no other possibility for Japan but to compensate high material costs by underpaying labour and appreciating internally the labour yen in terms of the official rate of the national currency. If the later mechanism of compensating high costs through the yen appreciation in terms of recapitalization became one of the most ingenious ones, the most difficult problem to be solved by economic policy at the beginning certainly was how to pay low wages and still obtain increasing production, mounting productivity of labour and a progressively growing national new capital formation.

The Japanese system of intervention appears very logic if analysed by its effects on the four groups of costs of production. Approached this way it does not leave much to be explained by specific Japanese habits. Besides it is based on the principle of the least possible intervention. Everything is left to free market forces that does not impinge on value relationships which are needed for implementing policy. The Japanese experience is a good example of how much value disparities can be brought about with a minimum of direct intervention provided all restrictions harmonise well in all their direct or indirect effects.

V

Material costs are the critical factor in all Japanese calculations because of disparities in transportation costs. There is nothing economic policy can do to lower this quantitatively most adverse item. But what policy can do, and really very efficiently has done, is to prevent such costs from becoming higher than is absolutely necessary.

Hence a superficially modest (but in fact vital) target of policy to obtain a structure of new investments selected by the principle of most rational use of imported material and the highest obtainable productivity of labour and capital in the exporting industry. The principle has its qualitative and its quantitative aspect.

The quality of investments to be preferred at a given time by new producers is suggested by the five—and one—year economic indicative plans issued by the administration. Plans in Japan lack any legal sanction. Changes in use or origin of imported raw materials or introduction of new technology in exports are only recommended and approximations of desired production increases are forecast. These usually understated forecasts are taken however very seriously by the producers. Even when it became a rule that planned figures were always too low and had to be increased during the current year the plan became a good indicator of what preferences were to be expected in the period for the banking pyramid to give to different kinds of new projects.

The discipline is safeguarded by the pyramidal organization of the Japanese banking system headed by the Bank of Japan, a state reserve bank and effective translator of principles of current economic policy into banking language. Immediately below in the next stratum of the pyramid lies the private, free banking sector. But the influence of the Bank still goes very far vertically through many strata of the pyramid.

In the first line of responsibility there are the (14) "city" banks, the only banks that have the right of rediscount at the cheap discount rate of the reserve bank. The proper use of credits emissions is safeguarded by the Bank through additional controlling instruments (window guidance, credit limits, the open market policy, reserve requirements) making the city banks of course only from the point of view of economic policy, work practically as branches of the Bank of Japan. Still these are otherwise typical commercial banks.

The equally private (64) "local" banks for the most variable part of their credit potential and thus for the degree of liquidity they have are in second line responsibility to the city banks, which are their only source of discount. Deposit requirements for credits are another means by which local banks are forced to follow the city banks closely in the implementation of the current official credit policy.

These three strata of banks cover more than half of the total outstanding loans of the country. But also all the remaining banks and financial institutions of the country directly depend on the pyramid for all changes in their liquidity. They too have no other choice but to follow the official credit policy in all the details of their activity in order to be able to rely eventually on this important financial background in cases of emergency.

It is characteristic of the Japanese technique of intervention to choose whenever possible such institutions or instruments of intervention that can be used simultaneously for two or more purposes, thus diminishing the total volume of regulation necessary and the need for additional control of the results. The banking pyramid is a good example. Originally set up only to be an efficient institution to collect savings and guarantee all the required safeguards to savers, the pyramid was soon elevated to this second function of selecting investment credits in close synchrony with economic policy. Finally it developed its third and perhaps most important role, as the regulator of financial liquidity (to be mentioned later). By having these three functions executed commercially by an otherwise free, reciprocally competing banking system, it has been possible to establish a very efficient handling of financial means with no administrative or bureaucratic interference.

Once this qualitative control of investment and holding the increase in material costs to a minimum has been established from the point of view of regulating production, there should in theory be no further need of introducing also quantitative control of imports or exports. But import demand is not only composed of the needs of production, but is also influenced by consumption. Moreover, not all exports originate from large scale enterprises financed by the banking pyramid. So Japan has also had to keep all the classical instruments of foreign trade control, foreign exchange and financial control. These were generally tolerated anyway and expanding more and more over the rest of the world. But Japan relied for most parameters of economic policy on the working of the banking control system described above, and as her growth rate improved, this quantitative instrumental control obtained more and more an accessory character. It could thus be easily liberalized. The use of these instruments in Japan at present is really of minor importance but an over extended period of such liberalization contributes a liberal aspect to the image of Japanese policy.

VI

The budgetary yen had to be kept mostly on parity with the current official exchange rate if additional financial strain was not imposed to the two remaining costs of production having thus to compensate also for such additional budgetary expansion. In principle this means that once fixed at the initial very low general taxation rate, the budgetary inflow must not exceed the current proportionate increase of GNP. But this non-disparity to the official exchange rate does not exclude the possibility of a nonetheless very dynamic cyclical influencing of the Japanese economy by the budget. This budgetary policy has two aspects, the short term and the long term one.

From the short term viewpoint a policy has been introduced of discontinuing economic cycles before their overheating has even started. This is just a consequent adaptation to the policy of preventing material costs from rising over the unavoidable level. Experience shows that overheated material costs which follow the full expansion of the cycle particularly in periods of growth, rarely return after the subsequent decline of the cycle to their previous levels and remain somehow inflated in comparison with prices of the previous period. Probably to prevent this unnecessary increase in material costs, different instruments of discontinuation of cycles have been extensively used (the open market policy, tax differentiation policy, functional separation of the wholesale price mechanism from tendencies of retail prices).

In the long run, budgetary balances have been shaped exactly to ensure with state savings a smooth development of gross national savings. At fixed rates of taxation budgetary expenditure became an inverse function of insufficiencies or surpluses of the steadily growing national savings trend. This helped in forming new capital at a steady rate neccessary to keep the financial yen appreciated at the level exactly required.

VII

Disparity of the yen earned by labour was for a long time (since the early fifties) practically the only possible source of compensation of the high costs Japan had to pay for imported material. The appreciation of the yen in terms of earnings to the extent that exporters could offer Japanese finished goods at competitive prices as if high transportation cost of raw materials to Japan, and finished goods from Japan, did not exist, was kept with the help of specially adapted instruments (life-long employment, dualism in industry, differential income policy between trades, policy of hobbling real wages behind productivity). Soon, however, the limits of implementing such a policy of growing production only by increasing employment of low-paid labour became quite evident.

If labour productivity was to increase, and incentive to be given for new capital formation, an increasing share of labour earnings in the increased value of real production had to be provided.

The way in which dosing and timing was practiced in this area by the authorities is one of the shining points of the successful economic policy. They did not allow the appreciation of the income yen to diminish faster than financial liquidity, and corresponding appreciation of the financial yen developed.

Around 1967 this process of shifting the compensatory role in costs from earnings to cheap capital was accomplished. It was then that the rate of increase in national output of Japan did not depend any more on corresponding increases of the input of labour. Since then, when the rate of growth of Japan reached its highest, the trend of this rate was determined by the progressive amount of capital input. It is generally estimated that Japanese real wages reached on the average in the early seventies the level of most western industrial countries.

VIII

It would be impossible to make the appreciation of the financial yen the main compensatory basis for the material costs depreciation without subduing the whole economic system to this particular aim. For this a steady degree of high financial liquidity realistically dosed, and a very subtle policy of interest rates had to be implemented. An absolute isolation of internal financial markets from abroad had of course to be preserved if the long term inverse tendencies of the Japanese needs as compared with tendencies on world markets and all their adverse oscillations were to be avoided.

This financial isolation has not been obtained so much by severe foreign exchange and the financial control. It is rather the hermetic working of the banking pyramid that has offered a much more reliable basis for operations of this kind.

In shaping the special parity of the value of the financial yen the banking pyramid is in charge of two fundamental functions. As has already been said, the first and most important is a thorough collecting of all available savings of the country, private, state or corporate, with a net of guarantees that give absolute security to the savers. The second is to mix within the banking disposabilities the right degree of financial liquidity to provide the necessary background for the planned investment policy. For this purpose the pyramid overwhelmingly dominates both the supply and the demand side of national financial turnover.

On the supply side the pyramid deals with all the three sources of new capital formation. By far the most important one is savings. It is worth studying the inventiveness of the Japanese in ensuring highest rates of savings, from ordinary savings appliances to disincentives to already existing demand for consumption. The issue of money is of course the next element in forming the volume of credits. In Japan new issue is exclusively channeled into investments. Issue cannot, as in many western countries, go alternatively, depending on the momentary tendencies of the markets, to cover in part an increase in general consumption. Finally, the Japanese practice a kind of discounting of future increases of productivity through their system of deposit requirements for each new credit. The rate of such deposits being in a certain relationship to the expected increase in productivity of the credited trade, banks could use these future economic values for new credit emissions before the values became real without causing inflation.

On the demand side changes of the Bank of Japan guideline discount rates have surprisingly less effect than variations of the voluntary maximum limits on lending rates set by the banks under the Temporary Interest Adjustment Law. At certain times these rates have been extremely differentiated. The weighted mixture of all these rates obtained on loans outstanding is in effect the collateral of the degree of appreciation of the financial yen in terms of the official exchange rate.

If in the long run high meterial costs was to be compensated by cheap disposable capital, with the taking over of this compensatory function form wages to recapitalization, the lending rate in Japan had to go down. This is exactly what happened in Japan between the fifties and the beginning of the seventies. During the same period the rates all over the world went steadily up. It is only in the first half of the seventies that the recapitalization in Japan became definitely higher than in the rest of the world. Since then there has been a closer development in tendencies of the Japanese discount rate with world market levels and higher liquidity alone became the outstanding feature of the Japanese financial markets.

To be able to implement such an independent financial policy, the banking system must work hermetically and follow strictly the instructions of the Bank of Japan. The pyramid must also, however, work hermetically in many other senses.

No new accumulated capital should be used for investments of an unplanned character. This has been sanctioned by the practise of banks of allowing credits only to clients who keep at the banks permanent, and in time of growth correspondingly increasing, deposits. To be sure of their loanworthiness in the future, enterprises tend to keep all their current disposable surpluses as different deposits (which explains why self-financing in Japanese industry is low relative to the high rate of new capital formation).

On the other hand the danger that accumulation of deposits and capital within the pyramid may leak out through the payment of higher profit rates by banks and enterprises is practically prevented by de facto profit maximization. Profits seem to be formally maximized only for city banks. But other banks would not be eligible for discount at city banks if they themselves did not keep the same practice of profit limitation; again industry would not be eligible for investment credits if it did not keep the same profit policy. This is necessary to avoid the reproach that the effects of enforcement of an extreme recapitalization are not equally spread over all strata of the producing population. Moreover profit limitation is unavoidable if the low rates of interest or special liquidity are to be kept on the level of an appreciated financial yen.

Hermetically closed within the banking pyramid all the recapitalization still remains in private ownership, since capital in banks (other than state banks) and enterprises and banking deposits are private. But all this private capital is available in practice only for financing operations in line with official policy. From the point of view of economic policy this capital is in fact in a way socialized. Of course, the banking pyramid embraces only the larger part of outstanding loans but in the rest of the economy, being dependent on the liquidity background that this semiofficial banking system offers, all the relevant investment initiatives remain subdued to the official line.

There exists, however, a kind of marginal money market in Japan to cover financing outside the planned line. At a high free interest rate (call rate) any bank can provide clients with credits. This rate oscillates corresponding to risks and current liquidity of the banks. This money market is a good indicator for the pyramid to get the right feeling for and measure of the appropriate necessary changes of other official rates of approved credits since the call rate tends to be in inverse correlation to the degree of general liquidity.

It seems quite evident that only thanks to such a synchronized working of the whole banking system could Japan obtain the fabulous yearly rates of saving and new capital formation that have enabled her to break world records.

IX

Risking a rough estimate of how in terms of disparities the Japanese system of costs compensation worked during, say, the seventies, when the average official rate of the yen was somewhere around 300 yen to the USA dollar, the parity of material costs was about 305 yen to the dollar or above. This assumes that total material costs in production represent 50% of the value of the national turn over (GNP+material costs) and takes disparities of transportation costs in foreign exchanges to be the lowest possible at that moment. Under such assumptions to keep the official rate of the yen in internal equilibrium the appreciation of the financial yen must have been somewhere around 285 yen to the dollar or less.

This relationship should be slightly corrected to the advantage of the disparity of the financial yen if we assume that part of the compensation is still covered by some smaller appreciation of the income or of the budgetary yen. It is possible that in some production Japanese wages are still below parity with the West, or that differentiation in taxation resulted in exclusively privileged positions of some exporters. Still it remains a matter of consideration whether there exist now enough concrete cases of this kind of calculation to be able substantially to influence aggregate national relationships.

If compared with western or eastern systems of intervention this synchronized system elevating structural disparities semiofficially to a national aggregate level avoided disparities accumulated without control by the adverse indirect effects and all the other unexpected effects that are globally criticized as consequences of modern intervention.

Computerlike this system can be quantitatively regulated and adapted to contemporaneous tendencies of liberalization or to antirecessive needs. It is increasingly helpful in explaining as time goes on, the strange stabilization of the Japanese position in international trade which is as though this nation never had the initial fundamental structural faults in her economic body to be solved on a scale unknown elsewhere.