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THE ECONOMIC CRISIS IN JAPAN

Mainstream Perspectives and an Alternative View

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ABSTRACT: Various explanations have been proposed for Japan's deepening economic crisis: (1) the country's "anticapitalist" economic institutions, (2) the failure to clean up bad bank loans and bankrupt companies, (3) a deflationary liquidity trap, (4) upward pressures on the value of the yen, and (5) balance-sheet adjustments instigated by the collapse of the 1980s "bubble economy." Our critical survey suggests that the kernel of truth in all these perspectives lies in their common (mostly unstated and unconscious) implication that Japan faces a crisis of capitalist maturity involving a worsening trade-off between economic stagnation and the exploitative, wasteful, and destructive utilization of productive capacity. This dilemma can only be overcome through an explicit rejection of capitalist priorities and a movement toward a more worker-community-centered economy.

As recently as the early 1990s, the Japanese economy was the envy of the West. "Japan Inc.," with its system of collaborative labor-management relations based on "lifetime employment," its state-directed industrial policies (especially planned credit allocation), and its less-militarized international relations, was widely viewed as a model for a more equitable and competitive twenty-first-century capitalism. The more free-market, shareholder-oriented, worker-unfriendly, and militarized capitalism of the United States was thought to be less in tune with the requirements of a high-tech post-cold war era.[1]

What a difference a decade makes. With its cascading business bankruptcies, its banking system in shambles, and its skyrocketing government debt alongside deflation and rising unemployment, the Japanese model is now almost universally viewed as being in terminal crisis. Most striking is how previously cele-

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brated institutions, such as lifetime employment and an activist state, are now widely condemned as artifacts of a premodern capitalism too inflexible and uncreative to cope with an increasingly globalized and high-tech world economy. Naturally, insofar as this image of Japanese economic weakness was reinforced by the recession-less decade enjoyed by the U.S. economy after 1991, its continued salience may depend in part on the extent to which the current U.S. economic slowdown, stock market weakness, and corporate governance crisis shatter the various illusions regarding the "new economy." The deeper these problems, the less we are likely to hear about the relative backwardness of Japanese capitalism.

Table 1. Real GDP Growth Rates (annual, percents)

Years	Japan	United States
1982-91[a]	4.1	2.9
1992-2001[a]	1.1	3.4
1987	4.1	3.1
1988	6.2	3.9
1989	4.7	2.5
1990	5.1	1.2
1991	3.8	-0.6
1992	1.0	3.1
1993	0.5	2.7
1994	1.1	4.0
1995	1.5	2.7
1996	3.6	3.6
1997	1.8	4.4
1998	-1.0	4.3
1999	0.7	4.1
2000	2.2	4.1
2001[b]	-0.4	1.2

[a]Period annual averages.
[b]Preliminary estimates.
Source: IMF, *World Economic Outlook*, various issues.

Regardless of the outcome of developments in the United States, however, it is clear that the Japanese system of economic organization suffers from serious problems that undermine its past reputation as a model. A crucial issue in this regard is the extent to which Japan's problems should be understood in terms of the peculiarities of the Japanese economy, or, alternatively, as an outcome of deeper crisis tendencies endemic to all forms of advanced capitalism. One's determination of which framework offers the greatest insights into Japan's economic situation is obviously of political importance, with clear implications for current policies and future social possibilities in Japan and elsewhere.

The leading mainstream explanations of Japan's economic problems tend to emphasize the weaknesses of specifically Japanese capitalism, largely ignoring the extent to which the country's crisis is rooted in the general contradictions of advanced capitalism. In contrast, we believe that Japan is indeed suffering from a crisis of capitalist maturity involving a worsening trade-off between economic stagnation and the exploitative, wasteful, and destructive utilization of productive capacity. This kind of crisis is endemic to all forms of mature capitalism, but it has taken on historically specific forms in the Japanese case — forms that the mainstream explanations unwittingly help reveal.

In what follows we first present some basic statistics to highlight Japan's recent economic experience. Then, we critically survey the five most prominent mainstream explanations for this experience.[2] They are: (1) the country's "anti-capitalist" economic institutions, (2) the failure to clean up bad bank loans and bankrupt companies, (3) a deflationary liquidity trap, (4) upward pressures on the value of the yen, and (5) balance-sheet adjustments instigated by the collapse of the 1980s "bubble economy." The first two explanations emphasize supply-side factors (declining productivity growth and competitiveness) while the last three focus on the causes of stagnating aggregate demand. Our survey is followed by an attempt to summarize the underlying (mostly unstated and unconscious) kernel of truth shared by these mainstream explanations, namely, that Japan appears to be suffering from a crisis of capitalist maturity. We conclude by highlighting the political importance and advantages of this understanding for working people and their communities.

Table 2. Growth Rates of Real Gross Fixed Capital Formation and Real Private Consumption in Japan (annual, percents)

Years	Gross Fixed Capital Formation	Private Consumption
1983-92[a]	5.1	3.6
1993-2001[a]	0.0	1.2
1993	-3.1	2.0
1994	-1.3	2.6
1995	0.1	1.3
1996	7.3	2.3
1997	0.8	0.9
1998	-4.2	0.2
1999	-0.7	1.1
2000	3.2	0.3
2001[b]	-1.7	0.5

[a]Period annual averages.
[b]Preliminary estimates.
Source: IMF, *World Economic Outlook,* various issues.

Indications of Economic Crisis

Following the work of Makoto Itoh, the growth of the Japanese economy over the past half-century can be divided into three periods: (1) the high-growth period (early 1950s through the early 1970s), during which annual real gross domestic product (GDP) growth averaged close to 10 percent; (2) a transition period (early 1970s until around 1990), during which average yearly growth was about 4 percent — considerably slower than before but still exceeding the growth rates of the more recession-plagued U.S. and European economies; (3) the present period of stagnation (beginning in the early 1990s), during which annual growth has averaged only about 1 percent.[3] Our concern here is with the third period.

Table 1 shows the relatively rapid growth of the Japanese economy compared to the U.S. economy over the years 1982-91. It also shows the reversal of this situation in the post-1991 decade, during which Japan suffered three recessions (in 1993, 1998, and 2001).

Table 2 shows the post-1992 stagnation of both gross fixed capital formation (which includes housing investment as well as fixed capital investment by private business and government) and private consumption. Total real fixed investment over the 1993-2001 period was nil. This was not only due to the sharp downturns during the three recession years: the only year during this period when fixed investment growth even reached the average for the previous decade was 1996, and this was immediately followed by a sharp recessionary plunge. Meanwhile, average annual private consumption growth shrank by a factor of two-thirds compared to the years 1983-92.

Table 3 shows that Japan's economic stagnation has been accompanied by deflation and near-zero nominal interest rates. Both consumer prices and the general price level (the latter measured by the GDP deflator or price index) first exhibited negative rates of increase in 1995 before recovering. However, deflation returned with a vengeance in 1999, and as of 2001 the Japanese economy had experienced three consecutive years of falling prices. Indeed, the GDP deflator *averaged* negative annual growth for the whole 1993-2001 period. Interest rates meanwhile fell toward zero, with the three-month CD rate effectively reaching zero by 2001.

Table 4 highlights public-sector budget trends. Here, continued growth of government consumption has combined with stagnating tax revenues to produce a rapid rise of both central government and general government deficits relative to GDP. The cumulative effect of these deficits is seen in the growth of general government liabilities, again compared to GDP. By early 2002, most analysts were placing Japan's general government debt/GDP ratio at or above 130 percent, easily the highest among OECD nations. Some analysts pin the main blame for the public debt problem on Japan's massive system of public construction projects: the *doken kokka* (construction state).[4] As shown in the second column of Table 4, however, the real growth of government investment rapidly decelerated after 1993, turning negative in five of the seven years after 1994; yet government deficits continued to rise.[5]

Table 3. Inflation and Interest Rates in Japan (percents)

			Interest Rates (yearly averages)		
Years	Inflation (yearly) CPI	GDP Deflator	3-Month CD	Bank of Japan Discount Rate	10-Year Government Bonds
1983-92[a]	1.8	1.8	--	--	--
1993-2001[a]	0.3	-0.6	--	--	--
1993	1.2	0.5	2.8	2.3	4.0
1994	0.7	0.1	2.1	1.8	4.2
1995	-0.1	-0.3	1.1	1.0	3.3
1996	0.0	-0.8	0.5	0.5	3.0
1997	1.7	0.3	0.5	0.5	2.1
1998	0.6	-0.1	0.6	0.5	1.3
1999	-0.3	-1.4	0.1	0.5	1.7
2000[b]	-0.8	-1.9	0.1	0.5	1.7

[a]Period annual averages.
[b]Preliminary estimates.
Source: IMF, *World Economic Outlook,* various issues, and IMF staff country reports.

Some international context for Japan's stagnation decade is provided by Table 5. Note that export growth seems to have held up quite well compared to consumption and capital investment. Real yearly export growth only dipped below zero twice, in 1998 and 2001 (which may help explain the recessions during those years). Indeed, the increasing ratios of both exports and imports to GDP suggest that the Japanese economy became more reliant on trade over the period. Notice also that the current account surplus/GDP ratio appears to closely follow the exchange rate. The yen appreciation of 1992-95 corresponds, for example, to a significant reduction in the current account/GDP ratio. With the subsequent weakening of the yen, the current account/GDP ratio recovered to its previous level.

"Anticapitalist" Capitalism

Perhaps the most popular mainstream explanation for Japan's economic stagnation is that Japan's economic system lacks the flexibility needed to undertake the continuous restructuring demanded by intensifying international competition. In this view, Japan's problems stem from a misguided and outmoded attempt to modify or overcome capitalist market dynamics. Singled out for special blame are Japan's activist state, system of interlocking corporate and corpora-

Table 4. Public Sector Indicators for Japan (percents)

	Real Annual Growth Rates		Ratios to GDP		
Years	**Government Consumption**	**Government Investment**	**Central Government Balance**	**General Government Balance**	**General Government Financial Liabilities**
1990				2.9	61.4
1991				2.9	58.2
1992	2.0	14.5		1.5	59.8
1993	2.4	15.7	-2.6	-1.6	63.0
1994	2.8	3.6	-3.5	-2.8	69.4
1995	4.3	-0.3	-4.1	-4.3	76.0
1996	2.8	9.3	-4.4	-4.9	80.6
1997	1.3	-10.4	-4.0	-3.7	84.7
1998	1.9	-2.6	-9.0	-5.6	97.3
1999	4.5	6.1	-8.0	-7.6	105.4[a]
2000	4.6	-7.3	-7.6	-8.5	114.1[a]
2001[a]	3.1	-4.1	-6.3	-8.5	122.1[a]

[a]Preliminary estimates.
Sources: First two columns: IMF staff country reports; third and fourth columns: IMF, *World Economic Outlook,* various issues; fifth column: Economic Planning Agency, Government of Japan, *The Japanese Economy: Recent Trends and Outlook* (February 2000), 30.

tion-bank relations, and highly insular employment practices. As the *New York Times* puts it:

> In the 1980s, it seemed that Japan had evolved a humane, efficient variant of capitalism. The Government sheltered banks and brokers from failures, while banks bailed out client companies and ailing competitors. Profitability was invariably subordinated to growth and stability. By suspending the cleansing action of the marketplace, the Japanese aimed to soften the rough edges of capitalism. That strategy has now been exposed as a destructive pipe dream.[6]

Along the same lines, Japanese economist Noguchi Yukio laments not only "the tendency of Japanese companies to pay more attention to the interests of their employees than of their shareholders," but also the government's protection of industry and "administrative guidance concerning various aspects of business activity through industry associations and other routes."[7]

According to this perspective, the country's tolerance of low returns explains the failure of Japanese corporations to efficiently downsize and reallocate their labor forces. Even with unemployment rising to record levels, the *Economist* complains that "Japan has yet to tackle its excess labor," arguing that "in Japan's ***keiretsu*** system of cross-shareholdings, many shareholders are corporate buddies facing similar dilemmas. They are unwilling to push for painful cuts in case they get the same treatment."[8] This situation is said to be exacerbated by Japanese labor-market practices — especially the "lifetime employment" and seniority-based pay systems that purportedly reduce labor-flexibility. According to Richard Katz, "companies with low sales don't cut jobs; they trim everyone's pay.…

Table 5. Trade Indicators for Japan

	Real Annual Growth Rates		Ratios to GDP			
Years	Exports	Imports	Current Account Balance	Exports (fob)	Imports (fob)	Exchange Rate[a]
1992			3.0	8.9	5.6	126.7
1993	1.3	-0.3	3.1	8.3	5.0	111.2
1994	3.4	7.7	2.7	8.0	5.0	102.2
1995	4.1	12.8	2.1	8.1	5.6	94.1
1996	6.4	13.2	1.4	8.5	6.7	108.8
1997	11.3	1.2	2.2	9.6	7.2	121.0
1998	-2.3	-6.8	3.0	9.6	6.4	130.9
1999	1.3	2.9	2.5	9.1	6.3	113.9
2000	12.1	9.9	2.5	9.8	7.3	107.8
2001[b]	-2.9	2.4	2.1	10.1	7.8	121.5

[a]Yen per $US, annual average.
[b]Preliminary estimates (except for exchange rate).
Source: IMF staff country reports.

[Japan's] labor market is incapable of rapidly shifting large numbers of workers from the disappearing jobs into new ones."[9]

The Japanese created their unique political economy in large part, it is often argued, because it was compatible with their country's traditional, anticapitalist value system. The *New York Times* claims that "to foreigners, Japan often seems virtually socialist in mind set, profoundly believing in social equality."[10] Other analysts, most notably Noguchi Yukio, describe Japan's system as "a set of arrangements put together in a relatively short period starting around 1940 as Japan mobilized all its energies to fight the Pacific War." After the war, the "1940 setup" was "used…not for all-out war but for an all-out campaign to achieve economic growth."[11] The two key principles of this setup, according to Noguchi, are "that production takes priority over all else" and "the anticompetition principle." The latter principle, he explains,

> operates on a more fundamental level. The goal…is to allow the Japanese people to work together with a single purpose. To this end, great attention is paid to teamwork and the equitable distribution of the results of the efforts; competition tends to be negated. The overriding objective is not to let anyone fall behind. The 1940 setup as a whole is, in short, a vast social security system.[12]

From either perspective, the solution to Japan's crisis is straightforward: the Japanese must get serious about reforming their system along free market lines. The government must refrain from trying to direct funds, stop protecting domestic industries, and in general deregulate and liberalize the economy. Banks must become independent from both corporate partners and government directives, and make loans based on profitability. Corporations must be subjected to market forces and allowed to fail. Paternalistic and inflexible labor-management relations should be abandoned, redundant workers laid off, and managers rewarded for making difficult downsizing decisions. Insofar as they make "the labor and financial markets…function flexibly," while releasing entrepreneurial energies through new business start-ups, these reforms will "enable a massive redistribution of human and physical resources" toward high-tech activities in which "Japan can hold on to a comparative advantage."[13] Although this viewpoint does not "expect or desire Japan to become a carbon copy of America," it does suggest that "Japan can become a lot more open and, in its own interests, it now needs to be."[14]

With the outmoded Japanese model becoming less and less competitive, the economy is said to have become more and more dependent on government bailouts and pork barrel spending. But with government deficits and debts now at record levels, this safety valve is no longer viable. Thus, without the needed structural changes, the outlook is for a deepening crisis and socioeconomic decay. Unfortunately, so the story goes, the Japanese people have yet to recognize the true seriousness of their situation; they have not yet embraced the crisis mentality needed to push through reforms. They "cannot summon the political will to lay off surplus workers, to extinguish insolvent banks, to snuff out the hopes of the kindly old ladies who run rice shops and futon stores."[15] Meanwhile, "putting off reform is only making the pain worse."[16]

One obvious question about the anticapitalist capitalism perspective is whether it provides a viable explanation for the sudden onset of severe stagnation in the 1990s. Observes Richard C. Koo, chief economist at the Nomura Research Institute:

> Although many structural issues undoubtedly need to be resolved, it is difficult to blame them entirely for the poor performance of the Japanese economy in the 1990s. This is because most structural problems date back for decades and so cannot explain why an economy that was so powerful until the very end of the 1980s suddenly lost its forward momentum from the 1990s onwards.[17]

Nor is the purported natural tendency of industrial policy to "degenerate into crony capitalism or plunder by myopic autocrats" sufficient to explain how a system that produced rapid growth and structural transformation suddenly became stagnant in the 1990s.[18]

In responding to this analytical challenge, conservatives have appealed to both systemic and conjunctural forces. On the systemic level, Katz distinguishes between two long-run phases of national-capitalist development: a "catch-up" phase, during which growth is mainly driven by increases in capital and labor inputs and the adaptation of foreign technologies, and a "mature" phase, in which growth is more reliant on endogenously generated technological advance rather than accumulation of factor inputs.[19] According to Katz, Japan began entering the mature phase around 1973 (coincidentally the year of the first oil shock), but its overregulated, overprotectionist, and inflexible economic institutions prevented the system-wide restructuring and technological advance needed for Japan to make a full-fledged transition to the globally leading-edge industrial and service-sector activities appropriate to its mature status. More specifically, in "the high growth era," government industrial policies focused on "promoting winners"; but "after the 1973 oil shock, when growth plummeted, the number of losers needing compensation rose abruptly. Meanwhile, the winners needed less help. And so, the brunt of policy shifted from promoting winners to propping up losers."[20] In short, the Japanese system "was a marvelous system to help a backward Japan catch up to the West. But it turned into a terrible system once Japan had caught up."[21]

For international regime theorist Bai Gao, the chronological development of Japan's economic problems was ultimately shaped by even broader systemic tendencies in global capitalism. He points to "two profound changes in the long-term movement of capitalist economies since the early 1970s: the shift in the cycle of capital accumulation from the expansion of trade and production to the expansion of finance and monetary activity, and the shift in the major policy paradigms in advanced capitalist economies from social protection to the reliance on market forces."[22] In Gao's view, these global-systemic shifts exposed a "dilemma in Japanese corporate governance between, on the one hand, strong coordination and, on the other hand, weak control and monitoring." Although the Japanese system was good at coordinating "contractual exchange among separate enterprises," it was less adept at establishing either "control of shareholders over management" or effective monitoring by banks of the credit-worthiness of corporate borrowers. The resulting "excess competition" among firms to rapidly accumulate productive capacity was perhaps appropriate for the catch-up phase of Japan's development in the regulated, protectionist, and production-oriented international environment of the 1950s and 1960s; but it became dysfunctional once Japanese capitalism matured in the context of the more open, flexible, and finance-led global economy that emerged after the early 1970s.[23]

Still, since all these systemic dynamics date from the 1970s, conservatives must also appeal to specific conjunctural factors in order to explain the exact timing of Japan's descent into outright stagnation in the 1990s. One is the reliance on wasteful public works spending as an artificial prop to growth — a strategy said to be no longer viable by the 1990s, given the public debt problem. (This issue is discussed below.) Another oft-cited factor is intensified competition from the newly industrializing countries (NICs) of East Asia (Hong Kong, Singapore, South Korea, and Taiwan). Noguchi, for example, argues that the NICs' movement "into the fields of high technology and heavy industry during the 1980s" undercut the dynamism of Japan's mass production industries, just when the information and communications revolution centered in the United States was undercutting the viability of Japan's system from the opposite end of the technology spectrum. The result: "a lost decade for Japan."[24]

However, it is above all the 1980s "bubble economy" that is credited with delaying the full onset of stagnation. The bubble involved simultaneous escalations of stock-share, land, and housing prices, which in turn fueled consumption and investment demand. But this all came to an end in the 1990s when (by most estimates) asset values fell by an amount equivalent to more than two years worth of GDP.[25] According to Noguchi, the significance of the bubble economy is that it postponed the free-market reforms needed to create a sounder basis for long-term growth:

> The boom generated by the bubbles of the late 1980s worked to delay the required transformation. Since structural reform requires adjustments in employment, it is not something that can be rushed. But just when companies should have been gradually carrying out these adjustments, they ended up making a wave of investments that were directed at the old style of manufacturing in response to the bubble-generated boom. Now they're feeling the heavy weight of this investment activity.[26]

For this story to be complete, however, there must be a coherent explanation of the bubble economy itself. The basic dynamics involved are well known and uncontroversial. As shown by Shigeto Tsuru, the internal funds of Japanese manufacturing corporations (retained profits plus depreciation funds), measured as a percentage of their gross investments, averaged only 59 percent during the 1956-60 period. By 1971-75, the ratio was averaging 75 percent, and in 1976-80 it averaged 109 percent. It then remained above 100 percent for the entire decade of the 1980s.[27] While directly augmenting the supply of funds available for speculative activities, this growth of corporate surpluses made corporations less dependent on bank credit. Forced to search for new customers, the banks turned to real estate and stock exchange dealers, plus construction firms, thereby further fueling the bubble.[28] The whole process was facilitated by the relaxation of government restrictions on real estate and construction loans, as well as on land use, and by the Bank of Japan's low interest rate policy.[29]

Conservatives explain these bubble dynamics in three ways. First, financial deregulation and low interest rate policies are viewed as deliberate attempts to delay deeper reforms. Katz thus argues that after the 1985 Plaza Accord, "which sent the yen soaring" and "cut off the trade surplus route to growth," Japanese authorities "responded by artificially pumping up real estate, stocks and capital investment...."[30] Second, conservatives blame unstable monetary and fiscal policies (whether misguided or deliberate) for creating a climate of heightened macroeconomic uncertainty that increased the weight of speculative investments compared to productive investments. Gao, for example, suggests that the post-Plaza Accord monetary and fiscal expansions "served to significantly increase investment risks," which in turn "shifted the incentive structure of private investments from production to the stock and real estate markets."[31] Third, the buildup of surplus funds and their use for speculation are themselves treated as symptoms of the deeper institutional and sectoral imbalances embedded in the Japanese system. Here, Gao argues that "the weak control and monitoring that characterized Japanese corporate governance...contributed directly to the rise of the bubble" by encouraging the competitive accumulation of speculative assets.[32] Katz, on his part, blames the growth of corporate surpluses on the overregulation and overprotection of less advanced sectors and firms. Together with the inflexible employment arrangements in core corporations (which inhibited any reallocation of labor), such government restraints are said to have prevented the channeling of corporate surpluses toward productive investments in the less advanced sectors. Meanwhile, the protection of inefficient producers fostered "excess savings" *among households* by raising the prices of consumer goods and services compared to a more market-friendly regime. In this way, Katz blames both the bubble economy and Japan's "demand-side problem" on the same antimarket institutions that have (in his view) created a "deformed dual economy" in Japan.[33]

By now it should be clear that the various attempts to fit the anticapitalist capitalism hypothesis to the sudden onset of stagnation are very ad hoc and implicitly reliant on an idealized model of neoliberal capitalism — a model based in large part on the pre-2001 "new economy" thinking centered in the United States, according to which financial bubbles, business cycles, and economic stagnation were only part of an overregulated, inflexible, less globalized, and pre-cyber-age past.[34] The idealized and epicyclical nature of the conservative narratives is clear from their treatment of financial deregulation as a poor substitute for "real" reforms and from their simultaneous appeal to overregulation and excess competition as key weak points of the Japanese system. There is also the attempt to blame rampant speculation on government constraints on the market and specific weaknesses in Japanese corporate governance compared to that in the United States — instead of recognizing (as recent developments in the United States verify once more) that the periodic shifting of surplus funds from productive to speculative activities and the accommodation of such shifts by government regulatory policies are inherent features of capitalism.[35] We also have the awkward effort to limit the causes of effective demand shortage ("excess savings") to supply-side restraints that indirectly constrain consumption and investment spending, even though, as Paul Krugman notes, "it is far from sure that the kinds of structural reform being urged on Japan will increase demand at all."[36] Indeed, by increasing unemployment, business bankruptcies, and economic insecurity, neoliberal reforms could further reduce demand and worsen stagnation. This last point highlights the most important antinomy in the anticapitalist capitalism interpretation: despite its emphasis on a transition to a "mature" capitalism in which growth is driven mainly by technological advance and not by the growth of physical capital and labor inputs, it refuses to recognize the logical implication that advanced capitalism — in all its forms — has a structural tendency to generate more savings than it can productively and profitably invest anytime it approaches full employment. Both stagnation and the channeling of economic resources into speculative activities may be viewed as symptoms of this underlying tendency.

The difficulties with the anticapitalist capitalism view are not only conceptual but empirical, especially insofar as it hinges on Japan's alleged inefficiency and declining competitiveness compared to the United States. Consider Table 6.[37] From the period averages in the first two rows, it would appear that Japan did suffer a significant decline in labor productivity growth and cost efficiency compared to the United States after 1992. But, when one looks at individual years, it becomes clear that Japan's labor productivity growth was as good or better than that of the United States in every nonrecessionary year but 1999. It is difficult to

Table 6. Productivity and Labor Cost in Manufacturing (annual percent growth rates)

	Labor Productivity		**Real Hourly Earnings**[c]		**Real Unit Labor Cost**[c]	
Years	Japan	USA	Japan	USA	Japan	USA
1983-92[a]	2.9	3.0	2.1	0.8	-0.8	-2.2
1993-2001[a]	1.9	3.7	2.0	1.9	0.1	-1.8
1993	-1.0	1.9	2.2	0.4	3.2	-1.5
1994	3.1	3.0	2.0	0.7	-1.1	-2.3
1995	4.5	3.9	2.5	-0.1	-2.0	-4.0
1996	3.9	3.5	2.6	-0.6	-1.5	-4.1
1997	4.7	4.3	2.7	0.0	-2.0	-4.3
1998	-4.2	5.3	1.0	4.2	5.2	-1.1
1999	3.5	4.6	0.7	2.6	-2.8	-2.0
2000	6.7	6.1	1.8	4.7	-4.9	-1.4
2001[b]	-4.4	1.1	2.5	5.1	6.9	4.0

[a]Period annual averages.
[b]Preliminary estimates.
[c]GDP-deflator basis.
Source: IMF, *World Economic Outlook,* various issues, and author calculations.

"…the labor market [in Japan] has always been quite 'flexible' (insecure) for the large number of contingent workers in core corporations and for the even larger ranks of low-wage workers in smaller enterprises." (Photo credit: J. Maillard/ILO)

see how inefficiencies in Japanese economic institutions could have cyclical (as opposed to secular) effects on labor productivity growth. The more likely explanation is that falling demand during recessions reduced labor productivity not because of declining efficiency as such but rather due to reductions in the rate of utilization of productive capacity. Such worsening demand-side problems would be consistent with a mature capitalist tendency to generate "excess savings" and economic stagnation.[38]

Moreover, it is evident that during both the 1983-92 period, *and up until the most recent nonrecession years,* the only reason that real unit labor cost fell more in the United States than in Japan in nonrecession years was because of relatively stagnant or declining real wages in the United States compared to Japan. It is only in the most recent years that real hourly earnings grew more slowly in Japan than in the United States, and this explains why the reduction in Japan's real unit labor cost compared "favorably" with that of the United States in the nonrecession years of 1999 and 2000. We put "favorably" in quotation marks because reductions in real unit labor cost signify that workers are getting a smaller share of what they produce, i.e., the rate of exploitation is rising.[39]

More generally, the conservatives' image of labor inflexibility simply does not square with the facts of Japan's post-World War II development.[40] In reality, so-called lifetime employment has never applied to more than a minority of Japanese workers, and even for them it has always ended at a very early "retirement" age of 55 or 60, after which they were forced into lower-wage positions.

And the labor market has always been quite "flexible" (insecure) for the large number of contingent workers in core corporations and for the even larger ranks of low-wage workers in smaller enterprises. Women in particular have suffered the costs of labor-market "flexibility" in their function as an easily accessible and disposable "buffer stock" for cyclical and sectoral employment restructurings throughout the postwar era.[41]

It was, in fact, the flexibility of Japanese labor power that, combined with industrial policies, enabled a series of export-oriented industrial restructurings that helped power the country's relatively rapid growth until 1990. These restructurings each involved a strategic shift of the economy's industrial-export core toward newer sectors and a large-scale "scrapping" (and movement offshore) of previous core activities. The 1960s shift from light-manufactured exports toward heavy and chemical industries was thus followed by the scrapping of the latter in favor of machinery production (especially automobiles, advanced consumer electronics, and office machines) in the mid to late 1970s. Subsequently, in the late 1980s, competitive pressures from the rising value of the yen led to a significant movement of machinery production offshore. This third round of "scrap-and-build," like earlier rounds, featured the imposition of significant downward "adjustments" in wages and work conditions. The main difference from earlier rounds was the third round's failure to build a new domestic industrial core that could provide an adequate basis for continued growth of output and employment. Attempts to focus domestic production on the most technologically advanced consumer and capital goods were not successful in this regard — although this outcome was fully revealed only with the end of the bubble economy. The failure to find sufficient productive outlets for Japan's investable resources was thus manifested not only in the sequence of bubble and stagnation but also in the *overall* hollowing-out of Japanese industry, as the country's total manufacturing employment fell from 15.7 million workers in 1992, to 14.6 million in 1995, and roughly 13 million by 2001.[42]

Bad Debts and Zombie Companies

Given the difficulties posed by the application of the anticapitalist capitalism hypothesis, some mainstream observers have sought out other explanations for Japan's sudden turn toward stagnation in the 1990s. One such account focuses on the country's massive overhang of bad bank loans, corresponding to large numbers of bankrupt corporations that continue to operate with the help of credit rollovers provided by the banks. According to this view, the debt overhang prevents banks from financing the expansion of healthier enterprises. Meanwhile, the presence of economically unviable "zombie" firms hampers growth by reducing overall productivity and clogging up markets that would be better served by more dynamic firms.[43]

This situation is said to have resulted from Japan's "chummy financial system, where banks served as cash conduits to affiliated conglomerates."[44] The Japanese banking system did play an important role in supporting the country's past growth. During the high-growth period Japanese firms depended heavily on external funds to finance their investments. And, as Tsuru points out, this external finance involved "not the balancing of supply and demand through the free play of market rates of interest" but "the rationing of funds" based on the priorities of the Bank of Japan, special investment banks, and major commercial banks.[45]

This system of finance eventually ran into problems. Mainstream analysts largely blame the Japanese corporate culture, which encouraged banks to lend to corporate partners regardless of profitability, for a growing mountain of bad debts variously estimated at between $1 trillion and $2 trillion.[46] Many banks have continued to make loans to insolvent companies who use the money to make payments on their old loans — a practice that allows banks to understate the number and value of nonperforming loans in their portfolios. The government has also tried to keep a lid on the bad debt problem by keeping interest rates low, by periodically infusing funds into the banks in exchange for partial loan write-offs, and by providing subsidized loans to troubled companies through the Japan Development Bank and the Fiscal Investment and Loan Program (which is financed by the country's public pension funds and massive postal savings system).

Critics argue that such credit rollovers and government half-measures only worsen the problem in the long run. Credit rollovers to unviable companies only add to future bank losses. Moreover, with insolvent companies being kept alive by fresh private and government loans, the stock market is kept in the doldrums. The weakness in stock share prices has, in turn, worsened the capital losses at private banks. As the *New York Times* observed in late 2001: "As Japan's 10-year bear market grinds on, the banks have run out of stocks they can sell at a profit.... In all, the country's 15 largest banks are expected to lose an estimated 3 trillion yen ($24.4 billion) on their stock holdings this year."[47]

In short, the declining stock market, extensions of new credit to troubled companies, and bank losses have interacted in a kind of vicious circle that prevents healthier companies (including the few that have efficiently downsized and upgraded themselves) from obtaining the credit they need for expansion. The continued presence of "corporate cadavers" on life-support also hampers economic growth by denying the "stronger firms space to breathe."[48] In formally extending this analysis to incorporate the collapse of the bubble economy, Gower and Wilson emphasize the role of "displaced capital," i.e., "physical assets which have become unproductive, perhaps (as in Japan) because the firms which hold them have become distressed following a [financial] shock." Specifically, they argue that such capital displacement creates "an 'overhang' of assets" that "undermines the incentives for new investment," especially insofar as the reallocation of capital is "subject to institutional constraints."[49]

From this perspective, the only way out of Japan's economic stagnation is to immediately "take...the uncomfortable steps needed to clean up the banking system."[50] The banks must be forced to write off bad debts, even if this requires a massive one-time subsidy from the government along the lines of the 1989 savings and loan bailout in the United States. (Naturally, this expense will require cutbacks in government investment and consumption, so as to avoid adding to the public debt problem.) At the same time, the unprofitable companies being propped up by bank loans must be allowed to fail, and their assets either scrapped or properly discounted and sold off to more profitable firms. This could of course involve considerable economic pain — a wave of bankruptcies with increased unemployment. Nonetheless, rather than ascribing Japan's failure to swallow this medicine to the fact that it could kill the patient, mainstream observers blame the country's lack of political will.[51]

There are three basic difficulties with this bad debts/insolvent companies explanation of Japan's crisis. Most obviously, it grossly discounts the costs associated with a sudden liquidation of bad debts and insolvent companies. As pointed out by Richard C. Koo, the U.S. savings and loans problem was, by "comparison with the problems of Japan,...a small-scale affair, with no relevance to Japan's current situation." Indeed, "if Japan had to adopt the S&L-type solution to its banking problems, the cost of the clean-up would be easily ten times the $160 billion it cost U.S. taxpayers." It follows that "liquidating assets...will force asset prices to fall even faster" in the Japanese case. Meanwhile, the sudden mass cutoff of loans to insolvent companies could "set off a horrendous chain reaction" in which "companies and banks that everybody once regarded as safe would be caught up," with the possible result that "there would not be any suitable borrowers left."[52]

Second, the bad debts/insolvent companies view is contradicted by the stagnation of loan demand in the 1990s. There is no evidence that a lack of credit has been a major factor holding back the growth of healthier enterprises (where they can be found). Despite the Bank of Japan's increasingly desperate efforts to "pump even more cash than before into the nation's money markets," even "near-zero short-term interest rates have yet to entice either businesses or consumers to borrow more and spend more; loan demand has not grown in nearly five years."[53] If, as Paul Krugman and others argue, loan demand is low *because of* low demand for goods and services, then "the claim that bank recapitalisation will unleash massive new lending" is "a questionable proposition."[54] In short, even if one is willing to discount the costs of a business bankruptcy wave, it is not clear that the liquidation of bad debts and troubled firms would do anything to spur a long-term recovery if this hinges first and foremost on a robust revival of business and household expenditure.

Third, the demand problem once again raises the question of whether a mature capitalist economy like Japan's really has sufficient potentially expansive productive enterprises and investment opportunities to ward off the stagnation problem. Even the *Economist* unwittingly indicates that this question is more basic than any misallocation of capital between zombie and healthy firms when it observes that "many of Japan's over-populated industries are mature, and the stronger companies in them can expand only at the expense of the weaker ones."[55] Given that there will always be stronger and weaker enterprises, it is hard to see how a more rapid rate of bankruptcies could resolve such a shortage of investment outlets under mature capitalism, unless the primary goal is to allocate an ever-growing share of society's resources to the scrapping and replacement of productive capacity — production for production's sake.

Deflation and the Liquidity Trap

Paul Krugman is one of the major proponents of an effective demand-based explanation for Japan's stagnation problems.[56] His analysis begins with the observation that "much of [Japan's] huge productive capacity remains unused because consumers and businesses just don't spend enough." Unfortunately, "the usual answer to a demand-side slump, reducing interest rates, hasn't worked: the Bank of Japan has cut the equivalent of the Fed funds rate all the way to zero, and yet the economy remains depressed." Although government deficit spending "has kept the economy afloat…such huge budget deficits cannot be sustained indefinitely…so the central question for Japanese policy is, What will allow the economy to come off fiscal life support?"[57]

The answer to this question obviously depends on the causes of the insufficiency in spending. According to Krugman, the basic problem is what he terms a "liquidity trap," i.e., a situation in which "the short-term real interest rate… needed to match saving and investment may well be negative." This low equilibrium real interest rate, says Krugman, reflects the country's "poor long-run growth prospects," especially "Japan's combination of declining birth rate and lack of immigration," which implies "a shrinking rather than growing labor force over the next several decades."[58] In short, "Japan's long-run growth must slow, even at full employment, because of demographics."[59] This pessimistic prospect, by lowering expected returns on capital, has reduced investment demand while increasing precautionary savings among Japanese households. The shrinkage of demand has led to deflation, which provides additional incentive

"Women in particular have suffered the costs of labor-market 'flexibility' in their function as an easily accessible and disposable 'buffer stock' for cyclical and sectoral employment restructurings throughout the postwar era." (J. Maillard/ILO) to hoard money rather than spend it. The result: an "output gap" (excess of planned savings over planned investment near full employment) of 7 percent of GDP or more.[60]

The desired policy response to this liquidity trap problem follows directly: "since *nominal* interest rates cannot be negative, the country therefore 'needs' expected inflation"[61] (emphasis in original) to obtain negative real interest rates and stimulate the dehoarding of money. Given that "fiscal expansion has reached a limit,"[62] the authorities must find some other way to raise inflationary expectations. Accordingly, Krugman urges "Japan to supplement deficit spending with an aggressive monetary policy: the Bank of Japan…should both pump money into markets and promise that the grinding deflation of recent years will be replaced with moderate inflation."[63] More specifically, the Bank of Japan must "extend open-market operations to those assets whose prices can still be driven up — most obviously, longer-term bonds and foreign currencies."[64] Given its sizable output gap and adverse long-run growth prospects, Japan "probably requires a sustained period — at least a decade — of inflation, to reduce the real long-term rate sufficiently."[65] Similar to other mainstream observers, Krugman faults a lack of political will for the failure to implement this policy package.[66]

Unfortunately, Krugman's insights are outweighed by his doubtful explanation for Japan's insufficiency of investment and consumption spending. It is hard to see how the prospective decline in population could suddenly reduce investment demand in the 1990s. Even in the neoclassical growth framework, in which the real rate of interest equilibrates aggregate saving and aggregate investment, long-run growth cannot be reduced to growth of the population (even if we identify the labor force with population — which is itself questionable). It also depends — as Krugman elsewhere recognizes — on the rates of productive capital accumulation and technological advance.[67] There is no obvious reason why rational investors should suddenly expect reduced aggregate rates of investment and technological change on the basis of long-run demographic trends that were well known prior to the 1990s.

It also seems a bit surreal to blame stagnating consumption *and* investment on a looming labor shortage, when unemployment is currently at record-high levels and is widely forecast to remain so for years to come. If anything is keeping household spending down, it is unemployment and job insecurity, not a sudden urge to cover future retirement needs due to pessimism about growth stemming from a future labor shortage.

Krugman's proposed solution to Japan's problems is also problematic. First, he misappropriates the term "liquidity trap." The traditional use of the term liquidity trap, as defined by Keynes, refers to a situation in which "after the rate of interest has fallen to a certain level, liquidity-preference may become virtually absolute in the sense that almost everyone prefers cash to holding a debt which yields so low a rate of interest."[68] It refers, in short, to an extreme kind of trade-off between the desire to hold money and the desire to hold nonmonetary financial assets. For Keynes and traditional Keynesian theory, the rate of interest equilibrates the supply and demand of money, not planned saving and planned investment as in neoclassical theory. Krugman redefines the liquidity trap to fit it in to the latter framework, so as to be able to reinterpret excess savings near full employment as a problem resolvable by an aggressive monetary policy.[69]

Second, Krugman's proposed solution to his liquidity trap — to reignite inflationary expectations through massive purchases of long-term bonds and foreign currencies, and through a publicly announced inflation target — essentially has the Bank of Japan initiating a speculative bubble for the purpose of creating popular expectations of rising prices. But in the absence of any reversal of Japan's "poor long-run growth prospects," it is difficult to see why this policy should be expected to produce sustainable growth.[70]

Third, Krugman's assertion that expansionary fiscal policy has reached its limits is also questionable. Indeed, Krugman's own analysis emphasizes the existence of a large surplus of full employment savings over private investment even at zero real interest rates, while part of his policy proposal (driving up long-term bond prices through massive central bank purchases) also implies some additional scope for deficit-financed government spending.[71] Perhaps realizing this, Krugman defends his preference for reflationary monetary policy by pointing to the inefficiency of government spending programs:

> Japan has already engaged in extensive public works spending in an unsuccessful attempt to stimulate its economy. Much of this spending has been notoriously unproductive: bridges more or less to nowhere, airports few people use, etc. True, since the economy is demand- rather than supply-constrained even wasteful spending is better than none. But there is a government fiscal constraint....And anyway, is it really true that it is impossible to use the economy's resources to produce things people actually want?[72]

One could just as well ask: is it really impossible to use the government budget to finance things people actually want? Is there no shortage of affordable housing or of clean, livable environments? Or, more generally, of work and living situations that do not require insanely long commuting times? Are there not unsatisfied social needs that could potentially be resolved collectively? Besides, one would think that the "things people actually want" should be the subject of an open, democratic discussion — not simply left to private markets in which what is produced is mainly determined by the desires of large units of profit-seeking capital.

Pressures on and from the Yen

Another explanation blames Japan's 1990s slump on the appreciation of the yen in international markets. Variations on this theme differ in terms of how the rising dollar/yen exchange rate has depressed aggregate demand and accentuated deflationary expectations. For some, the main problem is that an appreciated yen directly reduces the competitiveness of Japan's tradable goods production, thereby decreasing net exports. For others, the history of yen appreciations since 1971, combined with ongoing Japanese trade surpluses, has created a persistent expectation of *future* yen appreciations, and it is this *expectation* that is the main cause of deflationary expectations, increased money-hoarding, and slumping aggregate demand in Japan. The two positions yield quite different policy prescriptions, as we shall see.

The most prominent advocate of the first position has been Jeffrey Sachs. In an April 2001 *Financial Times* op-ed piece, Sachs first argues that "Japan is a structural net savings surplus economy, in which its aging population wants to save more than its companies can profitably invest in Japan. The result is a structural current account (and trade) surplus and a net supply of savings to the rest of the world."[73] This starting point is similar to Krugman's liquidity trap perspective. Unlike Krugman, however, Sachs emphasizes the effects of exchange rate movements on the trade surplus as a factor conditioning current and future growth prospects. In doing so, moreover, he tries to take account of the early-1990s collapse of the bubble economy as well as trade-related conflicts between Japan and the United States/Europe:

> In the normal course of events, the bursting of the financial bubble should have weakened the yen and raised the net trade surplus but Japan was warned sternly by the US and Europe against exporting its way out of recession.…Amazingly, the yen strengthened sharply between 1990 and 1995 while the Japanese economy was grinding to a halt.[74]

In Sachs's view, the adverse effects of the stronger yen help explain the inability of "fiscal stimulus [to] produce a domestic-demand-led recovery." With reduced trade competitiveness and net export growth, "nervous households simply increased their own savings alongside the widening budget deficit." Sachs then expands his analysis to incorporate disruptions from the 1997-98 Asian crisis as a factor worsening the yen problem, arguing that

> the limited yen depreciation between 1995 and 1998 might have helped Japanese recovery but for the east Asian financial crisis.…The problem came when the capital flows from Japan to the rest of east Asia suddenly ceased in mid-1997, so that the other Asian countries could no longer finance their purchases of Japanese exports.…When bank regulators in Japan started to crack down on the banks' bad balance sheets, the Japanese lenders abruptly called in their loans from the rest of east Asia, helping to trigger the broader regional crisis in 1997. The yen strengthened again in the midst of the crisis.[75]

This narrative raises some difficult questions of timing (see below); but it does yield a straightforward policy prescription: the yen should be depreciated by any means necessary. "A significant monetary-expansion-cum-currency-depreciation in Japan" is required to reduce "the dollar price of Japanese goods in world markets," which "would raise Japanese aggregate demand." Such a policy could also directly fight deflation "to the extent that the domestic price level rises in proportion with yen depreciation."[76]

The second, more expectations-based variation of the yen-appreciation argument, is due largely if not solely to the work of Ronald McKinnon and Kenichi Ohno.[77] They argue that the "deflationary psychology gripping [Japan's] economy" is underpinned by "the possibility of upward ratchets in the dollar value of the yen [which] induces Japanese households and firms to hold large speculative domestic cash balances." In other words, the hoarding of money and reduced spending are primarily due to the expected appreciation, as opposed to the actual value, of the yen.

This expectation is deeply rooted in the history of Japan-U.S. relations. Indeed, McKinnon argues that "pressure from the United States to appreciate the yen from 360 to the dollar in 1971 to just 80 in 1995 is the historical origin of Japan's deflationary psychology today." The pressure is structural (built into the regime of Japan-U.S. relations) in the sense that it "has been seen by both sides as a way of mitigating the threat of trade sanctions from the United States." This helps explain why the expectation of yen appreciation proved immune to the "strong dollar policy" announced by the U.S. Treasury in 1995 and the depreciation of the yen over the following three years. In this respect, the 1990s worsening of the U.S. trade deficit (corresponding in part to Japan's continued trade surplus) "reinforces the expectation that American mercantile pressure will return."[78]

The policy implications of this analysis sharply diverge from Krugman's liquidity trap perspective and Sachs's overvalued yen argument. In the McKinnon/Ohno view, neither a massive increase of the quantity of money in circulation alongside a preannounced inflation target, nor a current depreciation of the yen, will be sufficient to squelch deflationary expectations. Indeed, referring to the arguments of "unrestrained monetary expansionists" who "aim for a sharp yen depreciation," McKinnon suggests that such a strategy "would fail on several counts." First, it would likely stimulate competitive depreciations by other Asian countries, especially China. Second, it would likely elicit "protectionist responses from other industrial countries," above all from the United States. Third, without a change in the factors underpinning the "fear of future yen appreciation," this fear could "even be strengthened…in the face of current yen depreciation."[79]

A superior strategy, from this perspective, is to directly undercut the historical basis for the expectation of a higher yen through a structural change in U.S.-Japan relations. To effectively "unravel the syndrome of the ever-higher yen," this regime change must involve joint actions by the two governments. More specifically, the two governments should sign a "*commercial agreement* to limit future bilateral sanctions in trade disputes" and a "*monetary accord* to stabilize the yen/dollar rate over the long term." What is crucial, in this view, is not so much the precise level of the dollar/yen exchange rate but rather the need for "a formal pact to provide long-term assurance that American policy truly has changed permanently so that the future dollar value of the yen is likely to be no higher, and the Japanese (wholesale) price level no lower, than they are today"[80] (emphasis in original).

Both variations of the exchange-rate argument yield important insights into Japan's economic problems. Despite relatively low export/GDP ratios of around 10 percent during and after the early 1950s, Japan's pre-1990s economic growth was indirectly dependent on expanding exports — especially to North America. These exports were crucial to the success of growing investments in key manufacturing sectors and their supporting industries; they were thus essential to the maintenance of high overall rates of capital investment.[81] Moreover, the

“Japan’s crisis is, with all its peculiarities, at root a crisis of capitalist maturity. This conclusion leads us to predict that if Japan is to overcome its stagnation and remain capitalist, the Japanese people must by necessity accept not only a further intensification of labor exploitation, but also the increased waste of resources on unproductive activities (activities whose ‘productivity’ or ‘necessity’ is only definable in terms of market and profit-making priorities) and the increased capitalization of life-activity in general. (J. Maillard/ILO)

competitiveness of Japanese tradables production is undoubtedly reduced by a higher dollar value of the yen, everything else equal. The 1985 Plaza Accord, for example, was followed by the *endaka fukyo* or high yen crisis.[82] Finally, in emphasizing the tensions produced by Japan’s trade surpluses, the exchange-rate analyses provide a healthy antidote to the view that the country’s crisis is mainly due to its inflexible and inefficient anticapitalist capitalism.

Nonetheless, the yen-based perspectives do not adequately explain Japan’s 1990s slump. Neither perspective explains the evident contrast between Japan’s quick recovery from the post-Plaza Accord *endaka fukyo* and its subsequent failure to sustain any kind of cyclical recovery following the yen appreciation of 1990-95. In the former episode, production resumed its upward trend in 1987 even though the yen continued to appreciate through 1988. In the latter, the economy slumped into recession by 1998 despite the yen’s *depreciation* over the preceding three years — a depreciation driven by a major joint intervention by the Group of 7 nations in support of the U.S. Treasury’s “strong dollar policy.”

Elsewhere we have argued that the quick recovery from the *endaka fukyo* was underpinned partly by the ability of Japanese firms to hold down the U.S. dollar prices of their exports with less than proportionate declines in profits, as the higher yen reduced imported materials costs while the relative weakness of Japanese labor enabled corporations to effectively "adjust" wages and work conditions. An even more important factor, however, was the consumption and investment boom instigated by the bubble economy.[83] Sachs's exchange-rate-based framework would presumably ascribe the rise of the bubble economy to the adverse effects of the higher yen on tradables production relative to nontradables, with the latter including finance, housing, and other services. (McKinnon and Ohno, while agreeing, would presumably place more stress on *expected* yen appreciations in this connection.) But this is at best a partial account of the bubble economy, leaving out not only financial deregulation but also the underlying pressure toward speculative activities produced by corporations' growing accumulation of internal funds relative to productive investment opportunities, even before 1985.

And one must still explain why the Japanese economy slumped after 1995 even with a depreciating yen. Sachs treats this downturn as an outgrowth of the 1997-98 Asian crisis, but the timing of his analysis appears to be off. He blames the recession on an appreciation of the yen pursuant to the cessation and reversal of short-term capital flows from Japan to East Asia beginning in mid-1997. Yet, the yen did not strengthen until after mid-1998, by which time Japan was already in recession. The McKinnon/Ohno analysis, on the other hand, can consistently ascribe this recession to *expectations* of yen appreciation — expectations that could actually have been strengthened by the yen's 1995-98 depreciation. But the quicker recovery from the *endaka fukyo* remains largely unexplained unless one is willing to treat the bubble economy as a mere symptom of exchange rate expectations.

A Balance-Sheet Crisis

The last explanation we consider blames the crisis on stagnating demand due to the private-sector balance-sheet problems produced by the collapse of the bubble economy. Its most vocal proponent has been Richard C. Koo of the Nomura Research Institute. His diagnosis starts with the recognition that the post-bubble deflation of asset values (especially stock-share and real estate prices) has "left tens of millions of [household and firm] balance sheets all over the country underwater." Naturally, "in order to climb out of their negative equity position, households and companies were left with no choice but to refrain from consumption and investment and redirect any cash so saved to paying down debt. [They] switched their highest priorities from maximizing profits to minimizing debt." As a result, "the economy suffers from weak consumption and weak investment [which] depresses asset prices even further, forcing Japanese companies and households to take even more draconian measures to repair their balance sheets."[84]

The "vicious cycle" of financial belt-tightening and declining aggregate demand is reflected in the economy's intersectoral flows of funds. "From being a net taker of funds — ten percent of GDP in 1990 — the corporate sector today is a net supplier of funds (i.e., debt repayment) to the tune of four percent of GDP."[85] Indeed, as quoted by the *New York Times* in late 2001, Koo claimed that "shellshocked executives" were "saying they will never borrow again," and that "with all companies minimizing debt, you have an invisible hand pushing toward depression."[86] Meanwhile, "the household sector continued to save nearly ten percent of GDP or more."[87]

An important implication of Koo's analysis is that, with private-sector spending paralyzed by balance-sheet repair problems, large government deficits were and are necessary to head off a catastrophic depression. Contacted by *Fortune* magazine, Koo argued: "Everyone criticizes the pork-barrel spending....But let me tell you, without it there would have been a depression in Japan, pure and simple."[88] The notion that the government deficit is too large is also contradicted by the recent dip of the yield on ten-year government bonds to "1.25 percent...about the lowest long-term bond yield in history." In Koo's view, "this low rate makes perfect sense to the extent that...there is only one borrower left in the market and that is the government."[89]

Still, Koo argues that "fiscal stimulus cannot be used forever." It is fortunate, in his view, that "given the progress already made over the last ten years, it should not take more than two to three years before the balance sheets of Japanese companies are restored to the pre-bubble 1970-1986 average."[90] At that point, it will become possible to phase out government deficits, but only if private-sector spending recovers enough to create "a path of self-sustaining recovery."[91] This is where Koo's main policy proposal comes into play. In order to ensure a recovery of private investment, he argues, it is necessary "to create...investment opportunities," and this means that "the government will have to push strongly on deregulation and market-opening measures. Indeed it is in this context that structural reform is most needed." Moreover, such free-market reforms should be implemented now, when companies are still repairing their balance sheets.

One attractive aspect of the balance-sheet argument is that it works against the view that "the Japanese economy is in the doldrums...because people are complacent or lack the courage for reform." In fact, they are actively "trying to repair their balance sheets simultaneously," whereas "if complacency prevailed" this balance-sheet repair would not be taking place.[92]

The problem, of course, is that such financial belt-tightening, while rational for *individual* firms and households, has a crippling effect on *aggregate* demand. Although "everybody is doing the right thing from their individual perspective,...the combined result of all their efforts has been the opposite of their aggregate goal."[93]

An even greater strength of Koo's balance-sheet approach is that it places the collapse of the bubble economy at the center of the analysis. But this is also where its weakness becomes apparent. Koo does not consider the possibility that the bubble itself was fueled by a growing surplus of private savings over productive and profitable private investment opportunities endemic to mature capitalism. Instead, he argues, along the lines of the anticapitalist capitalism hypothesis, that Japan's saving-investment gap near full employment is — except for the balance-sheet repair problem — due to government protection and regulation, especially of nonfinancial and domestically oriented sectors. The connection between deregulation of protected sectors and the amount of investment demand provided by these sectors is not particularly clear, however. If retailing, for example, continues to be converted from small owner-operated shops into monopolistic chain stores such as those found in the United States, will this increase total investment in this sector? The answer is far from obvious — apart perhaps from an initial shakeout period during which the big corporate concerns establish their operations and consolidate their market shares. The effects of such restructurings on employment and the quality of life are also a matter of concern.

A Crisis of Capitalist Maturity

Our initial consideration of Japanese economic data showed that although Japan's growth "miracle" ended in the early 1970s it was only in the 1990s, after the end of the bubble economy, that the country experienced absolute economic stagnation. The country recently suffered through its third recession in the last ten years. With worsening deflation, neither near-zero interest rates nor rising government deficit spending have been sufficient to sustain positive growth. The stagnation crisis has deepened despite continued growth of exports and despite large trade surpluses. Subsequent sections surveyed the most prominent mainstream explanations for Japan's recent economic problems. Each approach was found to suffer important limitations and gaps, all of which make clear that Japan's crisis cannot be reduced to policy errors, anticapitalist values and institutions, or inadequate political will.

From the standpoint of Marxist theory, the inability of mainstream analyses to explain Japan's crisis is not surprising. With their uncritical, undialectical approach to capitalist relations and dynamics, mainstream analyses bypass the historical contradiction between competitive production for profit and production for human needs. This contradiction is constantly reproduced by the system's alienation of workers from control over necessary material and social conditions of production. One form this alienation takes is the growing difficulty capitalist economies have in finding profitable and productive investment outlets for the tremendous surplus product it is capable of producing when they are operating anywhere near full employment. This tendency is historical and structural insofar as it is driven neither by exogenous demographics nor by subjective evaluations of future growth prospects (as Krugman would have it) but by the contradiction between investment profitability and the prior buildup of mature capitalism's productive base.[94]

This difficulty leads to recessions and prolonged periods of economic stagnation. But it also generates structural countertendencies as capitalists and state functionaries seek to overcome this structural problem. One is to attempt to restore profitability by intensifying the exploitation of workers through wage cuts, work speedups, and new technologies that reduce the unit value of workers' consumption goods. However, this kind of response, by reducing workers' purchasing power relative to productive capacity, only worsens effective demand problems. Another countertendency is the increased investment of money capital in unproductive activities (economic waste), which can support the growth of productive activity insofar as the latter is constrained by insufficient aggregate demand. But if unproductive investments increase the weight of financial activity in the economic system, they may worsen speculative instabilities throughout that system. Unproductive activities like advertising, marketing, and proliferating retail and fast food establishments also tend to worsen the quality of economic, cultural, and ecological life. Yet another structural response to stagnation is the tendency toward the commodification of different kinds of human activities and traits that were formerly outside the circuits of money, commodities, and capital. This process, which is designed to open up new avenues for profit making, is also capable of supporting private accumulation, but only at the expense of further waste and ecological destruction as well as a qualitative vitiation of the cultural, psychological, and even spiritual content of life-activities that define human development.[95]

Taken together, the stagnation tendency and its countertendencies mean that mature capitalism tends to produce a worsening trade-off between economic stagnation, on the one hand, and an increasingly exploitative, wasteful, and destructive use of society's productive capacities, on the other. Despite their inadequacies, each of the mainstream analyses surveyed above sheds light on particular aspects of this crisis of capitalist maturity as it has unfolded in the case of Japan with all its historical and institutional specificities.

The anticapitalist capitalism explanation, for example, runs into the difficulty of explaining the *sudden* turn toward absolute stagnation in the 1990s. But this challenge usefully focuses attention on the factors that may have sustained capital investment and growth in previous years: rising exports, wasteful public works, and unproductive finance-led growth (the bubble economy). Importantly, Japan's competitive successes in export markets — successes that have required a series of capital restructurings complete with large-scale reallocations of both labor and means of production — are difficult to square with the notion that Japan suffers from a sudden onset of stagnating productivity and reduced competitiveness due to its anticapitalist values and institutions. Moreover, the data show that, outside recession years, Japan has maintained competitive rates of both labor productivity growth and reductions in unit labor costs. All of this suggests that the roots of the 1990s stagnation (and of the need to rely on pork-barrel construction and the bubble economy to keep the economy going) are to be found in Japan's historical successes at productive and competitive capital accumulation. In other words, Japan's crisis is an outcome of the general crisis tendencies of mature capitalism in their Japanese form; it does not connote Japan's failure to live by the rules of the capitalist game. The latter would only be true if capitalism did not in general contain immanent crisis tendencies.

The bad debts/zombie companies diagnosis also helps reveal the deep systemic character of Japan's stagnation problem. This approach unwittingly highlights the massive costs and even catastrophic economic breakdown that would result from the immediate liquidation of unpayable debts and insolvent enterprises. It also draws attention to the stagnation of loan demand in the 1990s — throwing further doubt on supply-side explanations of the crisis.

By focusing directly on the problem of the output gap (shortfall of investment relative to full employment savings), Krugman's liquidity trap approach shows how deflation has worsened Japan's stagnation, and why free-market reforms cannot produce an economic recovery unless they increase spending. Although Krugman's analysis suffers from an implausible emphasis on demographic determinants of economic growth, his general emphasis on "poor long-run growth prospects" unwittingly points to a more likely explanation for the output gap: the probability that Japan suffers from a structural tendency toward "excess savings" (surplus capital) over productive and profitable investment opportunities.[96] Krugman's opposition to fiscal policy as a way of filling Japan's output gap also indirectly poses the question of social prioritization of resource allocation — especially in situations where private sector activity cannot bring the economy anywhere close to full employment. This question challenges socialists, and all those who care about the well-being of the Japanese people, to envision concrete alternatives to the wasteful and antiecological "construction state" — alternatives likely involving reduced worktime, increased use of solar power, and other forms of ecological conversion implemented through new institutions of democratic economic governance.

The exchange-rate-based analyses add an essential international dimension to any perspective on Japan's stagnation decade. Despite their inadequate explanation of the bubble economy, they effectively highlight the importance of exports for Japan's continued growth up to the 1990s. They also draw attention to the conflictive, unsustainable character of Japan's export-led growth, in particular its dependence on the willingness of the United States and Europe to accept growing trade deficits with Japan.

Finally, Koo's balance-sheet recession approach indirectly highlights not only the problem of Japan's output gap addressed above, but also the issue of economic priorities. Putting the collapse of the bubble economy at the center of the analysis, Koo rightly asks where investment demand will come from once the bad debts left behind by the bubble are (as in his scenario) gradually cleared away. Koo would solve the problem by deregulating the economy, thereby opening up new opportunities for private investment. But this raises the question of how big the investment response to deregulation would be (and whether it would be mainly a one-shot effect). It also raises the question of the productive character of these private investments in terms of their connection (or lack thereof) to the meaningful satisfaction of individual and collective needs. The opening up of both previously protected and completely new sectors to private investment can be expected to produce a further commodification and capitalization of Japan's economic, social, and cultural life, with harmful human and environmental consequences. For example, the shopping-mall society with its chain stores and chain eateries converts public spaces into private cathedrals dedicated to the religion of hedonistic consumption. Thus, while it is theoretically possible for Japanese capitalism to overcome its economic stagnation by finding new areas of material and social life to dominate, this achievement is likely to simultaneously generate new barriers to the achievement of a healthy and sustainable human development.

In sum, while all five mainstream explanations are flawed, they nonetheless provide support for the argument that Japan's crisis is, with all its peculiarities, at root a crisis of capitalist maturity. This conclusion leads us to predict that if Japan is to overcome its stagnation and remain capitalist, the Japanese people must by necessity accept not only a further intensification of labor exploitation, but also the increased waste of resources on unproductive activities (activities whose "productivity" or "necessity" is only definable in terms of market and profit-making priorities) and the increased capitalization of life-activity in general.

Conclusion: Japan and the Politics of Crisis Analysis

Another option does exist: the people of Japan could work to build a new system that would run in line with saner, more worker-community-centered priorities. We strongly support this option. Unfortunately, by offering misleading explanations for Japan's crisis, mainstream theories have played an important role in keeping this option off the country's political agenda. By critically engaging and exposing the weaknesses in these mainstream approaches, we can create a more open and honest debate from which the Japanese people, and working people everywhere, can gain a more systemic and accurate understanding of Japan's stagnation and the real costs of proposed solutions.

Through their uncritical acceptance of capitalist relations and priorities, mainstream accounts of Japan's crisis marginalize the potential role of working-class capabilities and aspirations in economic policy debates. Working people and communities are treated as mere raw material ("human and social capital") for competitive capital accumulation ("economic growth"). As for workers' struggles to defend and improve their conditions in and against capitalism, mainstream accounts treat them as purely negative disruptions of the predetermined imperatives of the market. That worker-community struggles could provide a positive source of new development visions and policies is never considered. In this way, they are relegated to the underside of history.

For instance, in the period immediately following World War II, the Japanese people fought hard to create a humane and democratic society. Their democracy, production control, and industrial union movements were eventually defeated, but only through the use of force by U.S. and Japanese authorities.[97] Yet these movements, and their suppression, play little if any role in mainstream accounts of the postwar Japanese system with all its capitalistic successes and contradictions. By recognizing that Japan's crisis is at root a crisis in the maturation of the same capitalist system whose hegemony was forcibly reestablished after World War II, we can help rekindle this historical legacy and encourage the building of new movements for change, ones that — especially in light of renewed consciousness of the irrationalities, inequalities, and injustices of U.S. capitalism — might well enjoy the support of growing numbers of Americans.

This last appeal is addressed in particular to our socialist and social-democratic comrades who have used elements of the Japanese system as positive reference points for the formulation of progressive economic policy visions. Hoping to beat neoliberalism at its own game, these progressives argued that Japan's financial and investment planning systems, corporate labor-management regime, and less militarized economy and polity offered competitive *and* equitable alternatives to U.S.-style capitalist institutions. Japan's crisis has dealt a serious blow to this intellectual strategy — exposing the pitfalls for progressives of a one-sided emphasis on national capitalist specificities artificially separated from the general tendencies of capitalist development.[98] Yet many progressives continue to defend the virtues of Japanese capitalism by blaming its problems on the destructive effects of economic globalization, especially of the financial variety. The Japanese model, previously praised as highly competitive, is now said to require protection from global market forces.[99] Not surprisingly, given the way these debates develop, neoliberals have turned the progressives' contradictory retreat into a rout by arguing that it is globalization that is progressive and Japanese institutions that are backward.

This situation helps account for the increasingly fatalistic views among many progressive admirers of Japanese institutions — a fatalism that has taken two nonexclusive forms. First, there is the view that given Japan's current crisis and ongoing globalization pressures the best that can be hoped for in the present is a prolonged period of muddling through in which at least some elements of the Japanese system will hopefully be preserved.[100] Second, there are those who, again taking the deregulation and globalization of the Japanese economy as inevitable, aim to soften the blow with new social-democratic-type policies that rationalize the process and ameliorate its human and social costs. A prominent advocate of such third way thinking is the Japanese political-economist Kaneko Masaru, whose proposed reforms include asset taxes to more equitably resolve Japan's fiscal crisis; changes in the public pension, health insurance, and unemployment compensation systems to generalize worker access and enhance the portability between jobs of workers' claims; and a new system of formal qualification and portability of workers' skills and job experiences — all designed to give workers a greater sense of social ownership and self-worth.[101]

We find this overall trajectory of progressive Japan arguments to be politically tragic — especially considering that the current period is one of worsening global economic instability, discrediting of corporate capitalist institutions, intensified class struggle, and (despite the disruptive static of terrorism) growing international solidarity among workers' and other grassroots movements. In this setting, progressive scholars need to offer more than defenses of particular national-capitalist institutions and neoliberal social-democratic tinkering; we need a critical-systemic vision of capitalism that can inform popular struggles for worker-community-centered socioeconomic transformations on national, regional, and global levels. A necessary first step in this crucial task is to uncover the hidden subtexts of exploitation, social irrationality, and immanent crisis tendencies in mainstream accounts of capitalist growth and crisis. This step will not be taken insofar as progressive scholars continue to "celebrate difference" to the point of neglecting the contradictory dynamics common to all forms of capitalism.

Notes

The authors dedicate this essay to the late Rob Steven — Marxist scholar and socialist comrade.

1. For our critique of the left-liberal version of this Japan-mania, see Paul Burkett and Martin Hart-Landsberg, "The Use and Abuse of Japan as a Progressive

Model," in *Socialist Register 1996: Are There Alternatives?,* ed. Leo Panitch (London: Merlin, 1996), 62-92; Martin Hart-Landsberg and Paul Burkett, "The Left-Liberal Consensus on Japan: A Methodological and Political Critique," *Monthly Review* 48, no. 4 (1996): 26-38; Paul Burkett and Martin Hart-Landsberg, *Development, Crisis, and Class Struggle: Learning from Japan and East Asia* (New York: St. Martin's Press, 2000), chaps. 4-5; "Progressive Capitalism, Crisis, and Class Struggle: Lessons from Japan's Production Control and Democracy Movements, 1945-47," *Capital & Class,* no. 79 (winter 2002).

2. Our coverage is limited to English-language works, only some of which were written by Japanese political-economists. Nonetheless, we believe that our survey encompasses the leading mainstream views on Japan's crisis as they have developed both inside and outside Japan. It is of course understood that our work is only part of what will hopefully become a wider and more in-depth discussion among critical Japan scholars worldwide.
3. Makoto Itoh, *The Japanese Economy Reconsidered* (New York: Palgrave, 2000), chap. 1.
4. See especially Gavan McCormack, "Breaking the Iron Triangle," *New Left Review,* no. 13 (2002): 5-23. According to McCormack, "The *doken kokka* centers not on the archipelago's world-famous manufacturers but on an 'Iron Triangle' of politicians and bureaucrats, financial institutions and construction industry" (11).
5. These trends are consistent with the view that government deficits and wasteful public construction are mainly symptoms of stagnation rather than fundamental causes. This view draws further support from the steady decline of total (national and local) tax revenues as a ratio to national income, from 27.8 percent in 1990 to 22.3 percent in 1999. See Itoh, *The Japanese Economy Reconsidered,* 98. Itoh's entire discussion of the fiscal crisis of the Japanese state and its regressive distributional consequences is required reading in this connection. Ibid., 97-105.
6. Ron Chernow, "Grim Reckoning in Japan — and Beyond," *New York Times,* 17 November 1997, A19.
7. Noguchi Yukio (with Ushio Jiro), "Reforming Japan's 'War-Footing' Economic System," *Japan Echo* 21, no. 2 (1994): 15.
8. *Economist,* "Japan Inc on the Treadmill," 9 June 2001, 63-64.
9. Richard Katz, "A Crisis? Don't Tell the Japanese," *New York Times,* 8 July 1998, A21. Combined with an industrial policy "that protects the inefficient sectors at the expense of efficient sectors," this labor-inflexibility has, in Katz's view, created a "supply-side problem" of "low productivity growth." Katz, *Japan: The System That Soured* (Armonk, N.Y.: M. E. Sharpe, 1998), 12.
10. Nicholas D. Kristof, "Shrugging Off Doom: Shops Closing, Japan Still Asks, 'What Crisis?'" *New York Times,* 21 April 1998, A6.
11. Noguchi, "Reforming Japan's 'War-Footing' Economic System," 15. This viewpoint is well represented in *The Japanese Economic System and Its Historical Origins,* ed. Tetsuji Okazaki and Masahiro Okuno-Fujiwara (Oxford: Oxford University Press, 1999). For an alternative account tracing the roots of the main elements of the post-World War II Japanese system back to the Meiji Restoration, see Burkett and Hart-Landsberg, *Development, Crisis, and Class Struggle,* chap. 6-8.
12. Noguchi Yukio, "The Persistence of the 1940 Setup," *Japan Echo* 24 (1997): 81-83.
13. Noguchi Yukio, "Falling Prices Are Part of the Reform Process," *Japan Echo* (ProQuest online version) 28, no. 4 (2001): 2; Noguchi, "Reforming Japan's 'War-Footing' Economic System," 14.
14. Katz, *Japan: The System That Soured,* 24.

15. Kristof, "Shrugging Off Doom," A1.
16. Katz, "A Crisis?," A21.
17. Richard C. Koo, "The Japanese Economy in Balance Sheet Recession," *Business Economics* (ProQuest online version) 36, no. 2 (2001): 1.
18. Nicholas Crafts, "East Asian Growth before and after the Crisis," *IMF Staff Papers* 46, no. 2 (1999): 145.
19. For a general overview and evaluation of "catch-up" approaches, see Paul Burkett and Martin Hart-Landsberg, "A Critique of 'Catch-Up' Theories of Development," *Journal of Contemporary Asia* 33, no. 2 (2003): 147-71.
20. Katz, *Japan: The System That Soured,* 83.
21. Ibid., 4.
22. Bai Gao, *Japan's Economic Dilemma: The Institutional Origins of Prosperity and Stagnation* (Cambridge: Cambridge University Press, 2001), 7. He ascribes the timing of these shifts to the breakdown of the Bretton Woods system of fixed exchange rates and regulated capital flows.
23. Ibid., 15-16.
24. Noguchi Yukio, "An Information Technology Revolution to Revive Japan," *Japan Echo* (ProQuest online version) 27, no. 1 (2000): 1-2. This timing explanation may be questioned, however, insofar as the heavy and technology-intensive industrialization of the East Asian NICs was already well under way by the late 1970s. For the case of South Korea, see Martin Hart-Landsberg, *The Rush to Development: Economic Change and Political Struggle in South Korea* (New York: Monthly Review Press, 1993).
25. Koo, "The Japanese Economy," 6.
26. Noguchi, "Reforming Japan's 'War-Footing' Economic System," 13.
27. Shigeto Tsuru, *Japan's Capitalism: Creative Defeat and Beyond* (New York: Cambridge University Press, 1993), 188. The internal funds/gross investment ratio rose even more in certain key industries of the high-growth period. In the years 1960 to 1970, for example, it grew from 58 to 146 percent for construction firms, from 47 to 107 percent for cement manufacturers, from 34 to 154 percent for precision machinery firms, and from 29 to 109 percent for electrical machinery producers. Ibid., 189.
28. Terutomo Ozawa, "The 'Hidden' Side of the 'Flying Geese' Catch-up Model: Japan's *Dirigiste* Institutional Setup and a Deepening Financial Morass," *Journal of Asian Economics* 12, no. 4 (2001): 479-80.
29. Costas Lapavitsas, "State and Finance in Economic Development: Analytical Issues Relevant to the East Asian 'Miracle,'" *Seoul Journal of Economics* 10, no. 4 (1997): 429-35; Burkett and Hart-Landsberg, *Development, Crisis, and Class Struggle,* 134-35. Government subsidies and tax breaks for urban development projects also played an important role in the bubble.
30. Katz, *Japan: The System That Soured,* 12-13. *Note:* Under the Plaza Accord Japan agreed to a large appreciation of the yen.
31. Gao, *Japan's Economic Dilemma,* 16. Similarly, Noguchi Yukio argues that "preventing the [further] appreciation of the yen came to be regarded as the most important objective of macroeconomic policy. This became the major cause of the bubble." Noguchi Yukio, "Macroeconomic Policies and Asset Price Inflation: A Political-Economic Analysis of the 'Bubble' Economy," in *U.S.-Japan Macroeconomic Relations: Interactions and Interdependence in the 1980s,* ed. Noguchi Yukio and Kozo Yamamura (Seattle: University of Washington Press, 1996), 74.
32. Gao, *Japan's Economic Dilemma,* 16.
33. Katz, *Japan: The System That Soured,* chap. 8.
34. For an overview and critique of the "new economy" ideology, see "The New Economy: Myth and Reality," *Monthly Review* 52, no. 11 (2001), special issue.

35. Charles P. Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises,* 4th ed. (New York: Wiley, 2000); Martin H. Wolfson, *Financial Crises: Understanding the Postwar U.S. Experience,* 2d ed. (Armonk, N.Y.: M. E. Sharpe, 1994).
36. Paul Krugman, "Japan's Trap," unpublished manuscript, May 1998, 8. In "Reforming Japan's 'War-Footing' Economic System," Noguchi actually argues that government attempts "to promote demand…won't produce results" without "the structural reform that's now required" (13). More recently he has applauded worsening deflation as a sign that business restructurings and reforms are finally taking hold. See Noguchi, "Falling Prices," passim.
37. These numbers, it should be emphasized, are limited to the manufacturing sector and should be interpreted with all the usual caveats connected with wage and productivity statistics.
38. Katz's own data on real value added per labor hour in manufacturing show that, up until 1990, Japan's productivity continued to grow relative to that of the United States, France, Germany, and the United Kingdom. Katz, *Japan: The System That Soured,* 33. Outside manufacturing, Japan's labor productivity grew at a robust annual rate of 3.7 percent during the 1985-88 period, and even in 1993-94 it averaged 1.1 percent annual growth despite the 1993 recession. In the U.S. nonmanufacturing sector, labor productivity growth averaged only 0.9 percent per year over the years 1980-85. Ibid., 40.
39. Marc Linder, *Labor Statistics and Class Struggle* (New York: International Publishers, 1994), chap. 1.
40. For full details on the issues discussed in this paragraph and the next, see Rob Steven, *Japan's New Imperialism* (Armonk, N.Y.: M. E. Sharpe, 1990), and "Japanese Investment in Thailand, Indonesia, and Malaysia: A Decade of JASEAN," in Joe Moore, *The Other Japan: Conflict, Compromise, and Resistance since 1945,* rev. ed. (Armonk, N.Y.: M. E. Sharpe, 1997), 199-245; also Burkett and Hart-Landsberg, *Development, Crisis, and Class Struggle,* chaps. 8-10.
41. Bai Gao observes: "As a marginal labor force women entered and left the labor market flexibly according to the economic situation." Yet in his very next sentence, he claims that "Japan was able to pursue 'development without losers.'" Bai Gao, *Japan's Economic Dilemma,* 17.
42. Takatoshi Ito, "Japan and the Asian Economies: A 'Miracle' In Transition," *Brookings Papers on Economic Activity,* no. 2 (1996): 220; James Brooke, "Accelerating Decline in Japan Evokes Rust Belt Comparisons," *New York Times,* 31 August 2001, C2. In *Japan: The System That Soured,* Katz blames manufacturing job flight on the high domestic costs incurred by leading manufacturers due to protection of inefficient suppliers, which forced the former to set up shop elsewhere to remain competitive. Aside from its empirical problems in light of productivity and labor cost data, and its inconsistency with the labor-inflexibility hypothesis, this argument presumes that the Japanese state is powerful enough to protect backward firms and their workers, yet is completely impotent at preventing the massive outward flight of productive capital. But the historical evidence suggests that the international operations of Japan's leading corporations have always been planned and carried out in close consultation with the Japanese industrial policy and foreign aid apparatuses. See, for example, Jon Halliday and Gavan McCormack, *Japanese Imperialism Today* (New York: Monthly Review Press, 1973); Steven, *Japan's New Imperialism;* Edith Terry, "An East Asian Paradigm?" *Atlantic Economic Journal* 24, no. 3 (1996): 183-98, "Crisis? What Crisis?" Working Paper No. 50, Japan Policy Research Institute, October 1998, and "How Asia Got Rich: World Bank vs. Japanese Industrial Policy," *The Japanese Economy* 28, no. 2 (2000): 76-96.

43. Although this explanation often appears in the broader context of anticapitalist capitalism views, we treat it separately due to the policy importance of the bad debt problem. Also, not all proponents of the bad debts/zombie companies explanation embrace the anticapitalist capitalism thesis in its entirety. See, for example, Luke Gower and Dominic Wilson, "Displaced Capital and Japanese Economic Growth," *Journal of the Japanese and International Economies* 14, no. 2 (2000): 105-20.
44. James Brooke, "In Japan, a Lack of Political Will to Act Decisively on the Economy," *New York Times,* 17 December 2001, C14.
45. Tsuru, *Japan's Capitalism,* 108.
46. David E. Sanger, "Japan's Bad Debt Is Now Estimated near $1 Trillion," *New York Times,* 30 July 1998, A1; Brooke, "In Japan," C14. Katz writes: "Unfortunately, in Japan, capital was just a little too dedicated, a little too patient. One reason is that the biggest borrowers own the banks and vice versa....Capital was also a little too protected. Risk was taken out of the system." Katz, *Japan: The System That Soured,* 219.
47. Ken Belson, "Hurt by Bad Loans and Slumping Stocks, Two Large Japanese Banks Report Poor Earnings," *New York Times,* 23 November 2001, C3.
48. *Economist,* "Japan Inc," 64.
49. Gower and Wilson, "Displaced Capital," 106-107, 119.
50. *Economist,* "The Yen: On the Slide," 5 January 2002, 66.
51. While applauding Prime Minister Koizumi's proposals "to lift the huge burden of bad debts off the shoulders of commercial banks," the *Economist* complains "that the news is not yet bad enough," i.e., that the government has still not implemented the "real pain" needed to restore Japan's economic health — largely because "although the idea of reform is popular, ordinary voters do not feel a sense of crisis." *Economist,* "The Prime Minister Who Needs Things to Get Worse," 15 December 2001, 33-34.
52. Koo, "The Japanese Economy," 6-7.
53. Ken Belson, "The Bank of Japan Moves to Halt Economic Slide," *New York Times,* 20 December 2001, W1.
54. Paul Krugman, "Japan Heads for the Edge," *Financial Times,* online edition, 20 January 1999, 2. Krugman develops the statistical details of this argument in "It's Baaack: Japan's Slump and the Return of the Liquidity Trap," *Brookings Papers on Economic Activity,* no. 2 (1998): 141-42, 176-77.
55. *Economist,* "Japan Inc," 64.
56. Krugman's writings are available through his website: www.pkarchive.org/.
57. Paul Krugman, "Nihon Keizai Shambles," *New York Times,* 14 May 2000, Section 4, 15.
58. Krugman, "Japan's Trap," 1, 7.
59. Krugman, "It's Baaack," 174.
60. Ibid., 178.
61. Krugman, "Japan's Trap," 1.
62. Krugman, "Japan Heads for the Edge," 2.
63. Krugman, "Nihon Keizai Shambles," 15. "In a liquidity trap,...monetary policy will in fact be effective if the central bank can credibly promise to be irresponsible, to seek a higher future price level." Krugman, "It's Baaack," 139.
64. Paul Krugman, "Still Depressed about Japan," unpublished manuscript, 1999, 1.
65. Krugman, "It's Baaack," 180-81.
66. Krugman, "Japan Heads for the Edge," 1.
67. See, for example, Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73, no. 6 (1994): 62-78.
68. John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (New York: Harcourt Brace, 1964), 207.

69. Jan A. Kregel makes a similar point in "Krugman on the Liquidity Trap: Why Inflation Won't Bring Recovery in Japan," Working Paper No. 298, Jerome Levy Economics Institute, March 2000.
70. This difficulty is clear from Krugman's argument that "a liquidity trap involves a kind of credibility problem. A monetary expansion that the market expects to be sustained…will always work [to raise prices and demand], whatever structural problems the economy might have; if monetary expansion does not work…it must be because the public does not expect it to be sustained" ("It's Baaack," 142). But if there is a "structural problem" with demand itself, i.e., a shortage of privately profitable and productive investment opportunities relative to full employment savings even at a zero real interest rate, then there would seem to be no solid basis for such a self-fulfilling belief. Monetary policy effectiveness would seem to involve not just a catch-22 in this context, but rather a divorce of beliefs from structural fundamentals.
71. In "It's Baaack," Krugman criticizes the fiscal "jump-start" strategy on grounds that the attendant increase in government debt could become unsustainable in the event "that at a sufficiently distant date real [interest] rates…become strongly positive again" (178). But even this problem could be resolved through balanced-budget increases in government spending to spur the economy.
72. Krugman, "Japan's Trap," 8.
73. Jeffrey Sachs, "The Benefits of a Weaker Yen," *Financial Times,* 18 April 2001, 13.
74. Ibid.
75. Ibid. For details on the role of Japanese banks in triggering the 1997-98 Asian crisis, see Michael R. King, "Who Triggered the Asian Financial Crisis?" *Review of International Political Economy* 8, no. 3 (2001): 438-66.
76. Sachs, "The Benefits," 13.
77. Ronald McKinnon and Kenichi Ohno, "The Foreign Exchange Origins of Japan's Economic Slump and Low Interest Liquidity Trap," *World Economy* 24, no. 3 (2001): 279-315, and *Resolving Economic Conflict between the United States and Japan* (Cambridge, Mass.: MIT Press, 1997). We quote extensively from McKinnon's summation of their analysis: "The Foreign Exchange Origins of Japan's Liquidity Trap," *Cato Journal* 20, no. 1 (2000): 73-84.
78. Ibid., 74.
79. Ibid., 80.
80. Ibid., 80-81.
81. Burkett and Hart-Landsberg, *Development, Crisis, and Class Struggle,* chap. 9. For a recent debate on the issue of Japan's export-dependence, see Jim Kincaid, "Marxist Political Economy and the Crises in Japan and East Asia," *Historical Materialism,* no. 8 (2001): 93-95, and Martin Hart-Landsberg and Paul Burkett, "Development, Crisis, and Class Struggle in East Asia: A Reply," *Historical Materialism,* forthcoming. A full discussion of this question would have to address the history of Japanese imperialism and its tensions and conflicts with Western (especially U.S.) imperialism from the Meiji Restoration onward. This lies beyond the scope of the present article. Our views on Japanese imperialism are set out in *Development, Crisis, and Class Struggle,* chaps. 1-12.
82. Rob Steven, "The High Yen Crisis in Japan," *Capital & Class,* no. 34 (1988): 76-118.
83. Burkett and Hart-Landsberg, *Development, Crisis, and Class Struggle,* 116.
84. Koo, "The Japanese Economy," 2.
85. Ibid.
86. Brooke, "In Japan," C14.
87. Koo, "The Japanese Economy," 2.

88. Bill Powell, "Japan's Kamikaze Economy," *Fortune,* online edition, 3 September 2001, 3.
89. Koo, "The Japanese Economy," 5.
90. Ibid.
91. Ibid., 7.
92. Ibid., 5.
93. Ibid., 2.
94. Paul A. Baran and Paul M. Sweezy, *Monopoly Capital: An Essay on the American Economic and Social Order* (New York: Monthly Review Press, 1966); Paul M. Sweezy and Harry Magdoff, *The Irreversible Crisis* (New York: Monthly Review Press, 1988).
95. Ultimately, mature capitalism's expenditure of increasing amounts of society's economic surplus on unproductive pursuits, and its commodification of more areas of life-activity, may vitiate the productive forces themselves — labor power, nature, and their social combinations — leading to an absolute stagnation of society's productive powers. On this point, see Paul M. Sweezy, *Four Lectures on Marxism* (New York: Monthly Review Press, 1981), 69-70.
96. Interestingly, Krugman has recently suggested that the United States may be on the verge of its own liquidity trap problem in the wake of the deflation of the 1990s tech-economy bubble. But he fails to consider the possibility that such stagnationist pressures may be inherent to mature capitalism. See "Mind the Gap," *New York Times,* 16 August 2002, A19.
97. Joe Moore, *Japanese Workers and the Struggle for Power, 1945-1947* (Madison: University of Wisconsin Press, 1983); Hirosuke Kawanishi, ed., *The Human Face of Industrial Conflict in Post-War Japan* (London: Kegan Paul, 1999); John W. Dower, *Embracing Defeat: Japan in the Wake of World War II* (New York: New Press/W. W. Norton, 1999), chap. 8; Burkett and Hart-Landsberg, "Progressive Capitalism, Crisis, and Class Struggle," and *Development, Crisis, and Class Struggle,* chap. 7.
98. See the references in note 1 for details on this point.
99. See, for example, William K. Tabb, "Japan's Recession: The 800-Pound Crisis," *Dollars and Sense,* March/April 1999, 10-13, 40.
100. Ronald Dore, "Asian Crisis and the Future of the Japanese Model," *Cambridge Journal of Economics* 22, no. 6 (1998): 773-87; Ronald Dore, "Stock Market Capitalism and Its Diffusion," *New Political Economy* 7, no. 1 (2002): 115-21; William Lazonick, "The Japanese Economy and Corporate Reform: What Path to Sustainable Prosperity?" *Industrial and Corporate Change* 8, no. 4 (1999): 607-33; Andrew Gordon, "Scaring the Salaryman Isn't the Japanese Way," *New York Times,* 30 October 1999, A27.
101. Kaneko Masaru, "The Folly of Cash-Flow Management," *Japan Echo* 27, no. 3 (2000): 44-46, and "Plugging Japan's Income, Generation, and Education Gaps," *Japan Echo* 27, no. 6 (2000): 46-50; also Kaneko Masaru, Jinno Naohiko, and Nomura Hiroyasu, "Stop the Slide toward National Bankruptcy," *Japan Echo* 27, no. 6 (2000): 28-33.

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