

Japan in the Process of Institutional Transformation

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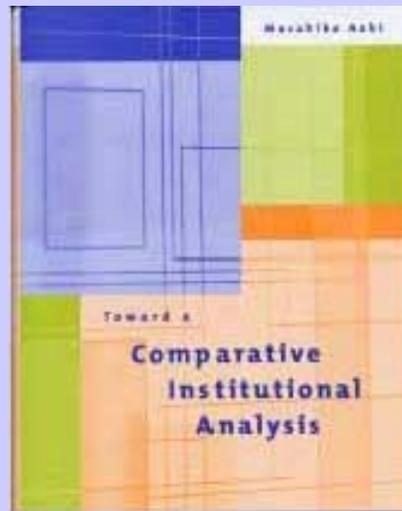
How can we characterize the present state of the Japanese political economy?

“The lost decade,”

or

in the process of institutional transformation?

CIA Approach



A view from RIETI



What are institutions?

- Established organizations such as WTO, METI, the Federal Reserve, etc.?
- Law, regulation?
- Customs?

It helps to think of the political economy as a game.

THE
THEORY
OF
MORAL SENTIMENTS.

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ideal plan of government, that he cannot suffer the smallest deviation from any part of it. He goes on to establish it completely and in all its parts, without any regard either to the great interests, or to the strong prejudices which may oppose it. He seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board. He does not consider that the pieces upon the chess-board have no other principle of motion besides that which the hand impresses upon them; but that, in the great 'chess-board' of human society, every single piece has a principle of motion of its own, altogether different from that which the legislature might choose to impress upon it. If these two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successful. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder.

- 18 Some general, and even systematical, ideas of the perfection of policy and law, may no doubt be necessary for directing the views of the statesman. But to insist upon establishing, and upon establishing all at once, and in spite of all opposition, every thing which that idea may seem to require, must often be the highest degree of arrogance. It is to erect his own judgment into the supreme standard of right and wrong. It is to fancy himself the only wise and worthy man in the commonwealth, and that his fellow-citizens should accommodate themselves to him and not he to them. It is upon this account, that of all political speculators, sovereign princes are by far the most dangerous. This arrogance is perfectly familiar to them. They entertain no doubt of the immense superiority of their own judgment. When such imperial and royal reformers, therefore, condescend to contemplate the constitution of the country which is committed to their government, they seldom see any thing so wrong in it as the obstructions which it may sometimes oppose to the execution of their own will. They hold in contempt the divine maxim of Plato,¹ and consider the state as made for themselves, not themselves for the state. The great object of their reformation, therefore, is to remove those obstructions; to reduce the authority of the nobility; to take away the privileges of cities and provinces, and to render both the greatest individuals and the greatest orders of the state, as incapable of opposing their commands, as the weakest and most insignificant.

¹ *l'c* 7 chess board § Cf. the two preceding footnotes.

² See § 16 above.

Game-theoretic framework:

Three elements

- The set of players with a respective set (repertoire) of strategic choices.
- The rule of the game that transforms the profile of actual choices by all the players into physical consequences: statutory law, technology, factor endowments, historical path, etc.
- Equilibrium; stable expectations (beliefs) regarding way that the game is played.

Institutions as shared beliefs

- **Shared beliefs** regarding the way that the game is being played = subjective representation of **equilibrium** (e.g., life-time employment, main bank system, etc.)
 - Self-enforcing
 - History matters (multiple equilibria)
 - Institutional interdependencies (transdisciplinary)
 - The roles of law and public debate in institutional change (focal point)

Bureau-pluralism

(compartmentalized pluralism)

- Institutional complementarities between life-time employment and industrial associations (interest groups).
- Parallel collusion between the interest group and the corresponding bureau
- Barriers to entry, partial optimization, politics as pluralist arbitration of incumbent interests

Four requisites of institutional change

- Institutional crisis (breakdown of shared beliefs)
- Entrepreneurial experimentation in the private sector
- Deregulation (re-regulation) to enhance diverse private experimentation, facilitate human-resource mobility across sectors, remove sectoral barriers and realize new Schumpeterian combinations
- Political leadership to overcome bureau-pluralism (or “zoku”-politicians exclusively engaged in representing and arbitrating incumbent sectoral interests).

Any signs of change?

- 1993 - The end of one-party rule and the burst of the bubble.
- 1997 - The end of the “convoy system.”
- 2001 - Administrative restructuring and the birth of the Koizumi cabinet
 - tax reform
 - university reform
 - the China problem (safe-guard issue)

The End