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Institutional inertia, adjustment, and change: Japan as a case of a coordinated market economy

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Institutional inertia, adjustment, and change: Japan as a case of a coordinated market economy

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ABSTRACT

This article reviews the contributions of three important books that analyze, respectively, the sources and patterns of institutional inertial, adjustment, and change of Japanese economy in response to the country's prolonged economic stagnation. Drawing on their scholarship, the article highlights the dual character of Japanese capitalism – the persistence of core elements of a coordinated market economy on the one hand, and the incremental revision of existing practices towards a liberal market model by state agencies and firms on the other hand. The case of Japan suggests that while coordinated market economies may face the danger of losing some of their comparative institutional advantages under rapid technological change and increased international competition, they may not make an unambiguous switch to liberal institutions, and may take a variety of reform paths in coping with internal and external pressures.

KEYWORDS

Japanese capitalism; institutional adaptation; institutional change; variety of capitalism; coordinated market economy.

Marie Anchordoguy (2005) *Reprogramming Japan: The High Tech Crisis under Communitarian Capitalism*, Ithaca, NY: Cornell University Press.
Michael Witt (2006) *Changing Japanese Capitalism: Societal Coordination and Institutional Adjustment*, New York: Cambridge University Press.
Steven Vogel (2006) *Japan Remodeled: How Government and Industry are Reforming Japanese Capitalism*, Ithaca, NY: Cornell University Press.

INTRODUCTION

Just as the rocketing of Japan's economy to the global forefront in the post-war period spawned sizable literature on the lessons of its success, the

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burst of its economic bubble and its economic slump since the 1980s has equally intrigued students of Japanese political economy. As Japan went from boom to bust, talk of 'Japan as number one' has been replaced with debate about the causes of, and cures for, its economic stagnation. These diagnoses cover a wide array of subjects that range from rigid business structures to inefficient government policies, from challenges of international environment to growing domestic pressures, and from materialist accounts to ideational explanations (Endo, 2001; Gao, 2001; Grimes, 2001; Hall, 2004; Katz, 1998; Pempel, 1998). It is against this background that three recent volumes have gained scholarly attention. They represent a growing body of literature that has not only provided the most updated empirical account of Japan's industrial malaise based on a vast amount of original data, but has also advanced sophisticated theories on the etiology and patterns of institutional inertia, adjustment and change in Japan's capitalism system.

What has puzzled these three authors is not so much Japan's dramatic turn from prosperity to stagnation, but rather, the type of slow *response* observed in Japan since the 1980s. They find that on the one hand many core characteristics of Japan's capitalist system have remained unchanged even after more than a decade of near-zero growth, and on the other hand, existing institutions, norms and practices are being incrementally contested and revised. While Marie Anchordoguy and Michael Witt have mainly examined factors that contribute to high level of institutional inertia and continuity in the face of crisis, Steven Vogel's analysis places more emphasis on the pattern of institutional adaptation and change. Despite their different focuses, these studies collectively suggest that to understand the behaviors of state agencies and firms in Japan, one has to go beyond the rational choice assumption of utility maximization to examine the concrete institutional contexts that agents are situated in. Meanwhile, to explore the patterns in which Japanese capitalism emerge, persist and evolve, one cannot separate the understanding of institutional continuity from that of institutional change.

All three works build on the varieties of capitalism (VOC) perspective and devote considerable attention to the coordinated character of Japan's market economy (Hall and Soskice, 2001). Yet they do not simply reiterate the logic of Japan's divergence from liberal market economies (LMEs). Rather, they seek to address the issue of how a typical coordinated market economy (CME) such as Japan responds to changing economic conditions over time. As the VOC approach has been previously criticized for being overly static and inadequate to understand situations other than settled equilibriums, the three studies have made a particularly useful contribution by exploring the dynamics (or the lack of) institutional adaptation and change in Japanese economy (Howell, 2003). Furthermore, their works help to shed light on the prospects of convergence and divergence between CMEs and LMEs. Regardless of their different messages about Japan's transition to a liberal market model, their analyses of various reforms in Japan have countered the prediction that CMEs are hard to sustain but easy to destroy, and that the forces of globalization and technological progress can be so powerful as to create cross-national convergence (Goodin, 2003; Thatcher, 2004). By elucidating the ways in which Japan has partially remodeled itself towards a liberal market system while simultaneously maintaining the core institutional features of CMEs, the three studies collectively depict a far more sophisticated picture than simple divergence or convergence, and raise a series of interesting questions that are worth further investigation.

COMMUNITARIAN CAPITALISM AND INSTITUTIONAL INERTIA

Of the three authors, Anchordoguy frames her analysis at the broadest level. Central to her explanation of both Japan's economic decline and its subsequent inability to bounce back is the notion of 'communitarian capitalism', which is the set of norms deeply rooted in Japan's capitalist system that promote a strong logic of community. These norms guide the behaviors of the state, firms and individuals and structure their relationship in such a way that privileges the group over the individual, cohesion over competition, risk-sharing over profit-making, and social stability over change. She traces the historical roots of communitarian capitalism to the wartime and the postwar period, when the desire to promote economic self-sufficiency and national autonomy and practices such as lifetime employment, seniority wages, *Keiretsu* groups and the *yokonarabi* competition began to emerge.[1] Moreover, as Japan's capitalist system coalesced after the war, such ideas and practices were institutionalized over time and became invisible yet powerful norms that permeated state agencies and firms and consolidated communitarian institutions and policies.

For Anchordoguy, the entrenchment of these norms constitutes an important explanation for both the rise and the current stagnation of Japan's economy. During the period of catch-up under a relatively stable technological trajectory, she argues, communal norms contributed to the formation of broad consensus in favor of industrial development and allowed the state to manage market for both economic and social goals. The *keiretsu* ties reduced transaction costs and concentrated scarce resources, thus helping to nurture the world-class competitors in specific industries. However, she finds that such risk-sharing and stability-promoting norms also resulted in rigid sets of employees and suppliers and similar firm strategies and product lines that stifled further innovation. Thus when technological change became rapid and unpredictable in the 1980s and 1990s, the strength of communitarian capitalism changed into a hindrance for technological progress, insulating Japanese firm from the gales of Schumpeterian 'creative destruction'. This proposition is supported by her empirical studies of high technology industries. For example, both her cases of telecommunications and software industries have demonstrated that while the postwar technonationalism and the MITI-led developmental route contributed to Japan's catching up with the world leaders such as AT&T and IBM, the industries found it hard to forge their own paths when foreign products could no longer be easily reverse-engineered. By relying on an obsolete factory approach that emphasized productivity rather than creativity and by using a set of domestic rather than global product standards, Japan became increasingly out of step with the world's leading technology since 1980s.

What Anchordoguy seeks to show here is not simply a scenario where a shift in global context creates a 'mismatch' between institutional environment and institutional functions. She also aims to demonstrate how deep seated norms further exacerbated the problem by preventing institutional adaptation and delaying the actors' response to global challenges of rapid technological development. A crucial thread running throughout the theoretical and empirical chapters is the way in which government and firms started to contest previous norms and practices but were extremely reluctant to switch their strategies. The results were a series of foot-dragging processes and incremental reform steps, richly depicted in Anchordoguy's detailed analysis of state and business reforms. The viability of lifetime employment was questioned but aversion to firing workers persisted. Corporate reforms were launched but firms were unwilling to cut off loyal suppliers. The limitation of using closed standards was recognized but none of the firms wanted to take the risk of switching to new technology. Introduction of competition was on the agenda but restriction on the emergence of winners and losers remained strong. Anchordoguy warns that such sluggish reform steps could only deepen the 'crisis' of communitarian capitalism. As the Japanese are clinging to the current system, she laments, the state, firms, and citizens chose economic decline by default.

The power of norms

Norms acquire a pivotal role in Anchordoguy's book. Builiding on a sociological institutionalist perspective, she views norms as 'routinized, taken for granted understandings about the way things are done'. By drawing attention to how such understandings heavily influence actors' choices, she poses a useful challenge to the rational choice assumption that individuals are autonomous maximizers of self-interest. If an agent's behavior is simply determined by carefully weighing economic costs and benefits, she questions, why should firms be unwilling to introduce merit-based wages, fire redundant workers or abandon obsolete suppliers even when such practices have been hurting economic efficiency for more than 15 years?

Without denying that firms, politicians and bureaucrats do pursue their self-interest, she contends that norms heavily influence and even fundamentally shape the way in which actors *perceive* their interests. Her understanding of relations between institutions and individual actions is heavily influenced by March and Olsen's 'logic of appropriateness' and the Weberian concerns of legitimacy (March and Olsen, 1989; Weber, 1978). Actors adhere to 'normal' patterns of behavior even when it harms their economic interest. They prize legitimacy over efficiency because norms profoundly shape the ways in which society perceives the role of firms, labor and capital in the economy. According to her account, for example, the firm in Japan is not just viewed as an instrument for pursuing profit, but a social unit upon which every aspect of an employee's life depends. Labor is not regarded as merely a variable input, but the most essential part of the enterprise. Firms followed the 'logic of the organization' (*soshiki no ronri*) rather than the 'logic of capital' (*shihon no ronri*), and they rejected the laissez faire competitive model (*kyoso hitei shugi*) and embraced instead a model of managed competition (Anchordoguy, 2005: 37, 125). Anchordoguy usefully reminds us that these shared communitarian perceptions and beliefs, accumulated from historical experiences and taking the form of intricate social conventions, can often be more useful than formal rules and laws for understanding Japan. This is embodied in Anchordoguy's study of various group behaviors, ranging from the state's perseverance to maintain sociopolitical stability, the firms' adherence to employee-first management and its aversion to big winners and losers, to citizens' valuation of egalitarianism and consumers' support of more expensive domestic industrial products.

Examining Japan's political economy through the lens of communitarian norms also helps overcome limitations in previous accounts of Japan's success or problems. The developmental state literature, for instance, focused overwhelmingly on the role of the state in promoting industrial growth without giving adequate attention to firms and citizens as well as the broad social context (Amsden, 1989; Evans, 1995; Johnson, 1982; Wade, 1990). Similar problems can also be observed in literature that attributes Japan's economic pathology to macroeconomic errors such as monetary and fiscal policies. Recognizing these limits, Anchordoguy seeks to bring society back into the analysis of Japan's political economy. She shows convincingly that without investigating social norms that govern the economic system, one could not reach a deeper understanding of the strengths and the weaknesses of Japan's capitalism. Moreover, instead of being limited to separate sets of static factors deriving from different periods of Japan's economic development, Anchordoguy draws attention to how largely the same institutions and norms can produce different results under changing economic and technological conditions. This enables her to situate the account in a longer time horizon and brings to the forefront the important issue of how institutions emerge, persist and adapt over time.

Institutional resilience or institutional immutability?

Anchordoguy's study highlights a substantial level of institutional inertia rooted in communitarian capitalism. She shows that the set of norms and institutions established under particular historical circumstances are particularly resistant to change despite the apparent economic inefficiencies they produce. Such a high degree of path dependence and institutional resilience provides a useful example in support of the historical institutionalists' critique of functionalist accounts of institutional change, which are typically optimistic about the plasticity of institutions and the autonomous adaptation or refinement of institutions in response to current needs (Williamson, 1993). While the mechanisms of learning or competition identified by functionalists may sometimes indeed lead to change, Anchordoguy's case study suggests that such dynamics may be far easier to be assumed than demonstrated. The barriers that reformers need to overcome can be substantial particularly when institutions have been in place for a considerable period of time.

However, there is a risk in viewing her main argument simply as a claim of institutional immutability. As both Thelen and Pierson have cautioned, analyses of path dependence and institutional inertia can easily become descriptions rather than explanations, unless one can specify particular mechanisms of institutional reproduction (Pierson, 2004; Thelen, 1999). However, Anchordoguy remains largely vague about the exact mechanisms that are at work, and fills this lacuna with an account of the persistence and prevalence of norms. While as mentioned above, norms have certainly played an important role in shaping actors' perceptions and behaviors, the question remains what channels or factors enable norms of communitarian capitalism to effectively counter and transcend strong pressure for change and to reproduce or even reinforce previous institutions. In many chapters, communitarian capitalism seems to have become synonymous with the 'culture' of Japanese society as a whole, while in other chapters it is analytically conflated with actual policies. The brush of norms is too broad for one to identify the level of causation, and institutional inertia in her analysis seems to carry the burden of both independent and dependent variables.

Ambiguity about the mechanisms of institutional reproduction can also give rise to problems in dealing with the prospects of institutional change. While throughout the empirical chapters Anchordoguy mentions various aspects of reforms and changes in state policies and business practices, she immediately points out how slow and little these changes are particularly in comparison to the rapid changes unleashed by market forces in US. However, precisely because the mechanisms of institutional inertia are unspecified, one would question to what extent have such changes begun to combat the forces of institutional inertia and to what extent they have not. How should one judge whether changes are 'too' incremental? Can incremental steps amount to large departures from past institutions even without a US style rate of change?

Furthermore, even dealing with rapid and incremental innovation requires very different organizational capacities and social relations, one would wonder whether Japan is indeed as vulnerable to global changes as she observes. After all, state agencies and firms in Japan were once praised for their capacity to tame market forces for developmental goals and harnessing international environment for domestic benefits. Particularly, as mentioned by Anchordoguy herself as well as shown in other studies, government agencies and several large firms have taken the leading role in experimenting with new corporate governance, stock options, and R&D approaches to encourage creativity and innovation (Vogel, 2006; Weiss, 2000). Thus it is questionable whether agents, although constrained by norms, are entirely enslaved by them. In addition, one would have a good reason to expect that different individuals or organizational actors respond differently to external pressures, and display uneven capacity for adaptation rather than what she describes as a 'simultaneous and homogeneous' slow response. In short, more concrete levels of causal mechanisms should be established to better understand how institutions in Japan's economy persist and change, and more empirical examination is needed in order to assess how agents' response are affecting Japan's industrial development.

SOCIAL COORDINATION AND INSTITUTIONAL ADJUSTMENT

Witt also views the world's entry into the information technology age as a major challenge and seeks to explain the slow rate of institutional change in Japan. But Witt addresses a broader concern of the fate of all coordinated market economies, which have generally lagged behind liberal market economies in terms of growth rate and per capita GDP from 1993 to 2003. He approaches the case of Japan by first demonstrating empirically that Japan's adaptation to the changing world economy has indeed been slow. This constitutes a useful effort, given the divided views on the degree of Japan's institutional change since the 1980s. Drawing on Redding's business systems model, Witt examines institutional change at the levels of culture, business environment, and business system. Both first hand interviews and second hand survey data suggest that although there have been observable changes in terms of ownership, overall there has been 'limited change in the rules of the game of Japanese business despite its one-and-a-half decades of economic pain (Witt, 2006: 17). For example, he finds that Japanese continue to hold the stakeholder view in favor of the shareholder view, value groups more than individuals, rely predominantly on banks rather than the markets for corporate funding, and emphasize the importance of employer–employee dependence.[2] These findings largely resonate with Anchordoguy's observations and provide an empirical foundation for rest of the analysis.

In his search for factors contributing to Japan's slow changing steps, Witt's findings resonate with previous studies that suggest two important mechanisms of institutional inertia: the role of vested interests and the lock-in effect of present institutions because of institutional complementarities. However, he raises an interesting question: since these factors exist in almost any institutional structure, why is their influence seeming to be more salient in Japan? Witt attributes his answers to the high level of societal coordination within the Japanes business system, which influences the *type* of institutional adjustment for the national economy. According to him, CMEs such as Japan and Germany are typically subjected to the processes of coordinated adjustment, as opposed to autonomous adjustment processes in LMEs. The former involve extensive bargaining and consensus-building process among actors at the aggregate level, such as employer associations, labor unions, interest groups and government, whereas the latter occur in the form of institutional innovations without involving active consultation with external actors. Compared with the autonomous adjustment processes, the coordinated adjustment processes leave actors of vested interests more chance to voice their needs and influence the bargaining processes. Meanwhile, these processes are also more likely to produce complementary institutions as they made it easier for major actors governed by these institutional structures to cooperate among one another in designing these institutions. As a result, CMEs were more subject to the influence of vested interests and institutional complementarities and were overall less flexible and adaptable.

Moreover, and crucial for Witt's analysis, these two adjustment processes incur different degree of risks to the whole system. Not only do actors in coordinated adjustment processes tend to generate universal, collective solutions that hardly fit various concrete, 'on the spot' needs, but once they get the initial response wrong, it may be difficult to correct, which entails negative impact on the entire institutional structure. By contrast, in the autonomous adjustment processes, individual firms at the micro-level autonomously search solutions for emerging problems and produce multitude of institutional innovations. While these processes may imply risk for each actor as a result of partial information and insufficient analytical capabilities, they have relatively little risk for the whole system, making mismatches between institutions and environment easier to correct.

He further supports his argument through a regression analysis which shows that from 1993 to 2003, the degree of societal coordination in major economies was negatively linked with growth rates and the amount of decrease in unemployment rates. This represents a striking departure from the period examined in Hall and Soskice's study, when CMEs paired comparable growth with lower unemployment rates than LMEs (Hall and Soskice, 2001: 20). Based on the evidence, Witt proposes a 'social capital as a public bad' thesis, arguing that the high level of social coordination and social capital one found in Japan and other CMEs may do more harm than good to the economy with the increased uncertainty and competition that accommodate with the coming of information technology age.

Contributing to Japan's slow rate of adaptation still further, argues Witt, is not only the coordinated response at the aggregate level, as other CMEs, but what he identifies as the relatively limited adjustment pressure from the micro-level actors such as individuals and firms. Differing from studies that focus on how micro-level actions influence institutional change through intentional collective action such as political bargaining, grassroots movements, and demonstrations, Witt draws attention to those autonomous, unintended and unofficial actions such as tax evasion and capital flight. These actions are initially only individual responses to institutional misalignment, but they may accumulate and build up pressure for change over time. However, Witt finds that compared with other CMEs, Japan has relatively less deviant behaviors of tax evasion and capital flight, indicated by smaller size and slower growth of shadow economy and outward FDI stock, respectively.[3] The low degree of deviance and pressure for change paired with a high level of social coordination has contributed to slowing down the rate of adjustment of the entire economy.

The prevalence of social networks

For Witt, the key mechanism that both facilitates societal coordination and prevents deviant behaviors at micro-level is the dense social networks permeating the business system in Japan. While the idea of networks is not new to studies of Japanese political economy, it is more often linked to the role of creating consensus and harmonizing public–private relations (Gerlach, 1992; Lincoln and Gerlach, 2004; Okimoto, 1998). By contrast, Witt draws attention to the possible ways that social networks can influence the rate of institutional adjustment. These networks, he suggests, not only lubricates coordination, but can also act as conduits of information, norms and values that transmit the pressure for compliance with existing institutions and practices. In addition, they also constitute important monitoring and controlling mechanism against deviant behaviors. While Witt also mentions the sort of communitarian norms emphasized by Anchordoguy, such as the spirit of 'hammering in the nail that stands out' and the habit of promoting acquiescence against idiosyncrasy and dissension, his study of various forms of social networks complements Anchordoguy's account by clarifying the channels and mechanisms that spread, diffuse and reinforce the communitarian norms.

In his empirical chapters, Witt examines in detail the operation of several major forms of social networks in Japan's business system: business groups, vertical *keiretsu*, R&D consortia, and the state–associations–firms nexus. He shows in comparative perspective that Japanese firms rely on networks much more heavily than those in the US, and at a similar level to Germany. Moreover, he brings to light a taken-for-granted and previously under-explored form of business networks, intra-industry loops, which go beyond formal state organizations to include informal networking within an industry and the links between certain industry and universities, banks, and the press (Witt, 2006: 106–46). He illustrates the characters, patterns and intensity of intra-industry loops through first hand survey data of three cases, the micromachines, semiconductor equipment, and the apparel industries, representing, respectively, the sunrise, mature, and sunset industries. He further finds that the perceived importance of network and frequency of using network ties vary with the life cycle of industries, with micromachines and apparel industries being higher than the semiconductor industry. While the findings have certainly made important empirical contributions to our understanding of Japanese capitalism, particularly in terms of intra-industry networks, they still leave many important questions unanswered.

As an impediment for institutional adjustment?

Witt and Anchordoguy share a similarly pessimistic view on Japan's response to increasing uncertainty and competition in the world economy. For both, this view is derived from the slow pace of institutional adjustment and adaptation observed in Japan's business since the 1980s, particularly when using the US as a reference point. While both of them concede that there have been certain changes, they emphasize the special characteristics of Japanese capitalism that dampen the flexibility and adaptability of institutions to a changing environment. Different from Anchordoguy, Witt demonstrates empirically that there indeed have been limited changes in Japan's business system over the past one or two decades. He also specifies the key mechanism for the slow adjustment – the social networks prevalent among Japanese firms. However, he seems to have made these networks his final target of investigation, and falls short of providing sufficient evidence in support of the hypothetical effects that networks should have on institutional adjustment. As he makes clear at the beginning of the book, 'What the book does is to provide theoretical argument and empirical evidence suggesting that societal coordination is inimical to quick institutional adjustment, with concomitant costs in terms of economic performance' (Witt, 2006: 16). However, there exists an observable 'gap' between his theoretical propositions and his empirical studies.

An original argument of the book mentioned above, for example, is that social networks and social capital can represent 'public bad' and burdensome obligations for involved parties, which forestall micro-level actions even in the face of institutional misalignment, thus 'there may be such as a thing as too much social capital' (Witt, 2006: 15). However, most of his empirical part focuses on examining the formation, features, contents, and operation of these networks, and to the extent that their effects are mentioned, they always serve beneficial purposes, ranging from coping with uncertainty, building mutual trust, to sharing information and technology. If it is indeed, as he suggests, that the type of coordination is beneficial for individual firms but harms the whole business system, where should we find the evidence for such an argument? Probably the only convincing example that shows the detrimental effects of networks is the R&D consortium in the micromachine industry, which spent large funding for research in what in hindsight was an inferior production technology (2006: 145). However, except for this half page long example, causal relations between societal coordination and institutional adjustment remain largely hypothetical, and statements of such relations occur in the form such as the networks 'may lead the entire industry down a technological path', or are 'likely to deprive the political economy of a potential source of institutional innovation' (2006: 180). In other places, we are told that where the coordinative capacity is involved, slow rates of institutional adjustment is simply known 'by extension' (2006: 105).

However, one would question, for example, why coordinated adjustment will necessarily lead to institutional rigidity instead of more flexibility? If social networks, as Witt's study shows, can serve as a useful buffer against the external shocks and provide a bridge period for actors to adjust their paces, and moreover, can provide necessary or even indispensable sources for reducing uncertainty in hard times as Japan now faces, why should we not expect such a mechanism to facilitate rather than block institutional adaptation? In other words, the statement that the process of coordinated adjustment is less efficient than that of autonomous adjustment may not be necessarily held for Japan's case without further evidence. Therefore, although Witt provides us with thought-provoking propositions on the mechanism responsible for Japan's slow adaptation, in the absence of clear evaluation of the benefits and costs brought by social coordination and social networks, both his account of the pattern of institutional adjustment and his prescriptions for faster adaptation are yet to be justified.

VARIETY OF REFORMS AND INSTITUTIONAL CHANGE

In contrast to Anchordoguy's and Witt's works, which are mainly concerned with Japan's institutional inertia and rigidity, Vogel's work presents us with a more dynamic picture of institutional adaptation and change under the impetus of economic pressures. In this ambitious study, Vogel provides one of the most comprehensive analyses of current reforms that the Japanese government and private sectors are undertaking since the 1990s, ranging from labor relations and financial system to corporate governance and supply networks. More importantly, he is able to capture and theorize the *actual patterns* in which these institutions are evolving, which constitutes a valuable contribution given Japan's currently complicated situation. As with Anchordoguy and Witt, Vogel draws attention to the fact that the essence of Japan's model has been preserved despite the ongoing reform process to liberalize the economy. However, he contends that existing institutions do not merely act as an impediment for further reforms, but actively shape the trajectories of institutional change by enabling institutional innovation. Through empirically rich analysis and sophisticated assessment, Vogel convincingly demonstrates that government agencies and industries in Japan have strived to adjust to environmental change as much as possible by maintaining and making new use out of existing institutions.

Vogel's work not only contributes to the understanding of Japan's common mode of institutional adaptation, but also elucidates helpfully the variation of reforms across issue areas and industries. He finds that in areas that are more exposed to US pressures, such as liberalizing stock commissions, and those that are relatively less politicized, such as corporate law and accounting, reforms have progressed relatively faster. By contrast, Japan has moved slowly and cautiously in resolving its banking crisis and combating deflation, the area that has experienced the most severe crisis. In terms of corporate restructuring, Vogel finds that the pace of reforms varies depending on corporate performance, ownership, production patterns and age of the industry. Among them, foreign ownership has had a clear impact on the degree of restructuring, as illustrated in his comparison of Toyota and Nissan. Whereas the former strengthened its ties with suppliers and refused to convert to a more liberal model, the later started the radical restructuring under a dramatic 'revival plan'.

The cross issue and cross industry comparisons depart from Anchordoguy and Witt's depictions, which took a somewhat monolithic view on institutional inertia or adjustment across the whole nation. Vogel paints a more sophisticated picture of how agents respond and adapt to pressure in different patterns and in various rates. Moreover, as Vogel suggests, this raises the question to the VOC perspective of 'how tightly the different parts of the Japanese system are linked' (Vogel, 2006: 113). Particularly, variation across issue area implies that institutional complementarities might be overstated. The increasing diversity among Japanese corporations questions the monolithic model of capitalism on the national level and suggests the possibility for different models to coexist within national boundaries.

Patterned innovation

For Vogel (2006: 216), patterned innovation, meaning 'innovation shaped by existing institutions', constitutes the core mode of adjustment in Japan since the 1990s. This pattern, Vogel suggests, differs from both the fundamental breaks with the past that Japan experienced in the Meiji Restoration and the Second World War or the routine adjustments prevalent in the 1970s. While the existing institutions have left a heavy imprint on various reform measures and have prevented Japan from converging on the liberal market model, the prolonged economic crisis and the growing pressures from global market have propelled actors to go beyond routine adjustments. Thus actors respond by *leveraging* the benefits of existing institutions to ride out their problems. For example, Vogel finds that Japanese firms utilized dense corporate networks to shift lifetime employment guarantee from the firm to the corporate group or to transfer their excess workers to subsidiaries so as to cut labor costs without violating their previous commitment. The financial sector has transformed to universal banking, but firms and banks have not abandoned each other; instead, they have drawn on their close ties to renegotiate new relations in the face of economic stagnation. MITI (METI since 2001) has maintained the tools of industrial policy and its close relation with private sectors, but has used them for upgrading technological capabilities and facilitating corporate restructuring instead of providing direct guidance. Government and industry have together preserved the essence of Japan's core institutions yet remodeled the economy into a more selective, more differentiated and more open system.

Through these empirical examples, Vogel sheds light on the way in which industries and government actively devise innovative solutions for new problems instead of being entirely constrained by institutional settings. Compared with Anchordoguy and Witt, who place emphasis on the negative effects of the strong norms that agents committed to or the dense social networks that they are enmeshed in, Vogel takes a more optimistic tone about the useful resources existing institutions can provide and the capacity of adaptation that agents possess, although within an acceptable range circumscribed by existing norms and institutions. Given the uneven pace and the ambivalent results of reforms suggested in the three works, it would be too early to come to any final judgment about Japan's overall institutional adaptability. Yet Vogel's work usefully reminds us that even when the main attributes of institutions remain in place, there is the possibility of what Thelen has termed 'institutional conversion', the situation in which actors innovatively use old institutions to serve new purpose and drive institutions to gradually evolve in new directions (Thelen, 2004).

Vogel further adds breadth to his study by placing Japan within an comparative perspective and contrasting its reform and restructuring process with that of Germany and US. Building on the VOC approach, he finds that different comparative institutional advantage has not only produced different types of economies, but also different styles of reforms and solutions. For example, since US corporations are less reliant on long-term cooperative relations with workers, banks, and suppliers, they have pursued liberalization and restructuring much more aggressively than their Japanese counterparts through policies of deregulation and through large-scale downsizing of workforce. Germany's similar institutional contexts with Japan have produced like-minded ambivalence about liberal reforms. But since German corporate networks are not as dense as Japan's *keiretsu*, they have not used job transfers within corporate groups, but have chosen to shorten work hours and design early retirement plans. These differences provide good support for Vogel's 'patterned innovation' argument that actors can both maintain the essence of existing institutions and utilize them as rich resources in revising the system. Meanwhile it also sheds new light on the VOC perspective by showing that comparative institutional advantages do not only produce variety of capitalist systems, but can also influence the ways in which the national economy gradually evolves and results in a variety of reforms.

An integrated model of institutional change

Based on the varieties of reform in Japan, Vogel proposes a model of institutional change that is not only helpful in capturing the pattern of reforms in Japan, but also contributes to the theoretical understanding of institutional dynamics more broadly. His model first of all provides a complementary understanding of the diversified logic of institutional analyses. Different from Anchordoguy's and Witt's studies, which tend to emphasize the sociological interpretation of actors' interests (either shaped by social norms or influenced by networks), Vogel suggests that it would be more useful to integrate the simple cost–benefit analysis from economic calculation, the comparative institutional logic from VOC approach, and the social considerations from the sociological perspective into what he calls 'three circles of rationality'. For example, he finds a combination of three logics to various degrees in his detailed case studies of how companies simultaneously reduce costs to increase efficiency, reorganize to enhance their comparative institutional advantage, and respond to changing social norms. Instead of trying to identify which logic trumps another, Vogel sheds light on how they interact and combine to shape final reform outcomes.

More importantly, Vogel's model brings to light the crucial role of micro–macro interaction in shaping the path of institutional evolution. On the one hand, he builds on the VOC perspective and emphasizes the micro logic of macro-level policies. Critical to political economy models that directly deduce industry policy preferences from actors' macro position within an economy, he suggests that firm level preferences, mediated through political institutions, can further shape and modify macro policy preferences. In the case of Japan, this is reflected in how firm level attitudes towards reforms were aggregated by industry associations so as to influence the decision-making process of political parties and government leaders. On the other hand, Vogel also demonstrates how macro-level policies, such as government laws and regulations, modify the constraints and opportunities for micro-level actors and shape their possible strategies of responding to change. This is shown, for example, in ways by which firms and banks leverage benefits of existing institutions to deal with policies in employment and financial regulations. By exploring the pattern of micro–macro interactions, Vogel sheds light on how adjustments at one level affect adjustments at the other level and how government and industry interact repeatedly to produce a transformation in a path-dependent yet creative way.

CONCLUSION: JAPANESE CAPITALISM IN TRANSITION

The three volumes have collectively highlighted the ways in which Japanese capitalism is evolving sine the 1980s, focusing, respectively, on the sources of institutional inertia, the mechanism of institutional adjustment, and the patterns of institutional change. On the one hand, they agree that Japan has not experienced a fundamental break with the past and has strived to preserve as much as possible the core elements of its capitalism, among which are lifetime employment, seniority wages, *keiretsu* networks, and bank credit-based financial system. On the other hand, they also find that existing institutions and practices do not stand still, but are constantly contested and gradually revised under *gaiatsu* and *naiatsu* (foreign and domestic pressures).Their scholarship demonstrates that in the case of Japan, it is not helpful to separate the understanding of institutional continuity from that of change, and it is more appropriate to conceive its capitalist system as a set of constantly evolving institutions and norms instead of a stable equilibrium. Furthermore, their works suggest the importance of going beyond simple cost–benefit calculation of economic interests in understanding the behaviors of government and industries. Particularly, existing institutions and norms have shaped the ways in which actors perceive their interests, define their menu of available strategies, and aggregate their preferences in particular ways to influence the pattern and pace of reforms.

Nevertheless, these three studies differ on their observation and theoretical understanding of Japan's institutional continuity and change.

Anchordoguy sees changes since the late 1980s or 1990s as overwhelmingly incremental, fundamentally communitarian, and extremely limited. She gives predominant attention to the overarching norms characterizing Japan's capitalism, which penetrate various economic practices, stifle the emergence of new firms, ideas, and organizational forms, create strong institutional inertia, and delay the steps of institutional adaptation of the whole economy. Witt shares a similar view regarding the limitation of Japan's change, but concentrates on examining how micro-level business networks, as an important mechanism for a high level of social coordination and low level of deviant behavior, contribute to the slow rate of institutional adjustment. By contrast, Vogel sees more variation in reform pace, and draws attention to how the Japanese model shapes its own path of transformation at both the macro- and the micro-levels and how government and industries interact with each other in making innovative use of existing institutions to solve new problems.

How can these three divergent findings be reconciled when they seem to base their interpretations on largely the same sets of empirical facts? Do the authors merely see what they look for through their own colored glasses? Further empirical evidence must be consulted to assess the merits of these different models, given that the current outcome of Japan's reform is ambivalent at best. Yet taken together, there is a good reason to believe that Japanese capitalism has been revising and adapting itself to the new conditions. First, it is doubtful whether existing institutional arrangements are as unfavorable for Japan's adaptation to new environment as Anchorchoduy and Witt suggest, particularly in consideration of the inadequacies of their works in justifying causal relations between norms or networks and their actual influence on institutional adjustment. Meanwhile, the extent to which adjustment and change is thwarted by institutional complementarities may be overstated. For example, both Witt and Vogel have identified foreign ownership as an important impetus for more merit-based and shareholder-friendly restructuring and a potential source to unravel institutional complementarities.

Moreover, the period of economic transition as what Japan and many other CMEs are now experiencing is particularly characterized by a high degree of uncertainty and intense debate of norms, ideas and policies, as shown in all three studies. Under such circumstances, entrepreneurial agents are expected to play larger roles in articulating and advancing their interests as opposed to more stable time when they often simply follow conventional rules, norms and procedures. The three studies show to various degrees that government agencies such as MITI (METI) and several leading firms such as Nissan have played crucial roles in defying and modifying previous practices, diffusing new ideas, packaging delicate compromises, and making cautious steps towards liberalization. Institutions thus not only condition and constrain agents' behaviors as Anchordoguy and

Witt suggest, but can also become important resources that actors draw on to search and negotiate for new solutions. This is a perspective embodied in Vogel's notion of 'patterned innovation' and also advocated by Hall and Thelen's recent study which uses the 'institutions as resources' approach in understanding institutional change in VOC (Hall and Thelen, 2005). This perspective is particularly important for examining institutional development as in contemporary Japan and Germany, where various institutions, while conditioned by their previous paths, are less likely to evolve *automatically* but are typically subjected to the contestation and maneuvering of politicians, bureaucrats and firms. Such contestation and revision processes, as Vogel illustrates, should not be conceived as only taking place at the micro-level, but should be better captured by the micro–macro loop running through the dynamic interactions between government policymakers and business actors.

However, greater tension exists among the messages these works carry about Japan's future and the policy implications they contain. While they all seem to agree that it is *unlikely* for Japan to completely converge on the US model, they divide fundamentally on the *desirability* of transferring to a US style liberal market model. Anchordoguy expresses the most direct criticism for Japan's hesitance in reforming current system, regarding this as a process in which 'Japanese are languishing together' (Anchordoguy, 2005: 234). She argues that Japan needs to redefine its social norms so as to give greater role for market competition in order to overcome the quandary. In other words, Japan must negotiate a new 'social contract' that would not only offer a safety net for those who fail but also reward those who succeed. Witt recommends a more careful weighing of cost and benefits in transforming to a US style system, but shares the fundamental concern that 'the stability under which coordinated market economies seem to thrive may never return' (Witt, 2006: 189). He sees the least risky approach for Japan to solve the current problem is not to destroy societal coordination, but to increase its adaptive responsiveness and to create more room for autonomous adjustments. Yet he views the adoption of such a change as a process which is lengthy and arduous, if not impossible. Vogel holds a more cautious attitude towards liberal market reforms and suggests that there is no clear evidence whether imitating the US model will indeed benefit Japan. He implicitly argues against abandoning the old model and an immediate switch to liberal norms and institutions. Instead, he holds a more optimistic view than both Anchordoguy's and Witt's and sees the gradual revision of the Japanese model based on learning and innovation process as a reasonable and plausible response to current problems.

Exploring the essence of this disagreement brings our attention to the ongoing struggle of two forces at a broader level: the force of globalization, liberalization and deregulation that propel national economies to converge on the liberal market models on the one hand, and the force of historically evolved national institutional settings that maintain the variety of capitalist systems on the other hand. To be sure, the case of Japan involves problems accumulated from its specific developmental path and is further complicated by the bursting of financial bubbles. Nevertheless, it constitutes an important example of how CMEs respond to the tension of these two forces.

The VOC literature predicts that even under the pressure of liberalization and deregulation, one should still expect to see a bifurcation between CMEs and LMEs, as firms and government will struggle to maintain their comparative institutional advantages (Hall and Soskice, 2001: 58). However, a crucial question raised by Anchordoguy and Witt in their volumes is to what extent such advantages *continue to exist* for CMEs in general and for Japan in particular. While CMEs may have sustained the resurgence of liberal markets since 1970s, it seems more dubitable, as noted by Anchordoguy and Witt, whether they can sustain the gale of 'creative destruction' advanced by technological revolution and the overwhelmingly severe international competition since 1980s and 1990s. Such an era of increased uncertainty and competition may be inherently at odds with stability, social coordination and incremental innovation, the hallmarks of CMEs. In particular, a series of liberal reforms that Japan and Germany launched in recent years suggest there may indeed be an asymmetry regarding institutional change leaning towards the direction of LMEs.

On the other hand, however, if we place the current situation into a longer historical perspective, as some scholars have suggested, the current turmoil aroused by the technological breakthrough may be followed by a maturation phase, a period more suitable for Japan and Germany to explore their institutional advantages (Boyer, 2003; Yamamura, 2003). While it remains to be seen whether this period will eventually come, the case of Japan shows that even under the current unfavorable circumstances – the dual pressures of international competition and domestic crisis – the institutions of CMEs are not as fragile and easy to destroy as some suppose. Other evidence has indicated that the differences between CMEs and LMEs have even widened rather than narrowed in recent years (Hall and Soskice, 2003). It is further possible, as suggested in Vogel's study, for multiple models to coexist within national boundaries instead of having one coherent model dominating the entire economy. Moreover, even though CMEs are all transforming into more liberalized and more open economic systems, the ways in which they reform their economy and the degree of liberalization they seek to pursue are likely to diverge among various institutional settings. These observations call for in-depth studies on the sources, mechanisms and patterns of institutional inertia, adjustment and change in CMEs represented by the three important works reviewed in this article.

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NOTES

1 *Yokonarabi* competition literally refers to horizontal competition while lined up side by side or homogeneous competition (Anchordoguy, 2005: 13–16). The notion insists on keeping the same pace and quality among competitors rather than outmaneuvering.
2 In the stakeholder view, according to Witt, the owners and the employees should both participate in the selection of managers, whereas in the shareholder view, the owners should run their business or appoint the manager.
3 Witt attributes the causes of this phenomenon to Japan's insular geography, the continued legitimacy that current economic institutions enjoy, and the conformity pressures deriving from established norms.

NOTES ON CONTRIBUTOR

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