

Introduction

The Puzzle of Japan's Welfare Capitalism

THE REAL VARIETIES OF WELFARE CAPITALISM

Japan's welfare state is puzzling. On most measures, Japan's welfare state is small. Its social spending levels are low; its tax revenue is small; and its benefit levels are meager (Figure 0.1).¹ Japan's social spending programs are among the least redistributive in the advanced industrial world (Table 0.1). At first glance, Japan's small welfare spending appears to confirm the conventional scholarly wisdom that attributes the development of a generous and redistributive welfare state to a strong social democratic party – supported by well-organized and centralized labor unions. Yet despite its meager social spending, Japan has nonetheless managed to achieve a fairly egalitarian income distribution. This situation stands in marked contrast to other countries with similarly small welfare states, including the United Kingdom and the United States, which remain the least egalitarian of the advanced industrial democracies.² Japan's "small" welfare state does not, in short, mean that Japan possesses a *laissez-faire* form of capitalism. On the contrary, the Japanese state interferes frequently and extensively with the market. Just as Sweden uses social policy as a form of industrial policy, Japan uses industrial policy as a form of social policy.³

¹ Unless otherwise noted, this chapter and Chapter 1 use the year 1990 as the base year of international comparison. I choose this year for two reasons. First, influential comparative studies that established different regime types used the data for the 1980s and the early 1990s, so using the date from the same period is a good strategy to highlight the difference between existing studies and my approach. Second, choosing 1990 as the base year allows me to highlight policy shifts that occurred since then.

² I cannot agree more with John Campbell (1992), who emphasizes the heuristic importance of the Japanese case. Japan has so often been treated as an outlier in comparative studies of advanced industrial societies. The literature on neocorporatism best illustrates the enigmatic status of Japan in comparative studies. In particular, see Kenworthy (1995), Korpi (1985), Shalev (1990), Siaroff (1999), and Soskice (1990a, 1990b).

³ See Pontusson (1991) for a similar point. Pempel (1991) makes a fascinating contrast between Japan and Sweden. For a different Japan-Sweden comparison, see Gould (1993).

TABLE O.I. *Country Ranking on Equality*

Pre-Tax/Transfer	Post-Tax/Transfer
Belgium	Finland
JAPAN	Belgium
Netherlands	Netherlands
Italy	Germany
Canada	Sweden
Finland	JAPAN
Germany	Canada
Switzerland	France
United States	Italy
France	United Kingdom
United Kingdom	Ireland
Sweden	Switzerland
Ireland	United States

Source: Provided by Chiaki Moriguchi (The data are based on the mid- and late-1980s.). See Moriguchi and Saez (2006).

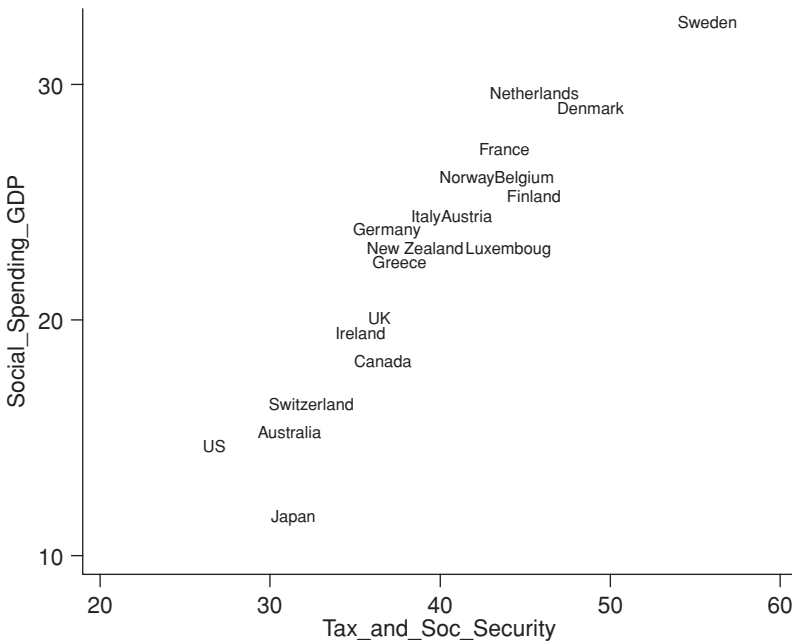


FIGURE O.I. Taxation and Social Spending as Percentage of GDP (1990). Source: OECD dataset. (Figures for taxation include revenue from social security contributions.)

This book offers a new way of thinking about welfare states and the politics that produces and sustains such states. Most studies of welfare states focus exclusively on a narrow range of social spending programs and rarely ask how different countries draw upon a combination of nonwelfare policies to protect

their citizens' well-being. This book broadens the traditional analysis of the welfare state by introducing the concept of functional equivalent programs.⁴ Welfare state studies have long ignored public works, subsidies to rural families, market-restricting regulations, and employment protections as mechanisms to protect the livelihood of citizens. Imagine, for instance, a middle-aged farmer in rural Niigata Prefecture without many nonagricultural job opportunities. The agricultural subsidies that he receives protect not only his job but the livelihood of his family. They are important functional equivalents to full employment policy and to more orthodox income transfers to families.

When viewed in this broader perspective, Japan possesses a much bigger welfare state than comparative welfare state scholars have recognized. Japan, while lagging behind large European welfare states in its public income transfers and social services to working-age citizens, has relied instead on functional equivalent programs, which go uncaptured by statistics on social spending.⁵ By extending the analysis to functional equivalent programs, one can identify the specific features of Japan's social protection.

Many of these functional equivalents in Japan either promote work-mediated welfare benefits or protect jobs. The Japanese government has used functional equivalents to deliver protection to very specific groups of beneficiaries – such as industries, occupational groups, and even businesses and citizens in specific geographical areas. Japan's social security programs have, partly as a consequence, developed in a highly fragmented manner. The two largest items – pension and health care – both developed as occupationally based social insurance schemes. In fact, Japan's social spending is heavily concentrated in old-age pension and health care payments.⁶ Despite Japan's meager benefits for working-age wage

⁴ Scholars of American social policy have been much better than scholars of European welfare states in recognizing the importance of functional equivalents. Dobbin (1992), Dobbin and Boychuk (1996), Hacker (2002), Quadagno and Hardy (1996), and Stevens (1990) in particular have looked at employer-provided corporate programs and other market-based welfare products. Howard (1997) focuses on tax expenditures. Salamon (1989) and Kamerman and Kahn (1989) discuss a whole range of policy tools at the disposal of the government to deliver protection. For a rare comparative study that uses a similar concept of functional equivalents, see Bonoli (2003).

⁵ In his typically thorough and insightful analysis of Japan's pension policy, Campbell (1992) notes how Japan has resorted to policies that stimulate activity rates of the elderly as a functional equivalent to orthodox programs. Calder's work on the postwar Japanese politics – now a classic – also demonstrates how Japan frequently relied on functional equivalents (Calder 1988). Calder, however, does not use the term functional equivalents nor does he contrast them with social security programs. Generally, scholars working on Japan have long been aware that the absence of social spending does not necessarily mean the absence of welfare provision. Although they rarely use the term functional equivalent, many scholars emphasize the role of companies and families in providing welfare in Japan, whereas others focus on the use of “nonsocial” policies such as industrial and financial policies for welfare purposes. See Dore (1973), Rose and Shiratori (1986), and Nobuhiro Hiwatari (1991) for emphasis on welfare provision by companies and families, and Calder (1988), Hatsuta and Yashiro eds. (1995), Kazuo Shibagaki (1985), and Robert Uriu (1996), among others, for studies that recognize how “nonsocial” policies were used in Japan as tools of social protection. I owe my work to their important insights and try to build upon them.

⁶ Lynch (2001) provides an excellent point about how some welfare states are biased in favor of the old rather than the young.

earners, public pensions and health care in Japan are relatively generous even by international standards.

Furthermore, the postwar Japanese state has used “welfare” to squeeze money from society without resorting to taxes.⁷ Japanese governments promoted savings-oriented programs of all kinds – both public and private welfare programs – and placed welfare funds under state control. To put it boldly, Japan socialized capital by means of state control over welfare funds. The vast reserves of long-term capital under the state’s control, in turn, have provided each Japanese government with a far greater financial capacity than its small tax revenue would otherwise have allowed. Despite its importance, the impact of Japan’s welfare system on its distinctive model of capitalism has never been adequately explained.

The concept of functional equivalents is not specific to Japan. More generally, this book challenges the orthodoxy of welfare state studies by arguing that we cannot understand the real scope and full nature of social protection in a country unless we look at the way different policy tools are combined. In this respect, although this book focuses primarily on Japan, it is written for readers more broadly interested in welfare states and the political economy of advanced industrial societies. More than any other advanced industrial society, Japan illuminates the limitations of existing notions of the welfare state. Gøsta Esping-Andersen (1990), in his extremely influential book, *The Three Worlds of Welfare Capitalism*, uses the concept of *decommodification* to capture qualitative differences among welfare states. Decommodification refers to the degree to which the welfare state makes citizens more independent from the wages earned in the market. By exclusively focusing on a few social welfare programs to measure the degree of decommodification, Esping-Andersen entirely overlooks a whole range of functional equivalents that attenuate the effects of market forces. His omissions, which are shared by many others, reflect what I call a *social democratic bias* in traditional welfare state studies. Esping-Andersen and others are mostly interested in identifying those dimensions of the welfare state that promote social rights. Their goal – implicitly or explicitly – is to demonstrate that social democratic countries promote social rights the best. As a result, many dimensions of welfare states that appear unrelated to social rights have been largely ignored. A good example of such neglect is the absence of any interest in the financial dimensions of the welfare state, despite their enormous impact on the nature of a particular market economy. If the task is to understand the real varieties of welfare capitalism, we need to overcome the social democratic bias.

THE STRUCTURAL LOGIC APPROACH

Why did Japan develop generous orthodox programs in some areas but not in others? Why did it so often employ functional equivalents rather than more

⁷ Calder (1990) and Anderson (1990) also note that the Japanese state has used “welfare” as a reason to promote postal savings and postal insurance to raise capital. As Calder explains, the Japanese government has used welfare funds via the Fiscal Investment and Loan Program (FILP). I demonstrate in this book that the Japanese government’s use of welfare funds for policy purposes has been much more extensive than the presence of FILP indicates. Chapter 6 provides the details.

orthodox social spending programs? Comparatively speaking, Japan has developed fairly decent public programs in pension and health care. But when it comes to unemployment benefits and income support to working families – such as family allowance and housing allowance – Japan still lags behind other countries. Where public welfare benefits lag behind, we find functionally equivalent welfare programs. What explains Japan’s asymmetrical development of welfare provision? Why has the Japanese state relied so heavily on savings-oriented programs? Once we place Japan in a comparative perspective, it becomes evident that other countries, too, rely on functional equivalents. In fact, there are countries that use sets of functional equivalents similar to those used in Japan. This finding leads us to a broader question in comparative politics. What factors determine why some countries combine certain types of social security programs and their functional equivalents in specific ways?

In answering these questions, this book employs an institutional model of welfare politics to explain why advanced industrial democracies combine specific types of social spending programs and their functional equivalents in different ways. It builds an institutional model of welfare politics on the basis of three features: (i) the government type – for example, majoritarian, coalition, minority; (ii) district magnitude – that is, the number of seats assigned to an electoral district; and (iii) the importance of the personal vote – that is, the personal vote becomes important when voters cast their votes for specific candidates rather than for parties and when candidates need to compete against their fellow party members at the polls. The government type and the importance of the personal vote determine the number of veto players in the government. Specific combinations of district magnitude and the relative importance of the personal vote determine what electoral strategies are most desirable in a given country. Different electoral strategies, in turn, determine what types of social protection possess the most advantageous distributive implications. Because the microlevel logic of welfare politics can be derived from the aforementioned features of the political system, I call my institutional model a “structural logic model.”

To put it briefly, the structural logic model claims that the Japanese electoral system (multimember districts and single nontransferable vote) produced strong incentives in favor of highly targeted forms of social protection. Electorally speaking, it made sense for the ruling party in Japan to target social protection at specific constituent groups or areas.⁸ Japan thus spent less on comprehensive social welfare programs, because such programs made it difficult to steer distributive benefits to specific areas and groups. Instead, Japan developed social insurance schemes and functional equivalents to social security programs that allowed occupational and geographical targeting. The largesse of functional equivalents in Japan meant that “redistribution” occurred outside the narrowly conceived welfare state. This explains an odd combination: an egalitarian society and meager social spending.

⁸ Tatebayashi (2004) provides an excellent argument and evidence on the issue of conservative politicians’ distributive strategies under the multimember districts combined with single nontransferable vote.

The structural logic model put forth in this book explains three sets of variations: (i) cross-national variations in the pattern of social protection; (ii) cross-policy variations within the same country during the same period; and (iii) historical changes within the same country. In other words, my structural logic offers a new explanation for previously unexplained differences and similarities between Japan and other advanced industrial societies. It also explains policy variations within Japan – both across issue areas and time. The following sections briefly review existing theories that account for each of these three sets of variations. The aim here is to situate my structural logic approach in relevant theoretical debates.

EXPLAINING WELFARE STATES

Comparatively speaking, Japan often appears as an outlier. Scholars have had a hard time pinning it down. Japan's public pension and health care schemes resemble those in continental European countries, but Japan also looks very much like the United States in its small social spending.⁹ Yet notwithstanding its small social spending, the Japanese government has intervened in the market in multiple ways – much like many continental European governments. To further complicate the picture, Japan's commitment to full employment resembles that of the Scandinavian social democratic welfare states. Existing theories of welfare politics simply cannot explain these similarities and differences.

Partisanship-Based Models of Welfare Politics

The dominant model of welfare politics explains the shape of a welfare state on the basis of the partisan composition of the government. Countries where social democratic parties dominate, so the argument goes, develop generous and universalistic welfare states, which emphasize full employment (Esping-Andersen 1985; Esping-Andersen and Korpi 1985; Hicks 1999; Hicks and Swank 1992; Huber and Stephens 2001; Korpi 1978, 1983; Rothstein 1985; Stephens 1979). Countries with Christian democratic party dominance also develop generous welfare states but they emphasize income transfers to families rather than universalistic coverage (Castles 1978, 1982; Huber and Stephens 2001; Van Kersbergen 1995). At first sight, the partisanship-based models of welfare politics appear to work well when we exclusively look at social spending programs. Small welfare states – Japan being one of them – lack strong social democratic or Christian democratic parties. These explanatory models nonetheless have two weaknesses. The first weakness is that they cannot explain cross-national variations among small welfare states. Partisanship-based models might explain why Japan and the United States differ from Sweden or Germany. But they cannot explain why Japan's social protection

⁹ Esping-Andersen (1997) calls Japan a hybrid between a liberal welfare state and a conservative welfare state.

system differs from that of the United States.¹⁰ As existing studies of the Japanese welfare state correctly point out, Japan has managed to introduce many public welfare programs despite its weak labor. Japan has a whole range of social security programs and their functional equivalents that are absent in the United States. The second weakness of partisanship-based models is that they fail to account for similarities that exist between Japan and social democratic or Christian democratic welfare states.¹¹ Some social democratic welfare states accumulate funds via welfare programs and also spend a lot on public works – much like Japan does. Both Japan and the Scandinavian social democratic countries also emphasize full employment. Japan also shares similarities with continental European Christian democratic countries such as Germany and Italy. They share highly fragmented social insurance schemes and all rely on regulatory interventions in the market – an important functional equivalent to orthodox social security schemes. Clearly, the models that associate partisanship and welfare states cannot explain all these differences and similarities between welfare states. Much of the literature is too Eurocentric. Scholars of Japanese social policy have long noted this failing.¹²

Cross-Class Alliance Model of Welfare Politics

Scholars skeptical of partisanship-based models focus theoretical attention on the preferences of employers and unions concerning social policy outcomes (Mares 1997, 2003; Martin 1995a, 1995b, 2000; Swenson 1991a, 1991b, 1997, 2002). Studies in this camp have greatly improved our understanding of social policy preferences of employers and unions. They have identified a range of factors – insurance against risks, labor cost, control and labor management needs – that affect employers' and unions' calculations over corporate welfare benefits, occupationally fragmented social insurance schemes, and tax-financed universalistic schemes.¹³ This approach appears, at least initially, to explain Japan well. Given Japan's highly dualistic labor market, the privileged core workers in large firms preferred company-based benefits over generous universalistic benefits. Indeed,

¹⁰ Chapter 1 provides detailed cross-national comparisons.

¹¹ Japan developed national health care, paid child care benefits, and long-term care insurance as public welfare programs – all of which still remain absent in the United States. Furthermore, a look at functional equivalents also indicates that the Japanese welfare state protects jobs to a much greater degree than the American welfare state does. The Japanese welfare state also interferes into the financial market in ways that the American welfare state does not. This means that not all functional equivalents are market-expanding ones typically emphasized by scholars of American social policy.

¹² Anderson (1990), Calder (1990), Campbell (1979, 1992), Kasza (2006), and Pempel (1982). Some have gone on to write about East Asian models of welfare states; see Goodman, White, and Kwon (1998).

¹³ Swenson (2002) has focused more on different types of human management needs as the basis of different employers' social policy preferences. Martin (1995a, 1995b) has focused more on employers' cost calculations. Mares (1997, 2003) advanced the initial insights of Baldwin (1990) that characterized the welfare state as an insurance mechanism against risks. For another application of this idea, see Burgoon (2001). Mares considers both employers' labor management needs and their cost calculations in determining their preference for a specific insurance scheme.

a universalistic policy would have redistributed from better-paid and more secure core workers to their less fortunate peers.¹⁴ Two problems exist, however, when applying this model to Japan. First, this model lacks a general model of political power. It sees welfare politics primarily as a game between unions and employers.¹⁵ Outside a handful of northern European countries, however, welfare politics consists of a much wider cast of actors.¹⁶ When do we know that a cross-class alliance of capital and labor can prevail over opposition by other groups, such as physicians, the insurance industry, or the self-employed (to name but a few possible participants in welfare politics)? Furthermore, in addition to societal actors, state actors also take part in welfare politics (Hecló 1974; Skocpol and Amenta 1986; Weir and Skocpol 1985). Do different types of civil service pursue different social policies to influence final policy outcome? Who prevails when there is a conflict of interest between state and societal actors? Models that emphasize the importance of cross-class alliance tend to ignore these questions.¹⁷ The absence of a general theory of power leads to a second weakness of this approach.

Second, most studies define the range of welfare options for employers and for unions too narrowly. The choices typically considered consist of private corporate welfare, fragmented social insurance schemes, and universalistic public welfare benefits. In the real world, however, unions and employers seek a much wider range of public policies than social insurance and universalistic benefits, including subsidies for private welfare schemes – subsidies that involve government spending or tax expenditures – and a whole range of regulatory interventions.¹⁸ We also observe unions and business demanding market-restricting regulations to protect, respectively, their jobs and profits. These policy options can best be understood, so this book argues, as functional equivalents to orthodox social security programs. The types of protection that unions and employers demand are partly a function of their power. Firms that possess political influence often seek

¹⁴ Esping-Andersen (1997) has made this point.

¹⁵ In this sense, it resembles the power resources model it criticizes.

¹⁶ In reality, however, as pointed out by Skocpol (1992), the view that class actors are the most important players in welfare politics must be treated skeptically.

¹⁷ Consider, for instance, whether a similar cross-class alliance in the automobile industry in Germany, Japan, and the United States produces the same amount of political power and policy outcomes in these respective countries. The fact that the U.S. automobile industry pays so much more for the health care costs of their workforce due to the absence of a national health care system in the United States suggests that this cross-class alliance does not possess the same weight in all countries. Katzenstein's work has been an exception (1985). He has not exclusively focused on the two class interests – capital and labor – but has also paid attention to a broader institutional context such as electoral systems that affect the likelihood of these class interests being materialized as public policy. Similarly, Cathie Jo Martin has always been more concerned with the issue of political capacity. Her recent work, in particular, focuses explicitly on the policy capacity of employer organizations (Martin and Swank 2004).

¹⁸ Swenson (2002) offers insights beyond the narrow range of welfare programs. He considers conditions in which employers might prefer cartels. He acknowledges that those employers he calls “segmentalist” might prefer cartel as social protection. He refers to Japan as a possible case of a country with segmentalist employers. Nonetheless, he does not identify when such segmentalist employers succeed or fail in forming cartels.

protective measures targeted at their companies. When lacking sufficient independent power, they might ally themselves with other firms in the same product market or in the same region to demand industry- or region-specific subsidies. Risk exposure is certainly an important factor. But political power is more often the decisive factor.

Institutionalist Models of Welfare Politics

Institutionalist models of welfare politics provide a theory of power different from the partisanship-based models of welfare politics. There are different strands of *institutionalist* theories. One strand focuses on the historical legacies of earlier institutional choices such as a choice of a particular type of welfare program or a state structure (King 1995; King and Rothstein 1993; Orloff 1993; Pierson 1994; Rothstein 1992; Skocpol and Amenta 1986; Weir 1992; Weir and Skocpol 1985). Scholars in this group explain cross-national differences in terms of such historical institutional legacies. The other strand focuses more on the role of institutions in setting the rules of the political game.¹⁹ Within this second strand, some scholars focus on the number of veto players, whereas others focus on electoral systems. It is important to consider theories within the second strand at more length because the theory I develop in this book belongs to this particular strand of institutionalist theories. The veto player theory attributes the presence of universalistic programs to the number of veto players in the polity. Most scholars in this group argue that legislative processes that contain many veto players make policy shifts difficult (Immergut 1992; Maioni 1998; Moe and Caldwell 1994; Pierson 1995; Skocpol 1996; Steinmo 1993; Steinmo and Watts 1995; Tsebelis 2002). Veto players, by definition, are actors (whether political parties or individual politicians) whose consent is necessary to make law. They argue that, for this reason, when the number of veto players is large, a country is less likely to develop universalistic programs, because it becomes very easy for a minority group to block what benefits the majority (Immergut 1992; Maioni 1998; Skocpol 1996; Steinmo 1993; Steinmo and Watts 1995).²⁰

¹⁹ I am exaggerating the contrast here to make distinctions clear. In reality, those historical institutionalist studies that focus on state structures mostly draw attention to the role of federal structures in blocking certain types of social welfare programs. The reasoning behind these arguments is basically the same with the veto player argument reviewed here as part of the second strand of institutionalist theories. Orloff (1993), for instance, pays close attention to the role of the federal structure in explaining welfare state developments in Britain, Canada, and the United States.

²⁰ Moe and Caldwell (1994) make a different argument to explain the same policy outcome. Instead of arguing that universalistic programs are difficult when the number of veto players is large, they explain why countries with few veto players might be more likely to introduce universalistic programs. They argue that, because policy reversals are easy in political systems with a small number of veto players, the current government opts for universalistic programs that benefit the majority in the hope that popular programs that benefit many are more difficult to roll back in the future. I would like to thank Terry Moe for bringing this to my attention. Tsebelis (2002) also agrees with the gist of their argument.

Another group of institutionalists attribute larger welfare states to proportional representation (Birchfield and Crepaz 1998; Boix 2001; Crepaz 1998; Iversen and Soskice 2006; Katzenstein 1985; Lijphart and Crepaz 1991). Most notably, Lijphart and Crepaz (1991) and Iversen and Soskice (2006) develop different causal logics, both of which predict a strong link between proportional representation (PR) and large welfare states. Lijphart and Crepaz (1991) claim that the use of PR gives rise to a more cooperative form of parliamentary politics that they call “consensual democracy.” Consensual democracy enables the introduction and expansion of welfare programs by facilitating cooperation among political parties.²¹ The use of single-member districts (SMD), in contrast, gives rise to a more confrontational politics – “majoritarian democracy” – leading to a smaller welfare state. Birchfield and Crepaz (1998) and Crepaz (1998) basically take the same view.²² Iversen and Soskice (2006) claim that PR systems are more likely than SMD systems to give rise to left-of-center governments that spend more on social programs.²³ They make this claim by developing a model focused on the voting behavior of the middle classes. They claim that middle-class voters – the pivotal group of voters in their model – are more likely to support a left-leaning government when a moderate party that represents their position forms a coalition partner (and thus possesses veto power).

An important tension exists between the electorally based account of welfare politics and a subgroup of veto player–based account. Huber, Ragin, and Stephens (1993) and Huber and Stephens (2001) claim that the number of veto players negatively affects the size of the welfare state. On this account, coalition governments should develop smaller welfare states than majoritarian governments because coalition governments have more veto players within the government than majoritarian governments do. Obviously, this argument runs counter to the claims made by Lijphart and Crepaz (1991), Birchfield and Crepaz (1998), Crepaz (1998), and Iversen and Soskice (2006).²⁴

²¹ They focus on differences between consensual and majoritarian democracies. Consensual democracies emerge in countries with PR, and display oversized cabinets, balanced power, executive dominance, and multiparty systems. In contrast, majoritarian democracies use plurality rules – as in single-member district systems – rather than proportional rules, and have minimal winning cabinets and a two-party system. This group associates consensual democracies with politics characterized by cooperation among political parties, whereas they associate majoritarian democracies with a more confrontational style of politics. They suggest that consensual democracies lead to larger welfare states. For a full description and definition, see Lijphart (1984) and Lijphart and Crepaz (1991). Crepaz (1996, 1998) and Steinmo and Tolbert (1998) also develop corollaries of this argument.

²² Crepaz extends the earlier argument by developing a new concept of collective and competitive veto players (Birchfield and Crepaz 1998; Crepaz 1998). Briefly stated, collective veto players arise in the same institutional arena such as within the parliament, whereas competitive veto players arise in different institutional arenas within the polity. Crepaz argues that the face-to-face transactions among collective veto players make them more cooperative.

²³ Rodden (2005) provides a simpler causal argument with the same implications. Rodden argues that SMD systems generate more representational bias in favor of rural voters, who tend to be more conservative. This is why PR is more likely than SMD to produce left-leaning governments and hence larger welfare states.

²⁴ Markus Crepaz tackles this tension by distinguishing two kinds of veto players – competitive and cooperative veto players. He considers veto players that arise from the constitutional structure of