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ECONOMY OF TRADE POLICY:
THE CASE OF JAPAN

Seiichi Katayama
Heinrich W. Ursprung*
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CEsifo
Poschingerstr. 5
81679 Munich
Germany
Phone: +49 (89) 9224-1410/1425
Fax: +49 (89) 9224-1409
<http://www.CEsifo.de>

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Abstract

In this paper we present a model of endogenous trade-policy formation which captures crucial aspects of the Japanese commercial and political culture. We analyze the influence of the portrayed cultural traits and show that cultural idiosyncrasies are important determinants of trade policy formation; especially the complex interaction of the two types of cultures is shown to have significant consequence for the policy outcome. Contrasting our model's behavior with the stylized facts of Japanese politics, we arrive at the conclusion that the model's behavior is compatible with the observed (trade) policy positions held by Japanese politicians over the last fifty years.

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*Seiichi Katayama
Research Institute for Economics and
Business Administration
Kobe University
Rokkodai-cho, Nada-ku
Kobe 657
Japan*

*Heinrich W. Ursprung
Department of Economics
University of Konstanz
Box D-138
78457 Konstanz
Germany
email: Heinrich.Ursprung@uni-konstanz.de*

Commercial Culture, Political Culture and the Political Economy of Trade Policy:

The case of Japan

1. Introduction

Social interactions are shaped by formal institutions and the prevailing cultural norms. The formal institutions place external constraints on individual behavior; the cultural norms are personally internalized to become components of an individual's preferences or belief system.

Although constraints, preferences, and also beliefs are all constituent parts of the economic model of behavior, economic theory has largely neglected the influence of specific institutional characteristics, and more so the influence of specific cultural traits, on social interaction – whether the interaction be commercial or political.¹ We focus in this paper on consequences of cultural idiosyncrasies from both of these perspectives. Cultural aspects become important when social phenomena transcend a limited period of time, and also in international relations between different societies. Our model investigates trade policy formation in a country endowed with a very specific culture. We adopt a long-term view in which the commercial and political cultural is liable to change, but we treat these changes as given.² There is no generally accepted, precise, definition of the concept of culture,³ and we apply the term to describe norms of social interaction that have evolved over time without deliberate design. Such behavioral norms belong in Hayek's (1973, chapter 2) terminology to the realm of "cosmos" and are characterized by conservatism, conformity, tacit knowledge, emotional encoding, and mutual reinforcement. Most importantly, culturally based social norms imply entitlements and obligations that are often encoded as standards of fairness or appropriate behavior and are enforced through reputation effects (cf. Schlicht, 1998, chapters 1 and 2).

1.1 The Japanese commercial culture

We shall not be concerned here with the formation and evolution of culture; we take cultural traits as given and investigate their influence on social interaction in a specific setting. Our object of investigation is political-economic interaction in the cultural setting of contemporary Japan. The key

¹ The neglect of institutional considerations is more evident in traditional welfare-theoretic policy studies than in political-economic investigations. Nevertheless, many authors have noticed an unfortunate lack of love for institutional details also in political-economic studies. For a discussion of this issue in the context of modeling endogenous trade policy, see Nelson (1999).

² For a model which endogenizes commercial culture in an international trade context, see Kaneda (1999).

³ The concept of political culture is the topic of a recent special twin-issue of the *European Journal of Political Economy* (2000, Nos. 1-2).

distinguishing feature of the contemporary Japanese business environment, as compared to the business environment in the United States, is the inter-firm specialization in tightly integrated production networks known as *keiretsu*. Relationship-specific investments are the source of relational quasi rents (cf. Aoki, 1988), which, ceteris paribus, increase the productivity of an entire network. Sufficiently complete contracts protecting relationship-specific investments from opportunistic behavior of the investor's business partners are costly or may be unavailable, and so relationship-specific investments are more likely to be undertaken in an environment fostering cooperation, fairness and trust.⁴ It is generally believed that the business environment in Japan has these characteristics to a high degree. Empirical studies of the automotive industry support this line of argument. Dyer and Chu (1997), for example, define trust as *one party's confidence that the other party in the exchange relationship will not exploit its vulnerabilities*, and document that supplier trust is significantly higher in Japan than in Korea or the United States. Sako and Helper (1998) also conclude that Japanese suppliers tend to confront a higher level of trust and a lower level of opportunism than U.S. suppliers. They point out that, in contrast to U.S. suppliers, Japanese suppliers distinguish between different types of trust -- customer opportunism, competence trust and goodwill trust. Most importantly, however, reciprocity is more embedded in the Japanese conceptualization of trust than in the U.S. counterpart.

These findings are complemented by comparative studies of supplier involvement in the automotive industry. In the mid-1980s the major Japanese companies manufactured less than 30% of their component parts in-house compared to 70% at General Motors (Aoki, 1988). In product development, the authoritative study by Clark and Fujimoto (1991) reports that Japanese suppliers do four times more engineering work for a typical project than U.S. suppliers (p. 136). The representative Japanese project, as a consequence, relies heavily on *black box parts* (designed by the supplier according to cost/performance requirements specified by the assembler), and the average U.S. project on *detail-controlled parts* for which most engineering work, including parts drawing, is done by the assembler (p. 144). European suppliers lie somewhere in between.

Such observations substantiate the view that the Japanese business environment, because it is endowed with a large stock of goodwill trust, sustains a higher level of asset specificity, which, in turn, can explain performance differences (see, for example, Dyer 1996, and Dyer and Chu 1997).

The identification of the origin and determinants of trust is more controversial. There are two schools of thought. In his popular treatise on trust, Fukuyama (1995) endorses and propagates the culturist view that mutual trust between business partners is an externality deriving from general norms of reciprocity of the surrounding societal network. In this view, goodwill trust cannot be cultivated

⁴ General studies investigating the determinants of trust (social capital) and its influence on economic performance are to be found in Knack and Keefer (1997) and Paldam and Svendsen (2000).

intentionally. It rather represents a cultural trait that individual business organizations accept as given. In the Japanese context, Hill (1995) traces the contemporary commercial culture back to the neo-Confucian ethical tradition that reached its greatest refinement during the 250 years of the Tokugawa shogunate (1603-1868). This tradition emphasized values such as group identification, collective responsibility, loyalty, reciprocal obligations, harmony, honesty and individual performance (see also Katayama, 2000).

On the other hand, several studies on the determinants of trust (see, for example, Dyer and Chu, 1997, and Sako and Helper, 1998) support the “nurturist” view, which maintains that it is possible to intentionally cultivate and develop trust in a dyadic commercial relationship. Partnering is thus seen as a culturally neutral capability that can be developed over time by a strategic management decision, to build up the required reputation. An interesting case study presented by Dyer (1995) documents that, since 1989, Chrysler Corporation has made a conscious attempt to move away from the traditional arms-length relationship in supplier management, and has been able to duplicate some key aspects of the Japanese keiretsu system within a relatively short period of time. In 1989, for example, 95% of Chrysler’s suppliers were chosen through competitive bidding, whereas six years later 95% of components were “re-sourced” to partner suppliers, and between 1990 and 1994 the total number of suppliers decreased from 2500 to 1387. It appears that Chrysler has been able to overcome the two fundamental problems associated with moving from arms-length relationships to supplier partnerships, namely, to fairly compensate suppliers and to provide them with adequate incentives to undertake relationship-specific efforts and investments. Chrysler’s success offers evidence that the keiretsu system is not culturally bound and is applicable outside Japan.

We do not intend to take a position in this controversy on the origins of trust. We rather proceed from the observation that the level of mutual trust varies considerably across business communities and that this attribute is characterized by considerable persistence. Whether it is a country’s culture that largely determines the level of trust in business partners or a costly build-up of reputation in dyadic business relationships (which, of course, may be facilitated by an accommodating cultural background) is not material for our paper. We in any case treat mutual trust in business partners as an exogenous phenomenon that changes only slowly over time, and we refer to such mutual trust as a given aspect of the commercial culture.

Our model will portray an economy with economic relationships strongly influenced by mutual cooperation and trust, and another economy where these features are absent or less significant, and we will consider the determination of the endogenous policy that governs international trade between the two countries. The analysis stresses the long-term relationship between suppliers of intermediate goods and downstream firms producing a final product. As an example, we employ the vertical keiretsu relationship

within Japanese corporate groups that has market and political interactions with the industry where the vertical relationships are at arms length.

In portraying the economic relationships we make use of the keiretsu representation developed by Spencer and Qiu (2000). The key idea of this keiretsu representation is that mutual cooperation and trust promote suppliers' willingness to invest in customer-specific assets, because the suppliers have good reason to believe that these investments will be honored in the future in fair price-negotiations. The relationship-specific long-term investments reduce the cost of the down-stream producer, the so-called (Japanese) J-maker. The price-setting mechanism is portrayed through a standard Nash bargaining solution.

A parameter measuring the relative bargaining power of the monopsonistic J-maker is a convenient indicator of the fairness standards in the domestic economy (Japan). We use this parameter to summarize the commercial culture. In the competing foreign (U.S.) industry, the business culture does not support long-term relationships based solely on trust, and we model this commercial environment as a perfectly competitive market for component parts. In the competitive environment, suppliers have no reason to believe that an investment in customer-specific assets not enforced through formal contracts will be profitable in the future. Specialized assets rather expose a naïve supplier to the uncovered risk of opportunistic exploitation since his business "partner" benefits from the investment. The out-sourced component parts of the (American) A-maker, as a consequence, do not incorporate (non-contractable) relationship-specific investments. The two scenarios coalesce in the limit if all bargaining power is with the J-maker. We can thus interpret the American market environment as one extreme on a continuum that ranges from environments in which agents behave in a completely trustworthy and fair manner, to environments populated by completely opportunistic agents.

1.2 The Japanese political culture

Culturally transmitted norms of social interaction also shape the behavior of persons in political life. We acknowledge the influence of political culture by specifying policy-makers' preferences in a manner that allows various social norms to be accommodated. We model the domestic (Japanese) political process using the electoral-competition approach (cf. Young and Magee, 1986, and Hillman and Ursprung, 1988). We believe that the scope of this approach is sufficiently wide to portray changes in political culture that have taken place in modern, i.e. post WWII, Japan. The electoral competition approach does, however, exclude some institutional and cultural settings, since it emphasizes the influence

of interest groups and thus principal-agent problems between government and voters at large.⁵ Our picture of the political process rules out the traditional view that maintains that politicians act like benevolent dictators; we rather describe politicians as rational utility maximizers who face election constraints. The electoral competition approach also recognizes that the Japanese political system is embedded in a cultural setting in which wholesale corruption or crony-capitalism is absent. We do not interpret the long and rather troubling history of monumental political scandals permeating the highest levels of Japanese politics as a sign of cultural deterioration.⁶ We rather concur with Hillman and Swank (2000), who see merit when voters can still be scandalized by disclosures that political discretion has been used in illegal ways. Scandals are, in this view, an indicator of a culture that values political integrity. As we see the political culture in Japan, "official corruption," which implies an explicit interaction between politicians and donors of campaign contributions, does, in the usual course of events, not take place. Policies are not corruptly "for sale" (to use the terminology of Grossman and Helpman, 1994), nor does the political culture allow politicians to convert political support into personal income (cf. Ursprung, 1990) - at least not on an overwhelming scale.

Our model portrays a political culture in which policies are designed with a view to electoral success. The policy platforms of the political parties competing for electoral success respond to the anticipated reaction of clientele interest groups who support election campaigns. The political culture is thus such that politicians are to some degree "personally corrupted", because they deviate from ideological policy stances to enhance election prospects. The degree to which the politicians are personally corrupted, or alternatively, the degree to which politicians feel an obligation towards the policy interest of their clientele (which the politicians may have internalized in the form of ideological motives), is a characterizing attribute of the political culture. We describe changes in Japanese political culture through a parameter measuring the relative weight of the ideological and electoral motives in political preferences. The parameter describing the prevailing political culture thus plays a similar role to the parameter describing the prevailing commercial culture: both measure the prevalence of internalized obligations or standards of fairness vis-à-vis close associates in the respective social network.⁷

We begin in part 2 by considering the influence of Japanese *commercial* culture on trade policy formation. We do this by assuming that policy-makers have not been captured by particular special

⁵ For a survey of the modeling approaches employed in endogenous trade theory and a discussion of the institutional settings to which they apply, see Hillman (1989).

⁶ In the long reign of the Liberal Democratic Party (LDP), major scandals broke at least every five or six years, the most notorious being Showa Denko (1948), the black Mist (1966), Lockheed (1976), Recruit (1988-89), and Sagawa Kyubin (1993). The Sagawa Kyubin scandal undeniably proved – just as the Lockheed scandal before – that politicians and bureaucrats had systematically accepted bribes in exchange for making exceptions to Japan's nominally rigid regulatory rules. Japanese citizens, however, did not simply accept these scandals with a cynical tolerance of "politics as usual." Following each scandal, there was media-led public outcry and the party's popularity would plummet (see Pempel, 1998, p. 5, 140, and 202).

interests. That is, competing political parties do not subscribe to political ideologies accommodating particular economic interests; they exhibit perfect personal corruption and choose the trade policies that maximize electoral prospects. In part 3 we then relax this assumption to investigate the influence of changes in the prevailing *political* culture on trade policy formation.

2. Modeling Japanese business culture

A combination of the basic idea of the keiretsu representation by Spencer and Qiu (2000) and the standard form of the electoral competition model gives rise to a natural sequencing of strategic moves. The least reversible move is the long-term investment in relationship-specific assets undertaken by the supplier.⁸ The supplier thus moves first by deciding on the value of the investment.⁹ Then the policy regime is decided upon: two competing parties simultaneously announce their policy platforms designated in terms of a tariff on imported intermediate goods. Directly affected domestic interests observe these policy pronouncements and simultaneously make decisions regarding support for the competing parties. The political support takes the form of campaign expenditures, which, via a contest success function, determine the election outcome and thereby the implemented trade policy. After the trade policy regime is made known, the two final-goods producers, the J-maker and the A-maker, simultaneously determine their output. In the final move, the J-maker negotiates the price for the intermediate good with the intermediate-good supplier.

The following equations portray the economic relationships:

$$(1) \quad \mathbf{p}_J = y_J (A - Y - p - w_0 + \mathbf{q} w_0 \sqrt{k})$$

$$(2) \quad \mathbf{f} = y_J (p - c) - k$$

$$(3) \quad \mathbf{p}_A = y_A (A - Y - c^* - w_0)$$

Equation (1) defines the profit of the J-maker. The J-maker's output is denoted by y_J and the A-maker's output by y_A . The two firms are Cournot competitors. Y denotes total output ($Y = y_A + y_J$). Market demand is $P = A - Y$, p denotes the price (cost) of the input per unit of output, and w_0 denotes the per unit assembly cost if the input is bought from a supplier who has not made any relationship-specific

⁷ For an alternative but in principle similar way of portraying political culture, see Epstein and Nitzan (2000).

⁸ We simplify the presentation by assuming that the J-maker needs only one input. We thereby relegate the problems associated with the public good character of the suppliers' campaign expenditures to the background. For an analysis of the easy-riding effects occurring in this context, see Ursprung (1990).

⁹ In the paper by Spencer and Qiu (1999) the suppliers' investment decisions and the production decisions by the final-goods producers are made at the same time. Our sequencing, however, seems to be more in line with the underlying idea.

investments. The keiretsu supplier's relationship-specific investment is denoted by k ; the last term in the bracket therefore denotes *the reduction in assembly cost due to the keiretsu investment* (\hat{e} is a parameter). In (2), the keiretsu supplier produces the intermediate good under constant average cost c ; his profit is denoted by ϕ .

The A-maker's profit π_A is defined in (3). The A-maker's supplier sells under perfect competition, so the input price equals his constant average cost of production c^* . We shall maintain the assumption that the cost of producing the basic intermediate good is lower in country A than in country J : that is, $c^* < c$. The A-maker thus buys his input at the price c^* . The basic assembly costs w_0 are assumed to be the same in the two countries.

We solve the model by backward induction. The price of the input is determined as a Nash bargaining solution. The J-maker's bargaining objective is to maximize his per-unit cost-reduction $[(1+t)c^* + w_0] - [p + w_0 - \mathbf{q}w_0\sqrt{k}] = (1+t)c^* - p + \mathbf{q}w_0\sqrt{k}$, where $(1+t)c^*$ is the tariff-inclusive cost of the imported input. The keiretsu supplier's bargaining objective is to maximize his per unit profit $p - c$. Denoting the J-maker's bargaining power by α and the keiretsu-supplier's by $1 - \alpha$, the Nash product is:

$$(4) \quad G = [(1+t)c^* - p + \mathbf{q}w_0\sqrt{k}]^\alpha [p - c]^{1-\alpha}.$$

The resulting Nash bargaining price that maximizes G is

$$(5) \quad p = (1 - \alpha)(\mathbf{q}w_0\sqrt{k} - \mathbf{d}) + c,$$

where δ denotes the input price difference $c - (1+t)c^*$ in country J . Notice, that for $\alpha=1$, the price p equals the average cost c .

We interpret α as a measure for the prevailing business culture. If $\alpha=1$, the supplier has no bargaining power and will thus not be treated in a "fair" manner: his relationship-specific investment will not be honored. On the other hand, if $\alpha=0.5$, both negotiating parties enjoy the same bargaining power, which implies that suppliers' relationship-specific investments will be honored in a perfectly fair manner.

Preceding the bargaining stage, the J-maker and the A-maker simultaneously determine their output. Maximizing π_J and π_A as given in (1) and (3) and taking into account the bargaining price in (5) yields

$$(6) \quad y_J = \frac{1}{3} [A + c^* - 2c - w_0 + 2(1 - \alpha)\mathbf{d} + 2\alpha\mathbf{q}w_0\sqrt{k}] \text{ and}$$

$$(7) \quad y_A = \frac{1}{3} [A + c - 2c^* - w_0 - (1 - \alpha)\mathbf{d} - \alpha\mathbf{q}w_0\sqrt{k}].$$

The corresponding profits are $\pi_J=y_J^2$, $\pi_A=y_A^2$ and

$$(8) \quad \mathbf{f}=y_J(1-\mathbf{a})\left[w_0\mathbf{q}\sqrt{k}-\mathbf{d}\right]-k.$$

The J-maker's profit function $\pi_J(\delta)=y_J^2$ is increasing and convex, the A-maker's profit function $\pi_A(\delta)=y_A^2$ is decreasing and convex, and the keiretsu-supplier's profit function $\phi(\delta)$ is decreasing and concave.¹⁰

$$\frac{\partial p_J}{\partial \mathbf{d}} = \frac{4}{3}(1-\mathbf{a})y_J \geq 0, \quad \frac{\partial^2 p_J}{\partial \mathbf{d}^2} = \frac{8}{9}(1-\mathbf{a})^2 \geq 0, \quad \frac{\partial p_A}{\partial \mathbf{d}} = -\frac{2}{3}(1-\mathbf{a})y_A \leq 0, \quad \frac{\partial^2 p_J}{\partial \mathbf{d}^2} = \frac{2}{9}(1-\mathbf{a})^2 \geq 0,$$

$$\frac{\partial \mathbf{f}}{\partial \mathbf{d}} \leq 0, \quad \frac{\partial^2 \mathbf{f}}{\partial \mathbf{d}^2} = -\frac{4}{3}(1-\mathbf{a})^2 \leq 0$$

In the lobbying stage of the game that precedes the production-decision stage, the J-maker has an evident incentive to support the liberal trade policy party. The keiretsu-supplier and the A-maker, on the other hand, have an incentive to support the protectionist party. Since campaign contributions are a pure public good for the protectionist interests, only the interest with the higher stake will actively support the protectionist party. It turns out that the keiretsu supplier's stake is always larger than the A-maker's stake.¹¹ We thus have

Lemma 1: *Only the keiretsu supplier actively supports the protectionist party in the election campaign. The A-maker, who is also in favor of the protectionist party, remains passive.*

The J-maker and his supplier maximize their respective expected profits $E\Pi$ taking into account the trade policy stances of the competing political parties, which commit to their respective policy platforms:

$$(9) \quad \max_{L_J} E\Pi_J = w\mathbf{p}(\mathbf{d}_p) + (1-w)\mathbf{p}(\mathbf{d}_L) - L_J$$

$$(10) \quad \max_{L_S} E\Pi_S = w\mathbf{f}(\mathbf{d}_p) + (1-w)\mathbf{f}(\mathbf{d}_L) - L_S$$

¹⁰ In order to establish that ϕ varies negatively with δ we assume that the J-maker would be able to stay in business if he had to buy basic domestic inputs: $y_J(K=\delta=0)=A+c^*-2c-w_0>0$.

¹¹ Using the equations (6 through 8), we compute the difference of the stakes of the supplier and the foreign producer as

$$D \equiv \Delta\Phi - \Delta p_A = \frac{1-\mathbf{a}}{3}(\mathbf{d}_L - \mathbf{d}_p) \left[\frac{1}{3}\Omega + \left(\frac{14}{3}\mathbf{a} - 2\right)w_0\mathbf{q}\sqrt{k} + \frac{7}{3}(1-\mathbf{a})(\mathbf{d}_L + \mathbf{d}_p) \right],$$

where $\Omega=A-w_0-7c^*+8c>0$ (see note 8). For $\alpha \in (1/2, 1)$, D is thus positive.

The variable w denotes the probability of the protectionist party's winning the election, L_J (L_S) the J-maker's (the keiretsu supplier's) lobbying outlays, and δ_L (δ_P) the liberal (protectionist) party's trade policy pronouncement. The probability w is determined via a standard Tullock contest success function:

$$(11) \quad w = \frac{\mathbf{x}L_S}{\mathbf{x}L_S + L_J}, \quad \text{for } L_S + L_J > 0 \quad \text{and} \quad w = \frac{1}{2}, \quad \text{for } \xi L_S + L_J = 0.$$

The parameter ξ measures the relative lobbying efficiency of the supplier. We assume that $\xi > 1$, i.e. the supplier is more efficient in lobbying than the J-maker. The rationale behind this assumption is that protecting the supplier from import competition is seen, at least in the political arena, as the protection of the whole work force of the supplier, whereas trade liberalization is not believed to have a significant positive impact on employment in the final goods sector.¹²

In the equilibrium of the lobbying contest, the election outcome w depends on the ratio of the two competing firms' respective stakes $\Delta\Pi_J = [\Pi_J(\delta_L) - \Pi_J(\delta_P)]$ and $\Delta\Phi = [\Phi(\delta_P) - \Phi(\delta_L)]$:¹³

$$(12) \quad w = \frac{\mathbf{x}\Delta\Phi}{\mathbf{x}\Delta\Phi + \Delta\Pi} = \frac{3\mathbf{x}\mathbf{j} - 2(1-\mathbf{a})(\mathbf{q}w_0\sqrt{k} - \mathbf{d}_L - \mathbf{d}_P)}{(4+3\mathbf{x})\mathbf{j} - 6\mathbf{x}(1-\mathbf{a})\mathbf{q}w_0\sqrt{k} + (4+6\mathbf{x})(1-\mathbf{a})(\mathbf{d}_L + \mathbf{d}_P)},$$

$$\text{where } \mathbf{j} = A + c^* - 2c - w_0 + 2\mathbf{a}\mathbf{q}w_0\sqrt{k}.$$

The two political parties act as Stackelberg leaders vis-à-vis their supporters. Anticipating the effect of the firms' lobbying (or endorsement) reaction summarized in equation (12), the protectionist and the liberal trade policy party choose their policy platforms δ_P and δ_L with the intention to maximize their respective probabilities of winning the election. As can be seen from equation (12), the slope of the iso- w lines in the policy pronouncement space is -45° ($\frac{d\mathbf{d}_P}{d\mathbf{d}_L} = -1$) and w increases in δ_L and δ_P . This relationship between

the electoral outcome and the parties' policy pronouncements is depicted in figure 1. Notice, first, that δ cannot be negative, i.e. the tariff cannot exceed $t=c/c^*-1$. This is so because at $\delta=0$ the domestic price of the imported input equals the cost of the domestically produced input if no relationship-specific investment has been made. The keiretsu supplier has no interest in a tariff exceeding c/c^*-1 because the J-maker can always buy from a domestic competitor at the price $p=c$. Figure 1 demonstrates that the unique Nash equilibrium of the policy pronouncement game is characterized by political concordance. For interior solutions $\delta \in (0, c-c^*)$ the common policy platform δ^* results from $w(\delta_L=\delta_P=\delta^*)=0.5$:

¹² The loss of employment is more visible than the gain that is brought about in a rather indirect manner. Not much has changed since Bastiat's time (Ce qu'on voit et ce qu'on ne voit pas).

¹³ This follows immediately from the first-order conditions of (9) and (10).

$$(13) \quad \delta^* = \frac{3\mathbf{x}}{6\mathbf{x}-4} \mathbf{q} w_0 \sqrt{k} - \frac{3\mathbf{x}-4}{12\mathbf{x}-8} \frac{\mathbf{j}}{1-\mathbf{a}}.$$

We thus have

Proposition 1: *If the political parties' objective is to maximize their respective probabilities of winning the election, the political process will give rise to political concordance.*

We are now in a position to analyze the first move made in the game, i.e. the investment decision made by the keiretsu supplier. The J-maker's output follows from (6) and (13) as

$$(14) \quad y_J = \frac{\mathbf{x}(a + 2\mathbf{q}w_0\sqrt{k})}{6\mathbf{x}-4},$$

where $a=A+c^*-2c-w_0$. The keiretsu supplier's profit amounts to

$$(15) \quad \mathbf{f} = y_J(1-\mathbf{a})[\mathbf{q}w_0\sqrt{k} - \mathbf{d}] - k = \frac{(3\mathbf{x}-4)\mathbf{x}}{2} \left(\frac{a + 2\mathbf{q}w_0\sqrt{k}}{6\mathbf{x}-4} \right)^2 - k.$$

Notice, that ξ needs to exceed 4/3 for the keiretsu supplier to stay in business. Maximizing ϕ yields the optimal relationship-specific investment k undertaken by the keiretsu supplier:

$$(16) \quad k = \left(\frac{(3\mathbf{x}-4)\mathbf{q}w_0\mathbf{x}a}{(6\mathbf{x}-4)^2 - 2\mathbf{q}^2w_0^2\mathbf{x}(3\mathbf{x}-4)} \right)^2.$$

Let us now summarize the result derived so far. First of all, observe that in (16) the investment k does not depend on our crucial parameter α , which describes the prevailing business culture (i.e. α is an inverse measure of fairness in business relations). Therefore, y_J , $\pi_J=y_J^2$ and ϕ do not depend on α either (see equations 14 and 15). The only variable that varies with α is the policy instrument δ^* . Equation (13) shows that δ^* varies negatively with α as long as δ^* is positive. The critical value of α at which $\delta^*=0$ can be derived from (13) and (16):

$$(17) \quad \hat{\mathbf{a}} = 1 - \frac{3\mathbf{x}-2}{\mathbf{q}^2w_0^2\mathbf{x}}.$$

This gives rise to:

Proposition 2

If the business culture is characterized by a sufficiently high level of mutual trust ($\mathbf{a} < \hat{\mathbf{a}}$), a decrease in mutual trust or fairness in business relations, i.e. an increase in the parameter \mathbf{a} , gives rise to a more protectionist trade policy: $\partial \mathbf{d}^* / \partial \mathbf{a} < 0$. In this regime the profits and outputs of the J-maker and the keiretsu supplier are not influenced by changes in the business culture: $\partial y_J / \partial \mathbf{a} = \partial \mathbf{p}_J / \partial \mathbf{a} = \partial \mathbf{f} / \partial \mathbf{a} = 0$.

Proposition 2 indicates that the political process mitigates the redistribution brought about by changes in the business culture. Since k is constant for $\mathbf{a} \in (0, \hat{\mathbf{a}})$, a decrease in mutual trust as measured by an increase in α , ceteris paribus increases the J-maker's profit and decreases the profit of the keiretsu supplier because the negotiation becomes tougher for the supplier and this results in a reduction of the price for the input. The political process, however, responds to the increase in α by increasing the tariff on imported inputs, i.e. our policy variable δ decreases. This implies that the threat point of the Nash bargaining game changes to the disadvantage of the J-maker: if bargaining with the keiretsu supplier breaks down, the J-maker now has to buy his input from the foreign supplier at a higher price. The political process thus improves the keiretsu supplier's bargaining position. It turns out that the exogenous *cultural effect* and the endogenous *political effect* neutralize each other. Nothing really changes as a consequence of the increase in α , only the tariff increases, but this has no real consequences since nothing is imported anyway.

3. Modeling political culture

In order to portray changing political culture, we now generalize the objective functions of the political parties. We continue to assume that the political parties maximize their respective utility, but now we assume that the parties' utility encompasses, beside the electoral motive, an ideological component. This ideological utility component we associate with the welfare of the respective clientele interest group. Assuming that total utility is a convex combination of the two utility components, we arrive at the following utility representations for the liberal and the protectionist party, respectively:

$$(20) \quad z_L = (1 - \beta)(1 - w) + \beta \lambda \pi_J$$

$$(21) \quad z_P = (1 - \beta)w + \beta \lambda \phi.$$

The parameter λ adjusts for the different dimensions of the two utility components and the parameter $\beta \in [0, 1]$ measures the parties' ideological bias. If $\beta = 0$, the parties' only objective is to announce policies

which maximize their respective probabilities of winning the election. If $\beta=1$, they announce a policy which would, if implemented, maximize their respective constituency's utility, that is, in our case, the clientele firm's profit. In this case the parties are completely captured by some economic interest. Thus, β also measures to what extent the political parties are captured by economic interests, and we interpret this *interest capture* as a cultural trait.¹⁴

In principle, the analysis proceeds as in part 2. However, in order to focus on the influence of changing political culture, we now move the keiretsu supplier's investment decision into the background by assuming that the supplier can either undertake an investment of given size ($k=\bar{k}$) or he can leave it ($k=0$). Apart from reasons of analytical convenience, this assumption seems to be justified for two reasons: first, one can argue that relationship-specific investments are indeed lumpy (the supplier either moves his factory into the vicinity of the producer or he stays where he is, etc.) and, second, we have shown in part 2 that, at least in an extreme regime of *political culture* ($\hat{\alpha}=0$), k is indeed largely independent of the prevailing business culture. The assumption $k \in \{0, \bar{k}\}$ does, therefore, not appear to be too restrictive. The analytical advantage is the following: if we assume that even in the most adverse of circumstances the keiretsu supplier decides to go ahead with the investment ($k=\bar{k}$), then the cumbersome maximization calculus with respect to the investment decision disappears and the backwards induction ends with the determination of the political parties' trade policy pronouncements.

The analysis proceeds as follows. First we derive the political parties' behavior as a function of the parameter β . In a second step we then investigate the interaction of business culture and political culture in determining trade policy outcomes. In a final section we compare the model's implications with the stylized facts of Japanese politics.

3.1 Political behavior and political culture

In part 2 we analyzed the special case $\beta=0$. In this section we derive the equilibrium policy pronouncements for positive values of β . If $\beta>0$, the policy-pronouncement game is no longer a zero-sum game, and we need to work out the solution with the help of the political parties' reaction functions.

We begin with the liberal trade policy party which maximizes z_L as given in equation (20) subject to the constraint that it announces a tax rate not exceeding the tax rate proposed by its opponent, i.e. $t_L \leq t_P$.

¹⁴ Notice, that even complete interest group capture does not mean that the parties necessarily act in the best interest of their clientele group. The parties do not maximize the expected profits of the interest groups but rather announce a trade policy that maximizes the respective interest group's profit *if they are elected to public office*.

or, alternatively, $\delta_L \geq \delta_p$. Since $1-w$ (see equation 12) and π_j are convex in δ_L , so is z_L . The liberal party's utility is thus maximized either at $\delta_L = \delta_p$, $\delta_L = \delta_p + \epsilon$ (where $\epsilon > 0$ is small), or $\delta_L = \bar{d}$. The values δ_p and $\delta_p + \epsilon$ need to be carefully distinguished because w is discontinuous at $\delta_L = \delta_p$. Figure 1 demonstrates that for $\delta_p > \delta^*$ ($\delta_p < \delta^*$) the choice is between δ_p and \bar{d} ($\delta_p + \epsilon$ and \bar{d}). The free trade platform \bar{d} will be chosen if $F > 0$, where

$$(22) \quad F \equiv \begin{cases} (1-\mathbf{b})[w(\mathbf{d}_p, \mathbf{d}_p + \mathbf{e}) - w(\mathbf{d}_p, \bar{\mathbf{d}})] + \mathbf{bl}\langle \mathbf{p}(\bar{\mathbf{d}}) - \mathbf{p}(\mathbf{d}_p + \mathbf{e}) \rangle, & \mathbf{d}_p < \mathbf{d}^* \\ (1-\mathbf{b})\left(\frac{1}{2} - w(\mathbf{d}_p, \bar{\mathbf{d}})\right) + \mathbf{bl}\langle \mathbf{p}(\bar{\mathbf{d}}) - \mathbf{p}(\mathbf{d}_p) \rangle, & \mathbf{d}_p > \mathbf{d}^* \end{cases}$$

The second term in F capturing party ideology is positive, decreasing and concave in δ_p and disappears at \bar{d} . The expression in the square bracket capturing the electoral motive is negative, increasing and concave, and the corresponding expression in the large round bracket is negative, decreasing and convex. Figure 2 depicts F as a function of δ_p .

Figure 2 indicates that for sufficiently low values of β , i.e. for $\beta < \beta_1$, F is always negative and the liberal trade policy party tries to duplicate the policy pronouncement of its opponent; to be more precise, if $\delta_p > \delta^*$, the liberal party duplicates the protectionist party's platform, and for $\delta_p < \delta^*$ it announces a trade policy that is just slightly more liberal than the policy proposal of the protectionist party. The respective reaction function is shown in panel L1 of figure 3. For an intermediate range of values of β ($\beta_1 < \beta < \beta_3$), the liberal party deviates from the unconditional duplication policy and announces free trade if δ_p is in a neighborhood (δ'_p, δ''_p) of δ^* (see figure 3, panels L2 and L3). For sufficiently large values of β ($\beta > \beta_3$), the liberal party announces free trade if the protectionist party announces a protectionist policy ($\delta_p < \delta_p''$) and free trade if the protectionist party announces a more liberal policy ($\delta_p > \delta_p''$). Only at $\beta = 1$, the liberal party always announces free trade (see figure 3, panels L4 – L6).

We now turn to the behavior of the protectionist party. The two functions entering the protectionist party's objective function z_L (see equation 21) are both concave in δ_L ; z_L is therefore also concave. An interior maximum is attained in the feasible policy space $\delta_p \in [0, \delta_L]$ if the first order condition

$$(23) \quad \frac{\partial z_p}{\partial \mathbf{d}_p} = (1-\mathbf{b}) \frac{\partial w}{\partial \mathbf{d}_p} + \mathbf{bl} \frac{\partial \mathbf{f}}{\partial \mathbf{d}_p} = 0$$

is satisfied, or alternatively, if $(1-\beta)w_p = \beta\lambda|\theta_p|$. For sufficiently low values of β , the electoral motive dominates the ideological motive and the LHS (the marginal benefit of convergence) exceeds the RHS (the marginal cost of abandoning the ideology) even if the liberal trade policy party announces free trade:

$\delta_L = \bar{\delta}$. Under these circumstances (see figure 4, panel a), the protectionist party also announces a liberal trade policy but avoids duplicating the free trade policy of its opponent, i.e. it announces the policy $\delta_p = \bar{\delta} - \varepsilon$. The protectionist party avoids policy duplication because for $\delta_L > \delta^*$ ($\delta_L < \delta^*$) the election probability $w(\delta_L - \varepsilon, \delta_L)$ exceeds (falls short of) $w(\delta_L, \delta_L) = 1/2$.¹⁵ If δ_L decreases from the free trade level $\bar{\delta}$ to δ_1 , w_p increases and policy convergence continues to hold; if $\delta_L < \delta^*$, the protectionist party, of course, duplicates the liberal party's platform. This behavior is summarized in the reaction function depicted in panel P1, figure 3.

For larger values of β (see figure 4, panel b), the marginal benefit and marginal cost curves intersect in the feasible policy space of the protectionist party if the liberal party announces free trade, ($\delta_L = \bar{\delta}$). If the liberal party moves towards the left ($\delta_L < \bar{\delta}$), the $(1-\beta)w_p$ -curve shifts upwards and the protectionist party announces a more liberal policy.¹⁶ This convergence of the two platforms comes to a halt at $\bar{\delta}_L$; for $\delta_L \leq \bar{\delta}_L$ the protectionist party (almost) duplicates the platform of its opponent. The reaction functions in figure 3, panels P2-P4, depict this reaction of the protectionist party.

For high values of β (see figure 4, panel c), marginal cost exceeds marginal benefit if the liberal party announces free trade. The protectionist party thus announces the highest tariff, i.e. $\delta_p = 0$. Only if the liberal party announces sufficiently protectionist trade policies, the marginal benefit curve shifts upwards enough to intersect with the marginal cost curve in the feasible policy space of the protectionist party. The protectionist party then begins to converge towards more liberal policies until it reaches the platform of its opponent (see figure 4, panel c). Notice, that for $\delta_L < \delta^*$ the convergence of the protectionist party may be discontinuous because of the discontinuity of the w -function at $\delta_L = \delta_p$. The reaction function depicted in figure 3, panel P5, summarizes this behavior. For very high values of β the marginal cost of convergence is always higher than the marginal benefit and the protectionist party always announces $\delta_p = 0$ (see figure 3, panel P6).

We are now in a position to derive equilibrium platform combinations for various values of our crucial parameter β , which portrays the prevailing political culture. In the panels I1-I6 in figure 3 the reaction functions of the two political parties are superimposed. For low values of β the electoral motive dominates the ideological motive and the result of part 2 of this paper carries over: in equilibrium the two parties announce the same trade policy δ^* , i.e. the two reaction functions “intersect” at $\delta_L = \delta_p = \delta^*$ (see panel I1). For very high values of β (see the panels I5 and I6) the ideological motive dominates the electoral motive and the two parties announce extreme policies: the liberal trade policy party announces

¹⁵ See figure 1.

¹⁶ The fact $\partial \delta_p / \partial \delta_L < 0$, can also be inferred from equation (23) via the implicit function rule.

free trade and the protectionist party announces a tariff which neutralizes the price advantage of the foreign suppliers, i.e. the two reaction functions intersect at the point $(\delta_p, \delta_L) = (0, \bar{d})$.

Starting out from this regime of complete political polarization, we now decrease the value of β . If the election motive becomes more prominent in the calculus of the political parties they begin to ponder political convergence since convergence increases the probability of winning the election. The protectionist party's objective function z_p is concave. This party therefore ponders *marginal* adjustment of its trade policy stance. The liberal party's objective function z_L is convex; the liberal party therefore ponders *dramatic policy shifts*, i.e. duplication of the policy stance of the opponent. We envisage here a development in which the protectionist party has first reason to adjust its trade policy stance. In the panels I4 and I3 of figure 3 the intersection of the two reaction functions is located at $\delta_L = \bar{d}$, whereas δ_p increases from 0 to $\bar{d}_p > 0$. For the respective range of β -values we thus have a regime of (partial) political convergence. This regime, however, breaks down when δ_p exceeds \bar{d}_p . Panel I2 in figure 3 demonstrates that for a range of β -values no equilibrium exists.¹⁷ This situation arises because the liberal party, at the platform combination $(\bar{d}, \bar{d}_p - e)$, would like to duplicate the trade policy announcement of its opponent for electoral reasons; the protectionist party, however, would react to this policy shift by moving away from its original policy stance and announcing a somewhat more protectionist policy in order to distinguish its policy from the liberal party. This more protectionist policy is, for ideological reasons, not acceptable anymore for the liberal party, which, under these circumstances, prefers its original stance \bar{d} . To this reversal, however, the protectionist party responds by moving back to where it was in the first place, etc.

Figure 5 shows how political polarization depends on our crucial parameter β . We summarize this insight in

Proposition 3

Depending on the prevailing political culture as measured by parameter \hat{a} , four qualitatively different regimes of political interaction between the two competing parties can emerge: (1) (complete) political polarization, (2) (incomplete) political convergence, (3) a regime of political turmoil in which the two parties often readjust their respective trade policy stances without converging to an equilibrium, and (4) political concordance in the sense of Hotelling and Downs.

¹⁷ We only consider equilibriums in pure strategies to represent solutions of our game.

Comparing the regimes 2 and 4, figure 3 (panel I3) reveals that $\tilde{d}_p > d^*$. As far as the probability w of the protectionist party's winning the election is concerned, the following can be asserted: in regime 2, w increases as β decreases and w reaches a value exceeding one half before the turmoil regime 3 is entered. This can immediately be inferred from figure 1, noticing that $\tilde{d}_p > d^*$. In regime 2, the expected trade policy $E\delta = w\delta_p + (1-w)\delta_L$ depends, of course, on β ; the influence of political culture on the expected trade policy appears, however, to be ambiguous. The only (trivial) conclusion we can draw is that the expected trade policy at the left hand end of regime 2 is more liberal than in regime 4.

3.2 *The interaction of business culture and political culture*

We now return to the analysis of the influence of business culture (as measured by the parameter α) on trade policy formation. As compared to part 2, we now, however, investigate the general case in which $\beta \in [0,1]$.

In the previous section we implicitly assumed a value of α which is compatible with a $d^* \in (0, \bar{d})$, i.e. with an interior solution of δ^* . Equation (13), however, reveals that for α sufficiently close to 1, the common trade policy platform which materializes for sufficiently low values of β will be $\delta_p = \delta_L = 0$, since $\delta^* < 0$. Analogously, it can be seen that for low values of α the common platform of the two contestants may well be $\delta_p = \delta_L = \bar{d}$ since δ^* can exceed \bar{d} . If $d^* \notin [0, \bar{d}]$, the sequence of equilibria depicted in Figure 5 does no longer apply: for low and high values of α the regimes 2 and 3, i.e. the regimes of political convergence and turmoil, need not be encountered if the development of political culture is characterized by a steady decline of the parameter β from 1 to 0. If the prevailing business culture is not based on mutual trust (α high), increasingly election motivated politicians will eventually cause the political equilibrium of complete polarization to break down and to transform into an equilibrium of political concordance. The same clean transformation occurs in a system characterized by a very high degree of mutual trust in the commercial sphere (α low, i.e. α close to 1/2).

Figure 6 provides an impression of the interaction of business and political culture in determining the trade policy stances of the political parties. The figure is based on a numerical example. The sequence of equilibria depicted in figures 3 and 5 corresponds to the development of the parameter constellation (α, β) characterized by arrow 2. The arrows 1 and 3 correspond to a development of the prevailing culture giving rise to a sudden transformation of political polarization into political concordance. Keeping political culture constant, we can also look at the influence of changes of the prevailing business culture. If, for a given political culture, a business culture strongly based on mutual trust is eroded over time and

gives way to a business culture characterized by interactions “at arms length,” we are faced with a development of the parameter constellation (α, β) as portrayed by the arrows A through D. Inspection of Figure 6 yields our final

Proposition 4

The interaction of commercial and political culture in trade policy determination is rather complex. Depending on the cultural development as represented in our model by the time paths of the parameter constellation $(\hat{\alpha}, \hat{\alpha})$, almost any sequence of the four possible policy regimes identified in Proposition 3 may emerge.

Proposition 4 implies that an empirical test of the interaction between commercial and political culture as proposed in our model - which, at least in principle, is general enough to portray a large variety of cultural settings - needs to be based on a historical development in which cultural traits went through substantial changes. We believe that the Japanese experience since WWII represents a historical incident which is very well suited to contrast the predictions of our model with the observed changes in political relations.

3.3 The Japanese experience

In this section we compare the development of trade policy making in Japan with the predictions of the model developed above. We begin with a brief description of the development of the party landscape in Japan. Our presentation relies heavily on the recent monograph by Pempel (1998). From this account we derive some stylized facts, which we then confront with the behavior of our model.

Even though elections in pre-WWII Japan were not completely insignificant, the Japanese history of electoral democracy begins with the first post-war election held in April 1946 (still under the Meiji constitution) in which some 363 political parties officially campaigned. The outcome confirmed the demise of the once powerful prewar party elite and the empowerment of the political left. The Japan Socialist Party (JSP) won the largest number of seats in the 1947 election under the new constitution and formed Japan’s first socialist-led cabinet. The postwar chaos and uncertainty in Japanese politics came to an end when, in 1955, the socialist movement overcame its division and, as a reaction, the conservatives formed the Liberal Democratic Party (LDP). After this consolidation, the LDP and the JSP dominated the party landscape for a long time; as late as the 1967 election the two largest parties still won 86% of the seats. Whereas in most democracies the extreme differences between capital and labor disappeared soon after WWII, the class cleavage continued to be the major issue in Japan. The JSP, for example, did not

abolish the idea of a “dictatorship of the proletariat” until the end of the 1980s. This political polarization resulted in an extended period of conservative hegemony.

The party duopoly began to crumble when the Democratic Socialist Party (1960) and the Clean Government (Komeito) Party (1974) formed as “parties of the center.” The extreme political polarization of the early period of the conservative regime was further softened up when, in 1976, the New Liberal Club split from the LDP and the Japan Communist Party transformed into a “lovable” party. During this intermediate period the sharp ideological left-right division between government and opposition thus slowly disappeared and the electoral contests became more competitive, since voters identified themselves more and more as independents (1960 fewer than 10%, 1995 about 50%). The ruling LDP lost as early as 1967 the majority of votes cast; the biased electoral system, however, still furnished it with a majority of seats. Nevertheless, the secular decline in the vote share of the ruling LDP began to threaten the conservative hegemony. To counter this trend, specific economic policies became more narrowly targeted and explicitly politicized in order to gain the political support of major interest associations, large socioeconomic blocs, and big donors.

The overt politicization of important aspects of economic policy proved to be beneficial to the LDP, but ultimately these adjustments came back to haunt the conservatives and to contribute to their toppling in the 1990s, largely as a result of corruption scandals (Pempel, 1998, p. 185). The end of the LDP dominance was the consequence of its unexpected break-up in June 1993 when the Hata faction supported the no-confidence motion against the cabinet and formed the Japan Renewal Party. In the following July 1993 election three new conservative parties, the Japan Renewal Party, the Japan New Party and the New Party Sakigake competed with the LDP for conservative votes. The result was that the LDP lost its majority and a coalition government formed that comprised all of the LDP’s opponents with the exception of the Communist Party. This government broke down in 1994 when the JSP and Sakigake walked out of the coalition. A minority government formed but was very short-lived and was replaced by a hitherto imponderable coalition between the LDP and the JSP with Sakigake as a broker. This coalition, which documents more than anything the increasing abandoning of ideological principles and the move towards a more election oriented political environment, held together until the 1996 elections.

The period up to the 1996 election was marked by great political instability; Japan had eight prime ministers in five years and the party landscape continued to undergo significant changes. A number of non-LDP parties merged into the New Frontier Party, the JPS, in order to signal its ideological transformation, changed its name to the Social Democratic Party of Japan (SDPJ), and a new liberal party, the Democratic Party, was formed. Four conservative parties thus competed in the 1996 election, where the big loser was the SDPJ. Even though the LDP was back in power by the end of 1996, its hold was far from secure. The party system had been undeniably transformed and more fragmentation, realignment,

and false starts are likely before any new equilibrated regime can be identified. Indeed, there is no guarantee that clarity will emerge for some time (Pempel, 1998, p. 205). Pempel even goes so far to compare Japan in the 1990s with the countries transforming from socialism: “that the old regime had been displaced was clear; that transition was under way was beyond question; but precisely how that transition would play out, and what new equilibrium would replace the old, was less evident. What was clear, however, was that like Humpty Dumpty, the old regimes in Japan just as in the former communist countries could not be put back together again” (p. 167).

Apart from the continual recombination of political parties, the most recent period of Japanese politics has been characterized by a struggle for power in which the contesting parties hardly articulated any clear-cut and distinctive policy positions. The traditional pattern of political support underwent a process of dramatic realignment. The conservatives lost the unequivocal political support of farmers and small business, whereas labor stood far closer to the conservatives on numerous issues than it had three decades earlier. The business-labor divisions have given way to sectoral differences that pitted business and labor in single industries or firms against business and labor in others (Pempel, 1998, p. 164). Trade policy issues, in particular, have generated sharp cleavages within the business sector; internationally highly competitive manufacturers in areas such as electronics, machine tools, and automobiles increasingly favor an open market policy, whereas less competitive industries look to the government for protection from foreign competition and guaranteed profitability within the domestic marketplace (see Pempel, 1998, pp. 165-166).

We are now in a position to summarize the stylized facts of the development of the political interaction in post-WWII Japan. Broadly speaking, one can distinguish three different regimes after the chaotic initial period that lasted until 1955. The *first regime* (mid 1950s – mid 1970s) was characterized by a strict *political polarization* based on the traditional ideological left-right cleavage. The conservative LDP enjoyed in Parliament a safe majority of seats vis-à-vis the socialist opposition and implemented an economic policy, which has been described by Pempel (1998) as a policy of “embedded mercantilism.” Nevertheless, this policy was, of course, much more liberal than the economic policy advocated by the anti-capitalist opposition. In the course of the *second regime* (mid 1970s – 1980s) the sharp ideological left-right division between government and opposition dissolved: new centrist parties formed in the middle of the political spectrum and the anti-capitalist opposition (the JSP and the Communist Party) began to endorse policies which appealed to a larger segment of the electorate. The observed *political convergence* was clearly instigated by a political class, which became more and more election oriented.¹⁸ The *third regime* covers the 1990s and the contemporary political interaction in Japan. It is characterized

¹⁸ Unfortunately, no *quantitative* studies exist which analyze the *development* of party platforms in Japan. The only relevant study undertaken so far refers to the election year 1996 (see Kato and Laver, 1998).

by an incessant recombination of political parties, a frequent repositioning of vague political platforms, and a continual realignment of political support. This process, which we describe as *political turmoil*, does not appear to converge to a steady state in the near future.

We believe that our model is suitable to portray these stylized facts and to provide some insights into the underlying mechanisms. Needless to say that we do not want to claim that this simple model represents a sufficiently complete representation of the complex political-economic interactions that have taken place in modern Japan. From the outset, our objective has been much less haughty, namely to demonstrate that the observed (trade) policy positions held by Japanese politicians over the last fifty years can be portrayed with the help of a simple model employing as a driving force two key aspects of the Japanese commercial and political culture.

Our case is summarized in figure 6 by the fat arrow depicting the development of the commercial and political culture as we see it. We interpret the evidence relating to the prevailing fairness standards in the Japanese business community to entail an initial increase in fairness (inverse of α) during the early period of keiretsu-building, followed by a steady decline over the last decade in which the globalization of the Japanese economy significantly deepened. As far as the political culture is concerned, we concur with the received wisdom of the political scientists and presuppose over the whole period of investigation a continuous weakening of ideological considerations in the politicians' motivation, i.e. an increasingly election oriented political class. We thus are faced with a steadily decreasing value of the parameter β . The parameter constellation depicted by the fat arrow in figure 6 moves through the regimes 1, 2 and 3. This course of events is perfectly consistent with the historical development: after an initial regime of political polarization, Japanese politics entered a regime of political convergence in the mid 1970s, and in the beginning of the 1990s a regime of political turmoil. We leave it to those who are more inclined than we to speculate whether, and if so, when, the underlying cultural forces will bring about a regime of political concordance. A similarly speculative exercise would be to ask the counterfactual question as to whether the present political instability in Japan would have been avoided if the commercial culture had sustained even more or, alternatively, less trust and fairness.

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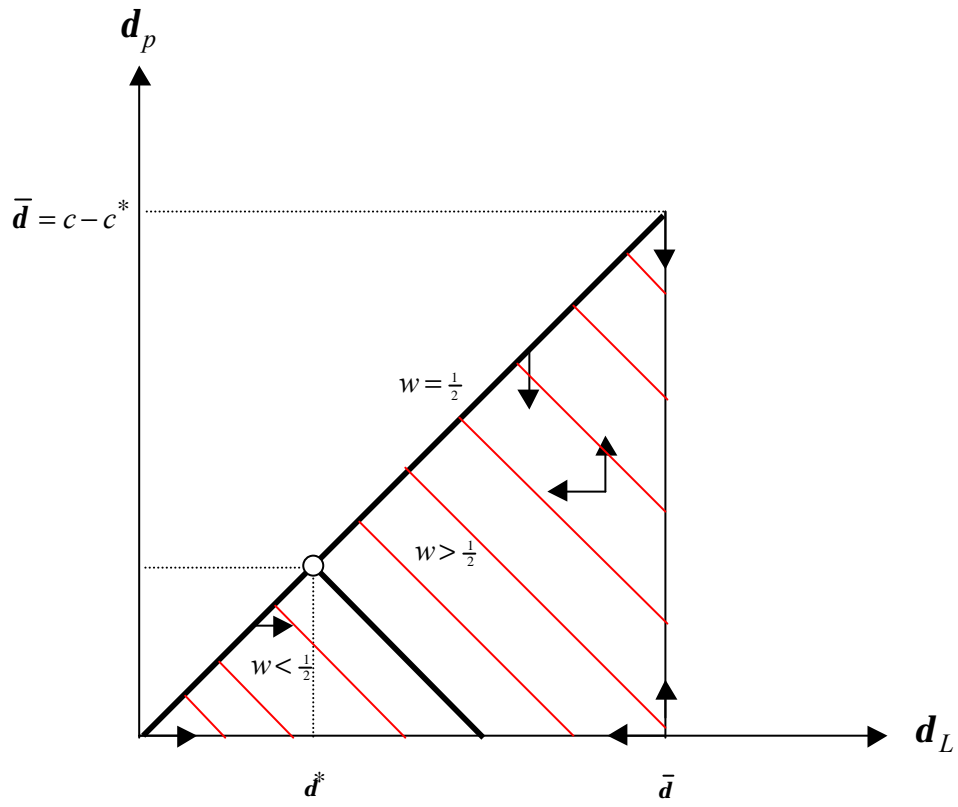


Figure 1

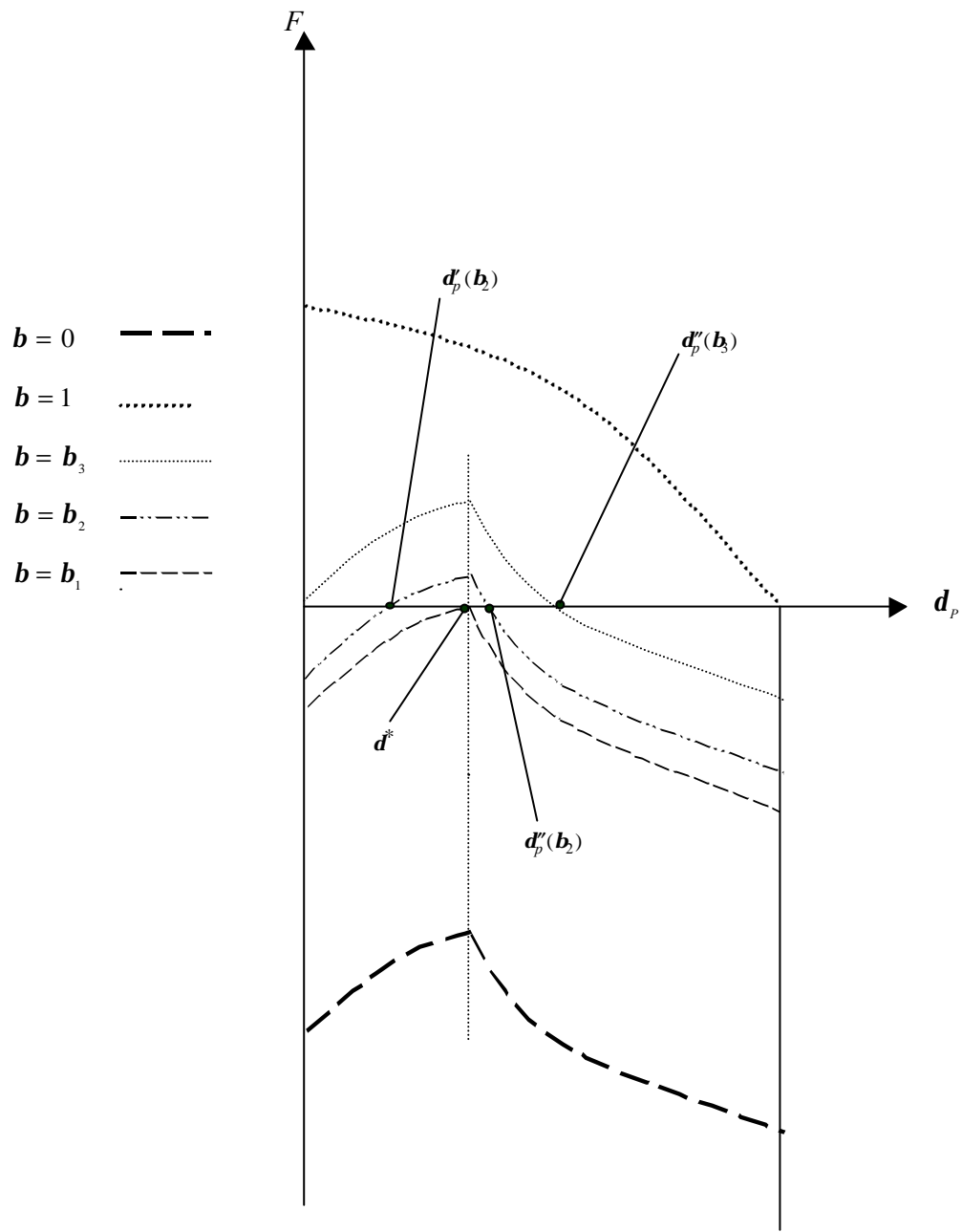


Figure 2

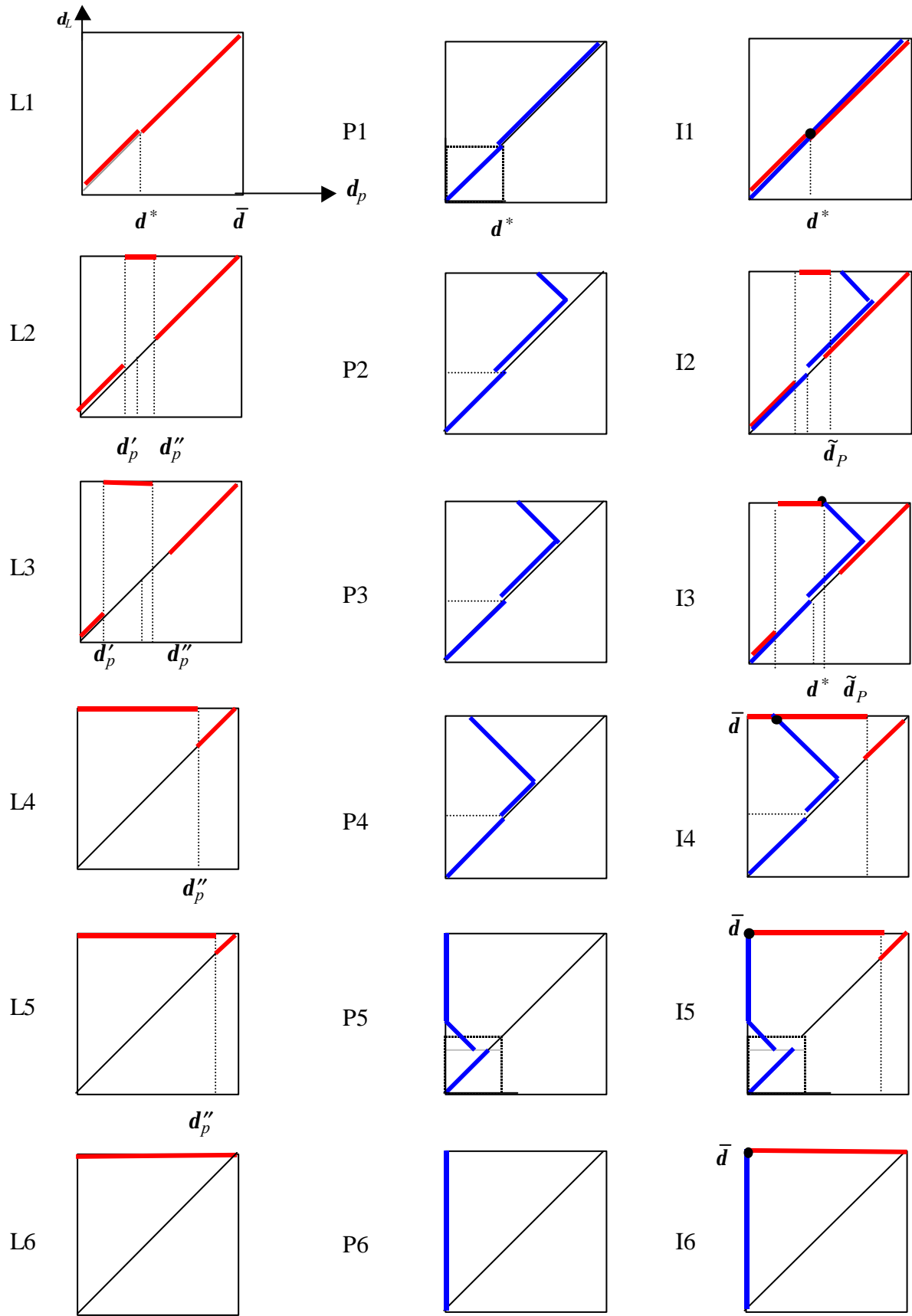
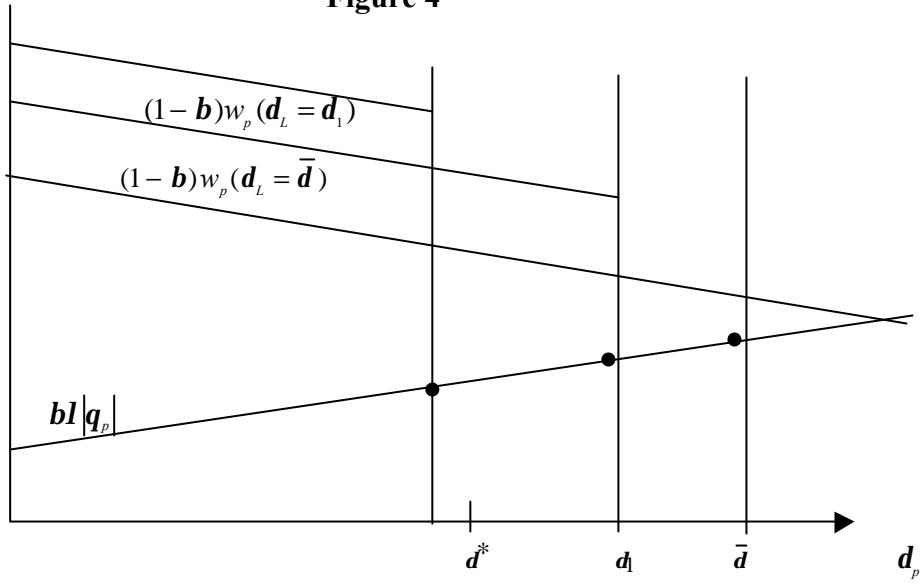


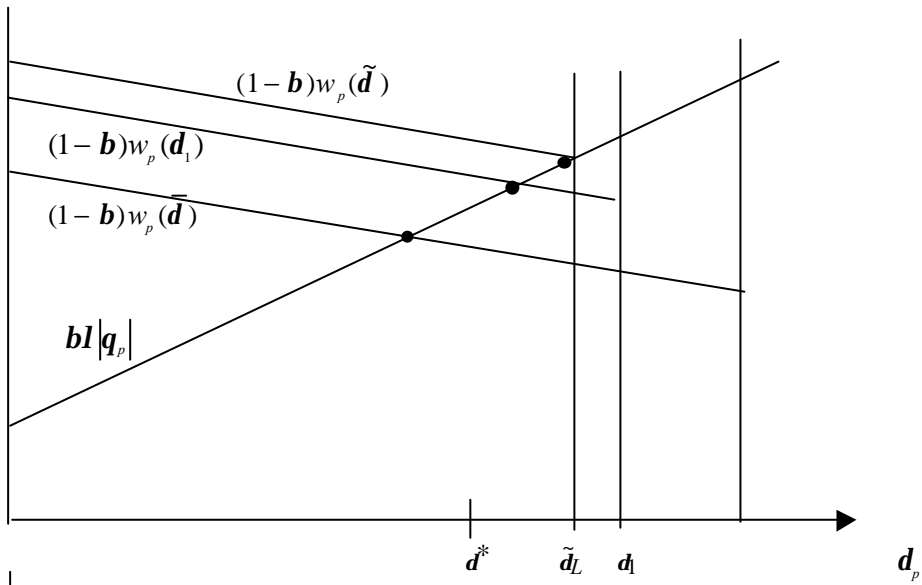
Figure 3

Figure 4

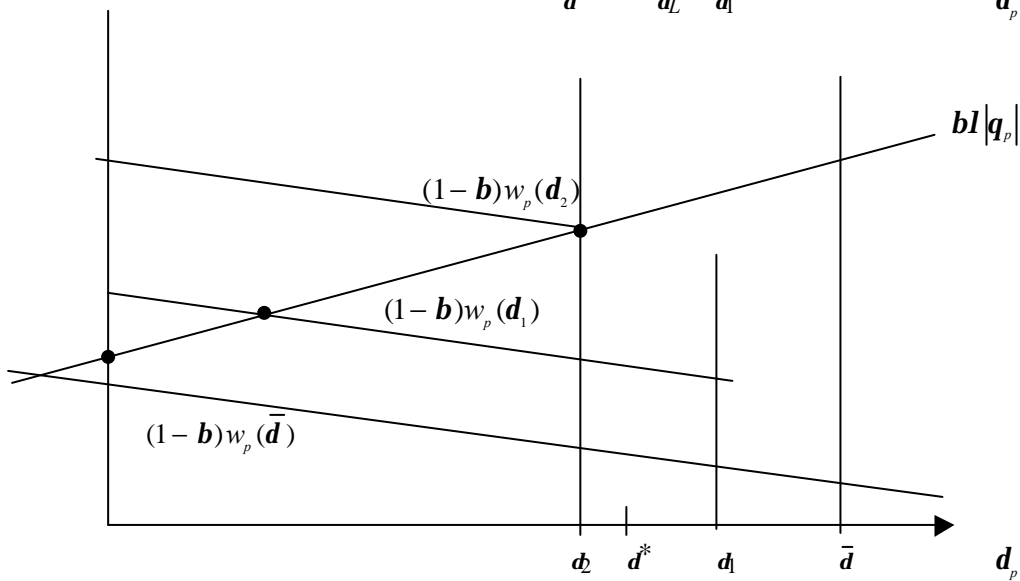
a)



b)



c)



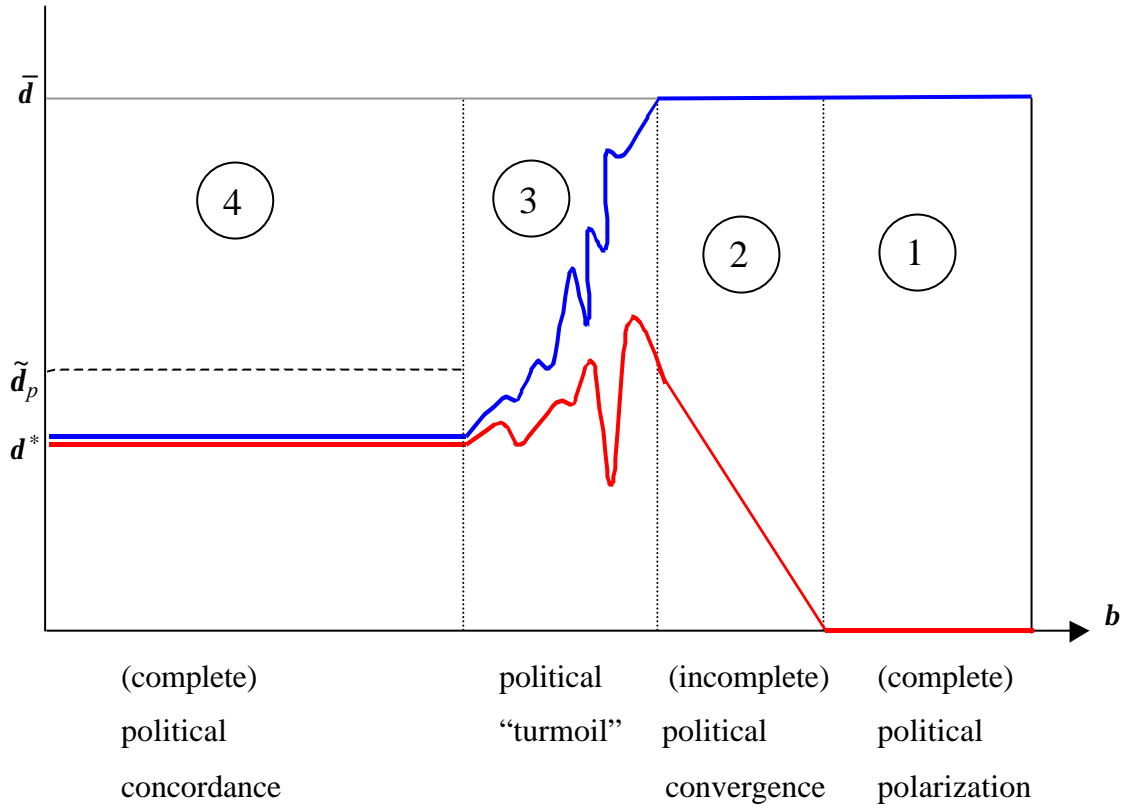
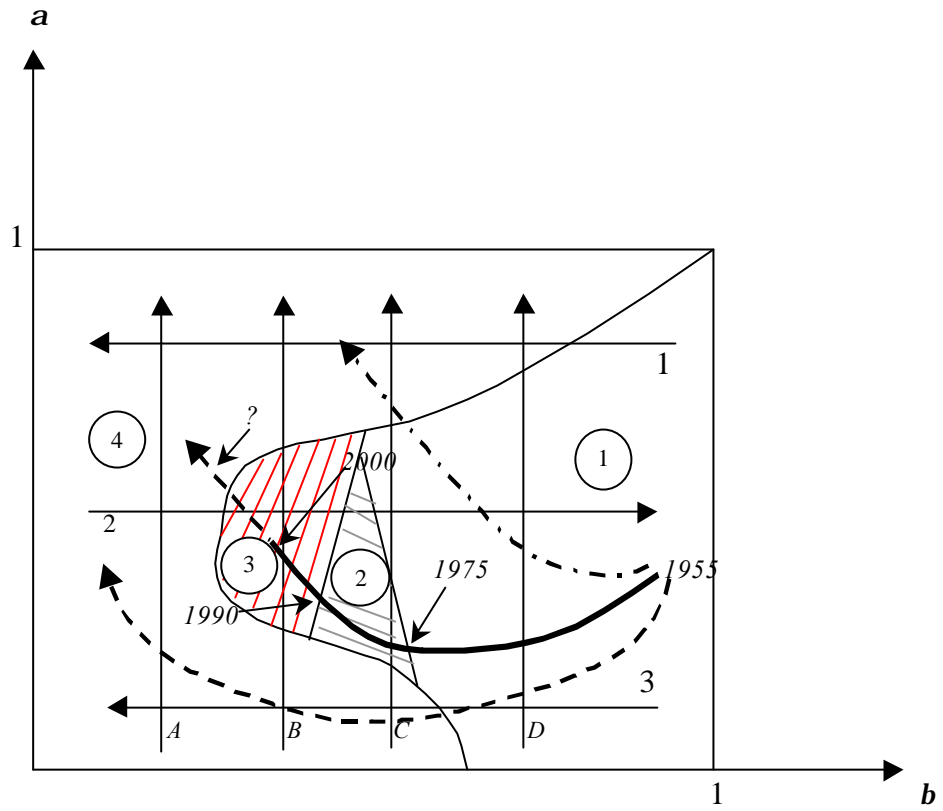


Figure 5



- ① political polarization
- ② political convergence
- ③ political turmoil
- ④ political concordance

Figure 6